MINUTES

To:	Board Members		
From:	Duke (ext. 297)		
Subject:	Minutes of the January 19, 2005 Board Meeting: Suspended Well Costs	**Date:**	January 24, 2005
cc:	Leisenring, Bielstein, L. Smith, Petrone, E. Smith, Mahoney, Gabriele, Polley, Getz, Sutay, Thompson, Posta, Project Team, FASB Intranet		

The Board meeting minutes are provided for the information and convenience of constituents who want to follow the Board's deliberations. All of the conclusions reported are tentative and may be changed at future Board meetings. Decisions become final only after a formal written ballot to issue a final Statement or Interpretation.

Topic: Amendment to FASB Statement No. 19, *Financial Accounting and Reporting by Oil and Gas Producing Companies*, for Suspended Well Costs

Basis for Discussion: Memorandum dated January 14, 2005

Length of Discussion: 11:15 am to 12:00 pm

Attendance:

- Board members present: Herz, Trott, Batavick, Crooch, Young, Schipper, and Seidman
- Board members absent: None
- Staff in charge of topic: Westerlund
- Other staff at Board table: L. Smith, Golden, and E. Smith
- Outside participants: None

Summary of Decisions Reached:

The Board discussed issues related to the proposed FASB Staff Position (FSP) FAS 19-a, “Accounting for Suspended Well Costs,” that would amend the guidance for suspended well costs in FASB Statement No. 19, *Financial Accounting and Reporting by Oil and Gas Producing Companies.* The Board made the following decisions:

1. An enterprise shall disclose in the notes to the financial statements (a) the amount of capitalized exploratory well costs that are pending the determination of proved reserves, (b) the net changes from period to period in the capitalized exploratory well costs in a rollforward format, (c) the amount of exploratory well costs that have been capitalized for a period of greater than one year after the completion of drilling and the number of projects for which those costs relate, (d) an aging of well costs that are capitalized for periods significantly greater than one year and the number of projects for which those costs relate, and (e) for those exploratory well costs that continue to be capitalized for more than one year after the completion of drilling, an enterprise shall describe the activities that it has undertaken to evaluate the reserves and the projects, the information still required to classify the associated reserves as proved, and the estimated timing of when the evaluation of the reserves will be completed.

2. The guidance in the proposed FSP should be applied to the first reporting period beginning after the date that the proposed FSP is finalized.

3. The Board agreed to a prospective application of the guidance to existing and newly capitalized exploratory drilling costs. An enterprise also will be required to provide transitional disclosures for periods preceding the adoption of the proposed FSP.

4. The Board approved the posting of proposed FSP FAS 19-a for a 30-day public comment period.

Objective of Meeting:

The objective of the meeting was for the Board to consider whether to approve the posting of proposed FSP FAS 19-a for public comment. The staff asked the Board to specifically consider (a) the disclosures, (b) the effective date, and (c) transition provisions of the proposed FSP. The objective was accomplished.

Matters Discussed and Decisions Reached:

1. Mr. Westerlund began by stating that the purpose of the meeting was for the Board to consider whether to approve the posting of a proposed FSP for public comment that would amend the guidance for suspended well costs in FASB Statement No. 19, *Financial Accounting and Reporting by Oil and Gas Producing Companies.* Mr. Westerlund stated that the staff would ask Board members to consider (a) the disclosures, (b) the effective date, and (c) transition provisions of the proposed FSP, as well as for their approval to post the proposed FSP for a 30-day comment period.

2. Mr. Westerlund asked the Board to consider the proposed disclosures, which incorporated the Board's recommendations, from the January 12, 2004 meeting.

a. An enterprise shall disclose in the notes to the financial statements the amount of capitalized exploratory well costs that are pending the determination of proved reserves. An enterprise also shall disclose the net changes from period to period in the capitalized exploratory well costs in a rollforward format.

b. An enterprise also shall disclose the amount of exploratory well costs that have been capitalized for a period of greater than one year after the completion of drilling and the number of projects for which those costs relate. Additionally, for exploratory well costs that are capitalized for periods significantly greater than one year, an enterprise shall provide an aging of those amounts and the number of projects for which those costs relate. For those exploratory well costs that continue to be capitalized for more than one year after the completion of drilling, an enterprise shall describe the activities that it has undertaken to evaluate the reserves and the projects, the information still required to classify the associated reserves as proved, and the estimated timing of when the evaluation of the reserves will be completed.

He then opened the deliberations to the Board.

3. Mr. Batavick disagreed with the proposed disclosures. He stated that the disclosures were excessive given the nature of the costs and the probability that the costs would represent an immaterial percent of an entity's net assets. He stated that the users of financial statements fully understand the risks associated with capitalizing well costs. He proposed that the disclosures be required only for annual periods and limited to the following: (a) disclosure of the amount of the costs, (b) a list of the major projects and their histories, and (c) an explanation of the change in amount capitalized from year to year. Quarterly disclosure would be required only when there is a material change in the amount of suspended well costs during an interim period.

4. Mr. Trott said he supported the proposed disclosures that were recommended by the staff because the disclosures provide important qualitative information that is related to an entity's exploration activities.

5. Mr. Young stated that the user community would be well served by the staff's recommended proposed disclosures. He stated his only concern is that the disclosures could put an entity at a competitive disadvantage.

6. Ms. Seidman agreed with Mr. Young. She added that she was interested in seeing if the feedback from the public comment period would indicate that the disclosures are too broad.

7. In response to a question posed by Mr. Young, Mr. Golden stated that if quarterly disclosures were not required by the proposed FSP, SEC registrants would still have to disclose material changes that occur on a quarterly basis. He

stated that to determine a material change one would look at both qualitative and quantitative information.

8. Ms. Schipper stated that the disclosures were necessary as the guidance moved from a rule to a judgment-based decision. She said that the objective of the disclosures is for investors to understand how management is applying judgment based on the indicators in the proposed FSP, and that it should be stated as such. She stated that providing a reconciliation of a beginning year balance and an ending year balance of suspended well costs is consistent with the Board's past actions. The reconciliation would help the investor understand how management's application of judgment affects the financial statements.

9. Mr. Herz stated that he believed that the objective of the disclosures should be stated in the proposed FSP, and that while he supported only an annual disclosure, he would not object to the staff's proposed disclosures until after constituents' comments were evaluated.

10. With the exception of Mr. Batavick , six Board members [BH, ET, MC, DY, KS, LS], agreed to include the staff's proposed disclosures in the proposed FSP.

11. Mr. Westerlund then asked the Board to consider the effective date and transition of the proposed FSP. He stated that the FASB staff recommends that the guidance in the proposed FSP be applied to the first reporting period beginning after the date that the proposed FSP is finalized. He asked the Board to consider the following transition alternatives: (a) retrospective application, (b) cumulative effect application, (c) prospective application to existing and newly capitalized exploratory drilling costs, and (d) retrospective application for existing capitalized costs that are charged to expense upon the initial application of this guidance.

12. Mr. Crooch stated that his concern was that prospective application would grandfather costs inappropriately capitalized under the current guidance in Statement 19. He stated that at adopition of the proposed FSP, all existing capitalized costs should first be evaluated under the current guidance in

Statement 19 and then should be written off if they do not meet the criteria in Statement 19 for continued capitalization. Mr. Crooch indicated that any write-off should be presented as a cumulative effect adjustment.

13. Ms. Schipper stated that the problem with retrospective application is hindsight bias. She stated that it would be difficult for companies to determine if they could have capitalized a well under the criteria in the proposed FSP based only on information they had at the time, especially if the well has since been proved.

14. Mr. Young asked if it were possible to have retrospective application of the disclosure but not of the accounting rules. He stated that it would capture information about wells that had been capitalized for more than one year. He said that he would apply the new guidance on a go-forward basis.

15. Mr. Trott stated that the proposed guidance should be applied prospectively to the existing cost capitalized under the current guidance. He stated that he believes that the FASB is not in a position to make an enforcement judgment on costs that had been capitalized previously. Another acceptable transition alternative would be to require retrospective restatement for those capitalized costs that would not be capitalized under the proposed FSP's guidance.

16. Ms. Seidman stated her concern with the potential hindsight bias involved with retrospective application in both alternatives (a) and (b). Under (c), the costs would be captured in a disclosure and are more consistent with other guidance issued in previous FSPs.

17. Mr. Crooch agreed with (c) except that he would add a requirement to write-off any amount included in capitalized well costs that, while complying with the proposed FSP, should not have been capitalized under the current guidance in Statement 19.

18. Mr. Batavick supported alternative (c) as written because of the difficulties in evaluating whether a project would have met the requirements of the proposed FSP at some time in the past.

19. Mr. Herz stated his preference for alternative (d) but understood the application concerns. He stated that there should be sufficient disclosure of qualitative information at the application of alternative (c) so that the user understands how long wells that were written off under the new guidance had been capitalized.

20. Mr. Young stated that he thought the disclosures of what was capitalized and suspended for more than one year before implementation and after should be required at a minimum, but requiring disclosures for all years presented would be better; that is, he would like to see a trend of the capitalized costs on the books.

21. Mr. Westerlund restated the Board's proposal that, in the year of adoption, the disclosures required by the proposed FSP would be required for each year that the income statement was presented.

22. Mr. Herz asked for the staff to provide an example of the proposed guidance and disclosures.

23. The Board unanimously agreed to post the proposed FSP for a 30-day pubic comment period subject to drafting.

Follow-up Items:

None.

General Announcements:

None.