

Interpretation of Recent SEC Reserves Reporting Guidance

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Based on SPE 170616 by Enrique
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Sources of Guidance on SEC Rules

- The regulations themselves (not always read with care by filers)
- Formal guidance issued by SEC staff in October, 2009 and May, 2013
- Public presentations by SEC staff as late as June, 2014 (e.g., John Hodgin, SPEE Annual Meeting, June 2014)
- Comment letter and response exchanges, 2010 to present

Key Issues Raised by SEC

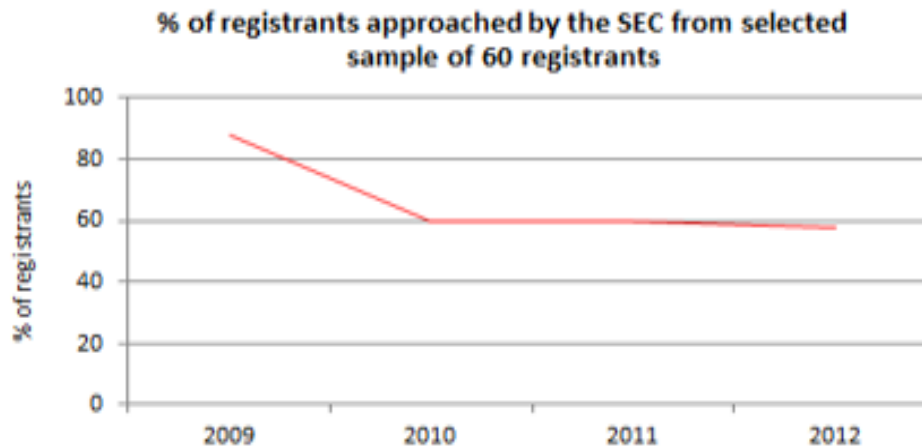
- Proved undeveloped reserves
 - Amount of PUD's converted to proved reserves during year
 - Annual PUD conversion rate
 - PUD reserves that take more than 5 years to mature to developed reserves
 - PUD reserves and undeveloped acreage
- NGL disclosures
- Project definition
- PUD locations more than one offset from existing producers
- Third party reports
- Changes in proved reserves

Sources of Information Reviewed for Our Study

- Regulations, formal guidance, public presentations
- Comment letters and responses from 60 companies during reporting cycles 2009, 2010, 2011, 2012



Finding: Different views, interpretations, and misunderstandings continue to exist as to what regulations require and what SEC staff will accept



Some Statistics on 60 Companies Reviewed

- All 60 filers approached at least once
 - 88% approached by SEC in connection with 2009 filings
 - 60% approached each year in filings for 2010, 2011, 2012
 - 22% approached four times
 - 34% approached three times
 - 32% approached two times
 - 12% approached only once
- Most frequently scrutinized companies (3 or 4 inquiries in last 4 years) are among largest companies and companies with relatively large component of unconventional resources in their portfolios

Key Issue 1 Raised by SEC Staff: Proved Undeveloped Reserves

- Amount of PUD's converted to developed reserves during year
 - Problem: volumes simply omitted in some filings, despite requirement in S-K 1203 (b)
 - Solution simple: always provide volumes in filings
- PUD reserves at year end and reconciliation of annual PUD reserves changes
 - Problem: Changes in reserves volumes disclosed, but not with sufficient clarity or completeness to allow proper reconciliation
 - Possible solution: Provide table in filing with following contents, which satisfies S-K 1203 and FASB ASC 932-235-50-5 requirements:

Changes to proved undeveloped reserves during the year

Volume (MMboe)

- | | |
|---|------|
| – Proved undeveloped reserves at 1 January XXXX | AA |
| – Revisions of previous estimates | BB |
| – Improved recovery | CC |
| – Extensions and discoveries | DD |
| – Purchases | EE |
| – Sales | (FF) |
| – Conversion to proved developed reserves during the year | (GG) |
| – Proved undeveloped reserves at 31 December XXXX | ZZ |

Key Issue 1: Proved Undeveloped Reserves (Cont'd)

- Annual PUD conversion rate
 - Target: average 20% conversion per year
 - Problem: life not so simple; conversion occurs in 'spurts'; which SEC accepts when explanation provided
 - Possible solution: provide clear and complete explanation
- PUD reserves that take more than 5 years to mature to developed
 - 5-year rule applicable only to proved reserves
 - Exceptions rare, particularly in North American resource plays
 - Helpful disclosures for readers of filing (not required):
 - Specify total PUD reserves volume that will not be developed within 5 years of first disclosure
 - Make simple statement like 'There are no PUD reserves that will be developed more than 5 years after initial disclosure'
- PUD reserves and undeveloped acreage
 - Few or no projects with development dates immediately before or after acreage expires should be disclosed

Key Issue 2: NGL Disclosures

- SEC staff interpretation: Discussion of S-K item 1204 in final rules, section IV B.5 and FASB ASC 932-235-50-4(a) and FASB ASC 932-235-50-6 require separate disclosure of NGL's
- Allusion to 'materiality' appears in item 1202 but not 1204
 - Problem: Opinions vary as to criterion for materiality: 5%, 10%, 15% often quoted. Because of wording in item 1204, SEC staff seems to disagree with all
 - Example quote from comment letter: 'As the disclosure requirements of item 1204 are not conditioned upon a significance criteria or threshold, we are not in a position to agree with your assessment.'
- Possible solution: Disclose NGL's separately regardless of perceptions about materiality. During the last three years more and more companies have disclosed NGL's separately

Key Issue 3: Project Definition

- Problem: Some filers contend that drilling programs requiring more than 5 years to complete constitute single projects and argue that initiation of project allows disclosure of PUD's up to time drilling program is completed
- Solution: SEC will not allow this practice in typical North American resource plays
- Quotes from comment letters:
 - “It appears to us that the drilling programs are composed of individual wells, each comprising a separate project that should be initiated within 5 years of booking to claim PUD reserves.”
 - “It appears that the U.S. proved undeveloped reserves scheduled for drilling beyond 5 years have the characteristics of drilling programs, not separate projects.”

Key Issue 4: PUD Locations More Than One Offset Distance from Existing Producers

- Problem: Amended regulation S-X does not specify number of offset locations that may be categorized as proved
- Solution: SEC has not objected (ultimately) to PUD's two or more offset locations away from economic production if filer's arguments are persuasive
 - Example: Statistical arguments, such as in SPEE Monograph3, have been accepted in some cases
 - Example: For one filer, 24% of registrant's PUD locations in the Barnett shale were more than one offset location from an existing producer and 6% were more than two locations away

Key Issue 5: Third Party Reports

- S-K Item 1202(a)8 outlines requirements
- Problem: SEC staff has identified many deficiencies in filings and has asked for updating, amendments to 10-K's, and refileing
- Solution: pay chose attention to SEC requirements in 1202(a)8
- Some common problems:
 - Different reserves reported by filer and by third party
 - Failure to disclose assumptions rather than list of generic methods
 - References to 'boiler plate' methodologies rather than actual methodologies used
 - Lack of clarification of whether report was a review or an audit

Key Issue 6: Changes to Proved Reserves

- FASB ASC 932-235-50-5 states “Changes in the net quantities of an entity’s proved reserves of oil and gas during the year shall be disclosed. Changes resulting from all the following shall be shown separately with appropriate explanation of all significant changes.”
- Problem: Often, “appropriate explanation” provided in generic form or not provided at all
- Possible Solution: We suggest a specific, rather than generic, narrative, related to each change category and volumes, expanding into the details of the nature of the changes

Other Issues, Less Frequently Addressed by SEC

- Delivery commitments
- Internal controls in reserves estimation process
- Reliable technology and compliance of methods disclosed
- Service contracts (e.g., Iraqi contracts)
- Production trends
- Procedures used to calculate prices
- Failure to include abandonment costs in calculating “Standardized Measure”

Misunderstandings Possibly Caused by Differences in PRMS and SEC Regulations

- Inclusion of fuel used in filer's own operations in reserves
- Different commercial conditions for different reserves categories
- Treatment of revenues from sales of non-hydrocarbons
- Reserves aggregation at project level
- Resource classification in unpenetrated fault blocks
- Consistency and repeatability of reliable technology required in SEC regulations
- Strict five-year rule in SEC regulation
- Use of forecast prices in PRMS as base case
- Project commerciality (based on best estimate) in PRMS vs. proved reserves viability in SEC

Summary of Key Issues Raised by SEC

- Proved undeveloped reserves
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- NGL's disclosures
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