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Department of Energy

memorandum

DATE: February 15, 1996

REPLY TO ATTN OF: IG-30

SUBJECT: U.S. Department of Energy Naval Petroleum and Oil Shale Reserves 1995 Financial Statement Audit under the Chief Financial Officers Act (WR-FC-96-01)

TO: Deputy Assistant Secretary for Naval Petroleum and Oil Shale Reserves (FE-60)

The attached report presents the results of the independent certified public accountant's audit of the Department of Energy's (Department) Naval Petroleum and Oil Shale Reserves (NPOSR) financial statements as of September 30, 1995. The auditors have expressed an unqualified opinion on the 1995 statements. Their reports on the NPOSR internal control structure and compliance with laws and regulations are also provided.

NPOSR consists of petroleum reserves in California and Wyoming and oil shale reserves in Colorado and Utah. The Government's interests in NPOSR are managed by the Department through its headquarters office in Washington, D.C. In addition, the Department has site offices in both California and Wyoming that are responsible for contractor oversight functions. Daily operations are conducted under contract by two management and operating contractors.

By law, NPOSR was authorized in 1976 to produce crude oil at the maximum efficient rate for six years. The law allowed production to be extended for three year periods, provided that the President of the United States certified that continued maximum production was in the best interest of the nation. The current three year period ends on April 5, 1997. Additional information about NPOSR is provided in the overview and notes to the financial statements.

The 1995 financial statement audit was performed under the provisions of the Inspector General Act (5 U.S.C. App.), as amended, the Chief Financial Officers (CFO) Act (31 U.S.C. 1500) and Office of Management and Budget implementing guidance to the CFO Act. The auditors' work was conducted in accordance with generally accepted Government auditing standards. To fulfill our audit responsibilities, we contracted with the independent public accounting firm of KPMG Peat Marwick LLP (KPMG) to conduct the audit for us, subject to our review.

The auditors' reports on the NPOSR internal control structure and compliance with laws and regulations disclosed reportable conditions and a noncompliance that are not considered material weaknesses. While these conditions do not have a material effect on the financial statements, they deserve corrective action. The auditors also considered the overview and performance measurement data for completeness and material consistency with the basic financial statements as noted in the internal control report.

During the course of the audit, KPMG identified certain other matters which, although not material to the financial statements, nevertheless warrant management's attention. Further discussion on steps to improve the situation is included in the attached management letter.

We believe that the financial statements, together with KPMG's opinion and our review of that work, provide NPOSR management and the Department's Chief Financial Officer with a basis for evaluating NPOSR's financial position and progress. NPOSR management reviewed the auditors' draft report, generally agreed with the issues disclosed, and indicated that corrective actions are in progress or are planned.

In accordance with Department Order 2320.2B, "Establishment of Departmental Position on Inspector General Reports," as amended by the October 11, 1994, memorandum on "Implementing Guidelines For Streamlining Pilot," additional management comments are not required since the report contains management's concurrence and corrective action plan for each issue disclosed.

We appreciated the cooperation of your staff during the review.

Gregory H. Friedman
Deputy Inspector General
for Audit Services

Attachments

cc: Director, Audit Liaison Division (CR-33)
Program Audit Liaison (FE-63)
L. Ackerly, Manager, Western Regional Audit Office

IG Report No. WR-FC-96-01

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KPMG

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U.S. Department of Energy

NAVAL PETROLEUM AND OIL SHALE RESERVES

Combined Financial Statements

September 30, 1995 and 1994

and

Management Overview and Supplemental Financial and Management Information

NAVAL PETROLEUM AND OIL SHALE RESERVES

Table of Contents

OVERVIEW

The Naval Petroleum and Oil Shale Reserves (NPOSR) were established by a series of Executive Orders in the early 1900's as a future source of liquid fuels for the military. NPOSR remained largely inactive until Congress, responding to the Arab oil embargo of 1973-74, passed the Naval Petroleum Reserves Production Act of 1976. The law authorized production for six years. Thereafter, NPOSR production could be reauthorized by the President in three-year increments. Every President, since enactment of the law, has determined that continuing NPOSR production is in the nation's best interest. NPOSR is currently authorized to continue production through April 5, 1997.

NPOSR consists of Naval Petroleum Reserve No. 1 (NPR-1) (jointly owned by the U.S. Government and Chevron USA, Inc. (Chevron)) and NPR-2, located in Kern County, California; NPR-3 in Natrona County, Wyoming; Naval Oil Shale Reserve (NOSR) No. 1 and NOSR-3, located in Garfield County, Colorado; and NOSR-2 in Uintah County, Utah, and Department of Energy (DOE) Headquarters (HQ) and DOE field offices with activities relating to the operation of NPOSR.

In this report, "NPRC\DOE - Elk Hills" consists of NPR-1, NPR-2, and DOE field office costs for Elk Hills, California. "NPOSR - CUW\DOE - Casper" consists of NPR-3, NOSR-1, NOSR-2, NOSR-3, and the DOE field office costs for Casper, Wyoming. DOE HQ reflects those amounts directly related to DOE HQ activities benefiting NPOSR operations. "DOE other field offices" consists of NPOSR related costs for all other DOE field offices, excluding those mentioned above.

Production from NPR-1, NPR-3, and NOSR-3 is sold by sealed bidding. Royalties are collected for the leased properties within NPR-2. Unlike production from NPR-1, 2, and 3, production from NOSR-1, 2, and 3 is restricted to "protection drilling". That is, development of these fields is limited to what is necessary for ensuring that surrounding development does not drain the resources underlying NOSR properties. Of the three NOSR properties, NPOSR produces and sells natural gas from NOSR-3 only. If full development, rather than protective drilling, were to be approved by Congress, the NOSR fields would yield substantial production and revenues for the U.S. Treasury.

Daily operations of all NPOSR properties are performed by Management and Operating (M&O) contractors co-located with NPOSR field staff in Elk Hills, California and Casper, Wyoming. The M&O contractors provide operations, maintenance, engineering, administrative and other necessary services to provide efficient operations of NPOSR.

From 1976 through 1995, NPOSR generated $ 16.4 billion in revenues for the U.S. Treasury while costs during that time amounted to only $ 3.3 billion. During Fiscal Year (FY) 1995, NPOSR generated $ 383.1 million in revenues, an increase of $ 21.6 million from 1994. NPOSR costs during FY 1995 totaled $ 203.6 million, including recognition of the cumulative effect of a change in accounting principle for $ 16.0 million, associated with impairment of long-lived assets, resulting in net income of $ 179.5 million, compared with net income of $ 137.7 million in FY 1994. At the 1995 level, the Government would accrue over $ 1 billion in profits from NPOSR over the next six years.

Contributing to increasing net income is an increased focus on improving profitability. This includes both reducing costs and increasing asset value. The most important accomplishment in this area has been the construction of a cogeneration plant that provides NPR-1 with its own source of electricity at significantly reduced costs. The $ 46.8 million plant (including both NPR and Chevron proportionate costs), which was completed six months ahead of schedule and $ 1.3 million (NPR-1 and Chevron) under budget, allows NPR-1 to save nearly $ 11 million a year in electricity costs and generates revenues of approximately $ 2.7 million a year through the sale of excess electricity.

Another significant cost-savings measure in FY 1995 was the downsizing of the M&O contractor work force at NPR-1. This effort resulted in the voluntary separation of approximately 200 employees, and will have significant impact on annual costs in the future. Other cost-saving measures include a reduction of compliance and reporting requirements ($ 2 million) and deferral of marginally economic investments ($ .5 million). Efforts to increase production and asset value include a more aggressive remedial program, use of horizontal drilling technology, and implementation of a Shallow Oil Zone gas injection program.

Additional projects are planned, which if adequate funding is allocated, could substantially increase revenues in the future. Among these planned projects at NPR-1 are the expansion of the cogeneration plant and modification of existing gas-separation facilities for a cryogenic plant. The cryogenic plant, for example, could potentially increase propane recovery from 45 to 95 percent in an economic manner. At an initial investment of $ 24 million, the project could have a payout of just 1.1 years and potentially generate net income after operating and capital costs (over 20 years) of $ 305 million.

Accompanying the FY 1996 budget request to Congress, the Administration proposed legislation authorizing DOE to sell NPR-1 and to determine what should be done with the remaining reserves. This legislation has been passed by Congress and is pending action by the President. Sales activities could begin only after it is signed into law.

A great deal of conjecture regarding the value of NPR-1 (Government's interest) has accompanied the divestment proposal. Initial Congressional Budget Office and Office of Management and Budget (OMB) estimates have ranged between $ 1.5 and $ 2.6 billion. Although it is difficult to pin down the analytical rigor devoted to those estimates, it is clear that they discount the large upside potential of the extremely prolific reservoirs and the huge natural gas resource which remains largely untapped at NPR-1.

DOE, on the other hand, has conducted a fairly rigorous analysis of NPR-1 and has valued it between $ 2.5 and $ 4.2 billion, depending on various production and investment scenarios. What is clear in any valuation of NPR-1 is that it is an exceptionally valuable resource with the potential for even greater value in the future.

NPR-1 is jointly owned by DOE and Chevron and operated under a Unit Plan Contract (UPC) executed in 1944 and amended in 1948. The UPC enables DOE and Chevron to develop the field on a reservoir basis, which allows for more efficient and greater recovery of petroleum resources by avoiding competitive production of individual parcels. Each participant shares in unit costs and production of petroleum in proportion to the acre-feet of oil in place that were underlying their respective surface lands as of November 20, 1942.

Under the terms of the UPC, either participant may request a redetermination of their equity shares of a producing zone. In FY 1995, a redetermination of the Dry Gas Zone was completed which resulted in an increase to the Government's percentage share from just over 77 percent to almost 84 percent. DOE and Chevron are in the process of revising the ownership percentages of the Shallow Oil Zone (see note 11(a) to the financial statements) which is ongoing. The Government's share of total unit production from NPR-1 currently averages 78 percent.

Future profitability of NPR-3 and NOSR-3 continued to be a concern for NPOSR in FY 1995. The staff at the DOE-Casper field office conducted an evaluation of operations to identify potential efficiencies in operations and cost reduction opportunities. The evaluation revealed that significant savings could be achieved through staff reductions by reassigning some contractor responsibilities to the Federal work force, streamlining administrative procedures, and restructuring the contractor work force as follows:

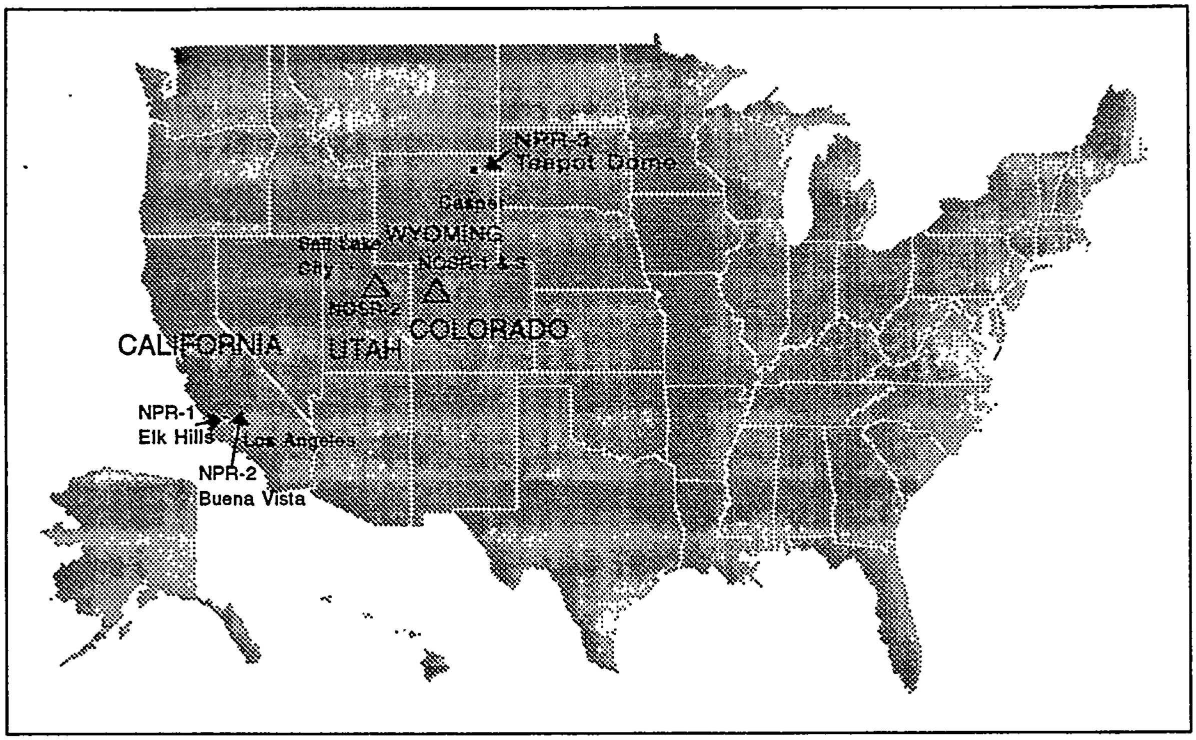
- Beginning in FY 1996 NPOSR staff will assume management and operating responsibilities for NOSR-3 which were performed by the contractor during FY 1995 and before.

- The number of contractor employees necessary for operating the field will be reduced from 124 to 109 at the beginning of FY 1996.

- Most contractor employees will be relocated to existing office space at the NPR-3 site, thereby reducing rent expense.

During FY 1995, the Rocky Mountain Oilfield Testing Center (RMOTC) at NPR-3 was established as a credible facility. RMOTC's goal for testing and demonstrating advanced technologies which will either reduce oil field costs, or increase productivity for the nation's independent producers was well received by the industry. RMOTC initiated 19 projects and published several articles in various professional journals and magazines. Many of these projects were jointly funded by DOE and external partners, with cash and in-kind contributions representing approximately 50 percent of the total expenditures for the program. In addition, to RMOTC's commitment to test and demonstrate new technologies, they have a strong commitment to technology transfer and training. During FY 1995, RMOTC hosted the first of several planned training programs for the Native Americans to enhance their knowledge of oilfield production and environmental applications; and is currently providing hands-on experience for a Native American graduate geology student on behalf of the Bureau of Indian Affairs. RMOTC also participated in the summer intern program for Historically Black Colleges and Universities by hosting 9 students from various universities.

The following map indicates the locations of the Naval Petroleum and Oil Shale Reserves.

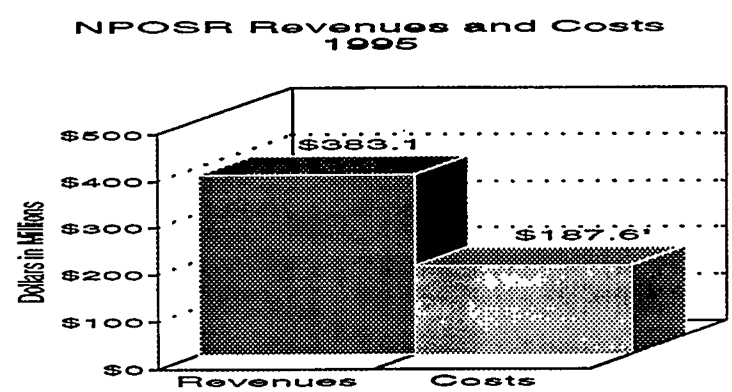


Fiscal Year 1995 PROGRAM HIGHLIGHTS--FINANCIAL

DOE's share of NPOSR revenues during FY 1995 totaled $ 383.1 million. This was an increase of $ 21.6 million over FY 1994. The increase in revenue was due to higher crude oil prices, although this was partially offset by lower prices for natural gas. DOE's share of NPOSR costs during FY 1995 totaled $ 187.6 million, excluding recognition of the cumulative effect of a change in accounting principle of $ 16.0 million, associated with impairment of long-lived assets (see note 19 to the financial statements), resulting in net income of $ 195.5 million. This is an increase of $ 47.3 million in net income before cumulative effect of change in accounting principle over FY 1994 and is attributable to higher oil prices, and implementation of cost reduction measures, including cost benefits realized as a result of constructing the cogeneration facility.

DOE HQ costs of $ 2.3 million and DOE Other Field Offices costs of $ 1.5 million were allocated to NPRC\DOE - Elk Hills and NPOSR - CUW\DOE - Casper in the amounts of $ 3.5 million and $ .3 million, respectively. With consideration of the DOE HQ and DOE Other Field Offices costs allocation, NPRC\DOE - Elk Hills generated net income of $ 209 million, while NPOSR - CUW\DOE - Casper operations resulted in a net loss of $ 13.5 million, excluding recognition of the cumulative effect of a change in accounting principle of $ 16.0 million, associated with impairment of long-lived assets (see note 19 to the financial statements). In reference to the combining financial statements, DOE HQ, and DOE Other Field Offices, are reflected separately.

The following chart displays the NPOSR total revenues and costs for FY 1995.

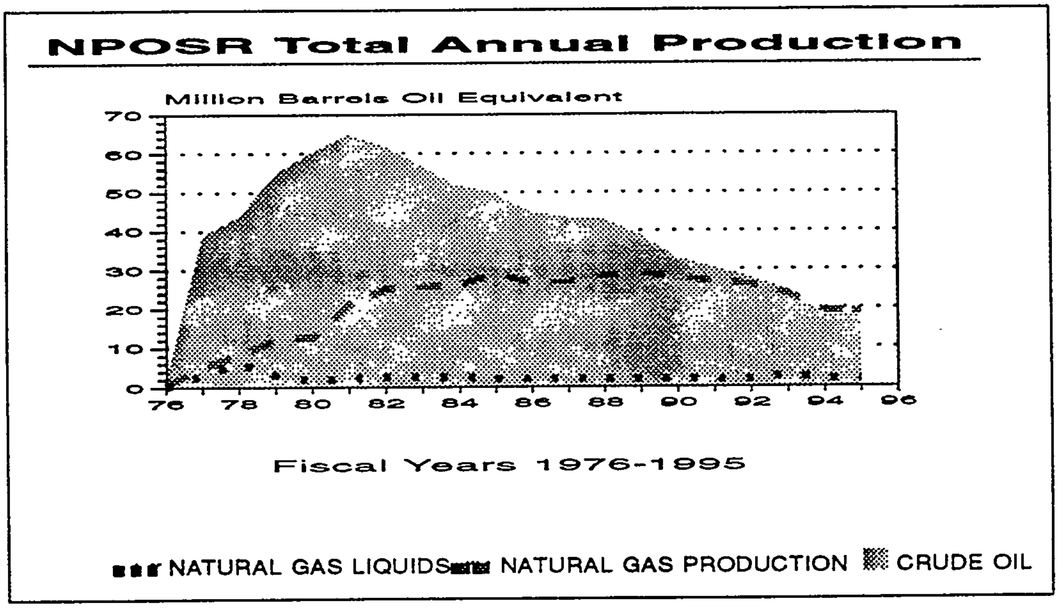


*Excluding recognition of the cumulative effect of a change in accounting principle of $16.0 million

Fiscal Year 1995 PROGRAM HIGHLIGHTS--PRODUCTION

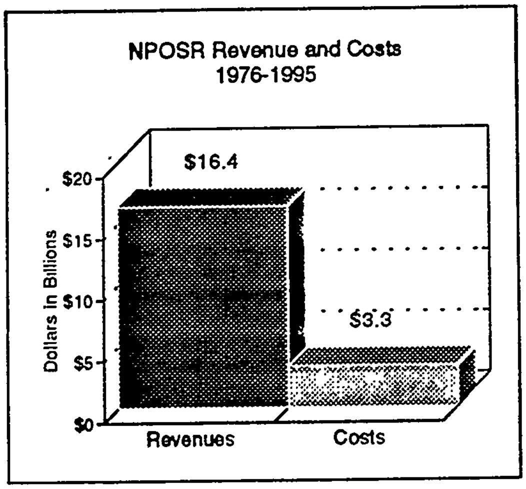
DOE's share of total FY 1995 production yielded 39,094,387 BOE, a decrease of 366,897 BOE from FY 1994. This is a decline rate of less than 1 percent, significantly lower than historical averages, and represents the second consecutive year that hydrocarbon production has essentially been held level. NPR-1 crude oil production decreased due to delays in implementing drilling programs, but was offset by increased natural gas production. NPR-3 crude oil production increased slightly, while natural gas production remained relatively steady. (Production figures for NPR-1 and NPR-3 include reinjected gas.)

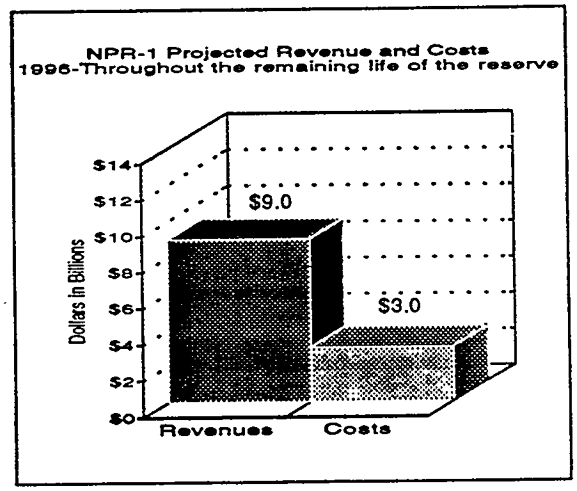
The following chart displays total NPOSR production from 1976 to 1995.



Performance Measures

NPOSR, as a whole, has been extremely profitable and forecasts continued profitability since its oil and gas properties have several decades of remaining economic life.





In accordance with OMB guidance, program and financial performance measures are presented for petroleum production and sales. The performance measures for NPOSR, as a whole, are presented in the Overview section. For a presentation by facility, refer to the Supplemental Financial and Management Information section.

Program Performance Measures

The program performance measures for NPOSR disclose program results in relation to program mission, goals and objectives. The performance measures consider production factors such as production rates, lifting costs, downtime per well and manpower costs per well.

1. PRODUCTION RATES measure the degree of success in achieving production targets for the fiscal year.

PRODUCTION RATE PER YEAR	TARGET PRODUCTION FY 1995	ACTUAL PRODUCTION FY 1995	PERCENT DIFFERENCE FY 1995	TARGET PRODUCTION FY 1994	ACTUAL PRODUCTION FY 1994	PERCENT DIFFERENCE FY 1994
CRUDE OIL (BARRELS)	19,630,331	18,567,790	(5.41)%	17,982,873	19,360,371	7.66 %
NATURAL GAS (MCF)*	109,052,367	100,016,801	(8.29)%	96,645,887	97,729,093	1.12 %
PROPANE (GALLONS)	44,959,005	48,751,133	8.43 %	43,103,532	42,703,727	(0.93)%
BUTANE & BUTANE PLUS (GALLONS)	29,474,271	29,085,128	(1.32)%	32,214,629	29,879,866	(12.67)%
ISOBUTANE (GALLONS)	8,869,500	8,738,868	(1.47)%	8,869,500	8,911,320	0.47 %
NATURAL GASOLINE (GALLONS)	42,284,925	42,778,287	1.17 %	48,918,418	42,354,250	(13.42)%

* Cubic Feet, Thousands

COMMENT: Overall, NPOSR production was at or near projected target levels. The most significant differences were in crude oil and natural gas, which were under target by 5 and 8 percent, respectively. This variance is attributable to delays encountered in implementing development activities, but is still within acceptable estimating standards for the industry. All other products were at or above target expectations.

2. LIFTING COSTS per BOE are the costs incurred to produce a barrel of oil equivalent (BOE) after completion of drilling and before removal for sale or transportation. In other words, lifting costs per BOE are the costs to bring one BOE to the surface. It is computed by dividing direct costs by the quantity produced.

	FY 1995	FY 1994
Lifting Costs per BOE	$1.86	$1.79

COMMENT: Lifting Costs per BOE rose 4 percent over last years costs primarily due to inflation and the higher costs associated with producing oil as reservoirs are depleted.

3. DOWNTIME PER WELL is the average number of days that producible wells are shut down for maintenance, remedials, etc. and is computed by dividing the total number of days producible wells are down by the total number of producible wells.

	FY 1995	FY 1994
Downtime per Well (Days)	13.15	12.00

COMMENT: Producible wells are economically feasible wells and exclude all injection wells, water wells, uneconomic oil and gas wells, and abandoned wells. The downtime per well in FY 1995 is fairly consistent with FY 1994, and is relatively low when compared to industry accepted standards of 15 to 20 days.

4. MANPOWER COSTS PER WELL measures the direct labor costs per active well. Active wells include all wells (producing, injection, and water wells) multiplied by DOE's equity share (by Zone at NPR-1 and working interest at NOSR-3).

	FY 1995	FY 1994
Manpower Costs per Well	$27,776	$29,757

COMMENT: Subcontractor labor is estimated by sampling some of the largest subcontracts and calculating the percentage of those costs that is labor. The percentage is then applied to all subcontractor costs to estimate total subcontractor costs. Manpower costs per well continue to decrease due to successful efforts to reduce labor costs and staffing, and the increased number of active wells.

5. OPERATING COSTS include Federal staffing and support service costs as well as costs usually considered "overhead". Operating costs exclude direct labor for drilling and completions, exploration and capital investment for new facilities and facility modifications.

	FY 1995	FY 1994
Operating Costs per BOE	$3.35	$3.67

COMMENT: Operating costs have been reduced through various cost cutting measures, among them a 26 percent reduction in the number of employees.

6. NET PROFIT MARGIN PER BOE is computed by subtracting all expenses from gross revenues and dividing by the BOE produced.

	FY 1995	FY 1994
Net Profit per BOE	$5.18	$3.75

COMMENT: NPOSR considers this the most important performance measure. Net profit per BOE increased during FY 1995 largely due to a rise in oil prices, and a concerted effort to reduce operating costs.

7. RETURN ON PLANT, PROPERTY AND EQUIPMENT measures the relationship of net revenues to the value of assets.

	FY 1995	FY 1994
Net Revenue / Net Asset Value	$0.39	$0.27

COMMENT: This measure provides the dollars of net revenues per dollars of asset value.

Financial Management Performance Measures

There were no specific performance measures identified in this area for the NPOSR activities. However, the NPOSR adheres to sound financial management practices and policies. Bills are paid on time, accounts receivable are properly managed and sound internal controls are in place. In addition, reviews of NPOSR are continuously being performed by both internal and external parties.

Future Economic Considerations

Estimated Proved Developed and Undeveloped Reserves:

NPR-1 estimated DOE's net proved oil and gas reserves and changes thereto for the years 1995 and 1994 are shown in the following table. These quantities were estimated in the current year by DOE reservoir engineers at the site location, assisted by Bechtel Petroleum Operations Inc. and Systems Technology Associates. Current-year estimates include revisions to the FY 1993 Long Range Plan (LRP) estimates, increasing both proved developed and undeveloped reserves, in the amount of 75.4 MMBOE and 32.8 MMBOE, respectively. The revisions were primarily due to the fact that the 1993 LRP projections cut off beyond the year 2032, and the current-year projections extend through the remaining life of the reserves.

The proved liquid and gas reserves reported are consistent with current knowledge of the characteristics and production history of the reserves. They include only such reserves as can be classified as proved. Estimates of reserve quantities are based on sound geological and engineering principles; but, by their very nature, are estimates that are subject to substantial upward or downward revision as additional information regarding producing fields and technology becomes available. Proved reserves do not include additional quantities that may result from extensions of currently proved areas, or from application of secondary or tertiary recovery processes not yet tested and/or determined to be economical. Proved developed reserves are the quantities expected to be recovered through existing wells with existing equipment and operating methods. Proved undeveloped reserves are the quantities expected to be recovered through additional capital expenditures.

ESTIMATED PROVED DEVELOPED AND UNDEVELOPED RESERVES
CONSOLIDATED (GOVERNMENT SHARE)

	1995	1994
	(MMBOE)	
Proved Developed and Undeveloped Reserves:		
Beginning of year	358.3	383.8
Revisions of previous estimates	75.4	0.0
Production*	(25.4)	(25.5)
End of year	408.3	358.3
Proved Developed Reserves:		
Beginning of year	341.0	366.5
Revisions of previous estimates	32.8	0.0
Production*	(25.4)	(25.5)
End of year	348.4	341.0

NOTES:

MMBOE: Million Barrels of Oil Equivalent**

* Production numbers are net of injected gas in the amount of 11.8 MMBOE and 12.0 MMBOE respectively, for 1995 and 1994. Production numbers above compared to the numbers reflected in the performance measures will differ due to the treatment of injected gas and minor rounding differences.

** Oil equivalent calculation is based on the following:
- 6,000 MBTU = 1 BOE
- Wet gas (produced) 1 MCF = 1,240 MBTU
- Residue gas (injection and sold) 1 MCF = 1,107 MBTU

Standardized Measure of Future Net Cash Flows Related to Proved Developed and Undeveloped Oil and Gas Reserves:

The standardized measure of discounted future net cash flows, related to the above proved oil and gas reserves for NPR-1, is calculated in accordance with the requirements of Statement of Financial Accounting Standards (SFAS) No. 69, with certain modifications. Estimated future cash inflows from production are computed by applying average (SFAS No. 69 requires year end prices) annual prices for oil, gas, and natural gas liquids (propane, normal butane, isobutane, and natural gasoline) to average annual quantities of estimated DOE net proved developed and undeveloped reserves to be produced and sold.

Future price changes for the next two years' prices for each of the products are forecasted using the current average prices for all the products, the recent trends in the actual prices for each product, and the local (California) market conditions (supply vs. demand relationship). For the years thereafter, the prices are escalated at the assumed annual inflation of 3 percent per year. Future operating costs for the next year's operating cost rates (per reservoir, per kind of the cost rates) are forecasted using last year's actual operating cost rates (per reservoir, per kind of the cost rates), and the expected operating cost changes and operating strategies. For the years thereafter, the operating cost rates are escalated at the assumed annual inflation of 3 percent per year. Drilling, facilities, and other costs are based on the recent actual costs for similar items and the anticipated activities in the future, incorporating appropriate modifications, as required. For the years in the future, these costs are escalated at the assumed annual inflation of 3 percent per year. Discounted future net cash flows are calculated using 10 percent mid-period discount factors. This discounting requires a year-by-year estimate of when the future expenditures will be incurred and when the reserves will be produced and sold.

STANDARDIZED MEASURE OF DISCOUNTED FUTURE
NET CASH FLOWS FOR NPR-1
AS OF SEPTEMBER 30, 1995
(in thousands)

Future cash inflows	$ 8,981,643
Future costs	(3,031,879)
Future net cash flows	5,949,764
10% annual discount for estimated timing of cash flows	(3,816,890)
Standardized measure of discounted future net cash flows relating to proved oil and gas reserves	$ 2,132,874

Limitations of the Financial Statements

The financial statements have been prepared to report the financial position and results of operations of NPOSR, pursuant to the requirements of the Chief Financial Officers Act of 1990.

While the statements have been prepared from the books and records of the entity in accordance with the formats prescribed by OMB, the statements are different from the financial reports used to monitor and control budgetary resources which are prepared from the same books and records.

These statements should be read with the realization that they are for a sovereign entity, that unfunded liabilities reported in the financial statements cannot be liquidated without the enactment of an appropriation, and that the payment of all liabilities other than for contracts can be abrogated by the Government, acting in its sovereign capacity.

KPMG Peat Marwick LLP

60 East South Temple
Suite 900
Salt Lake City, UT 84111

Independent Auditors' Report on Financial Statements

The Deputy Assistant Secretary
Naval Petroleum and Oil Shale Reserves
United States Department of Energy:

We have audited the accompanying combined statements of financial position of the U.S. Department of Energy (DOE) Naval Petroleum and Oil Shale Reserves (NPOSR) as of September 30, 1995 and 1994, and the related combined statements of operations and changes in net position, cash flows, and budgetary resources and actual expenses for the years then ended. These combined financial statements are the responsibility of NPOSR management. Our responsibility is to express an opinion on these combined financial statements based on our audits.

We conducted our audits in accordance with generally accepted auditing standards; *Government Auditing Standards*, issued by the Comptroller General of the United States; and Office of Management and Budget (OMB) Bulletin 93-06, *Audit Requirements for Federal Financial Statements*. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the combined financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

The financial statements were prepared in conformity with the hierarchy of accounting principles and standards approved by the principals of the Federal Accounting Standards Advisory Board. This hierarchy is a comprehensive basis of accounting other than generally accepted accounting principles. Primary differences include the presentation of combined statements of budgetary resources and actual expenses, certain form and content changes to the combined financial statements and cash flows, and certain other disclosures.

In our opinion, the combined financial statements referred to above present fairly, in all material respects, the combined financial position of NPOSR at September 30, 1995 and 1994, and the combined results of its operations and changes in net position, cash flows, and budgetary resources and actual expenses for the years then ended in conformity with the accounting policies described above.

In accordance with *Government Auditing Standards*, we also issued reports dated November 10, 1995 on our consideration of NPOSR's internal control structure and on its compliance with laws and regulations.

U.S. Department of Energy
Washington, D.C.

Our audits were made for the purpose of forming an opinion on the combined financial statements taken as a whole. The accompanying combining information is presented for purposes of additional analysis of the combined financial statements rather than to present the financial position, result of operations and changes in net position, cash flows, and budgetary resources and actual expenses of the individual locations. The combining information has been subjected to the auditing procedures applied in the audits of the combined financial statements and, in our opinion, is fairly stated in all material respects in relation to the 1995 combined financial statements taken as a whole.

As discussed in notes 1 and 19 to the combined financial statements, NPOSR adopted Financial Accounting Standards Board's Statement of Financial Accounting Standards (SFAS) No. 121 *Accounting for the Impairment of Long-Lived Assets and for Long-Lived Assets to be Disposed of*, effective September 30, 1995. As discussed in notes 1 and 10 to the combined financial statements, NPOSR changed its method of accounting for postretirement benefits other than pensions to adopt the provisions of SFAS No. 106 *Employers' Accounting for Postretirement Benefits Other than Pensions*, effective October 1, 1993.

The information presented in management's Overview and the Supplemental Financial and Management Information is not a required part of the combined financial statements, but is supplementary information required by OMB Bulletin 94-01, *Form and Content of Agency Financial Statements*. We have considered whether this information is materially inconsistent with the combined financial statements. Such information has not been subjected to the auditing procedures applied in the audits of the combined financial statements and, accordingly, we do not express an opinion on it. The performance information included in management's Overview and the Supplemental Financial and Management Information is addressed in our auditors' report on the internal control structure in accordance with OMB Bulletin 93-06.

This report is intended for the information of the management of NPOSR and DOE. This restriction is not intended to limit the distribution of this report, which is a matter of public record.

KPMG Peat Marwick LLP

Salt Lake City, Utah
November 10, 1995

U.S. DEPARTMENT OF ENERGY
NAVAL PETROLEUM AND OIL SHALE RESERVES

Combined Statements of Financial Position

As of September 30, 1995 and 1994

	1995	1994
ASSETS		
Financial resources:		
Fund balances with U.S. Treasury (note 2)	$ 567,746,256	$ 583,476,726
Cash (note 2)	4,500	4,500
Accounts receivable, net, non-federal (note 3)	20,722,925	17,339,392
Inventories held for sale, net (note 4)	2,740,100	2,336,674
Intragovernmental accounts receivable	9,982	52,841
Total financial resources	591,223,763	603,210,133
Nonfinancial resources:		
Advances and prepayments, non-federal	126,546	137,645
Advances and prepayments, federal	--	50
Materials for own use (note 4)	5,002,342	10,176,905
Property, plant and equipment, net (note 5)	526,171,865	549,413,177
Total nonfinancial resources	531,300,753	559,727,777
Total assets	$1,122,524,516	$1,162,937,910

The accompanying notes are an integral part of these financial statements.

	1995	1994
LIABILITIES		
Funded liabilities:		
Account payable; non-federal	S 27,493,071	$ 34,231,001
Accrued payroll and benefits	3,088,845	3,185,066
Deferred revenue, non-federal	27,227	7,252
Other funded liabilities, non-federal (note 8)	2,936,808	3,202,069
Total funded liabilities	33,545,951	40,625,388
Unfunded liabilities:		
Accrued annual leave	457,548	432,010
Pension and other retirement benefits, non-federal (note 10)	13,140,314	15,109,162
Environmental liabilities (note 11(b))	38,360,360	24,100,000
Total unfunded liabilities	51,958,222	39,641,172
Total liabilities	85,504,173	80,266,560
Commitments and contingencies (notes 6, 9, 10, and 11)		
NET POSITION		
Fund balances (note 12):		
Unexpended reimbursements	534,261,909	544,191,621
Invested capital	526,171,865	549,413,177
Cumulative results of operations	28,544,791	28,707,724
	1,088,978,565	1,122,312,522
Less future funding requirements (note 13)	51,958,222	39,641,172
Net position	1,037,020,343	1,082,671,350
Total liabilities and net position	$1,122,524,516	$1,162,937,910

The accompanying notes are an integral part of these financial statements

U.S. DEPARTMENT OF ENERGY
NAVAL PETROLEUM AND OIL SHALE RESERVES

Combined Statements of Operations and Changes in Net Position

For the Fiscal Years Ending September 30, 1995 and 1994

	1995	1994
APPROPRIATIONS	$ 186,993,054	$ 214,772,000
PROGRAM REVENUES AND EXPENSES		
Revenues (note 14):		
Sales of product	381,093,096	361,244,125
Interest, nonfederal	6,763	30,841
Other income	1,982,364	196,980
Total revenues	383,082,223	361,471,946
Expenses:		
Program and operating expenses (note 15):		
Personal services and benefits	61,467,625	55,174,019
Contractual services	44,613,879	49,822,036
Utilities, rent and communications	6,378,747	16,134,277
Supplies and materials	13,008,500	14,403,390
Equipment not capitalized	4,650,706	4,900,277
Travel and transportation	5,340,704	4,789,248
Printing and reproduction	173,360	291,859
Other	22,786,956	18,498,401
Depreciation	45,303,714	62,013,677
Environmental restoration (note 11)	14,260,360	12,800,000
Miscellaneous expenses (credits) (note 16)	(1,943,310)	2,541,769
Less joint interest reimbursement (excluding capital addition reimbursements of $7,733,433 and $15,806,964)	28,462,700	28,072,571
Net expenses	187,578,541	213,296,382
Net income before cumulative effect of change in accounting principle	195,503,682	148,175,564
Cumulative effect of change in accounting principle (notes 10 and 19)	(16,003,699)	(10,454,129)
Net income	179,499,983	137,721,435
TRANSFERRED TO U.S. TREASURY	412,144,044	402,914,860
Shortage of appropriations and net income over transfers	($45,651,007)	($50,421,425)
NET POSITION		
Beginning balance	$1,082,671,350	$1,133,092,775
Shortage of appropriations and net income over transfers	(45,651,007)	(50,421,425)
Ending balance	$1,037,020,343	$1,082,671,350

The accompanying notes are an integral part of these financial statements

U.S. DEPARTMENT OF ENERGY
NAVAL PETROLEUM AND OIL SHALE RESERVES

Combined Statements of Cash Flows

For the Fiscal Years Ending September 30, 1995 and 1994

	1995	1994
CASH FLOWS FROM OPERATING ACTIVITIES		
Net income	$179,499,983	$137,721,435
Depreciation	45,303,714	62,013,677
Provision for inventory obsolescence	4,432,628	--
Provision for asset impairment	16,003,699	--
Unfunded environmental restoration	14,260,360	12,800,000
Other unfunded expenses, net	(1,943,310)	12,995,898
Increase in accounts receivable	(3,340,674)	(37,719)
Decrease in inventories	338,509	1,285,033
Decrease in advances and prepayments	11,149	34,221
Increase (decrease) in accounts payable	(6,737,930)	4,817,486
Increase (decrease) in other liabilities	(341,507)	3,023,331
Net cash provided by operations	247,486,621	234,653,362
CASH FLOWS FROM INVESTING ACTIVITIES		
Purchases of property, plant, and equipment (net of retirements)	(38,066,101)	(58,851,604)
CASH FLOWS FROM FINANCING ACTIVITIES		
Appropriations	186,993,054	214,772,000
Transferred to U.S. Treasury	(412,144,044)	(402,914,860)
Net cash used in financing activities	(225,150,990)	(188,142,860)
Net cash used in operating, investing, and financing activities	(15,730,470)	(12,341,102)
Fund balances with U.S. Treasury and cash, beginning of year	583,481,226	595,822,328
Fund balances with U.S. Treasury and cash, end of year	$567,750,756	$583,481,226

The accompanying notes are an integral part of these financial statements.

U.S. DEPARTMENT OF ENERGY
NAVAL PETROLEUM AND OIL SHALE RESERVES

Combined Statements of Budgetary Resources and Actual Expenses

For the Fiscal Years Ending September 30, 1995 and 1994

	BUDGET		ACTUAL
	Resources	Obligations Incurred	Net Expenses
1995	$637.111,376	$198.026.671	$187.578.541
1994	$658.774.306	$210.527.248	$213.296.382

BUDGET RECONCILIATION

		1995	1994
A.	Net expenses	$187,578.541	$213.296,382
B.	Add:		
	(1) Capital acquisitions	38,066,101	58.851.604
	(2) Other expended budget authority	(6.558,065)	(1,740,816)
	(3) Joint interest reimbursements	36,196,133	43,879,535
C.	Less:		
	(1) Depreciation	45,303,714	62,013.677
	(2) Unfunded environmental restoration	14,260.360	12.800,000
	(3) Other unfunded expenses	(1,943,310)	2,541,769
	(4) Other	(1,220.645)	1,022.891
D.	Accrued expenditures	198,882,591	235,908,368
E.	Less reimbursements	1,929.824	1,968,097
F.	Accrued expenditures (note 18)	$196,952.767	$233.940.271

The accompanying notes are an integral part of these financial statements.

(1) Summary of Significant Accounting Policies

(a) Basis of Presentation

These financial statements have been prepared to report the financial position and results of operations of the Naval Petroleum and Oil Shale Reserves (NPOSR) Program. Unless stated otherwise, references to "NPOSR" refer to the combined activity of the petroleum and oil shale operations.

NPOSR prepares its financial statements in accordance with the form and content for entity financial statements specified by the Office of Management and Budget (OMB) in OMB Bulletin 94-01, and DOE policy, procedures manuals, contract provisions, and/or related guidance, which are summarized below.

(b) Description of Reporting Entity

NPOSR consists of petroleum reserves in California and Wyoming, oil shale reserves in Colorado and Utah, and the Rocky Mountain Oilfield Testing Center (RMOTC) in Wyoming. The Federal government's interests in NPOSR are managed by the Department of Energy (DOE) through DOE's headquarters office in Washington, D.C. In addition to the DOE headquarters office, DOE has site offices in both California and Wyoming that are responsible for contractor oversight functions. Day-to-day operations are conducted under contract by two management and operating contractors. In addition, NPOSR contracts for certain services with other DOE field offices.

The accompanying combined financial statements of NPOSR include the accounts of all funds under NPOSR control.

(i) DOE - Headquarters (DOE HQ)

The Secretary of DOE has delegated the overall responsibility for achieving the mission and goals of NPOSR to the Assistant Secretary for Fossil Energy. Under the Assistant Secretary's direction, the Deputy Assistant Secretary for NPOSR is responsible for the programmatic and operational management of NPOSR. DOE HQ office provides staff support to the Assistant Secretary and Deputy Assistant Secretary. Consequently, NPOSR incurs certain DOE HQ expenses including payroll, travel, office equipment purchases, and other administrative services and supplies expense.

(ii) DOE - Site Offices (DOE - Elk Hills and DOE - Casper)

DOE site offices are responsible for monitoring day-to-day operations, and performing contractor oversight functions. The site offices report directly to DOE HQ. Expenses incurred primarily include payroll, certain subcontract costs, travel, and other administrative costs. A summary of specific locations for which oversight functions are performed is provided below.

(iia) Naval Petroleum Reserves in California (NPRC)

NPRC consists of the interests of DOE in both the unit and nonunit operations of Naval Petroleum Reserve No. 1 (NPR-1) and in Naval Petroleum Reserve No. 2 (NPR-2). The principal interests are minerals under the surface lands in Kern County, California. DOE's site office is in Elk Hills, California.

Except for certain limited acreage, NPR-1 is operated as a unit in accordance with a Unit Plan Contract (UPC) executed June 19, 1944, and amended December 22, 1948, by the United States of America and Standard Oil Company of California (Standard). Standard transferred its interest in the UPC to its wholly owned subsidiary, Chevron USA, Inc. (Chevron), effective January 1, 1977. The UPC enables the unit participants to develop the field on a reservoir basis rather than a parcel-by-parcel basis. Under the UPC, each participant shares in the unit costs and production of petroleum in proportion to the acre-feet of commercially productive oil and gas formations (zones) underlying their respective surface lands as of November 20, 1942.

Based on the most recent equity determination studies agreed upon by the two parties, it is estimated that approximately 22 percent of the commercially productive formations within the unit is owned by Chevron. Chevron's share of NPR-1 production is delivered in kind. In addition, Chevron may purchase crude oil and natural gas via a competitive bid process open to the public.

(iib) Naval Petroleum Oil Shale Reserves, Colorado, Utah, and Wyoming (NPOSR - CUW)

NPOSR-CUW consists of interests of DOE in the Naval Petroleum Reserve No. 3 (NPR-3) in Natrona County, Wyoming, Naval Oil Shale Reserves (NOSR) Nos. 1 and 3 in Garfield County, Colorado, NOSR No. 2 in Uintah County, Utah, and the RMOTC in Wyoming. DOE's site office is in Casper, Wyoming.

At present. DOE is not authorized by law to develop the oil shale resources at the NOSRs. However, the oil shale reserves in Colorado are situated close to natural gas producing fields and some portion of these gas resources underlie NOSRs Nos. 1 and 3. DOE has the responsibility for protecting the Government's interest in these resources. As a result. under the gas protection program. DOE either drills offset wells or communitizes wells whose drainage area overlaps private and Federal land with private owners. whereby development costs of new wells and production are shared based on percentage ownership of the surface acreage. Cash advances are received from joint interest owners for their share of the communitized well operating costs.

(iii) Management and Operating Contractors

Bechtel Petroleum Operations. Inc. (Bechtel) and Fluor Daniel. Inc. (Fluor Daniel) are management and operating contractors (contractors) performing operations, maintenance. logistics support. engineering. technical. and administrative services. In return. DOE reimburses all allowable costs under the contracts, pays award fees. and provides the property. plant. and equipment necessary for the operations of NPOSR. Bechtel has served as the management and operating unit contractor for NPRC in accordance with DOE contract (No. DE-ACO1-85FE60520) since July 31. 1985. Bechtel's contract expires on September 30, 1996. Fluor Daniel was awarded the DOE management and operating contract (No. DE-AC01-92FE62316) for NPOSR- CUW effective October 1, 1992. Fluor Daniel's contract expires September 30. 1997.

The contractors integrate their accounting systems with DOE through the use of reciprocal accounts. The contractors are required under provisions of their respective contracts to maintain a separate set of accounts and records for recording and reporting all financial related transactions in accordance with DOE accounting practices and procedures.

(iv) DOE Other Field Offices

Certain other DOE field offices have performed services for NPOSR. Services rendered include environmental studies on endangered species and habitat. enhanced oil recovery analysis, microfilming, and other.

The costs associated with these services amounted to $1.475.410 and $1.454.408. respectively. during 1995 and 1994.

(c) Basis of Accounting

Transactions are recorded on an accrual accounting basis and a budgetary basis. Under the accrual method. revenues are recognized when earned and expenses are recognized when a liability is incurred. without regard to receipt or payment of cash. Budgetary accounting facilitates compliance with legal constraints and controls over the use of federal funds.

The statements of financial position include only DOE's interest in NPR-1. as Chevron's interests in the respective asset and liability amounts have been deducted. Joint interest reimbursements billed to Chevron for its respective share of the operating costs incurred to operate NPR-1 are presented in the accompanying statements of operations and changes in net position as a component of net income.

NPR-1 includes primarily lands withdrawn from public sale initially in 1912. with additional withdrawals in 1942. NPR-3 includes lands withdrawn from public sale in 1915. The Secretary of the Navy was granted authority to take possession of all properties within NPR-1 and NPR-3 for the sole control and use of the United States. Therefore, no value is shown for crude oil and gas reserves underlying these lands.

(d) Appropriations and Revenues

Congress annually adopts a budget appropriation that provides NPOSR with funding to meet operating expense requirements. Proceeds from sales at NPR-1 and NPOSR-CUW and royalties from NPR-2 are deposited into the U.S. Treasury as required by the Production Act of 1976.

Crude oil, natural gas, and liquid gas products are sold under contracts to public customers at bid prices. Gross revenue is recorded at the time the product is delivered to the customer at the pipeline or truck terminal. Royalties are recorded as revenues when the product is delivered by the operator of leased acreage in which DOE has a royalty interest. NPR-2 royalty income is paid directly to DOE by the lessees.

(e) Funds with the U.S. Treasury and Cash

NPOSR does not maintain cash in commercial bank accounts. Cash receipts and disbursements are processed by the U.S. Treasury. Funds with the U.S. Treasury represent appropriated funds that are available to pay current liabilities and finance authorized purchase commitments. Cash balances held outside the U.S. Treasury represent imprest cash amounts.

Revenues from sales of petroleum products are deposited in the U.S. Treasury's Miscellaneous Receipts account and, except for revenues generated from the sale of natural gas from wells drilled or communitized in 1990 and thereafter at NOSR-3, are not available for expenditure by the NPOSR.

(f) Allowance for Doubtful Accounts

The allowance for doubtful accounts is based on a case-by-case basis (i.e.. specific identification method).

(g) **Inventories**

NPOSR inventories are comprised of supplies that will be consumed in future operations and products held for sale. The consumable inventory is stated at the lower of cost, using the weighted-average method; or estimated realizable value. Recorded values for consumable inventory are adjusted for the results of physical inventories taken periodically in accordance with a cyclical counting plan. Product inventory held for sale primarily consists of crude oil in the pipeline that is valued at the current market price.

(h) **Property, Plant, and Equipment**

Costs for real property with an expected life in excess of two years, and costs for personal property with an expected life in excess of two years and an initial cost of at least $5,000, are capitalized. Costs of major additions, improvements, and replacement of equipment are capitalized; and costs of maintenance and repairs are charged to expense as incurred. Costs and accumulated depreciation of equipment retired, abandoned, or otherwise disposed of are removed from the accounts upon disposal, and any resulting gain or loss is included in operations in the year of disposition.

Exploration and development operations are accounted for by the successful-efforts method, in accordance with Statement of Financial Accounting Standards (SFAS) No. 19 of the Financial Accounting Standards Board (FASB). Tangible and intangible costs of drilling and equipping development wells and development-type stratigraphic test wells are capitalized, whether or not the wells are productive. Costs of drilling exploratory wells are initially capitalized pending determination of whether or not such wells have found proven reserves. If such wells do not find proven reserves, the costs, net of any salvage value, are charged to exploratory expenses.

Depreciation is computed on DOE's interest in drilling and development costs, well equipment, gas plant (NPR-3), and production facilities based on the units-of-production method. Depreciation of gas plant (NPR-1), buildings, structures, office, and other equipment is computed on the straight-line method over the estimated useful lives, which range from 6 to 30 years. Depreciation on used plant, consisting of plant and equipment temporarily out of service, is computed on the straight-line method over the estimated useful lives, which range from 5 to 50 years.

Effective September 30, 1995, NPOSR adopted SFAS No. 121, *Accounting for the Impairment of Long-Lived Assets and for Long-Lived Assets to be Disposed of*, which sets forth circumstances under which an entity must review long-lived assets for impairment. The cumulative effect of the change in method for accounting for impaired long-lived asset is reported in the 1995 combined statement of operations and changes in net position.

(i) Liabilities

Liabilities represent the amount of monies or other resources that are likely to be paid by NPOSR as the result of a transaction or event that has already occurred. However, no liability can be paid by NPOSR absent an appropriation. Liabilities for which an appropriation has not been enacted are, therefore, classified as unfunded liabilities, and there is no certainty that the appropriations will be enacted. Also, liabilities of NPOSR arising from other than contracts can be abrogated by the Government, acting in its sovereign capacity.

(j) Accrued Annual Leave

Accrued annual leave is accrued as it is earned, and the accrual is reduced as leave is taken. Each year, the accrued annual leave balance is adjusted to reflect current pay rates. To the extent that current or prior year appropriations are not available to fund annual leave earned but not taken, funding will be obtained from future financing sources.

Sick leave and other types of nonvested leave are expensed as leave is taken.

(k) Retirement Plans

NPOSR personnel, as employees of either DOE or of the management and operating contractors, may be participants in certain benefit plans. The provisions of these plans are discussed in note 10.

Bechtel sponsors a defined benefit health care plan for substantially all retirees and employees. Effective October 1, 1993, NPOSR adopted SFAS No. 106, *Employers Accounting for Postretirement Benefits Other than Pensions*, which establishes a new accounting principle for the cost of retiree health care and other postretirement benefits, as far as it pertains to Bechtel acting as a contractor for NPRC. Prior to 1994, NPOSR recognized these benefits on the pay-as-you-go method (i.e., cash basis). The cumulative effect of the change in method of accounting for postretirement benefits other than pensions is reported in the 1994 combined statement of operations and changes in net position.

DOE does not report plan assets, accumulated plan benefits, or unfunded liabilities, if any, applicable to its employees. Reporting such amounts is the responsibility of the Office of Personnel Management and the Federal Employees Retirement System.

Statement of Federal Financial Accounting Standards (SFFAS) No. 4. *Managerial Cost Accounting Concepts and Standards for the Federal Government*, directs the full cost reporting of employment benefits by employing entity. Under this concept, NPOSR will be required to accrue the costs to the Federal government of providing pension, life, health, and other post-employment benefits (severance payments, counseling and training, workers compensation benefits, etc.): "regardless of whether the benefits are funded by the reporting entity or by direct appropriations to the trust funds". SFFAS No. 4 will be effective after September 30, 1996.

(l) Reclassifications

Certain reclassifications have been made in order to conform 1994 financial information with the 1995 financial information format. These reclassifications do not impact the financial position or results of operations of NPOSR.

(m) Use of Estimates

NPOSR's management has made certain estimates and assumptions relating to the reporting of assets and liabilities and the disclosure of contingent assets and liabilities to prepare these financial statements. Actual results could differ from those estimates.

(2) Fund Balances with U.S. Treasury and Cash

Fund balances (appropriated) with U.S. Treasury include the following as of September 30, 1995 and 1994:

	1995	1994
Unexpended allotments	$142,180,032	$150,141,465
Unapportioned revenues	425,566,224	433,335,261
Total	$567,746,256	$583,476,726

Cash consists of imprest funds of $4,500 as of September 30, 1995 and 1994.

(3) Accounts Receivable

Accounts receivable include the following as of September 30, 1995 and 1994:

	1995	1994
Sales of products and earned royalties	$ 12,735,439	$ 11,023,930
Chevron's share of operating costs	7,956,750	6,262,669
Other	128,058	150,115
Allowance for doubtful accounts	(97,322)	(97,322)
	$ 20,722,925	$ 17,339,392

Chevron's share of operating costs is comprised of billed costs for August and September and Chevron's unbilled share of unit costs at September 30, 1995 in the amount of $1,417,348.

(4) Inventories

Inventories include the following as of September 30, 1995 and 1994:

	1995	1994
Materials for own use	$ 13,730,145	$ 14,667,948
Less allowance for obsolescence and overstocking	7,629,275	1,981,832
Less Chevron's ownership	1,098,528	2,509,211
	5,002,342	10,176,905
Held for sale	2,740,100	2,336,674
	$ 7,742,442	$ 12,513,579

(5) Property, Plant, and Equipment

Property, plant, and equipment includes the following as of September 30, 1995 and 1994:

	1995	1994
Buildings, structures, and improvements	$ 29,800,556	$ 29,268,249
Gas and electric production, transmission, and distribution systems	389,809,620	337,423,632
Crude oil extraction, water supply pumping, treatment, and distribution systems	1,017,884,616	993,619,086
Office, transportation, security, ADP, and other equipment	21,102,448	21,153,965
Less Chevron's ownership	273,237,036	254,153,054
	1,185,360,204	1,127,311,878
Less NPOSR accumulated depreciation	672,309,095	633,737,327
	513,051,109	493,574,551
Construction work-in-progress (net of Chevron ownership of $2,801,306 and $14,777,374, respectively)	13,120,756	55,838,626
	$ 526,171,865	$ 549,413,177

(6) Operating Leases

Bechtel has entered into an operating lease for a telephone communication system. The lease requires monthly rental payments of $18,884 and expires in July of 1996. DOE site office in Casper, Wyoming, has entered into an operating lease for an office building. The lease requires annual rental payments of $134,126 and expires in September of 1996.

The contractors also enter into various rental agreements for equipment used in NPOSR operations on a day-to-day and/or month-to-month basis. Rent expense amounted to approximately $2,934,900, and $2,293,049, respectively, for 1995 and 1994.

(7) Related Party Transactions

Vehicles are leased on a month-to-month basis to the contractors through an interagency agreement between DOE and General Services Administration (GSA). Monthly rent charges are determined based on the number and type of vehicles in service and are submitted to GSA. DOE receives a reimbursement from GSA for operating expenses incurred, including gas and oil, repairs, etc. These transactions are summarized as follows for 1995 and 1994:

	1995	1994
Rent expense	$ 1,365,047	$ 1,258,197
Reimbursement of operating expenses	(417,213)	(386,182)

Certain management, construction and supporting services are provided to the contractors by their respective general and central staff organizations, or by affiliated companies. Cost of services provided amounted to $473,799, and $1,979,488, respectively, for 1995 and 1994. These costs were reviewed and approved by the respective DOE site offices.

NPOSR-CUW has contracted with the Bureau of Land Management (BLM) to administer the surface resources management of the NOSR lands in a manner consistent with the surrounding public lands. Specific activities performed by BLM include road maintenance, prevention of erosion damage to the range and streams, monitoring of cattle grazing on NOSR lands, and the prevention of illegal hunting activities. BLM monitors NOSR lands from three different offices (Vernal, UT.; Grand Junction, CO.; and Moab, UT.) BLM bills NPR-3 on a quarterly basis. Cost of services provided amounted to $104,509, and $75,643, respectively, for 1995 and 1994.

(8) Other Funded Liabilities, Nonfederal

Other funded liabilities, nonfederal, covered by budgetary resources include the following as of September 30, 1995 and 1994:

	1995	1994
Accrued funded vacation pay	$ 2,509,902	$ 2,675,064
Employee payroll deductions	419,267	519,365
Other	7,639	7,640
	$ 2,936,808	$ 3,202,069

(9) Sales Commitments

NPOSR sells crude oil, natural gas, and various liquid gases produced from NPR-1, NPR-3, and NOSR No. 3. Products are sold under contracts ranging from two months to one year. Invoice prices are determined by one of the following two pricing mechanisms:

(a) Bid prices are adjusted monthly to reflect changing market conditions by formulas reflected in the sales contracts; or

(b) A bid premium or discount is applied monthly to a market index specified in the sales contracts.

NPOSR had the following product sales commitments under the applicable pricing mechanism in effect at September 30, 1995:

(a) - Bid Price

Product	Unit of Measure	Bid Quantity	Bid Price Range Low	Bid Price Range High
Crude oil	Bbls/day	11,900	$13.3700	$17.8800
Natural gas	MMBTU/day	131,874	0.7700	1.3489
Liquid products	Gallons/day	232,400	0.2605	0.4602

(b) - Bid Premium or Discount

Product	Unit of Measure	Bid Quantity	Premium/(Discount) Low	Premium/(Discount) High
Crude oil	Bbls/day	38,800	($0.34000)	$ 0.25400
Liquid products	Gallons/day	109,000	(0.06083)	(0.03000)

Quantities noted are per day commitments.

(10) Pension and Other Retirement Benefits

Bechtel has a defined-benefit pension plan covering all full-time employees. The benefits are based on years of service and the employee's highest five (5) consecutive years of compensation. Bechtel and/or individual employees may in future years make contributions to the plan, acting under the advice of the actuary, to meet the minimum funding requirements of the Employee Retirement Income Security Act of 1974 to maintain the plan and trust for employees. The following table sets forth the plan's status as of September 30, 1995 and 1994:

	1995	1994
Actuarial present value of benefit obligations:		
Vested benefit obligation	$ 16,230,897	$ 11,258,884
Accumulated benefit obligation	$ 16,787,791	$ 11,985,863
Projected benefit obligation for services rendered to date	$ 23,440,470	$ 20,110,790
Plan assets at fair value	(18,684,413)	(13,634,654)
Plan assets less than projected benefit obligation	4,756,057	6,476,136
Unrecognized net loss	(5,495,648)	(4,121,931)
Unrecognized prior service cost	187,878	275,224
Unrecognized net asset recognized over 15 years	2,723,930	3,048,803
	2,172,217	5,678,232
Less Chevron's portion	474,233	1,205,530
Accrued pension cost*	$ 1,697,984	$ 4,472,702

* of which $931,754 and $3,005,292, respectively, represent unfunded liabilities.

The net pension cost includes the following for 1995 and 1994:

	1995	1994
Service cost-benefits earned during the period	$ 1,594,823	$ 2,298,440
Interest cost on projected benefit obligation	1,713,744	1,659,270
Actual return on plan asset	(3,147,214)	(24,209)
Net amortization and deferral	1,837,944	(940,079)
	1,999,297	2,993,422
Curtailment (voluntary termination) effect	(2,251,369)	--
	(252,072)	2,993,422
Less Chevron's portion	(55,456)	631,826
Net pension cost (gain)	$ (196,616)	$ 2,361,596

Assumptions used in accounting for the pension plan for 1995 and 1994 are as follows:

	1995	1994
Discount rate	7.5%	7.0%
Rate of increase in compensation level	5.0%	6.0%
Expected long-term rate of return on assets	7.0%	8.5%

The discount rate is 7.5% as of October 1, 1995.

In addition to the defined-benefit pension plan, Bechtel sponsors defined-benefit plans that provide postretirement medical and dental benefits to full-time employees who meet minimum age and service requirements. The plans are contributory, with retiree contributions adjusted annually, and contain other cost-sharing features such as deductibles and coinsurance. The accounting for the plans anticipate future cost-sharing changes to the written plans that are consistent with Bechtel's expressed intent to increase the retiree contribution rate annually for the expected general inflation rate for that year. Bechtel's intent to fund the cost of these postretirement benefits is subject to the discretion of DOE.

Notes to Financial Statements

NPOSR adopted SFAS No. 106, *Employers' Accounting for Postretirement Benefits Other Than Pensions*, as of October 1, 1993, as far as it pertains to Bechtel acting as a contractor for NPRC. The cumulative effect of adopting SFAS No. 106 as of October 1, 1993, was a decrease of NPOSR's net position (as reflected in the accompanying combined statement of operations and changes in net position for 1994) in the amount of $10,454,129.

The following table sets forth the plan's status as of September 30, 1995 and 1994:

	1995	1994
Accumulated postretirement benefit obligation:		
Retirees	$ 1,900,000	$ 1,584,000
Fully eligible active plan participants	3,658,000	2,792,000
Other active plan participant	6,689,000	8,502,000
Total accumulated benefit obligation	12,247,000	12,878,000
Plan assets at fair value	--	--
Accumulated postretirement benefit obligation in excess of plan assets	12,247,000	12,878,000
Unrecognized net gain	3,405,000	2,500,000
	15,652,000	15,378,000
Less Chevron's portion	3,443,440	3,274,130
Accrued postretirement benefit cost included in unfunded liabilities	$12,208,560	$12,103,870

The net period postretirement benefit cost includes the following for 1995 and 1994:

	1995	1994
Service cost	$ 954,000	$ 1,112,000
Interest cost	1,099,000	984,000
Actual return on plan assets	--	--
Net amortization and deferral	--	--
	2,053,000	2,096,000
Curtailment (voluntary termination) effect	(1,615,000)	--
	438,000	2,096,000
Less Chevron's portion	96,360	446,259
Net periodic postretirement benefit cost	$ 341,640	$ 1,649,741

For measurement purposes. an annual rate of increase in the per-capita cost of covered benefits (i.e.. health care cost trend rate) of 10.5 percent (medical) and 8.2 percent (dental) were assumed for 1995. Both rates were assumed to decrease gradually to 5.5 percent by the year 2004 and remain at that level thereafter. The health-care cost trend rate assumption has a significant effect on the amounts reported. For example, increasing the assumed health-care cost trend rates by one percentage point in each year would increase the accumulated postretirement benefit obligation as of September 30, 1995 by $2.180.000 and the aggregate of the service and interest cost components of net periodic postretirement benefit cost for the year ended September 30, 1995 by $398,000. without taking into account the effects of the voluntary termination of 194 employees (curtailment), as of July 31, 1995.

The weighted average discount rate used in determining the accumulated postretirement benefit obligation was 7.5 percent as of September 30. 1995. Funded costs for post retirement benefits other than pension amounted to $164,000, and $104.000. respectively, for 1995 and 1994.

The following table sets forth the reconciliation of unfunded pension and other retirement benefits as of September 30. 1995:

	Total	Chevron's portion	DOE's portion
Unfunded pension liability	$ 1.194.557	$ 262.803	$ 931.754
Funded portion	977.660	211.430	766.230
Total pension liability	$ 2.172.217	$ 474.233	$ 1.697.984
Unfunded pension liability (SFAS No. 87)			$ 931,754
Accrued postretirement benefit cost included in unfunded liabilities (SFAS No. 106)			12.208.560
Future funding requirements (note 13)			$ 13.140.314

All permanent DOE employees participate in either the Civil Service Retirement System (CSRS). or the Federal Employees Retirement System (FERS). DOE makes matching contributions equal to 7 percent of pay to the CSRS. Most employees hired after December 31. 1983. are automatically covered by FERS and Social Security. Employees hired prior to January 1. 1984. can elect to either join FERS and Social Security or remain in CSRS. A primary feature of FERS is that it offers a savings plan to DOE employees. which automatically contributes 1 percent of pay and matches any employee contribution up to an additional 4 percent of pay. Total DOE contributions for the two plans amounted to $466.254 and $472.830, respectively. for 1995 and 1994.

All regular employees of the contractors are eligible to participate in company sponsored 401(k) retirement plans. Bechtel matched employee contributions fifty cents per dollar for employee contributions up to 6 percent of compensation for all plan participants. Fluor Daniel matches employee contributions dollar per dollar up to 3.5 percent of compensation plus 1.5 percent for all participants for employees covered under Personnel Appendix benefits. Total contributions to these plans amounted to $970,225, and $882,898, respectively, for 1995 and 1994.

(11) Commitments and Contingencies

(a) Ownership Adjustments

As described in note 1, DOE shares ownership of the oil and gas reserves of the Elk Hills NPR-1 unit (Elk Hills) with Chevron. Ownership percentages are determined in proportion to the acre-feet of commercially productive formations (zones) underlying their respective surface lands. The ownership percentages in effect at September 30, 1995 were calculated based upon reserve studies dated in 1957 for the Shallow Oil zone, 1980 (retroactive to 1942) for the Stevens zone, 1942 for the Dry Gas zone, and 1976 for the Carneros zone. In accordance with the Unit Plan Contract, production participation (proportionate ownership percentages) for Elk Hills will be adjusted retroactively at such time that updated reserve studies are completed and agreed upon by the two parties. Accordingly, revisions to DOE estimated reserves would be required at such time, if any, that the two parties mutually agree upon updated and revised reserve studies.

DOE and Chevron are in the process of revising the ownership percentages of the Shallow Oil zone. In November, 1995, an independent petroleum engineer hired by both parties to study the issue released a report recommending DOE's ownership of the Shallow Oil zone be decreased from 70.0199 percent to 65.7786 percent. If the ownership percentages in this report are adopted, DOE would owe Chevron approximately 12.7 million barrels of crude oil from past production and enter negotiations regarding ultimate payback. One possible settlement is for Chevron to receive all of DOE's share of production from the Shallow Oil zone for approximately 3.5 years to pay back the 12.7 million barrels. At $15 per barrel, the 12.7 million barrels of payback oil is worth approximately $190 million. In addition, Chevron could receive 3.9 million barrels of future additional production worth approximately $58.5 million, at $15 per barrel. DOE is not obligated to accept this advisory report. According to the UPC, the next stage in resolving the ownership dispute is the responsibility of the Secretary of Energy, who has delegated authority to the Assistant Secretary for Fossil Energy, who can accept or reject the report, or ask for additional work.

New equity participation between DOE and Chevron was agreed to in December 1994, for the Dry Gas zone. The equity will increase DOE's share of production (and a commensurate increase in the share of production costs) from 77.0492 percent to 83.8726 percent of the Dry Gas zone. Under the terms of the Unit Plan Contract with Chevron, balancing is retroactive to 1942 and results in a net gas volume owed to DOE of 6.8 Billions of Cubic Feet (Bcf), worth approximately $10.7 million at current gas prices. There are no plans to review the ownership percentages of the Stevens, Carneros, or Asphaltos zones. However, Congress is considering proposals to privatize Elk Hills, which would require a definitive settlement of ownership of all zones.

Management of NPOSR believes that the reserve figures found in NPR-1's long-range plan reasonably reflect the hydrocarbons to be recovered from NPR-1.

(b) Environmental and Site Restoration

NPOSR and other oil and gas companies have, in recent years, become subject to increasingly demanding environmental standards imposed by federal, state, and local environmental laws and regulations. It is the policy of NPOSR to comply with applicable environmental laws and regulations.

NPOSR is obligated for environmental clean-up and site-restoration requirements at NPR-1 and NPR-3 as individual wells and facilities are abandoned and, ultimately, as operations are terminated. NPOSR's share of estimated clean-up and restoration costs at NPR-1 is approximately $328 million (based on FY95 Long Range Plan, proved reserves development case). NPOSR started recognizing an unfunded liability for the estimated restoration requirements at NPR-1 in 1993, and as of September 30, 1995, the unfunded liability for NPR-1 is approximately $32 million. The accrual for NPR-1 is based on actual revenues in relation to total estimated revenues over the remaining life of the facility. NPOSR's share of estimated total clean-up and restoration costs at NPR-3 is approximately $6.4 million, which was provided for in 1995. Total NPOSR accrued costs as of September 30, 1995 and 1994 amount to $38,360,360 and $24,100,000, respectively.

(c) Litigation and Claims

At present, NPOSR is a party in various administrative proceedings, legal actions, alleged personal injury, and claims brought by or against it. In the opinion of NPOSR management and legal counsel, the ultimate resolution of these proceedings, actions, and claims will not materially affect the financial position or results of operations of NPOSR. Certain of these actions are summarized as follows:

(i) Celeron Gathering Corp. vs. United States

Celeron Gathering Corp. filed suit against DOE under the Contracts Dispute Act pursuant to its contract with DOE to purchase crude oil at NPR-1 from LACT Station 24Z from October 1, 1988 to April 1, 1989. NPR-1 experienced waste water disposal problems at 24Z resulting in its inability to deliver the full estimated 10,000 "barrels of oil per day" called for in the contract. NPR-1 allowed Celeron to take additional deliveries of crude oil at LACT Station 18G during the last two months of its contract to make up for the under deliveries at 24Z, but at the prices in effect on the days of delivery. Celeron, alleging bad faith, has sued for $1.2 million, the alleged difference in prices in effect during the fall of 1988 and the prices in effect in February and March of 1989, plus interest and attorney fees. This case has progressed through the discovery phase with arguments on both parties motions for summary judgement being denied by the court. A trial was held in May, 1995, but no ruling has yet been issued. Both parties have filed post-trial briefs. The outcome of the court's ruling cannot be determined at this time. However, attorneys for NPOSR believe that a judgement, if any, will be substantially less than Celeron's claims.

(ii) Appeals of Golden West Refining et al.

Golden West and three other purchasers of NPR-1 crude oil have submitted appeals to the Energy Board of Contract Appeals (EBCA) alleging that the DOE wrongfully extended their contract due to expire on April 1, 1992 and as a result allege that they have suffered losses aggregating $900,000 plus interest. On August 31, 1995, the EBCA ruled in favor of Golden West et al. for a settlement amount of $666,739. DOE anticipates that an appeal will be filed, based on a disagreement with the methodology used by EBCA to determine the settlement amount. DOE believes the appropriate amount of damages is $250,000. The eventual amount cannot be determined at this time.

(12) Fund Balances

Fund balances include the following as of September 30. 1995 and 1994:

	1995	1994
Unexpended reimbursements:		
Unobligated:		
Available	$ 14,420,676	$ 21.522.422
Unavailable	424,664,028	426,694,636
Undelivered orders	95,177.205	95.974.563
	534.261.909	544.191.621
Invested capital	526,171.865	549.413,177
Cumulative results of operations:		
Beginning of year	28,707,724	16,966,625
Excess (shortage) of financing sources over funded expenses and transfers	(33,333,957)	(24,625,530)
Intrafund allocations	33.171.024	36.366.629
End of year	28,544.791	28.707.724
	$ 1.088.978.565	$ 1.122.312.522

(13) Future Funding Requirements

Future funding requirements include the following as of September 30, 1995 and 1994:

	1995	1994
Pension and other retirement benefits (note 10)	$ 13,140,314	$ 15.109.162
Annual leave	457.548	432.010
Environmental restoration (note 11)	38.360.360	24.100.000
	$ 51.958.222	$ 39.641.172

(14) Revenues

Revenues include the following during 1995 and 1994:

	1995	1994
Sales of product:		
Crude oil	$ 305,566,528	$ 277.747.481
Natural gas	35,501,529	42,653.104
Propane	16,344,262	16.414.117
Butane	7,208.381	7,152,504
Isobutane	3,919.290	3,402,748
Gasoline	10,236,354	11.716.920
Natural gas condensate	40.150	26.495
	378.816.494	359.113.369
Royalties	1,715,352	1.633,849
Pipeline tariff	561.250	496.907
	381,093,096	361,244,125
Interest income	6.763	30.841
Other income*	1,982.364	196.980
	$ 383.082.223	$ 361.471.946

* Includes $1,945,573 in sales of excess electric power from the cogeneration facility in 1995 ($-0- in 1994).

(15) Operating Expenses

Operating expenses (by program) include the following during 1995 and 1994:

	1995	1994
Operations and maintenance	$ 165.372.629	$ 162,284.624
Drilling	22.688.787	32,989,653
Facilities construction	15,577.640	44,991,111
Program direction	7,627.980	7,169.572
NOSR	3.036.243	5,169.774
RMOTC	758.372	--
Depreciation	45.303.714	62,013,677
Other expenses	1.475.410	1.409.108
Gross expenditures	261,840.775	316,027.519
Less joint interest reimbursements	36.196.133	43.879.534
Gross DOE expenditures	225,644,642	272,147,985
Less capital expenditures	38.066.101	58.851.603
Net expenditures	$ 187.578.541	$ 213.296.382

(16) Miscellaneous Expenses (Credits)

Miscellaneous expenses (credits) include the following during 1995 and 1994:

	1995	1994
Unfunded post retirement benefit costs	$ 104.690	$ 1.649.741
Unfunded pension costs (credits)	(2.073.538)	894.186
Unfunded annual leave costs (credits)	25.538	(2.158)
	$(1.943.310)	$ 2.541.769

(17) Significant Customers

The following customers each accounted for greater than ten percent of total revenue from public sources at NPR-1, NPR-3, and NOSR-3, respectively, during 1995:

Customer	NPR-1	NPR-3	NOSR-3
EOTT Energy Corporation	$ --	$11,067,118	$ --
Associated Gas Service	--	--	1,888,390
Texaco Trading / Texaco Refining & Exploration	60,136,642	--	--
Celeron Gathering / Celeron Trading & Transportation	72,085,144	--	--

(18) Reconciliation of Combined Statements of Budgetary Resources and Actual Expenses:

There are no reconciling differences between "accrued expenditures" in the accompanying combined statements of budgetary resources and actual expenses and "accrued expenditures" as per SF-133, line 16, for 1995 and 1994.

(19) Impairment of Assets

Effective September 30, 1995, NPOSR adopted SFAS No. 121, *Accounting for the Impairment of Long-Lived Assets and for Long-Lived Assets to be Disposed of.* SFAS No. 121 sets forth circumstances under which an entity must review long-lived assets for impairment. One of the criteria occurs when the entity has experienced a current period operating loss combined with a recent history of operating losses such as recent NPOSR - CUW operations. Impairment of the revenue generating assets occurs when the carrying value of those assets may not be recoverable.

The provision for asset impairment is associated primarily with assets used in oil and gas production at NPOSR -CUW. These assets include capitalized drilling costs, completion costs steam generation facilities, flowlines, production equipment and related facilities which are being depreciated using the units of production method of depreciation. The amount of the loss was calculated as the difference between the carrying value of the assets as of September 30, 1995 and the estimated expected future cash flows discounted at 10 percent. The provision for asset impairment at NPR-3, and at NOSR-1 and NOSR-3, amount to $8,852,023 and $7,151,676, respectively. These amounts are reflected as the cumulative effect of a change in accounting principle in the accompanying combined statement of operation and changes in net position for 1995.

U.S. DEPARTMENT OF ENERGY
NAVAL PETROLEUM AND OIL SHALE RESERVES

Combining Statement of Financial Position

As of September 30, 1995

ASSETS	NPRC \ DOE - Elk Hills	NPOSR - CUW \ DOE - Casper	DOE HQ	DOE Other Field Offices	Total NPOSR
Financial resources:					
Fund balances with U.S. Treasury	$535,192,586	$25,987,742	$7,227,103	($661,175)	$567,746,256
Cash	3,000	1,500	--	--	4,500
Accounts receivable, net, non-federal	19,786,418	936,507	--	--	20,722,925
Inventories held for sale, net	2,629,304	110,796	--	--	2,740,100
Intragovernmental accounts receivable	10,132	(150)	--	--	9,982
Total financial resources	557,621,440	27,036,395	7,227,103	(661,175)	591,223,763
Nonfinancial resources:					
Advances and prepayments, non-federal	123,033	3,003	510	--	126,546
Materials for own use	3,835,483	1,166,859	--	--	5,002,342
Property, plant and equipment, net	509,768,366	16,394,610	8,889	--	526,171,865
Total nonfinancial resources	513,726,882	17,564,472	9,399	--	531,300,753
Total assets	$1,071,348,322	$44,600,867	$7,236,502	($661,175)	$1,122,524,516

See independent auditors' report.

	NPRC \ DOE - Elk Hills	NPOSR - CUW \ DOE - Casper	DOE HQ	DOE Other Field Offices	Total NPOSR
LIABILITIES					
Funded liabilities:					
Account payable, non-federal	$23,952,147	$3 495.076	$32.770	$13,078	$27,493 071
Accrued payroll and benefits	2,786,515	248,164	54,166	--	3,088,845
Deferred revenue, non-federal	--	27.227	--	--	27,227
Other funded liabilities, non-federal	2,551,014	378 155	7,639	--	2,936,808
Total funded liabilities	29,289,676	4,148,622	94,575	13,078	33,545,951
Unfunded liabilities:					
Accrued annual leave	254,386	69,461	133,701	--	457,548
Pension and other retirement benefits, non-federal	13,140,314	--	--	--	13,140,314
Environmental liabilities	32,001,140	6,359,220	--	--	38,360,360
Total unfunded liabilities	45,395,840	6 428 681	133,701	--	51,958,222
Total liabilities	74,685,516	10,577,303	228,276	13,078	85,504,173
NET POSITION					
Fund balances	1,042,058,646	40,452,245	7,141,927	(674,253)	1,088,978,565
Less future funding requirements	45,395,840	6,428,681	133,701	--	51,958,222
Net position	996,662,806	34 023 564	7,008,226	(674,253)	1,037,020,343
Total liabilities and net position	$1,071,348,322	$44 600 867	$7,236,502	($661,175)	$1,122,524 516

See independent auditors' report

U.S. DEPARTMENT OF ENERGY
NAVAL PETROLEUM AND OIL SHALE RESERVES

Combining Statement of Operations and Changes in Net Position

For the Fiscal Year Ending September 30, 1995

	NPRC \ DOE - Elk Hills	NPOSR - CUW \ DOE - Casper	DOE HQ	DOE Other Field Offices	Total NPOSR
APPROPRIATIONS	$166,468,034	$16,371,000	$2,374,999	$1,779,021	$186,993,054
PROGRAM REVENUES AND EXPENSES					
Revenues:					
Sales of product	366,349,735	14,743,361	--	--	381,093,096
Interest, nonfederal	5,673	1,090	--	--	6,763
Other Income	1,976,336	6,028	--	--	1,982,364
Total revenues	368,331,744	14,750,479	--	--	383,082,223
Expenses:					
Program and operating expenses:					
Personal services and benefits	53,497,303	6,086,770	1,883,552	--	61,467,625
Contractual services	39,490,695	3,321,510	344,702	1,456,972	44,613,879
Utilities, rent and communications	5,270,439	1,106,120	--	2,188	6,378,747
Supplies and materials	11,910,066	1,098,434	--	--	13,008,500
Equipment not capitalized	4,613,454	37,252	--	--	4,650,706
Travel and transportation	4,997,248	276,557	66,899	--	5,340,704
Printing and reproduction	160,138	8,891	4,331	--	173,360
Other	21,502,287	1,268,419	--	16,250	22,786,956
Depreciation	36,876,459	8,422,315	4,940	--	45,303,714
Environmental restoration	7,901,140	6,359,220	--	--	14,260,360
Miscellaneous expenses(credits)	(1,968,618)	(6,722)	32,030	--	(1,943,310)
Less joint interest reimbursement	28,432,753	29,947	--	--	28,462,700
Net expenses	155,817,858	27,948,819	2,336,454	1,475,410	187,578,541
Net income (loss)	212,513,886	(13,198,340)	(2,336,454)	(1,475,410)	195,503,682
Cumulative effect of change in accounting principle	--	(16,003,699)	--	--	(16,003,699)
Net income (loss)	212,513,886	(29,202,039)	(2,336,454)	(1,475,410)	179,499,983
TRANSFERRED TO U.S. TREASURY	399,255,154	12,888,890	--	--	412,144,044
Excess (shortage) of appropriations and net income over transfers	($20,273,234)	($25,719,929)	$38,545	$303,611	($45,651,007)
NET POSITION					
Beginning balance	$1,016,936,040	$59,743,493	$6,969,681	($977,864)	$1,082,671,350
Excess (shortage) of appropriations and net income over transfers	(20,273,234)	(25,719,929)	38,545	303,611	(45,651,007)
Ending balance	$996,662,806	$34,023,564	$7,008,226	($674,253)	$1,037,020,343

See independent auditors' report.

U.S. DEPARTMENT OF ENERGY
NAVAL PETROLEUM AND OIL SHALE RESERVES

Combining Statement of Cash Flows

For the Fiscal Year Ending September 30, 1995

	NPRC \ DOE - Elk Hills	NPOSR - CUW \ DOE - Casper	DOE HQ	DOE Other Field Offices	Total NPOSR
CASH FLOWS FROM OPERATING ACTIVITIES					
Net income (loss)	$212,513,886	($29,202,039)	($2,336,454)	($1,475,410)	$179,499,983
Depreciation	36,876,459	8,422,315	4,940	--	45,303,714
Provision for inventory obsolescence	4,242,572	190,056	--	--	4,432,628
Provision for asset impairment	--	16,003,699	--	--	16,003,699
Unfunded environmental restoration	7,901,140	6,359,220	--	--	14,260,360
Other unfunded expenses, net	(1,968,617)	(6,723)	32,030	--	(1,943,310)
Decrease (increase) in accounts receivable	(3,430,129)	89,007	448	--	(3,340,674)
Decrease (increase) in inventories	732,978	(394,469)	--	--	338,509
Decrease in advances and prepayments	5,193	5,061	895	--	11,149
Increase (decrease) in accounts payable	(8,268,520)	1,540,585	(9,995)	--	(6,737,930)
Increase (decrease) in other liabilities	(412,081)	65,120	5,454	--	(341,507)
Net cash provided by (used in) operations	248,192,881	3,071,832	(2,302,682)	(1,475,410)	247,486,621
CASH FLOWS FROM INVESTING ACTIVITIES					
Purchases of property, plant, and equipment (net of retirements)	(26,220,881)	(11,845,220)	--	--	(38,066,101)
CASH FLOWS FROM FINANCING ACTIVITIES					
Appropriations	166,468,034	16,371,000	2,374,999	1,779,021	186,993,054
Transferred to U.S. Treasury	(399,255,154)	(12,888,890)	--	--	(412,144,044)
Net cash provided by (used in) financing activities	(232,787,120)	3,482,110	2,374,999	1,779,021	(225,150,990)
Net cash provided by (used in) operating, investing, and financing activities	(10,815,120)	(5,291,278)	72,317	303,611	(15,730,470)
Fund balances with U.S. Treasury and cash, beginning of year	546,010,706	31,280,520	7,154,786	(964,786)	583,481,226
Fund balances with U.S. Treasury and cash, end of year	$535,195,586	$25,989,242	$7,227,103	($661,175)	$567,750,756

See independent auditors' report.

U.S. DEPARTMENT OF ENERGY
NAVAL PETROLEUM AND OIL SHALE RESERVES

Combining Statement of Budgetary Resources and Actual Expenses

For the Fiscal Year Ending September 30, 1995

	BUDGET		ACTUAL
	Resources	Obligations Incurred	Net Expenses
Total	$637,111,376	$198,026,671	$187,578,541

BUDGET RECONCILIATION

	NPRC \ DOE - Elk Hills	NPOSR - CUW \ DOE - Casper	DOE HQ	DOE Other Field Offices	Total NPOSR
A. Net expenses	$155,817,858	$27,948,819	$2,336,454	$1,475,410	$187,578,541
B. Add:					
(1) Capital acquisitions	26,220,880	11,845,221	--	--	38,066,101
(2) Other expended budget authority	(6,762,479)	204,414	--	--	(6,558,065)
(3) Joint interest reimbursements	36,196,133	--	--	--	36,196,133
C. Less:					
(1) Depreciation	36,876,459	8,422,315	4,940	--	45,303,714
(2) Unfunded environmental restoration	7,901,140	6,359,220	--	--	14,260,360
(3) Other unfunded expenses	(1,968,618)	(6,722)	32,030	--	(1,943,310)
(4) Other	(1,220,645)	--	--	--	(1,220,645)
D. Accrued expenditures	169,884,056	25,223,641	2,299,484	1,475,410	198,882,591
E. Less reimbursements	--	1,929,824	--	--	1,929,824
F. Accrued expenditures	$169,884,056	$23,293,817	$2,299,484	$1,475,410	$196,952,767

See independent auditors' report.

SUPPLEMENTAL FINANCIAL AND MANAGEMENT INFORMATION

NPRC/DOE-Elk Hills (NPR-1 & NPR-2, and DOE Elk Hills, California field office)

Naval Petroleum Reserves No. 1 (NPR-1) and No. 2 (NPR-2)

NPR-1, Elk Hills, covers 47,409 acres in Kern County, California, and is located about 35 miles west of Bakersfield. Approximately 23 million barrels of crude oil were produced in 1995 of which 17.9 million barrels represent DOE's share. Elk Hills ranks among the ten largest domestic producing oil fields in the lower 48 states. Elk Hills is also one of the nation's top ten producing gas fields, producing 326.6 million cubic feet per day in Fiscal Year (FY) 1995, and approximately 436 thousand gallons per day of natural gas liquids, more than half the total California production.

Most of NPR-1 is operated according to the provisions of a Unit Plan Contract (UPC) executed in 1944 and amended in 1948 by its two owners, the United States and Chevron Corporation, the parent company of Chevron U.S.A. Inc., formerly Standard Oil Company of California (Chevron). The UPC enables the unit participants to develop the field on a reservoir basis rather than a parcel-by-parcel basis, and allows for more efficient and greater recovery of petroleum resources by avoiding competitive production of the individual parcels. Under the UPC, each participant shares in the unit costs and production of petroleum in proportion to the acre-feet of commercially productive oil and gas formations (zones) underlying their respective surface lands as of 1942.

The parties' percentage participating shares of the producing zones within the Elk Hills unit are as follows:

Zone	Government	Chevron
Dry Gas	83.8726%	16.1274%
Shallow Oil*	70.0119%	29.9881%
Stevens	79.6357%	20.3643%
Carneros	100.0000%	0.0000%
Asphaltos	100.0000%	0.0000%

* The UPC invests the Secretary of Energy with the responsibility for making determinations regarding equity participation between DOE and Chevron. This authority has been delegated to the Assistant Secretary for Fossil Energy. The UPC also requires that equity adjustments be retroactive to 1942. In 1989, Chevron requested a redetermination of equity participation in the Shallow Oil Zone. Both DOE and Chevron conducted independent studies of equity participation, the results of which were significantly different. The DOE study proposes a revision to equity increasing the Government's share of production by approximately 5%, worth an estimated \$ 250 million (\$ 190 million for the additional oil which DOE would have received from 1942 to December 1995, and \$ 58.5 million for additional future production under the revised equity percentage). The Chevron study proposes a decrease to the Government's equity similarly worth about \$ 250 million. The Assistant Secretary has not made a final determination.

The Government's average share of total unit production from NPR-1 is approximately 78 percent. Field development and daily operations are performed under a management and operating contract with Bechtel Petroleum Operations, Inc. that began July 31, 1985, and was extended through September 30, 1995. Subsequently, it has been extended again through September 30, 1996 with an option to extend the contract for an additional 10 months.

NPR-1 reached its peak rate of oil production (181.000 BOPD) in July 1981. NPOSR's share of production in FY 1995 was forecasted to average about 51,850 BOPD and the actual average was 49,089 BOPD. Current production forecasts for FY 1996 are not available. The Annual Operating Plan FY 1996, which will contain production forecasts. cannot be prepared until funds are appropriated. The manner in which reserves are developed and field operations are conducted depends. in large measure, on the appropriated funds made available to the program. Until the Annual Operating Plan is prepared, the best estimate of FY 1996 oil production from the FY 1995 Long Range Plan (proved reserves case, which includes both proved developed and undeveloped reserves) is 65,746 BOPD. of which the Government's share is approximately 51,280 BOPD.

The Government's sales and other revenues at NPR-1 and NPR-2 for FY 1995 were $ 368.3 million. In accordance with Public Law, 1995 proceeds from sales of products at NPR-1 and royalties from NPR-2 are deposited into the U.S. Treasury Miscellaneous Receipts account.

Below is an accounting of revenues from petroleum product sales and other revenue for NPR-1 and NPR-2. In addition, $ 36.2 million was billed to Chevron as a reimbursement for their share of the costs (not shown in the below table). Of the $ 36.2 million, $ 28.4 million represents operating expenses and $ 7.8 million represents capital expenditures.

	1995	1994
Crude oil	$294,586,168	$268,792,097
Natural gas	33,009,540	39,922,595
Propane	16,197,731	16,217,201
Butane	6,685,299	6,667,878
Isobutane	3,919,290	3,402,748
Gasoline	10,236,354	11,716,920
Interest income	36,437	29,761
Subtotal	364,670,819	346,749,200
Cogenerator	1,945,573	0
NPR-2 royalties	1,715,352	1,633,849
Total	$368,331,744	$348,383,049

During FY 1995, DOE's share of NPRC/DOE-Elk Hills expenses totaled $ 155.8 million resulting in net income of $ 212.5 million. net of Chevron's share of NPR-1 costs of $ 28 4 million, and before allocation of DOE Headquarters and DOE Other Field Office costs. The majority of NPRC DOE-Elk Hills and Chevron costs consisted of personal and contractual services ($ 93 million); depreciation ($ 36.9 million); utilities. rent and communications ($ 5 2 million); and environmental restoration ($ 7.9 million). The remaining costs ($ 41.2 million) consisted of the cumulative effect of a change in supplies and materials ($ 11.9 million); and other miscellaneous ($ 29.3 million). NPRC/DOE-Elk Hills received $ 28.4 million in reimbursements from Chevron for these costs. Total capitalized costs amounted to $ 34.0 million, of which NPRC/DOE-Elk Hills's share amounted to $ 26.2 million.

NPR-2, Buena Vista Hills, California, covers 30,181 acres and is adjacent to and south of NPR-1. The Buena Vista Hills field has been producing oil since the early 1920's. Of the 30,181 acres within the boundaries of NPR-2, the Government owns 10,446 acres (34.6%) and the remainder is privately-owned. All of the Government's productive land (9,224 acres) has been leased in 17 separate units which "checkerboard" NPR-2. All NPR-2 development and production operations are performed by the lessees, with the Government receiving a royalty from production. Total NPR-2 production per month, predominantly from stripper wells, was 76,907 barrels and 278,387 MCF of natural gas during FY 1995.

The Government's revenues (royalties) from NPR-2 oil, gas, and related liquid product royalties during FY 1995 totaled $ 1.7 million. Minimal expenditures for NPR-2 in FY 1995 provided for lease surveillance, production, accounting, and oversight.

NPOSR-CUW/DOE-Casper (NPR-3, NOSR-1, NOSR-2, NOSR-3, and DOE Casper, Wyoming, field office)

Naval Petroleum Reserve No. 3 (NPR-3)

NPR-3, Teapot Dome, is a Federally-owned oil field of 9,481 acres located 35 miles north of Casper, Wyoming, in Natrona County. Full production was initiated in 1976. Previous activity was a period of lease production during the 1920's and offset production from 1958 to 1976. Fluor Daniel is the current management and operating contractor; their contract runs through September 30, 1997.

Crude oil, natural gas, and associated liquefied petroleum gases (LPG) are produced at NPR-3. Both sweet and sour grades of crude oil are sold on the open market as are two LPG products (propane and a butane-gasoline mixture). The majority of natural gas produced at NPR-3 is reinjected for pressure maintenance, with the remainder expended in minor field uses. Estimated remaining recoverable reserves at NPR-3 total about 1.4 million barrels using current production techniques.

The FY 1995 revenues derived from all sources at NPR-3 totaled $ 12.2 million. These were deposited into the U.S. Treasury Miscellaneous Receipts Account. During FY 1995, costs at NPR-3 totaled $ 31.6 million, including recognition of the cumulative effect of a change in accounting principle allocation of $ 8.9 million, associated with impairment of long-lived assets, resulting in a net loss of $ 19.4 million (including DOE Casper, Wyoming field office allocations). This loss is largely due to provisions for environmental and site restoration costs of $ 6.4 million and the asset impairment costs of $ 8.9 million (see notes 11(b) and 19, respectively, to the financial statements)

Naval Oil Shale Reserves No. 1 (NOSR-1), No. 2 (NOSR-2), and No. 3 (NOSR-3)

NOSR-1 and NOSR-3 are two adjacent oil shale reserves of 40,760 and 14,130 acres, respectively, located about eight miles west of Rifle, Colorado in Garfield County. The Government owns all lands and minerals at NOSR-1 and NOSR-3, except for about 600 acres of oil shale claims at NOSR-1.

NOSR-2's oil shale resource is estimated to contain about 18 billion barrels of shale oil in place with recoverable resource identified as 2.3 billion barrels.

NOSR-3 contains no oil shale, but was set aside by executive order in 1924 to afford working space, spent shale disposal, and access to the Colorado River in support of NOSR-1 shale oil development. The Bureau of Mines constructed and operated an experimental oil shale mine and retorting facility on NOSR-3 at Rulison, Colorado between 1925 and 1929. NOSR-3 was later the site of the Anvil Points Oil Shale Research Facility which was established in 1945, subsequently operated periodically from 1945 to 1982, and was demolished in FY 1986.

Congress granted DOE authority to fund part of the NOSR-3 Natural Gas Protection Program with a revolving fund. This fund is made up of revenues received from the sale of natural gas after November 5, 1990 from wells drilled or communitized in FY 1990 and thereafter. This fund can be used for operation and maintenance, protection drilling, and construction of surface facilities.

To protect the Government's interest in the natural gas underlying the NOSRs, DOE has developed a program with two key elements. communitization and offset drilling. In communitization, the Government formally shares in the production and costs from wells drilled near the boundary of the NOSRs. The owners agree to develop the mineral resource jointly and to share the costs and production based on percentage ownership of the mineral acreage. In addition, pooling of tracts under communitization agreements is done where the separate tracts cannot be developed and operated independently in conformity with State well spacing requirements or established well development programs.

The FY 1995 NOSR-3 sales revenues for natural gas sales totaled $ 2.6 million, the receipts of which are recorded as an appropriation reimbursement in accordance with Public Law 102-154. FY 1995 costs totaled $ 12.4 million, including recognition of the cumulative effect of a change in accounting principle allocation of $ 7.1 million, associated with impairment of long-lived assets (see note 19 to the financial statements). The net loss for FY 1995 was $ 9.8 million (including Casper. Wyoming field office cost allocations).

Headquarters

The \$ 2.3 million of direct Headquarters costs related to NPOSR are to support the Office of Assistant Secretary for Fossil Energy. Costs include payroll, travel, office equipment, and other administrative services and have been allocated to the specific sites based on a weighted average of the total costs.

DOE Other Field Offices

Other DOE field offices supported NPOSR in several ways. The office in Las Vegas, Nevada engaged EG&G of Nevada to provide environmental studies on endangered species and habitat restoration at NPR-1. The Bartlesville Energy Technology Center performed analysis of the 29R oil reservoir at NPR-1 to determine technical and economical methods for oil recovery. And the Albuquerque site continued its efforts to establish an automated system for data storage and retrieval at NPR-1. The cost of these efforts totaled \$1.5 million.

PROGRAM PERFORMANCE MEASURES

1a. ANNUAL PRODUCTION	NPR-1					
	TARGET PRODUCTION FY 1995	ACTUAL PRODUCTION FY 1995	PERCENT DIFFERENCE FY 1995	TARGET PRODUCTION FY 1994	ACTUAL PRODUCTION FY 1994	PERCENT DIFFERENCE FY 1994
Crude Oil (Barrels)	18,925,516	17,917,473	(5.33)%	17,399,598	18,762,687	7.83%
Natural Gas (MCF)	103,502,878	95,078,454	(8.14)%	91,785,213	93,687,973	2.07%
Propane (Gallons)	44,364,055	48,252,992	8.77%	42,579,757	41,976,002	(1.42%)
Butane (Gallons)	27,591,236	27,296,461	(1.07)%	32,641,844	27,868,602	(14.62%)
Natural Gasoline (Gallons)	42,284,925	42,778,287	1.17%	48,918,418	42,354,250	(13.42%)
Isobutane (Gallons)	8,869,500	8,738,868	(1.47)%	8,869,500	8,911,320	0.47%

Production includes hydrocarbons which are reinjected or used in field and cogeneration operations (MCF reinjected 63,663,285)

1b. ANNUAL PRODUCTION	NPR-3					
	TARGET PRODUCTION FY 1995	ACTUAL PRODUCTION FY 1995	PERCENT DIFFERENCE FY 1995	TARGET PRODUCTION FY 1994	ACTUAL PRODUCTION FY 1994	PERCENT DIFFERENCE FY 1994
Crude Oil (Barrels)	702,625	647,611	(7.83)%	581,085	595,827	2.54%
Natural Gas (MCF)	1,910,045	2,010,218	5.24%	2,049,840	2,162,520	5.50%
Propane (Gallons)	594,950	498,141	(16.27)%	523,775	727,725	38.94%
Butane Plus (Gallons)	1,883,035	1,788,667	(5.01)%	1,572,785	2,011,264	27.88%

Gas production includes gas which is reinjected into the oil reservoir or used for enhanced oil recovery and other field operations (MCF reinjected 2,301,516, MCF lost/used 75,955 MCF. The difference between production and reinjection is gas purchased and then stored for later use.)

1c. ANNUAL PRODUCTION	NOSRs					
	TARGET PRODUCTION FY 1995	ACTUAL PRODUCTION FY 1995	PERCENT DIFFERENCE FY 1995	TARGET PRODUCTION FY 1994	ACTUAL PRODUCTION FY 1994	PERCENT DIFFERENCE FY 1994
Crude Oil (Barrels)	2,190	2,706	23.56%	2,190	1,857	(15.21%)
Natural Gas (MCF)	3,639,444	2,928,129	(19.54)%	2,810,834	1,878,600	(33.17%)

All NOSR 3 production is sold and not reinjected

PROGRAM PERFORMANCE MEASURES

1d. ANNUAL PRODUCTION	TOTAL					
	TARGET PRODUCTION FY 1995	ACTUAL PRODUCTION FY 1995	PERCENT DIFFERENCE FY 1995	TARGET PRODUCTION FY 1994	ACTUAL PRODUCTION FY 1994	PERCENT DIFFERENCE FY 1994
Crude Oil (Barrels)	19,630,331	18,567,790	(5.41)%	17,982,873	19,360,371	7.66%
Natural Gas (MCF)	109,052,367	100,016,801	(8.29)%	96,645,887	97,729,093	1.12%
Propane (Gallons)	44,959,005	48,751,133	8.43%	43,103,532	42,703,727	(0.93)%
Butane & Butane Plus (Gallons)	29,474,271	29,085,128	(1.32)%	34,214,629	29,879,866	(12.67)%
Natural Gasoline (Gallons)	42,284,925	12,778,287	1.17%	48,918,418	42,354,250	(13.42)%
Isobutane (Gallons)	8,869,500	8,738,868	(1.47)%	8,869,500	8,911,320	0.47%

This measures the degree of success in achieving stated production targets for a given fiscal year. It is computed by dividing the actual production by the target production for each product.

2. LIFTING COSTS	NPR-1		NPR-3		NOSRs		TOTAL	
	ACTUAL FY 1995	ACTUAL FY 1994	ACTUAL FY 1995	ACTUAL FY 1994	ACTUAL FY 1995	ACTUAL FY 1994	ACTUAL FY 1995	ACTUAL FY 1994
Direct Cost (Govt share)	$ 66,718,765	$ 65,043,140	$ 5,439,057	$ 5,100,953	$ 363,238	$ 279,733	$ 72,521,060	$ 70,723,826
BOE Produced	$ 37,567,020	$ 38,124,866	$ 1,036,639	$ 1,021,461	$ 490,728	$ 311,957	$ 39,094,387	$ 39,461,284
Lifting Cost of BOE	$ 1.78	$ 1.71	$ 5.25	$ 5.29	$ 0.74	$ 0.89	$ 1.86	$ 1.79

Lifting costs are costs incurred to produce a barrel of oil and equivalent gas after completion of drilling and before removal for sale or transportation, and are computed by dividing direct costs by production. This measure reflects the unit cost to the Government of producing one barrel of oil equivalent (BOE).

3. DOWNTIME PER WELL	NPR-1		NPR-3		NOSRs		TOTAL	
	ACTUAL FY 1995	ACTUAL FY 1994	ACTUAL FY 1995	ACTUAL FY 1994	ACTUAL FY 1995	ACTUAL FY 1994	ACTUAL FY 1995	ACTUAL FY 1994
Downtime Per well	15.00	14.00	11.49	9.60	0.87	0.80	13.15	12.00

This measure is the average number of days per well that producible wells are shut down for maintenance, remedials, etc., and is computed by dividing the total number of days producible wells are down for the fiscal year by the total number of producible wells. Under 20 days is considered an accepted level of performance.

PROGRAM PERFORMANCE MEASURES

4. MANPOWER COSTS PER WELL	NPR-1 ACTUAL FY 1995	NPR-1 ACTUAL FY 1994	NPR-3 ACTUAL FY 1995	NPR-3 ACTUAL FY 1994	NOSRs ACTUAL FY 1995	NOSRs ACTUAL FY 1994	TOTAL ACTUAL FY 1995	TOTAL ACTUAL FY 1994
Direct Labor Cost	$ 41,765,415	$ 42,280,311	$ 1,771,578	$ 1,852,764	$ 70,961	$ 86,376	$ 43,607,954	$ 44,219,451
Active Wells	$ 921	$ 869	$ 620	$ 579	$ 29	$ 38	$ 1,570	$ 1,486
$ Per Active Well	$ 45,348	$ 48,654	$ 2,857	$ 3,200	$ 2,447	$ 2,273	$ 27,776	$ 29,757

This measure expresses labor costs per active well, and is computed by dividing direct labor costs by the total number of active wells.

5. OPERATING COSTS	NPR-1 ACTUAL FY 1995	NPR-1 ACTUAL FY 1994	NPR-3 ACTUAL FY 1995	NPR-3 ACTUAL FY 1994	NOSRs ACTUAL FY 1995	NOSRs ACTUAL FY 1994	TOTAL ACTUAL FY 1995	TOTAL ACTUAL FY 1994
Operating Costs	$ 118,941,399	$ 132,066,168	$ 9,595,242	$ 9,926,287	$ 2,559,029	$ 2,670,963	$ 131,095,670	$ 144,663,418
BOF Produced	$ 37,567,020	$ 38,124,866	$ 1,036,639	$ 1,021,461	$ 490,728	$ 314,957	$ 39,094,387	$ 39,461, 84
$ Per BOEG Produced	$ 3.17	$ 3.46	$ 9.26	$ 9.72	$ 5.21	$ 8.48	$ 3.35	$ 3.67

This measure is expressed as the total operating costs including overhead incurred per barrel of oil and equivalent gas produced in the operation of a producing property, and is computed by dividing operating costs by production. Capital investment costs for drilling, completions and facilities are excluded.

6. NET PROFIT MARGIN PER BOEG	NPR-1 and NPR-2 ACTUAL FY 1995	NPR-1 and NPR-2 ACTUAL FY 1994	NPR-3 ACTUAL FY 1995	NPR-3 ACTUAL FY 1994	NOSRs ACTUAL FY 1995	NOSRs ACTUAL FY 1994	TOTAL ACTUAL FY 1995	TOTAL ACTUAL FY 1994
Gross Revenues	$ 368,331,744	$ 348,383,049	$ 12,213,813	$ 10,181,994	$ 2,536,666	$ 2,952,202	$ 383,082,223	$ 361,517,245
Costs	$ 159,356,812	$ 194,977,910	$ 15,791,873	$ 14,460,262	$ 5,283,515	$ 3,903,509	$ 180,432,200	$ 213,341,681
Net Revenues	$ 208,974,932	$ 153,405,139	$ (3,578,060)	$ (4,278,268)	$ (2,746,849)	$ (951,307)	$ 202,650,023	$ 148,175,564
Quantity Produced (BOEG)	$ 37,567,020	$ 38,124,866	$ 1,036,639	$ 1,021,461	$ 490,728	$ 314,957	$ 39,094,387	$ 39,461, 84
Net Profit loss Per BOE	$ 5.56	$ 4.02	$ (3.45)	$ (4.19)	$ (5.60)	$ (3.02)	$ 5.18	$ 3.75

This measure is defined as net revenue per BOE, and is computed by subtracting expenses from gross revenues and dividing by production. NPOSR believes this is the most important performance measure. (NPR-3 measures exclude $ 16 million of combined "Asset Impairment Expense" and $ 0.8 million in Rocky Mountain Oilfield Testing Center Costs and $ 6.4 million in "Environmental Restoration" costs.)

PROGRAM PERFORMANCE MEASURES

7. RETURN OF PLANT PROPERTY & EQUIPMENT	NPR 1		NPR-3		NOSRs		TOTAL	
	ACTUAL FY 1995	ACTUAL FY 1994	ACTUAL FY 1995	ACTUAL FY 1994	ACTUAL FY 1995	ACTUAL FY 1994	ACTUAL FY 1995	ACTUAL FY 1994
Net Revenues	$ 208,974,932	$ 153,405,139	$ (3,578,060)	$ (4,278,268)	$ (2,746,849)	$ (951,307)	$ 202,650,023	$ 148,175,564
Net Asset Value	$ 509,768,366	$ 520,423,944	$ 5,647,838	$ 15,364,782	$ 10,746,772	$ 13,610,622	$ 526,162,976	$ 549,399,348
$ Net Revenues Per $ Net Asset Value	$ .41	$ .29	$ (.63)	$ (.28)	$ (.26)	$ (.07)	$ .39	$ .27

This measure is the relationship of net revenues to the value of assets, and is computed by dividing net revenues by net asset value. Fiscal Year 1994 figures have been adjusted from last year's financial report. Net Asset Value now includes the cost of "work in progress"

KPMG Peat Marwick LLP

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Independent Auditors' Report on Compliance with Laws and Regulations

The Deputy Assistant Secretary
Naval Petroleum and Oil Shale Reserves
United States Department of Energy:

We have audited the combined financial statements of the U.S. Department of Energy (DOE) Naval Petroleum and Oil Shale Reserves (NPOSR), as of and for the year ended September 30, 1995, and have issued our report thereon dated November 10, 1995.

We conducted our audit in accordance with generally accepted auditing standards; *Government Auditing Standards*, issued by the Comptroller General of the United States; and the Office of Management and Budget (OMB) Bulletin 93-06, *Audit Requirements for Federal Financial Statements*. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the combined financial statements are free of material misstatement.

Compliance with laws and regulations applicable to NPOSR is the responsibility of the management of NPOSR, a unit of the United States Department of Energy. As part of obtaining reasonable assurance about whether the combined financial statements are free of material misstatement, we tested compliance with laws and regulations that may directly affect the combined financial statements and certain other laws and regulations designated by OMB and DOE, including:

- Clean Air and Water (Contract Clause FAR 52.223-2)
- Cost Accounting Standards (Contract Clause FAR 52.230-3)
- State and Local Taxes (Contract Clause DEAR 970.5204-23)
- Litigation and Claims (Contract Clause DEAR 970.5204-31)
- Federal Managers' Financial Integrity Act (FMFIA) (DOE Order 1000.3B)
- Chief Financial Officers' Act of 1990
- Environmental Protection (Contract Clause DEAR 970.5204-62)

However, the objective of our audit of the combined financial statements was not to provide an opinion on overall compliance with such provisions. Accordingly, we do not express such an opinion.

Naval Petroleum and Oil Shale Reserves
U.S. Department of Energy

As part of our audit, we obtained an understanding of management's process for evaluating and reporting on internal control and accounting systems as required by FMFIA and compared NPOSR's most recent FMFIA reports with the evaluation we conducted of NPOSR's internal control structure.

The results of our tests disclosed the following instance of noncompliance that is required to be reported herein under *Government Auditing Standards* for which the ultimate resolution cannot presently be determined. Accordingly, the financial statement impact that may result has not been recognized in the combined financial statements.

STATUS OF PRIOR YEAR FINDINGS

The purpose of this section is to provide a status report for those comments reported on in the prior year, for which management has considered, but are still pending resolution or require further attention.

Bechtel Petroleum Operations, Inc. (Bechtel)
Elk Hills, California

Retentions on Subcontract Payments

Audit Comment:

Bechtel's contract clause concerning payments under fixed price construction subcontracts requires Bechtel to withhold a percentage of contract payment amounts until final completion and acceptance of work. Bechtel withheld incorrect amounts for 2 of 11 subcontract payments we tested. In these two instances, Bechtel under-withheld amounts totaling $11,000 because the procurement department did not forward contract modifications to the accounting department, timely. Therefore, the accounting department used outdated data when calculating retention amounts. As a result, amounts withheld were below the minimum contract retention percentage needed to cover possible liquidation damages if the subcontractors' work was not satisfactory.

Audit Recommendation:

Bechtel's management should establish procedures to insure that the accounting department receives progress payment clauses and contract modifications timely to provide for proper withholding of retention amounts.

Naval Petroleum and Oil Shale Reserves
U.S. Department of Energy

Management's Response:

Bechtel concurs and plans to implement an automated system to transmit contract modifications electronically. A batch report will be developed by August 31, 1996, which will print nightly notifying the accounts payable department of subcontract modifications approved by the acquisitions department.

Status:

Bechtel has purchased and is customizing the software mentioned in management's response. Bechtel is in the process of developing a batch report to notify the accounts payable department of approved subcontract modifications. Until this batch report has been implemented, the situation still exists.

* * * * * *

We considered this instance of noncompliance in forming our opinion on whether NPOSR's 1995 combined financial statements are presented fairly, in all material respects, in conformity with applicable accounting policies in effect for NPOSR, and this report does not affect our report dated November 10, 1995 on those financial statements.

Except as described above, the results of our tests of compliance disclosed no instances of noncompliance that are required to be reported herein under *Government Auditing Standards* or OMB Bulletin 93-06.

This report is intended for the information of the management of NPOSR and DOE. This restriction is not intended to limit the distribution of this report, which is a matter of public record.

KPMG Peat Marwick LLP

Salt Lake City, Utah
November 10, 1995

KPMG Peat Marwick LLP

60 East South Temple
Suite 900
Salt Lake City, UT 84111

Independent Auditors' Report on the Internal Control Structure

The Deputy Assistant Secretary
Naval Petroleum and Oil Shale Reserves
United States Department of Energy:

We have audited the combined financial statements of the U.S. Department of Energy (DOE) Naval Petroleum and Oil Shale Reserves (NPOSR), as of and for the year ended September 30, 1995, and have issued our report thereon dated November 10, 1995.

We conducted our audit in accordance with generally accepted auditing standards; *Government Auditing Standards*, issued by the Comptroller General of the United States; and Office of Management and Budget (OMB) Bulletin 93-06, *Audit Requirements for Federal Financial Statements.* Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the combined financial statements are free of material misstatement.

The management of NPOSR, a unit of the U.S. Department of Energy, is responsible for establishing and maintaining an internal control structure. In fulfilling this responsibility, estimates and judgments by management are required to assess the expected benefits and related costs of internal control structure policies and procedures. The objectives of an internal control structure are to provide management with reasonable, but not absolute, assurance that transactions, including those relating to obligations and costs, are executed in compliance with applicable laws and regulations that could have a direct and material effect on the combined financial statements and any other laws and regulations that OMB, NPOSR management, or the DOE have identified as being significant and for which compliance can be objectively measured and evaluated; funds, property, and other assets are safeguarded against loss from unauthorized use or disposition; transactions are executed in accordance with management's authorization and properly recorded and accounted for to permit the preparation of reliable financial reports in accordance with the provisions of OMB Bulletin 94-01, *Form and Content of Agency Financial Statements*, and to maintain accountability over the assets; and that data that support reported performance measures are properly recorded and accounted for to permit preparation of reliable and complete performance information. Because of inherent limitations in any internal control structure, errors or irregularities may nevertheless occur and not be detected. Also, projections of any evaluation of the structure to future periods is subject to the risk that procedures may become inadequate because of the changes in conditions or that the effectiveness of the design and operation of policies and procedures may deteriorate.

Naval Petroleum and Oil Shale Reserves
U.S. Department of Energy

In planning and performing our audit of the combined financial statements of NPOSR for the year ended September 30, 1995, we obtained an understanding of the internal control structure. With respect to the internal control structure, we obtained an understanding of the design of relevant policies and procedures and whether they have been placed in operation and we assessed control risk in order to determine our auditing procedures for the purpose of expressing our opinion on the combined financial statements and not to provide an opinion on the internal control structure. Accordingly, we do not express such an opinion.

Our evaluation of the controls for performance information was limited to those controls designed to ensure the existence and completeness of the information. With respect to the performance measures control objective, we obtained an understanding of relevant internal control structure policies and procedures designed to permit the preparation of reliable and complete performance information, and we assessed control risk.

We noted certain matters involving the internal control structure and its operation that we consider to be reportable conditions under standards established by the American Institute of Certified Public Accountants and OMB Bulletin 93-06. Reportable conditions involve matters coming to our attention relating to significant deficiencies in the design or operation of the internal control structure which, in our judgment, could adversely affect the organization's ability to ensure that the objectives of the internal control structure, as previously defined, are being achieved.

Those matters that we consider to be reportable conditions are summarized below according to location:

DOE Site Office
Elk Hills, California

Consistency of Published Information

Audit Comment:

DOE/NPRC's fiscal year 1995 Long Range Plan (the Plan) contained inconsistent information in the following four instances. First, the Plan presented graphical data for petroleum reserves using three different reporting periods, instead of presenting the data using one reporting period. Second, various Plan sections displayed conflicting data because preparers did not apply updates to information consistently. Third, the Plan did not identify or explain why it contained two different methods for converting thousands of cubic feet (MCF) of gas production, net of the MCF used for injection, into barrels of oil equivalents. Fourth, the Plan's reserve estimate data was not consistent with the information included in the Reserve Estimates study published in April of 1995. The study was a reserve analysis for NPR-1 conducted by a team of DOE/NPRC, Bechtel, and independent engineers.

Naval Petroleum and Oil Shale Reserves
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Audit Recommendation:

DOE/NPRC should take the necessary actions to ensure that its Long Range Plan contains consistent information.

Management's Response:

DOE/NPRC concurs. The inconsistencies referred to were in part due to the result of software limitations. DOE/NPRC has since implemented the use of Merak's PEEP software and has taken steps to clarify all future reports so that the reader will better understand why various data is reported in a particular manner.

The audit finding also states that DOE/NPRC used inconsistent conversion factors when converting gas into barrels of oil equivalent. DOE/NPRC maintains the two conversion factors, though different, were appropriately applied in their respective portions of the Plan. Both conversion factors are acceptable methods in the oil and gas industry.

Finally, the reason that the Plan's reserve estimate data was not consistent with information included in the Reserve Estimates is that the two documents are for different purposes. The Plan is designed for making investment decisions. The Reserve Study is designed to quantify remaining hydrocarbons.

Bechtel Petroleum Operations, Inc. (Bechtel)
Elk Hills, California

<u>Verification of Authorization by Accounts Payable</u>

Audit Comment:

Bechtel's operating instruction 130-001, (B)(3)(m)(1) on expenditure processing procedure, requires the Accounts Payable department to verify that all service field ticket dollar amounts over $1,000 are properly authorized and within authorized limits, with a random check performed on those tickets below $1,000. Our sample of invoices showed that 2 out of 13 invoices representing about $18,000 out of $77,000 were not properly authorized. According to Bechtel's Accounts Payable department, they do not consistently verify approval authority or limits for each field ticket because the volume processed is not manageable with current staffing levels. As a result, the possibility exists for Bechtel to pay for services without proper authorization.

Audit Recommendation:

Bechtel should improve verification controls to ensure that field tickets over $1,000 are properly authorized and within limits.

Management's Response:

Bechtel's management is currently in the process of determining best business practices for NPRC. Once determination has been made, Bechtel will seek to obtain approval from DOE-NPRC. Best business practices will be determined and incorporated into the Bechtel operating instructions by August 31, 1996, for DOE-NPRC approval.

Update of Authorization Listing

Audit Comment:

Bechtel policy requires that all payments for materials and services be supported by properly authorized requisitions. However, our test of 30 requisitions for materials and services showed that Bechtel processed and paid 10 requisitions, representing about $75,000 out of a universe of $129,700, without the proper authorization. This occurred because the list and database of authorized individuals and their dollar limits that were used by the Acquisition department in approving a requisition and used by the Accounts Payable department in paying an invoice were not current or consistent with the requisition authorization limits shown in general management procedure 3.5. As a result, Bechtel had limited assurance that only properly authorized materials and services would be acquired.

Audit Recommendation:

Bechtel should implement procedures assigning responsibility for someone to update the list and database of authorized individuals and limits. The individual should also ensure that the list and database are consistent with general management procedure 3.5.

Management's Response:

Bechtel concurs that authorization lists and databases should be current. Bechtel has taken steps to ensure that someone updates the lists and databases. Bechtel will develop and implement a procedure for the ongoing maintenance of the lists by May of 1996.

Transfers of Materials

Audit Comment:

An effective accounting system should provide for the capturing of all transactions. During test work, we noted that Bechtel did not adjust the fixed asset accounts for materials removed from wells. Bechtel was removing tubing, rods, and other materials from wells, but did not communicate these actions to the Property Management department. Bechtel subsequently repaired the items and used them in other wells. The Property Management department capitalized the repair cost to the other wells in the fixed asset system; however, Bechtel failed to transfer the original cost, less accumulated depletion to the new wells. This situation related to more than 150 wells.

Audit Recommendation:

Bechtel should inform responsible personnel of the need to advise the Property Management department when they remove material from wells.

Management's Response:

Bechtel concurs. The Property Management department will reiterate the responsibility for initiating Material Field Transfers by March 31, 1996.

STATUS OF PRIOR YEAR FINDINGS

The purpose of this section is to provide a status report for those comments reported on, in the prior year for which management has considered, but are still pending resolution or require further attention.

Proper Verification of Expenditure Requisition Approval

Audit Comment:

Bechtel's acquisition operational policy 7.18 requires that the Acquisitions department process all requisitions received with proper departmental approval in accordance with department procurement instructions. Therefore, the Acquisitions department should verify the requisition for proper authorization prior to initiating a purchase. During our 1994 procedures, our judgmental sample of material requisitions showed that 4 of 20 requisitions were not properly approved. One error occurred when the requisitioner was not on the approved list of personnel. The other three sample errors were found on electronic requisitions for purchases totaling $50,000 where the input field for authorization on the electronic record was blank. According to Bechtel's Acquisitions department, they do not consistently verify approval authority for each requisition because the authorization list is outdated and the volume processed is not manageable with current staffing levels. As a result, Bechtel purchased materials without proper authorization.

Audit Recommendation:

Bechtel should ensure that the Acquisitions department follows procedures to verify requisition authorization prior to initiating the purchase to prevent improper purchases of material and services.

Management's Response:

Bechtel concurs. An automated system with the means for electronic approval is planned for implementation by early fiscal year 1996. The computer will electronically verify authority and dollar limits of approver. In the meantime, Bechtel will update the requisition list and will verify authority for each requisition prior to processing for purchase.

Status:

The new automated system has not been implemented. As an element of our 1995 examination, we judgmentally selected 30 requisitions for review, 10 of which were not properly approved. All of the errors occurred when the requisitioners submitted the initial subcontract requisitions for amounts greater than authorized. In addition, three individuals given responsibility for signing Authorization for Expenditure (AFE) invoices did not have cards on file giving them authorization to sign. Management does not expect to receive the new software mentioned in "management's response" before the beginning of fiscal year 1997. The new software will not send requisitions to Acquisitions department without appropriate approvals. This continual postponement has the effect of causing the existing internal controls to deteriorate and therefore more timely attention by management is necessary.

Naval Petroleum and Oil Shale Reserves
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Bechtel Petroleum Operations, Inc. (Bechtel)
Elk Hills, California

Maintaining the Integrity of Accounting Systems

Audit Comment:

An adequate system of internal control requires a set of standards to provide assurance that any information system developed will meet a specific level of quality. Bechtel does not subject its Work in Process (WIP) system to the same set of standards as other Bechtel financial information systems. Bechtel has one individual in the accounting department that developed the WIP system with limited support from the information services (IS) department. This individual makes changes to the WIP system that may not be subject to IS department and user review or testing prior to implementation. The individual limits system documentation to copies of the source code and no one in the IS department tests the adequacy or accuracy of the system controls. The individual in the accounting department who maintains the WIP system is not part of the IS department and, therefore, is not subject to the same set of standards, review, or supervision as others who are part of IS. Thus, Bechtel's WIP system contains changes that have not been properly documented, adequately reviewed and tested, or formally approved. Bechtel's lack of WIP system documentation would also require more time for a new person to understand the system and provide technical support.

Audit Recommendation:

Bechtel should ensure the WIP system is subject to the same set of standards, review, and supervision as financial information systems maintained by the IS department.

Management's Response:

Bechtel concurs. All financial systems will be subjected to proper review, testing, approval, and documentation standards regardless of whether the IS department or users provide maintenance of such system. An implementation and test procedure will be developed and applied to the WIP system by April 30, 1996.

Status:

Management has provided written instruction to the individual responsible for the WIP system to obtain proper approval before making changes to the WIP system, and to document all changes properly, according to the standards of the IS department. Bechtel is in the process of documenting the WIP system; however, there is still no control in place to insure that the individual responsible will obtain approval before making changes. Bechtel plans to develop an implementation and test procedure. One procedure for Bechtel to consider is the addition of a report that automatically prints any changes to the WIP system. Thus, a supervisor could receive and review all changes to the system.

Naval Petroleum and Oil Shale Reserves
U.S. Department of Energy

Allowability of State Franchise Tax

Audit Comment:

Bechtel's contract requires that all operating expenses be recorded on a timely basis and preapproved by the contracting officer if not specifically addressed within the contract. We reported for fiscal year 1993 that Bechtel had recorded $785,000 for costs related to California franchise taxes for calendar years 1985 through 1991. Because the contracting officer was not sure of their allowability, we recommended that DOE determine whether California franchise taxes are allowable costs and, if so, establish a receivable for Chevron's portion of the costs. DOE concurred with the finding.

During fiscal year 1994, Bechtel recorded an additional $1,386,000 for costs related to California franchise taxes for fiscal years 1992 through 1994. If DOE determines that these costs are allowable, Chevron would have to reimburse DOE for its proportionate share. In November of 1994, the contracting officer notified Bechtel that the documentation provided was not sufficient to justify allowing the California franchise tax as a reimbursable cost. However, the notification did not specify what was lacking in the documentation Bechtel provided.

Audit Recommendation:

Bechtel should submit more definitive information requested by the contracting officer or pursue other avenues to resolve this dispute over the allowability of California franchise taxes.

Management's Responses:

Bechtel's concurs.

Status:

Bechtel has submitted more detailed documentation to the DOE site office. Bechtel believes it has adequate precedent to support its case. However, the Administrative Contracting Officer at the DOE site office has reviewed the information and found it to be insufficient to support the request for payment. Bechtel has accrued $2.2 million for prior years and an additional $540,000 in the current year as a contingent liability for franchise taxes. The Administrative Contracting Officer is aware that the contingent liability for franchise taxes was accrued for in the current year's financial statements. Bechtel is pursuing avenues to resolve this issue with the Contracting Officer. Subsequent to year end, Bechtel submitted a letter to the Contracting Officer requesting reimbursement for California state franchise taxes.

* * * * *

A material weakness is a reportable condition in which the design or operation of one or more of the specific internal control structure elements does not reduce to a relatively low level the risk that errors or irregularities in amounts that would be material to the financial statements being audited, or material to a performance measure or aggregation of related performance data, may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions.

Our consideration of the internal control structure would not necessarily disclose all matters in the internal control structure that might be reportable conditions and, accordingly, would not necessarily disclose all reportable conditions that are also considered to be material weaknesses, as defined above. However, we believe none of the reportable conditions described above is a material weakness.

We also noted other matters involving the internal control structure and its operation that we reported to the management of NPOSR in a separate letter dated November 10, 1995.

This report is intended for the information of the management of NPOSR and DOE. This restriction is not intended to limit the distribution of this report, which is a matter of public record.

KPMG Peat Marwick LLP

Salt Lake City, Utah
November 10, 1995

KPMG Peat Marwick LLP

60 East South Temple
Suite 900
Salt Lake City, UT 84111

The Deputy Assistant Secretary
Naval Petroleum and Oil Shale Reserves
United States Department of Energy:

We have audited the combined financial statements of the U.S. Department of Energy (DOE) Naval Petroleum and Oil Shale Reserves (NPOSR), as of and for the year ended September 30, 1995, and have issued our report thereon dated November 10, 1995. In planning and performing our audit of the combined financial statements of NPOSR, we considered the internal control structure in order to determine our audit procedures for the purpose of expressing our opinion on the combined financial statements and not to provide assurance on the internal control structure. We have not considered the internal control structure since the date of our report.

During our audit, we noted certain matters involving the internal control structure and other operational matters that are presented for your consideration. These comments and recommendations, all of which have been discussed with the appropriate members of management, are intended to improve the internal control structure or result in other operating efficiencies. They are summarized below according to location:

DOE Chief Financial Officer
Washington, D.C.

<u>Standard General Ledger Implementation</u>

Audit Comment:

Office of Management and Budget (OMB) revised Circular A-127, *Financial Management Systems* (A-127), in July 1993 requires Federal agencies to record financial events throughout their financial management systems by implementing the U.S. Treasury's Standard General Ledger (SGL) at the transaction level, effective October 1, 1993. To comply with A-127, agencies must prepare financial reports and record transactions in a manner consistent with SGL rules, and should have supporting transaction detail readily available for SGL accounts.

Department field offices use the Departmental Integrated Standardized Core Accounting System (DISCAS) to process accounting transactions. DISCAS information is transmitted to the Department's Financial Information System (FIS) which summarizes and reports Department-wide financial information. Both DISCAS and FIS utilize the Department's chart of accounts rather than SGL accounts. The Department has prepared a program that crosswalks FIS amounts to the appropriate SGL accounts, however, the use of a crosswalk does not comply with the requirements to implement the SGL at the transaction level.

The Department intends to convert DISCAS data fields to utilize Treasury's SGL account numbers, which would then provide SGL data at the transaction level. However, due to shortages of programming personnel and funding, the Department is unable to determine when the DISCAS modifications will be completed.

Audit Recommendation:

The Department should complete modifications in its federal financial systems to satisfy the SGL requirement as soon as possible.

Management Response:

We concur that we have not implemented SGL at the transaction level as required by OMB Circular A-127, "Financial Management Systems". Our plan has always been to complete this implementation with the implementation of the Management Analysis Reporting System (MARS) which has been delayed due to budget constraints. Phase II of MARS has been implemented in January of this year. Transaction level implementation will occur in Phase III of MARS. Since we cannot determine when Phase III of MARS will be implemented, we are unable to determine the date for transaction level SGL implementation.

Bechtel Petroleum Operations, Inc. (Bechtel)
Elk Hills, California

Separation of Duties Over Computerized Transactions

Audit Comment:

Effective purchasing system controls separate the duties of maintaining and changing the computerized materials requisitioning system controls, from the duties of approving transactions processed by the computerized systems. However, Bechtel procedures for the Acquisitions department database allowed the person who updated the table of individuals authorized to approve requisitions and their dollar limits, to insert his own name in the table and any amount as the dollar limit. There was no compensating control, such as having requisitions authorized by this person approved by someone else. Accordingly, the potential exists for improper purchases to occur.

Audit Recommendation:

Bechtel should establish procedures whereby the individual responsible for maintaining and changing the computerized materials requisitioning system does not have the authority to initiate and approve requisitions for materials.

Management's Response:

Bechtel concurs with the audit comment and recommendation. Bechtel plans to develop and implement procedures which will reassign duties to segregate maintenance of the electronic table from authority to requisition by March 31, 1996.

Payment Approval for Credit Card Purchases

Audit Comment:

An adequate system of internal control requires the separation of duties between persons authorized to incur an expense and the persons approving payment. Existing procedures allow three Bechtel department supervisors to approve the payment of their own company credit card purchases, up to $2,500 per purchase. Bechtel has not established procedures requiring independent approval of supervisor purchases. This lack of separation of duties could result in the improper expenditure of government funds.

Audit Recommendation:

Bechtel should establish administrative procedures requiring approval of credit card purchases made by supervisors by an independent, possibly a different Department, supervisor.

Management's Response:

Bechtel concurs with the audit comment and recommendation. One of the department supervisors no longer has a credit card and a superior is reviewing the purchases of the other two department heads. In addition, Bechtel intends to develop and implement procedures, by August 31, 1996, concerning the future issuance of credit cards and procedures for reviewing purchases, including those by department heads.

Small Tools Inventory

Audit Comment:

Effective inventory controls include appropriate separation of duties between the controls over, and reporting of, inventory balances. However, custodians of small tools are performing the physical inventory counts for assets in their custody. Bechtel's policy does not require someone other than the custodian to conduct the inventory of small tools. Thus, custodians have the opportunity to report items in inventory that are not physically present.

Audit Recommendation:

Bechtel should establish procedures requiring the periodic physical inventory of small tools by someone independent of the custodian of such items to ensure proper accountability.

Management's Response:

Bechtel concurs and plans to establish procedures requiring the independent inventory of small tools by August 31, 1996.

Property Numbers for Controllable Equipment

Audit Comment:

Property accounting procedures should provide responsible personnel with the information needed to record and depreciate capitalized assets in an efficient and timely manner. Once a project manager issues the Notice of Completion (NOC), Property Accounting department must obtain property numbers used to record assets in appropriate categories in the fixed asset system. However, the Property Accounting department is not receiving timely property numbers, referred as UNX, for controllable equipment from the Receiving department.

Without timely property numbers, the Property Accounting department cannot act on the NOCs and transfer work in process to completed plant. Thus, the financial statements overstate the work in process (WIP) balance, and understate the fixed asset balance and the related depreciation expense.

Audit Recommendation:

Bechtel should reemphasize its procedures relating to providing timely information to the Property Accounting department.

Management's Response:

Bechtel concurs and will reemphasize the procedures by March 31, 1996.

DOE Site Office
Elk Hills, California

Inventory of Fixed Assets

Audit Comment:

Subsection 109-1.5106-5 of the DOE Property Management Regulations (DOEPMR) requires that physical inventories of moveable capital equipment be performed "not less frequently than every two years." We noted that neither DOE nor Bechtel has performed an inventory to verify the existence of capitalized fixed asset amounts since the assets were originally capitalized. DOE and Bechtel policies do not require the inventorying of capital project assets after the project costs are transferred to fixed assets. Given the significance of the fixed asset balance (48% of total assets for NPRC/DOE Elk Hills), the current year finding regarding the removal of equipment without the notification to Property Accounting, and the potential sale of the facility, DOE may wish to determine the existence of, and accuracy of recorded balances for fixed assets.

Audit Recommendation:

DOE should direct Bechtel to perform a complete inventory of all tangible assets in fiscal 1996 and periodically thereafter. The periodic inventories could consist of cycle counts, to cover a different portion of the fixed assets each year.

Management Response:

DOE concurs with the audit comment and recommendation.

STATUS OF PRIOR YEAR FINDINGS

The purpose of this section is to provide a status report for those comments reported on in the prior year, for which management has considered, but are still pending resolution or require further attention.

Bechtel Petroleum Operations, Inc. (Bechtel)
Elk Hills, California

Bidder Quote Recording Errors

Audit Comment:

DOE contract guidelines require responsible purchasing procedures. Buyers have incorrectly recorded vendors' pricing quotations when transcribing them to contract award records. An error occurred when an independent review of the bid transcription was not performed. The transcription error caused the issuance of a purchase order for $8,000 which was subsequently invoiced and paid instead of the $4,000 amount per the bid quote. Subsequent to this finding, acquisition management notified the vendor of the overpayment and is anticipating a refund.

Audit Recommendation:

Bechtel should establish procedures for independently verifying that contract awarded amounts are the same as the vendor's pricing quotation.

Management's Response:

Bechtel concurs. Bechtel's purchasing supervisor will review all purchase orders exceeding the buyer's authority, generally $10,000. Buyers will review purchase orders within the buyer's commitment authority to avoid administrative cost in excess of the potential benefit.

Status:

Bechtel requires reviews of purchase orders exceeding each buyer's authority, as noted in management's response. However, buyers' authorities range from $0 to $100,000, depending on the buyer's experience and qualification. Because of the $100,000 upper limit, we believe Bechtel should implement the audit recommendation.

* * * * *

Should you have any questions concerning the matters presented herein, we would be pleased to discuss them with you at your convenience.

This report is intended for the information and use of the management of NPOSR and DOE. This restriction is not intended to limit the distribution of this report, which is a matter of public record.

KPMG Peat Marwick LLP

Salt Lake City, Utah
November 10, 1995