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U.S. Department of Energy

NAVAL PETROLEUM AND OIL SHALE RESERVES

Combined Financial Statements

September 30, 1994 and 1993

and

**Management Overview and Supplemental
Financial and Management Information**

MASTER

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NAVAL PETROLEUM AND OIL SHALE RESERVES

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OVERVIEW

The U. S. Department of Energy (DOE) Naval Petroleum and Oil Shale Reserves (NPOSR) was established by a series of Executive Orders in the early 1900s 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 re-authorized 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.

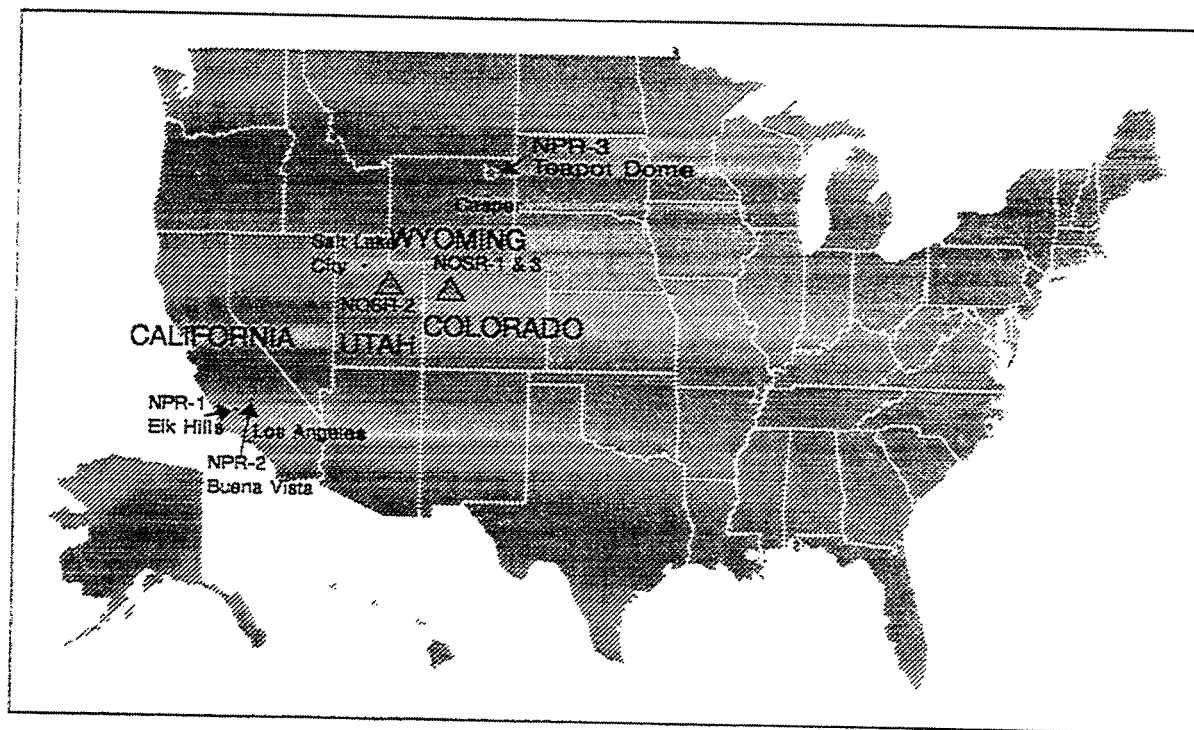
NPOSR consists of Naval Petroleum Reserve No. 1 (NPR-1) (jointly owned by the U.S. Government and Chevron USA, Inc.) and NPR-2, located in Kern County, California; NPR-3 in Natrona County, Wyoming; Naval Oil Shale Reserve No. 1 (NOSR-1) and NOSR-3, located in Garfield County, Colorado; and NOSR-2 in Uintah County, Utah. Products from NPR-1, NPR-3, and NOSR-3 are sold by sealed bidding. Royalties are collected for the leased properties within NPR-2.

Production from NOSR Nos. 1, 2, & 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. Currently, NPOSR produces and sells natural gas from NOSR-3 only. If full development, rather than protective drilling, were to be approved by Congress, then the NOSR fields will yield substantial production and revenues for the U.S. Treasury.

Daily operations are performed by Management and Operating (M&O) contractors collectively with NPOSR field staff in California and Wyoming. The M&O contractors provide operations, maintenance, engineering, administrative and other necessary services to provide efficient operations of NPOSR.

In May 1993, DOE's partner at NPR-1, Chevron USA, Inc., submitted an unsolicited proposal to operate that Reserve. Chevron purports that it can save DOE millions of dollars annually in operating costs while extending the producing life of the Reserve, thus increasing ultimate hydrocarbon production. DOE held extensive discussions with Chevron until May 1994, when DOE suspended discussions as it sought to resolve a number of internal business, legal, and policy issues. Congress continued to encourage DOE to examine better management techniques, using competition for improving NPR-1 operation to the extent practical.

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

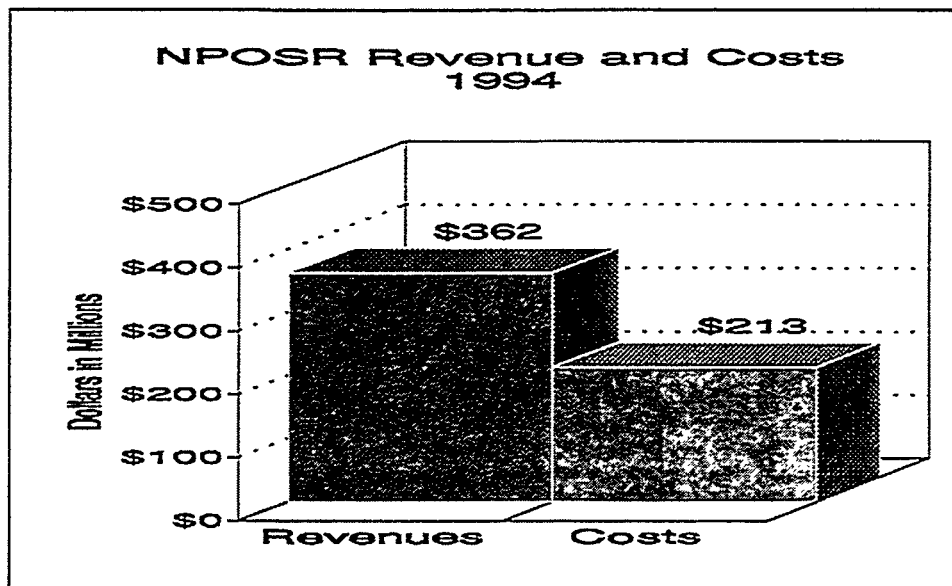


FY 1994 PROGRAM HIGHLIGHTS--FINANCIAL

Revenues during FY 1994 were \$361.5 million. This was a decrease of \$41.0 million from FY 1993 even though production increased by 1,101,000 barrels of oil equivalents (BOE). This decrease in revenue is largely due to lower crude oil, natural gas, and gas liquids prices. DOE's share of costs was \$223.8 million, including recognition of the cumulative effect of a change in accounting principle for \$10.5 million, associated with post retirement benefits other than pensions, resulting in net income of \$137.7 million, compared with \$214.4 million net income for FY 1993.

Headquarters costs of \$2,228,841 and other field offices' costs of \$1,454,406 were allocated to NPR-1 and NPR-3 in the amounts of \$3,491,571 and \$191,680 respectively. NPR Nos. 1 and 2 generated net income of \$142.9 million. NPR-3 operations resulted in a net loss of \$4.3 million. NOSR-3 experienced a net loss of \$0.9 million.

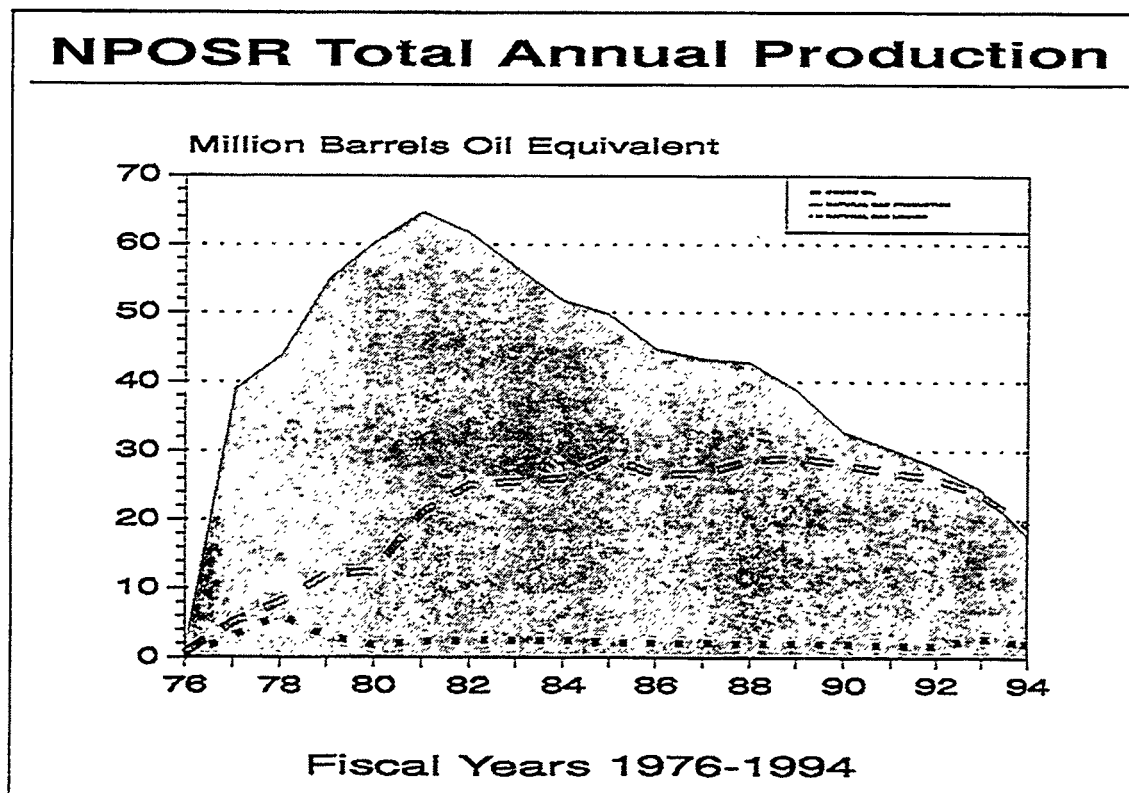
The following chart displays the NPOSR total revenues and costs for FY 1994.



FY 1994 PROGRAM HIGHLIGHTS—PRODUCTION

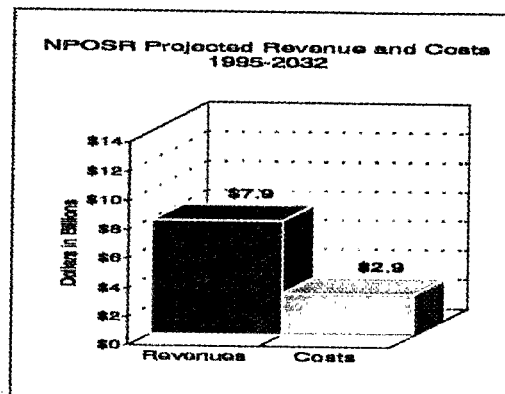
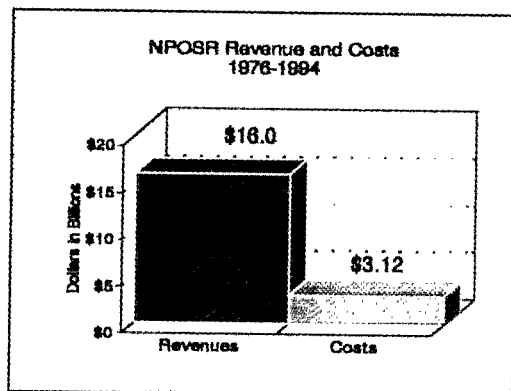
DOE's share of total FY 1994 production yielded 39,461,284 BOE, an increase of 1,101,000 BOE over the 38,360,284 BOE produced in FY 1993. The largest increases were in NPR-1 crude oil and natural gas production, which increased by 54,000 BOE and 1,275,000 BOE, respectively. These increases were offset by a decline in NPR-3 crude oil and natural gas production of 130,100 BOE and 98,500 BOE respectively. (Production figures for NPR-1 and NPR-3, include total reinjected gas of 12,359,596 BOE, net of Chevron's share.)

The following chart displays total NPOSR production from 1976 to 1994.



Performance Measures

NPOSR, as a whole, has been extremely profitable and projects 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. 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.

FY 1992 was the first year that performance measures were required to be included with the submission of the annual financial statements. The performance measures were modified this year to provide more useful information.

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

PRODUCTION RATE PER YEAR	TARGET PRODUCTION FY 1994	ACTUAL PRODUCTION FY 1994	PERCENT DIFFERENCE FY 1994	TARGET PRODUCTION FY 1993	ACTUAL PRODUCTION FY 1993	PERCENT DIFFERENCE FY 1993
CRUDE OIL (BARRELS)	17,982,873	19,360,371	7.66	19,069,067	19,436,305	1.93
NATURAL GAS (MCF)*	96,645,887	97,729,093	1.12	93,247,059	92,211,117	(.02)
PROPANE (GALLONS)	43,103,532	42,703,727	(0.93)	40,633,625	42,417,347	4.39
BUTANE & BUTANE PLUS (GALLONS)	34,214,629	29,879,866	(12.67)	30,330,040	31,604,029	4.20
ISOBUTANE (GALLONS)	8,869,500	8,911,320	0.47	8,869,500	8,614,000	(2.88)
NATURAL GASOLINE (GALLONS)	48,918,418	42,354,250	(13.42)	42,741,500	43,581,000	1.96

*Cubic Feet, Thousands

COMMENTS: Oil and natural gas production exceeded the targets due to development programs designed to halt or slow production decline. This included a more aggressive remedial workover program, horizontal and infill drilling, and Shallow Oil Zone gas and water injection programs. The amount of natural gas liquids processed was under target due to the natural gas becoming leaner as it was recycled through the reservoirs.

2. LIFTING COSTS are costs incurred to produce a barrel of oil and gas equivalent (BOE) after completion of drilling and before removal for sale or transportation.

	<u>FY 1994</u>	<u>FY 1993</u>
Lifting cost per BOE	\$1.79	\$1.87

COMMENTS: The decrease in lifting cost per BOE reflects the implementation of cost reduction measures.

3. DOWNTIME PER WELL is the average number of days per well that producible wells are shut-down for maintenance, remedials, etc.

	<u>FY 1994</u>	<u>FY 1993</u>
Downtime per well (Days)	12.0	13.1

COMMENT: The downtime per well in FY 94 remained fairly consistent with FY 1993, and is low as compared to accepted industry standards of 15 to 20 days.

4. MANPOWER COSTS PER WELL expresses the direct labor costs per active well.

	<u>FY 1994</u>	<u>FY 1993</u>
Manpower Costs per Well	\$29,757	\$31,974

COMMENT: The slight decrease from FY 1993 is due to efforts to reduce labor costs and staffing, and the increased number of active wells.

Financial Performance Measures

The financial performance measures for NPOSR disclose financial conditions and results in terms of dollars spent. The performance measures consider operating costs, net profit margin and return on plant and equipment.

5. OPERATING COSTS expresses the operating costs incurred, including overhead, per barrel of oil and equivalent gas produced.

	<u>FY 1994</u>	<u>FY 1993</u>
Operating Costs per BOE	\$3.66	\$3.79

COMMENTS: There is a slight decrease in this measure from FY 1993, primarily due to cost reduction efforts.

6. NET PROFIT MARGIN PER BOE shows the net revenue generated per barrel of oil and equivalent gas produced.

	<u>FY 1994</u>	<u>FY 1993</u>
Gross Revenues	\$361,517,245	\$402,498,990
Costs	213,341,681	188,107,223
Net Revenues	148,175,564	214,391,767
Quantity Produced (BOE)	39,461,184	38,360,284
Net Profit per BOE	\$3.76	\$5.59

COMMENT: There is a decrease from FY 1993, which reflects both the low product sale prices received for the year and increased depreciation costs incurred for the write-off of the deep test well at NPR-1.

7. RETURN ON PLANT, PROPERTY AND EQUIPMENT expresses the relationship of net revenues to the value of assets in place which generate the revenues.

	<u>FY 1994</u>	<u>FY 1993</u>
Net Revenue/Net Asset Value	\$0.27	\$0.39

COMMENT: There is a decrease from FY 1993 resulting from reduced revenue due to low product sale prices and an increase in asset value in FY 1994 (most significantly the cogeneration facility).

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:

The NPOSr's estimated net proved oil and gas reserves and changes thereto for the years 1994 and 1993 are shown in the following table. These quantities are estimated by the contractor's reserves engineers and reviewed by DOE's reserves engineers at the site locations.

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 reasonably be classified as proved. Estimates of reserve quantities are based on sound geological and engineering principles, but, by their very nature, are still 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 determined to be economical. Proved developed reserves are the quantities expected to be recovered through existing wells with existing equipment and operating methods.

ESTIMATED PROVED DEVELOPED AND UNDEVELOPED RESERVES
CONSOLIDATED (GOVERNMENT SHARE)

	<u>1994</u>	<u>1993</u>
Proved developed and undeveloped reserves:	(MMBOE)	
Beginning of year	389.4	418.1
Revisions of previous estimates	1.4	(1.6)
Production*	<u>(26.8)</u>	<u>(27.1)</u>
End of year	<u>364.0</u>	<u>389.4</u>
Proved Developed Reserves:		
Beginning of year	<u>372.1</u>	<u>399.8</u>
End of year	<u>345.3</u>	<u>372.1</u>

NOTE:

MMBOE: Million Barrels of Oil Equivalent

* Net of injected Gas. (12.4 MBOE)

Standardized Measure of Future Net Cash Flows Related to Proved 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 No. 69. Estimated future cash inflows from production are computed by applying year-end prices for oil and gas to year-end quantities of estimated net proved reserves. Future price changes are limited to those provided by contractual arrangements in existence at the end of each reporting year. Future development and production costs are those estimated future expenditures necessary to develop and produce year-end estimated proved reserves based on year-end cost indices, assuming continuation of year-end economic conditions. Discounted future net cash flows are calculated using 10 percent midperiod 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.

STANDARDIZED MEASURE OF DISCOUNTED FUTURE
NET CASH FLOWS FOR NPR-1
AS OF SEPTEMBER 30, 1994
(in thousands)

Future Cash Inflows	\$ 7,862,925
Future Production Costs	(2,824,824)
Future Development Costs	<u>(81,847)</u>
Future Net Cash Flows	4,956,254
10% Annual Discount For Estimated Timing of Cash Flows	<u>(3,465,185)</u>
Standardized Measure of Discounted Future Net Cash Flow Relating to Proved Oil and Gas Reserves	<u>\$ 1,491,069</u>

Limitations of the Financial Statements

The financial statements have been prepared to report the financial position and results of operations of the entity, 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.

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Independent Auditors' Report on Financial Statements

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

We have audited the accompanying combined statements of financial position of the U.S. Department of Energy Naval Petroleum and Oil Shale Reserves (NPOSR) as of September 30, 1994 and 1993, 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* (1988 Revision), 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, 1994 and 1993, 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 in note 1.

As discussed in note 1 to the combined financial statements, NPOSR changed its method of accounting for postretirement benefits other than pensions to adopt the provisions of the Financial Accounting Standards Board's Statement of Financial Accounting Standards No. 106 *Employers' Accounting for Postretirement Benefits Other than Pensions* on October 1, 1993.

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

Our audits were made for the purpose of forming an opinion on the combined financial statements referred to in the first paragraph of this report, 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 combined financial statements taken as a whole.

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 internal control structure in accordance with OMB Bulletin 93-06.

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

KPMG Peat Marwick LLP

November 19, 1994

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

Combined Statements of Financial Position

As of September 30, 1994 and 1993

	1994 =====	1993 =====
ASSETS -----		
Financial resources:		
Fund balances with U.S. Treasury (note 2)	\$583,476,726	\$595,817,828
Cash (note 2)	4,500	4,500
Accounts receivable, net, nonfederal (note 3)	17,339,392	17,209,506
Inventories held for sale, net (note 4)	2,336,674	2,381,972
Intragovernmental accounts receivable	52,841	145,008
Total financial resources	----- 603,210,133 -----	----- 615,558,814 -----
Nonfinancial resources:		
Advances and prepayments, nonfederal	137,695	171,916
Inventories for own use (note 4)	10,176,905	11,416,640
Property, plant and equipment, net (note 5)	549,413,177	552,575,250
Total nonfinancial resources	----- 559,727,777 -----	----- 564,163,806 -----
 Total assets	 \$1,162,937,910 =====	 \$1,179,722,620 =====

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

	1994 =====	1993 =====
LIABILITIES -----		
Funded liabilities:		
Accounts payable, nonfederal	\$34,232,300	\$29,413,515
Accrued payroll and benefits	2,990,561	373,298
Deferred revenue, nonfederal	7,252	2,875
Other funded liabilities, nonfederal (note 8)	3,395,275	2,994,883
	-----	-----
Total funded liabilities	40,625,388	32,784,571
	-----	-----
Unfunded liabilities:		
Accrued annual leave	432,010	434,168
Pension and other retirement benefits, nonfederal (note 10)	15,109,162	2,111,106
Accrued environmental restoration (note 11)	24,100,000	11,300,000
	-----	-----
Total unfunded liabilities	39,641,172	13,845,274
	-----	-----
Total liabilities	80,266,560	46,629,845
	-----	-----
Commitments and contingencies (notes 6, 9, 10, and 11)		
NET POSITION -----		
Fund balances (note 12):		
Unexpended reimbursements	544,191,621	577,396,174
Invested capital	549,413,177	552,575,250
Cumulative results of operations	28,707,724	16,966,625
	-----	-----
	1,122,312,522	1,146,938,049
	-----	-----
Future funding requirements (note 13)	(39,641,172)	(13,845,274)
	-----	-----
Net position	1,082,671,350	1,133,092,775
	-----	-----
Total liabilities and net position	\$1,162,937,910	\$1,179,722,620
	=====	=====

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, 1994 and 1993

	1994 =====	1993 =====
APPROPRIATIONS	\$214,772,000	\$ -
PROGRAM REVENUES AND EXPENSES		
Revenues (note 14):		
Sales of product	361,289,424	402,458,839
Interest, nonfederal	30,841	14,839
Other income	196,980	25,312
	-----	-----
Total revenues	361,517,245	402,498,990
	-----	-----
Expenses:		
Program and operating expenses (note 15):		
Personal services and benefits	55,174,019	55,596,307
Contractual services	49,822,036	42,258,180
Utilities, rent, and communications	16,134,277	17,864,644
Supplies and materials	14,403,390	13,753,383
Equipment not capitalized	4,900,277	5,904,588
Travel and transportation	4,789,248	5,327,396
Printing and reproduction	291,859	296,817
Other	17,611,031	20,139,247
Depreciation	62,013,677	42,647,700
Environmental restoration (note 11)	13,687,370	11,300,000
Miscellaneous expenses (note 16)	2,587,068	1,653,159
Less joint interest reimbursements (excluding capital		
addition reimbursements of \$15,806,964 and \$8,848,093)	(28,072,571)	(28,634,198)
	-----	-----
Net expenses	213,341,681	188,107,223
	-----	-----
Net income before cumulative effect of change in		
accounting principle	148,175,564	214,391,767
	-----	-----
Cumulative effect of change in accounting principle (note 1)	10,454,129	-
	-----	-----
Net income	137,721,435	214,391,767
	-----	-----
TRANSFERRED TO U.S. TREASURY	402,914,860	1,586
	-----	-----
Excess (shortage) of appropriations and net income		
over transfers	(\$50,421,425)	\$214,390,181
	=====	=====
NET POSITION		
Beginning balance	\$1,133,092,775	\$918,702,594
Excess (shortage) of appropriations and net income		
over transfers	(50,421,425)	214,390,181
	-----	-----
Ending balance	\$1,082,671,350	\$1,133,092,775
	=====	=====

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, 1994 and 1993

	1994 =====	1993 =====
CASH FLOWS FROM OPERATING ACTIVITIES		
Net income	\$137,721,435	\$214,391,767
Depreciation	62,013,677	42,647,700
Change in inventory obsolescence	—	(888,183)
Unfunded environmental restoration	12,800,000	11,300,000
Other unfunded expenses, net	12,995,898	807,921
Decrease (increase) in accounts receivable	(37,719)	3,704,158
Decrease in inventories	1,285,033	3,340,147
Decrease (increase) in advances and prepayments	34,221	(46,399)
Increase in accounts payable	4,818,785	3,644,129
Increase in other liabilities	3,022,032	551,453
	-----	-----
Net cash provided by operating activities	234,653,362	279,452,693
	-----	-----
CASH FLOWS FROM INVESTING ACTIVITIES		
Purchases of property, plant, and equipment (net of retirements)	(58,851,604)	(40,996,285)
	-----	-----
CASH FLOWS FROM FINANCING ACTIVITIES		
Appropriations	214,772,000	—
Transferred to U.S. Treasury	(402,914,860)	(1,586)
	-----	-----
Net cash used in financing activities	(188,142,860)	(1,586)
	-----	-----
Net cash provided by (used in) operating, investing, and financing activities	(12,341,102)	238,454,822
Fund balances with U.S. Treasury and cash, beginning of year	595,822,328	357,367,506
	-----	-----
Fund balances with U.S. Treasury and cash, end of year	\$583,481,226	\$595,822,328
	=====	=====

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, 1994 and 1993

	BUDGET		ACTUAL
	Resources	Obligations Reimbursed	Net Expenses
1994	\$658,774,306	\$210,527,248	\$213,341,681
1993	\$699,879,826	\$240,899,815	\$188,107,223
BUDGET RECONCILIATION			
		1994	1993
A. Net expenses		\$213,341,681	\$188,107,223
B. Add:			
(1) Capital acquisitions		58,851,603	40,996,285
(2) Other expended budget authority		(1,740,816)	(2,451,964)
(3) Joint interest reimbursements		43,879,535	37,482,291
C. Less:			
(1) Depreciation		62,013,677	42,647,700
(2) Unfunded annual leave expense		(2,159)	20,555
(3) Unfunded environmental restoration		12,800,000	11,300,000
(4) Other unfunded expenses		12,998,056	787,366
(5) Allowance for doubtful accounts		—	86,554
(6) Post closing adjustment		(9,385,939)	(578,000)
D. Accrued expenditures		235,908,368	209,869,660
E. Less reimbursements		1,968,097	439,979,695
F. Accrued expenditures, direct (note 18)		\$233,940,271	(\$230,110,035)

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

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

Notes to Financial Statements

September 30, 1994 and 1993

(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, and oil shale reserves in Colorado and Utah. 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 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

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 of NPOSR is responsible for the programmatic and operational management of NPOSR. DOE headquarters office provides staff support to the Assistant Secretary and Deputy Assistant Secretary. Consequently, NPOSR incurs certain headquarters expenses including payroll, travel, office equipment purchases, and other administrative services and supplies expense.

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(ii) DOE - Site Offices

DOE site offices are responsible for monitoring day-to-day operations, and performing contractor oversight functions. The site offices report directly to DOE headquarters. 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 1 (NPR-1) and in Naval Petroleum Reserve 2 (NPR-2). The principal interests are minerals under the surface lands in Kern County, California. DOE 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 (Contract) executed June 19, 1944, and amended December 22, 1948, by the USA and Standard Oil Company of California (Standard). Standard transferred its interest in the Contract to its wholly owned subsidiary, Chevron USA, Inc. (Chevron), effective January 1, 1977. The Contract enables the unit participants to develop the field on a reservoir basis rather than a parcel-by-parcel basis. Under the Contract, 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 purchases crude oil and natural gas at bid prices similar to other public customers.

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(iib) Naval Petroleum and Oil Shale Reserves in 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, and NOSR No. 2 in Uintah County, Utah. DOE site office is in Casper, Wyoming.

At present, DOE is not planning 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 (NPOSR), Inc. (FD) are integrated, 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 NPR-1 in accordance with DOE contract (No. DE-AC01-85FE60520) since August 1, 1985. Bechtel's contract expires on July 31, 1995. FD was awarded the DOE management and operating contract (No. DE-AC01-92FE62316) for NPR-3, effective October 1, 1992.

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(iii) Management and Operating Contractors (continued)

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 Field Offices

Certain 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 \$1,454,408 and \$1,930,403, respectively, during 1994 and 1993.

(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 DOE's interest only 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. Furthermore, the financial statements include only NPOSR's portion of expenses, revenues, and assets related to NOSR.

NPR-1 includes lands mostly withdrawn from public sale initially in 1912 and enlarged 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.

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(d) Revenues and Other Financing Sources

Congress annually adopts a budget appropriation that provides NPOSR with funding to meet operating expense requirements. Prior to October 1, 1991, NPOSR was authorized to use appropriated funds from the U.S. Department of Treasury (Treasury) for operations while revenues were remitted to the General Fund of the Treasury. Proceeds from sales at NPR-1 and NPR-3 and royalties from NPR-2 were deposited into the U.S. Treasury as required by the Production Act of 1976.

In accordance with Public Law, NPOSR appropriations for 1993 and 1992 NPOSR activities were funded with revenues generated from operations. Final appropriations for 1993 and 1992 were \$0 as earned revenues exceeded the amounts originally appropriated. Excess revenues were available for future NPOSR funding requirements. Revenue collections including proceeds from sales of product at NPR-1 and NPR-3 natural gas sales and royalties from NPR-2 were deposited into DOE appropriation account 89X0219 with the U.S. Treasury. Furthermore, joint interest reimbursements received from Chevron for its share of the costs to operate NPR-1 were remitted to such account.

In accordance with Public Law, effective October 1, 1993, NPOSR was again authorized to use appropriated funds for operations while revenues are deposited into the U.S. Treasury General Fund account.

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.

(f) Allowance for Doubtful Accounts

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

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(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 less estimated cost of disposal.

(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 plants (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.

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Notes to Financial Statements

(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 NPR-1. 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.

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Notes to Financial Statements

(1) Reclassifications

Certain reclassifications have been made in order to conform 1993 financial information with the 1994 financial information format. These reclassifications do not impact the financial position or results of operations of NPOS.

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

Fund balances (appropriated) with U.S. Treasury include the following as of September 30, 1994 and 1993:

	<u>1994</u>	<u>1993</u>
Unexpended allotments	\$150,141,465	\$156,418,144
Unapportioned revenues	<u>433,335,261</u>	<u>439,399,684</u>
Total	<u>\$583,476,726</u>	<u>\$595,817,828</u>

Cash includes imprest funds of \$4,500 as of September 30, 1994 and 1993.

In accordance with Public Law, 1993 cash collections in the amount of \$441,180,354 were used to offset operating costs and are treated as an appropriation reimbursement.

(3) Accounts Receivable

Accounts receivable include the following as of September 30, 1994 and 1993:

	<u>1994</u>	<u>1993</u>
Sales of products and earned royalties	\$ 11,023,930	\$ 9,221,661
Chevron's share of operating costs	6,262,669	8,036,931
Other	150,115	48,236
Allowance for doubtful accounts	<u>(97,322)</u>	<u>(97,322)</u>
	<u>\$ 17,339,392</u>	<u>\$17,209,506</u>

Chevron's share of operating costs is comprised of billed costs for July and August and an estimate of the allocated share of September's costs. The estimate is adjusted to actual and billed in October.

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(4) Inventories

Inventories include the following as of September 30, 1994 and 1993:

	<u>1994</u>	<u>1993</u>
Materials for own use	\$ 14,667,948	\$ 16,145,618
Less allowance for obsolescence and overstocking	(1,981,833)	(1,700,000)
Less Chevron's ownership	<u>(2,509,211)</u>	<u>(3,028,978)</u>
	10,176,905	11,416,640
Held for sale	<u>2,336,674</u>	<u>2,381,972</u>
	<u>\$ 12,513,579</u>	<u>\$ 13,798,612</u>

(5) Property, Plant, and Equipment

Property, plant, and equipment includes the following as of September 30, 1994 and 1993:

	<u>1994</u>	<u>1993</u>
Buildings, structures, and improvements	\$ 29,268,249	\$ 28,959,806
Gas and electric production, transmission, and distribution systems	337,423,632	327,583,988
Crude oil extraction, water supply pumping, treatment, and distribution systems	993,619,086	997,445,568
Office, transportation, security, ADP, and other equipment	21,153,965	20,887,615
Less Chevron's ownership	<u>(254,153,054)</u>	<u>(247,552,615)</u>
	1,127,311,878	1,127,324,362
Less accumulated depreciation	<u>(635,737,327)</u>	<u>(603,189,449)</u>
	493,574,551	524,134,913
Construction work-in-progress (net of Chevron ownership of \$14,777,374 and \$6,197,331, respectively)	<u>55,838,626</u>	<u>28,440,337</u>
	<u>\$ 549,413,177</u>	<u>\$ 552,575,250</u>

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(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 \$124,616 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 \$2,293,049, and \$1,757,000, respectively, for 1994 and 1993.

(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 1994 and 1993:

	<u>1994</u>	<u>1993</u>
Rent expense	\$ 1,258,197	\$ 1,289,414
Reimbursement of operating expenses	(386,182)	(441,913)

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 \$1,979,488, and \$1,765,404, respectively, for 1994 and 1993. 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 \$75,643, and \$111,206, respectively, for 1994 and 1993.

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(8) Other Funded Liabilities, Nonfederal

Other funded liabilities, nonfederal, covered by budgeting resources include the following as of September 30, 1994 and 1993:

	<u>1994</u>	<u>1993</u>
Accrued funded vacation pay	\$ 2,675,064	\$ 2,611,201
Employee payroll deductions	600,221	376,043
Other	<u>119,990</u>	<u>7,639</u>
	<u>\$ 3,395,275</u>	<u>\$ 2,994,883</u>

(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 four months to one year. Invoice prices are adjusted monthly to reflect changing market conditions by formulas reflected in the sales contracts. NPOSR had the following product sales commitments in effect at September 30, 1994:

	<u>Measured</u> <u>By</u>	<u>Bid</u> <u>Quantity</u>	<u>Ranges</u>
Crude oil	Bbls/day	51,180	\$12.65 to 16.80
Natural gas	MMBTU/day	65,300	0.95 to 1.58
Liquid products	Gallons/day	232,300	0.19 to 0.37

Quantities noted are per day commitments.

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(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, 1994 and 1993:

	<u>1994</u>	<u>1993</u>
Actuarial present value of benefit obligations:		
Vested benefit obligation	<u>\$ 11,258,884</u>	<u>\$ 11,358,035</u>
Accumulated benefit obligation	<u>\$ 11,985,863</u>	<u>\$ 11,830,020</u>
Projected benefit obligation for services rendered to date	\$(20,110,790)	\$(23,601,758)
Plan assets at fair value	<u>13,634,654</u>	<u>14,045,834</u>
Plan assets less than projected benefit obligation	(6,476,136)	(9,555,924)
Unrecognized net loss	4,121,931	10,545,326
Unrecognized prior service cost	(275,224)	(300,536)
Unrecognized net asset recognized over 15 years	<u>(3,048,803)</u>	<u>(3,373,676)</u>
	(5,678,232)	(2,684,810)
Less Chevron's portion	<u>1,205,530</u>	<u>573,704</u>
Accrued pension cost*	<u>\$ (4,472,702)</u>	<u>\$ (2,111,106)</u>

* of which \$3,005,292 and \$2,111,106, respectively, represent unfunded liabilities.

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The net pension cost includes the following for 1994 and 1993:

	<u>1994</u>	<u>1993</u>
Service cost-benefits earned during the period	\$ 2,298,440	\$ 1,479,179
Interest cost on projected benefit obligation	1,659,270	1,251,720
Actual return on plan assets	(24,209)	(455,061)
Net amortization and deferral	<u>(940,079)</u>	<u>(914,768)</u>
	2,993,422	1,361,070
Less Chevron's portion	<u>(631,826)</u>	<u>(573,704)</u>
Net pension cost	<u>\$ 2,361,596</u>	<u>\$ 787,366</u>

Assumptions used in accounting for the pension plan for 1994 and 1993 are as follows:

	<u>1994</u>	<u>1993</u>
Discount rate	7.0%	8.5%
Rate of increase in compensation levels	6.0%	6.0%
Expected long-term rate of return on assets	8.5%	8.5%

The discount rate is 8.5% as of October 1, 1994.

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.

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 NPR-1. 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.

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

Accumulated postretirement benefit obligation:

Retirees	\$ 1,584,000
Fully eligible active plan participants	2,792,000
Other active plan participants	<u>8,502,000</u>
Total accumulated benefit obligation	12,878,000
Plan assets at fair value	<u>-</u>
Accumulated postretirement benefit obligation in excess of plan assets	12,878,000
Unrecognized net gain	<u>2,500,000</u>
	15,378,000
Less Chevron's portion	<u>3,274,130</u>
Accrued postretirement benefit cost included in unfunded liabilities	<u>\$12,103,870</u>

Net period postretirement benefit cost for 1994 includes the following components:

Service cost	\$ 1,112,000
Interest cost	984,000
Actual return on plan assets	-
Net amortization and deferral	<u>-</u>
	2,096,000
Less Chevron's portion	<u>(446,259)</u>
Net periodic postretirement benefit cost	<u>\$ 1,649,741</u>

For measurement purposes, an annual rate of increase in the per capita cost of covered benefits (i.e., health care cost trend rate) of 11.5 percent (medical) and 8.5 percent (dental) were assumed for 1994; both rates were assumed to decrease gradually to 5.5 percent by the year 2005 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, 1994 by \$438,000 and the aggregate of the service and interest cost components of net periodic postretirement benefit cost for the year ended September 30, 1994 by \$2,379,000.

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The weighted average discount rate used in determining the accumulated postretirement benefit obligation was 8.5 percent as of September 30, 1994. Funded costs for post retirement benefits other than pension amounted to \$104,000, and \$150,245, respectively, for 1994 and 1993.

The following table sets forth the reconciliation of unfunded pension and other retirement benefits as of September 30, 1994:

	<u>Total</u>	<u>Chevron's portion</u>	<u>DOE's portion</u>
Unfunded pension liability	\$3,818,232	\$ 812,940	\$ 3,005,292
Funded portion	<u>1,860,000</u>	<u>392,590</u>	<u>1,467,410</u>
Total pension liability	<u>\$5,678,232</u>	<u>\$1,205,530</u>	<u>\$ 4,472,702</u>
Unfunded pension liability (SFAS No. 87)			\$ 3,005,292
Accrued postretirement benefit cost included in unfunded liabilities (SFAS No. 106)			<u>12,103,870</u>
Future funding requirements (note 13)			<u>\$15,109,162</u>

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, 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 \$472,830 and \$453,706, respectively, for 1994 and 1993.

All regular employees of the contractors are eligible to participate in company sponsored 401(k) retirement plans. Bechtel matches employee contributions fifty cents per dollar for employee contributions up to 6 percent of compensation for all plan participants. FD matched employee contributions dollar per dollar up to 3.5 percent of compensation plus 1.5 percent for all participants for employees retaining project benefits. FD matches employee contributions dollar per dollar up to 4 percent for new project employees covered under FD benefits. New employees are also eligible for benefits under the FD Employees' Retirement Plan where FD contributes 7 percent of applicable compensation. Total contributions to these plans amounted to \$882,898, and \$994,476, respectively, for 1994 and 1993.

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(11) Commitments and Contingent Liabilities

(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, 1994, 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. An ownership percentage revision for the Dry Gas Zone was recently negotiated and completed with Chevron. As a result of this effort, the Government's equity share of the Dry Gas Zone increased from 77.0492 percent to 83.8726 percent. Negotiations for an ownership percentage revision for the Shallow Oil Zone are currently underway and are expected to be completed in FY 1995. Presently, there are no plans to review ownership percentages for the Stevens or Carneros zones.

Management of NPOSR believe that the reserve figures found in NPR-1's long range plan reasonably reflect the hydrocarbons to be recovered from NPR-1. These estimates do not result in a significant ownership adjustment for DOE.

(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 endeavor to comply with applicable environmental laws and regulations.

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Notes to Financial Statements

(b) Environmental and Site Restoration (continued)

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. Estimated costs to be incurred over the next 30 years amount to approximately \$315 million at NPR-1 (NPOSR share). DOE management for NPR-3 believe that costs to be incurred, net of recoveries for salvage value and property disposals, are insignificant. Beginning in 1993, NPOSR started recognizing an unfunded liability for the estimated restoration requirements at NPR-1. The accrual is based on actual revenues in relation to total estimated revenues over the remaining life of the facility. Accrued costs for 1994 and 1993 amount to \$12,800,000 and \$11,300,000, respectively (NPOSR share), and are included in the accompanying combined financial statements.

The governmental regulations covering environmental issues are very complex and are subject to continual change. Accordingly, changes in the regulations or interpretations thereof, and/or the ultimate settlement of amounts sought from other parties, if any, as well as the imprecision implicit in estimating future costs and events, could result in material future costs to NPOSR in excess of the amounts accrued.

(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 price in effect on the day(s) of delivery. Celeron, alleging bad faith, has sued for \$1.2 million, the alleged difference in price in effect during the

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Notes to Financial Statements

fall of 1988 and the price(s) 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 settlement has been encouraged by the court; however, if negotiations are not successful, the court will set a trial date. The outcome cannot be determined at this time.

(ii) Appeals of Golden West Refining

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 24, 1994, the EBCA ruled the Department wrongfully extended these contracts and directed the party to negotiate damages. The DOE has filed a motion to stay any action on damages pending the department's determination whether to appeal the EBCA's decision to the Federal Circuit.

(12) Fund Balances

Fund balances include the following as of September 30, 1994 and 1993:

	<u>1994</u>	<u>1993</u>
Unexpended reimbursements:		
Unobligated:		
Available	\$ 21,522,422	\$ 14,611,301
Unavailable	426,694,636	444,368,710
Undelivered orders	<u>95,974,563</u>	<u>118,416,163</u>
	<u>544,191,621</u>	<u>577,396,174</u>
Invested capital	<u>549,413,177</u>	<u>552,575,250</u>
Cumulative results of operations:		
Beginning of year	16,966,625	19,047,826
Excess (shortage) of financing sources over funded expenses and transfers	(24,625,530)	226,498,102
Intrafund allocations	<u>36,366,629</u>	<u>(228,579,303)</u>
End of year	<u>28,707,724</u>	<u>16,966,625</u>
	<u>\$1,122,312,522</u>	<u>\$1,146,938,049</u>

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NAVAL PETROLEUM AND OIL SHALE RESERVES

Notes to Financial Statements

(13) Future Funding Requirements

Future funding requirements include the following as of September 30, 1994 and 1993:

	<u>1994</u>	<u>1993</u>
Pension and other retirement benefits (note 10)	\$ 15,109,162	\$ 2,111,106
Annual leave	432,010	434,168
Environmental restoration (note 11)	<u>24,100,000</u>	<u>11,300,000</u>
	<u>\$ 39,641,172</u>	<u>\$ 13,845,274</u>

(14) Revenues

Revenues include the following during 1994 and 1993:

	<u>1994</u>	<u>1993</u>
Sales of Product:		
Crude oil*	\$277,792,780	\$315,456,702
Natural gas	42,653,104	36,972,429
Propane	16,414,117	17,044,450
Butane	7,152,504	8,482,804
Isobutane	3,402,748	4,030,141
Gasoline	11,716,920	17,514,249
Natural gas condensate	<u>26,495</u>	<u>34,317</u>
	359,158,668	399,535,092
Royalties	1,633,849	2,615,675
Pipeline tariff	<u>496,907</u>	<u>308,072</u>
	361,289,424	402,458,839
Interest income	30,841	14,839
Other income	<u>196,980</u>	<u>25,312</u>
	<u>\$361,517,245</u>	<u>\$402,498,990</u>

*Includes \$120,849,926 of sales to the Strategic Petroleum Reserves in 1993 (\$ -0- in 1994).

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Notes to Financial Statements

(15) Operating Expenses

Operating expenses (by program) include the following during 1994 and 1993:

	<u>1994</u>	<u>1993</u>
Operations and maintenance	\$162,284,624	\$168,448,319
Drilling	32,989,653	22,143,723
Facilities construction	44,991,111	20,900,012
Program direction	7,169,572	7,603,261
NOSR	5,169,774	4,814,301
Depreciation	62,013,677	42,647,700
Other expenses	<u>1,454,407</u>	<u>28,483</u>
Gross expenditures	316,072,818	266,585,799
Less joint interest reimbursements	<u>(43,879,534)</u>	<u>(37,482,291)</u>
Gross DOE expenditures	272,193,284	229,103,508
Less capital expenditures	<u>(58,851,603)</u>	<u>(40,996,285)</u>
Net expenditures	<u>\$213,341,681</u>	<u>\$188,107,223</u>

(16) Miscellaneous Expenses

Miscellaneous expenses include the following during 1994 and 1993:

	<u>1994</u>	<u>1993</u>
Unfunded post retirement benefit costs	\$ 1,649,741	\$ -
Unfunded pension costs	894,186	787,366
Unfunded annual leave costs	(2,158)	20,555
Adjustment to inventories held for sale	<u>45,299</u>	<u>845,238</u>
	<u>\$ 2,587,068</u>	<u>\$ 1,653,159</u>

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Notes to Financial Statements

(17) Significant Customers

The following customers each accounted for greater than ten percent of total revenue from public sources at NPR-1 and NPR-3, respectively, during 1994:

<u>Customer</u>	<u>NPR-1</u>	<u>NPR-3</u>
Chevron USA	\$ -	\$ 2,725,116
Govt Energy	-	9,242,740
Texaco Trading/Texaco Refining	52,325,226	-
Celeron Gathering/Celeron Trading & Transportation	41,655,840	-
Tosco Corporation	55,307,731	-

(18) Reconciliation of Combined Statements of Budgetary Resources and Actual Expenses includes the following for 1994 and 1993:

	<u>1994</u>	<u>1993</u>
Accrued expenditures, direct, per combined statements of budgetary resources and actual expenses	\$ 233,940,271	\$(230,110,035)
Adjusting entry for 1992 revenues collected and deposited into the General Fund at the U.S. Treasury instead of being deposited into the DOE appropriation account	-	(16,362,428)
Other	-	(120,683)
Accrued expenditures per SF-133, line 16	<u>\$ 233,940,271</u>	<u>\$(246,593,146)</u>

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

Combining Statement of Financial Position

As of September 30, 1994

	NPRC/ BECHTEL	NPOSR- CUW/FD	DOE HEADQUARTERS	DOE FIELD OFFICES	TOTAL NPOSR
=====	=====	=====	=====	=====	=====
ASSETS					

Financial resources:					
Fund balances with U.S. Treasury	\$546,007,706	\$31,279,020	\$7,154,786	(\$964,786)	\$583,476,726
Cash	3,000	1,500	—	—	4,500
Accounts receivable, net, nonfederal	16,314,992	1,023,920	480	—	17,339,392
Inventories held for sale, net	2,253,057	83,617	—	—	2,336,674
Intragovernmental accounts receivable	51,429	1,444	(32)	—	52,841
	-----	-----	-----	-----	-----
Total financial resources	564,630,184	32,389,501	7,155,234	(964,786)	603,210,133
	-----	-----	-----	-----	-----
Nonfinancial resources:					
Advances and prepayments, nonfederal	128,226	8,064	1,405	—	137,695
Inventories for own use	9,187,280	989,625	—	—	10,176,905
Property, plant and equipment, net	520,423,944	28,975,404	13,829	—	549,413,177
	-----	-----	-----	-----	-----
Total nonfinancial resources	529,739,450	29,973,093	15,234	—	559,727,777
	-----	-----	-----	-----	-----
 Total assets	 \$1,094,369,634	 \$62,362,594	 \$7,170,468	 (\$964,786)	 \$1,162,937,910
	=====	=====	=====	=====	=====

See independent auditors' report.

	NPRC/ BECHTEL	NPOSR- CUW/FD	DOE HEADQUARTERS	DOE FIELD OFFICES	TOTAL NPOSR
	=====	=====	=====	=====	=====
LIABILITIES					

Funded liabilities:					
Accounts payable, nonfederal	\$32,221,976	\$1,954,481	\$42,765	\$13,078	\$34,232,300
Accrued payroll and benefits	2,908,236	33,613	48,712	-	2,990,561
Deferred revenue, nonfederal	-	7,252	-	-	7,252
Other funded liabilities, nonfederal	2,840,065	547,571	7,639	-	3,395,275
	-----	-----	-----	-----	-----
Total funded liabilities	37,970,277	2,542,917	99,116	13,078	40,625,388
	-----	-----	-----	-----	-----
Unfunded liabilities:					
Accrued annual leave	254,155	76,184	101,671	-	432,010
Pension and other retirement benefits, nonfed	15,109,162	-	-	-	15,109,162
Accrued environmental restoration	24,100,000	-	-	-	24,100,000
	-----	-----	-----	-----	-----
Total unfunded liabilities	39,463,317	76,184	101,671	-	39,641,172
	-----	-----	-----	-----	-----
Total liabilities	77,433,594	2,619,101	200,787	13,078	80,266,560
	-----	-----	-----	-----	-----
NET POSITION					

Fund balances	1,056,399,357	59,819,677	7,071,352	(977,864)	1,122,312,522
Future funding requirements	(39,463,317)	(76,184)	(101,671)	-	(39,641,172)
	-----	-----	-----	-----	-----
Net position	1,016,936,040	59,743,493	6,969,681	(977,864)	1,082,671,350
	-----	-----	-----	-----	-----
Total liabilities and net position	\$1,094,369,634	\$62,362,594	\$7,170,468	(\$964,786)	\$1,162,937,910
	=====	=====	=====	=====	=====

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, 1994

	NPRC/ BECHTEL	NPOS- CUW/FD	DOE HEADQUARTERS	DOE FIELD OFFICES	TOTAL NPOS
	=====	=====	=====	=====	=====
APPROPRIATIONS	\$173,682,037	\$29,056,786	\$10,690,427	\$1,342,750	\$214,772,000
PROGRAM REVENUES AND EXPENSES					
Revenues:					
Sales of product	348,353,288	12,936,136	-	-	361,289,424
Interest, nonfederal	29,761	1,080	-	-	30,841
Other income	-	196,980	-	-	196,980
	-----	-----	-----	-----	-----
Total revenues	348,383,049	13,134,196	-	-	361,517,245
	-----	-----	-----	-----	-----
Expenses:					
Program and operating expenses:					
Personal services and benefits	47,297,710	6,413,962	1,462,347	-	55,174,019
Contractual services	45,096,033	2,627,192	644,763	1,454,048	49,822,036
Utilities, rent and communications	16,056,510	75,279	2,488	-	16,134,277
Supplies and materials	12,282,142	2,112,359	8,889	-	14,403,390
Equipment not capitalized	4,900,277	-	-	-	4,900,277
Travel and transportation	4,544,492	133,111	111,645	-	4,789,248
Printing and reproduction	237,602	52,285	1,972	-	291,859
Other	17,502,102	108,571	-	358	17,611,031
Depreciation	56,241,766	5,766,522	5,389	-	62,013,677
Environmental restoration	12,800,000	887,370	-	-	13,687,370
Miscellaneous expenses	2,600,279	(4,559)	(8,652)	-	2,587,068
Less joint interest reimbursements	(28,072,571)	-	-	-	(28,072,571)
	-----	-----	-----	-----	-----
Net expenses	191,486,342	18,172,092	2,228,841	1,454,406	213,341,681
	-----	-----	-----	-----	-----
Net income before cumulative effect of change in accounting principle	156,896,707	(5,037,896)	(2,228,841)	(1,454,406)	148,175,564
	-----	-----	-----	-----	-----
Cumulative effect of change in accounting principle	10,454,129	-	-	-	10,454,129
	-----	-----	-----	-----	-----
Net income (loss)	146,442,578	(5,037,896)	(2,228,841)	(1,454,406)	137,721,435
	-----	-----	-----	-----	-----
TRANSFERRED TO U.S. TREASURY	392,067,273	10,847,587	-	-	402,914,860
	-----	-----	-----	-----	-----
Excess (shortage) of appropriations and net income over transfers	(\$71,942,658)	\$13,171,303	\$8,461,586	(\$111,656)	(\$50,421,425)
	=====	=====	=====	=====	=====
NET POSITION					
Beginning balance	\$1,088,878,698	46,572,190	(\$1,491,905)	(\$856,208)	\$1,133,092,775
Excess (shortage) of appropriations and net income over transfers	(71,942,658)	13,171,303	8,461,586	(111,656)	(50,421,425)
	-----	-----	-----	-----	-----
Ending balance	\$1,016,936,040	\$59,743,493	\$6,969,681	(\$977,864)	\$1,082,671,350
	=====	=====	=====	=====	=====

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, 1994

	NPRC/ BECHTEL	NPSR - CUW/FD	DOE HEADQUARTERS	DOE FIELD OFFICES	TOTAL NPSR
	=====	=====	=====	=====	=====
CASH FLOWS FROM OPERATING ACTIVITIES					
Net income	\$146,442,578	(\$5,037,896)	(\$2,228,841)	(\$1,454,406)	\$137,721,435
Depreciation	56,241,766	5,766,522	5,389	-	62,013,677
Unfunded environmental restoration	12,800,000	-	-	-	12,800,000
Other unfunded expenses (income), net	12,997,825	6,723	(8,650)	-	12,995,898
Decrease (increase) in accounts receivable	247,501	(284,800)	(420)	-	(37,719)
Decrease (increase) in inventories	1,391,919	(106,886)	-	-	1,285,033
Decrease (increase) in advances and prepayments	36,028	(1,943)	136	-	34,221
Increase (decrease) in accounts payable	6,055,969	(1,159,837)	(77,347)	-	4,818,785
Increase in other liabilities	2,906,383	111,632	4,017	-	3,022,032
	-----	-----	-----	-----	-----
Net cash provided by (used in) operating activities	239,119,969	(706,485)	(2,305,716)	(1,454,406)	234,653,362
	-----	-----	-----	-----	-----
CASH FLOWS FROM INVESTING ACTIVITIES					
Purchases of property, plant, and equipment (net of retirements)	(53,618,155)	(5,233,449)	-	-	(58,851,604)
	-----	-----	-----	-----	-----
CASH FLOWS FROM FINANCING ACTIVITIES					
Appropriations	173,682,037	29,056,786	10,690,427	1,342,750	214,772,000
Transferred to U.S. Treasury	(392,067,273)	(10,847,587)	-	-	(402,914,860)
	-----	-----	-----	-----	-----
Net cash used in financing activities	(218,385,236)	18,209,199	10,690,427	1,342,750	(188,142,860)
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Net cash provided by (used in) operating, investing, and financing activities	(32,883,422)	12,269,265	8,384,711	(111,656)	(12,341,102)
	-----	-----	-----	-----	-----
Fund balances with U.S. Treasury and cash, beginning of year	578,894,128	19,011,255	(1,229,925)	(853,130)	595,822,328
	-----	-----	-----	-----	-----
Fund balances with U.S. Treasury and cash, end of year	\$546,010,706	\$31,280,520	\$7,154,786	(\$964,786)	\$583,481,226
	=====	=====	=====	=====	=====

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, 1994

	BUDGET				ACTUAL
			Resources	Obligations Reimbursed	Net Expenses
TOTALS			\$658,774,306	\$210,527,248	\$213,341,681
			=====	=====	=====
	NPRC/ BECHTEL	NPOSR— CUW/FD	DOE HEADQUARTERS	DOE FIELD OFFICES	TOTAL NPOSR
	=====	=====	=====	=====	=====
BUDGET RECONCILIATION					
A. Net expenses	\$191,486,341	\$18,172,091	\$2,228,843	\$1,454,406	\$213,341,681
B. Add:					
(1) Capital acquisitions	53,618,155	5,233,448	—	—	58,851,603
(2) Other expended budget authority	(1,855,108)	114,651	—	(359)	(1,740,816)
(3) Joint interest reimbursements	43,879,535	—	—	—	43,879,535
C. Less:					
(1) Depreciation	56,241,766	5,766,522	5,389	—	62,013,677
(2) Unfunded annual leave expenses	(231)	6,722	(8,650)	—	(2,159)
(3) Unfunded environmental restoration	12,800,000	—	—	—	12,800,000
(4) Other unfunded expenses	12,998,056	—	—	—	12,998,056
(5) Post closing adjustment	(9,385,939)	—	—	—	(9,385,939)
	=====	=====	=====	=====	=====
D. Accrued expenditures	214,475,271	17,746,946	2,232,104	1,454,047	235,908,368
E. Less reimbursements	—	1,968,097	—	—	1,968,097
	=====	=====	=====	=====	=====
F. Accrued expenditures, direct	\$214,475,271	\$15,778,849	\$2,232,104	\$1,454,047	\$233,940,271
	=====	=====	=====	=====	=====

See independent auditors' report.

SUPPLEMENTAL FINANCIAL AND MANAGEMENT INFORMATION

Naval Petroleum Reserve Nos. 1 & 2 (NPR-1 & NPR-2)

NPR-1, Elk Hills, covers 47,409 acres in Kern County, California, and is located about 35 miles west of Bakersfield. Almost 24.1 million barrels of crude oil were produced in 1994 of which 18.8 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 321.3 million cubic feet per day in FY 1994, and over 416.3 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 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. 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 formations (zones) underlying its surface lands.

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

<u>Zone</u>	<u>Government</u>	<u>Chevron U.S.A.</u>
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 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 August 1, 1985, and is scheduled to terminate July 31, 1995.

NPR-1 reached its peak rate of oil production (181,000 BOPD) in July 1981, and was producing approximately 66,800 BOPD at the end of FY 1994. Production in FY 1994 was forecasted to average about 65,900 BOPD and the actual average was 66,000 BOPD, of which the Government's share was 51,400 BOPD. Production for FY 1995 is forecasted to average about 69,000 BOPD.

Since the establishment of the Reserve in 1912, over 1 billion barrels of crude oil have been produced at Elk Hills, 761 million barrels of which have been produced since open-up on July 3, 1976. Based on the most recent reserve information, total reserves remaining at the end of FY 1994 are estimated to be 435 million barrels of crude oil equivalent. The Government's share of proved reserves is 346.7 million barrels of crude oil.

The Government's sales and other revenues at NPR-1 and NPR-2 for FY 1994 were \$348.4 million. In accordance with Public Law, 1994 proceeds from sales of products at NPR-1 and royalties from NPR-2, are deposited into the U.S. Treasury General Fund account.

During FY 1994, DOE's share of NPR-1 costs not capitalized were \$202 million resulting in net income of \$146.4 million, net of Chevron's share of NPR-1 costs of \$28.1 million, and before allocation of Headquarters and other Field Office costs. The majority of NPR-1's costs consisted of personal and contractual services (\$92.4 million); depreciation (\$56.2 million); utilities, rent and communications (\$16.1 million); and environmental restoration (\$12.8 million). The remaining costs (\$52.6 million) consisted of the cumulative effect of a change in accounting principle (\$10.5 million); supplies and materials (\$12.3 million); other (\$17.5 million); and various (\$12.3 million). DOE received \$28.1 million in reimbursements from Chevron for these costs. Total capitalized costs amounted to \$69.4 million, of which DOE's share amounted to \$53.6 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, predominantly from stripper wells, averaged 3,387 BOPD during FY 1994 of which the Government's share was 1,853 BOPD. About 650 million barrels of oil have been produced from NPR-2 from the early 1920's through FY 1994. The Government's share of total remaining recoverable reserves for NPR-2 are estimated at 4 million barrels.

The Government's revenues from NPR-2 oil, gas, and related liquid product royalties during fiscal year 1994 totaled \$1.6 million. Minimal expenditures for NPR-2 in FY 1994 provided for lease surveillance, production, accounting, and oversight.

Below is an accounting of revenues from petroleum product sales and other revenue for NPR-1 and NPR-2. In addition, \$43.9 million was billed to Chevron as a reimbursement for their share of the costs (not shown in the below table). Of the \$43.9 million, \$28.1 million represents operating expenses and \$15.8 million represents capital expenditures.

	<u>1994</u>	<u>1993</u>
Crude Oil	\$268,792,097	\$302,257,380
Natural Gas	39,922,595	33,504,911
Propane	16,217,201	16,860,322
Butane	6,667,878	7,916,849
Isobutane	3,402,748	4,030,141
Gasoline	11,716,920	17,514,249
Interest Income	<u>29,761</u>	<u>35,519</u>
Subtotal	346,749,200	382,119,371
 NPR-2 Royalties	 <u>1,633,849</u>	 <u>2,615,675</u>
Total	<u>\$348,383,049</u>	<u>\$384,735,046</u>

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. John Brown E & C Inc., formerly Lawrence-Allison & Associates, West, Inc., was the management and operating contractor from September 1981, until September 30, 1992. A decision was made to re-compete the contract rather than extend the current contract for another five years. On October 1, 1992 Fluor Daniel became the new management and operating contractor.

Estimated remaining recoverable reserves at NPR-3 total about 1.7 million barrels using current production techniques.

The FY 1994 revenues derived from all sources at NPR-3 totaled \$10.2 million, which are deposited into the U.S. Treasury General Fund Account. During FY 1994, costs at NPR-3 totaled \$14.5 million, including \$.2 million for Headquarters for program direction and support, resulting in a net loss of \$4.3 million, compared with a net loss of \$1.8 million in FY 1993 (including Headquarters cost allocations). The FY 1994 net loss was partially attributed to a decrease in the average price of oil from \$18.56 per barrel to \$15.92 per barrel.

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

Naval Oil Shale Reserves No. 1 (NOSR-1) and No. 3 (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-1 is estimated to have over 18 billion barrels of shale oil in place, with approximately 2.5 billion barrels of oil recoverable from shale rated at 30 gallons per ton or better. NOSR-3 has natural gas reserves but no commercial oil shale, and was originally set aside to gain closer access to the Colorado River and as working space to support NOSR-1 activities. NOSR-2, consists of 90,400 acres located in Carbon and Uintah Counties, Utah. At present, there are no plans for development at NOSR-2.

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 1994 NOSR-3 sales revenues for natural gas sales totaled \$3.0 million, the receipts of which are recorded as an appropriation reimbursement in accordance with Public Law 102-154. FY 1994 costs totaled \$3.9 million. The net loss for FY 1994 was \$0.9 million. These losses are due to the front-end capital investment required for drilling and related facilities. These expenses are expected to be recouped in the future.

DOE - Headquarters

The \$2.2 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 Field Offices

The 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 for these efforts were \$1.5 million.

PROGRAM PERFORMANCE MEASURES

1a. PRODUCTION RATE (Per Year)	NPR-1					
	TARGET PRODUCTION FY 1994	ACTUAL PRODUCTION FY 1994	PERCENT DIFFERENCE FY 1994	TARGET PRODUCTION FY 1993	ACTUAL PRODUCTION FY 1993	PERCENT DIFFERENCE FY 1993
Crude Oil (Barrels)	17,399,598	18,762,687	7.83%	18,270,075	18,708,440	2.40%
Natural Gas (MCF)	91,785,213	93,687,973	2.07%	88,330,000	87,518,126	(1.02%)
Propane (Gallons)	42,579,757	41,976,002	(1.42%)	39,931,000	41,865,500	4.84%
Butane (Gallons)	32,641,844	27,868,602	(14.62%)	28,324,000	29,857,000	5.41%
Natural Gasoline (Gallons)	48,918,418	42,354,250	(13.42%)	42,741,500	43,581,000	1.96%
Isobutane (Gallons)	8,869,500	8,911,320	0.47%	8,869,500	8,614,000	(2.88%)

1b. PRODUCTION RATE (Per Year)	NPR-3					
	TARGET PRODUCTION FY 1994	ACTUAL PRODUCTION FY 1994	PERCENT DIFFERENCE FY 1994	TARGET PRODUCTION FY 1993	ACTUAL PRODUCTION FY 1993	PERCENT DIFFERENCE FY 1993
Crude Oil (Barrels)	581,085	595,827	2.54%	796,430	725,765	(8.87%)
Natural Gas (MCF)	2,049,840	2,162,520	5.50%	2,582,740	2,290,891	(11.30%)
Propane (Gallons)	523,775	727,725	38.94%	702,625	551,847	(21.46%)
Butane Plus (Gallons)	1,572,785	2,011,264	27.88%	2,006,040	1,747,029	(12.91%)

1C. PRODUCTION RATE (Per Year)	NOSR#					
	TARGET PRODUCTION FY 1994	ACTUAL PRODUCTION FY 1994	PERCENT DIFFERENCE FY 1994	TARGET PRODUCTION FY 1993	ACTUAL PRODUCTION FY 1993	PERCENT DIFFERENCE FY 1993
Crude Oil (Barrels)	2,190	1,857	(15.21%)	2,562	2,100	(18.03%)
Natural Gas (MCF)	2,810,834	1,878,600	(33.17%)	2,334,319	2,402,100	2.90%

PROGRAM PERFORMANCE MEASURES

1d. PRODUCTION RATE (Per Year)	TOTAL				
	TARGET PRODUCTION FY 1994	ACTUAL PRODUCTION FY 1994	PERCENT DIFFERENCE FY 1994	TARGET PRODUCTION FY 1993	PERCENT DIFFERENCE FY 1993
Crude Oil (Barrels)	17,982,873	19,360,371	7.66%	19,069,067	1.93%
Natural Gas (MCF)	96,645,887	97,729,093	1.12%	93,247,059	(.02%)
Propane (Gallons)	43,103,532	42,703,727	(0.93%)	40,633,625	4.39%
Butane & Butane Plus (Gallons)	34,214,629	29,879,866	(12.67%)	30,330,040	4.20%
Natural Gasoline (Gallons)	48,918,418	42,354,250	(13.42%)	42,741,500	1.96%
Isobutane (Gallons)	8,869,500	8,911,320	0.47%	8,869,500	(2.89%)

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

2. LIFTING COSTS	NPR-1		NPR-3		NOSR's		TOTAL
	ACTUAL FY 1994	ACTUAL FY 1993	ACTUAL FY 1994	ACTUAL FY 1993	ACTUAL FY 1994	ACTUAL FY 1993	
DIRECT COST (Govt share)	65,043,140	66,666,652	5,400,953	5,136,708	279,733	199,193	72,002,553
BOEG PRODUCED	38,124,866	36,795,519	1,021,461	1,162,315	314,957	402,450	38,360,284
LIFTING COST OF BOEG	1.71	1.81	5.29	4.42	0.89	0.50	1.87

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 BOEG produced. This measure reflects the unit cost to the Government to produce one barrel of oil equivalent (BOE: natural gas and liquid products are converted to barrels of oil).

3. DOWNTIME PER WELL (days)	NPR-1		NPR-3		NOSR's		TOTAL
	ACTUAL FY 1994	ACTUAL FY 1993	ACTUAL FY 1994	ACTUAL FY 1993	ACTUAL FY 1994	ACTUAL FY 1993	
AVERAGE DAYS PER WELL PER YEAR	14.0	11.0	9.6	16.0	0.8	0.0	13.1

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 industry accepted level of performance.

PROGRAM PERFORMANCE MEASURES

	NPR-1		NPR-3		NOSR#		TOTAL	
	ACTUAL FY 1994	ACTUAL FY 1993	ACTUAL FY 1994	ACTUAL FY 1993	ACTUAL FY 1994	ACTUAL FY 1993	ACTUAL FY 1994	ACTUAL FY 1993
4. MANPOWER COSTS PER WELL								
DIRECT LABOR COST	42,280,311	43,693,864	1,852,764	2,481,600	86,376	59,301	44,219,451	46,234,765
ACTIVE WELLS	869	840	579	571	38	35	1,486	1,446
\$ PER ACTIVE WELL	48,654	52,017	3,200	4,346	2,273	1,694	29,757	31,974

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

	NPR-1		NPR-3		NOSR#		TOTAL	
	ACTUAL FY 1994	ACTUAL FY 1993	ACTUAL FY 1994	ACTUAL FY 1993	ACTUAL FY 1994	ACTUAL FY 1993	ACTUAL FY 1994	ACTUAL FY 1993
5. OPERATING COSTS								
OPERATING COSTS	132,066,168	131,340,034	9,926,287	12,430,469	2,670,963	1,694,321	144,663,418	145,464,824
BOEG PRODUCED	38,124,866	36,795,519	1,021,461	1,162,315	314,957	402,450	39,461,284	38,360,284
\$ PER BOEG PRODUCED	3.46	3.57	9.72	10.69	8.48	4.21	3.66	3.79

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 the BOEG produced. Capital investment costs for drilling, completions and facilities are excluded.

PROGRAM PERFORMANCE MEASURES

	NPR-1		NPR-3		NOSR-1		TOTAL	
	ACTUAL FY 1994	ACTUAL FY 1993	ACTUAL FY 1994	ACTUAL FY 1993	ACTUAL FY 1994	ACTUAL FY 1993	ACTUAL FY 1994	ACTUAL FY 1993
6. NET PROFIT MARGIN PER BOEG								
GROSS REVENUES	348,383,049	384,735,046	10,181,994	14,227,112	2,952,202	3,536,832	361,517,245	402,498,990
COSTS	194,977,910	167,258,390	14,460,262	16,833,855	3,903,509	4,014,978	213,341,681	188,107,223
NET REVENUES	153,405,139	217,476,656	(4,278,268)	(2,606,743)	(951,307)	(478,146)	148,175,564	214,391,767
QUANTITY PRODUCED (BOEG)	38,124,866	36,795,519	1,021,461	1,162,315	314,957	402,450	39,461,284	38,360,284
NET PROFIT PER BOE (GVT SHARE)	4.02	5.91	(4.19)	(2.24)	(3.02)	(1.19)	3.76	5.59

This measure is defined as net revenue per BOEG, and is computed by subtracting expenses from gross revenues and dividing by BOEG produced. NPOSH believes this is the most important performance measure, and that despite declining production and soft product markets, the program provides a substantial benefit to the Government as indicated by the net income per barrel of oil equivalent produced. 1994 net revenues for NPR-1 do not reflect the cumulative effect of the \$10,454,129 cost for the change in accounting principle.

	NPR-1		NPR-3		NOSR-1		TOTAL	
	ACTUAL FY 1994	ACTUAL FY 1993	ACTUAL FY 1994	ACTUAL FY 1993	ACTUAL FY 1994	ACTUAL FY 1993	ACTUAL FY 1994	ACTUAL FY 1993
7. RETURN OF PLANT PROPERTY & EQUIPMENT								
NET REVENUES	153,405,139	217,476,656	(4,278,268)	(2,606,743)	(951,307)	(478,146)	148,175,564	214,391,767
NET ASSET VALUE	520,423,944	523,047,555	14,965,083	18,395,261	10,805,484	8,063,733	546,194,511	549,506,549
\$ OF NET REVENUES PER \$ OF NET ASSET VALUE	.36	.42	(.29)	(.14)	(.09)	(.06)	.27	.39

This measure is the relationship of net revenues to the value of assets, and is computed by dividing gross revenue less expenses by the net asset value.

NOTE:

Subcontract labor will be estimated by sampling a number of the largest subcontracts and developing a percentage of the subcontract that is labor. This percentage will then be applied to the total for subcontract costs. This figure will be footnoted in the financial statements.

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

Independent Auditors' Report on Compliance with Laws and Regulations

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

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, 1994, and have issued our report thereon dated November 19, 1994.

We conducted our audit in accordance with generally accepted auditing standards; *Government Auditing Standards* (1988 Revision), 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.

Compliance with laws and regulations applicable to NPOSR is the responsibility of the management of NPOSR. As part of obtaining reasonable assurance about whether the combined financial statements are free of material misstatement, we tested compliance with those 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 (DOE Order 1000.3B)
- Chief Financial Officers' Act of 1990

However, our objective was not to provide an opinion on overall compliance with such laws and regulations. Accordingly, we do not express such an opinion.

As part of our audit, we also obtained an understanding of management's process for evaluating and reporting on internal control and accounting systems as required by the Federal Managers' Financial Integrity Act (FMFIA) and compared NPOSR's fiscal year 1994 FMFIA reports with the evaluation we conducted of NPOSR's internal control system.

The results of our tests indicate that, with respect to the items tested, NPOSR complied, in all material respects, with the provisions referred to in the third paragraph of this report. However, we noted two conditions which, although not material, require your attention. With respect to items not tested, nothing came to our attention to cause us to believe that NPOSR had not complied, in all material respects, with those provisions.

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

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

Subcontract Restrictions

Audit Comment:

The Federal Acquisition Regulation (FAR) 10.004 (b) (2), prohibits specifying a particular brand name, product, or feature of a product, peculiar to one manufacturer unless (i) the particular brand name, product, or feature is essential to the Government's requirements, and that other companies' similar products, or products lacking the particular feature, would not meet the minimum requirements for the item and (ii) the authority to contract without providing for full and open competition supported by the required sole source justification and approvals. In the past, Bechtel contracted for open hole logging services from a particular company because of its unique propriety equipment and technology.

In 1994, DOE withdrew its approval of Bechtel's sole source justification for open hole logging service with this particular contractor. Subsequently, Bechtel issued a competitive solicitation for open hole logging services which included specific brand name tools and technology of the prior vendor. Bechtel awarded the contract to the vendor with the patented tools and technology even though another contractor submitted the lowest bid. Bechtel claimed that the lowest bidder, a worldwide logging services contractor, did not meet the solicitation requirements. Bechtel's restrictive specifications possibly defeated the DOE's desire for open competition, indicated by the withdrawal of its sole source approval, and prevented delivery of a potentially acceptable service for a more reasonable price.

Audit Recommendation:

Bechtel should comply with FAR by ensuring that competitive solicitation specifications are not unduly restrictive and eliminate a competitive source that could deliver an acceptable product for a more reasonable price.

Management's Response:

Bechtel concurs that as technical determinations may be made that may serve to restrict competition, the buyers/subcontract administrators will review the specifications to ensure that they are not unduly restrictive.

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 in a timely manner. Therefore, the basis for calculating retentions was outdated procurement data. As a result, amounts withheld were below the minimum contract retention percentage to cover possible liquidation damages (i.e. late completion, claims, etc.) if the subcontractors' work was not satisfactory.

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

Audit Recommendation:

Bechtel's management should establish procedures to insure that the accounting department receives progress payment clauses and contract modifications in a timely manner so that proper retentions are withheld.

Management's Response:

Bechtel concurs. An automated system to transmit contract modifications electronically will be implemented.

* * * * *

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

November 19, 1994

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

Independent Auditors' Report on Internal Controls

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

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, 1994, and have issued our report thereon dated November 19, 1994.

We conducted our audit in accordance with generally accepted auditing standards; *Government Auditing Standards* (1988 Revision), 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.

In planning and performing our audit of the combined financial statements of NPOSR for the year ended September 30, 1994, we considered its internal control structure in order to determine our auditing procedures for the purpose of expressing our opinion on the combined financial statements and to determine whether the internal control structure meets the objectives identified in the following paragraph. Our consideration included obtaining an understanding of the internal control policies and procedures and assessing the level of control risk relevant to (1) all significant cycles, classes of transactions, or account balances and (2) the performance information control objectives described in the following paragraph.

The management of NPOSR 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 related to obligations and costs, are executed in compliance with applicable laws and regulations that could have a direct and material effect on the combined and combining financial statements and other laws and regulations that the OMB, NPOSR management, or the Inspector General have identified as being significant 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 properly recorded and accounted for to permit the preparation of reliable financial reports in accordance with OMB Bulletin provisions of 94-01, *Form and Content of Agency Financial Statements*, and to maintain accountability over the assets; and 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.

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

For the purpose of this report, we have classified the significant internal control structure policies and procedures in the following categories:

- Trade receivables, sales, and cash receipts cycle
- Accounts payable, purchases, and disbursements cycle
- Payroll cycle
- Oil and gas division - joint interest costs and revenue cycle

For all of the internal control structure categories listed above, we obtained an understanding of the design of relevant policies and procedures, determined whether they have been placed in operation, assessed control risk, and performed tests of the control procedures.

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 that, 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. The reportable conditions noted during our audit, all of which have been discussed with the appropriate members of management, are summarized below according to location:

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.

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

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.

Access to Supporting Documentation

Audit Comment:

DOE Acquisition Regulation 970.5204-9 requires a separate and distinct set of accounts, records, documents, and evidence supporting the receipt, use, and disposition of all property. Bechtel could not locate several documents to support additions to facilities or other fixed assets. This problem occurred because access to the document vault is unrestricted and Bechtel does not maintain an adequate record of the removal of source documents. As a result, Bechtel employees must spend time tracking down missing documents, or find another way to obtain the information. This creates inefficiencies and takes employees away from productive tasks.

Audit Recommendation:

Bechtel should restrict access to the document vault to only authorized employees. In addition, the vault clerk should maintain a record of the location of all documents removed from the vault.

Management's Response:

Bechtel concurs. There have been recent changes in personnel and procedures for document removal that have been revised and reemphasized to mitigate the problem.

Proper Verification of Expenditure Requisition Approval

Audit Comment:

Bechtel's acquisition operational policy 7.18 requires that acquisitions process all requisitions received with proper departmental approval in accordance with procurement instructions. Therefore, acquisitions should verify the requisition for proper authorization prior to initiating a purchase. 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.

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

Audit Recommendation:

Bechtel should ensure that acquisitions follow 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.

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

Overriding Controls in Payment System

Audit Comment:

Bechtel's computerized payment system requires matching a receiving report to a purchase order before making a payment for supplies and services. Bechtel's accounts payable personnel are overriding the computerized system of internal controls by creating a fictitious receiving report when initiating the prepayment of items such as seminar fees, magazine subscriptions, etc. Bechtel's employees can initiate such actions without supervisory review because they have ready access to that segment of the materials management system. As a result, Bechtel employees could create improper payments disguised as prepaid items and misappropriate government funds.

Audit Recommendation:

Bechtel should establish procedures to limit accounts payable's ability to access the receiving report segment of the materials management system without requiring supervisory review and approval before processing a prepayment for supplies or services.

Management's Response:

Bechtel concurs. Current system replacement efforts include specifications to overcome this deficiency to remove accounts payable personnel's ability to create receiving reports in these situations.

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

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 these costs are determined to be allowable, Chevron would be required to reimburse DOE for its proportionate share. In November of 1994, the contracting officer notified Bechtel that documentation provided to justify allowability of the California franchise tax as a reimbursable cost was insufficient and determined that the costs were unallowable until more definitive information is provided. However, the notification did not specifically identify what was insufficient with 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 Response:

Bechtel concurs.

* * * * *

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. A material weakness is a reportable condition in which the design or operation of a specific internal control structure element does not reduce to a relatively low level the risk that errors or irregularities in amounts that would be material in relation to the financial statements being audited or material to a performance measure or aggregation of related performance measures may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. 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 19, 1994.

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 Port Manned LLP

November 19, 1994

KPMG Peat Marwick LLP

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

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

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, 1994, and have issued our report thereon dated November 19, 1994. 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:

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

Depreciation of Fixed Assets

Audit Comment:

Generally accepted accounting principles require an entity to capitalize and depreciate fixed assets at the time the asset is placed into service, except for certain cost limits. Bechtel did not record depreciation between September 1993 and February 1994, because the newly established general ledger system did not interface with the fixed asset system during that four-month period. Upon completion of the interface, system managers overlooked determining whether the lack of interface caused accounting problems. Therefore, NPR-1's fiscal year 1994 financial statements understated depreciation expense by \$1.7 million and overstated the net value of capital property, resulting in a post closing audit adjustment.

An additional problem related to the above was noted for the recording of depreciation for completed projects. Bechtel held six completed capital projects totaling \$4.2 million in work in process (WIP) for periods of seven to twelve months past their completion date resulting in an understatement of depreciation expense of \$300,000. The error occurred due to difficulties encountered with interface development between Bechtel's new general ledger system and the WIP system. This resulted in delays in closing completed projects as alternative procedures to insure the proper recording of transactions did not exist.

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Audit Recommendation:

Bechtel should instruct managers to check for transaction problems that might arise during periods of interrupted interfacing between automated systems. Bechtel should also ensure that the depreciation transactions are properly recorded in the general ledger.

Management's Response:

Bechtel concurs that the stated deficiencies regarding recording depreciation took place. More attention will be paid in the future to prevent similar occurrences.

System Interface

Audit Comment:

Considering the concept of best business practices, all accounting information systems should properly interface to eliminate duplicating input tasks and reduce the risk of human error. The WIP system is not interfacing with the fixed asset system. As a result, property personnel must manually enter financial information twice if the transaction impacts both systems. The closing of an average drilling project requires property personnel to double enter 6 to 7 records with 14 numbers per record, for a total of approximately 85 numbers. This double entry of data into both systems increases the possibility of human error and decreases employee productivity. As a result, the WIP system, and ultimately the general ledger, may not agree with the fixed asset system (or vice-versa).

Audit Recommendation:

Bechtel should evaluate the economic feasibility of creating an interface between the WIP system and the fixed asset system.

Management's Response:

Bechtel concurs. Future system enhancement or replacement efforts will include specifications to prevent the stated inefficiency.

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.

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Management's Response:

Bechtel concurs. All purchase orders (P.O.'s) exceeding the buyer's authority, generally \$10,000, will be reviewed by the purchasing supervisor. P.O.'s within the buyer's commitment authority will be reviewed by the buyer to avoid administrative cost in excess of the potential benefit.

Responsiveness to Bid Specifications

Audit Comment:

DOE contractors are generally required to award a contract to the lowest responsive bidder in a competitive procurement. Bechtel made an award to a subcontractor they thought met all solicitation requirements. However, the numeric amount and written amount on the vendor's bid were different. The bid bond's written amount was about \$70,000 less than the numeric amount, and the amount required by the solicitation. Also, the written amount generally takes precedence over the numeric amount. Bechtel personnel did not detect the difference prior to award although they ruled the lowest bidder's proposal was nonresponsive because its bid bond was less than that required by the solicitation. As a result of the award to a nonresponsive bidder, Bechtel may not have adequate bond coverage should the vendor default on the bid.

Audit Recommendation:

Bechtel should emphasize to procurement personnel the importance of reviewing the propriety of documents to prevent awarding contracts to nonresponsive bidders. Bechtel should also require an increase in the vendor's bond if the contract is ongoing.

Management's Response:

Bechtel concurs. Modifications to procedures include a bond checklist to assure accuracy and completeness of all submitted bonds. Additionally, Bechtel will require bonds in a penal sum consistent with the Miller Act and FAR.

**Flour Daniel (FD)
Casper, Wyoming**

Environmental and Site Restoration Costs

Audit Comment:

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. As part of NPOSR's policy to comply with applicable environmental laws and regulations, NPOSR is responsible for environmental cleanup and site restoration requirements at NPR-3 as individual wells and facilities are abandoned and, ultimately, as operations are terminated. One such site is the Salt Creek Field for which DOE and FD have not determined an estimate of restoration costs or recognized an unfunded liability for such costs.

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Audit Recommendation:

FD should perform a thorough analysis of the future environmental cleanup cost requirements for NPR-3 and begin recognizing an unfunded liability for the estimated restoration costs associated with the Salt Creek Field.

Management's Response:

DOE management concurs and will perform an analysis of the requirements for environmental clean-up and restoration costs associated with NPR-3. The appropriate costs will be recorded in the fiscal year 1995 financial statements.

**DOE Site Office
Elk Hills, California**

Proper Accrual of Contract Costs

Audit Comment:

Generally accepted accounting principles require the recording of costs in the period in which the product or service is received. Accounting personnel at the DOE site office failed to properly accrue costs totaling \$940,000 for August and September 1994 invoices submitted by two contractors. The individual responsible for recording DOE site office costs did not fully understand the concept of accrued expenses and the obligation of funds. The individual thought the accrual of liabilities and expenses had occurred simultaneously with the obligation of funds for anticipated expenditures. However, the obligation of funds to cover known expenditures is only a budgetary reporting transaction made at the time a purchase or service order is approved and, therefore, does not affect site office accrued liabilities or expenses. As a result, the DOE site office understated expenses and accrued liabilities by \$940,000 in the combined financial statements for the year ended September 30, 1994, causing a post closing audit adjustment.

Audit Recommendation:

DOE site office personnel should properly accrue all known contract expenses in the period in which they occur. In addition, personnel responsible for recording DOE site office financial information should have an appropriate level of understanding and training required to fulfill accounting responsibilities.

Management's Response:

DOE concurs with the finding. The finance manager will conduct a more extensive review of accrued costs in the future. Finance personnel will receive training needed to maintain accounting information. Given the limitations and restrictions of hiring properly qualified individuals to these positions, the required training is extensive and will require a significant amount of time.

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Recording of Contract Costs

Based on DOE accounting procedures, only those charges approved by DOE are considered contract costs for financial reporting purposes. In 1994, DOE site office contract expenses included disputed costs and retention fees not approved for payment by the contracting officer. The individual responsible for processing invoices records the invoice total submitted by the vendor into the DOE accounting system (which expenses the costs and sets up the liability) prior to review for payment approval. However, these expensed amounts are not properly adjusted for unapproved costs or retention fees unpaid by the disbursements office creating an overstatement of expense. In one such instance, the vendor submitted an invoice for \$75,000 of which \$30,000 was for services not covered under the current contract because a contract modification was not obtained. The accounts payable clerk recorded the entire \$75,000 and did not adjust the amount expensed (costed) for the noncontract costs. Based on discussions with DOE site office personnel in finance and contracting, the failure to properly adjust these costs could result in an overstatement of expenses and liabilities because disputed unapproved costs and retention fees are often resubmitted for payment on subsequent invoices. In addition, the duplicate recording of costs may be hard to identify as DOE site office personnel do not perform periodic reconciliations of support service contractor costs.

Audit Recommendation:

DOE site office personnel should properly adjust costs recorded into the DOE accounting system to reflect unapproved costs and retention fees to avoid duplicate recording of costs. Accounting personnel should also perform periodic reconciliations of support service contractor costs against payments to ensure expense is properly stated.

Management's Response:

DOE concurs with the finding. A program analyst was detailed to the financial management branch effective October 17, 1994. One responsibility given to the analyst is the reconciliation of support service contractor costs against payments to ensure expense is properly stated.

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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

Proper Recognition and Recording of Costs

Audit Comment:

We reported in fiscal year 1993 that Bechtel followed the practice of not recognizing depreciation on capital assets for WIP until the project was closed, although some project assets were placed in service at an earlier date. We recommended Bechtel implement procedures to review WIP projects where it is possible to identify segments placed in use and transfer the related costs to a completed plant subject to depreciation. Bechtel agreed to review, prior to each fiscal year-end, potential projects where assets might have been placed in service before completing the project.

Bechtel reviewed and made partial closing on the projects that we questioned. Bechtel did not, however, perform the year-end review nor did they establish written procedures requiring such a review by the project manager.

Audit Recommendation:

Bechtel should modify its authorization for expenditure (AFE) closure procedures to require the periodic review of WIP projects to identify segments where material capital assets were placed in use and transfer the related costs to completed plant.

Management's Response:

Bechtel will modify its AFE closure procedures to address timely capitalization of material capital asset amounts.

* * * * *

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

November 19, 1994