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United States Government

Department of Energy

memorandum

DATE: March 19, 1997

REPLY TO
ATTN OF: IG-35

SUBJECT: U. S. Department of Energy Naval Petroleum Reserve Number 1, 1996 Financial Statement Audit (WR-FC-97-04)

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

The attached report presents the results of the independent certified public accountants' audit of the Department of Energy's (Department) Naval Petroleum Reserve Number 1 (NPR-1) financial statements as of September 30, 1996. The auditors have expressed an unqualified opinion on the 1996 statement of financial position and the related statements of operations and changes in net position.

The 1996 financial statement audit was performed under the provisions of the Inspector General Act (5 U.S.C. App.) as amended. The auditors' work was conducted in accordance with generally accepted auditing standards. To fulfill our audit responsibilities, we contracted with the independent public accounting firm of KPMG Peat Marwick LLP (KPMG) to conduct the audit for us, subject to our review.

We believe that the NPR-1 financial statements, together with KPMG's opinion and our review of that work, provide management with a basis for evaluating NPR-1's financial position and results of operations for the period audited.

Since this report does not contain recommendations, a formal response is not required. We appreciate the cooperation of your staff during the review.

Lawrence R. Ackerly

Lawrence R. Ackerly, Regional Manager
Western Regional Audit Office
Office of Inspector General

Attachment

cc: Director, Audit Liaison Division, CR-33
Program Audit Liaison, FE-63
Manager, Capital Regional Audit Office, IG-34

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MASTER

IG Report No. WR-FC-97-04

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U.S. Department of Energy

NAVAL PETROLEUM RESERVE NUMBER 1

Financial Statements

September 30, 1996 and 1995

NAVAL PETROLEUM RESERVE NUMBER 1

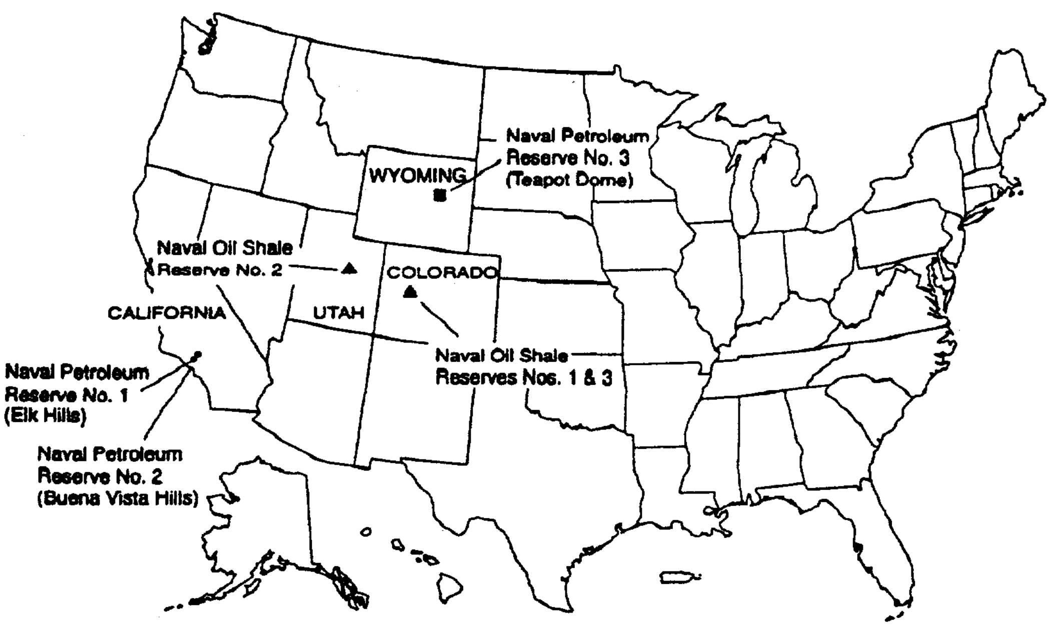
Table of Contents

OVERVIEW

Purpose and History

The Naval Petroleum and Oil Shale Reserves (NPOSR) produces crude oil and associated hydrocarbons from the Naval Petroleum Reserves (NPR) numbered 1, 2, and 3, and the Naval Oil Shale Reserves numbered 1, 2, and 3 in a manner to achieve the greatest value and benefits to the United States taxpayer.

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 reauthorized by the President in three-year increments. Since enactment of the law, every President has determined that continuing NPOSR production is in the nation's best interest. NPOSR currently is authorized to continue production through April 5, 2000.



The Financial statements include only the operations of NPR-1.

NPR-1, located in Kern County, California, about 35 miles west of Bakersfield, consists of a management and operating contractor responsible for daily operations of NPR-1 and a Department of Energy (DOE) field office responsible for overseeing operations of NPR-1. NPR-1 is jointly owned by the United States Government (about 78 percent) and Chevron USA, Inc. (Chevron) (about 22 percent) and is operated according to the provisions of a Unit Plan Contract (UPC) executed in 1944 and last amended May 25, 1976.

Unaudited - see accompanying accountants report.

Purpose and History (continued)

Under the UPC, each participant shares in the unit costs and production of hydrocarbons in proportion to the weighted acre-feet of commercially productive oil and gas formations (zones) underlying the respective surface lands as of 1942. The participating shares of NPR-1 as of September 30, 1996 are:

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

* Based on November 1994 redetermination

Under the terms of the UPC, either participant may request a redetermination of their participating share of a producing zone (redeterminations of participating shares are retroactive to 1942). In November 1994, a redetermination of the Dry Gas Zone (DGZ) was completed, which resulted in an increase in the Government's percentage for the DGZ from 77.0492 percent to 83.8726 percent. Subsequently, Chevron requested a redetermination of the Shallow Oil Zone (SOZ) and requested that a settlement agreement on the DGZ be postponed until a final SOZ determination is made. Therefore, for purposes of calculating shares of DGZ production and costs, DOE's share is considered to be 77.0492 percent during this intermediate period. Chevron and NPOSR have since presented their cases on the SOZ to the Assistant Secretary of Fossil Energy who has been delegated responsibility for making final equity determinations. Participating percentages for all zones are being finalized for divestment as required by the 1996 Defense Authorization Act.

NPR-1 Production, Revenues, and Expenses

NPR-1's total Fiscal Year (FY) 1996 production was 38.5 million barrels of oil equivalent (BOE), an increase of 875,000 BOE over FY 1995 production. (A BOE is a unit of measure in which quantities of natural gas and natural gas liquids (NGL) are converted into equivalent barrels of oil.) Production which is not reinjected into the field is sold by sealed bidding.

During FY 1996 production increased by 875,000 BOE and net income increased about 22 percent from FY 1995. The implementation of an NPOSR marketing effort, together with higher prices for crude oil and other petroleum products, and reduced expenses due to downsizing efforts have resulted in significantly higher profits for NPR-1.

The formation of a marketing group, which includes both DOE and support services personnel from throughout NPOSR, was instrumental in developing a sales program for all of NPOSR to maximize sales revenues. Adopting standard industry practices used within private energy sectors, the marketing group incorporated several major changes into the sales program at NPR-1 just prior to the start of FY 1996. Some of these changes included new pricing indices, new contract terms and documents, new payment terms, better customer communications, and a streamlining of the entire sales process.

Unaudited - see accompanying accountants report.

NPR-1 Production, Revenues, and Expenses (continued)

FY 1995 revenues were up $19.9 million over FY 1994, and FY 1996 revenues were $28.6 million over FY 1995 revenues. The projections for FY 1997 look even better, with the first quarter of FY 1997 already experiencing revenues exceeding $46 million over the same period in FY 1996.

During FY 1996, NPR-1 generated $395.2 million in revenues and totaled $138.3 million in expenses, resulting in net income of $256.9 million, compared with net income of $209.9 million in FY 1995. At the 1996 level, the Government would accrue about $1 billion in profits from NPR-1 in just four years.

Significant Accomplishments

The cogeneration plant, which provides NPR-1 with its own source of electricity by using natural gas produced on site, completed its second year of operation. Revenues from the sale of excess electricity amounted to $2.4 million for FY 1996, up from $1.9 million in FY 1995. Not only does the cogeneration plant produce a revenue stream, but it allows NPR-1 to avoid approximately $12 million in annual costs if it were to purchase electricity instead of producing it. Construction of new control buildings at both of NPR-1's Low Temperature Separation gas processing plants was completed in FY 1996. The plants now feature state-of-the-art computer process controls and safety enhancements that meet or exceed safety codes and standards. Another facilities project completed at NPR-1 in FY 1996 involved the modification of three tank settings to allow for increased oil production from the Stevens Zone. The $885,000 project cost has a payout of less than six months and more than a 1,000 percent rate of return.

NPR-1 received a significant honor from the oil and gas industry in FY 1996. *Hart's Oil and Gas World*, one of the industry's leading publications, named NPR-1 the winner of its "Best Advanced Recovery Project" in its Best of the Pacific contest. NPR-1 was recognized for using the first large-hole horizontal wells for improved recovery from the 26R pool at Elk Hills. In FY 1996, the successful and highly profitable horizontal drilling program at Elk Hills was expanded to include the SOZ and the 7R pool. Production from all horizontal wells rose to 11,600 barrels of oil per day in FY 1996, an increase of 36 percent over FY 1995.

One of the most significant accomplishments in FY 1996 in terms of production was in the SOZ, the oldest producing zone at NPR-1. Completion of a successful gas-injection project, along with profitable liner replacement and infill drilling programs, boosted production in the SOZ to more than 16,000 barrels per day--the highest production level from that zone since 1988 and a 7.6 percent increase over FY 1995.

The FY 1996 drilling and remedial programs at NPR-1 yielded more than 8,600 barrels of oil per day in additional production. The $46 million cost for these programs was recouped in only 10 months, and tens of millions of dollars will be generated in new net revenues in the future.

With total revenues of $395.2 million and net income to the Government of $256.9 million in FY 1996, NPR-1 is a highly profitable asset. The Elk Hills field is ranked 12th in production of all the oil and gas fields in the U.S., and 8th in the lower 48 states. The field produced its billionth barrel of oil in 1992, making Elk Hills only the 13th field in the nation to reach this significant milestone. Even with production already topping a billion barrels, a great deal of oil and gas still remains to be produced. In its annual ranking of U.S. oil fields for 1996, the *Oil & Gas Journal* placed Elk Hills eighth in the nation in terms of remaining reserves.

Unaudited - see accompanying accountants report.

Divestment of Naval Petroleum Reserve Number 1

The future may hold many changes for NPR-1 with the passage of the Defense Authorization Act (Act) during FY 1996. The Act, signed by President Clinton on February 10, 1996, establishes a process and schedule for conducting the sale of NPR-1 within two years from enactment.

The process for selling NPR-1 includes contracting for the services of an investment banker to independently administer the sale; five independent experts in the valuation of the oil and gas fields to separately assess the value of the Government's interest in NPR-1 to be used as the basis for establishing a minimum acceptable price; one independent petroleum engineer to finalize equity with Chevron as required by the Act; and one independent petroleum engineer to prepare a reserve report. To date, firms have been hired to provide investment banking services, five independent oil and gas field valuations, equity finalization, a reserve report, legal services, environmental technical support, and support for the Department's Divestment Administration Team.

DOE recently announced its strategy to sell the Government's portion of the Elk Hills field in segments rather than as a single asset in order to increase competition and ensure the highest value to taxpayers. Bids will be solicited for an "operating working interest," where the buyer will become the field's operator, and for multiple "nonoperating working interests," where purchasers will bid for smaller interests in the field. Five independent evaluators have been given the task of assessing the value of the field. Although an official assessment of the field's value is not yet complete, initial estimates have placed the value of Elk Hills somewhere between $1.5 and $4 billion, clearly an exceptionally valuable resource. DOE expects to issue a solicitation for offers in April 1997, with purchase proposals due in September 1997. The sale of the Elk Hills field could be the largest U.S. Government privatization since Conrail in 1987.

Program Performance Measures

The program performance measures for NPR-1 disclose program results in relation to program mission, goals, and objectives. The performance measures consider production factors such as production rates, lifting costs, downtime per well and manpower costs per well.

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

ANNUAL PRODUCTION	TARGET PRODUCTION FY 1996	ACTUAL PRODUCTION FY 1996	PERCENT OF TARGET FY 1996	TARGET PRODUCTION FY 1995	ACTUAL PRODUCTION FY 1995	PERCENT OF TARGET FY 1995
Crude Oil (Barrels)	17,211,336	16,893,523	98.15%	18,925,516	17,917,473	94.67%
Natural Gas (MCF)	99,387,350	104,368,718	105.01%	103,502,878	95,177,926	91.96%
Propane (Gallons)	64,987,384	47,018,296	72.35%	44,364,055	48,252,992	108.77%
Butane & Butane Plus (Gallons)	36,095,227	29,575,153	81.94%	27,591,236	27,296,461	98.93%
Natural Gasoline (Gallons)	57,195,957	45,356,551	79.30%	42,284,925	42,778,287	101.17%
Isobutane (Gallons)	11,712,000	8,741,673	74.64%	8,869,500	8,738,868	98.53%

Comments: Crude oil and natural gas production were very close to the target levels, however, production of the liquid products (propane, butane, isobutane, and natural gasoline) fell below target levels.

Unaudited - see accompanying accountants report.

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

	FY 1996	FY 1995
Lifting cost per BOE	$1.25	$1.78

Comments: Lifting costs were significantly reduced in large measure due to a work force decrease of approximately 25 percent and a slight increase in production. An NPR-1 staff reduction near the end of FY 1995 reduced salaries and benefits by $13,000,000. Costs were also reduced through strict control at every operating level. Every maintenance project or workover was planned and implemented with cost savings in mind. Salvage equipment and less expensive services were considered for every work order.

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

	FY 1996	FY 1995
Downtime per well (days)	13.09	15.00

Comments: Producible wells are economically feasible wells and exclude all injection wells, water wells, uneconomic oil and gas wells, and abandoned wells. The downtime per well in FY 1996 is fairly consistent with FY 1995, and is relatively low when compared to industry accepted standards of 15 to 20 days.

4. MANPOWER COSTS PER WELL measures the direct labor costs per active well. Active wells include all wells (producing, injection, and water wells) multiplied by DOE's interest.

	FY 1996	FY 1995
Manpower costs per well	$36,064	$45,348

Comments: Manpower costs per well continue to decrease due to successful efforts to reduce labor costs and staffing. During FY 1996, we are beginning to see the benefits of the downsizing effort undertaken during FY 1995.

Unaudited - see accompanying accountants report.

5. OPERATING COSTS include Federal staffing and support service costs as well as costs usually considered "overhead." Capital investments for drilling, completions, and facilities are excluded from this measure as well as certain nonrecurring expenses.

	FY 1996	FY 1995
Operating costs per BOE	$2.58	$3.19

Comments: Operating costs have been reduced through various cost cutting measures, among them a reduction in the number of employees due to early retirement incentives, a reduction in office expenditures such as rent, telephone, and other miscellaneous items.

6. NET PROFIT MARGIN PER BOE is computed by dividing net income before appropriations and transfers by BOE produced.

	FY 1996	FY 1995
Net profit per BOE	$6.68	$5.58

Comments: NPR-1 considers this the most important performance measure. Net profit per BOE increased during FY 1996 largely due to a rise in oil prices and a concerted effort to reduce operating costs.

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

	FY 1996	FY 1995
Net revenue/net asset value	$0.51	$0.41

Comments: The return on capital assets is approximately 51¢ for each dollar--up 10¢ from the past year and reflects the increased profitability of the program.

Unaudited - see accompanying accountants report.

Estimated NPR-1 Reserves

The NPR-1 estimated DOE share of proved oil and gas reserves and changes thereto for FY 1996 and FY 1995 are shown in the following table. These quantities were estimated in FY 1995 by DOE reservoir engineers at the site location, assisted by Bechtel and other subcontractors. Current year estimates are made by subtracting FY 1996 production from last years estimates. "Proved Developed and Undeveloped" reserves are estimated to be 383.3 million barrels of oil equivalent (MMBOE) and "Proved Developed" reserves are estimated to be 323.4 MMBOE, respectively. As part of the divestiture effort, DOE has contracted with an independent petroleum engineering firm to prepare an updated reserve report which DOE anticipates issuing in April 1997.

ESTIMATED NPR-1 PROVED DEVELOPED
AND UNDEVELOPED RESERVES
(GOVERNMENT SHARE)

	1996	1995
Proved Developed and Undeveloped Reserves (MMBOE)*:		
Beginning of year	408.3	358.3
Revisions of previous estimates	-	75.4
Production**	(25.0)	(25.4)
End of year	383.3	408.3
Proved Developed Reserves (MMBOE)*:		
Beginning of year	348.4	341.0
Revisions of previous estimates	-	32.8
Production**	(25.0)	(25.4)
End of year	323.4	348.4

* MMBOE = Million Barrels of Oil Equivalent and is converted as follows:
- 6 Million British thermal units (MMBtu) = 1 BOE
- 1 Thousand cubic feet (MCF) of wet gas produced = 1.240 MMBtu
- 1 MCF of residue gas reinjected or sold = 1.107 MMBtu

** Production numbers are net of injected gas in the amount of 13.5 MMBOE and 11.8 MMBOE for 1996 and 1995, respectively.

The proved liquid and gas reserves reported are consistent with current knowledge of the characteristics and production history of the reserves. They include only such reserves as can be classified as proved. FY 1995 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/or determined to be economical. Proved developed reserves are the quantities expected to be recovered through existing wells with existing equipment and operating methods. Proved undeveloped reserves are the quantities expected to be recovered through additional development cost and new wells with existing equipment and operating methods.

Unaudited - see accompanying accountants report.

NPR-1 Discounted Future Net Cash Flows

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 estimated annual prices for oil, gas, and natural gas liquids (propane, normal butane, isobutane, and natural gasoline) to average annual quantities of estimated DOE net proved developed and undeveloped reserves to be produced and sold. Such estimates are taken from the *FY 1995 Long Range Plan--Naval Petroleum Reserves in California Vol. II* (LRP).

The FY 1995 LRP includes forecasted future cash inflows using the then-current FY 1995 prices for all products, the trends in the actual prices, and the local (California) market conditions (supply vs. demand relationship). For FY 1996 and beyond, prices were escalated at an assumed annual inflation rate of 3 percent. Similarly, future operating costs were forecasted using past operating cost rates (per reservoir, per kind of the cost rates), and the expected operating cost changes and operating strategies for FY 1995. For FY 1996 and beyond, the operating cost rates were escalated at the assumed annual inflation rate of 3 percent. Drilling, facilities, and other costs were based on actual costs for similar items and the anticipated activities in the future, incorporating appropriate modifications, as required. For FY 1996 and beyond, these costs are escalated at the assumed annual inflation of 3 percent per year. Discounted future net cash flows are calculated using a 10 percent mid-period discount factor.

STANDARDIZED MEASURE OF
NPR-1 FUTURE NET CASH FLOWS
AS OF SEPTEMBER 30, 1996
(in thousands)

Future cash inflows	$ 8,574,244
Future costs	(2,894,330)
Future net cash flows	5,679,914
10% annual discount for estimated timing of cash flows	(3,780,942)
Standardized measure of discounted future net cash flows relating to proved oil and gas reserves	$ 1,898,972

Limitations of the Financial Statements

The financial statements have been prepared to report the financial position and results of operations of NPR-1.

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.

Unaudited - see accompanying accountants report.

KPMG Peat Marwick LLP

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

Independent Auditors' Report on Financial Statements

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

We have audited the accompanying statements of financial position of the U.S. Department of Energy (DOE) Naval Petroleum Reserve Number 1 (NPR-1) as of September 30, 1996 and 1995, and the related statements of operations and changes in net position, and cash flows for the years then ended. These financial statements are the responsibility of NPR-1 management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with generally accepted auditing standards. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the 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.

As described in Note 1, the financial statements were prepared in conformity with the hierarchy of accounting principles and standards defined in U.S. Office of Management and Budget Bulletin No. 94-01, *Form and Content of Agency Financial Statements*. This hierarchy is a comprehensive basis of accounting other than generally accepted accounting principles.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of NPR-1 at September 30, 1996 and 1995, and the results of its operations and changes in net position, and cash flows for the years then ended in conformity with the accounting policies described in Note 1.

Our audits were made for the purpose of forming an opinion on the financial statements taken as a whole. The information presented in management's overview is presented for purposes of additional analysis and is not a required part of the financial statements. We have considered whether this information is materially inconsistent with the financial statements. Such information has not been subjected to the auditing procedures applied in the audits of the financial statements and, accordingly, we do not express an opinion on it.

KPMG Peat Marwick LLP

Salt Lake City, Utah
November 15, 1996

U.S. DEPARTMENT OF ENERGY

NAVAL PETROLEUM RESERVE NUMBER 1

Statements of Financial Position

September 30, 1996 and 1995

Assets	1996	1995
Current assets:		
Fund balance with U.S. Treasury and cash (note 2)	$ 516,149,393	535,120,203
Accounts receivable (note 3)	39,757,706	19,380,848
Inventories (note 4)		
Materials and supplies, net	2,893,002	3,835,483
Product inventories held for sale	1,891,318	2,629,304
Advances and prepayments, net	101,765	123,033
Total current assets	560,793,184	561,088,871
Property, plant, and equipment:		
Drilling and development	783,105,521	754,075,060
Production facilities	378,543,893	372,721,196
Gas plants	167,881,233	166,507,902
General property	30,082,240	30,006,405
Less joint owner share	280,156,692	273,237,036
	1,079,456,195	1,050,073,527
Less accumulated depreciation	584,287,797	550,093,823
	495,168,398	499,979,704
Construction in process, net	7,127,991	9,788,662
Net property and equipment	502,296,389	509,768,366
Total assets	$ 1,063,089,573	1,070,857,237
Liabilities		
Current liabilities:		
Accounts payable	$ 21,504,989	23,965,225
Accrued liabilities (note 5)	47,100,086	5,337,529
Total current liabilities	68,605,075	29,302,754
Unfunded liabilities, net (note 6)	58,587,701	45,395,840
Total liabilities	127,192,776	74,698,594
Net Position		
Net position	935,896,797	996,158,643
Total liabilities and net position	$ 1,063,089,573	1,070,857,237

See accompanying notes to financial statements.

U.S. DEPARTMENT OF ENERGY

NAVAL PETROLEUM RESERVE NUMBER 1

Statements of Operations and Changes in Net Position

Years ended September 30, 1996 and 1995

	1996	1995
Product revenues:		
Crude	$ 304,339,013	294,024,918
Dry gas	36,603,692	33,009,540
Natural gasoline	18,479,957	10,236,354
Propane	18,236,680	16,197,731
Butane	9,893,616	6,685,299
Isobutane	4,441,098	3,919,290
Total product revenues	391,994,056	364,073,132
Other revenues:		
Cogeneration	2,422,688	1,945,573
Pipeline tariff	370,797	561,250
Other	418,677	36,437
Total other revenues	3,212,162	2,543,260
Total revenues	395,206,218	366,616,392
Expenses (note 7):		
Operating expenses	75,048,141	99,910,360
General and administrative	31,723,672	42,421,117
Total gross operating expenses	106,771,813	142,331,477
Less joint owner interest	20,760,619	28,432,753
Net expenses	86,011,194	113,898,724
Depreciation	39,079,163	36,876,459
Unfunded expenses	13,165,397	5,932,293
Total expenses	138,255,754	156,707,476
Net income before appropriations and transfers	256,950,464	209,908,916
Appropriations	129,386,000	168,247,055
Transferred to U.S. Treasury	(424,710,132)	(397,470,542)
Shortage of net income and appropriations under transfers	$ (38,373,668)	(19,314,571)
Net position:		
Net position, beginning balance, as previously stated	$ 996,158,643	1,015,473,214
Adjustment (note 14)	(21,888,178)	-
Net position, beginning balance, as restated	974,270,465	1,015,473,214
Shortage of net income and appropriations under transfers	(38,373,668)	(19,314,571)
Net position, ending balance	$ 935,896,797	996,158,643

See accompanying notes to financial statements.

U.S. DEPARTMENT OF ENERGY

NAVAL PETROLEUM RESERVE NUMBER 1

Statements of Cash Flows

Years ended September 30, 1996 and 1995

	1996	1995
Cash flows from operating activities:		
Net income before appropriations and transfers	$ 256,950,464	209,908,916
Adjustments affecting cash flow:		
Depreciation	39,079,163	36,876,459
Provision for inventory obsolescence	21,195	4,242,572
Increase in unfunded environmental restoration liabilities	11,378,000	7,901,140
Increase (decrease) in unfunded pension, other retirement benefits, and accrued annual leave	1,813,861	(1,968,617)
Increase in accounts receivable	(20,376,858)	(3,499,389)
Decrease in inventories	1,659,272	732,978
Decrease in prepayments	21,268	5,193
Decrease in accounts payable	(2,460,236)	(8,269,829)
Increase (decrease) in accrued liabilities	41,762,557	(410,772)
Net cash provided by operating activities	329,848,686	245,518,651
Cash flows from investing activities - purchases of property and equipment	(31,607,186)	(26,220,881)
Cash flows from financing activities:		
Appropriations	129,386,000	168,247,055
Adjustment (note 14)	(21,888,178)	-
Transferred to U.S. Treasury	(424,710,132)	(397,470,542)
Net cash used in financing activities	(317,212,310)	(229,223,487)
Net cash used in operating, investing, and financing activities	(18,970,810)	(9,925,717)
Fund balance with U.S. Treasury and cash, beginning of year	535,120,203	545,045,920
Fund balance with U.S. Treasury and cash, end of year	$ 516,149,393	535,120,203

See accompanying notes to financial statements.

U.S. DEPARTMENT OF ENERGY

NAVAL PETROLEUM RESERVE NUMBER 1

Notes to Financial Statements

September 30, 1996 and 1995

(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 and changes in net position of the Naval Petroleum Reserve Number 1 (NPR-1). They have been prepared from the books and records of NPR-1 based on a comprehensive basis of accounting other than generally accepted accounting principles. The hierarchy of accounting principles is defined in OMB Bulletin No. 94-01, *Form and Content of Agency Financial Statements*, and consists of individual standards agreed to and published by the Joint Financial Management Improvement Program principals; form and content requirements included in OMB Bulletin 94-01; accounting standards contained in Department of Energy (DOE) accounting policy, procedures manuals, and related guidance; and accounting principles published by authoritative standard setting bodies and other authoritative sources in the absence of other guidance in the first three parts of this hierarchy and if the use of such accounting principles improves the meaningfulness of the financial statements.

Primary differences between the comprehensive basis of accounting used by NPR-1 and generally accepted accounting principles include certain form and content changes to the financial statements and cash flows, and certain other disclosures. For example, the financial statements of NPR-1 include transactions with the U.S. Treasury that would not occur in the commercial sector.

The NPR-1 financial statements also do not follow all of the form and content requirements of OMB Bulletin No. 94-01. For example, they do not distinguish between intragovernmental and governmental assets and liabilities in the statement of financial position.

(b) Description of Reporting Entity

NPR-1 consists of the DOE's interest in petroleum reserves in California, excluding DOE's interest in Naval Petroleum Reserve No. 2. The principal interests are minerals under the surface lands in Kern County, California. The DOE's interest in NPR-1 is managed by the DOE through DOE's headquarters office in Washington, D.C. In addition to the headquarters, DOE has a site office located in Elk Hills, California, that is responsible for contractor oversight functions. Day-to-day operations are conducted under contract by a management and operating contractor. NPR-1 also contracts for certain services with other DOE field offices.

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

(b) Description of Reporting Entity (continued)

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

The accompanying financial statements of NPR-1 include the accounts of all funds under NPR-1 control.

(i) NPOSR - Headquarters (NPOSR-HQ)

The Secretary of DOE has delegated the overall responsibility for achieving the mission and goal of the Naval Petroleum and Oil Shale Reserves (NPOSR) to the Assistant Secretary for Fossil Energy. Under the Assistant Secretary's direction, the Deputy Assistant Secretary for NPOSR is responsible for programmatic and operational management of NPOSR. The NPOSR headquarters office provides staff support to the Assistant Secretary and Deputy Assistant Secretary. Consequently, certain headquarters expenses including payroll, travel, office equipment purchases, and other administrative services and supplies expense are incurred in support of NPOSR. Headquarters expenses amounted to $5,895,487 (including $3,159,329 of divestment related expense) and $2,336,454 for 1996 and 1995, respectively; however, these expenses are not allocated to the individual units comprising NPOSR and therefore no headquarter expenses are reflected in the NPR-1 financial statements.

(ii) DOE - Site Office

The DOE site office is responsible for monitoring day-to-day operations, and performing contractor oversight functions. The site office reports directly to NPOSR-HQ. Expenses incurred primarily include payroll, certain subcontract costs, travel, and other administrative costs.

(iii) Management and Operating Contractor

Bechtel Petroleum Operations, Inc. (Bechtel) is the management and operating contractor performing operations, maintenance, logistics support, engineering, technical, and administrative services. In return, DOE reimburses all allowable costs under the contract, pays award fees, and provides the property, plant, and equipment necessary for the operations of NPR-1. Bechtel has served as the management and operating contractor for NPR-1 in accordance with DOE contract (No. DE-AC01-85FE60520) since July 31, 1985. As authorized by the Defense Authorization Act (Public Law 104-106), the Bechtel contract has been extended through July 30, 1997.

Bechtel integrates their accounting system with DOE through the use of reciprocal accounts. Bechtel is required under provisions of its contract 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.

(c) Basis of Accounting

Transactions are recorded on an accrual basis of accounting. 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.

The statements of financial position exclude Chevron's interests in NPR-1 for the respective asset and liability amounts, except for current liabilities. Current liabilities are presented gross with an offsetting receivable for Chevron's interest. Joint interest reimbursements billed to Chevron for its respective share of the costs incurred to operate NPR-1 are presented in the accompanying statements of operations and changes in net position; however, such reimbursements are not a component of net income.

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

(d) Appropriations and Revenues

Congress annually adopts a budget appropriation providing NPR-1 with funding to meet operating and capital expense requirements.

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. Proceeds from sales at NPR-1 are deposited into the U.S. Treasury as required by the Production Act of 1976. Revenues included in the statements of operations and changes in net position are net of Chevron's interest.

(e) Funds with the U.S. Treasury

NPR-1 does not maintain cash in commercial bank accounts. Cash receipts and disbursements are processed by the U.S. Treasury. Funds with the U.S. Treasury represent appropriated funds that are available to pay current liabilities and finance authorized purchase commitments. Cash balances held outside the U.S. Treasury represent imprest cash amounts.

Revenues from the sale of petroleum products are deposited in the U.S. Treasury's Miscellaneous Receipts account and are not available for expenditure by NPR-1.

(f) Inventories

NPR-1 inventories held for sale consist primarily of crude oil in the pipeline that is valued at the current market price. NPR-1 operating materials and supplies consist of inventories that will be consumed in future operations. 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.

(f) Inventories (continued)

Gas balancing arrangements are accounted for using the entitlements method. Over (under) allocations are recorded as an offset to inventory and amounted to ($43,809) and $533,328 for 1996 and 1995, respectively.

(g) 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. 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, and production facilities based on the units-of-production method. Depreciation of gas plant, 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.

(h) Advances and Prepayments

Payments in advance of the receipt of goods and services are recorded as prepaid charges at the time of prepayment and recognized as expenses when the related goods or services are received.

(i) Liabilities

Liabilities represent the amount of monies or other resources that are likely to be paid by NPR-1 as the result of a transaction or event that has already occurred. However, no liability can be paid by NPR-1 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 NPR-1 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 expended as leave is taken.

(k) Retirement Plans

NPR-1 personnel, as employees of either DOE or Bechtel, may be participants in certain benefit plans. Bechtel sponsors a defined-benefit pension plan and a defined-benefit health care plan for certain retirees and employees. The provisions of these plans are discussed in note 11. DOE does not report plan assets, accumulated plan benefits, or unfunded liabilities, if any, applicable to its employees. Reporting such amounts is the responsibility of the Office of Personnel Management and the Federal Employees Retirement System.

Statement of Federal Financial Accounting Standards (SFFAS) No. 4, *Managerial Cost Accounting Concepts and Standards for the Federal Government*, directs the full cost reporting of employment benefits by employing entity. Under this concept, NPR-1 will be required to accrue the costs to the Federal government of providing pension, life, health, and other post-employment benefits (severance payments, counseling and training, workers' compensation benefits, etc.) "regardless of whether the benefits are funded by the reporting entity or by direct appropriations to the trust funds." SFFAS No. 4 will be effective for fiscal years beginning after September 30, 1996.

(l) Reclassifications

Certain reclassifications have been made in order to conform 1995 financial information with the 1996 financial information format. These reclassifications do not impact the financial position or results of operations of NPR-1.

(m) Use of Estimates

NPR-1 management has made certain estimates and assumptions relating to the reporting of assets and liabilities and the disclosure of contingent assets and liabilities to prepare these financial statements. Actual results could differ from these estimates.

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

A federal entity's fund balance with Treasury is the aggregate amount of funds in the entity's accounts with Treasury for which the entity is authorized to make expenditures and pay liabilities. Fund balance with Treasury is an intragovernmental asset; that is, it is a claim of a federal entity against another federal entity. From the reporting entity's perspective, a fund balance with Treasury is an asset because it represents the federal entity's claim to the federal government's resources. However, from the perspective of the federal government as a whole, it is not an asset; and while it represents a commitment to make resources available to federal departments, agencies, programs and other entities, it is not a liability. Fund balances (appropriated) with the U.S. Treasury and cash include the following as of September 30, 1996 and 1995:

	1996	1995
Unexpended allotments	$ 92,721,471	112,552,282
Unapportioned revenues	423,424,922	422,564,921
Petty cash	3,000	3,000
Total	$ 516,149,393	535,120,203

(3) Accounts Receivable

Accounts receivable, which arise from transactions with nonfederal entities, include the following as of September 30, 1996 and 1995:

	1996	1995
Crude oil sales	$ 28,292,474	8,752,421
Other product sales	6,165,687	2,057,219
Chevron's share of billed operating costs	2,792,348	6,539,402
Chevron's share of unbilled operating costs	1,799,974	1,417,349
Cogeneration	554,000	478,568
Other	153,223	135,889
Total	$ 39,757,706	19,380,848

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(4) Inventories

Inventories include the following as of September 30, 1996 and 1995:

	1996	1995
Materials and supplies	$ 11,149,173	12,373,230
Less allowance for obsolescence and overstocking	7,418,024	7,439,219
Less Chevron's interest	838,147	1,098,528
Total materials and supplies	2,893,002	3,835,483
Product inventories held for sale	1,891,318	2,629,304
Total	$ 4,784,320	6,464,787

(5) Accrued Liabilities

Accrued liabilities include the following as of September 30, 1996 and 1995:

	1996	1995
Due to U.S. Treasury for uncollected receivables and unsold product inventories (note 14)	$ 41,550,555	-
Due to U.S. Treasury for reimbursement of legal claims paid	1,390,802	-
Compensated absences	2,329,060	2,206,600
Payroll and employee benefits	1,279,669	2,153,269
Funded pension expense	550,000	977,660
Total	$ 47,100,086	5,337,529

(6) Unfunded Liabilities

Unfunded liabilities net of Chevron's share include the following as of September 30, 1996 and 1995:

	1996	1995
Environmental restoration	$ 43,379,140	32,001,140
Postretirement benefits other than pension	13,178,100	12,208,560
Pension	1,749,611	931,754
DOE annual leave	280,850	254,386
Total	$ 58,587,701	45,395,840

(7) Expenses

DOE and Chevron share unit expenses in accordance with the unit plan contract. Gross expenses, excluding DOE direct expenses, include Chevron's interest. However, costs charged to Chevron are subtracted in total to determine net expenses. Expenses include the following during 1996 and 1995:

	1996	1995
Operating expenses:		
Oil and gas production:		
Wages and benefits	$ 18,337,789	25,423,127
Subcontract services	24,855,572	28,777,134
Materials and supplies	9,206,818	10,502,624
Other	5,604,436	15,479,407
	58,004,615	80,182,292
Gas gathering and processing:		
Wages and benefits	5,507,444	6,308,882
Subcontract services	3,277,637	3,209,852
Materials and supplies	4,923,233	5,436,710
Other	361,378	699,419
	14,069,692	15,654,863
Congeneration:		
Wages and benefits	379,741	887,201
Subcontract services	372,531	238,561
Materials and supplies	557,725	384,829
Other	54,500	369,734
	1,364,497	1,880,325
Environmental:		
Wages and benefits	476,370	490,631
Subcontract services	983,971	1,528,091
Materials and supplies	8,382	9,063
Other	140,614	165,095
	1,609,337	2,192,880
Total operating expenses	75,048,141	99,910,360

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(7) Expenses (continued)

	1996	1995
General and administrative:		
Bechtel expenses:		
Wages and benefits	$ 7,861,679	16,766,443
Contract operator award fee	5,305,450	5,367,000
Subcontract services	277,070	683,260
Materials and supplies	281,813	153,443
Other	7,790,061	9,298,512
	21,516,073	32,268,658
DOE direct expenses:		
Wages and benefits	3,479,301	3,578,958
Subcontract services	5,948,413	6,012,223
Other	779,885	561,278
	10,207,599	10,152,459
General and administrative	31,723,672	42,421,117
Gross expenses	106,771,813	142,331,477
Cost charged to joint owner	(20,760,619)	(28,432,753)
Net expenses	86,011,194	113,898,724
Depreciation:		
Wells and production equipment	32,425,308	28,512,727
Gas gathering and processing	5,428,226	6,641,440
Other	1,225,629	1,722,292
	39,079,163	36,876,459
Unfunded expenses:		
Pension expense	817,857	(2,073,537)
Postretirement other than pension	969,540	104,690
Environmental restoration	11,378,000	7,901,140
	13,165,397	5,932,293
Total expenses	$ 138,255,754	156,707,476

The oil and gas production expenses include dry hole costs, contained primarily in the subcontract services line, of $1,067,144 and $1,043,810 for 1996 and 1995, respectively.

(8) Operating Leases

Bechtel has entered into an operating lease for a telephone communication system. The lease required payments of approximately $226,600 annually and expires in December 1996.

Bechtel has entered into various rental agreements for equipment used in NPR-1 operations on a day-to-day and/or month-to-month basis. Rent expense, net of Chevron's interest, amounted to approximately $1,559,246 and $2,136,067 for 1996 and 1995, respectively.

(9) Related Party Transactions

Vehicles are leased on a month-to-month basis to NPR-1 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, net of Chevron's interest, are summarized as follows for 1996 and 1995:

	1996	1995
Rent expense	$ 1,001,352	1,130,746
Reimbursement of operating expenses	(330,396)	(365,913)

Certain management, construction, and support services are provided to Bechtel by its respective general and central staff organization, or by affiliated companies. Cost of services provided amounted to ($28,982) and $348,539 for 1996 and 1995, respectively. These costs were reviewed and approved by the DOE site office.

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Notes to Financial Statements

(10) Sales Commitments

NPR-1 sells crude oil, natural gas, and various natural gas liquids (NGL) produced at NPR-1. Products are sold under contracts ranging from one month to one year. Invoice prices are based on established indices which are adjusted monthly with a specific bid premium or discount applied to the index specified in the sales contracts. NPR-1 had the following product sales commitments under the applicable pricing mechanism in effect at September 30, 1996:

Product	Units of Measure*	Bid Quantity	Index**	Premium / Discount Low	High
Crude Oil	Bbls/day	15,000	NYMEX	$(2.0850)	$(1.8480)
Crude Oil	Bbls/day	29,350	Postings	(0.0514)	0.2570
Natural Gas	MMBtu/day	77,800	Index Prices	(0.0048)	(0.0027)
Natural Gasoline	Gallons/day	113,500	Postings	(0.0199)	0.0000
NGL	Gallons/day	219,500	OBG	(0.0649)	0.0671

* Units of measure: Bbls = barrels; MMBtu = Million British thermal units
** Description of indices:

NYMEX - Invoice prices are indexed to the average of closing sweet crude oil prices reported by the New York Mercantile Exchange for the last 10-days of the near-month. The invoice price is constant during the delivery month.

Postings - Postings are prices at which refineries offer to buy oil. NPR-1 oil and NPR-1 natural gasoline are sold at a bonus/discount to the average of the three highest postings for their region. The invoice prices may change several times each month.

Index Prices - Natural Gas prices are calculated once each month and are tied to the monthly index prices reported by *Inside FERC's Gas Market Report* and *Natural Gas Week's Natural Gas Intelligence*.

OBG - NGL invoice prices are calculated once each month, and are indexed to spot prices published in *Bloomberg's Oil Buyers' Guide*.

(11) 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, 1996 and 1995:

	1996	1995
Actuarial present value of benefit obligations:		
Vested benefit obligation	$ 18,278,162	16,230,897
Accumulated benefit obligation	$ 18,645,478	16,787,791
Projected benefit obligation for services rendered to date	$ 24,702,881	23,440,470
Plan assets at fair value	(21,052,179)	(18,684,413)
Plan assets less than projected benefit obligation	3,650,702	4,756,057
Unrecognized net loss	(3,425,517)	(5,495,648)
Unrecognized prior service cost	168,849	187,878
Unrecognized net asset recognized over 15 years	2,399,057	2,723,930
	2,793,091	2,172,217
Less Chevron's portion	614,480	474,233
Accrued pension cost*	$ 2,178,611	1,697,984

* Includes unfunded pension costs of $1,749,611 and $931,754 for 1996 and 1995, respectively.

(11) Pension and Other Retirement Benefits (continued)

The net pension cost includes the following for 1996 and 1995:

	1996	1995
Service cost-benefits earned during the period	$ 1,303,924	1,594,823
Interest cost on projected benefit obligation	1,756,756	1,713,744
Actual return on plan asset	(1,608,675)	(3,147,214)
Net amortization and deferral	(116,284)	1,837,944
	1,335,721	1,999,297
Curtailment (voluntary termination) effect	-	(2,251,369)
	1,335,721	(252,072)
Less Chevron's portion	293,859	(55,456)
Net pension cost (gain)	$ 1,041,862	(196,616)

Assumptions used in accounting for the pension plan for 1996 and 1995, are as follows:

	1996	1995
Discount rate	7.75%	7.50%
Rate of increase in compensation level	5.00%	5.00%
Expected long-term rate of return on assets	8.50%	8.00%

The discount rate is 7.75% as of October 1, 1996.

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.

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Notes to Financial Statements

(11) Pension and Other Retirement Benefits (continued)

The following table sets forth the plan's status as of September 30, 1996 and 1995:

	1996	1995
Accumulated postretirement benefit obligation:		
Retirees	$ 4,647,000	1,900,000
Fully eligible active plan participants	2,852,000	3,658,000
Other active plan participant	7,825,000	6,689,000
Total accumulated postretirement benefit obligation	15,324,000	12,247,000
Plan assets at fair value	-	-
Accumulated postretirement benefit obligation in excess of plan assets	15,324,000	12,247,000
Unrecognized net gain	1,571,000	3,405,000
	16,895,000	15,652,000
Less Chevron's interest	3,716,900	3,443,440
Accrued postretirement benefit cost included in unfunded liabilities	$ 13,178,100	12,208,560

Net period postretirement benefit cost for 1996 and 1995 includes the following components:

	1996	1995
Service cost	$ 889,000	954,000
Interest cost	1,065,000	1,099,000
Actual return on plan assets	-	-
Net amortization and deferral	-	-
	1,954,000	2,053,000
Curtailment effect	-	(1,615,000)
	1,954,000	438,000
Less Chevron's interest	429,880	96,360
Net periodic postretirement benefit cost	$ 1,524,120	341,640

(11) <u>Pension and Other Retirement Benefits</u> (continued)

For measurement purposes, an annual rate of increase in the per-capita cost of covered benefits (i.e., health care cost trend rate) of 8.5 percent (medical) and 7.1 percent (dental) were assumed for 1996. Both rates were assumed to decrease gradually to 5.5 percent by the year 2002 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, 1996 by $2,402,000 and the aggregate of the service and interest cost components of net periodic postretirement benefit cost for the year ended September 30, 1996 by $388,000.

The weighted average discount rate used in determining the accumulated postretirement benefit obligation was 7.75 percent as of September 30, 1996. Funded costs for postretirement benefits other than pension amounted to $304,000, and $164,000 for 1996 and 1995, respectively.

The following table sets forth the reconciliation of unfunded pension and other retirement benefits as of September 30, 1996:

	Total	Chevron's portion	DOE's portion
Unfunded pension liability	$ 2,243,091	493,480	1,749,611
Funded portion	550,000	121,000	429,000
Total pension liability	$ 2,793,091	614,480	2,178,611

Unfunded pension liability (SFAS No. 87)	$ 1,749,611
Accrued unfunded post retirement benefit cost (SFAS No. 106)	13,178,100
Total pension liability	$ 14,927,711

All permanent DOE employees participate in either the Civil Service Retirement System (CSRS), or the Federal Employees Retirement System (FERS). DOE makes matching contributions equal to 7 percent of pay to the CSRS. Most employees hired after December 31, 1983, are automatically covered by FERS and Social Security. Employees hired prior to January 1, 1984, can elect to either join FERS and Social Security or remain in CSRS. A primary feature of FERS is that it offers a savings plan to DOE employees, in which DOE 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 $422,472 and $466,254 for 1996 and 1995, respectively.

(11) Pension and Other Retirement Benefits (continued)

All regular employees of Bechtel are eligible to participate in a company sponsored 401(k) retirement plan. Bechtel matches employee contributions fifty cents per dollar for employee contributions up to 6 percent of compensation for all plan participants. Total contributions to the plan amounted to $498,209 and $745,172 for 1996 and 1995, respectively.

(12) 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. Participating percentages are determined in proportion to the weighted acre-feet of commercially productive formations (zones) underlying their respective surface lands as of November 20, 1942. The participating percentages in effect at September 30, 1996, were calculated based upon equity studies dated in 1957 for the Shallow Oil Zone (SOZ), 1976 for the Carneros Zone, 1980 for the Stevens Zone, and 1994 for the Dry Gas Zone (although the two parties have tentatively agreed to continue using the 1942 percentages pending resolution of the SOZ). In accordance with the Unit Plan Contract, production participation (proportionate participating percentages) for Elk Hills will be adjusted retroactively to 1942 at such time that updated equity studies are completed and agreed-upon by the two parties.

DOE and Chevron are in the process of revising the participating percentages of the SOZ. In November 1995, an independent petroleum engineer hired by both parties to study the issue released a report showing DOE's participation in the SOZ decreasing from 70.0119 percent to 65.7786 percent. If the participating percentages in this report are adopted, DOE would owe Chevron approximately 12.7 million barrels of crude oil due to past production and 3.9 million barrels of future production based on remaining reserves at September 30, 1995. This could equate to Chevron receiving all of DOE's share of production from the SOZ for approximately 3.5 years to pay back the 12.7 million barrels. At $15 per barrel, the 12.7 million barrels of payback oil is worth approximately $190 million, and the 3.9 million barrels of future additional production is worth approximately $58.5 million. DOE believes that the consultant study contains serious methodological errors, and has challenged the results. The next stage in resolving the dispute is the responsibility of the Assistant Secretary for Fossil Energy, who can accept or reject the report, or ask for additional work.

(a) Ownership Adjustments (continued)

During FY 1995, DOE and Chevron completed a redetermination of participating percentages that increased DOE's percentage for the Dry Gas Zone from 77.0492 percent to 83.8726 percent. The two parties have postponed a settlement agreement for the Dry Gas Zone pending resolution of the SOZ dispute. Participating percentages for all zones are being finalized for divestment as required by the 1996 Defense Authorization Act (see note 15, "Divestment of Naval Petroleum Reserve No. 1"). The nonunit Asphalto Zone is owned 100 percent by DOE and therefore participating percentages in this zone are not a consideration.

Management of NPOSR believes that the reserve figures found in the *FY 1995 Long Range Plan--Naval Petroleum Reserves in California Vol. II (LRP)* reasonably reflect the hydrocarbons to be recovered from NPR-1. The reserves are being updated as part of the divestiture effort. The DOE anticipates issuing a new reserve report in April 1997.

(b) Environmental and Site Restoration

NPR-1 and other oil and gas entities 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 NPR-1 to endeavor to comply with applicable environmental laws and regulations.

NPR-1 is obligated for environmental cleanup and site-restoration requirements as individual wells and facilities are abandoned and, ultimately, as operations are terminated. Total future cleanup and restoration costs at NPR-1 are estimated at $328 million (based on FY 1995 LRP, proved reserves development case). NPR-1 started recognizing an unfunded liability for the estimated restoration costs in 1993. The portion of costs recognized each year is based on the ratio of actual revenues to total estimated revenues over the remaining life of the facility. As of September 30, 1996 and 1995, the recognized unfunded liability was $43,379,140 and $32,001,140, respectively.

(c) Litigation and Claims

At present, NPR-1 is a party in various administrative proceedings, legal actions, alleged personal injury, and claims brought by or against it. In the opinion of NPR-1 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 NPR-1.

(c) Litigation and Claims (continued)

Currently, there is one case pending which involves a claim with the Energy Board of Contract Appeals (EBCA). In 1985, the appellant filed a claim alleging it had been overcharged for crude oil purchased from DOE in November 1979. The appellant argues DOE improperly interpreted certain terms in the contract and claims damages and interest of approximately $1.85 million. While this case was pending, the EBCA decided a parallel case involving interpretation of the same contract clauses. Because of the similarity of the issues, DOE filed a motion for summary judgment, which was granted in favor of DOE in August 1994. The unsuccessful party in the parallel case appealed the EBCA decision to the U.S. Court of Appeals for the Federal Circuit. In December 1995, the Federal Circuit rejected EBCA's utilization of *stare decisis* and collateral estoppel and remanded the case to EBCA for trial on two issues. The parties completed the trial portion of the case in March 1997. The judge established a post trial briefing schedule that ends mid July 1997, and will issue a decision in due course.

(13) Significant Customers

The following customers each accounted for greater than 10 percent of total revenue from public sources at NPR-1, during 1996:

Customer	1996
Texaco Trading/Texaco Refining/ Texaco Natural Gas	$59,232,432
Celeron Gathering/Celeron Trading & Transportation	73,118,561
Koch Oil	47,224,523

(14) Change in Recording Liabilities to the U.S. Treasury

Effective October 1, 1995, NPR-1 adopted DOE Accounting Handbook (Handbook), Chapter 13, paragraph 10 *Miscellaneous Receipts*. The Handbook requires that miscellaneous receipts be recorded in conformity with account codes as defined in the United States Government Standard General Ledger (SGL) chart of accounts. The SGL requires that certain miscellaneous receipts, which pursuant to law are required to be remitted to the U.S. Treasury, be accrued as a liability to the U. S. Treasury at the time the miscellaneous receipt receivable is established. As of October 1, 1995, NPOSR established a liability and reduced fund balance for the amount of miscellaneous receipts receivable at that date. This resulted in an adjustment to beginning fund balance of $21,888,178.

(15) Divestment of Naval Petroleum Reserve Number 1

The Defense Authorization Act for FY 1996 (Act), which authorizes and outlines the process for the sale of NPR-1, was approved by Congress and signed into law by President Clinton on February 10, 1996. The Act requires that the sale be completed within two years from the date of enactment, or February 10, 1998. As outlined in the Act, DOE must contract the services of a team of divestment advisors to administer the sale, prepare a reserve report, finalize equity with Chevron, and establish a minimum acceptable price for the Government's approximate 78 percent share of the Elk Hills field. The current time line established by DOE for the divestiture calls for a solicitation of offers to be issued in April 1997, with purchase proposals due in September 1997. Sale of the Government's interest in the Elk Hills field could be the largest sale of a single federal asset since the privatization of Conrail in 1987.