PETROLEUM DEVELOPMENT CORP
Form 10-Q/A
December 23, 2005

CONFORMED COPY

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-Q/A

Amendment No. 1 to Form 10-Q

[X] Quarterly Report Pursuant to Section 13 or 15(d) of

the Securities Exchange Act of 1934

For the period ended March 31, 2005

OR

[ ] Transition Report Pursuant to Section 13 of 15(d) of

the Securities Exchange Act of 1934

For the transition period from ____ to

Commissions file number 0-7246

I.R.S. Employer Identification Number 95-2636730

PETROLEUM DEVELOPMENT CORPORATION

(A Nevada Corporation)

103 East Main Street

Bridgeport, WV 26330

Telephone: (304) 842-6256

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes _ No XX

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date: 16,589,824 shares of the Company's Common Stock ($.01 par value) were outstanding as of April 30, 2005.

Indicate by check mark whether the registrant is an accelerated filer (as definition in Rule 12b-2 of the Exchange Act).
Yes XX No __

PETROLEUM DEVELOPMENT CORPORATION AND SUBSIDIARIES

INDEX

EXPLANATORY NOTE - 2005 RESTATEMENT

Overview

As previously reported on Form 10-K/A as filed with the Securities and Exchange Commission on December 13, 2005, the Company identified that certain derivative transactions, certain aspects of the Company's oil and gas property accounting including methods used to calculate depreciation for oil and gas properties and possible impairments of the carrying values of those properties, incorrect adoption of an accounting standard and certain aspects of its income tax provision were accounted for improperly. Accordingly this amendment to the Quarterly Report on Form 10-Q for the quarter ended March 31, 2005 (the "Form 10-Q") of Petroleum Development Corporation (the "Company") is being filed in order to restate the condensed consolidated financial statements as of March 31, 2005 and 2004 and for the quarters ended March 31, 2005 and 2004 and to make corresponding changes to Item 2, Management's Discussion and Analysis of Financial Condition and Results of Operations, and Item 4, Controls and Procedures. Certain restated prior periods as previously reported on Form 10-K/A for 2004 are reflected in this Form 10-Q/A and noted as restated. See restatement Note 10 on Page 13 of this filing.

This non-cash restatement had the following effect on Net Income:

	Quarter Ended March 31,	
	(Unaudited)	(Unaudited)
(In thousands)	2005	2004
Net income as previously reported	$13,338	$8,439
Adjustments to net income	(2,698)	(733)
Restated net income	$10,640	$7,706

This non-cash restatement had the following effect on Stockholders' Equity:

	As of March 31,	
	(Unaudited)	(Unaudited)
(In thousands)	2005	2004
Stockholders' equity as previously reported	$ 173,818	$ 134,330
Adjustments to Stockholders' equity	(9,040)	(10,576)
Restated Stockholders' equity	$ 164,778	$ 123,754

No attempt has been made in this Form 10-Q/A to update other disclosures presented in the Form 10-Q, except as required to reflect the effects of the restatement. This Form 10-Q/A does not reflect events occurring after the filing to the Form 10-Q or modify or update these disclosures, including exhibits to the Form 10-Q affected by subsequent events. Information not affected by the restatement is unchanged and reflects the disclosures made at the time of the original filing of the Form 10-Q. This Form 10-Q/A includes, however, as Exhibits 31.1, 31.2, and 32.1 new certifications of the Company's Chief Executive Officer and Chief Financial Officer, as required by applicable rules. Accordingly, this Form 10-Q/A should be read in conjunction with the Company's filings made with the Securities and Exchange Commission subsequent to the filing of the Form 10-Q, including any amendments to those filings.

History of Accounting Issues

Please refer to the Annual Report on Form 10-K/A for the year ended December 31, 2004, for more information.

As a part of its preparation of the financial statements for the quarter ended June 30, 2005, the Company undertook a review of its accounting for oil and gas derivatives. The Company uses derivative instruments as a means of reducing financial exposure to fluctuating oil and gas prices and interest rates. The Company included changes from period to period in the fair value of derivatives classified as cash flow hedges ("Hedges") as increases and decreases to Accumulated Other Comprehensive Income ("AOCI") as allowed by Statement of Financial Accounting Standards No. 133, "Accounting for Derivative Instruments and Hedging Activities" ("FAS 133"). This Hedge accounting treatment is allowed for certain derivatives, including the types of derivatives used by the Company to reduce exposure to changes in oil and gas prices associated with the sale of oil and gas production and for its natural gas marketing operations and interest rates. In order to qualify for Hedge accounting treatment, specific standards and documentation requirements must be met. The Company believed that its longstanding derivative accounting treatment was permitted under FAS 133. However, after a review of the applicable derivative accounting rules, the Company's accounting policies and documentation of the Company's derivatives, management determined that the Company's derivatives did not qualify for Hedge accounting under FAS 133. The management of the Company reported its determination to the Audit Committee and with the approval of the Committee postponed the filing of its second quarter financial statements until the appropriate accounting could be determined and completed.

In conjunction with the work to correct the Hedge accounting, the Company conducted a thorough review of its financial statements and accounting policies. As a result of the review additional issues were identified that were incorrectly accounted for and needed to be corrected. After determining the impact of the required changes the Company determined that restatements of previously filed financial reports were necessary. These previously filed financial reports should not be relied upon. Descriptions of the errors corrected in this restatement follow:

1. The Company revised its accounting for its derivative transactions, primarily due to the reasons set forth below. The Company used hedge accounting for derivative positions that did not qualify for hedge accounting. These errors began in the first quarter of 2001, the effective date of FAS 133, and continued through the first quarter of 2005.

a. The Company did not have sufficient documentation required for these derivatives to qualify for hedge accounting treatment and did not test them periodically for effectiveness as required by FAS 133.

b. The Company did not record the fair value of certain natural gas purchases and sales contracts which were deemed to be derivatives on its consolidated balance sheet, and changes in fair value were not recorded in earnings.

c. The Company reported the fair value of derivative transactions entered into on behalf of its affiliated partnerships on the balance sheet net of the amount due to/from the partnerships. The fair value of these derivative transactions should have been reported at gross.

2. The Company revised its accounting for oil and gas properties primarily due to the following reasons.

a. The Company's division of its oil and gas properties into fields for calculation of depreciation and depletion and for the determination of impairments was not consistent with applicable rules in FAS 19. According to FAS 19, a field is defined to be "an area consisting of a single reservoir or multiple reservoirs all grouped on or related to the same individual geological structural feature and/or stratigraphic condition". In accounting for its oil and gas properties, the Company included areas that should have been treated as separate fields as part of a single field. The financial impacts of corrections to divide the Company's oil and gas properties into revised fields were included in the restated financial statements.

b. It was determined that certain policies and procedures the Company followed for calculating quarterly depreciation were incorrect. The Company utilized the previous annual oil and gas reserve reports to estimate quarterly depreciation and adjusted the yearly depreciation based upon the new oil and gas reserve report at the end of the next year. However, each interim period's depreciation must stand on its own and should not be adjusted at the year end upon the issuance of a new oil and gas reserve report. The financial impacts of corrections to calculate each interim period's depreciation on its own were included in the restated financial statements.

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c. The Company also used its proved developed reserves, as defined by Securities and Exchange Commission rules, to calculate depreciation. The Company's proved developed reserves included the anticipated recompletion of the Codell formation in Wattenberg Field in Colorado as well as behind pipe zones in the Appalachian Basin. After reviewing the rules, the Company concluded that both the future estimated costs and the reserves from these "behind pipe reserves" should be excluded in calculating the depreciation amounts. This change resulted in increases in depreciation compared to the method previously used by the Company until the recompletions and behind pipe reserves are completed. The financial impacts of corrections to exclude both the future estimated costs and the reserves from these "behind pipe reserves" in calculating depreciation amounts were included in the restated financial statements.

3. The Company revised its accounting for its asset retirement obligations due to the following reason.

a. The Company interpreted FAS No. 143 as requiring the recording of a liability based on the probable occurrence of certain conditional future events. The Company incorrectly based its estimates of future disposal costs of wells on its historical record of disposing of its wells in ways that transferred asset retirement costs to other parties. The Company has concluded that a liability should be recognized when a legal obligation exists, regardless of conditional future events, and that the full fair value of potential future disposal costs should have been recorded despite the Company's historical practice of transferring most of the obligation to other parties. This error began in the first quarter of 2003, the effective date of FAS No.143, and continued through the first quarter of 2005 and is being corrected through this restatement.

4. The Company revised its accounting for its provision for income taxes in its financial statements due to the following reason.

a. The Company incorrectly determined the portion of the percentage depletion of oil and gas properties for tax purposes which was treated as a permanent difference in the calculation of its tax provision, and incorrectly determined the classification of certain accrued and deferred income tax balances.

During the review and its determination of the magnitude of the errors, management of the Company reported its progress to the Audit Committee, KPMG LLP and to the Board of Directors. On the basis of its analysis of the errors, the management recommended to the Audit Committee and the Board of Directors on October 17, 2005 that previously reported financial results should be restated to reflect the correction of the errors. The Audit Committee agreed with this recommendation. Pursuant to the recommendation of the Audit Committee, the Board of Directors determined at its meeting on October 17, 2005 that the previously reported results for Petroleum Development Corporation be restated to correct the errors in the accounting for derivatives and in the Company's oil and gas property accounting. In light of the restatement the Board of Directors also determined that the financial statements and other information containing the errors should no longer be relied upon.

Based on the information to date, these accounting issues did not influence incentive or other compensation in the past. Going forward the adjustments in the restated financials will not be used to influence positively any person's compensation.

Restatement

In response to the issues raised by the review of the Company's accounting policies and procedures described above:

1. We have completed a review of the documentation and accounting for derivative transactions used by the Company for its commodity based derivative transactions and interest rate swap.

2. We will account for existing and future derivative transactions as non-hedges unless they meet all of the requirements for treatment as cash flow hedges including the appropriate documentation.

3. We have revised our division of properties into fields to correspond with the definition of "fields" according to FAS 19.

4. We have revised our policies and procedures for calculating depreciation, depletion and amortization to correct the errors previously identified.

5. We have revised our policies and procedures for calculating asset retirement obligations to correct errors previously identified.

6. We have revised our policies and procedures for calculating our income tax provision to correct errors previously identified.

7. We have implemented extensive employee training and purchased additional financial and tax reporting software programs.

8. We have obtained the services of a derivatives expert and are in the process of obtaining an oil and gas accounting and income tax specialist for consulting and review services.

We have restated the previously issued financial statements to reverse the effects of the incorrect use of hedge accounting, the errors in oil and gas property accounting, the error in calculating the asset retirement obligations, and the error in income taxes.

Effects of the Restatement

The following tables set forth the effects of the restatement with respect to the quarters ended March 31, 2005 and 2004.

Effects on Statements of Income

Income (expense)(in thousands; per-share amounts in dollars)	Quarter Ended March 31, (Unaudited) 2005	(Unaudited) 2004
Depreciation, depletion, and amortization	$ (32)	$ (36)
Asset retirement obligations	$ (104)	$ (97)
Disqualification of hedge accounting	(4,147)	(1,013)
Provision for income taxes	1,585	413
Net decrease in reported net income	$ (2,698)	$ (733)
Basic, as reported	$ 0.80	$ 0.53
Adjustment	(0.16)	(0.04)
Basis, as restated	$ 0.64	$ 0.49
Diluted, as reported	$ 0.80	$ 0.52
Adjustment	(0.16)	(0.05)
Diluted, as restated	$ 0.64	$ 0.47

As set forth in Item 4 of this Form 10-Q/A and more fully described in item 9A of the Annual Report on Form 10-K/A filed by the Company with respect to the year ended December 31, 2004, the Company has determined that its disclosure controls and procedures were not effective as of March 31, 2005.

PART I - FINANCIAL INFORMATION

Report of Independent Registered Public Accounting Firm

The Board of Directors

Petroleum Development Corporation:

We have reviewed the accompanying condensed consolidated balance sheet of Petroleum Development Corporation and subsidiaries as of March 31, 2005, and the related condensed consolidated statements of income and cash flows for the three-month periods ended March 31, 2005 and 2004. These condensed consolidated financial statements are the responsibility of the Company's management.

We conducted our reviews in accordance with the standards of the Public Company Accounting Oversight Board (United States). A review of interim financial information consists principally of applying analytical review procedures and making inquiries of persons responsible for financial and accounting matters. It is substantially less in scope than an audit conducted in accordance with the standards of the Public Company Accounting Oversight Board (United States), the objective of which is the expression of an opinion regarding the financial statements taken as a whole. Accordingly, we do not express such an opinion.

Based on our reviews, we are not aware of any material modifications that should be made to the condensed consolidated financial statements referred to above for them to be in conformity with U. S. generally accepted accounting principles.

We have previously audited, in accordance with standards of Public Company Accounting Oversight Board (United States), the consolidated balance sheet of Petroleum Development Corporation and subsidiaries as of December 31, 2004, and the related consolidated statements of income, stockholders' equity and cash flows for the year then ended (not presented herein); and in our report dated March 30, 2005, except as to the restatement discussed in Note 22 to the consolidated financial statements which is as of December 13, 2005, we expressed an unqualified opinion on those consolidated financial statements. As discussed in that report, the consolidated financial statements as of December 31, 2004 and 2003, and for each of the years in the three-year period ended December 31, 2004 have been restated and the report also included an explanatory paragraph referring to a change in accounting for asset retirement obligations in 2003. In our opinion, the information set forth in the accompanying condensed consolidated balance sheet as of December 31, 2004 is fairly stated, in all material respects, in relation to the consolidated balance sheet from which it has been derived.

As discussed in note 10 to the condensed consolidated financial statements the Company has restated the condensed consolidated balance sheets as of March 31, 2005 and December 31, 2004, and the condensed consolidated statements of income and cash flows for the three month periods ended March 31, 2005 and 2004.

KPMG LLP

Pittsburgh, Pennsylvania

May 5, 2005, except as to note 10, which is as of December 16, 2005

PETROLEUM DEVELOPMENT CORPORATION AND SUBSIDIARIES

Condensed Consolidated Balance Sheets

March 31, 2005 and December 31, 2004

<u>ASSETS</u>

	2005 (Unaudited) (Restated)	2004 (Restated)
Current assets:		
Cash and cash equivalents	$ 94,629,100	$ 77,735,300
Accounts and notes receivable	36,247,100	36,065,300
Inventories	3,837,600	1,657,300
Prepaid expenses	8,819,100	9,878,900
Total current assets	143,532,900	125,336,800
Properties and equipment	319,677,500	299,748,700
Less accumulated depreciation, depletion and amortization	97,000,200	92,165,400
	222,677,300	207,583,300
Other assets	2,667,700	2,108,200
	$ 368,877,900	$ 335,028,300

(Continued)

PETROLEUM DEVELOPMENT CORPORATION AND SUBSIDIARIES

Condensed Consolidated Balance Sheets, Continued

March 31, 2005 and December 31, 2004

LIABILITIES AND STOCKHOLDERS' EQUITY

	2005 (Unaudited) (Restated)	2004 (Restated)
Current liabilities:		
Accounts payable and accrued expenses	$ 78,527,500	$ 69,696,600
Advances for future drilling contracts	54,421,100	42,497,300
Funds held for future distribution	15,404,400	12,911,800
Total current liabilities	148,353,000	125,105,700
Long-term debt	18,000,000	21,000,000
Other liabilities	5,086,400	3,927,500
Deferred income taxes	24,500,700	22,976,300
Asset retirement obligations	8,160,100	7,998,200
Stockholders' equity:		
Common stock par value $0.01 per share; authorized 50,000,000 shares; issued and outstanding 16,589,824 shares and 16,589,824 shares	165,800	165,800
Additional paid-in capital	37,684,300	37,684,300
Retained earnings	127,692,400	117,052,500
Unamortized stock award	(764,800)	(882,000)
Total stockholders' equity	164,777,700	154,020,600
	$ 368,877,900	$ 335,028,300

See accompanying notes to unaudited condensed consolidated financial statements.

PETROLEUM DEVELOPMENT CORPORATION AND SUBSIDIARIES

Condensed Consolidated Statements of Income

Three Months ended March 31, 2005 and 2004

(Unaudited)

	2005 (Restated)	2004 (Restated)

Revenues:				
Oil and gas well drilling operations	$	32,351,200	$	29,499,300
Gas sales from marketing activities		17,522,000		22,058,900
Oil and gas sales		18,663,700		16,316,200
Well operations and pipeline income		2,112,400		1,837,500
Other income		6,213,800		58,100
Total revenues		76,863,100		69,770,000
Costs and expenses:				
Cost of oil and gas well drilling operations		27,629,000		25,355,700
Cost of gas marketing activities		17,901,600		21,889,700
Oil and gas production and well operations cost		4,163,400		3,906,100
General and administrative expenses		1,617,500		994,200
Depreciation, depletion, and amortization		4,856,900		4,544,400
Total costs and expenses		56,168,400		56,690,100
Income from operations		20,694,700		13,079,900
Interest expense		147,800		209,600
Oil and gas price risk management loss, net		3,659,100		830,000
Income before income taxes		16,887,800		12,040,300
Income taxes		6,247,900		4,334,400
Net income	$	10,639,900	$	7,705,900
Basic earnings per common share	$	0.64	$	0.49
Diluted earnings per common share	$	0.64	$	0.47

See accompanying notes to unaudited condensed consolidated financial statements.

PETROLEUM DEVELOPMENT CORPORATION AND SUBSIDIARIES

Condensed Consolidated Statements of Cash Flows

Three Months Ended March 31, 2005 and 2004

(Unaudited)

	2005 (Restated) (a)	2004 (Restated) (a)

Cash flows from operating activities:		
Net income	$10,639,900	$ 7,705,900
Adjustments to net income to reconcile to cash provided by (used in) operating activities:		
Deferred federal income taxes	1,524,400	2,373,800
Depreciation, depletion & amortization	4,856,900	4,544,400
Accretion of asset retirement obligation	115,000	105,700
(Gain)/loss from sale of assets	(5,163,100)	3,000
Leasehold acreage expired or surrendered	9,100	51,000
Amortization of stock award	117,200	900
Unrealized loss on derivative transactions	4,147,500	1,012,900
Decrease (increase) in current assets	4,966,400	(20,600)
Decrease in other assets	13,000	18,800
Increase (decrease) in current liabilities	13,273,700	(28,915,700)
(Decrease) increase in other liabilities	(870,400)	168,900
Total adjustments	22,989,700	(20,656,900)
Net cash provided by (used in) operating activities	33,629,600	(12,951,000)
Cash flows from investing activities:		
Capital expenditures	(20,099,500)	