Kosmos Energy Ltd.
Form 10-Q
November 10, 2011
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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

(Mark One)

x QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the quarterly period ended September 30, 2011

o TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the transition period from to

Commission file number: 001-35167

Kosmos Energy Ltd.

(Exact name of registrant as specified in its charter)

Bermuda (State or other jurisdiction of incorporation or organization)	**98-0686001** (I.R.S. Employer Identification No.)
Clarendon House **2 Church Street** **Hamilton, Bermuda** (Address of principal executive offices)	**HM 11** (Zip Code)

Registrant s telephone number, including area code: **+1 441 295 5950**

Not applicable

(Former name, former address and former fiscal year, if changed since last report)

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 x No o

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes x No o

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of large accelerated filer, accelerated filer and smaller reporting company in Rule 12b-2 of the Exchange Act.

Large accelerated filer o	Accelerated filer o
Non-accelerated filer x (Do not check if a smaller reporting company)	Smaller reporting company o

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes o No x

Indicate the number of shares outstanding of each of the issuer s classes of common stock, as of the latest practicable date.

Class	Outstanding at November 1, 2011
Common Shares, $0.01 par value	389,867,068

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GLOSSARY AND SELECT ABBREVIATIONS

The following are abbreviations and definitions of certain terms used in this report. Unless listed below, all defined terms under Rule 4-10(a) of Regulation S-X shall have their statutorily prescribed meanings.

ASC	Financial Accounting Standards Board Accounting Standards Codification.
ASU	Financial Accounting Standards Board Accounting Standards Update.
Barrel or *bbl*	A standard measure of volume for petroleum corresponding to approximately 42 gallons at 60 degrees Fahrenheit.
boe	Barrels of oil equivalent. Volumes of natural gas are converted to barrels of oil using a conversion factor of 6,000 cubic feet of natural gas to one barrel of oil.
boepd	Barrels of oil equivalent per day.
bopd	Barrels of oil per day.
bwpd	Barrels of water per day.
Dated Brent	Refers to a cargo of blended North Sea Brent crude oil that has been assigned a date for loading onto a tanker. Physically, Brent is light but still heavier than West Texas Intermediate crude.
Development	The phase in which an oil or natural gas field is brought into production by drilling development wells and installing appropriate production systems.
Development well	A well drilled within the proved area of an oil or gas reservoir to the depth of a stratigraphic horizon known to be productive.
Drilling and completion costs	All costs, excluding operating costs, of drilling, completing, testing, equipping and bringing a well into production or plugging and abandoning it, including all costs associated with labor and other construction and installation, location and surface damages, cementing, drilling mud and chemicals, drillstem tests and core analysis, engineering and well site geological expenses, electric logs, plugging back, deepening, rework operations, repairing or performing remedial work of any type, plugging and abandoning.
Dry hole	A well that has not encountered a hydrocarbon bearing reservoir.
E&P	Exploration and production.
Exploration well or *Exploratory well*	A well drilled either (a) in search of a new and an as yet undiscovered pool of oil or natural gas or (b) with the hope of significantly extending the limits of a pool already developed.
FASB	Financial Accounting Standards Board.
Field	A geographical area under which an oil or natural gas reservoir exists in commercial quantities.
Finding and development costs	Capital costs incurred in the acquisition, exploration, appraisal and development of proved oil and natural gas reserves divided by proved reserve additions.
FPSO	Floating production, storage and offloading vessel.
Mbbl	Thousand barrels of oil.
Mcf	Thousand cubic feet of natural gas.
Mcfpd	Thousand cubic feet per day of natural gas.
Mmbbl	Million barrels of oil.
Mmboe	Million barrels of oil equivalent.
Mmcf	Million cubic feet of natural gas.
Natural gas	Natural gas is a combination of light hydrocarbons that, in average pressure and temperature conditions, is found in a gaseous state. In nature, it is found in underground accumulations, and may potentially be dissolved in oil or may also be found in its gaseous state.
Plan of development or *PoD*	A written document outlining the steps to develop a field.
Producing well	A well that is found to be capable of producing hydrocarbons in sufficient quantities so that proceeds from the sale of such production exceed production expenses and taxes.

Prospect(s)	A potential trap that may contain hydrocarbons and is supported by the necessary amount and quality of geologic and geophysical data to indicate a probability of oil and/or natural gas accumulation ready to be drilled. The five required elements (generation, migration, reservoir, seal and trap) must be present for a prospect to work and if any of them fail neither oil nor natural gas will be present, at least not in commercial volumes.

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Proved reserves	Estimated quantities of crude oil, natural gas and natural gas liquids that geological and engineering data demonstrate with reasonable certainty to be economically recoverable in future years from known reservoirs under existing economic and operating conditions, as well as additional reserves expected to be obtained through confirmed improved recovery techniques, as defined in SEC Regulation S-X 4-10(a)(2).
Royalty	A fractional undivided interest in the production of oil and natural gas wells or the proceeds therefrom to be received free and clear of all costs of development, operations or maintenance.
Working interest	A percentage of ownership in an oil and gas license granting its owner the right to explore, drill and produce oil and gas from a tract of property. Working interest owners are typically obligated to pay a corresponding percentage of the cost of leasing, drilling, producing and operating a well or unit. The working interest also entitles its owner to share in production with other working interest owners based on the percentage of working interest owned.

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KOSMOS ENERGY LTD.

CONSOLIDATED BALANCE SHEETS

(In thousands, except share data)

	September 30, 2011 (Unaudited)	December 31, 2010
Assets		
Current assets:		
Cash and cash equivalents	$ 656,442	$ 100,415
Restricted cash	22,949	80,000
Receivables:		
Joint interest billings	89,614	124,449
Oil sales	114,933	
Notes	109,441	113,889
Other	4,734	615
Inventories	33,010	37,674
Prepaid expenses and other	15,733	13,278
Current deferred tax assets	50,127	89,600
Total current assets	1,096,983	559,920
Property and equipment:		
Oil and gas properties, net of accumulated depletion of $90,872 and $6,430, respectively	1,122,904	989,869
Other property, net of accumulated depreciation of $7,300 and $5,343, respectively	8,102	8,131
Property and equipment - net	1,131,006	998,000
Other assets:		
Restricted cash	3,500	32,000
Long-term receivables - joint interest billings, net of allowance		21,897
Deferred financing costs and other assets, net of accumulated amortization of $4,388 and $32,093, respectively	57,041	78,217
Long-term deferred tax assets	2,297	
Derivatives		1,501
Total assets	$ 2,290,827	$ 1,691,535
Liabilities and shareholders equity/unit holdings equity		
Current liabilities:		
Current maturities of long-term debt	$	$ 245,000
Accounts payable	197,224	163,495
Accrued liabilities	41,409	53,208
Derivatives	30,023	20,354
Total current liabilities	268,656	482,057
Long-term liabilities:		
Long-term debt	1,000,000	800,000
Derivatives	9,674	15,104
Asset retirement obligations	19,622	16,752
Deferred tax liability	12,513	12,513
Other long-term liabilities	15,661	1,014

Total long-term liabilities		1,057,470		845,383
Convertible preferred units, 100,000,000 units authorized:				
Series A zero and 30,000,000 units issued at September 30, 2011 and December 31, 2010, respectively				383,246
Series B zero and 20,000,000 units issued at September 30, 2011 and December 31, 2010, respectively				568,163
Series C zero and 884,956 units issued at September 30, 2011 and December 31, 2010, respectively				27,097
Shareholders equity/unit holdings equity:				
Preference shares, $0.01 par value; 200,000,000 authorized shares; zero issued at September 30, 2011 and December 31, 2010				
Common shares, $0.01 par value; 2,000,000,000 authorized shares; 390,214,659 and zero issued at September 30, 2011 and December 31, 2010, respectively		3,902		
Common units, 100,000,000 units authorized; zero and 19,069,662 issued at September 30, 2011 and December 31, 2010, respectively				516
Additional paid-in capital		1,607,754		
Accumulated deficit		(650,471)		(615,515)
Accumulated other comprehensive income		3,522		588
Treasury stock, at cost, 646,235 and zero shares at September 30, 2011 and December 31, 2010, respectively		(6)		
Total shareholders equity/unit holdings equity		964,701		(614,411)
Total liabilities, convertible preferred units and shareholders equity/unit holdings equity	$	2,290,827	$	1,691,535

See accompanying notes.

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KOSMOS ENERGY LTD.

CONSOLIDATED STATEMENTS OF OPERATIONS

(In thousands, except per share data)

(Unaudited)

	Three Months Ended September 30, 2011	Three Months Ended September 30, 2010	Nine Months Ended September 30, 2011	Nine Months Ended September 30, 2010
Revenues and other income:				
Oil and gas revenue	$ 230,262	$	$ 446,914	$
Interest income	2,492	675	7,459	2,548
Other income	91	1,313	735	3,793
Total revenues and other income	232,845	1,988	455,108	6,341
Costs and expenses:				
Oil and gas production	24,185		58,481	
Exploration expenses, including dry holes	11,005	18,960	104,657	52,764
General and administrative	39,093	27,845	72,140	50,804
Depletion and depreciation	42,593	578	88,960	1,655
Amortization - deferred financing costs	2,194	7,644	13,999	20,555
Interest expense	16,581	19,146	55,239	45,645
Derivatives, net	(4,984)	10,339	5,250	15,310
Loss on extinguishment of debt			59,643	
Doubtful accounts expense			(39,782)	
Other expenses, net	(79)	31	(18)	20
Total costs and expenses	130,588	84,543	418,569	186,753
Income (loss) before income taxes	102,257	(82,555)	36,539	(180,412)
Income tax expense (benefit)	50,481	(6)	48,505	(174)
Net income (loss)	51,776	(82,549)	(11,966)	(180,238)
Accretion to redemption value of convertible preferred units		(16,661)	(24,442)	(48,602)
Net income (loss) attributable to common shareholders/unit holders	$ 51,776	$ (99,210)	$ (36,408)	$ (228,840)
Net income (loss) per share attributable to common shareholders:				
Basic	$ 0.13			
Diluted	$ 0.13			
Pro forma basic			$ (0.03)	
Pro forma diluted			$ (0.03)	
Weighted average number of shares used to compute net income (loss) per share:				
Basic	368,996			
Diluted	369,341			

Pro forma basic	349,792
Pro forma diluted	349,792

See accompanying notes.

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CONSOLIDATED STATEMENTS OF SHAREHOLDERS EQUITY/UNIT HOLDINGS EQUITY

(In thousands)

(Unaudited)

	Common Units		Common Shares		Additional Paid-in	Accumulated	Accumulated Other Comprehensive	Treasury	
	Units	Amount	Shares	Amount	Capital	Deficit	Income	Stock	Total
Balance as of December 31, 2010	19,070	$ 516		$	$	$ (615,515)	$ 588	$	$ (614,411)
Issuance of profit units	1,783								
Relinquishments of profit units	(2,686)								
Equity-based compensation					29,264				29,264
Derivatives, net							2, 934		2,934
Accrete convertible preferred units to redemption amount					(1,452)	(22,990)			(24,442)
Common shares issued upon corporate reorganization	(18,167)	(516)	341,177	3,412	1,000,052				1,002,948
Common shares issued at initial public offering, net of offering costs			34,518	345	580,029				580,374
Restricted stock awards			14,520	145	(145)				
Restricted stock forfeitures					6			(6)	
Net loss						(11,966)			(11,966)
Balance as of September 30, 2011		$	390,215	$ 3,902	$ 1,607,754	$ (650,471)	$ 3,522	$ (6)	$ 964,701

See accompanying notes.

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KOSMOS ENERGY LTD.

CONSOLIDATED STATEMENTS OF CASH FLOWS

(In thousands)

(Unaudited)

	Nine Months Ended September 30, 2011	2010
Operating activities		
Net loss	$ (11,966)	$ (180,238)
Adjustments to reconcile net loss to net cash provided by (used in) operating activities:		
Depletion, depreciation and amortization	102,959	22,210
Deferred income taxes	37,176	
Unsuccessful well costs	87,845	43,127
Derivative related activity	8,674	25,630
Equity-based compensation	29,264	1,672
Doubtful accounts expense	(39,782)	
Loss on extinguishment of debt	59,643	
Other	1,939	(265)
Changes in assets and liabilities:		
Increase in receivables	(36,786)	(59,696)
(Increase) decrease in inventories	2,126	(3,188)
Increase in prepaid expenses and other	(2,455)	(6,216)
Increase in accounts payable	33,729	34,574
Decrease in accrued liabilities	(5,220)	(10,790)
Net cash provided by (used in) operating activities	267,146	(133,180)
Investing activities		
Oil and gas assets	(282,098)	(330,173)
Other property	(1,928)	(1,113)
Notes receivable	4,448	(60,878)
Restricted cash	85,551	(59,000)
Net cash used in investing activities	(194,027)	(451,164)
Financing activities		
Borrowings under long-term debt	1,393,000	665,000
Payments on long-term debt	(1,438,000)	
Net proceeds from the initial public offering	580,374	
Deferred financing costs	(52,466)	(17,315)
Net cash provided by financing activities	482,908	647,685
Net increase in cash and cash equivalents	556,027	63,341
Cash and cash equivalents at beginning of period	100,415	139,505
Cash and cash equivalents at end of period	$ 656,442	$ 202,846
Supplemental cash flow information		
Cash paid for:		
Interest	$ 36,854	$ 35,125
Income taxes	$ 850	$ 762

Non-cash activity:				
Deemed payment and termination of notes receivable	$		$	90,197

See accompanying notes.

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KOSMOS ENERGY LTD.

CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (LOSS)

(In thousands)

(Unaudited)

	Three Months Ended September 30, 2011	Three Months Ended September 30, 2010	Nine Months Ended September 30, 2011	Nine Months Ended September 30, 2010
Net income (loss)	$ 51,776	$ (82,549)	$ (11,966)	$ (180,238)
Other comprehensive income (loss):				
Change in fair value of cash flow hedges				(4,838)
Loss on cash flow hedge included in operations	1,193	1,278	2,934	4,383
Other comprehensive income (loss)	1,193	1,278	2,934	(455)
Comprehensive income (loss)	$ 52,969	$ (81,271)	$ (9,032)	$ (180,693)

See accompanying notes.

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KOSMOS ENERGY LTD.

Notes to Consolidated Financial Statements

(Unaudited)

1. Organization

Kosmos Energy Ltd. was incorporated pursuant to the laws of Bermuda in January 2011 to become a holding company for Kosmos Energy Holdings. Kosmos Energy Holdings is a privately held Cayman Islands company that was formed March 5, 2004. As a holding company, Kosmos Energy Ltd. s management operations are conducted through a wholly owned subsidiary, Kosmos Energy, LLC. The terms Kosmos, the Company, we, us, our, ours, and similar terms when used in the present tense or prospectively or for historical periods since May 16, 2011 r to Kosmos Energy Ltd. and its wholly owned subsidiaries and for historical periods prior to May 16, 2011 refer to Kosmos Energy Holdings and its wholly owned subsidiaries, unless the context indicates otherwise. We are an independent oil and gas exploration and production company focused on underexplored regions in Africa. Kosmos Energy Ltd. transitioned from its development stage to operational activities in January 2011. Accordingly, reporting as a development stage company is no longer deemed necessary.

Contemporaneous with Kosmos Energy Ltd. s initial public offering, the Series A Convertible Preferred Units, Series B Convertible Preferred Units and Series C Convertible Preferred Units (collectively the Convertible Preferred Units) and common units of Kosmos Energy Holdings were exchanged into common shares based on the pre-offering equity value of such interests in our corporate reorganization (the corporate reorganization). This resulted in the Convertible Preferred Units and the common units being exchanged into 277,697,828 and 63,478,643 common shares of Kosmos Energy Ltd., respectively, or 341,176,471 common shares in the aggregate. The 341,176,471 common shares included 10,032,827 restricted shares issued to management and employees in exchange for unvested profit units in connection with our corporate reorganization. The common shares have one vote per share and a par value of $0.01. As a result of this corporate reorganization, Kosmos Energy Holdings became wholly owned by Kosmos Energy Ltd.

Kosmos Energy Ltd. completed its initial public offering of 33,000,000 common shares on May 16, 2011. In June 2011, the Company closed the sale of an additional 1,518,242 common shares pursuant to the over-allotment option exercised by the underwriters of the initial public offering. This partial exercise of the over-allotment option brings the total number of common shares sold in the offering to 34,518,242. Our net proceeds from the sale of 34,518,242 common shares, after underwriting discounts and commissions and offering expenses, were $580.4 million.

We have one business segment, which is the exploration and production of oil and natural gas.

2. Accounting Policies

General

The interim-period financial information presented in the consolidated financial statements included in this report is unaudited and, in the opinion of management, includes all adjustments of a normal recurring nature necessary to present fairly the consolidated financial position as of September 30, 2011, the consolidated results of operations for the three and nine months ended September 30, 2011 and 2010, and consolidated cash flows for the nine months ended September 30, 2011 and 2010. The results of the interim periods shown in this report are not necessarily indicative of the final results to be expected for the full year. These consolidated financial statements and the accompanying notes should be read in conjunction with our audited consolidated financial statements for the year ended December 31, 2010, included in our final prospectus.

Principles of Consolidation

The accompanying consolidated financial statements include the accounts of Kosmos Energy Ltd. and its wholly owned subsidiaries. All intercompany transactions have been eliminated.

Use of Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States requires management to make estimates and assumptions that affect the reported amounts of assets, liabilities, revenues and expenses, and the disclosures of contingent assets and liabilities. Actual results could differ from these estimates.

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Cash and Cash Equivalents

Cash and cash equivalents consist of all demand deposits and funds invested in highly liquid instruments with original maturities of three months or less at the date of purchase.

Restricted Cash

As of September 30, 2011, we had $22.9 million of current restricted cash related to funds that will be utilized for payment on interest and commitment fees on our commercial debt facility. In accordance with our commercial debt facility, we are required to maintain a balance that is sufficient to meet the payment of interest and fees for the next six-month period. The $3.5 million long-term restricted cash is related to cash collateralization for performance guarantees related to our petroleum agreements.

As of December 31, 2010, in accordance with our commercial debt facilities that existed as of December 31, 2010, we had restricted cash of $89.0 million, of which $80.0 million was included in current assets. Additionally, effective December 30, 2010, we provided a $23.0 million cash collateralized irrevocable standby letter of credit (Letter of Credit) with respect to our share of Tullow Ghana Limited s (TGL) Letter of Credit related to TGL s drilling contract for the Eirik Raude semi-submersible rig. In March 2011, the restricted cash related to the debt facilities agreement and the cash collateral for the Letter of Credit was released as a result of our debt refinancing. The Letter of Credit was collateralized by our available borrowing capacity under the commercial debt facility until it expired on September 14, 2011.

Receivables

The Company s receivables consist of joint interest billings, oil sales, notes and other receivables for which the Company generally does not require collateral security. Receivables from joint interest owners are stated at amounts due, net of an allowance for doubtful accounts. We determine our allowance by considering the length of time past due, future net revenues of the debtor s ownership interest in oil and natural gas properties we operate, and the owner s ability to pay its obligation, among other things. The Company s allowances for doubtful accounts totaled zero and $39.8 million as of September 30, 2011 and December 31, 2010, respectively. See Note 5 Joint Interest Billings.

Inventories

Inventories consisted of $26.6 million and $25.2 million of materials and supplies and $6.4 million and $12.5 million of hydrocarbons as of September 30, 2011 and December 31, 2010, respectively. The Company s materials and supplies inventory primarily consists of casing and wellheads and is stated at the lower of cost, using the weighted average cost method, or market.

Hydrocarbon inventory is carried at the lower of cost, using the weighted average cost method, or market. Hydrocarbon inventory costs include expenditures and other charges (including depletion) directly and indirectly incurred in bringing the inventory to its existing condition. Selling expenses and general and administrative expenses are reported as period costs and excluded from inventory costs.

Exploration and Development Costs

The Company follows the successful efforts method of accounting for costs incurred in oil and natural gas exploration and production operations. Acquisition costs for proved and unproved properties are capitalized when incurred. Costs of unproved properties are transferred to proved properties when proved reserves are found. Exploration costs, including geological and geophysical costs and costs of carrying unproved properties, are expensed as incurred. Exploratory drilling costs are capitalized when incurred. If exploratory wells are determined to be commercially unsuccessful or dry holes, the applicable costs are expensed. Costs incurred to drill and equip development wells, including unsuccessful development wells, are capitalized. Costs incurred to operate and maintain wells and equipment and to lift oil and natural gas to the surface are expensed.

The Company evaluates unproved property periodically for impairment. These costs are generally related to the acquisition of leasehold costs. The impairment assessment considers results of exploration activities, commodity price outlooks, planned future sales or expiration of all or a portion of such projects. If the quantity of potential future reserves determined by such evaluations is not sufficient to fully recover the cost invested in each project, the Company will recognize an impairment loss at that time.

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Depletion, Depreciation and Amortization

Proved properties and support equipment and facilities are depleted using the unit-of-production method based on estimated proved oil and natural gas reserves. Capitalized exploratory drilling costs that result in a discovery of proved reserves and development costs are amortized using the unit-of-production method based on estimated proved developed oil and natural gas reserves for the related field.

Depreciation and amortization of other property is computed using the straight-line method over the assets estimated useful lives (not to exceed the lease term for leasehold improvements), ranging from three to seven years.

	Years Depreciated
Leasehold improvements	6
Office furniture, fixtures and computer equipment	3 to 7
Vehicles	5

Amortization of deferred financing costs is computed using the straight-line method over the life of the related debt.

Capitalized Interest

Interest costs from external borrowings are capitalized on major projects with an expected construction period of one year or longer. Capitalized interest is added to the cost of the underlying asset and is amortized over the useful lives of the assets in the same manner as the underlying assets.

Asset Retirement Obligations

The Company accounts for asset retirement obligations as required by ASC 410 Asset Retirement and Environmental Obligations. Under these standards, the fair value of a liability for an asset retirement obligation is recognized in the period in which it is incurred if a reasonable estimate of fair value can be made. If a reasonable estimate of fair value cannot be made in the period the asset retirement obligation is incurred, the liability is recognized when a reasonable estimate of fair value can be made. If a tangible long-lived asset with an existing asset retirement obligation is acquired, a liability for that obligation is recognized at the asset s acquisition date. In addition, a liability for the fair value of a conditional asset retirement obligation is recorded if the fair value of the liability can be reasonably estimated. We capitalize the asset retirement costs by increasing the carrying amount of the related long-lived asset by the same amount as the liability. We record increases in the discounted abandonment liability resulting from the passage of time in depletion and depreciation in the consolidated statement of operations.

Variable Interest Entity

A variable interest entity (VIE), as defined by ASC 810 Consolidation, is an entity that by design has insufficient equity to permit it to finance its activities without additional subordinated financial support or equity holders that lack the characteristics of a controlling financial interest. VIEs are consolidated by the primary beneficiary, which is the entity that has the power to direct the activities of the VIE that most significantly impact the VIE s performance and will absorb losses or receive benefits from the VIE that could potentially be significant to the VIE.

Our wholly owned subsidiaries, Kosmos Energy Finance and Kosmos Energy Finance International, meet the definition of a VIE and the Company, which is the ultimate parent of both subsidiaries, is the primary beneficiary. Kosmos Energy Finance and Kosmos Energy Finance International are consolidated in these financial statements.

As of September 30, 2011 and December 31, 2010, Kosmos Energy Finance had zero and $58.0 million, respectively, in cash and cash equivalents. Kosmos Energy Finance did not have any assets or liabilities as of September 30, 2011, and will have no financial statement activity in the future. As of December 31, 2010, Kosmos Energy Finance s other assets and liabilities are shown separately on the face of the consolidated balance sheet in the following line items: current and long-term restricted cash; deferred financing costs; long-term derivatives asset; current and long-term debt; and current and long-term derivatives liabilities.

Prior to the incorporation of Kosmos Energy Finance International on March 18, 2011, Kosmos Energy Finance International did not have any financial statement activity. Kosmos Energy Finance International s assets and liabilities are shown separately on the face of the consolidated balance sheet as of September 30, 2011, in the following line items: current restricted cash; deferred financing costs; long-term debt; and current and long-term derivatives liabilities. At September 30, 2011, Kosmos Energy Finance International had $157.6 million in cash and cash equivalents, $7.5 million in accrued liabilities and $2.2 million in other long-term liabilities.

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Impairment of Long-lived Assets

The Company reviews its long-lived assets for impairment when changes in circumstances indicate that the carrying amount of an asset may not be recoverable. ASC 360 Property, Plant and Equipment requires an impairment loss to be recognized if the carrying amount of a long-lived asset is not recoverable and exceeds its fair value. The carrying amount of a long-lived asset is not recoverable if it exceeds the sum of the undiscounted cash flows expected to result from the use and eventual disposition of the asset. That assessment shall be based on the carrying amount of the asset at the date it is tested for recoverability, whether in use or under development. An impairment loss shall be measured as the amount by which the carrying amount of a long-lived asset exceeds its fair value. Assets to be disposed of and assets not expected to provide any future service potential to the Company are recorded at the lower of carrying amount or fair value less cost to sell.

Derivative Instruments and Hedging Activities

We utilize oil derivative contracts to mitigate our exposure to commodity price risk associated with our anticipated future oil production. These derivative contracts consist of deferred premium puts and compound options (calls on puts). We also use interest rate swap contracts to mitigate our exposure to interest rate fluctuations related to our commercial debt facilities. Our derivative financial instruments are recorded on the balance sheet as either an asset or a liability measured at fair value. We do not apply hedge accounting to our oil derivative contracts. Effective June 1, 2010, we discontinued hedge accounting on our interest rate swap contracts and accordingly the changes in the fair value of the instruments are recognized in income in the period of change. See Note 10 Derivative Financial Instruments.

Estimates of Proved Oil and Natural Gas Reserves

Reserve quantities and the related estimates of future net cash flows affect our periodic calculations of depletion and impairment of our oil and natural gas properties. Proved oil and natural gas reserves are the estimated quantities of crude oil, natural gas and natural gas liquids that geological and engineering data demonstrate with reasonable certainty to be recoverable in future periods from known reservoirs under existing economic and operating conditions. As additional proved reserves are discovered, reserve quantities and future cash flows will be estimated by independent petroleum consultants and prepared in accordance with guidelines established by the Securities and Exchange Commission and the FASB. The accuracy of these reserve estimates is a function of:

- the engineering and geological interpretation of available data;
- estimates of the amount and timing of future operating cost, production taxes, development cost and workover cost;
- the accuracy of various mandated economic assumptions; and

- the judgments of the persons preparing the estimates.

Revenue Recognition

We use the sales method of accounting for oil and gas revenues. Under this method, we recognize revenues on the volumes sold. The volumes sold may be more or less than the volumes to which we are entitled based on our ownership interest in the property. These differences result in a condition known in the industry as a production imbalance.

Stock-based Compensation

For stock-based compensation equity awards, compensation expense is recognized in the Company s financial statements over the awards vesting periods based on their grant date fair value. The Company utilizes (i) the closing stock price on the date of grant to determine the fair value of service vesting restricted stock awards and (ii) a Monte Carlo simulation to determine the fair value of restricted stock awards with a combination of market and service vesting criteria.

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Income Taxes

The Company accounts for income taxes as required by ASC 740 Income Taxes. Under this method, deferred income taxes are determined based on the difference between the financial statement and tax basis of assets and liabilities using enacted tax rates in effect for the year in which the differences are expected to reverse. Valuation allowances are established when necessary to reduce deferred tax assets to the amounts expected to be realized. On a quarterly basis, management evaluates the need for and adequacy of valuation allowances based on the expected realizability of the deferred tax assets and adjusts the amount of such allowances, if necessary. See Note 15 Income Taxes.

Foreign Currency Translation

The U.S. dollar is the functional currency for the Company s foreign operations. Foreign currency transaction gains and losses and adjustments resulting from translating monetary assets and liabilities denominated in foreign currencies are included in other expenses. Cash balances held in foreign currencies are de minimis, and as such, the effect of exchange rate changes is not material to any reporting period.

Recent Accounting Standards

In May 2011, the FASB issued ASU No. 2011-04, Amendments to Achieve Common Fair Value Measurement and Disclosure Requirements in U.S. GAAP and IFRSs, to develop common requirements for valuation and disclosure of fair value measurements in accordance with U.S. GAAP and International Financial Reporting Standards. This ASU is effective for fiscal years and interim periods within those years beginning after December 15, 2011. We do not expect the adoption of this ASU will have a material effect on our consolidated financial statements.

In June 2011, the FASB issued ASU No. 2011-05, Presentation of Comprehensive Income, to improve the comparability, consistency and transparency of financial reporting and to increase the prominence of items reported in other comprehensive income. This ASU is effective for fiscal years and interim periods within those years beginning after December 15, 2011. We do not expect the adoption of this ASU will have a material effect on our consolidated financial statements.

3. Notes Receivable

Effective May 7, 2010, TGL, as operator of and acting on behalf of the Jubilee Unit parties under the Unitization and Unit Operating Agreement (Jubilee UUOA), entered into an Advance Payments Agreement (Advance Payments Agreement) with MODEC, Inc. (MODEC) related to partial funding of the construction of the FPSO. The payment limit for the Advance Payments Agreement is $466.3 million, of which Kosmos Energy Ghana HC s (Kosmos Ghana) a wholly owned subsidiary, share is $122.2 million. Of the $466.3 million, $341.1 million was deemed to have been advanced from TGL to MODEC. In September 2011, the maturity date of the Advance Payments Agreement was extended from September 15, 2011 to October 28, 2011 (see Note 18 Subsequent Events). MODEC is required to repay TGL on the earlier of the maturity date, or the date of the first drawdown under MODEC s long-term financing. The remaining balance due under the Advance Payments Agreement as of September 30, 2011 and December 31, 2010, was $109.4 million and $113.9 million, respectively. We recognized interest income of $1.5 million and zero for the three months ended September 30, 2011 and 2010, respectively, and $4.3 million and zero for the nine months ended

September 30, 2011 and 2010, respectively.

4. Jubilee Field Unitization

The Jubilee Field in Ghana, discovered by the Mahogany-1 well in June 2007, covers an area within both the West Cape Three Points (WCTP) and Deepwater Tano (DT) Blocks. Consistent with the Ghanaian Petroleum Law, the WCTP and DT Petroleum Agreements and as required by Ghana s Ministry of Energy, it was agreed the Jubilee Field would be unitized for optimal resource recovery. Kosmos Ghana and its partners negotiated a comprehensive unit operating agreement, the Jubilee UUOA, to unitize the Jubilee Field and govern each party s respective rights and duties in the Jubilee Unit. On July 13, 2009, the Ministry of Energy provided its written approval of the Jubilee UUOA. The Jubilee UUOA was executed by all parties and was effective July 16, 2009. The tract participations were 50% for each block. TGL is the Unit Operator, and Kosmos Ghana is the Technical Operator for the development of the Jubilee Field. The accounting for the Jubilee Unit included in these consolidated financial statements is in accordance with the tract participation stated in the Jubilee UUOA. Pursuant to the terms of the Jubilee UUOA, the percentage of such interests is subject to a process of redetermination. The initial redetermination process was completed on October 14, 2011. Any party to the Jubilee UUOA with more than a 10% Unit Interest (participating interest in the Jubilee Unit) may call for a second redetermination after two years from December 1, 2011. As a result of the initial redetermination process, the tract participation was determined to be 54.36660% for the WCTP Block and 45.63340% for the DT Block. Our Unit Interest was increased from 23.50868% (our percentage after Tullow s acquisition of EO Group see Note 5 Joint Interest Billings) to 24.07710%. The consolidated

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financial statements as of September 30, 2011, are based on these redetermined tract participations. As a result of the change in our Unit Interest, we recorded increases in oil and gas properties, inventory, notes receivable, current deferred tax asset and operator general and administrative expenses of $19.4 million, $3.9 million, $2.6 million, $0.2 million and $0.6 million, respectively, with an offsetting reduction of $14.2 million in JIB receivables and an increase of $12.5 million in long-term liabilities. Our capital costs due related to the increased Unit Interest are payable over a two-year period starting in December 2011. Although the Jubilee Field is unitized, Kosmos Ghana s working interest in each block outside the boundary of the Jubilee Unit area was not changed. Kosmos Ghana remains operator of the WCTP Block outside the Jubilee Unit area.

5. Joint Interest Billings

The Company s joint interest billings consist of receivables from partners with interests in common oil and gas properties operated by the Company. Joint interest billings are classified on the face of the consolidated balance sheets as current or long-term based on when collection is expected to occur. As of September 30, 2011 and December 31, 2010, we had $89.6 million and $124.4 million, respectively, included in current joint interest billings receivable and zero and $21.9 million, respectively, were included in long-term joint interest billings receivable. Long-term balances are shown net of allowances of zero and $39.8 million as of September 30, 2011 and December 31, 2010, respectively.

In August 2009, Ghana National Petroleum Corporation (GNPC) notified our unit partners and us that it would exercise its right for the applicable contractor group to pay its 2.5% WCTP Block share and 5.0% DT Block share of the Jubilee Field development costs and be reimbursed for such costs plus interest out of a portion of GNPC s production revenues under the terms of the WCTP Petroleum Agreement and DT Petroleum Agreement, respectively. As of September 30, 2011 and December 31, 2010, the joint interest billing receivable due from GNPC was $22.4 million and $29.6 million, respectively.

EO Group Limited s (EO Group) share of costs under the WCTP Petroleum Agreement until first production occurred were paid by Kosmos Ghana. EO Group was required to reimburse Kosmos Ghana for all development costs paid by Kosmos Ghana on EO Group s behalf. The related receivable became due upon commencement of production in 2010.

On July 22, 2011, Tullow Oil plc closed a transaction to acquire EO Group s entire 3.5% interest in the WCTP Petroleum Agreement, including the correlative interest in the Jubilee Unit. As a result of the transaction, we received full repayment of the long-term joint interest billing receivable related to Jubilee Field development costs paid on EO Group s behalf. The related valuation allowance of $39.8 million was reversed during the second quarter of 2011. In addition, our unit participation interest in the Jubilee Unit increased 0.01738%. This resulted from the elimination of EO Group s carry by the other Jubilee owners of GNPC s additional paying interest of 3.75% in the Jubilee Unit. Our working interest in the remainder of the WCTP Block was not changed by the transaction and remains 30.875% (giving effect to GNPC s optional additional paying interest).

6. Property and Equipment

Property and equipment is stated at cost and consisted of the following:

		September 30, 2011		December 31, 2010
		(In thousands)		
Oil and gas properties, net:				
Proved properties	$	562,363	$	426,831
Unproved properties		255,477		198,149
Support equipment and facilities		395,936		371,319
Less: accumulated depletion		(90,872)		(6,430)
	$	1,122,904	$	989,869

We recorded depletion expense of $41.3 million and zero for the three months ended September 30, 2011 and 2010, respectively, and $85.4 million and zero for the nine months ended September 30, 2011 and 2010, respectively. The Company had depletion costs of $5.5 million and $6.4 million included in crude oil inventory and other receivables as of September 30, 2011 and December 31, 2010, respectively.

7. Suspended Well Costs

The Company capitalizes exploratory well costs into oil and gas properties until a determination is made that the well has either found proved reserves or is impaired. If proved reserves are found, the capitalized exploratory well costs are reclassified to proved properties. The well costs are charged to expense if the exploratory well is determined to be impaired.

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The following table reflects the Company s capitalized exploratory well activities as of and during the nine months ended September 30, 2011. The table excludes $48.0 million in costs that were capitalized and subsequently expensed in the same period.

		September 30, 2011 (In thousands)
Beginning balance (January 1, 2011)	$	167,511
Additions to capitalized exploratory well costs pending the determination of proved reserves		114,717
Reclassification due to determination of proved reserves		
Capitalized exploratory well costs charged to expense		(39,868)
Ending balance (September 30, 2011)	$	242,360

The following table provides aging of capitalized exploratory well costs based on the date drilling was completed and the number of projects for which exploratory well costs have been capitalized for more than one year since the completion of drilling:

		September 30, 2011		December 31, 2010
		(In thousands, except well counts)		
Exploratory well costs capitalized for a period of one year or less	$	108,673	$	49,022
Exploratory well costs capitalized for a period greater than one year		133,687		118,489
Ending balance	$	242,360	$	167,511
Number of projects with exploratory well costs that have been capitalized for more than one year		3		3

As of September 30, 2011, the exploratory well costs capitalized for more than one year since the completion of drilling are the Mahogany-3, Mahogany-4, Mahogany-5 and Mahogany Deep-2 exploration wells in the WCTP Block and the Tweneboa-1, Tweneboa-2 and Enyenra-1 wells in the DT Block. All costs incurred are approximately one to three years old.

Odum Discovery Due to the technical challenges presented by the gravity of the oil encountered in the Odum discovery, we determined to not declare the discovery commercial during the second quarter of 2011. Accordingly, the related suspended well costs associated with the Odum discovery of $32.6 million were written off.

Mahogany East Area Three appraisal wells, Mahogany-4, Mahogany-5 and Mahogany Deep-2, have been drilled. The Mahogany East Area was declared commercial in September 2010, and a plan of development (PoD) was submitted to Ghana s Ministry of Energy as of May 2, 2011. In a letter dated May 16, 2011, the Minister of Energy did not approve the PoD and requested the WCTP PA Block partners make separate declarations for the Mahogany extended area (east of the Jubilee Unit) and Mahogany deep discoveries, which were combined by the WCTP Block partners as Mahogany East in September 2010 and the PoD submission as of May 2, 2011; and requested other information. The WCTP PA partners believe the combined submission was proper and have held meetings with GNPC which resolved issues relating to the work program in the PoD. GNPC and the WCTP PA Block partners continued working to resolve other differences; however, the WCTP PA contains specific timelines for PoD approval and discussions, which expired at the end of June 2011. On June 30, 2011, we, as Operator of the WCTP Block and on behalf of the WCTP PA Block partners, delivered a Notice of Dispute to the Minister of Energy as provided under the WCTP PA. This Notice of Dispute establishes a process for negotiation and consultation for a period of 30 days (or longer if mutually agreed) among senior representatives from the Minister of Energy, GNPC and the WCTP PA Block partners to resolve the matter of approval of the PoD. We and the WCTP Block partners are in discussions with the Ministry of Energy and GNPC to resolve differences on the PoD.

Tweneboa Discovery Three appraisal wells, Tweneboa-2, Tweneboa-3 and Tweneboa-4, have been drilled. Following additional appraisal, drilling and evaluation, a decision regarding commerciality of the Tweneboa discovery is expected to be made by the DT block partners in 2012. Within six months of such a declaration, a plan of development would be prepared and submitted to Ghana s Ministry of Energy.

Enyenra Discovery Two appraisal wells, Enyenra-2A and Enyenra-3A, have been drilled. Following additional appraisal, drilling and evaluation, a decision regarding commerciality of the Enyenra discovery is expected to be made by the DT block partners in 2012. Within six months of such a declaration, a plan of development would be prepared and submitted to Ghana s Ministry of Energy.

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8. Accounts Payable and Accrued Liabilities

At September 30, 2011 and December 31, 2010, $197.2 million and $163.5 million, respectively, were recorded for invoices received but not paid. Accrued liabilities were $41.4 million and $53.2 million at September 30, 2011 and December 31, 2010, respectively, and consisted of the following:

	September 30, 2011		December 31, 2010	
	(In thousands)			
Accrued liabilities:				
Accrued exploration and development	$	15,917	$	26,843
Accrued interest		7,484		655
Accrued general and administrative expenses		6,516		23,393
Taxes other than income		630		1,936
Income taxes		10,862		381
	$	41,409	$	53,208

9. Debt

In March 2011, the Company secured a $2.0 billion commercial debt facility (the Facility) from a number of financial institutions and extinguished the then existing commercial debt facilities. The Facility supports our oil and gas exploration, appraisal and development programs and corporate activities. The total loan commitments of the Facility may be increased up to a maximum of $3.0 billion if the lenders increase their commitments or if loan commitments from new financial institutions are added.

As part of the debt refinancing in March 2011, we recorded a $59.6 million loss on the extinguishment of debt. Additionally, we have $61.3 million of deferred financing costs related to the Facility, which are being amortized over the term of the Facility.

Interest expense was $9.3 million and $10.1 million (net of capitalized interest of $1.0 million and $3.0 million), and commitment fees were $2.2 million and $2.1 million for the three months ended September 30, 2011 and 2010, respectively. Interest expense was $36.6 million and $27.0 million (net of capitalized interest of $3.0 million and $7.1 million) and commitment fees were $5.7 million and $5.2 million for the nine months ended September 30, 2011 and 2010, respectively.

The interest is the aggregate of the applicable margin (3.25% to 4.75%, depending on the amount of the Facility that is being utilized and the length of time that has passed from the date the Facility was entered into); LIBOR; and mandatory cost (if any, as defined in the Facility). Interest is payable on the last day of each interest period (and, if the interest period is longer than six months, on the dates falling at six-month intervals after the first day of the interest period). Kosmos pays commitment fees on the undrawn and unavailable portion of the total commitments. Commitment fees for the lenders are equal to 40% per annum of the then-applicable respective margin when a commitment is available for utilization and, equal to 20% per annum of the then-applicable respective margin when a commitment is not available for utilization. The Company recognizes interest expense in accordance with ASC 835 Interest, which requires interest expense to be recognized using the effective interest method. We determined the effective interest rate based on the estimated level of borrowings under the Facility. Accordingly, we recognized $1.0 million and $2.2 million of additional interest expense during the three and nine months ended September 30, 2011, respectively.

The Facility provides a revolving-credit and letter of credit facility for an availability period that expires on May 15, 2014 (in the case of the revolving-credit facility) and on the final maturity date (in the case of the letter of credit facility). The available facility amount is subject to borrowing base constraints and also is constrained by the amortization schedule (once repayments under the Facility begin). As of May 15, 2014, outstanding borrowings will be subject to an amortization schedule. The first required payment could be as early as June 15, 2014, subject to the level of outstanding borrowings. The Facility has a final maturity date of March 29, 2018.

Kosmos has the right to cancel all the undrawn commitments under the Facility. The amount of funds available to be borrowed under the Facility, also known as the borrowing base amount, is determined each year on June 15 and December 15 as part of a forecast that is prepared by and agreed to by Kosmos and the Technical and Modeling Banks. The formula to calculate the borrowing base amount is based, in part, on the sum of the net present values of net cash flows and relevant capital expenditures reduced by certain percentages. As of September 30, 2011, borrowings under the Facility totaled $1.0 billion. As of September 30, 2011, the undrawn availability under the Facility was an additional $407.3 million.

If an event of default exists under the Facility, the lenders can accelerate the maturity and exercise other rights and remedies, including the enforcement of security granted pursuant to the Facility over certain assets held by us.

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We were in compliance with the financial covenants contained in the Facility as of August 31, 2011, our most recent forecast date, which requires the maintenance of:

- the field life cover ratio, not less than 1.30x; and
- the loan life cover ratio, not less than 1.10x,

in each case, as calculated on the basis of all available information. The field life cover ratio is broadly defined, for each applicable forecast period, as the ratio of (x) net present value of net cash flow through the depletion of the Jubilee Field plus the net present value of capital expenditures incurred in relation to the Jubilee Field and certain other fields in Ghana, to (y) the aggregate loan amounts outstanding under the Facility. The loan life cover ratio is broadly defined, for each applicable forecast period, as the ratio of (x) net present value of net cash flow through the final maturity date of the Facility plus the net present value of capital expenditures incurred in relation to the Jubilee Field and certain other fields in Ghana, to (y) the aggregate loan amounts outstanding under the Facility.

At September 30, 2011, the scheduled maturities of debt during the five year period and thereafter are as follows:

	Payments Due by Year (In thousands)					
	2011 (1)	**2012**	**2013**	**2014**	**2015**	**Thereafter**
Commercial debt facility(2)	$	$	$	$	$	$ 1,000,000

(1) Represents payments for the period October 1, 2011 through December 31, 2011.

(2) The scheduled maturities of debt are based on the level of borrowings and the available borrowing base as of September 30, 2011. Any increases or decreases in the level of borrowings or decreases in the available borrowing base would impact the scheduled maturities of debt during the five year period and thereafter.

10. Derivative Financial Instruments

The Company uses financial derivative contracts to manage exposures to commodity price and interest rate fluctuations. We do not hold or issue derivative financial instruments for trading purposes.

The Company applies the provisions of ASC 815 Derivatives and Hedging, which requires each derivative instrument to be recorded in the balance sheet at fair value. If a derivative has not been designated as a hedge or does not otherwise qualify for hedge accounting, it must be adjusted to fair value through earnings. The Company does not apply hedge accounting treatment to its oil derivative contracts and, therefore, the changes in the fair values of these instruments are recognized in income in the period of change. These fair value changes, along with the cash settlements of expired contracts, are shown in our statement of operations.

Effective June 1, 2010, the Company discontinued hedge accounting on all interest rate derivative instruments. Therefore, the Company recognizes, from that date forward, changes in the fair value of the instruments in income during the period of change. The effective portions of the discontinued hedges as of May 31, 2010, are included in accumulated other comprehensive income or loss (AOCI(L)) in the equity section of the accompanying consolidated balance sheets, and are being transferred to earnings when the hedged transaction is recognized in earnings.

Oil Derivative Contracts

In 2010, we entered into various oil derivative contracts to provide an economic hedge of our exposure to commodity price risk associated with anticipated future oil production. These contracts consist of deferred premium puts and compound options (calls on puts).

The Company manages market and counterparty credit risk in accordance with policies and guidelines approved by the Board. In accordance with these policies and guidelines, the Company s management determines the appropriate timing and extent of derivative transactions. We have included an estimate of nonperformance risk in the fair value measurement of our commodity derivative contracts as required by ASC 820 Fair Value Measurements and Disclosures.

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The following table sets forth the volumes in barrels underlying the Company s outstanding oil derivative contracts and the weighted average Dated Brent prices per bbl for those contracts as of September 30, 2011:

Type of Contract and Period	bbl/day	Weighted Average Floor Price	Weighted Average Deferred Premium/bbl
Deferred Premium Puts			
October 2011 - December 2011	11,332	$ 72.01	$ 9.12
January 2012 - December 2012	4,625	62.74	7.04
January 2013 - December 2013	2,515	61.73	7.32
Compound Options (calls on puts)			
July 2012 - December 2012(1)	5,399	66.48	6.73
January 2013 - June 2013(1)	3,855	66.48	7.10

(1) The calls expire June 29, 2012, and have a weighted average premium of $4.82/bbl.

Interest Rate Swaps Derivative Contracts

In 2010, Kosmos entered into derivative instruments in the form of interest rate swaps, which hedge risk related to interest rate fluctuation, whereby it converts the interest due on certain floating rate debt to a weighted average fixed rate. The following table summarizes our open interest rate swaps as of September 30, 2011:

Termination Date	Notional Amount (In thousands)	Fixed Rate	Floating Rate
June 2014	$ 77,500	0.98%	6-month LIBOR
June 2015	75,007	1.34%	6-month LIBOR
June 2016	161,250	2.22%	6-month LIBOR
June 2016	161,250	2.31%	6-month LIBOR

Effective June 1, 2010, the Company discontinued hedge accounting on all existing interest rate derivative instruments. Prior to June 1, 2010, any ineffectiveness on the interest rate swaps was immaterial; therefore, no amount was recorded in earnings for ineffectiveness. We have included an estimate of nonperformance risk in the fair value measurement of our interest rate derivative contracts as required by ASC 820 Fair Value Measurements and Disclosures.

The following tables disclose the Company s derivative instruments as of September 30, 2011 and December 31, 2010:

	Estimated Fair Value Asset (Liability)	
	September 30,	December 31,

Type of Contract	Balance Sheet Location	2011	2010
		(In thousands)	
Derivatives not designated as hedging instruments:			
Derivative asset:			
Commodity	Derivatives assets - current	$	$
Interest rate	Derivatives assets - current		
Commodity	Derivatives assets - noncurrent		
Interest rate	Derivatives assets - noncurrent		1,501
Derivative liability:			
Commodity	Derivatives liabilities - current	(22,812)	(13,979)
Interest rate	Derivatives liabilities - current	(7,211)	(6,375)
Commodity	Derivatives liabilities - long-term	(4,784)	(14,340)
Interest rate	Derivatives liabilities - long-term	(4,890)	(764)
Total derivatives not designated as hedging instruments		$ (39,697)	$ (33,957)

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Type of Contract	Location of Gain/(Loss)	Amount of Gain/(Loss) Three Months Ended September 30, 2011	Amount of Gain/(Loss) Three Months Ended September 30, 2010	Amount of Gain/(Loss) Nine Months Ended September 30, 2011	Amount of Gain/(Loss) Nine Months Ended September 30, 2010
		(In thousands)			
Derivatives in cash flow hedging relationships:					
Interest rate	AOCI(L)	$	$	$	$ (455)
Interest rate(1)	Interest expense	(1,193)	(1,278)	(2,934)	(4,383)
Total derivatives in cash flow hedging relationships		$ (1,193)	$ (1,278)	$ (2,934)	$ (4,838)
Derivatives not designated as hedging instruments:					
Commodity	Derivatives, net	$ 4,984	$ (10,339)	$ (5,250)	$ (15,310)
Interest rate	Interest expense	(3,921)	(5,715)	(9,933)	(9,079)
Total derivatives not designated as hedging instruments		$ 1,063	$ (16,054)	$ (15,183)	$ (24,389)

(1) Amounts were reclassified from AOCI(L) into earnings.

The fair value of the effective portion of the derivative contracts on May 31, 2010, is reflected in AOCI(L) and is being transferred to interest expense over the remaining term of the contracts. In accordance with the mark-to-market method of accounting, the Company recognizes all future changes in fair values of its derivative contracts as gains or losses in earnings during the period in which they occur. The Company expects to reclassify $0.2 million of losses from AOCI(L) to interest expense within the next 12 months. See Note 11 Fair Value Measurements for additional information regarding the Company s derivative instruments.

11. Fair Value Measurements

In accordance with ASC 820 Fair Value Measurements and Disclosures, fair value measurements are based upon inputs that market participants use in pricing an asset or liability, which are classified into two categories: observable inputs and unobservable inputs. Observable inputs represent market data obtained from independent sources, whereas unobservable inputs reflect a company s own market assumptions, which are used if observable inputs are not reasonably available without undue cost and effort. These two types of inputs are further prioritized into the following fair value input hierarchy:

- Level 1 quoted prices for identical assets or liabilities in active markets.

- Level 2 quoted prices for similar assets or liabilities in active markets, quoted prices for identical or similar assets or liabilities in markets that are not active, inputs other than quoted prices that are observable for the asset or liability and inputs derived principally from or corroborated by observable market data by correlation or other means.

- Level 3 unobservable inputs for the asset or liability. The fair value input hierarchy level to which an asset or liability measurement in its entirety falls is determined based on the lowest level input that is significant to the measurement in its entirety.

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The following tables present the Company s assets and liabilities that are measured at fair value on a recurring basis as of September 30, 2011 and December 31, 2010, for each fair value hierarchy level:

	Fair Value Measurements Using:			
	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Total
		(In thousands)		
September 30, 2011				
Assets:				
Money market accounts	$ 475,941	$	$	$ 475,941
Interest rate derivatives				
Liabilities:				
Commodity derivatives		(27,596)		(27,596)
Interest rate derivatives		(12,101)		(12,101)
Total	$ 475,941	$ (39,697)	$	$ 436,244
December 31, 2010				
Assets:				
Money market accounts	$ 18,056	$	$	$ 18,056
Interest rate derivatives		1,501		1,501
Liabilities:				
Commodity derivatives		(28,319)		(28,319)
Interest rate derivatives		(7,139)		(7,139)
Total	$ 18,056	$ (33,957)	$	$ (15,901)

All fair values have been adjusted for nonperformance risk resulting in a decrease of the commodity derivative liabilities of approximately $0.8 million and a decrease of the interest rate derivatives of approximately of $0.4 million as of September 30, 2011. When the accumulated net present value for all of the derivative contracts with a counterparty is in an asset position, the Company uses the counterparty s credit default swap (CDS) rates to estimate non-performance risk. When the accumulated net present value for all derivative contracts for a counterparty are in a liability position, the Company uses its internal rate of borrowing to estimate our non-performance risk.

The book values of cash and cash equivalents, joint interest billings, notes and other receivables, and accounts payable and accrued liabilities approximate fair value due to the short-term nature of these instruments. The carrying values of our debt approximates fair value since they are subject to short-term floating interest rates that approximate the rates available to the Company for those periods. The Company s long-term receivables after allowance approximate fair value.

Commodity Derivatives

The Company s commodity derivatives represent crude oil deferred premium puts and compound options for notional barrels of oil at fixed Dated Brent oil prices. The values attributable to the Company s oil derivatives are based on (i) the contracted notional volumes, (ii) independent active futures price quotes for Dated Brent, (iii) a credit-adjusted yield curve applicable to each counterparty by reference to the CDS market and (iv) an independently sourced estimate of volatility for Dated Brent. The volatility estimate was provided by certain independent brokers who are active in buying and selling oil options and was corroborated by market-quoted volatility factors. The deferred premium is included in the fair market value of the puts and compound options. The Company s commodity derivative liability measurements represent Level 2 inputs in the hierarchy priority. See Note 10 Derivative Financial Instruments for additional information regarding the Company s derivative instruments.

Interest Rate Derivatives

As of September 30, 2011 and December 31, 2010 the Company had interest rate swaps with notional amounts of $475.0 million, whereby the Company pays a fixed rate of interest and the counterparty pays a variable LIBOR-based rate. The values attributable to the Company s interest rate derivative contracts are based on (i) the contracted notional amounts, (ii) LIBOR yield curves provided by independent third parties and corroborated with forward active market-quoted LIBOR yield curves and (iii) a credit-adjusted yield curve as applicable to each counterparty by reference to the CDS market. The Company s interest rate derivative asset and liability measurements represent Level 2 inputs in the hierarchy priority.

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12. Asset Retirement Obligations

The following table summarizes the changes in the Company s asset retirement obligations:

	September 30, 2011 (In thousands)
Asset retirement obligations:	
Beginning asset retirement obligations	$ 16,752
Liabilities incurred during period	1,257
Revisions in estimated retirement obligations	
Liabilities settled during period	
Accretion expense	1,613