

US ENERGY CORP
Form 10-Q
May 10, 2010

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

- Quarterly report pursuant to section 13 or 15(d) of the Securities Exchange Act of 1934
For the quarter ended March 31, 2010 or
- 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: 0-6814

[Missing Graphic Reference]

U.S. ENERGY CORP.

(Exact name of registrant as specified in its charter)

Wyoming
(State or other jurisdiction of
incorporation or organization)

83-0205516
(I.R.S. Employer
Identification No.)

877 North 8th West, Riverton, WY
(Address of principal executive offices)

82501
(Zip Code)

Registrant's telephone number, including area
code:

(307) 856-9271

Not Applicable

(Former name, address and 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 Company was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

YES NO

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 Regulations 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

NO

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 definitions of “large accelerated filer,” “accelerated filer” and “smaller reporting company” in Rule 12b-2 of the Exchange Act.

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

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).

YES NO

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

At May 7, 2010, there were issued and outstanding 26,737,320 shares of the Company's common stock, \$.01 par value.

U.S. ENERGY CORP. and SUBSIDIARIES

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PART I. FINANCIAL INFORMATION

ITEM 1. Financial Statements

U.S. ENERGY CORP.
CONDENSED BALANCE SHEETS
ASSETS
(Unaudited)
(In thousands)

	March 31, 2010	December 31, 2009
CURRENT ASSETS:		
Cash and cash equivalents	\$ 19,350	\$ 33,403
Marketable securities		
Held to maturity - treasuries	25,480	22,059
Available for sale securities	855	1,178
Accounts receivable		
Trade	4,248	3,882
Reimbursable project costs	2	2
Income taxes	353	353
Other current assets	1,105	1,223
Total current assets	51,393	62,100
INVESTMENT	3,921	2,958
PROPERTIES AND EQUIPMENT:		
Oil and gas properties under full cost method, net	33,311	26,002
Undeveloped mining claims	21,969	21,969
Commercial real estate, net	22,985	23,200
Property, plant and equipment, net	9,309	9,301
Net properties and equipment	87,574	80,472
OTHER ASSETS	1,213	1,193
Total assets	\$ 144,101	\$ 146,723

The accompanying notes are an integral part of these statements.

U.S. ENERGY CORP.
CONDENSED BALANCE SHEETS
LIABILITIES AND SHAREHOLDERS' EQUITY
(Unaudited)
(In thousands, except shares)

	March 31, 2010	December 31, 2009
CURRENT LIABILITIES:		
Accounts payable	\$2,055	\$6,500
Accrued compensation	784	1,748
Current portion of long-term debt	200	200
Other current liabilities	213	224
Total current liabilities	3,252	8,672
LONG-TERM DEBT, net of current portion	600	600
DEFERRED TAX LIABILITY	8,158	7,345
ASSET RETIREMENT OBLIGATIONS	228	211
OTHER ACCRUED LIABILITIES	799	762
SHAREHOLDERS' EQUITY:		
Common stock, \$.01 par value; unlimited shares authorized; 26,502,658 and 26,418,713 shares issued, respectively	265	264
Additional paid-in capital	119,608	118,998
Accumulated surplus	11,012	9,485
Unrealized gain on marketable securities	179	386
Total shareholders' equity	131,064	129,133
Total liabilities and shareholders' equity	\$144,101	\$146,723

The accompanying notes are an integral part of these statements.

U.S. ENERGY CORP.
CONDENSED STATEMENTS OF OPERATIONS
(Unaudited)
(In thousands, except shares and per share data)

	Three months ended March	
	31,	
	2010	2009
OPERATING REVENUES:		
Oil and gas	\$6,824	\$674
Real estate	639	734
	7,463	1,408
OPERATING COSTS AND EXPENSES:		
Oil and gas	2,500	812
Impairment of oil and gas properties	--	1,063
Real estate	553	512
Water treatment plant	349	443
Mineral holding costs	57	--
General and administrative	2,668	2,005
	6,127	4,835
OPERATING INCOME (LOSS)	1,336	(3,427)
OTHER INCOME AND (EXPENSES):		
Gain on sales of assets	115	5
Equity gain/(loss) from unconsolidated investment	963	(91)
Miscellaneous income	1	5
Interest income	59	87
Interest expense	(17)	(38)
	1,121	(32)
INCOME (LOSS) BEFORE INCOME TAXES	2,457	(3,459)
INCOME TAXES:		
Current (provision for) benefit from	--	677
Deferred (provision for) benefit from	(930)	435
	(930)	1,112
NET INCOME (LOSS)	\$1,527	\$(2,347)
NET INCOME (LOSS) PER SHARE		
Basic	\$0.06	\$(0.11)
Diluted	\$0.05	\$(0.11)
Weighted average shares outstanding		
Basic	26,487,162	21,654,519
Diluted	27,785,572	21,654,519

The accompanying notes are an integral part of these statements.

U.S. ENERGY CORP.
CONDENSED STATEMENTS OF CASH FLOWS
(Unaudited)

	(In thousands)	
	Three months ended	
	March 31,	
	2010	2009
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net income (loss)	\$1,527	\$(2,347)
Adjustments to reconcile net income (loss) to net cash provided by (used in) operations		
Depreciation, depletion and amortization	2,634	1,089
Accretion of discount on treasury investment	(22)	(94)
Impairment of oil and gas properties	--	1,063
Equity (gain)/loss from unconsolidated investment	(963)	91
Deferred income taxes	930	(435)
Gain on sale of assets	(115)	(5)
Noncash compensation	376	387
Noncash services	15	19
Net changes in assets and liabilities	(1,362)	(994)
NET CASH PROVIDED BY (USED IN) OPERATING ACTIVITIES	3,020	(1,226)
CASH FLOWS FROM INVESTING ACTIVITIES:		
Acquisition and development of oil and gas properties	\$(13,803)	\$(1,149)
Net (investment in) redemption of treasury investments	(3,398)	9,475
Development of real estate	--	(90)
Minining property option payment	--	1,000
Acquisition of property and equipment	(189)	(66)
Proceeds from sale of property and equipment	118	5
Net change in restricted investments	(20)	5,298
NET CASH (USED IN) PROVIDED BY INVESTING ACTIVITIES	(17,292)	14,473

The accompanying notes are an integral part of these statements.

U.S. ENERGY CORP.
CONDENSED STATEMENTS OF CASH FLOWS
(Unaudited)

	(In thousands)	
	Three months ended March 31,	
	2010	2009
CASH FLOWS FROM FINANCING ACTIVITIES:		
Issuance of common stock	\$ 219	\$ --
Repayments of debt	--	(17,888)
Stock buyback program	--	(1,008)
NET CASH PROVIDED BY (USED IN) FINANCING ACTIVITIES	219	(18,696)
NET DECREASE IN CASH AND CASH EQUIVALENTS	(14,053)	(5,449)
CASH AND CASH EQUIVALENTS AT BEGINNING OF PERIOD	33,403	8,434
CASH AND CASH EQUIVALENTS AT END OF PERIOD	\$ 19,350	\$ 2,985
SUPPLEMENTAL DISCLOSURES:		
Interest paid	\$ 5	\$ 19
NON-CASH INVESTING AND FINANCING ACTIVITIES:		
Unrealized gain	\$ 62	\$ 454
Acquisition and development of oil and gas properties through accounts payable	\$ 1,269	\$ --
Acquisition and development of oil and gas through asset retirement obligation	\$ 13	\$ --

The accompanying notes are an integral part of these statements.

U.S. ENERGY CORP.

Notes to Condensed Financial Statements (Unaudited)

1) Basis of Presentation

The accompanying unaudited condensed financial statements for the periods ended March 31, 2010 and March 31, 2009 have been prepared by U.S. Energy Corp. (“USE” or the “Company”) in accordance with generally accepted accounting principles (“GAAP”) in the United States of America. The Condensed Balance Sheet at December 31, 2009 was derived from audited financial statements. In the opinion of the Company, the accompanying condensed financial statements contain all adjustments (consisting of only normal recurring adjustments) necessary to present fairly the financial position of the Company for the reported periods. Entities in which the Company holds at least 20% ownership or in which there are other indicators of significant influence are generally accounted for by the equity method, whereby the Company records its proportionate share of the entities’ results of operations. Certain information and footnote disclosures normally included in financial statements prepared in accordance with GAAP have been condensed or omitted. The unaudited condensed financial statements should be read in conjunction with the Company’s December 31, 2009 Annual Report on Form 10-K. Subsequent events have been evaluated for financial reporting purposes through the date of the filing of this Form 10-Q. See Note 10.

2) Summary of Significant Accounting Policies

For detailed descriptions of the Company’s significant accounting policies, please see Form 10-K for the year ended December 31, 2009 (Note B pages 84 to 92).

We follow accounting standards set by the Financial Accounting Standards Board, commonly referred to as the “FASB.” The FASB sets generally accepted accounting principles (GAAP) that we follow to ensure we consistently report our financial condition, results of operations, and cash flows.

The FASB recognized the complexity of its standard-setting process and embarked on a revised process in 2004 that culminated in the release on July 1, 2009, of the FASB Accounting Standards Codification,TM sometimes referred to as the Codification or ASC. The Codification does not change how the Company accounts for its transactions or the nature of related disclosures made. However, when referring to guidance issued by the FASB, the Company refers to topics in the ASC. The above change was made effective by the FASB for periods ending on or after September 15, 2009.

Use of Estimates

The preparation of financial statements in conformity with generally accepted accounting principles in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities, disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Significant estimates include oil and gas reserves used for depletion and impairment considerations and the cost of future asset retirement obligations. Due to inherent uncertainties, including the future prices of oil and gas, these estimates could change in the near term and such changes could be material.

U.S. ENERGY CORP.

Notes to Condensed Financial Statements (Unaudited)
(Continued)

Oil and Gas Properties

The Company follows the full cost method in accounting for its oil and gas properties. Under the full cost method, all costs associated with the acquisition, exploration and development of oil and gas properties are capitalized and accumulated in a country-wide cost center. This includes any internal costs that are directly related to development and exploration activities, but does not include any costs related to production, general corporate overhead or similar activities. Proceeds received from disposals are credited against accumulated cost except when the sale represents a significant disposal of reserves, in which case a gain or loss is recognized. The sum of net capitalized costs and estimated future development and dismantlement costs for each cost center is depleted on the equivalent unit-of-production method, based on proved oil and gas reserves. Excluded from amounts subject to depletion are costs associated with unevaluated properties.

Under the full cost method, net capitalized costs are limited to the lower of unamortized cost reduced by the related net deferred tax liability and asset retirement obligations or the cost center ceiling. The cost center ceiling is defined as the sum of (i) estimated future net revenue, discounted at 10% per annum, from proved reserves, based on unescalated average prices per barrel of oil and per MMBtu of natural gas at the first day of each month in the 12-month period prior to the end of the reporting period and costs, adjusted for contract provisions, financial derivatives that hedge the Company's oil and gas revenue and asset retirement obligations, (ii) the cost of properties not being amortized, and (iii) the lower of cost or market value of unproved properties included in the cost being amortized, less (iv) income tax effects related to differences between the book and tax basis of the natural gas and crude oil properties. If the net book value reduced by the related net deferred income tax liability and asset retirement obligations exceeds the cost center ceiling limitation, a non-cash impairment charge is required in the period in which the impairment occurs. At March 31, 2010, the book value of the Company's oil and gas properties did not exceed the cost center ceiling.

Revenue Recognition

The Company records natural gas and oil revenue under the sales method of accounting. Under the sales method, the Company recognizes revenues based on the amount of natural gas or oil sold to purchasers, which may differ from the amounts to which the Company is entitled based on its interest in the properties. Natural gas balancing obligations as of March 31, 2010 were not significant.

Revenues from real estate operations are reported on a gross revenue basis and are recorded at the time the service is provided.

Recent Accounting Pronouncements

As of March 31, 2010, there have been no recent accounting pronouncements currently relevant to the Company in addition to those discussed on pages 90 to 92 of our Annual Report on Form 10-K for the year ended December 31, 2009. The Company continues to review current outstanding statements from the Financial Accounting Standards Board ("FASB") and does not believe that any of those statements will have a material effect on the financial statements of the Company when adopted.

U.S. ENERGY CORP.

Notes to Condensed Financial Statements (Unaudited)
(Continued)

3) Properties and Equipment

Land, buildings, improvements, machinery and equipment are carried at cost. Depreciation of buildings, improvements, machinery and equipment is provided principally by the straight-line method over estimated useful lives ranging from 3 to 45 years.

Components of Property and Equipment as of March 31, 2010 and December 31, 2009 are as follows:

	(In thousands)	
	March 31, 2010	December 31, 2009
Oil and Gas properties		
Unevaluated	\$ 4,273	\$ 3,993
Well in progress	4,449	1,367
Evaluated	30,797	24,595
	39,519	29,955
Less accumulated depreciation		
depletion and amortization	(6,208)	(3,953)
Net book value	33,311	26,002
Mining properties	21,969	21,969
Commercial real estate	24,622	24,600
Less Accumulated depreciation		
depletion and mortization	(1,637)	(1,400)
Net book value	22,985	23,200
Building, land and equipment	14,112	14,196
Less accumulated depreciation		
depletion and amortization	(4,803)	(4,895)
Net book value	9,309	9,301
Totals	\$ 87,574	\$ 80,472

Oil and Gas Exploration Activities

The Company participates in oil and gas projects as a non-operating working interest owner and has active agreements with several oil and gas exploration and production companies. Our working interest varies by project, but typically ranges from approximately 5% to 65%. These projects may result in numerous wells being drilled over the next three to five years.

U.S. ENERGY CORP.

Notes to Condensed Financial Statements (Unaudited)
(Continued)

Williston Basin, North Dakota

During the first quarter of 2010, the Company completed 3 gross wells (1.02 net) with net costs to the Company of \$4.6 million. One additional gross well (0.44 net) was being drilled at March 31, 2010 with net costs to the Company of \$1.1 million. This brings the total wells drilled through March 31, 2010 under the Drilling Participation Agreement with Brigham Oil & Gas, L.P. ("Brigham") a Delaware limited partnership wholly-owned by Brigham Exploration Company (a Delaware corporation), to 9 gross completed and producing wells (3.99 net) and one gross well (0.44 net) in progress. The remaining 5 gross initial wells under the Drilling Participation Agreement will be drilled during the balance of 2010.

As a result of participating in all 15 wells, the Company will earn the rights to drill an additional 15 wells in the Bakken formation and potentially an additional 30 wells in the Three Forks formation for a total of 60 wells if the state of North Dakota allows two wells per formation in each spacing unit. Brigham operates all of the wells. If the spacing is ultimately increased to three wells per 1,280 acre spacing unit, the potential number of drilling locations could increase to 90. The drilling of each well typically takes 30 days while the completion typically takes 21-28 days.

U.S. Gulf Coast

In February 2010, the Company spud a well (0.042 net), the ALMI #1, targeting a gas prospect located in south central Louisiana. Drilling was in progress at March 31, 2010, with net costs to the Company of \$303,000. See Note 10, Subsequent Events.

In February 2010, the Company spud a well (0.10 net), the Main Pass 74 #A-19, targeting an oil and gas prospect located 15 miles offshore of south east Louisiana. The operator experienced down hole difficulties during the drilling of this well and the Company recorded additional costs of \$967,000 in excess of the original drilling budget during the first quarter of 2010. Drilling was in progress at March 31, 2010, with net costs to the Company of \$3.1 million. See Note 10, Subsequent Events.

In March 2010, the Company drilled a productive well (0.048 net), the Weyerhaeuser 18 #1, targeting a gas prospect in Louisiana. The net capitalized cost to the Company through March 31, 2010 is \$85,000.

The Company is also actively pursuing the potential of acquiring additional exploration, development or production stage oil and gas properties or companies. To further this effort, the Company has engaged an investment banker to assist in finding, evaluating and if necessary, financing the potential acquisition of such assets.

Full cost pool capitalized costs are amortized over the life of production of proven properties. Capitalized costs at March 31, 2010 and December 31, 2009 which were not included in the amortized cost pool were \$8.7 and \$5.4 million, respectively. These costs consist of wells in progress, seismic costs that are being analyzed for potential drilling locations and land costs all related to unproved properties. No capitalized costs related to unproved properties are included in the amortization base at March 31, 2010 and December 31, 2009. It is anticipated that these costs will

be added to the full cost amortization pool in the next two years as properties are evaluated, drilled or abandoned.

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U.S. ENERGY CORP.

Notes to Condensed Financial Statements (Unaudited)
(Continued)

Ceiling Test Analysis – The Company performs a quarterly ceiling test for each of its oil and gas cost centers, which in 2010, there was only one. The ceiling test incorporates assumptions regarding pricing and discount rates over which management has no influence in the determination of present value. In arriving at the ceiling test for the quarter ended March 31, 2010, the Company used \$69.64 per barrel for oil and \$3.983 per MMBtu for natural gas (and adjusted for property specific gravity, quality, local markets and distance from markets) to compute the future cash flows of the Company’s producing property. The discount factor used was 10%.

At March 31, 2010, the ceiling was in excess of the net capitalized costs as adjusted for related deferred income taxes and no impairment was required. Furthermore, as of March 31, 2010, there were no unproved properties that were considered to be impaired and reclassified to properties being amortized. Management will continue to review its unproved properties based on market conditions and other changes and if appropriate, unproved property amounts may be reclassified to the amortized base of properties within the full cost pool. During the quarter ended March 31, 2009, the Company recorded a \$1.1 million impairment.

Wells in Progress - Wells in progress represent the costs associated with wells that have not reached total depth or been completed as of period end. They are classified as wells in progress and withheld from the depletion calculation and the ceiling test. The costs for these wells are then transferred to evaluated property when the wells reach total depth and are cased and the costs become subject to depletion and the ceiling test calculation in future periods.

Mineral Properties

The Company capitalizes all costs incidental to the acquisition of mineral properties. Mineral exploration costs are expensed as incurred. When exploration work indicates that a mineral property can be economically developed as a result of establishing proved and probable reserves, costs for the development of the mineral property as well as capital purchases and capital construction are capitalized and amortized using units of production over the estimated recoverable proved and probable reserves. Costs and expenses related to general corporate overhead are expensed as incurred. All capitalized costs are charged to operations if the Company subsequently determines that the property is not economical due to permanent decreases in market prices of commodities, excessive production costs or depletion of the mineral resource.

Mineral properties at March 31, 2010 and December 31, 2009 reflect capitalized costs associated with the Company’s Mount Emmons molybdenum property near Crested Butte, Colorado. The Company has entered into an agreement with Thompson Creek Metals Company USA (“TCM”) to develop this property. TCM may earn up to a 75% interest in the project for the investment of \$400 million. The Company’s carrying balance in the Mount Emmons property at March 31, 2010 and December 31, 2009 is as follows:

	(In thousands)
Costs associated with Mount Emmons	
at December 31, 2009	\$ 21,969

Development costs during the
quarter

ended March 31, 2010	--
Costs at March 31, 2010	\$ 21,969

U.S. ENERGY CORP.

Notes to Condensed Financial Statements (Unaudited)
(Continued)

Real Estate

The Company evaluates its long-lived assets, which consist of commercial real estate, for impairment when events or changes in circumstances indicate that the related carrying amount may not be recoverable. Impairment calculations are generally based on market appraisals. If estimated future cash flows, on an undiscounted basis, are less than the carrying amount of the related asset, an asset impairment is considered to exist. Changes in significant assumptions underlying future cash flow estimates may have a material effect on the Company's financial position and results of operations. The Company does not obtain appraisals on an ongoing basis for the property. The Company however did obtain an appraisal in 2009. Rental property conditions have not changed significantly in the area of the Company's property. At March 31, 2010 and December 31, 2009, management determined that no impairment existed on the Company's long-lived asset as the 2009 appraised value exceeded construction and carrying value and rental rates remained strong and costs within projected limits.

4) Asset Retirement Obligations

The Company accounts for its asset retirement obligations under FASB ASC 410-20, "Asset Retirement Obligations." The Company records the fair value of the reclamation liability on its inactive mining properties and its operating oil and gas properties as of the date that the liability is incurred. The Company reviews the liability each quarter and determines if a change in estimate is required as well as accretes the discounted liability on a quarterly basis for the future liability. Final determinations are made during the fourth quarter of each year. The Company deducts any actual funds expended for reclamation during the quarter in which it occurs.

The following is a reconciliation of the total liability for asset retirement obligations:

	(In thousands)	
	March 31, 2010	December 31, 2009
Beginning asset retirement obligation	\$ 211	\$ 144
Accretion of discount	4	12
Liabilities incurred	13	55
Ending asset retirement obligation	\$ 228	\$ 211
Mining properties	\$ 131	\$ 128
Oil and gas wells	97	83
Ending asset retirement obligation	\$ 228	\$ 211

U.S. ENERGY CORP.

Notes to Condensed Financial Statements (Unaudited)
(Continued)

5) Fair Value

The Company adopted Financial Accounting Standards Board Accounting Standards Codification Topic 820 “Fair Value Measurements and Disclosures” (FASB ASC 820) on January 1, 2008, as it relates to financial assets and liabilities. The Company adopted FASB ASC 820 on January 1, 2009, as it relates to nonfinancial assets and liabilities. FASB ASC 820 establishes a fair value hierarchy that prioritizes the inputs the Company to measure fair value. The three levels of the fair value hierarchy defined by FASB ASC 820 are as follows:

- Level 1 — Unadjusted quoted prices is available in active markets for identical assets or liabilities.
- Level 2 — Pricing inputs, other than quoted prices within Level 1, which are either directly or indirectly observable.
- Level 3 — Pricing inputs that are unobservable requiring the Company of valuation methodologies that result in management’s best estimate of fair value.

The Company’s assessment of the significance of a particular input to the fair value measurement requires judgment and may affect the valuation of the nonfinancial assets and liabilities and their placement in the fair value hierarchy levels. The fair value of the Company’s asset retirement obligations and other accrued liabilities are determined using discounted cash flow methodologies based on inputs that are not readily available in public markets. The fair value of the asset retirement obligations and other accrued liabilities are reflected on the balance sheet as detailed below.

Description	March 31, 2010	(In thousands) Fair Value Measurements at March 31, 2010 Using		
		Quoted Prices in Active Markets Significant for Identical Assets (Level 1)	Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Other accrued liabilities	\$ 799			