



SECURITIES AND EXCHANGE COMMISSION

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NEW RULES PROPOSED FOR DISCLOSURE OF FINANCIAL DATA BY PETROLEUM COMPANIES

The Commission issued for public comment today two rulemaking proposals for the disclosure of financial data by companies in the petroleum industry. These proposals come at a time when interest in accounting matters related to oil and gas companies is high because of provisions of the Energy Policy and Conservation Act of 1975 (EPCA), which require the Commission to assure the development of accounting practices to be followed for oil and gas producers "for purposes of developing a reliable energy data base..."

The Energy Policy and Conservation Act authorizes the Commission to rely on accounting practices developed by the Financial Accounting Standards Board, the private sector body responsible for establishing financial accounting standards. This was a recognition of the Commission's long-standing policy of looking to the private sector for leadership in the establishment of accounting principles. In July, 1977, the FASB issued an exposure draft of a proposed standard which would require companies to follow a form of the "successful efforts" methods of accounting for costs incurred in exploring for and developing oil and gas reserves. The FASB's proposal, if adopted, would prohibit companies from using the alternative "full cost" accounting method. The full cost method permits companies to capitalize as assets certain costs incurred in exploration and development, such as dry wells and abandoned leases, which are required to be charged against earnings under the successful efforts method. In Release No. 33-5861, issued on August 31, 1977, the Commission proposed, among other matters, the adoption of the FASB's accounting proposals as the accounting practices which oil and gas producers would be required to follow in reporting to the Department of Energy.

The Commission today issued Release No. 33-5877 to supplement these proposed accounting standards with disclosures of certain operating and financial data in financial statements. These proposed rules would also apply to reporting data to the Department of Energy. The Commission's proposal generally parallels the disclosures in financial statements proposed by the FASB.

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The proposed disclosures include (1) the disclosure of data on quantities of estimated proved reserves, (2) costs incurred in exploration, development, and production activities, (3) financial data classified by function, and (4) revenues from production of oil and gas.

The Commission noted, in the Release issued today, that questions have been raised recently concerning the relationship of its responsibilities for public financial reporting and its responsibilities under EPCA. On October 6, 1977, the U.S. Senate passed an amendment to this Act, which would add provisions indicating that the requirements for development of accounting practices were "...intended to apply only to...the preparation of reports to be filed with the Department of Energy for use in compiling a reliable energy data base...." The Senate amendment, which must now be considered by a House-Senate conference committee, further provides that the Act's provisions "...shall (not) be construed to establish or affect the establishment of generally accepted accounting principles for financial reporting purposes."

In Release No. 33-5877, the Commission reviewed its long-standing concern about financial reporting by petroleum companies and noted past unsuccessful attempts to resolve the issues surrounding the undesirable diversity of accounting methods used by oil and gas companies. The Commission stated the following:

"While the accounting practices to be developed pursuant to (the Energy Policy and Conservation Act) are for the purpose of developing a reliable energy data base pertaining to oil and gas production, the accounting practices clearly encompass those needed to prepare financial statements.... Even if the (Act's) requirements are considered to pertain only to reporting to (the Department of Energy), the Commission's consideration of issues involved in accounting for oil and gas producing activities would still extend to financial accounting and reporting standards used in the preparation of financial statements to be included in filings with the Commission. The Commission is addressing these issues based on its explicit authority over financial reporting under the Federal securities laws.... (T)he Commission does not consider the separation of issues related to reporting to (the Department of Energy) and reporting to investors to be practicable or consistent with the Commission's responsibilities under the Federal securities laws."

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Comments on Release No. 33-5877 are due by November 25, 1977. The comment period on Release No. 33-5861 was also extended until that date.

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In a separate action, Release No. 33-5878, the Commission today proposed for public comment rules to require publicly owned oil and gas companies to disclose the present value of future net revenues from estimated production of proved oil and gas reserves. Currently, companies are required to disclose only the estimated quantities of their proved reserves. The Commission indicated that the disclosure of data pertaining to reserve values is expected to provide investors with significant current economic information about companies' operations.

These proposed rules were developed after receiving a report of a research study, "Measuring and Reporting the 'Replacement' Cost of Oil and Gas Reserves" by Professors Glen A. Welsch and Edward B. Deakin of the University of Texas at Austin. The study was sponsored by the American Petroleum Institute and was undertaken to investigate approaches to applying the replacement cost disclosure concept to oil and gas reserves. Beginning in 1976, the Commission's rules require large, nonfinancial companies to disclose information on the costs to replace inventories and productive capacity as a means of describing the effects of inflation and other current economic conditions. Because of the severe difficulties of applying the replacement concept in the extractive industries, a one-year delay was provided to permit the research effort described above.

The research team concluded that deriving the costs to replace oil and gas reserves was not feasible, and recommended a surrogate for disclosing replacement cost data. The research team's recommendation was based on computing a value of a company's existing proved reserves using a discounted cash flow technique. The research team contended its approach was necessary to meet the "...needs of policy makers or investors because (historical data alone) will not provide sufficient information about the current economics of the oil and gas industry."

The American Petroleum Institute opposed the research team's recommendation and offered an alternative approach based on historical financial and operating data to meet the Commission's objectives in requiring disclosure of replacement cost information.

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The Commission's proposed rules are similar to the recommendations of the University of Texas research team but differ in certain respects. The proposed rules provide for the disclosure of a valuation of proved oil and gas reserves based on the application of specified computation guidelines.

The SEC expects the proposed data to be useful to analysts and investors in focusing on the significant economic aspects of oil and gas exploration. Generally accepted accounting principles preclude companies from recognized earnings when oil and gas reserves are discovered. Earnings are reported based on sales of oil and gas produced, which occurs typically over a number of years following discovery of the oil and gas reserves. As a consequence, the results of successful operations are obscured in reported earnings.

The disclosure of quantities of reserves compensates to a certain extent for this inherent inability of accounting based on historical costs. The Commission indicated that placing a value on reserves would facilitate more effective financial analysis and provide insights into the qualitative differences in reserves, such as differences resulting from price controls, stage of development, location, and grade of product. These data are expected to enable the management of a company to more effectively describe to investors the economic substance of its operations in its narrative analyses reported earnings.

In addition, the Commission recognized that application of its prescribed guidelines to develop the data proposed for disclosure would result in the data often not being representative of management's estimate of the current value of its company's oil and gas properties. Nevertheless, the Commission did not consider the usefulness of the data to be significantly impaired because of these factors. It indicated that uniform computations were needed to achieve acceptable objectivity and comparability of data reported by different companies. Companies would be permitted to supplement the required disclosures with additional information computed on other bases.

Public comments on Release No. 33-5857 are due March 31, 1978.

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