



**SECURITIES AND
EXCHANGE COMMISSION**

Washington, D. C. 20549

(202) 755-4846



78-32

STATEMENT OF THE HONORABLE
HAROLD M. WILLIAMS
CHAIRMAN, SECURITIES AND EXCHANGE COMMISSION

ACCOUNTING PRACTICES FOR OIL AND GAS
PRODUCERS

AUGUST 29, 1978

The Commission is meeting today to take action relating to financial accounting and reporting practices for oil and gas producing activities. In view of the important and complex nature of the matter before us and the high interest in our determinations, this meeting will be conducted somewhat differently from a typical meeting of the Commission open to the public pursuant to the provisions of the Government in the Sunshine Act.

In addition, we will permit the public to observe the press briefing to be held immediately following this meeting; however, only members of the press will be able to ask questions. Copies of my opening remarks have been prepared and will be made available to those in attendance here today. .

Over the past year, each Commissioner has participated actively in our proceeding on oil and gas accounting, especially in preparing for and participating in the exhaustive public hearing that was held this spring. Each of us has consulted at length with the staff and has thoroughly analyzed the important issues under consideration--issues that are complex and significant both for the petroleum industry and for financial reporting broadly. An extensive amount of background material,

analyses and comments submitted by interested persons, was thoroughly analyzed by our staff and made available to each of us. Following the close of the public comment period in May, the staff prepared and discussed with each Commissioner its analyses and views on the various alternative courses of action open to the Commission. During the summer, as these discussions continued, it became clear, based upon the staff's suggestions and our own individual assessments of matters before us, that we were arriving at the same conclusions on the issues.

Over the past weeks each Commissioner has commented to the staff on drafts of the recommended public releases. Since we have come to similar conclusions on the fundamental questions to be resolved, we expect today to give our approval to these releases. You will hear directly from the Commissioners in attendance today. Although Commissioner Karmel is not present, she has specifically asked that her concurrence with the staff recommendations be noted at today's meeting. The releases themselves should be available for public distribution later in the week.

Because of this unanimous agreement among the individual Commissioners, I will summarize at the outset of this meeting the major conclusions embodied in the recommendations of the staff. They are:

- (1) Traditional accounting methods--successful efforts and full cost--fail to provide sufficient useful information on the financial position and operating results of oil and gas producers;
- (2) Information supplemental to primary financial statements is required to enable assessment of the financial position and operating results of a company and to permit comparison of companies engaged in oil and gas producing activities;
- (3) Development of an accounting method based on a valuation of proved oil and gas reserves would provide significant useful information, and steps should be taken to develop such a method; and
- (4) In these circumstances, requiring either successful efforts or full cost as a uniform method of accounting is unwarranted.

The ultimate objective of the Commission is the development of a method of accounting for oil and gas producing activities that recognizes valuations of proved oil and gas reserves in the balance sheets and income statements of oil and gas producers. We have designated this method of accounting as reserve recognition accounting or "RRA." Today, the Commission will institute a series of steps that seek the development of RRA. The first is a requirement for the disclosure of valuation data on proved oil and gas reserves, as previously proposed by the Commission. Then, for 1979 financial statements, the Commission will propose presentation of a supplemental earnings summary prepared on the basis of RRA. On the basis of the experience gained from the disclosure of the reserve valuation data and, if adopted, the supplemental RRA earnings summary, the Commission will consider proposing that RRA be incorporated in the primary financial statements of oil and gas producers.

The feasibility of RRA, however, is not assured because of the inherent imprecision of reserve valuations, and, therefore, the ultimate method of reporting is not yet determinable. Consequently, the Commission's approach in seeking its development is

a measured one. The Commission will also seek to establish an advisory committee of highly qualified persons in this complex area to assist it in assessing the problems to be resolved.

This process of determining the feasibility of RRA will require several years. During this period, the Commission is taking steps to assure that investors and policy-makers have adequate information to gain an understanding of the financial position and operating results of oil and gas producers and to compare the financial status of companies within the industry. Besides the disclosure of valuation data on proved oil and gas reserves, the Commission will be adopting rules that require the disclosure of supplemental historical financial and operating information, including quantities of proved oil and gas reserves and cash flow from production activities.

The recommendations now before the Commission for implementing its conclusions also include rules to specify a form of the successful efforts method of accounting that oil and gas producers may follow, which is the same as that prescribed in Statement No. 19 of the Financial Accounting Standards

Board. Alternatively, the Commission will allow oil and gas producers to follow the full cost method as defined by rules that will be proposed separately for public comment.

Because of the far-reaching implications of this action by the Commission, I will discuss certain matters relating to these conclusions and the reasoning behind them. The staff will then describe specifically the manner in which the Commission's conclusions are to be implemented.

The major shortcomings of financial statements of oil and gas producers prepared on the basis of the successful efforts and full cost accounting methods became clearly apparent to the Commissioners and to the staff early in our deliberations. Neither of these methods is adequate without extensive supplemental disclosure of financial and operating information. If such appropriate disclosures are provided, further significant improvement in the information conveyed by financial reporting can only be achieved if valuation data on oil and gas reserves are incorporated in the primary financial statements.

The Commission's new disclosure rules will result in significant improvement in the quality of information on the operations of oil and gas producers made available to the investing public and to government policy-makers. That goal was the foundation of the Commission's deliberations and we are confident that we have been successful in fulfilling our responsibilities in this regard. The frequent complaints about the lack of relevant and comparable financial information on oil and gas producers can no longer be sustained in view of the disclosures that will be required. The information necessary for an understanding of the financial position and operating results of a company and the information needed to compare companies within the industry will be available to anyone interested in undertaking such analyses.

The dilemma posed by the successful efforts and full cost methods takes on much less significance once adequate disclosure of the relevant information for decision-making by investors and government policy-makers is assured. Each Commissioner has found both of these traditional methods so deficient in terms of providing useful information

that a choice between them is futile. The claimed advantages of one method over the other simply are not justified, because neither reflects the economic substance of oil and gas exploration in a meaningful manner. In these circumstances, the Commissioners could not in good faith choose one of these methods as a uniform method for the industry.

Thus, the Commission has concluded that it should strive to develop RRA and assure in the meantime that adequate information is provided to permit meaningful analyses of financial position and operating results of oil and gas producers. It has further concluded that, during the implementation of RRA, the arbitrary selection of either successful efforts or full costing as a uniform method for the industry would be costly, confusing, and unjustified.

The release to be issued by the Commission will address a number of important issues in order to explain fully the Commission's decision. I encourage each of you to review it closely. The Commission considers it a major statement on certain issues fundamental to its current views on financial reporting.

The relationship between expected economic effects of applying financial accounting standards and the standard-setting process is one matter that will be discussed in the release. Accounting changes, especially changes as substantial as those considered in this proceeding, invariably involve costs and confusion. The economic and competitive consequences asserted by some commentators in this instance, however, have been based on overstated and oversimplified presumptions. The Commission has ultimately concluded that any such impact of a requirement that companies follow the successful efforts method would be short-lived and much less severe than predicted by these commentators. The Commission believes further that allocation of capital in the market place should be based on the competitive performance of companies and not on their accounting methods.

It is also the firm view of the Commission that financial reporting must seek to provide useful information to investors rather than to influence the decision-making process of managers. The Commission agrees

with the FASB's conclusion that the objectives of financial reporting should be formulated in terms of the needs of those for whom the information is intended. If managers take uneconomic actions in response to new financial reporting standards that accomplish these objectives, such actions reflect on the judgment of the managers involved and not on the standard-setting process.

The conclusions in this proceeding do not represent a change in the Commission's policy toward the FASB. The oil and gas accounting project of the Commission has been unique in many ways, including the impact of the requirements of the Energy Policy and Conservation Act of 1975. The release will reiterate the strong support of the FASB expressed by the Commission in its recent report to Congress on accounting and auditing matters; however, the Commission's relationship with the FASB must allow for occasional differing judgments on issues in view of the responsibilities and independence of each body. The Commission would welcome further

initiatives or participation by the FASB in the continuing efforts relating to financial reporting for oil and gas producing activities. If the FASB should decide to take the initiative in this regard, the degree of involvement by the Commission would likely be diminished.

Further, I feel compelled to reiterate a personal view that I expressed during the Commission's public hearing in Houston. I, as well as the Commission, have been strongly supportive of the efforts of the private sector, through the FASB, to take the initiative in setting accounting standards, with appropriate participation by the Commission in the process. Yet, the Commission has responsibilities for public financial reporting under the federal securities laws in addition to the specific responsibilities in this instance under the Energy Policy and Conservation Act. In meeting these responsibilities, there may from time to time be substantive issues in financial reporting on which the Commission will feel obligated to take a position inconsistent with the FASB.

Finally, I would like to comment on the activities of those who sought to overturn the FASB's decision. While active participation in the due process proceedings involving establishing of financial accounting standards is to be strongly encouraged, the ultimate test of the ability of the private sector to govern itself in the accounting area is dependent on the willingness of those subject to abide by the process even in cases in which the standards being established are contrary to their self-interest. If accounting principles are to have integrity and if the resulting financial information reported by companies is to be credible, the process by which such accounting principles are established must be objective and professional and cannot be subjected to political pressure or even its appearance. If it becomes accepted or expected that accounting principles are determined or modified in order to secure purposes other than economic measurement--even such virtuous purposes as energy production--we assume a grave risk that confidence in the credibility of our financial information system will be undermined.

The issues involved in this proceeding were difficult and the course the Commission is undertaking will not be easy or simple. It will require a significant commitment by the Commission and active continuing participation by all those interested in financial reporting for the petroleum industry. We believe the actions the Commission is taking today will result in a major improvement in information now available to investors and to government policy-makers and hold promise for considerable further improvement in financial reporting for this vital sector of our economy.