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ONE HUNDRED EIGHTH CONGRESS

U.S. House of Representatives
Committee on Energy and Commerce
Washington, DC 20515-6115

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CHAIRMAN

May 4, 2004

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The Honorable Spencer Abraham
Secretary
Department of Energy
1000 Independence Avenue, S.W.
Washington, D.C. 20585

The Honorable Patrick Henry Wood III
Chairman
Federal Energy Regulatory Commission
888 First Street, N.E.
Washington, D.C. 20426

The Honorable William H. Donaldson
Chairman
Securities and Exchange Commission
450 Fifth Street, N.W.
Washington, D.C. 20549

Mr. Robert H. Herz
Chairman
Financial Accounting Standards Board
401 Merritt 7, P.O. Box 5116
Norwalk, Connecticut 06856

Dear Secretary Abraham and Chairmen Donaldson, Wood, and Herz:

I am examining (1) the implementation of the accounting practices requirements of the Energy Policy and Conservation Act of 1975, and (2) the facts and circumstances surrounding a number of recent high-profile announcements by oil companies and natural gas producers that they had substantially overstated their oil and gas reserves. For example, oil company Royal Dutch/Shell Group cut its proved reserves for the third time this year, bringing the total revision to 22 percent, while Standard & Poor's Ratings Services moved to cut Shell's long-term credit rating, citing the downgrades and the so-called Davis Polk internal report that highlighted what S&P called "durably weak corporate governance with significant digressions from SEC rules." Natural gas producer El Paso Corp. cut its reserve tally by 35 percent and said it would write down its natural gas assets by \$1 billion because of the revision. This turn of events is totally unacceptable, and raises disturbing issues regarding the Nation's energy reliability and security, the integrity of the energy and securities markets, and the protection of consumers and investors. The Committee on Energy and Commerce has jurisdiction over energy, the setting of accounting standards by the Financial Accounting Standards Board (FASB), and consumer protection, and may soon delve into these matters.

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To assist in my examination, I respectfully request that you submit the following information by the close of business on Tuesday, May 25, 2004:

1. The accounting practices provisions (42 U.S.C. Sec. 6383) of the Energy Policy and Conservation Act of 1975 required the Securities and Exchange Commission (SEC) to develop within two years accounting practices to be followed in the preparation of accounts by persons engaged, in whole or in part, in the production of crude oil or natural gas in the United States. It required the SEC to consult with the Secretary of Energy (DOE), the Federal Energy Regulatory Commission (FERC), and the General Accounting Office (GAO) in developing such practices, and authorized the SEC to defer to FASB pronouncements, under certain circumstances. It also spelled out general requirements for these accounting practices.

Please discuss and explain the steps that have been taken to implement, administer, and enforce this mandate.

2. Please discuss and explain the key requirements of Statement of Financial Accounting Standards Nos. 19 (Financial Accounting and Reporting by Oil and Gas Producing Companies), 25 (Suspension of Certain Accounting Requirements for Oil and Gas Producing Companies), and 69 (Disclosures about Oil and Gas Producing Activities).

Please explain the difference between “successful efforts,” “full cost,” and “value” accounting. Which method has been mandated for SEC registrants and why? What impact has that determination had on transparency and accuracy of accounting and disclosures? Is this issue being revisited in light of the recent scandals?

3. In 1979, FAS 25 adopted the definitions of “proved oil and gas reserves,” “proved developed oil and gas reserves,” and “proved undeveloped oil and gas reserves” developed by the Department of Energy for its Financial Reporting System and adopted by the SEC in 1978 in ASR No. 257. Proved oil and gas reserves are defined as “the estimated quantities of crude oil, natural gas, and natural gas liquids which geological and engineering data demonstrate with reasonable certainty to be recoverable in future years from known reservoirs under existing economic and operating conditions, i.e., prices and costs as of the date the estimate is made.” The key determination is “reasonable certainty.”

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Please identify and explain any SEC or FASB guidance relevant to assessing “reasonable certainty.” Is this guidance adequate? Is it being reviewed in light of the recent debacles? If not, why not?

4. What is the relevance and importance of oil and gas reserve disclosures to investors? To national energy policy decisions and national economic planning? What would be the impact of significant misrepresentations of such reserves? What steps are you taking to restore credibility and reliability in this area?
5. Press reports indicate that the SEC is conducting a formal investigation into widespread overbooking and subsequent write-down and restatement of oil and natural gas reserves by the Royal Dutch/Shell Group.

In the wake of this debacle, is the SEC examining practices and disclosures across the industry? If not, why not? If so, please explain the scope of that inquiry.

Is the SEC investigating announced reserve write-downs and restatements by any other companies? If so, please identify each company, the percentage/amount of overstatement and/or subsequent write-down, the estimated restatement and its financial impact if known, and the outside auditor in each case.

6. Was the SEC or its staff aware of these problems beforehand or did they come as a surprise? Did Wall Street analysts raise any concerns about oil and gas reserve accounting and disclosures prior to Shell’s revelations earlier this year?

For the period covering the past ten years, how many SEC staff were assigned to review these filings and what has been their background and training? What level of review has been given to oil and gas filings, especially the disclosures of reserve quantities in the financial statements?

7. In a recent *Leader* entitled “Needlessly murky,” The Economist (April 10, 2004, at 12) sharply criticized U.S. accounting rules on how oil and gas companies book reserves. “The boldest reform required now is for the SEC to demand that all energy firms whose shares are traded in America have their reserves reviewed by independent auditors. Ironically, oil firms from Russia, India and China have already done this to bolster their credibility.”

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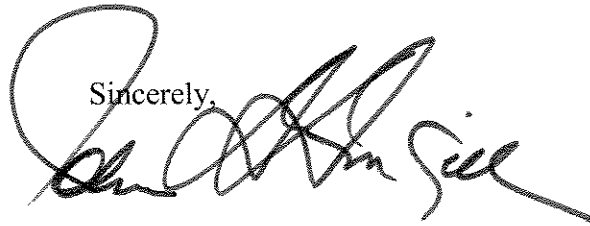
What is the rationale of the SEC and FASB for not having adopted this requirement? Is this under reconsideration in light of the recent debacles? If not, why not?

8. The report of the law firm Davis Polk & Wardwell to the Shell Group audit committee found that "the booking of 'aggressive' reserves and their continued place on Shell's books were only possible because of certain deficiencies in the company's controls. For example, the internal reserves audit function was both understaffed and undertrained." It also found that Shell's internal guidelines "were not adequately designed to yield compliant reporting of proved reserves."

What internal and external checks are required regarding internal controls? What is the responsibility of management for establishing and maintaining an adequate internal control structure and procedures for financial reporting? What is the responsibility of auditors for flagging problems in internal controls? Why did they miss the current crop of problems?

Thank you for your cooperation and assistance. Please have your staff direct any questions you may have about this inquiry to Consuela Washington (202-225-3641) or Bruce Harris (202-226-3400) of the Committee on Energy and Commerce Democratic staff.

Sincerely,



JOHN D. DINGELL
RANKING MEMBER

cc: The Honorable Joe Barton, Chairman
Committee on Energy and Commerce

The Honorable Cliff Stearns, Chairman
Subcommittee on Commerce, Trade, and Consumer Protection

The Honorable Jan Schakowsky, Ranking Member
Subcommittee on Commerce, Trade, and Consumer Protection

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The Honorable Ralph Hall, Chairman
Subcommittee on Energy and Air Quality

The Honorable Rick Boucher, Ranking Member
Subcommittee on Energy and Air Quality