



September 5, 2008

EXECUTIVE DIRECTOR

Cynthia M. Fornelli

GOVERNING BOARD

Chairman
James S. Turley, Chairman and CEO
Ernst & Young LLP

Vice Chair
Michele J. Hooper, Co-Founder
& Managing Partner
The Directors' Council

Vice Chair
Barry C. Melancon, President and CEO
AICPA

Charles M. Allen, CEO
Crowe Chizek and Company LLC

Harvey J. Goldschmid, Dwight Professor of Law
Columbia University

Dennis M. Nally, Chairman and Senior Partner
Pricewaterhouse Coopers LLP

Ed Nusbaum, CEO and Executive Partner
Grant Thornton LLP

Lynn S. Paine, John G. McLean Professor
Harvard School of Business

Barry Salzberg, CEO
Deloitte LLP

Dave Scudder, Managing Partner
McGadrey & Pullen, LLP

John B. Veihmeyer, Deputy Chairman
& Americas Regional Chairman
KPMG LLP

Jack Weisbaum, CEO
BDO Seidman, LLP

Ms. Florence Harmon
Acting Secretary
U.S. Securities and Exchange Commission
100 F Street, NE
Washington, D.C. 20549-1090

Re: File Number S7-15-08, *Modernization of the Oil and Gas Reporting Requirements*

Dear Ms. Harmon,

The Center for Audit Quality (CAQ or the Center) is an autonomous public policy organization serving investors, public company auditors and the capital markets and is affiliated with the American Institute of CPAs. The CAQ's mission is to foster confidence in the audit process and to aid investors and the markets by advancing constructive suggestions for change rooted in the profession's core values of integrity, objectivity, honesty and trust. Based in Washington, D.C., the CAQ consists of approximately 800 member firms that audit or are interested in auditing public companies.

CAQ appreciates the opportunity to respond to the Securities and Exchange Commission's (SEC or Commission) Proposed Rule on *Modernization of the Oil and Gas Reporting Requirements* (Proposed Rule). We support the Commission's objectives to modernize and update the current definitions and disclosure requirements relating to oil and gas reserves.

Consistent with our response letter dated February 19, 2008, to the Commission's Concept Release on *Possible Revisions to the Disclosure Requirements Relating to Oil and Gas Reserves* (Concept Release Response), we note that the majority of the requests for comment raised in the Proposed Rule pertain to technical engineering topics that are outside the expertise of our member firms, and therefore we have not responded to each question in the Proposed Rule. However, we continue to believe that the definition of proved reserves and the form and content of oil and gas reserves disclosures are important to investors and therefore we have

provided the following observations for the Commission's consideration. Throughout our response, "FAS 19" refers to Statement of Financial Accounting Standard (FAS) No. 19, *Financial Accounting and Reporting by Oil and Gas Producing Companies*, "FAS 25" refers to FAS No. 25, *Suspension of Certain Accounting Requirements for Oil and Gas Producing Companies, an amendment of FAS 19* and "FAS 69" refers to FAS No. 69, *Disclosures about Oil and Gas Producing Activities*.

Revisions and Additions to the Definition Section of Rule 4-10 of Regulation S-X

Year-End Pricing

In section II.B. of the Proposed Rule, the Commission proposes to revise the definitions in Rule 4-10 of Regulation S-X to change the price used in calculating reserves from the period end closing price to the average price for a 12-month period. The Commission states that the 12-month average price would be used for the purposes of disclosure (both the FAS 69 disclosures and those required by Regulation S-K), but it would not change the price used for accounting purposes (which would remain the single day, year-end price).

In order to promote comparability among registrants and to maintain consistency, we recommend that the Commission maintain a common definition of reserves for both accounting and disclosure purposes using one pricing assumption to determine economic producibility. While we do not disagree with the proposal to use the 12-month average price, we do not support using one price for disclosure and another price for accounting, which would be illogical, inconsistent and confusing for investors. In addition, determining and reporting reserves based on two different prices would increase the cost and complexity for registrants.

If the Commission adopts the proposed definition for disclosure purposes, whether or not it chooses to conform the definition for accounting purposes, changes to the accounting literature and related rules would be required.

- If the Commission adopts a common definition using the 12-month average, the guidance in FAS 19 regarding the determination of reserve quantities would not need to be amended, because paragraph 7 of FAS 25 requires that registrants use the definition of proved reserves adopted by the SEC. However, the guidance in paragraph 30.a. of FAS 69 regarding the computation of the standardized measure would need to be amended to require the use of the 12-month average price.
- If the Commission adopts a definition for disclosure purposes that is different than the definition for accounting purposes, the guidance in FAS 25 would need to be amended in order to clarify which definition of reserves should be used for accounting purposes. FAS 69 also would need to be amended as discussed in the point above.

Finally, we note that the conclusion regarding pricing also could have implications to auditors in relation to the unaudited supplemental information required by FAS 69 and the procedures prescribed in AU 558 and AU 9558 (as promulgated by the AICPA Auditing Standards Board (ASB) and as adopted in PCAOB Rule 3200T on an interim basis). We have described these issues in the section below entitled "Potential Implications to the Auditing Standards".

Effects on the Full Cost Accounting Method

As previously stated, we believe that the 12-month average price should be used to determine reserves for the purposes of both accounting and disclosure. Accordingly, we recommend that the Commission revise the computation of estimated future revenues and expenditures for the full cost ceiling test described in Rule 4-10 from a period-end-price to a trailing-12-month-average-price for both year-end and interim period calculations. If the Commission amends the full cost ceiling test in this manner, Staff Accounting Bulletin (SAB) Topics 12-D-3b, 12-D-3c and 12-F also would need to be revised.

Disclosure of Non-Traditional Resources

Under the Proposed Rule, the Commission would revise the definition of "oil and gas producing activities" to include the extraction of non-traditional resources, including bitumen extracted from oil sands and oil and gas extracted from coalbeds and shales. As we noted in our Concept Release Response, in our experience, oil and gas companies do not draw any operational distinction between traditional and non-traditional resources. Thus, allowing disclosure of non-traditional proved reserves as oil and gas reserves would help investors evaluate the significance of these resources in relation to traditional oil and gas reserves. We therefore continue to support the Commission's proposed revisions to include such non-traditional resources within the definition of "oil and gas producing activities". However, we note that FAS 19 excludes from its scope "the extraction of hydrocarbons from shale, tar sands, or coal." We urge the SEC to work with the FASB to revise the scope of FAS 19 such that reserves from non-traditional resources that are included in oil and gas reserves pursuant to the Proposed Rule also are accounted for as oil and gas producing activities pursuant to FAS 19.

Additionally, we recommend that the Commission reconsider the proposed limitation within Section II.C. (*Extraction of bitumen and other non-traditional resources*) of the Proposed Rule regarding the ability to consider the prices of processed resources when estimating proved oil and gas reserves. Therein, the Commission states "...if a company extracting the resources also builds its own processing plant on-site or near the extraction location (other than field processing of gas to extract liquid hydrocarbons), we do not believe it would be appropriate for that company to use the price of its processed product to determine the economic producibility of the unprocessed product." In our view, if a registrant has constructed such a plant, and that plant is critical to the registrant's evaluation of the economic producibility of the resources and its related investment decisions for the project, it should be permitted to report reserves based on a price that considers the processed price.

Allowing registrants to disclose reserves estimated on such a basis would allow investors to gain a more comprehensive understanding of the resources held by such companies and to better evaluate the investment decisions and future prospects of such companies.

New Technology

In light of the Commission's intention to permit broader use of technologies to establish the proper classification of reserves as described in Section II.D. of the Proposed Rule, we repeat our comment from our Concept Release Response that the Commission coordinate with the FASB to consider amending FAS 19 with respect to the accounting treatment for certain exploratory geological and geophysical costs.

Definition of Reserves

Under the Proposed Rule, the Commission has provided a definition of the term "reserves" based on the Petroleum Resources Management System (*PRMS*) definition of the term, including within this definition reserves anticipated to be recoverable based on a company's "legal right to produce." We encourage the Commission to clarify when the "legal right to produce" extends beyond the initial term of an oil and gas concession. We recommend that the Commission base this clarification on the guidance included in the *PRMS* framework, which seems consistent with the informal guidance from the SEC staff in the past.

Proposed Amendments to Codify the Oil and Gas Disclosure Requirements in Regulation S-K

As described in proposed Item 1200 of Regulation S-K, the Commission has proposed various new oil and gas reserve disclosures. Based on our experience with FAS 69, we believe the Commission's estimate understates the incremental burden to prepare the proposed disclosures. Further, it is unclear how many of the new disclosures (e.g., the disclosure of conventional accumulations and continuous accumulations described in Item 1202, the disclosure of reserve additions by supporting technology described in Item 1202, and the disclosure of the number of producing wells described in Item 1208, among others) would enhance the ability of investors to evaluate the relative value of oil and gas companies. We therefore urge the Commission to reevaluate its Cost-Benefit Analysis of the Proposed Rule and reconsider whether each proposed disclosure provides meaningful information for investors.

In addition, we note that the proposed Item 1200 disclosures would not be included within the notes to the financial statements with the current FAS 69 disclosures, even though those proposed disclosures would complement, and in some cases overlap, the FAS 69 disclosures. Consistent with the recommendations of the Commission's Task Force on Disclosure Simplification, we agree that users of financial statements would be best served if all information with respect to oil and gas reserves was located together in one place in a filing. We therefore encourage the Commission to require that all oil and gas reserve disclosures within filings, including those currently required by

FAS 69, be provided in a single separate location outside of the financial statements. Further, if the Commission adopts a pricing basis for the FAS 69 disclosures that is different from the pricing used for accounting recognition and measurement in the financial statements, leaving the FAS 69 disclosures in the footnotes could be very confusing, and possibly misleading. If the Commission concurs that all oil and gas reserve disclosures should be located together in one place outside the financial statements, we would encourage the SEC to coordinate with the FASB and the PCAOB to amend FAS 69 and AU 9558, as appropriate.

Proposed Conforming Changes to Form 20-F

Under the Proposed Rule, the Commission proposes to revise the instructions to Form 20-F to conform the disclosure requirements for foreign private issuers. As discussed in this letter, we believe that certain aspects of the proposed disclosure requirements should be reconsidered. Nevertheless, we support the Commission's proposal to harmonize the disclosure requirements for foreign private issuers to promote comparability.

The IASB is currently considering establishing a set of guidelines for oil and gas extractive activities, including a definition of reserves. We note in the Proposed Rule that the Commission intends to discuss its rulemaking project with the IASB and work to harmonize the rules upon effectiveness of the proposed rules, if adopted. We support this on-going dialogue between the Commission and the IASB, although we recommend that such discussions should not delay the issuance of the final rules.

In addition, we note that foreign private issuers that comply with IFRS, as issued by the IASB, are not required to include a reconciliation to U.S. GAAP in filings with the Commission. These companies might use other internationally recognized definitions of reserves for purposes of their financial statements that are different from the SEC definition of reserves. Previously, these companies would have been required to reflect any impact of such a difference in their U.S. GAAP reconciliation. We recommend that the SEC address the reserve disclosure requirements under both FAS 69 and Regulation S-K for foreign private issuers that file using a different definition of reserves.

Impact of Proposed Amendments on Accounting Literature

Change in Accounting Principle or Estimate

We note that the Commission has concluded that any accounting changes arising from the Proposed Rule should be considered a change in accounting estimate, pursuant to FAS No. 154, *Accounting Changes and Error Corrections*, and be accounted for prospectively. We concur with this conclusion, and we encourage the Commission to address whether this accounting treatment would also apply to a company that changes its accounting for non-traditional resources if FAS 19 is amended to provide for accounting for these resources as oil and gas activities (e.g., a bitumen

mining company that would be required to account for bitumen production under the oil and gas accounting rules).

Potential Implications to the Auditing Standards

The requirements for auditors in relation to the supplemental information required by FAS 69 are prescribed in AU 558 and AU 9558. We recommend that the Commission coordinate with the PCAOB regarding how the Proposed Rule interacts with the auditing standards, and provide the following comments for the Commission's consideration in this area.

- AU 558.07(b) states that, with respect to supplemental information, the auditor ordinarily should compare the supplemental information for consistency with the audited financial statements. Further, AU 9558.05(c) states that the auditor should compare the entity's reserve quantity information with the corresponding information used for depletion and amortization, and make inquiries when differences exist. As described in the Proposed Rule, the Commission is not proposing to change the pricing assumption used for accounting purposes. As a result, companies would continue to depreciate property, plant, and equipment related to oil and gas producing activities using a units-of-production basis over reserves determined using single-day, year end prices while reserves for disclosure purposes would be determined using a 12-month average price. As stated earlier in our letter, we recommend that the Commission revise its proposal in the final rule to require the use of the same price for both accounting and disclosure. However, if the final rule includes different prices for the determination of reserve quantities for accounting and for disclosure purposes, we recommend that the Commission coordinate with the PCAOB to amend AU 558.07(b) and AU 9558.05(c) to provide further guidance for auditors in applying these procedures.
- AU 9558.05(d) states that the auditor should make inquiries about the calculation of the standardized measure of discounted net cash flows, including whether the prices used to develop future cash inflows from estimated production of proved reserves are based on prices received at the end of the entity's fiscal year. If FAS 69 paragraph 30.a. is amended to use the 12-month average price, the standardized measure would no longer be based on year end prices. Therefore, we recommend the Commission coordinate with the PCAOB to amend the procedures prescribed in AU 9558.05(d) to reflect any amendment to FAS 69.

Application of Interactive Data Format

Consistent with our response letter dated August 1, 2008, to the Commission's rule proposal, *Interactive Data to Improve Financial Reporting*, we support the objectives of enhanced electronic financial reporting to increase the speed and usability of financial information. The introduction of eXtensible Business Reporting Language (XBRL) is an important step in achieving more effective and efficient preparation of corporate reporting as well as consumption and analysis by users in the



business reporting supply chain - management, investors, analysts, creditors, auditors, and regulators.

However, it might be premature at this time to mandate detailed-tagging (as opposed to 'block-text' tagging) of tabular oil and gas disclosures in the XBRL format considering that (a) preparers might need to undertake incremental efforts to implement the new tabular disclosures, and (b) currently there is no well-developed standard list of electronic tags for those tabular disclosures. The tabular disclosure taxonomy should be expanded, including the addition of more granular content, and exposed for public comment such that a more robust taxonomy is available sufficiently in advance of the proposed adoption dates.

The SEC should consider implementing a voluntary program for oil and gas companies to submit their tabular oil and gas disclosures in XBRL format, similar to its voluntary program for mutual funds' risk and return summary. The lessons learned from a voluntary program could be considered and modifications implemented, if necessary, before any mandated detailed-tagging of tabular oil and gas disclosures using XBRL.

* * * * *

We appreciate the opportunity to comment on the Proposed Rule and would welcome the opportunity to respond to any questions you may have regarding any of our comments and recommendations.

Sincerely,



Cynthia M. Fornelli
Executive Director
Center for Audit Quality

cc: SEC
Chairman Christopher Cox
Commissioner Luis Aguilar
Commissioner Kathleen L. Casey
Commissioner Troy Paredes
Commissioner Elise B. Walter
Conrad Hewitt, Chief Accountant
John W. White, Director of the Division of Corporation Finance



PCAOB

Mark W. Olson, Chairman

Daniel L. Goelzer, Member

Willis D. Gradison, Member

Steven B. Harris, Member

Charles D. Niemeier, Member

Thomas Ray, Chief Auditor and Director of Professional Standards

FASB

Robert Herz, Chairman

IASB

Sir David Tweedie, Chairman

