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September 8, 2008

Secretary  
U.S. Securities and Exchange Commission  
100 F Street, NE  
Washington, DC 20549-1090

**File No. S7-15-08**  
**Proposed Rule on Modernization of the Oil and Gas Reporting Requirements**  
**Release Nos. 33-8935; 34-58030**

We thank you for the opportunity to comment on the SEC Proposed Rule: *Modernization of the Oil and Gas Reporting Requirements* ("Proposed Rule"). We are generally supportive of the proposed amendments to modernize and update oil and gas disclosure requirements to align them with current practices and changes in technology. However, we have some concerns about certain inconsistencies in accounting and reporting that would result from application of the Proposed Rule.

The remainder of this letter provides general and specific comments on the Proposed Rule from our perspective as auditors of public companies engaged in oil and gas producing activities.

**General Considerations**

We strongly encourage the Commission to continue coordinating its efforts with the FASB and IASB in order to maximize usefulness and clarity about reserve reporting and financial accounting. We note that the recent Final Report of the Advisory Committee on Improvements to Financial Reporting recommended that the SEC and FASB work together to integrate SEC and FASB disclosure requirements into a cohesive whole to ensure meaningful communication and logical presentation of disclosures based on consistent objectives and principles and that competing models should be avoided. As discussed in the specific comments below, in order to avoid confusion for investors and minimize exceptions and differences, we believe that the Commission should fully consider the Advisory Committee recommendations before deciding on a disclosure regime that would require presentation of reserve information using different pricing assumptions.

Further, coordination with the IASB is necessary to achieve consistency among U.S. GAAP and IFRS filers as it relates to the definition of proved, probable and possible reserves. We believe this is of particular importance because, under the Proposed Rule, IFRS filers will continue to use oil and gas reserve quantities for accounting that are



determined differently than those utilized by domestic registrants. This inconsistency may become more prevalent as some U.S. registrants move toward adoption of IFRS in the coming years.

The new disclosures proposed by the Commission should be evaluated not only for their usefulness to investors but also balanced against the increased effort and cost associated with preparing those disclosures. We encourage the Commission to evaluate the comments of users and preparers in this regard.

## **Pricing**

The oil and gas price is a significant assumption used in the determination of the quantities of proved reserves. The proposing release indicates that it is not the Commission's intention to change the year-end prices that are used to determine the quantities of proved reserves for accounting purposes under the successful efforts or the full cost methods of accounting. The proposing release further indicates that the Commission intends for registrants to utilize *12-month average prices* for purposes of complying with Statement 69<sup>1</sup> disclosures, and that the Commission intends to discuss this change with the FASB.

We strongly believe that the same pricing assumption should be used to determine the economic producibility of proved reserves (i.e. a resource which generates revenue that is expected to exceed its cost of operations) for both accounting (under full cost and successful efforts methods of accounting) and disclosures (under Statement 69 and proposed Item 1200 of Regulation S-K). As proposed, we believe the amendments to Rule 4-10<sup>2</sup> relating to the change in the pricing assumption will result in unintended, and possibly inappropriate, accounting and disclosure consequences which require further consideration as outlined below.

- Successful efforts method of accounting - Paragraph 7 of Statement 25<sup>3</sup> (which rescinded paragraph 271 of Statement 19<sup>4</sup>) requires that registrants use the definition of proved reserves adopted by the SEC for its reporting purposes. The Commission's proposed use of 12-month average prices for determining the quantities of proved reserves in Rule 4-10(a) will, by application of Statement 25, cause a 12-month average price to be used for accounting under Statement 19.

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<sup>1</sup> FASB Statement 69, Disclosures about Oil and Gas Producing Activities

<sup>2</sup> SEC Rule 4-10 of Regulation S-X, Financial accounting and reporting for oil and gas producing activities pursuant to the federal securities laws and the Energy Policy and Conservation Act of 1975.

<sup>3</sup> FASB Statement 25, Suspension of Certain Accounting Requirements for Oil and Gas Producing Companies

<sup>4</sup> FASB Statement 19, Financial Accounting and Reporting by Oil and Gas Producing Companies

- Full cost method of accounting - The definition of proved reserves in Rule 4-10(a) is used in the application of the full cost method under Rule 4-10(c) and SAB Topic 12D<sup>5</sup>. The Proposed Rule will result in future net revenues for the full cost ceiling test (Rule 4-10(c)(4)) being computed by applying *year-end prices* to the *quantities* of proved reserves determined using *12-month-average prices* (as proposed in Rule 4-10(a)(24)).
- Disclosures about oil and gas producing activities - Paragraphs 10 and 30 of Statement 69 refer to proved reserves as defined in paragraph 11(a) of Statement 19. As discussed above, Statement 19, as amended, applies the definitions of proved reserves in Rule 4-10(a). If Statement 69 is not revised, the Proposed Rule will result in future cash inflows (included in the disclosure of standardized measure of discounted future net cash flows relating to the quantities of proved oil and gas reserves required by paragraph 30(a) of Statement 69) being computed by applying *year-end prices* to the *quantities* of proved reserves determined using *12-month average prices* (as proposed in Rule 4-10(a)(24)).

We believe it is inappropriate to compute future cash flows by applying *year-end prices* to the *quantities* of proved reserves that are determined using *12-month average prices* in the two instances noted above.

We recommend that the Commission:

- adopt the same pricing assumption to determine the economic producibility of proved reserves for both accounting (under full cost and successful efforts methods of accounting) and disclosures (under Statement 69 and proposed Item 1200).
- revise Rule 4-10(c)(4), and coordinate with the FASB to revise paragraph 30(a) of Statement 69, to require twelve-month average prices be used in both the cash flow calculations required in the limitation of capitalized costs in Rule 4-10(c)(4) and the future cash inflows required by Statement 69.

### **Legal Right to Produce**

The Proposed Rule states that the estimated remaining quantities of oil and gas reserves and related substances anticipated to be recoverable must meet the criterion of, among others, “the legal right to produce.” The Proposed Rule does not provide a specific definition of “the legal right to produce.” However, the Proposed Rule defines proved

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<sup>5</sup> Part D, Application of Full Cost Method of Accounting, of SEC Staff Accounting Bulletin Topic 12: Oil and Gas Producing Activities



oil and gas reserves as “...those quantities of oil and gas, which by analysis of geoscience and engineering data, can be estimated with reasonable certainty to be economically producible—from a given date forward, from known reservoirs, and under existing economic conditions, operating methods, and government regulations—prior to the time at which contracts providing the right to operate expire, unless evidence indicates that the renewal is reasonably certain, regardless of whether deterministic or probabilistic methods are used for the estimation.” We believe the staff should consider providing specific definitional guidance for “the legal right to produce” when estimated oil and gas reserves at economic levels exist after the expiration of current legal, regulatory, or contractual provisions. We suggest such definitional guidance include how oil and gas reserves that exist at economic levels after expiration of current legal, regulatory, or contractual provisions should be included, or excluded, from a registrant’s accounting and disclosure reserve quantities and whether any separate disclosures should be included in a registrant’s filing if such reserves do exist.

We note that the use of “reasonably certain” in the definition of proved reserves appears to require a level of certainty that is higher than applied in current practice. We believe registrants in current practice record reserve quantities in established markets when the grant of a renewal is probable subsequent to the expiration of the concession period. This practice is based on guidance in the SEC Staff’s *Frequently Requested Accounting and Financial Reporting Interpretation & Guidance* dated March 31, 2001, which states:

The history of issuance and continued recognition of permits, concessions and commerciality agreements by regulatory bodies and governments should be considered when determining whether hydrocarbon accumulations can be classified as proved reserves. Automatic renewal of such agreements cannot be expected if the regulatory body has the authority to end the agreement unless there is a long and clear track record which supports the conclusion that such approvals and renewal are a matter of course.

We believe the staff should clarify whether the Proposed Rule changes current practice for estimating proved oil and gas reserves at economic levels that exist after the expiration of current legal, regulatory, or contractual provisions.

## **Market**

The definition of reserves in Rule 4-10(a)(28) states that, “Reserves are estimated remaining quantities of oil and gas and related substances anticipated to be recoverable, as of a given date, by the application of development projects to known accumulations based on:...installed means to delivering the oil, gas, or related substances to

markets....” In certain geographies, a registrant may have an installed means of delivering the substance to market, however, there may not be a spot or liquid market. For example, in a number of geographies gas is sold under a long-term contract to a single customer (often a governmental organization) for a duration that is shorter than the legal, regulatory or contractual right to produce. We recommend the SEC provide guidance as to whether:

- the quantities of proved reserves may only be recorded for the quantities covered by existing sales contracts; or
- the probability of renewals or new sales contracts may be considered, and if so, what criteria should be applied.

### **Auditing Considerations**

To the extent that a final rule affects registrants’ Statement 69 disclosures, the Commission should coordinate with the PCAOB to revise the information covered under AU 558<sup>6</sup> and AU 9558<sup>7</sup>. Paragraph 7 of AU 558 requires auditors to perform certain procedures with respect to supplementary information, including comparing the supplementary information for consistency with the audited financial statements. Paragraph 5 of AU 9558 specifically addresses supplementary oil and gas reserve information and includes a requirement for the auditors to inquire as to whether, “The prices used to develop future cash inflows from estimated production of the proved reserves are based on prices received at the end of the entity’s fiscal year....”

As discussed previously, there is a general agreement among preparers, professional advisors and users of financial reports that information is easier to use and understand if it is presented in a logical fashion with all relevant information contained in one place. If a final rule results in registrants presenting Statement 69 supplemental disclosures that are inconsistent with the underlying data used in generation of the financial statements, we believe that the Statement 69 supplemental disclosures should be relocated from unaudited supplemental information included in the financial statements to the same section of a registrant’s report that includes the proposed Item 1200 disclosures, with coordination with the FASB and PCAOB to amend Statement 69 and AU 9558 as necessary.

### **Accounting Change**

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<sup>6</sup> PCAOB Auditing Standards AU 558, Required Supplementary Information (incorporated under PCAOB Rule 3200T)

<sup>7</sup> PCAOB Auditing Standards AU 9558, Required Supplementary Information: Auditing Interpretations of Section 558 (incorporated under PCAOB Rule 3200T)



We are supportive of the Commission’s view that the proposed change in reserve definition for activities which are defined as oil and gas producing activities in existing Rule 4-10(a)(1) should be treated as a change in estimate under Statement 154<sup>8</sup>. As a change in estimate, any impact of adoption of the Commission’s new definition on the amounts recorded in the financial statements in accordance with Statement 19 and S-X Rule 4-10(c), and quantities of proved reserves disclosed in the tables provided under Statement 69, would be separately disclosed. No retrospective application would be required. This appears consistent with paragraph 7 of Statement 25 which indicates that, “Previously reported quantities shall not be revised retroactively if the SEC definitions are changed.” See further comments under “Oil and Gas Accounting versus Mining Accounting” and “Proposed Implementation Date.”

The Proposed Rule does not indicate how the change in reserve quantities effected by the new rules would be reflected in the proposed Item 1200 disclosures. We recommend that the Commission clarify that changes to reserve disclosures outside of the financial statements would also be treated prospectively.

We believe that if the impact of first-time application of a final rule on the financial statements and the proposed Item 1200 disclosures is disclosed separately it would assist users of the reserve information to distinguish those changes from other revisions of previous estimates (e.g., changes resulting from new information available about production or changes in economic factors).

### **Oil and Gas Accounting versus Mining Accounting**

We support the proposal to require registrants to follow oil and gas accounting principles for unconventional sources such as bitumen extracted from oil sands and oil and gas extracted through a traditional mining technique. Historically, registrants accounted for extraction of these resources as mining activities. To this end, we believe that the Commission should provide specific guidance to registrants on:

- The accounting upon transition from mining activities to oil and gas producing activities upon the issuance of a final rule.
- The accounting when a registrant moves between mining and oil and gas producing activities subsequent to the issuance of a final rule (e.g., because of a change in the economic environment a registrant commences coal gasification and marketing activities rather than continuing its existing coal extraction and marketing activities).

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<sup>8</sup> FASB Statement 154, Accounting Changes and Error Corrections



The adoption of oil and gas accounting rules for products such as bitumen and oil and gas extracted through a traditional mining technique will result in adjustments to oil and gas reserves used for accounting purposes. Registrants accounting for activities traditionally considered mining activities currently utilize proved and probable reserves to recognize and measure capitalized costs and calculate depletion, depreciation, and amortization, whereas under oil and gas accounting principles, only proved reserves are used for such measurements. We believe that upon issuance of a final rule, a registrant that currently applies mining accounting principles for unconventional oil and gas activities should account for the change as a change in accounting principle that would require retrospective application under Statement 154, absent a special transition provision promulgated by the Commission or FASB. We believe consistent treatment of all changes brought about by application of the Commission's final rules would be in the best interests of preparers, professional advisors and users of the information.

We also note that Statement 19 excludes from its scope "the extraction of hydrocarbons from shale, tar sands, or coal." We urge the Commission to work with the FASB to revise the scope of Statement 19 such that reserves from non-traditional resources that are included in oil and gas reserves pursuant to the Proposed Rule are also accounted for as oil and gas producing activities pursuant to Statement 19.

### **Proposed Implementation Date**

As discussed above, we agree with the Commission's characterization of the change in reserve definition as a change in estimate under Statement 154. However, it is unclear as to the specific point in time at which any changes in estimates and related disclosures should be implemented. The Proposed Rule would require compliance with the Commission's new requirements beginning in annual reports on Forms 10-K and 20-F filed for the years ending December 31, 2009 and registration statements filed after January 1, 2010. The Proposed Rule does not indicate whether the accounting effects should be recognized for the annual period, which might require adoption in the first quarter of fiscal year 2009, or in the fourth quarter of the fiscal year at the year-end balance sheet date, or as of some other date. We recommend that this adoption date be clarified in a final rule.

### **Other SEC Guidance**

In the proposing release the Commission does not address how the Proposed Rule would impact the various Staff Accounting Bulletins that provide interpretive guidance about



accounting and disclosure for oil and gas producing activities. The following SAB Topic 12 references would require harmonization with a final rule:

- Question 3.b of SAB Topic 12A provides guidance about what disclosure is permitted about the value of oil and gas reserves other than proved reserves. It is unclear whether this guidance would remain applicable in light of the proposed permitted disclosures of probable and possible reserves.
- Question 3.d of SAB Topic 12A indicates that in the case where the balance sheet of the general partner is included in a registration statement for a limited partnership the disclosures specified in paragraphs 10-17 and 30-34 of Statement 69 are required. Similarly, Question 4 of SAB Topic 2D requires all Statement 69 disclosures to supplement financial statements included in an exchange offer and the SEC staff has a practice of requiring the same information in financial statements of acquired oil and gas properties filed to comply with Rule 3-05 of Regulation S-X. A final rule should address these situations since the entities to which these disclosures relate may not be issuers as defined by securities law. We would expect that the disclosure requirements for these situations would be consistent with disclosure provided by registrants applying a final rule.
- Question 3.c. of SAB Topic 12D provides for consideration of events subsequent to the period-end but prior to the date of the auditors' report on the financial statements in reducing or eliminating full cost ceiling test impairments. Clarification will be required as to the continued availability and application of this SAB Topic to the full cost ceiling test requirements. For instance, when using a 12-month average price in the full cost ceiling test, is it still appropriate to use a *subsequent* single-day price or should a rolling 12-month price be considered?
- SAB Topic 12G clarifies that extraction of methane gas through conventional methods is an oil and gas activity. This staff guidance should be deleted as the definition of oil and gas producing activities in the Proposed Rule now includes extraction of marketable hydrocarbons from coalbeds.

### **Foreign Private Issuers**

Foreign private issuers (“FPIs”) preparing their financial statements under IFRS as issued by the IASB are required to provide Statement 69 disclosures under Item 18 of Form 20-F using the S-X Rule 4-10 definition of proved reserves. As IFRS does not define proved reserves, FPIs may use other internationally recognized definitions of reserves for financial statement purposes (i.e., reserves beyond proved) which may be different than those specified in S-X Rule 4-10(a). Similar (but not identical) Statement 69 disclosure issues arise as noted earlier for domestic registrants if a dual pricing





assumption is retained in a final rule, resulting in different definitions of proved reserves for accounting and disclosure purposes.

We encourage continued discussion with the IASB to achieve consistency in accounting for oil and gas producing activities. If harmonization of reserve definitions between IFRS and U.S. GAAP is not achieved before a final rule is adopted we recommend that the Commission clarify in a final rule how the Commission's disclosure requirements apply to IFRS filers.

## **XBRL**

As indicated in our letter dated August 1, 2008 to the Commission in response to the XBRL proposed rule<sup>9</sup>, we are generally supportive of the Commission's efforts to improve the usefulness of financial statement information by making it more accessible to investors through the use of interactive data. A detailed oil and gas taxonomy does not exist and it is not clear at this time who will create and maintain the taxonomy. These issues will need to be resolved before expanding use of XBRL beyond block-tagging of Statement 69 information included in the unaudited supplemental information to the financial statements.

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<sup>9</sup> SEC Release No. 33-8924, Interactive Data to Improve Financial Reporting



We appreciate the opportunity to submit our comments on the Proposed Rule. If you have any questions regarding our comments, please contact Sam Ranzilla, (212) 909-5837, [sranzilla@kpmg.com](mailto:sranzilla@kpmg.com) or Melanie Dolan, (202) 533-4934, [mdolan@kpmg.com](mailto:mdolan@kpmg.com).

Sincerely yours,

**KPMG LLP**

cc:

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