CFA INSTITUTE
Centre for Financial Market Integrity

29 August 2008

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

Re: File Number S7-16-08
Proposed Rule: Modernization of the Oil and Gas Reporting Requirements

Dear Ms. Harmon:

The CFA Institute Centre for Financial Market Integrity (CFA Institute Centre), in consultation with its Corporate Disclosure Policy Council (CDPC), appreciates the opportunity to comment on the rule proposal issued by the U.S. Securities and Exchange Commission (SEC or Commission). The CFA Institute Centre is the research, policy, and advocacy arm of CFA Institute, and represents the views of its investment professional members, including portfolio managers, investment analysts, and advisors, worldwide.

We strongly support the SEC's intent, through this rule proposal, to provide investors with more direct and understandable information related to oil and gas reserves. As we noted in our prior comment letter[1], the information provided on companies' balance sheets for oil and gas reserves may bear little relationship to their current economic value. Many of the recommendations will provide benefits to investors.

We do not agree with the proposal to base disclosures on historical 12-month average prices. The CFA Institute Centre continues to advocate for the use of fair value measurement for financial reporting. This could be accomplished by using prices from the futures pricing curve for oil and gas trading activities.

We believe the Commission's proposed change in the pricing model will lead to added complexity both for companies and users, as the proposed disclosures would have to be reconciled with those required by FASB Statement No. 69, *Disclosures about Oil and Gas Producing Activities*. We encourage the SEC to work with the FASB to implement a unified pricing model for all oil and gas reporting.

[1] CFA Institute provided comments to the SEC in February 2008 related to their Concept Release on Oil and Gas Reserves. The full letter is available on the CFA Institute website: www.cfainstitute.org/centre/topics/comment/2008/pdf/sec_oil_and_gas.pdf

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We enthusiastically support many of the disclosure changes outlined in the rule proposal. The proposals to revise current practice and remove reporting on prohibited sources of hydrocarbons, and the updating of definitions and technology requirements offer many benefits to investors.

We also support the call to increase the use of standardized reporting formats. All users of the information benefit from the comparability provided by structured tables and the incorporation of the requirements into the XBRL reporting platform.

In the balance of this letter, we will address these areas in further detail. We hope our views will offer assistance in the SEC's determination of the final rules to be used for the modernization of oil and gas disclosures.

Concern with Historical Prices

We do not support the recommendation to move to a model based on the use of a 12-month historical pricing average for valuing reserves, but agree there is a need to change from the current practice. The CFA Institute Centre consistently advocates for the use of fair value measurements in reporting financial information rather than using historical price-based measurements. We believe that calculating prices from the futures pricing curve would better approximate the economic value of the company's reserve holdings.

We recognize the volatility that results from using prices as of a single date, but we believe that such volatility reflects the underlying economics of the oil and gas industry. The securities of oil and gas companies are valued based on price expectations imbedded in the futures pricing curve and not on historical prices.

Our recommendation would be to use futures pricing information, such as that available from NYMEX for natural gas or crude oil. Providing reserve values based on futures prices allows investors to better forecast the earning potential of the firm. A forward looking pricing model incorporates the current expectations of market participants.

Potential concerns over the availability of such prices can be addressed. If future prices are not available for specific geographic markets or certain oil and gas grades or products, the reporting company should be able to make reasonable estimates using market-based inputs (analogous to Level II inputs of the fair value hierarchy discussed in FASB Statement No. 157).

Increased Complexity

While the SEC's proposal offers many improvements to the disclosures for oil and gas reporting, the proposal also increases reporting complexity by creating a disclosure system separate from that of FASB Statement No. 69 and which is based on a different pricing mechanism. The use of different pricing models requires both preparers and users to understand the competing models and leaves investors to reconcile the differences.

The final report of the SEC Advisory Committee on Improvements to Financial Reporting (CIFiR) included the following recommendation, which aptly summarizes our position as well:

> *The SEC and the FASB should work together to develop a disclosure framework to:*
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> - *Integrate existing SEC and FASB disclosure requirements into a cohesive whole to ensure meaningful communication and logical presentation of disclosures, based on consistent objectives and principles. This would eliminate redundancies and provide a single source of disclosure guidance across all financial reporting standards.*
>
> - *Require disclosure of the principal assumptions, estimates, and sensitivity analyses that may impact a company's business, as well as a qualitative discussion of the key risks and uncertainties that could significantly change these amounts over time. This would encompass transactions recognized and measured in the financial statements, as well as events and uncertainties that are not recorded."*[2]

By following the spirit of this CIFiR recommendation, the disclosure changes of the oil and gas reporting proposal could greatly benefit investors. Instead, the proposal as it presently reads would cause comparable items to be measured differently. We encourage the SEC to work with the FASB to update all pricing requirements within oil and gas reporting.

In addition, we believe that incorporating averages of historical prices is poor regulatory policy. Its use here may encourage those who seek to obscure the effects of price changes on financial statements to pressure standard setters to use historical average prices for financial instruments and other assets and liabilities with volatile markets. Financial markets are highly sensitive to price changes and financial data are most useful when they reflect current market prices.

The disclosure of sensitivity analysis, especially around pricing assumptions, would also provide significant improvements for investors. Requiring companies to provide an analysis of a possible 10 percent price change, whether up or down, along with information on how the price average was determined, would enhance the usefulness of the disclosures for investors.

Aside from the changes to the pricing model, we encourage the SEC to consider the work under way at the International Accounting Standards Board. The IASB's extractive industry project[3] may provide the opportunity to eliminate optional accounting choices currently allowed in the standards—such as the full cost and successful efforts models—instead adopting a model that reflects the economic value of the activity. Given the Commission's announced intent to

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[2] This is Recommendation 1.2 of the recommendations made to the SEC. The final report is available on the SEC website: www.sec.gov/about/offices/oca/acifr/acifr-finalreport.pdf

[3] Additional information on the extractive activities project is available on the IASB website: www.iasb.org/Current+Projects/IASB+Projects/Extractive+Activities/Summary.htm

transition US companies to IAS, we believe that the IASB project should be considered before adopting the proposed rules.

Improved Disclosures

We support many of the disclosure changes outlined in the proposal. With the technological and business advances over the past 25 years, updates are needed to ensure the best disclosures are permitted in companies' regulatory filings. The following are several key recommendations of the rule proposal we support, regardless of the decision on changes to the pricing model:

a. Elimination of the exclusion of oil and gas from "non-traditional" or "unconventional" sources, such as oil sands and coal beds. All classes of reserves should allow for the incorporation of all forms of marketable hydrocarbon products.

b. Allowing the disclosure of reserves classified as Probable and Possible. This information benefits investors attempting to assess the long-term potential of the reporting company.

c. Updating the definitions related to the allowable technologies used to estimate reserve volumes. Given the ongoing advancements in technology, the open ended definitions with the required disclosures ensures new technology changes can be easily incorporated once they become accepted industry practices.

d. Updating the many definitions concerning reserves and other disclosures to align with current industry practices. The SEC should continue to monitor the work of the Society of Petroleum Engineers (SPE) for potential future updates to classifications and best practices within the oil and gas industry.

e. The additional disclosures related to the qualifications of those primarily responsible for preparing reserve estimates. By having the new items apply to both internal staff and contracted 3rd parties, users are better equipped to understand the objectivity and independence of the reserve estimates.

Disclosures such as those described above provide investors with the additional information needed to understand the context of the financial statement amounts. Given that comparable items are commonly provided in other corporate reports, the SEC's proposal improves the usefulness of the information by combining the data in a single report.

Standardized Format

The comparability and consistency of information across companies and time periods remains important to CFA Institute members. The tables outlined throughout the proposal introduce a level of structure that increases those qualities within the reported information. We encourage the SEC and other regulators to take this standardized approach when updating their disclosure requirements.

We advise caution when changes potentially allow the aggregation or summation of values across different items, such as reserve classes. A key principle of our publication, "A Comprehensive Business Reporting Model: Financial Reporting for Investors" (CBRM)[4], is that information be presented and explained on a disaggregated basis. Reporting companies should be required to provide disaggregated details on reserve types and locations to ensure their disclosures meet the needs of investors.

We enthusiastically support the SEC's plan to move all financial reporting requirements to an XBRL platform. The updates to oil and gas disclosures should be incorporated into the mandate once approved. We request that the SEC ensure that appropriate guidance and taxonomy (tag) updates are completed along with the adoption of the final rules.

Once the SEC approves its comprehensive XBRL requirements, it should incorporate the determination of required fields and guidance during the development phase of disclosure updates. This will allow those who review the proposal to also review these XBRL-related changes. It is important to ensure a full and complete due process for all aspects of the proposal.

Conclusion

We applaud the Commission for the steps outlined in the rule proposal to increase the disclosures related to oil and gas reporting requirements. We believe many of the changes can be implemented as proposed. The Commission should engage the FASB to address the potential pricing model differences that would arise between current standards and the proposal.

Central tenets of the CFA Institute Centre[5] mission are to promote fair and transparent global capital markets, and to advocate for investor protections. An integral part of our efforts toward meeting those goals is ensuring that the corporate financial reporting and disclosures provided to investors and other end users is of high quality. The CFA Institute Centre also develops, promulgates, and maintains guidelines encouraging the highest ethical standards for the global investment community through standards such as the CFA Institute Code of Ethics and Standards of Professional Conduct.

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[4] Chapter 2 provides a discussions of all the key concepts of the CBRM, which is available on the CFA Institute website: http://www.cfapubs.org/doi/pdf/10.2469/ccb.v2007.n6.4818

[5] The CFA Institute Centre for Financial Market Integrity is part of CFA Institute. With offices in Charlottesville, VA, New York, Hong Kong, and London, CFA Institute is a global, not-for-profit professional association of more than 96,000 investment analysts, portfolio managers, investment advisors, and other investment professionals in 134 countries, of whom nearly 83,000 hold the Chartered Financial Analyst® (CFA®) designation. The CFA Institute membership also includes 135 member societies in 56 countries and territories.

The consultation of the CDPC provides the practitioners' perspective in the promotion of high-quality financial reporting and disclosures that meet the needs of investors. The CDPC is comprised of investment professionals with extensive expertise and experience in the global capital markets, some of whom are also CFA Institute member volunteers.

We appreciate the opportunity to provide comments to the Commission and its staff regarding the rule proposal. If the Commissioners or their staff have questions or seek further elaboration of our views, please contact Glenn Doggett, CFA, by phone at 434.951.5278 or by e-mail at glenn.doggett@cfainstitute.org.

Sincerely,

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Gerald I. White, CFA
Chair, Corporate Disclosure Policy Council

cc: Robert Herz, Chair, Financial Accounting Standards Board
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