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Wildcatter Wrangle

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The accounting profession's rule-making body, already typecast as Caspar Milquetoast for repeatedly watering down stiff accounting proposals in recent years, appears ready to play the same role in a new drama.

Under heavy pressure from the oil industry, the Accounting Principles Board seems likely to reverse a tentatively proposed accounting change that would have sharply lowered the reported earnings of many oil companies, particularly smaller ones.

The board's Committee on Extractive Industries has decided to recommend to the board next month that the oil companies be allowed to continue using the controversial "full-cost" method of accounting. Insiders believe the board will concur.

The full-cost method gives a boost to current reported earnings of oil companies choosing to use the system because it permits them to stretch over a period of years such current costs as unsuccessful exploration and drilling expenses. Thus, they can report much higher earnings in the early years of an exploration program than they could if they charged off the expenses as incurred.

Most major oil companies shun the full-cost system and instead charge off these costs as they are incurred. But roughly half of the publicly held oil-exploration companies use the full-cost system, including Occidental Petroleum Corp., Tenneco Inc., Texaco Inc. and Texas Oil & Gas Corp.

Reflecting the importance of the accounting method to these companies, their stocks generally took a nosedive when the accountants' Extractive Industries Committee in November announced a "highly tentative position" withdrawing most benefits of full-cost accounting as practiced by companies operating in the U.S. and Canada.

Battle Lines Drawn

Not surprisingly, these companies lept into battle with the accountants. And not surprisingly in view of recent accounting board history, the companies apparently have succeeded in winning a reversal.

The board still bears scars from its protracted controversy over tighter rules for merger accounting. Over much of 1970, the board, badly split and under heavy pressure from industry, repeatedly weakened its proposals before reaching a compromise. (But the board has taken on a tremendous number of industries in recent years in attempts to make accounting rules more consistent. Currently keeping the board especially busy are guidelines for life insurers.)

Under regulations of the Securities and Exchange Commission and the major stock exchanges, corporate financial reports must be certified as conforming to "generally accepted accounting principles." It's the job of the 18-member Accounting Principles Board to set these principles.

Severely criticized for its sometimes bewildering and contradictory array of principles, the board in recent years has been trying to narrow the choices of accounting methods. In many cases, such as in accounting for oil-drilling expenses, the same basic costs may be reflected in shareholder reports in several different ways, to the confusion of shareholders and securities analysts. But the board's efforts, as in the current oil case, have often riled corporate treasurers, bringing reversals or compromises.

Anguished Outcry From Some

The vehemence of the attack by oil companies using the full-cost method stunned some accountants at hearings in November. Occidental called the committee proposal attacking full-cost "truly incredible." Underwriters said the proposed new rule would make it extremely difficult for smaller companies to get financing, especially in stock sales, because their earnings would be "distorted" downward.

A parade of companies using the full-cost method, their analysts, auditors and others, testified that the overall impact of adopting such restrictive proposals would be to discourage aggressive exploration just as the U.S. faces an energy crisis and just as U.S. oil and gas companies face the need to raise some $150 billion in the next decade for capital and exploratory spending.

Officials of "full-cost companies" that have already learned of the committee's reversal consider the battle won. But not all the analysts or accountants involved are happy about the reversal, and some complain that the committee caved in abysmally under pressure. "The whole thing was outrageous," fumes David Norr, a securities analyst, a committee member, and a partner in First Manhattan Co. "This was the howl of the mob determining accounting principles."

'Interesting Exchanges'

Joseph Cummings, committee chairman and a partner in Peat, Marwick, Mitchell & Co. in New York, concedes the companies using the full-cost method were quite upset and "a few interesting exchanges" took place. But he says the companies' arguments persuaded the committee to change course.

Committee members now are drafting their recommendations on oil accounting, for presentation to the Accounting Principles Board at a meeting March 8 to 10 Mr. Cummings says the recommendations will place certain restraints on full-cost accounting. But in effect the companies will be allowed to amortize, or spread out, their exploration and other costs pretty much as they have been, because they can still use an entire country or continent as a "cost center."

In accounting jargon, the "cost center" is the geographic area within which drilling and other exploratory costs may be balanced off against the income from reserves in that area. Under the present full-cost procedure, companies using the method have considered all of the U.S. and even all of North America as their "cost center"—meaning that they could capitalize all of the costs involved in a fruitless search for oil in, say, Louisiana, and balance them off against income from reserves in California over a period of years.

The harshly criticized November proposal of the Extractive Industries Committee would have narrowed the cost center down to a single producing field. Some oil analysts viewed this position as a compromise of sorts between full-cost advocates and those who favored immediate write-offs, because it did allow costs within the field to be accounted for as capital items.

Support From the Opposition

But to most companies using the full-cost method, the decision was clearly a death blow to their way of accounting. Even Robert Mays, comptroller of Standard Oil Co. (New Jersey), who as a mild critic of the full-cost method and whose company uses more conservative accounting, agrees that the proposal amounted to a rescission of most full-cost benefits.

"Companies frequently start out working within a broad geographic area of interest," he says, "and spend a lot of time and money identifying prospects in the area without locating a producing field. What do you do with all of the costs involved in working the whole area, the costs that can't be associated with a given field? The inference of the original (accounting panel) memorandum is that you would write them off" against current earnings rather than making them capital items to be amortized over several years.

In its review of oil industry accounting methods, the Accounting Principles Board is seeking to arrive at a set of principles to make the earnings of separate oil companies a good deal more uniform. But the uproar over the November proposals and the switch in position by the Extractive Industry Committee apparently are resulting in a continuation of two basically different ways of accounting for key expenses of oil companies.

There would, however, be some steps toward uniformity, if the committee recommendations are adopted. For example, all oil and gas companies would be required to capitalize (and therefore spread out) their costs for geological and geophysical work, property acquisition, carrying costs and several other expenses — practically all costs leading up to drilling.

Once drilling occurs, however, a company could go in either of two directions. If the well is a dry hole, a company could conservatively write off the cost of drilling it immediately, considering that field its cost center. But if a "full-cost company" drills a dry well, it will be permitted to consider the whole country its cost center, just as it does now. So it can stretch out the cost of that dry hole instead of writing it off immediately, provided it has offsetting revenues from enough proven reserves somewhere else in the country.

But critics of the plan say drilling costs generally represent a huge chunk of total expenses in exploration, and only a small percentage of wildcat wells strike oil in commercial quantities. They feel that allowing separate oil companies to treat such an important cost item in two different ways perpetuates a confusing dual system.

Choices in Oil Discoveries

Under the new committee proposals, a company finding oil also would have a dual choice. Under conservative accounting, companies could write off all costs, including predrilling costs, not associated with that specific find. A concern using full-cost accounting could treat that discovery exactly as it always has, capitalizing all the costs and lumping the reserves found into its total, nationwide pool.

The "full-cost companies," however, wouldn't be allowed to capitalize exploration and drilling expenses in an amount beyond the value of their existing national reserves (currently, there is no such limit). Also, under the new recommendations, oil companies would have to fully disclose expenditures on separate unsuccessful explorations, the amount of capitalization of these expenses, what reserves were discovered in given areas, and the quality of those reserves.

Richard Lemmon, adviser to the Extractive Industry Committee chairman, believes the new recommendations will bring a measure of uniformity to oil accounting. "Actually, we don't have just two accounting methods right now, but more like 200, because each method is applied with many variations," he says. "I think now we will have one accounting method, requiring the same capital expense decisions before discovery but allowing some flexibility afterward."

Others aren't so sure. Says one puzzled executive of a major oil concern, "None of it makes sense unless you've got a darn good astrologer on your staff." An accountant specializing in oil concerns says the Accounting Principles Board has "suffered through some big battles lately with the insurance industry and over investment tax credits." He adds, "So maybe they're trying some sort of compromise here. But any compromise which permits the two systems to exist is no compromise. It's simply walking away from the problem."