

“SOX in The Patch” Roundtable Compliance and Reporting Session III

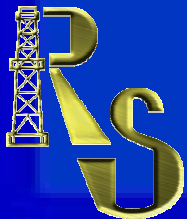
Executing External Controls From the perspective of a reserves engineer

By

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The role of an Independent Auditor

- Independence of auditor
- Definition of terms
- Observations about SOX and reserves
- “Auditing Standards”
- Improving investor/regulator confidence
- The view from “Wall Street”
- Congressional concerns
- Levels of interaction with Independent Auditor



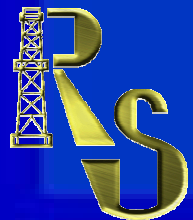
What does “independent” mean?

- Employee-owned (Ideally)
- No ownership connection with client/industry
- No client comprising “significant” part of business
- No “outcome based” fees or other incentives



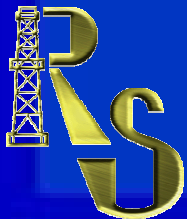
Terms commonly used (and often misunderstood)

- Review
 - Audit
- Reserves Report



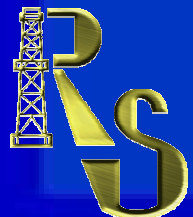
Review

- Process review is an analysis of the process and procedures established to assure that reserves have been estimated in compliance with relevant standards. May involve review of qualifications of internal audit personnel and independence available to them
- Reserves review may involve a cursory investigation of client-selected properties for various purposes.



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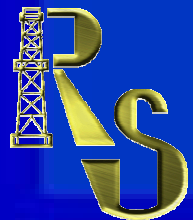
Reserves Audit

- An examination for the purpose of expressing an opinion that a reserves report is reasonable ***in the aggregate*** and generally conforms to accepted engineering and geological principals and relevant reserves definitions.
- May include all or a portion of the properties of an entity
- Report is in the form of a letter
- Tolerances usually within 5 to 10 %



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Reserves Report

- A “grass roots” evaluation in which the estimator has examined and evaluated all available source data for the purposes of producing an independent estimate of reserves and reserves information.
- Reserves report may be internally or externally prepared



An engineer's view of SOX's requirements regarding petroleum reserves

- Management (CEO, CFO, Board) commitment to transparent and competent estimation and reporting of proved reserves to SEC standards
- Commitment should provide for independence of estimator – both internal and external
- Estimators should not be influenced by outcome-based incentives



An engineer's view of SOX's requirements regarding petroleum reserves

Continued.....

- Ongoing education of evaluators – best practices, ethics and continuing education
- Engagement of third-party evaluators as deemed appropriate by management – no requirement for such (yet)
- Internal “peer-review” reserves process necessary for quality control and consistency



Auditing Standards

- 1977 SPE "Standards Pertaining to the Estimating and Auditing of Oil and Gas Reserves Information"
- 2001 Update to above



Improving quality of reserves estimates and investor confidence

– a Proposal to Certify the Reserves Evaluators

- Certification will involve (a) recommended practices (b) ethics training (c) reserves definitions and (d) continuing education
- Potential sponsors include (a) SPEE (b) SPE (c) AAPG and (d) WPC
- Organizational committee meeting set for June 15
- Program to be web-based, examination required, non-mandatory
- No other mandated U.S. or international standards (except Canada)



The view from “Wall Street” about reserves

- Financial Analysts
- Investment bankers
- Institutional Investors
- Rating Agencies



Congressional concerns

- May 4 letter from Congressman John Dingell to DOE, FERC, SEC and FASB
- Questions about Shell "debacle"
- Questions about SEC's reserves staff
- Why not mandatory third party reserves audits
- "Why did they (auditors) miss the current crop of problems"



Potential levels of consultant involvement with reserves oversight

- Consultation in developing internal reserves preparation and audit process
- External review of internal reserves preparation and audit process
- External participation in internal reserves audit process
- Reserves classification oversight – selected properties
- Reserves audits/studies for certain properties selected by client company



Potential levels of consultant involvement with reserves oversight

Continued.....

- Reserves audits/studies for designation portion of client's properties – possibly one-third of company properties each year for a three-year audit cycle.
- Reserves audit/studies for 70–90% of company's reserves
- Reserves audit/studies for 100% of company's reserves



**Thanks for listening –
now let's hear from you.**

