

Opening Statement

Chairman Michael G. Oxley

Committee on Financial Services

“Shell Games: Corporate Governance and Accounting for Oil and Gas Reserves” **July 21, 2004**

Nearly two years ago, this Committee passed the most critical securities legislation enacted since the 1930s, the Sarbanes-Oxley Act of 2002. While the Act’s corporate reforms and the rigorous measures taken by the Public Company Accounting Oversight Board have helped rebuild investor confidence in our capital markets, the corporate governance failures that led to the passage of the legislation have not completely disappeared.

Tomorrow, this Committee will hear reports from a panel of experts on how the Sarbanes-Oxley Act has benefited the American investor and helped to restore accountability in the governing bodies of publicly traded corporations. Today, we examine some unfortunate examples of why that reform was necessary.

The abuses by corporate insiders who contemptuously disregarded the interests of public shareholders while seeking their own personal enrichment unfortunately were not limited to any one industry. However, the problems that have recently been alleged at El Paso and Shell, among others, raise some compelling questions about accounting practices and internal controls at energy companies.

There has been growing unease in the industry about a widespread tendency to overbook reserves. Regulators cracked down on energy companies in the 1970s when it appeared they were being cavalier with their reserve disclosures. A report by an energy consultancy in 2001 noted the pressure on managers of publicly traded energy companies “to push the envelope of credibility in efforts to buoy investor confidence and thus increase stock value.” The consultants blamed the overbooking on incentive programs that offered bonuses for big reserve estimates.

The financial statements of energy companies, like those of all public companies, necessarily include estimates that may not ultimately prove to be accurate. In the oil and gas industry, the most important number, which is an estimate, is a company’s proven reserves – the oil and gas in the ground that a company claims to own. If reserve estimates are made in a way that is biased – for example, because bonuses are tied to high reserve estimates – this obviously compromises the financial statements of the company. I understand that Shell has since removed reserve bookings as a component of executive-performance reviews that are used to calculate bonuses.

We will examine today whether additional steps should be taken to ensure that oil companies’ reserve estimates are not compromised by improper incentives.

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In addition, we will examine the accounting rules themselves to ensure that the rules that the SEC has put in place have kept up with technology to provide investors with the most accurate possible information about a company's proved reserves, and, accordingly, its financial position. Some critics contend that the rules that the Commission currently applies to determine whether reserves can be treated as "proven" or not are outdated. We will learn more about these concerns today.

And finally, we will examine questions of corporate governance, in light of the unusual corporate structure at Shell. Some experts have attributed the lack of transparency at Shell to the company's unique corporate arrangement, which consists of two separate boards charged with overseeing the company. I am encouraged by reports that Shell has already undertaken a review of its corporate structure in response to this criticism. I believe there is significant opportunity for Shell to repair some of the confidence that has been lost by re-making its corporate structure to reflect the image of transparency and candor that is embodied in the majority of publicly traded corporations as a result of the Sarbanes-Oxley Act.

I look forward to hearing testimony from our distinguished panel of witnesses.

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