

should be recorded at their fair market value.

**Question 3:** How should “common control accounting” be applied to the specific assets and liabilities of the new exchange company?

**Interpretive Response:** Under “common control accounting” the various accounting methods followed by the offeree entities should be conformed to the methods adopted by the new exchange company. It is not appropriate to combine assets and liabilities accounted for on different bases. Accordingly, as in the case of any merger between oil and gas companies, all of the oil and gas properties of the new entity must be accounted for on the same basis (either full cost or successful efforts) applied retroactively.

**Question 4:** In Form 10-K filings with the Commission, the staff has permitted limited partnerships to omit certain of the oil and gas reserve data disclosures required by Statement 69 in some circumstances. Is it permissible to omit these disclosures from the financial statements included in an exchange offering?

**Interpretive Response:** No. Normally full disclosures of reserve data and related information are required. The exemptions previously allowed relate only to partnerships where value-oriented data are otherwise available to the limited partners pursuant to the partnership agreement. The staff has previously stated that it will require all of the required disclosures for partnerships which are the subject of merger or exchange offers.<sup>5</sup> These disclosures may, however, be presented on a combined basis.

The staff believes that the financial statements in an exchange offer registration statement should provide sufficient historical reserve quantity and value-based disclosures to enable offerees and secondary market public investors to evaluate the effect of the exchange proposal. Accordingly, in all cases, it will be necessary to present information as of the latest year-end on reserve quantities and the future net revenues associated with such quantities. In certain circumstances, where the exchange is accounted for as a purchase, the staff will consider, on a case-by-case basis, granting exemptions from (i) the disclosure requirements for year-to-year reconciliations of reserve quantities, and (ii) the requirements for a summary of oil and gas producing activities and a summary of changes in the net present value of reserves. For instance, the staff may consider requests for exemptions in cases where the

properties acquired in the exchange transaction are fully explored and developed, particularly if the management of the emerging company has not been involved in the exploration and development of such properties.

**Question 5:** Assume an exchange transaction is to be accounted for as a purchase and recorded at the fair value of the properties. If the exchange company will use the full cost method of accounting, does the full cost ceiling limitation apply as of the date of the financial statements reflecting the exchange?

**Interpretive Response:** Yes. The full cost ceiling limitation on costs capitalized does apply. However, as discussed under Topic 12.D.3, the Commission has stated that in unusual circumstances, registrants may request an exemption if as a result of a major purchase, a write-down would be required even though it can be demonstrated that the fair value of the properties clearly exceeds the unamortized costs.

**Question 6:** What pro forma financial information is required in an exchange offer filing?

**Interpretive Response:** The requirements for pro forma financial information in exchange offer filings are the same as in any other filings with the Commission and are detailed in Article 11 of Regulation S-X.<sup>6</sup> Rule 11-02(b) specifies the presentation requirements, including periods presented and types of adjustments to be made. The general criteria of Rule 11-02(b)(6) are that pro forma adjustments should give effect to events that are (i) directly attributable to the transaction, (ii) expected to have a continuing impact on the registrant and (iii) factually supportable. In the case of an exchange offer, such adjustments typically are made to:

(1) Show varying levels of acceptance of the offer.

(2) Conform the accounting methods used in the historical financial statements to those to be applied by the new entity.

(3) Recompute the depreciation, depletion and amortization charges, in cases where the new entity will use full-cost accounting, on a combined basis. If this computation is not practicable, and the exchange offer is accounted for as a reorganization, historical depreciation, depletion and amortization provisions may be aggregated, with appropriate disclosure.

(4) Reflect purchase cost in the pro forma statements (where the exchange offer is accounted for on the purchase basis), including depreciation, depletion

and amortization based on the purchase cost.

(5) Provide pro forma reserve information.

(6) Reflect significant changes, if any, in levels of operations (revenues or costs), or in income tax status and to reflect debt incurred in connection with the transaction.

In addition, the depreciation, depletion and amortization rate which will apply for the initial period subsequent to consummation of the exchange offer should be disclosed.

**Question 7:** Are there conditions under which the presentation of other than full historical financial statements would be acceptable?

**Interpretive Response:** Generally, full historical financial statements as specified in Rules 3-01 and 3-02 of Regulations S-X are considered necessary to enable offerees and secondary market investors to evaluate the transaction. Where securities are being registered to offer to the security holders (including limited partners and other ownership interests) of the businesses to be acquired, such financial statements are normally required pursuant to Rule 3-05 of Regulation S-X, either individually for each entity or, where appropriate, separately for the offeror and on a combined basis for other entities, generally excluding corporations. However, certain exceptions may apply as explained in the outline below:

#### A. Purchase Accounting

1. If the registrant can demonstrate that full historical financial statements of the offeree partnerships are not reasonably available, the staff may permit presentation of audited Statements of Combined Gross Revenues and Direct Lease Operating Expenses for all years for which an income statement would otherwise be required. In these circumstances, the registrant should also disclose in an unaudited footnote the amounts of total exploration and development costs, and general and administrative expenses along with the reasons why presentation of full historical financial statements is not practicable.

2. The staff will consider requests to waive the requirement for prior year financial statements of the offeree partnerships and instead allow presentation of only the latest fiscal year and interim period, if the registrant can demonstrate that the prior years' data would not be meaningful because the offeree partnerships had no material quantity of production.

<sup>5</sup> See SAB 40, Topic 12.A.3.c.

<sup>6</sup> As announced in FRR 2 (July 9, 1982).