

DISCRETIONARY DISCLOSURE OF RESERVES BY OIL AND GAS COMPANIES: AN ECONOMIC ANALYSIS

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DISCRETIONARY DISCLOSURE OF RESERVES BY OIL AND GAS COMPANIES: AN ECONOMIC ANALYSIS

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INTRODUCTION

This paper attempts to increase our understanding of voluntary information disclosure in general and, in particular, the decision by Australian oil and gas companies to disclose information in their annual reports regarding estimated reserves.¹ Unlike a number of previous studies, we focus on an industry-specific disclosure decision. Our investigation is premised on the view that the decision to provide information in the annual report about reserves depends on the agency costs faced by the various contracting parties (Jensen and Meckling, 1976). In this context, the disclosure decision is viewed as a means of reducing these costs.

The next section reviews prior analytical and empirical research regarding voluntary disclosure decisions. Full disclosure equilibrium is not supported by empirical evidence of considerable managerial discretion in determining disclosure policies. We consider the analysis by Verrecchia (1983) with respect to proprietary costs of disclosure and argue that his approach reconciles prior analytical research and recent empirical findings. More importantly, the insights provided by Verrecchia are significant in developing a robust empirical test of agency-based models of information disclosure policy. To the extent that proprietary costs of disclosure confound tests of the derived demand for information disclosure, some explicit control of this influence is needed.

Recognition of this fundamental restriction motivates this industry-specific study of a voluntary disclosure decision. If proprietary costs are relatively homogeneous within a defined industry group, focusing on the disclosure of oil and gas reserves represents a more powerful test of the agency-cost framework.

Determinants of the derived demand for disclosure are considered in the third section. Arguments reflecting agency costs are reviewed with respect to leverage, firm size, cash flow risk and the separation of ownership and control. In addition, it is suggested that auditor identity may be related to information disclosure: the demand for differentiated audit quality has been shown to reflect the agency-cost variables used in the disclosure model and auditors, concerned

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