



LETTER OF COMMENT NO. 1981

August 8, 2008

Technical Director
Financial Accounting Standards Board
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File Reference No. 1025-300: Financial Accounting Standards Board's ("FASB" or the "Board") Exposure Draft ("ED") of a proposed Statement of Financial Accounting Standards ("SFAS"), *Disclosure of Certain Loss Contingencies*—an amendment of FASB Statements No. 5 and 141(R).

We appreciate the opportunity to comment on the proposed Statement of Financial Accounting Standards, *Disclosure of Certain Loss Contingencies*—an amendment of FASB Statements No. 5 and 141(R).

The terms "we," "us," "our," "our Company" and "EPM" refer to Evolution Petroleum Corporation.

EPM is a small independent oil and gas producer, headquartered in Houston, Texas, with a market capitalization of approximately \$112 million as of August 7, 2008. Our petroleum operations began in September of 2003 and we became a public company in May 2004. Our common stock is traded on the American Stock Exchange ("AMEX") under the ticker symbol EPM.

We commend the Board's past work on improving the transparency in financial statements. However, we believe that these provisions are more suitably applied to the current practice as dictated by SFAS No. 5 *Accounting for Contingencies* ("SFAS No. 5"), which requires quantitative treatment if the outcome is both probable, and can be reasonably estimated. To deviate from this standard suggests that unreasonable estimates should be disclosed.....something that would be misleading and of detrimental usefulness.

We fully agree, however, that reliable estimates are desirable and should be used. Unfortunately, reliable estimates are often the exception rather than the rule. Consider that neither the defendant, plaintiff, judge, legal counsel, or even the jury, can estimate or predict the outcome of a jury trial, until the foreman finally speaks. Why? Because the outcome is generally driven by emotion, and not about the facts. Human nature, especially in group mode, is just downright unpredictable.

SFAS No. 5, if applied correctly and prudently by responsible managers, provides the necessary foundation for adequate disclosure of information necessary for users to assess the likelihood, timing, and amount of future cash flows associated with loss contingencies. We believe that SFAS No. 5, together with additional requirements for qualitative information with respect to those contingencies required to be disclosed or accrued under SFAS No. 5, would add to the transparency of financial statements and provide users of financial statements with appropriate information to make informed decisions.

While the objectives of the Board is principled, the means, we feel, is counter productive in improving the overall usefulness of financial statements and fulfilling the objective of financial reporting as described in FASB Concepts Statement No. 1 *Objectives of Financial Reporting by Business Enterprises* (FASB Concepts No. 1”), which is to provide useful information so that investors, creditors and other users can make rational decisions.

The new proposed quantitative requirements, which would expand disclosures about loss contingencies, regardless of the likelihood of loss, and would require an estimate of the maximum exposure of loss from the contingency, even when information is not available to make an appropriate and reasonable estimate, would lead to confusion amongst users of the financials statement, may mislead users into making decisions that are not consistent with enterprise's present and continuing ability to generate cash flows, the economic resources of an enterprise, the claims to those resources, nor be helpful to those users who may wish to use the financial statements in helping to estimate its value. Reliability on financial statements would be further complicated as it would be nearly impossible to discern between those claims that are probable, reasonable possible, or remote. By aggregating the quantitative information of all contingent liabilities in a tabular presentation, regardless of the likelihood of becoming a future liability, the user could be mislead into believing the companies potential obligations were significantly greater than reality. This would negatively affect the company and its stakeholders and possible subject the company to legal action.

We feel the SFAS No. 5, long established, should continue to be the definitive guidance with respect to disclosure of loss contingencies.

Our responses to the specific questions included in the ED are provided below.

If you have any questions about our comments, please contact Sterling McDonald or Greg Goodale at 713-935-0122.

Question 1 - Will the proposed Statement meet the project's objective of providing enhanced disclosures about loss contingencies so that the benefits of those disclosures justify the incremental costs? Why or why not? What costs do you expect to incur if the Board were to issue this proposed Statement in its current form as a final Statement? How could the Board further reduce the costs of applying these requirements without significantly reducing the benefits?

According to FASB Concept No. 1, the primary objective of financial reporting is to provide useful information so that investors, creditors and other users can make rational decisions. We do not believe the requirements of this ED fulfill this objective. Disclosing the quantitative and qualitative information dictated in this ED would be misleading to users of financial statements, as it would be complicated for a user to discern between those claims that are probable, reasonable possible, or remote. By aggregating the quantitative information in a tabular presentation further would add to this confusion and could lead the user to conclude that the obligations of the company are greater than they actually are, which could negatively affect the company and its shareholders.

⇒ **Although the costs of this ED would be substantial to large companies with numerous claims, the cost to the small company may be more severe and indirect. In addition to misleading users, we believe the proposed estimates applied to the many situations where reasonable estimates are not possible, invite further litigation. Estimate too high, and selling stockholders sell on the disclosure, later to sue for their lost profits. Estimate too low, and the holding stockholders later sue for their losses. Other costs related to evaluations of estimates and the competition for limited management resources at a time when conflict resolution is already consuming, are of greater concern to the small company.**

Question 2 - Do you agree with the Board's decision to include within the scope of this proposed Statement obligations that may result from withdrawal from a multiemployer plan for a portion of its unfunded benefit obligations, which are currently subject to the provisions of Statement 5? Why or why not?

⇒ **We do not participate in such plans. Therefore, contingent liabilities as described in SFAS No. 132(R) *Employers' Disclosures about Pensions and Other Postretirement Benefits* an amendment of FASB Statements No. 87, 88, and 106 are not applicable to us. However, consistent with our reasons as discussed earlier, we believe SFAS No. 5 is appropriate for both the accrual and disclosure of these liabilities.**

Question 3 - Should an entity be required to provide disclosures about loss contingencies, regardless of the likelihood of loss, if the resolution of the contingencies is expected to occur within one year of the date of the financial statements and the loss contingencies could have a severe impact upon the operations of the entity? Why or why not?

⇒ **No. The provision: "could have a severe impact", without consideration to the likelihood of the loss would give credibility to any frivolous claim. To disclose the quantitative and qualitative information with respect to claims that are deemed by management to have a remote chance that the future event or events will confirm the incurrence of a liability would give credibility to those claims at the detriment of claims that may be legitimate. To further aggregate maximum exposure of remote claims with those that**

may be reasonably possible or probable that future events will confirm a liability, would further mislead the user. Given there is no mechanism to differentiate the total exposure the ED could have a detrimental effect on the company and its stakeholders. Management's decisions to exclude claims based on their best judgment would be left open to second guessing by third parties based on subsequent events.

Question 4 - Paragraph 10 of Statement 5 requires entities to "give an estimate of the possible loss or range of loss or state that such an estimate cannot be made." One of financial statement users' most significant concerns about disclosures under Statement 5's requirements is that the disclosures rarely include quantitative information. Rather, entities often state that the possible loss cannot be estimated. The Board decided to require entities to disclose the amount of the claim or assessment against the entity, or, if there is no claim or assessment amount, the entity's best estimate of the maximum possible exposure to loss. Additionally, entities would be permitted, but not required, to disclose the possible loss or range of loss if they believe the amount of the claim or assessment is not representative of the entity's actual exposure.

a. Do you believe that this change would result in an improvement in the reporting of quantitative information about loss contingencies? Why or why not?

⇒ **No. Although reliably reasonable estimates can be useful and desirable, too often estimates using these standards are just not humanly possible. Further, to include information and estimates as to maximum exposure to those claims that are deemed remote by management will only confuse and mislead the user.**

b. Do you believe that disclosing the possible loss or range of loss should be required, rather than optional, if an entity believes the amount of the claim or assessment or its best estimate of the maximum possible exposure to loss is not representative of the entity's actual exposure? Why or why not?

⇒ **We believe keeping the provision optional is appropriate because any requirement to force a company to include estimates, no matter how difficult or impractical it may be, may subject the company to additional exposure of litigation.**

c. If you disagree with the proposed requirements, what quantitative disclosures do you believe would best fulfill users' needs for quantitative information and at the same time not reveal significant information that may be prejudicial to an entity's position in a dispute?

⇒ **We believe the current quantitative and qualitative disclosure requirements of SFAS No. 5 appropriately fulfill users' needs.**

Question 5 - If a loss contingency does not have a specific claim amount, will an entity be able to provide a reliable estimate of the maximum exposure to loss (as required by paragraph 7(a)) that is meaningful to users? Why or why not?

- ⇒ **Generally, providing reliable estimates of maximum exposures is not possible, except where monetary amounts are limited by law (such as civil fines, limitations on damages and the like). With respect to jury awards (and those of some judges), a reliable estimate is not humanly possible, until the foreman finally speaks. A case in point is O.J. Simpson's two trials for the same crime, one criminal and one civil. Two completely opposed stunning outcomes, with the civil trial providing an unpredictably large and unexpected damage award. Further, one could speculate that the civil trial and damage award may not have ever occurred, had the criminal trial resulted in a conviction.**
- ⇒ **In addition to misleading users, we believe these estimates invite further litigation. Estimate too high, and selling stockholders sell on the disclosure, later to sue for their lost profits. Estimate too low, and the holding stockholders later sue for their losses.**
- ⇒ **Lastly, estimates that prove to be too high may prejudicially affect defendant's outcome, with plaintiff's counsel prejudicially using defendant's estimates for plaintiff's further gain.**

Question 6 - Financial statement users suggested that the Board require disclosure of settlement offers made between counterparties in a dispute. The Board decided not to require that disclosure because often those offers expire quickly and may not reflect the status of negotiations only a short time later. Should disclosure of the amount of settlement offers made by either party be required? Why or why not?

- ⇒ **No. Settlement offers may prove too dynamic in the short term and any disclosure may be outdated as soon it is released to the public.**
- ⇒ **It is patently and prejudicially unfair for one party to a litigation or negotiation to be required to publicly disclose its position.**

Question 7 - Will the tabular reconciliation of recognized loss contingencies, provided on an aggregated basis, provide useful information about loss contingencies for assessing future cash flows and understanding changes in the amounts recognized in the financial statements? Why or why not?

- ⇒ **No. To further aggregate maximum exposure of remote claims with those that may be reasonably possible or probable, would further mislead the user.**
- ⇒ **In the case of smaller companies with few loss contingencies, the purpose of aggregation would be defeated.**

Question 8 - This proposed Statement includes a limited exemption from disclosing prejudicial information. Do you agree that such an exemption should be provided? Why or why not?

⇒ **Limited exemption, no. General exemption, yes. If this ED is codified, then it will be critical, especially for small companies, to protect its position in a dispute. In no event is it appropriate for any entity to be required to disclose prejudicial information that would benefit an adverse party.**

Question 9 - If you agree with providing a prejudicial exemption, do you agree with the two-step approach in paragraph 11? Why or why not? If not, what approach would you recommend and why?

⇒ **We believe that the approach may be appropriate for large companies with numerous claims and large balance sheets, however, step one of the prejudicial exemption may be futile for smaller companies. We would not protest step two as long as it is reasonably practical.**

Question 10 - The International Accounting Standards Board (IASB) continues to deliberate changes to IAS 37, Provisions, Contingent Liabilities and Contingent Assets, but has not yet reconsidered the disclosure requirements. The existing disclosure requirements of IAS 37 include a prejudicial exemption with language indicating that the circumstances under which that exemption may be exercised are expected to be extremely rare. This proposed Statement includes language indicating that the circumstances under which the prejudicial exemption may be exercised are expected to be rare (instead of extremely rare). Do you agree with the Board's decision and, if so, why? If not, what do you recommend as an alternative and why?

⇒ **No. We believe that quantitative disclosure estimates concerning conflict resolution are almost always prejudicial to the disclosing party. Therefore, we believe the exemption should not be considered rare at all, especially with respect to smaller companies.**

Question 11 - Do you agree with the description of prejudicial information as information whose "disclosure . . . could affect, to the entity's detriment, the outcome of the contingency itself"? If not, how would you describe or define prejudicial information and why?

⇒ **Yes, and we believe the affectation of the outcome would be routine and not rare.**

Question 12 - Do you believe it is operational for entities to disclose all of the proposed requirements for interim and annual reporting periods? Should the tabular reconciliation be required only annually? Why or why not?

⇒ **Notwithstanding our preceding points on the ED, we feel that quarterly information with respect to contingencies should be consistent with information disclosed in annual reports.**

Question 13 - Do you believe other information about loss contingencies should be disclosed that would not be required by this proposed Statement? If so, what other information would you require?

⇒ **No. We feel that the current guidance of SFAS No. 5, together with new qualitative requirements as discussed above, is adequate and appropriate for loss contingencies.**

Question 14 - Do you believe it is operational for entities to implement the proposed Statement in fiscal years ending after December 15, 2008? Why or why not?

⇒ **No. For large and small companies alike, the task of implementing this proposed standard, putting in place a process to estimate all claims, would be quite onerous.**

Respectfully submitted,

Sterling H. McDonald
Chief Financial Officer