Financial reporting and accounting practices used in the petroleum industry differ both among firms within the industry and also from practices of other industries in several respects. One area of difference is accounting for prediscovery costs. Because such costs are relatively large and because a large degree of uncertainty is associated with the potential benefits sought by incurrence of such costs, this area has provoked many practices; most can be grouped either as successful-efforts costing (SEC) or full-costing (FC) practices. The practice of capitalizing only those prediscovery costs which are directly identifiable with discovery of a commercial reserve and treating all other costs as operating expense is referred to as successful-efforts costing. On the other hand, the practice of capitalizing all prediscovery costs irrespective of their result is called the full-costing method.

There has been a substantial amount of discussion and debate over the relative propriety of these two methods of accounting. This study is an attempt to analyze the effect of using the alternative methods (SEC and FC) on various accounting variables. It is not proposed to make a judgement as to the relative desirability of one policy over the other. An analysis of the nature of accounting numbers produced by such accounting systems. A brief background discussion of accounting practices in the petroleum industry is given in the next few paragraphs. The second section of the paper presents the analysis of accounting policies for a steady-state (unchanging) firm. The analysis is extended to the case of changing firms in the third section. Summary and conclusions are given in the fourth section.