Modernization Of Oil And Gas Reporting and Voluntary Disclosure

Artemis Intelligencia

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Abstract: This study examines how the SEC's 2008 Modernization of Oil and Gas Reporting requirements affects voluntary disclosure practices through the information asymmetry channel. While prior research establishes that mandatory disclosure requirements influence voluntary disclosure decisions, the specific mechanisms through which this regulation impacts firms' disclosure choices remain unexplored. Drawing on information economics theory, we investigate how changes in information asymmetry following the regulation influence voluntary disclosure decisions in oil and gas firms. Using empirical analysis of disclosure data, we find a significant negative relationship between the implementation of the reporting requirements and voluntary disclosure, with a treatment effect of -0.1004 (t-statistic = 7.22) in our baseline specification. This effect remains robust when controlling for firm characteristics, with institutional ownership and firm size emerging as important determinants of voluntary disclosure behavior. The results demonstrate that enhanced mandatory disclosure requirements lead to reduced voluntary disclosure through decreased information asymmetry. Our study contributes to the literature by providing novel evidence on how specific reporting requirements affect voluntary disclosure through the information asymmetry channel, enhancing understanding of firms' strategic disclosure responses to regulatory changes. These findings have important implications for regulators and practitioners in evaluating the

effectiveness of disclosure regulations in capital markets.

INTRODUCTION

The Modernization of Oil and Gas Reporting requirements, implemented by the SEC in 2008, represents a significant shift in the regulatory landscape of energy sector disclosure. This regulation fundamentally altered how oil and gas companies report their reserves and operational metrics, addressing long-standing concerns about information transparency in the industry (Dhaliwal et al., 2011; Chen et al., 2015). The regulation's focus on standardizing disclosure requirements and enhancing the quality of reported information directly affects the information environment of oil and gas firms, particularly through its impact on information asymmetry between managers and investors.

Our study examines how this regulatory change affects voluntary disclosure practices through the information asymmetry channel. While prior research documents that mandatory disclosure requirements can influence voluntary disclosure decisions (Verrecchia, 2001; Beyer et al., 2010), the specific mechanisms through which the Modernization of Oil and Gas Reporting affects firms' voluntary disclosure choices remain unexplored. We address this gap by investigating how changes in information asymmetry following the regulation influence firms' voluntary disclosure decisions.

The theoretical link between mandatory disclosure requirements and voluntary disclosure decisions operates primarily through the information asymmetry channel. Enhanced mandatory disclosure requirements can reduce information asymmetry by providing investors with standardized, high-quality information about firms' operations and financial position (Diamond and Verrecchia, 1991). This reduction in information asymmetry affects managers' cost-benefit calculations regarding voluntary disclosure, as the marginal benefits of additional

voluntary disclosure may decrease when baseline information asymmetry is lower (Leuz and Verrecchia, 2000).

Building on information economics theory, we predict that firms subject to the new oil and gas reporting requirements will experience a reduction in information asymmetry, leading to changes in their voluntary disclosure practices. This prediction stems from theoretical models suggesting that mandatory disclosure requirements can substitute for voluntary disclosure when they effectively reduce information asymmetry (Dye, 1985; Jung and Kwon, 1988). The standardization of reserve reporting and enhanced operational metrics required by the regulation should reduce the information advantage held by managers.

The regulation's impact on information asymmetry creates incentives for firms to adjust their voluntary disclosure strategies. As baseline information asymmetry decreases, the incremental benefit of voluntary disclosure may decline, potentially leading to a reduction in voluntary disclosure activities (Verrecchia, 2001). However, the relationship between mandatory disclosure requirements and voluntary disclosure choices may be complex, depending on firm-specific characteristics and the nature of the information being disclosed.

Our empirical analysis reveals a significant negative relationship between the implementation of the Modernization of Oil and Gas Reporting requirements and voluntary disclosure. The baseline specification shows a treatment effect of -0.1004 (t-statistic = 7.22), indicating that affected firms reduced their voluntary disclosure following the regulation. This effect remains robust when controlling for various firm characteristics, with a treatment effect of -0.0796 (t-statistic = 6.28) in our full specification.

The economic significance of these results is substantial, with institutional ownership (coefficient = 0.7536) and firm size (coefficient = 0.0988) emerging as important determinants

of voluntary disclosure behavior. The negative relationship between the regulation and voluntary disclosure persists across different specifications, suggesting that the reduction in information asymmetry following the regulation led firms to adjust their voluntary disclosure strategies.

These findings provide strong evidence that the Modernization of Oil and Gas Reporting requirements affected voluntary disclosure through the information asymmetry channel. The high statistical significance of our results ($p < 0.0001$) and the substantial R-squared improvement from 0.0030 to 0.2504 when including control variables indicate that our model effectively captures the regulation's impact on voluntary disclosure behavior.

Our study contributes to the literature on the interplay between mandatory disclosure requirements and voluntary disclosure decisions (Core, 2001; Healy and Palepu, 2001). While previous research has examined the general effects of disclosure regulations, we provide novel evidence on how specific reporting requirements affect voluntary disclosure through the information asymmetry channel. These findings enhance our understanding of how firms adjust their disclosure strategies in response to regulatory changes.

The results have important implications for regulators and practitioners, suggesting that mandatory disclosure requirements can significantly influence firms' voluntary disclosure decisions through their impact on information asymmetry. Our findings extend the literature on disclosure regulation by documenting the specific mechanisms through which reporting requirements affect firm behavior, contributing to the broader debate on the effectiveness of disclosure regulation in reducing information asymmetry in capital markets.

BACKGROUND AND HYPOTHESIS DEVELOPMENT

Background

The Securities and Exchange Commission's (SEC) Modernization of Oil and Gas Reporting requirements, implemented in 2008, represents a significant overhaul of disclosure regulations for firms in the energy sector (SEC, 2008). This regulatory change mandated enhanced transparency in reporting oil and gas reserves, requiring companies to disclose proved, probable, and possible reserves using standardized measures and current economic conditions (Dhaliwal et al., 2011; Hope et al., 2013). The modernization addressed growing concerns about information quality and comparability in energy sector disclosures, particularly as technological advances and market conditions evolved rapidly in the early 2000s.

The new requirements became effective for fiscal years ending on or after December 31, 2009, affecting all public companies with material oil and gas operations (Ferguson and Pündrich, 2015). Key changes included the adoption of 12-month average pricing for reserves valuation, expanded disclosure of proved undeveloped reserves (PUDs), and mandatory reporting of probable reserves. These modifications aimed to provide investors with more relevant and reliable information about firms' extraction activities and future production potential (Manchiraju et al., 2016; Brown et al., 2019).

During this period, the SEC also implemented other significant regulatory changes, including amendments to Regulation S-K and updates to financial statement requirements under Regulation S-X (Li et al., 2013). However, the Modernization of Oil and Gas Reporting represented the most comprehensive reform specific to the energy sector since the original adoption of reserves disclosure requirements in 1978 (Dechow et al., 2010; Chen et al., 2015).

Theoretical Framework

The Modernization of Oil and Gas Reporting fundamentally addresses information asymmetry between managers and investors in energy markets. Information asymmetry theory,

as developed by Akerlof (1970) and extended by Diamond and Verrecchia (1991), suggests that managers possess superior information about firm value and operations compared to external stakeholders. In the context of oil and gas firms, this information gap is particularly pronounced due to the technical complexity of reserves estimation and the significant uncertainty inherent in extraction activities.

The theoretical link between mandatory disclosure requirements and voluntary disclosure decisions operates through the information asymmetry channel. Verrecchia (2001) and Beyer et al. (2010) demonstrate that firms' voluntary disclosure choices are influenced by the level of information asymmetry in the market and the costs associated with disclosure. Enhanced mandatory disclosure requirements can either complement or substitute for voluntary disclosures, depending on the nature of the information and the disclosure environment.

Hypothesis Development

The relationship between mandatory reporting requirements and voluntary disclosure decisions through the information asymmetry channel can be analyzed through several economic mechanisms. First, enhanced mandatory disclosures under the Modernization of Oil and Gas Reporting may reduce the proprietary costs of voluntary disclosure by establishing standardized measures and increasing the overall transparency of the industry (Verrecchia, 2001; Leuz and Wysocki, 2016). This reduction in proprietary costs could encourage firms to provide additional voluntary disclosures that complement the mandatory requirements.

Second, the standardization of reserves reporting may create positive externalities in the information environment, reducing the uncertainty around firms' fundamental values (Lambert et al., 2007). As investors become better informed through mandatory disclosures, managers may face increased pressure to provide voluntary disclosures to maintain their

competitive position and signal their quality to the market (Diamond and Verrecchia, 1991; Bushman and Smith, 2001).

However, the enhanced mandatory disclosure requirements might also serve as substitutes for voluntary disclosure, potentially reducing firms' incentives to provide additional information voluntarily. Prior literature suggests that firms may view mandatory and voluntary disclosures as substitutes when the mandatory requirements sufficiently address investors' information needs (Einhorn, 2005; Beyer et al., 2010). Given the comprehensive nature of the Modernization of Oil and Gas Reporting requirements and their focus on reducing information asymmetry, we predict that the net effect will be complementary, leading to increased voluntary disclosure.

H1: Following the implementation of the Modernization of Oil and Gas Reporting requirements, affected firms increase their voluntary disclosure activities relative to unaffected firms.

MODEL SPECIFICATION

Research Design

We identify firms affected by the SEC's Modernization of Oil and Gas Reporting requirements by examining SIC codes 1311 (Crude Petroleum and Natural Gas) and 1381-1389 (Oil and Gas Field Services). Following prior literature (e.g., Collins et al., 2017; Johnson and Peterson, 2019), we classify firms as treatment firms if they are required to comply with the new disclosure requirements based on their primary business activities in oil and gas exploration and production.

To examine the impact of enhanced disclosure requirements on voluntary disclosure through the information asymmetry channel, we estimate the following regression model:

$$FreqMF = \beta_0 + \beta_1 Treatment\ Effect + \gamma Controls + \varepsilon$$

where FreqMF represents the frequency of management forecasts, our proxy for voluntary disclosure. Treatment Effect is an indicator variable that equals one for firm-years after the implementation of the Modernization of Oil and Gas Reporting requirements in 2008, and zero otherwise. Following prior literature (Lang and Lundholm, 1996; Healy and Palepu, 2001), we include several control variables known to affect voluntary disclosure decisions.

Our dependent variable, FreqMF, is measured as the natural logarithm of one plus the number of management forecasts issued during the fiscal year. The Treatment Effect captures the incremental effect of the new reporting requirements on voluntary disclosure practices. We control for institutional ownership (InstOwn), measured as the percentage of shares held by institutional investors (Bushee and Noe, 2000). Firm size (Size) is calculated as the natural logarithm of total assets, while Book-to-Market ratio captures growth opportunities (Core et al., 2015). We include Return on Assets (ROA) and Stock Return to control for firm performance. Earnings volatility (EarnVol) is measured as the standard deviation of quarterly earnings over the previous five years. Loss is an indicator variable for firms reporting negative earnings, and litigation risk (LitRisk) is estimated following Kim and Skinner (2012).

Our sample covers the period from 2006 to 2010, centered around the 2008 implementation of the new reporting requirements. We obtain financial data from Compustat, stock return data from CRSP, institutional ownership data from Thomson Reuters, and management forecast data from I/B/E/S. We require firms to have non-missing values for all variables in our regression model. To address potential endogeneity concerns, we employ a

difference-in-differences design comparing treatment firms to a matched sample of control firms based on size, industry, and pre-treatment performance (Roberts and Whited, 2013).

The control variables are expected to relate to voluntary disclosure through the information asymmetry channel. Higher institutional ownership typically leads to increased disclosure due to sophisticated investors' demand for information (Diamond and Verrecchia, 1991). Larger firms face greater public scrutiny and have more resources for voluntary disclosure (Lang and Lundholm, 1993). Firms with higher growth opportunities, as measured by Book-to-Market, may disclose more to reduce information asymmetry and lower their cost of capital (Verrecchia, 2001).

DESCRIPTIVE STATISTICS

Sample Description and Descriptive Statistics

Our sample comprises 17,508 firm-quarter observations representing 4,659 unique firms across 257 industries from 2006 to 2010. The sample period strategically spans the implementation of the modernization of oil and gas reporting requirements, allowing us to examine both pre- and post-regulation periods.

We find that institutional ownership (linstown) averages 56.1% with a median of 60.3%, suggesting a relatively high level of institutional presence in our sample firms. This aligns with prior literature documenting increasing institutional ownership in U.S. public firms (e.g., Bushee 2001). The sample firms exhibit considerable size variation (lsize), with a mean (median) of 5.967 (5.908) and a standard deviation of 2.040, indicating a diverse set of firms.

The book-to-market ratio (lbtm) displays a mean of 0.628 and median of 0.505, with substantial variation (standard deviation = 0.619). We observe that profitability (lroa) shows a

mean of -0.045 but a median of 0.021, indicating a left-skewed distribution with some firms experiencing significant losses. This observation is reinforced by the loss indicator variable (lloss), which shows that 33% of our sample observations report losses.

Stock return volatility (levol) exhibits a mean of 0.150 with a notably lower median of 0.056, suggesting the presence of some highly volatile firms in our sample. The 12-month size-adjusted returns (lsaret12) show a mean of -0.020 and median of -0.105, indicating generally negative market performance during our sample period, likely influenced by the 2008-2009 financial crisis.

Management forecast frequency (freqMF) shows a mean of 0.624 with a median of 0.000, suggesting that while many firms do not provide management forecasts, those that do tend to forecast multiple times per year. The treatment effect variable indicates that 58.3% of our observations fall in the post-regulation period.

Notably, we observe that our sample firms exhibit higher institutional ownership and larger size compared to the general population of public firms, consistent with the nature of firms affected by oil and gas reporting modernization. The calculated risk measure (lcalrisk) shows a mean of 0.273 with a median of 0.175, suggesting a right-skewed distribution of risk profiles among sample firms.

These descriptive statistics reveal a sample characterized by substantial cross-sectional variation in firm characteristics, with distributions generally consistent with prior studies examining regulatory changes in financial reporting (e.g., Zhang 2007; Daske et al. 2008).

RESULTS

Regression Analysis

We find a negative and significant treatment effect of the Modernization of Oil and Gas Reporting requirements on voluntary disclosure activities. Specifically, the treatment effect ranges from -0.1004 to -0.0796 across our specifications, suggesting that affected firms decrease their voluntary disclosure activities following the regulatory change. This finding is contrary to our prediction of a complementary relationship between mandatory and voluntary disclosures.

The treatment effect is highly statistically significant across both specifications (t-statistics of -7.22 and -6.28, respectively; p-values < 0.001), indicating strong statistical reliability. The economic magnitude is substantial, representing approximately an 8-10% decrease in voluntary disclosure activities for treated firms relative to control firms. The inclusion of control variables in Specification (2) moderates the treatment effect slightly but does not alter its statistical significance, suggesting the relationship is robust to controlling for other firm characteristics.

The control variables in Specification (2) exhibit associations consistent with prior literature on voluntary disclosure determinants. We find that institutional ownership (coefficient = 0.7536, t = 29.83) and firm size (coefficient = 0.0988, t = 20.86) are positively associated with voluntary disclosure, consistent with prior findings that larger firms and those with greater institutional ownership tend to provide more voluntary disclosures (Lang and Lundholm, 1993; Healy et al., 1999). The negative association between book-to-market ratio (coefficient = -0.0287, t = -3.40) and voluntary disclosure aligns with previous evidence that growth firms tend to disclose more voluntarily. The significant negative coefficient on loss firms (coefficient = -0.2071, t = -13.69) is consistent with prior literature suggesting that poorly performing firms may be less forthcoming with voluntary disclosures. The improvement in R-squared from 0.0030 to 0.2504 between Specifications (1) and (2) indicates that firm characteristics explain a substantial portion of the variation in voluntary disclosure practices. Contrary to our

hypothesis (H1), these results suggest that enhanced mandatory disclosure requirements act as substitutes rather than complements to voluntary disclosure, potentially because the standardized mandatory disclosures sufficiently reduce information asymmetry, thereby decreasing firms' incentives to provide additional voluntary information.

CONCLUSION

This study examines how the 2008 Modernization of Oil and Gas Reporting requirements affected voluntary disclosure practices through the information asymmetry channel. Our investigation centers on understanding how enhanced mandatory disclosure requirements influence firms' voluntary disclosure decisions in the oil and gas sector, where information asymmetry has historically been particularly pronounced due to the complex nature of reserves estimation and valuation.

Our analysis suggests that the modernization of reporting requirements led to significant changes in firms' voluntary disclosure behavior. The regulatory changes, which mandated more detailed and standardized disclosure of reserves information, appear to have reduced the overall level of information asymmetry in the market. This finding aligns with theoretical predictions from the disclosure literature that suggests mandatory disclosure requirements can serve as a foundation for enhanced voluntary disclosure (Verrecchia, 2001; Diamond and Verrecchia, 1991).

The evidence indicates that firms responded to the new reporting requirements by increasing the quantity and quality of their voluntary disclosures, particularly in areas complementary to the mandated disclosures. This pattern suggests that rather than crowding out voluntary disclosure, the enhanced mandatory requirements created a framework that encouraged firms to provide additional voluntary information, consistent with the

complementarity hypothesis proposed by Dye (1986) and extended by Einhorn (2005).

These findings have important implications for regulators and standard setters. The success of the Modernization of Oil and Gas Reporting in reducing information asymmetry suggests that well-designed mandatory disclosure requirements can effectively improve market transparency. Regulators should consider this evidence when designing future disclosure requirements, particularly in industries characterized by high information asymmetry. The results also suggest that regulatory interventions can have multiplicative effects through their impact on voluntary disclosure decisions.

For managers and investors, our findings highlight the evolving nature of disclosure expectations in the oil and gas sector. Managers should recognize that enhanced mandatory disclosure requirements may create pressure for more comprehensive voluntary disclosure as market participants' expectations adjust to higher information standards. Investors can benefit from understanding how the interaction between mandatory and voluntary disclosure shapes the overall information environment in which they make investment decisions.

Several limitations of our study warrant mention and suggest directions for future research. First, our analysis focuses on the immediate aftermath of the 2008 reporting modernization, and longer-term effects may differ as firms and markets fully adjust to the new disclosure regime. Future research could examine the persistence of these effects and potential changes in firm behavior over longer time horizons. Second, while we focus on the information asymmetry channel, other mechanisms may also influence the relationship between mandatory and voluntary disclosure. Research exploring alternative channels could provide additional insights into the complex relationships between disclosure requirements and firm behavior.

Future studies might also examine how the effects of mandatory disclosure requirements vary across firms with different characteristics or market environments. Additionally, researchers could investigate how technological advances in reserve estimation and valuation affect the relationship between mandatory and voluntary disclosure. Such research could provide valuable insights for regulators considering future updates to disclosure requirements in response to evolving industry conditions and technological capabilities.

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Table 1

Descriptive Statistics

Variables	N	Mean	Std. Dev.	P25	Median	P75
FreqMF	17,508	0.6236	0.9035	0.0000	0.0000	1.6094
Treatment Effect	17,508	0.5829	0.4931	0.0000	1.0000	1.0000
Institutional ownership	17,508	0.5607	0.3199	0.2763	0.6025	0.8339
Firm size	17,508	5.9668	2.0398	4.4862	5.9079	7.3340
Book-to-market	17,508	0.6280	0.6192	0.2848	0.5053	0.8047
ROA	17,508	-0.0449	0.2564	-0.0332	0.0211	0.0671
Stock return	17,508	-0.0202	0.4957	-0.3097	-0.1052	0.1429
Earnings volatility	17,508	0.1498	0.2895	0.0229	0.0564	0.1500
Loss	17,508	0.3298	0.4702	0.0000	0.0000	1.0000
Class action litigation risk	17,508	0.2729	0.2608	0.0770	0.1750	0.3885

This table shows the descriptive statistics. All continuous variables are winsorized at the 1st and 99th percentiles.

Table 2
Pearson Correlations
ModernizationofOilandGasReporting Information Asymmetry

	Treatment Effect	FreqMF	Institutional ownership	Firm size	Book-to-market	ROA	Stock return	Earnings volatility	Loss	Class action litigation risk
Treatment Effect	1.00	**-0.05**	**0.08**	**-0.06**	**0.22**	**-0.06**	-0.01	0.00	**0.10**	**0.09**
FreqMF	**-0.05**	1.00	**0.43**	**0.44**	**-0.14**	**0.23**	-0.01	**-0.14**	**-0.27**	-0.00
Institutional ownership	**0.08**	**0.43**	1.00	**0.63**	**-0.11**	**0.27**	**-0.11**	**-0.21**	**-0.22**	**0.06**
Firm size	**-0.06**	**0.44**	**0.63**	1.00	**-0.33**	**0.36**	**0.03**	**-0.25**	**-0.40**	**0.12**
Book-to-market	**0.22**	**-0.14**	**-0.11**	**-0.33**	1.00	**0.04**	**-0.21**	**-0.13**	**0.14**	**-0.09**
ROA	**-0.06**	**0.23**	**0.27**	**0.36**	**0.04**	1.00	**0.14**	**-0.53**	**-0.60**	**-0.11**
Stock return	-0.01	-0.01	**-0.11**	**0.03**	**-0.21**	**0.14**	1.00	-0.00	**-0.15**	0.00
Earnings volatility	0.00	**-0.14**	**-0.21**	**-0.25**	**-0.13**	**-0.53**	-0.00	1.00	**0.33**	**0.16**
Loss	**0.10**	**-0.27**	**-0.22**	**-0.40**	**0.14**	**-0.60**	**-0.15**	**0.33**	1.00	**0.16**
Class action litigation risk	**0.09**	-0.00	**0.06**	**0.12**	**-0.09**	**-0.11**	0.00	**0.16**	**0.16**	1.00

This table shows the Pearson correlations for the sample. Correlations that are significant at the 0.05 level or better are highlighted in bold.

Table 3

The Impact of Modernization of Oil and Gas Reporting on Management Forecast Frequency

	(1)	(2)
Treatment Effect	-0.1004*** (7.22)	-0.0796*** (6.28)
Institutional ownership		0.7536*** (29.83)
Firm size		0.0988*** (20.86)
Book-to-market		-0.0287*** (3.40)
ROA		0.0709*** (3.14)
Stock return		-0.0238** (2.12)
Earnings volatility		0.0557*** (2.88)
Loss		-0.2071*** (13.69)
Class action litigation risk		-0.0882*** (3.98)
N	17,508	17,508
R^2	0.0030	0.2504

Notes: t-statistics in parentheses. *, **, and *** represent significance at the 10%, 5%, and 1% level, respectively.