Federal Accounting Standards Advisory Board

February 4, 2008

Memorandum

To: Members of the Board

From: Rick Wascak, Assistant Director

Through: Wendy M. Payne, Executive Director

Subj: Accounting for Federal Oil and Gas Resources **Summary of Comment Letters Received through February 4, 2008[1] - Tab D-1**

MEETING OBJECTIVES

Staff requests that the Board respond to the following questions:

a. Should a public hearing be scheduled?

b. If not, are there individual respondents from whom you wish to seek clarification directly? (Note that staff expects to work closely with respondents who proposed alternatives to ensure that technical provisions are clear.)

Following the meeting, staff will continue analyzing the responses and developing an issue paper for discussion at a later meeting.

BRIEFING MATERIALS

This memo is included as Tab D-1 and provides a brief summary of responses. Tab D-2 presents the actual responses received. Tabs D-3 and D-4 present the results of the

[1] The staff prepares Board meeting materials to facilitate discussion of issues at the Board meeting. This material is presented for discussion purposes only; it is not intended to reflect authoritative views of the FASAB or its staff. Official positions of the FASAB are determined only after extensive due process and deliberations.

Department of Interior filed test of the proposal and the alternative view presented in the ED respectively.

BACKGROUND

The exposure draft (ED), *Accounting for Federal Oil and Gas Resources*, proposed accounting standards for Federal oil and gas resources. The proposed standards would result in the recognition of an asset and a related liability. The asset would be referred to as "estimated petroleum royalties" and would present the royalty share of the Federal oil and gas resources classified as "proved reserves." The asset's value would be calculated by multiplying the estimated quantity of proved oil and lease condensate, natural gas plant liquids (NGPLs), and gas reserves by the effective average royalty rate for each quantity and by the average per unit price for each quantity.

The related liability would be for the royalty share of the Federal oil and gas resources classified as "proved reserves" designated to be distributed to others, i.e., state governments and – at the component entity level – other federal agencies and the general fund of the U.S. Treasury. The liability would be calculated by assessing the total estimated petroleum royalties to be distributed to others.

When oil and gas resources are extracted and royalties are earned, revenue and a depletion expense equal to the earned revenue would be recognized by the Federal government. When revenue collections are distributed a reduction in the liability for revenue distributions to others would be recognized. Gains and losses due to changes in the estimated quantity of proved oil and lease condensate, NGPLs, and gas reserves, the effective regional average royalty rates, and the average per unit prices would be recognized based on an annual valuation of the asset with an associated adjustment to the liability for revenue distributions to others. In addition, when rights to a future royalty stream are identified to be sold, the value of the related rights would be disclosed.

Additional information about Federal oil and gas resources not classified as proved reserves would be disclosed in notes to the financial statements or reported as required supplementary information (RSI).

An alternative approach to valuing estimated petroleum royalties is fair value and the CBO member believes that fair value is feasible and preferable. The member's alternative view proposed that fair value be derived from market transactions or discounted cash flows.

The proposed standards would be effective for periods beginning after September 30, 2009 (FY2010), with early implementation permitted.

SUMMARY OF OUTREACH EFFORTS

The ED was issued May 21, 2007 with comments requested by September 21, 2007. However, because the Board received a request for the comment period to be extended and because few responses had been received, the Board agreed to extend the comment period until January 11, 2008. Upon release of the exposure draft, notices and press releases were provided to:

a) The Federal Register;

b) *FASAB News;*

c) The *Journal of Accountancy, AGA Today, the CPA Journal, Government Executive, the CPA Letter,* and *Government Accounting and Auditing Update;*

d) The CFO Council, the Presidents Council on Integrity and Efficiency, Financial Statement Audit Network, and the Federal Financial Managers Council; and

e) Committees of professional associations generally commenting on exposure drafts in the past.

This broad announcement was followed by direct mailings or e-mails of the exposure draft to the following:

a) Relevant congressional committees:

   a. Senate Committee on Energy and Natural Resources
   b. Senate Committee on Finance
   c. Senate Committee on Indian Affairs
   d. House Committee on Financial Services
   e. House Committee on Natural Resources

b) Federal agencies:

   a. Office of Financial Management, Department of the Interior (DOI)
   b. Office of the Special Trustee (OST), DOI
   c. Office of Financial Management, Department of Energy
   d. Reserves and Products Division, Office of Oil and Gas, Energy Information Administration (EIA), Department of Energy
   e. Office of the Chief Accountant, Securities and Exchange Commission (SEC)

c) Public interest groups:

   a. National Congress of American Indians (NCAI) President and Area (Regional) Vice Presidents

d) Oil and gas industry companies/professional organizations:

   a. World Petroleum Congress (WPC)
   b. American Petroleum Institute (API)
   c. Society of Petroleum Engineers (SPE)
   d. Ryder Scott Company
   e. National Petroleum Council (NPC)
   f. International Energy Agency (IEA)
   g. British Petroleum (BP)

h. Royal Dutch Shell
i. Chevron
j. Exxon Mobil

To encourage responses, a reminder notice was provided on September 12, 2007 and January 9, 2008 to our Listserv. In addition, we contacted professional associations and affected agencies directly.

RESULT

As of February 4, 2008, we have received eight responses from the following sources:

	FEDERAL (Internal)	**NON-FEDERAL (External)**
Users, academics, others		4
Auditors	1	
Preparers and financial managers	3	

Staff previously sent you individual letters one through eight in the first distribution of Board meeting material. An index of all respondents in the order the letters were received is presented at the end of this memorandum.

STAFF SUMMARY AND ANALYSIS

The staff summary presented below is intended to support your consideration of the comments and not to substitute for reading the individual letters. Individual comment letters are provided in Tab D-2. The following table provides a quick reference to the overall response to individual questions.

Note that Letters 1 and 8 are excluded from the question by question tally because none of the individual questions were addressed. These two respondents object to the proposal in its entirety. Staff believes that the Letter 1 respondent objects to the proposal in its entirety based on the assertion that "the belief of estimating proved reserves on estimation distorts the financial statements." The respondent submitting Letter 8 believes the concept of potential assets is "not fully developed" and suggests – among other things - that all such resources be addressed in a single standard. These letters will receive greater attention as staff identifies specific issues for discussion at a later meeting.

Also, most letters did not address every question. Therefore, the count does not equal six (eight less the two omitted letters) in all cases.

Table 1 - Tally of Responses By Question

<table>
<tr><th>QUESTION</th><th>YES
/AGREE</th><th>NO
/DISAGREE</th><th>COMMENTS</th></tr>
<tr><td colspan="4">Q1. The Board’s proposal for quantifying the Federal government’s royalty share of proved reserves is to use a single best estimate of recovering reserves based on known geological, engineering, and economic data. This approach is known in the oil and gas industry as the deterministic method. This method would exclude reserves other than proved reserves. In contrast, a probabilistic method of estimation uses the known geological, engineering, and economic data to generate a range of estimates and their associated probabilities of recovering reserves. It would include more than proved reserves. <u>Determination of Quantity</u>:
a. Which of the following two options would you prefer?</td></tr>
<tr><td>i. Capitalize estimated petroleum royalties from the proved reserves based on the deterministic method as proposed in the ED.</td><td>5</td><td colspan="2">An emphasis was placed on the need for EIA to partner with DOI (#5).
Option i:
Consistency and Objectivity
Conservatism
Authoritative source
Desires conformance to SEC definition
Readily available information</td></tr>
<tr><td>ii. Capitalize estimated petroleum royalties from proved reserves, probable reserves, and possible reserves based on the methodology proposed in the alternative view.</td><td></td><td></td><td>No respondents supported this option.</td></tr>
</table>

QUESTION	YES/AGREE	NO/DISAGREE	COMMENTS
Q2. The Board proposes to value the Federal government's royalty share of proved reserves based on average regional prices and effective average regional royalty rates experienced during the 12 months preceding the balance sheet date. An alternative approach to valuing estimated petroleum royalties is fair value. Fair value is the price that would be received for an asset or paid to transfer a liability in a transaction between market participants at the measurement date. One Board member believes that fair value is feasible and preferable. The Board member believes that fair value could be derived from market transactions or discounted cash flows. The view of the majority of the Board members is that fair value would not produce a more reliable valuation. Determination of Value: Which method do you believe is most appropriate for valuing estimated petroleum royalties?			
iii. Value the royalty share of proved reserves based on average regional prices and effective average regional royalty rates experienced during the 12 months preceding the balance sheet date.	3		Consistency (fair value is subjective) Reliable
iv. Value estimated petroleum royalties using the alternative view fair value method.			Interior proposes a present value measurement but does not assert that it is a fair value approach.

QUESTION	YES /AGREE	NO/DISAGREE	COMMENTS
Q3. Some Board members believe that the amount of information proposed to be disclosed in the notes and provided as RSI is excessive. a. Do you believe that each item of information, whether disclosed in the notes or provided as RSI, is necessary to meet reporting objectives and is cost-beneficial to provide? Particularly, consider Table 1 on pages 68 and 69 and Table 2 on pages 70 and 71. It would be helpful if specific information that respondents believe could be deleted or added were identified.		3 *Plus one comment that agency disclosure should mirror the CFR disclosure.	Interior has not objected to the information and states that it can be readily produced but seeks clarification of requirements.
b. How would each item of information be used for decision-making or assessing the financial position of the Federal government?			Not of general interest to readers. Cost outweighs benefits.
c. Please explain the reasons for your position and any alternative you propose.			Develop an IT solution to report
Q4. The proposed standards would require that an estimated value for royalty relief be reported as RSI. The Minerals Management Service (MMS) has a variety of royalty relief programs. Royalty relief is the reduction, modification, or elimination of any royalty to promote development, increase production, or encourage production of marginal resources on certain leases or categories of leases. a. Do you believe that a monetary value for royalty relief should be reported as RSI? Please explain the reasons for your position.	2		
b. Do you believe the quantity of production for which relief was granted during the reporting period should be reported as RSI? Please explain the reasons for your position.	1		*One respondent supported this disclosure if disclosures and RSI are not reduced. (#3)

QUESTION	YES/AGREE	NO/DISAGREE	COMMENTS
Q5. Statement of Federal Financial Accounting Standards (SFFAS) 7, Accounting for Revenue and Other Financing Sources (as amended), requires that agencies report on assets held in a fiduciary capacity. The Board recently issued SFFAS 31, Accounting for Fiduciary Activities. SFFAS 31 will supersede SFFAS 7 with respect to fiduciary activities but continues the requirement to report on assets held in a fiduciary capacity. The Department of Interior (DOI) manages oil and gas resources on behalf of individual Indians and Indian tribes. This proposed standard – because it classifies oil and gas resources as assets – would result in additional information being disclosed for oil and gas assets managed in a fiduciary capacity. Note, however, that fiduciary reporting does not extend to inclusion of the additional disclosures or RSI that are proposed in this document for Federal oil and gas resources. Thus, with respect to fiduciary activities, only disclosure of the assets, liabilities, and related inflows and outflows would result from this proposal. Some Board members have expressed concern that the costs may exceed the benefits of disclosing fiduciary assets and liabilities measured in conformance with this proposed standard. Since this proposal may significantly increase the fiduciary assets disclosed, we are requesting input on the cost-benefit of the requirement with respect to fiduciary activities. See paragraph. a. Do you believe it is cost-beneficial to require disclosure of the value of estimated fiduciary petroleum royalty assets, liabilities, and related inflows and outflows? Please explain the basis for your beliefs.	1	2	No analysis performed but appearance of cost outweighing benefit. Note that Interior asserts that the provision is inconsistent with guidance provided regarding SFFAS 31. Staff will develop this as an issue but wishes to note that the referenced letter addresses aggregation and not omission.

QUESTION	YES/AGREE	NO/DISAGREE	COMMENTS
Q6. The proposed standards would require the component entity to provide extensive disclosures and RSI. However, the Consolidated Financial Report (CFR) of the United States government would be required to include limited disclosures and no supplementary information. These divergent reporting requirements are consistent with SFFAC 4, *Intended Audience and Qualitative Characteristics for the Consolidated Financial Report of the United States Government*. SFFAC 4 provides that the CFR should be highly aggregated and offer references to other reports. a. Do you believe that the CFR disclosure requirements should be limited as proposed? Please explain the basis for your beliefs.	3		

QUESTION	YES/AGREE	NO/DISAGREE	COMMENTS
Q6. This proposal includes accommodations intended to reduce the cost or burden of implementation. These accommodations are identified below along with the alternatives considered and rejected by a majority of the members. Please comment on any accommodation that you believe is not appropriate or that you believe does not sufficiently reduce the cost or burden of the proposal. a. Asset recognition is limited to proved reserves. However, the Board believes that other than proved reserves (e.g., unproved reserves and undiscovered resources) also are assets. b. The valuation technique provided relies on readily available information. However, fair value, which would require additional information, may be a more appropriate valuation technique. c. This proposal requires use of existing sales volume and sales value information to determine an average price for end of period valuation. Use of market prices as of the end of the reporting period was considered. In addition to the relative cost of obtaining market values, the Board does not believe the valuation would be improved. d. Information to calculate effective royalty rates is readily available and the proposal provides for their use in valuing estimated petroleum royalties. An alternative considered was the use of statutory provisions for certain types of leases. e. Regional data is readily available and the proposal provides for its use in valuing estimated petroleum royalties. An alternative considered was the use of field by field data.	1		Interior concurred with items a and e. An alternative approach was proposed for the remaining items.

An index of respondents is presented below in the order the letters were received. Individual comment letters follow the index in Sub-tab 2:

#1 – Helene A. Baker ,Texas/Oklahoma Regional AGA Vice President Elect.

#2 – Office of Financial Management, Environmental Protection Agency, Christopher S. Osborne, Financial Manager.

#3 – AGA Financial Management Standards Board, Robert L. Childree, Chair.

#4 – Office of the Under Secretary Of Defense, Department of Defence, James E. Short, Deputy Chief Financial Officer.

#5 – Office of Financial Management, Department of the Interior, Daniel L. Fletcher, Director

#6 – Accounting Committee, American Petroleum Institute, Joseph H. Bakies, Chair.

#7 – Financial Management and Assurance, Government Accountability Office, McCoy Williams, Managing Director.

#8 – Federal Issues and Standards Committee, Greater Washington Society of Certified Public Accountants, Daniel L. Kovlak, Chair.