Federal Accounting Standards Advisory Board

December 4, 2008

Memorandum

To: Members of the Board

From: Julia E. Ranagan, Assistant Director

Through: Wendy M. Payne, Executive Director

Subj: Natural Resources – Tab A[1]

OVERALL MEETING OBJECTIVE

The purpose of this session is to discuss a draft revised exposure draft (ED) on *Accounting for Federal Oil and Gas Resources* so that staff can work towards a pre-ballot draft for the April 2009 board meeting.

SPECIFIC MEETING GOALS

The two primary goals for this 105 minute session are to:

1. Reach consensus[2] on the level of detail to be included in the revised ED with respect to asset valuation guidance, pro forma transactions, illustrative disclosures and RSI presentations;
2. Reach consensus on whether staff should attempt to broaden the scope of the revised ED to address all natural resources;

As time permits, the following secondary goals will be addressed:

3. Reach consensus on the primary measurement attribute or method to be required (present value vs. formula from original ED);

[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.
[2] Consensus as used in this paper means "general agreement," not necessarily full agreement. Members are asked to arrive at a conclusion that, while it may not be your preferred choice, is an acceptable option (litmus test is whether the conclusion would keep you up at night).

4. Reach consensus on whether the preparer should be permitted to select the measurement attribute or method from two or more options;
5. Reach consensus on whether the preparer can change the estimation attribute or method once one has been established;
6. Reach consensus on whether the SFFAS 33 guidance for displaying gains and losses from changes in assumptions and selecting discount rates should be applied to long-term assumptions for oil and gas; and,
7. Reach consensus on the phase-in of the requirements from RSI to basic.

BRIEFING MATERIAL

Attached to this transmittal memorandum, you will find a staff discussion paper on the significant changes made to the original exposure draft. In addition, the following materials are included in their respective tabs:

- ❑ Tab A-1 – Draft Revised ED, *Accounting for Federal Oil and Gas Resources*
- ❑ Tab A-2 – Natural Resources History of Project and Key Decisions

The DOI field test team reviewed a draft of the revised ED and provided comments to staff via email. These comments have been incorporated into the draft ED via comment boxes in the right-hand margin.

In an effort to cut down on the amount and cost of duplicate material that is provided for each meeting, the following materials that have been provided in the past will be available at the board table in an individual binder for each member (as was done at the October board meeting):

- ❑ Task Force Discussion Paper, *Accounting for the Natural Resources of the Federal Government*, issued June 2000
- ❑ ED, *Accounting for Federal Oil and Gas Resources*, issued May 2007
- ❑ Comment Letters on ED
- ❑ Field Test Questionnaire Responses (in color to mark differences)
- ❑ Comparison of ED to Field Test Questionnaire Responses (in color to mark differences)

You may electronically access all of the briefing material at http://www.fasab.gov/meeting.html.

NEXT STEPS

Once the board has reached consensus on the level of detail to be contained in the standard and the scope of the standard (oil and gas only vs. all natural resources), staff will complete the following next steps:

Oil and Gas Only

February 2009 Meeting

- Provide additional information on the fiduciary reporting requirement to enable the board to reach consensus on whether to retain the recognition requirements as an integral part of the fiduciary activities Schedules of Fiduciary Activity and Net Assets;
- Provide additional information on the classification of short-term vs. long-term liabilities as it would apply to revenues to be distributed to others to enable the board to reach consensus on how to treat the oil and gas liabilities;
- Provide additional information on the ability of DOI to provide the component entity RSI as currently required to enable the board to reach consensus on whether to retain the RSI requirements from the original ED;
- Provide additional information on how to treat custodial reporting for other commodities to enable the board to reach consensus on how the other commodities should be addressed in the interim until standards on all natural resources are issued.

April 2009 Meeting

- Provide a pre-ballot revised exposure draft that incorporates decisions from the February 2009 meeting.
- Provide a ballot draft that incorporates final member comments via email after the meeting.

May 2009

- Issue a revised exposure draft with comments due by late July 2009.

August 2009 Meeting

- Discuss comments received on revised exposure draft.

October 2009 Meeting

- Finalize wording.
- Provide pre-ballot draft after meeting via email.

November 2009

- Provide ballot draft via email (will not be on December 2009 agenda if approved before meeting and there are no issues).
- Provide proposed standard to sponsors.

February 2010

- Issue final standard after sponsor review.

<u>*All Natural Resources*</u>

January – May 2009
- Research additional natural resources; and,
- Apply oil and gas approach to other resources, as appropriate.

June 2009 Meeting
- Provide a draft revised exposure draft that incorporates all natural resources. Staff anticipates that the standards section would be fairly concise, but the basis for conclusions would be extremely long.

August 2009 Meeting
- Provide another draft revised exposure draft that incorporates member comments from June meeting. In addition, address outstanding issues such as:
    - Provide additional information on the fiduciary reporting requirement to enable the board to reach consensus on whether to retain the recognition requirements as an integral part of the fiduciary activities Schedules of Fiduciary Activity and Net Assets;
    - Provide additional information on the classification of short-term vs. long-term liabilities as it would apply to revenues to be distributed to others to enable the board to reach consensus on how to treat the oil and gas liabilities;
    - Provide additional information on the ability of DOI to provide the component entity RSI as currently required to enable the board to reach consensus on whether to retain the RSI requirements from the original ED;
    - Provide additional information on how to treat custodial reporting for other commodities to enable the board to reach consensus on how the other commodities should be addressed in the interim until standards on all natural resources are issued.

October 2009 Meeting
- Provide another draft revised exposure draft that incorporates member comments from August meeting.

December 2009 Meeting
- Provide a pre-ballot revised exposure draft that incorporates decisions from the October 2009 meeting.
- Provide a ballot draft that incorporates final member comments via email after the meeting.

January 2010
- Issue a revised exposure draft with comments due by late March 2009.

April 2010 Meeting
- Discuss comments received on revised exposure draft.

June 2010 Meeting

- Finalize wording.
- Provide pre-ballot draft after meeting via email.

July 2010

- Provide ballot draft via email (will not be on August 2010 agenda if approved before meeting and there are no issues).
- Provide proposed standard to sponsors.

October 2010

- Issue final standard after sponsor review (earliest effective date of standard would be for periods beginning after September 30, 2011).

BACKGROUND

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

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). The proposed standards would be effective for periods beginning after September 30, 2009 (fiscal year 2010), with early implementation permitted.

See Tab A-2 for a timeline history of the project and key decisions since its original inception in May 1995.

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If you require additional information or wish to suggest another alternative not considered in the staff paper, please contact me as soon as possible. Ideally, I would be able to respond to your request for information or develop more fully the alternative you wish considered in advance of the meeting. If you have any questions or comments prior to the meeting, please contact me by telephone at 202.512.7377 or by e-mail at ranaganj@fasab.gov.

Attachment

SIGNIFICANT CHANGES MADE TO THE ORIGINAL ED

The significant changes made to the original ED as a result of the Board's consideration of the comments received, the field test questionnaires, and discussions with DOI representatives are summarized below:

1. **Removed specific reference to "proved oil and lease condensate, natural gas plant liquids (NGPLs), and gas reserves" throughout document; now refer more broadly to "proved oil and gas reserves."** Further breakdown into the components of oil and gas will be considered by the federal entity as part of the estimation methodology.

   This change was made to provide more flexibility in the selection of commodities and types to be separately computed (e.g., crude oil, lease condensate, wet gas, dry gas, onshore, offshore, etc). The ultimate goal is to have one asset value for all estimated petroleum royalties. The breakout by commodity and type would be determined by the federal entity as part of the estimation methodology. Paragraph 26 of the draft revised ED requires that estimates of future federal royalty receipts on proved reserves known to exist as of the reporting date should be divided further by commodity and type and calculated separately if material differences would otherwise result.

2. **Removed the detailed asset valuation implementation guidance.** The draft revised ED provides federal entities with flexibility in developing the estimation methodology for valuing oil and gas natural resources. In an environment heavily affected by changes in prices, technological advancements, economic and operating conditions, and known geological, engineering, and economic data, estimation methodologies may need to be regularly updated to reflect changing economic and technological conditions. The Board believes that the detailed estimation methodology for valuing oil and gas natural resources should be developed by federal entities rather than centrally by the Board.[3] The Board reached this conclusion based on discussions about recent changes that have occurred since the original ED was issued and the need to continually update the accounting standards as a result of volatile conditions in the oil and gas industry. The Board also considered DOI's willingness to develop the methodology and work with the auditors to phase in the required reporting from RSI to basic over a period of two or three years and return to FASAB only on issues that could not be resolved with the auditors.

   This change was made based on the comment letters received on the original ED, the field test questionnaires, and discussions with DOI representatives at the October meeting. Board members directed staff to pursue a less detailed standard at the June meeting. This direction was further reinforced by the Board members reactions to DOI's willingness to develop the methodology and work with the auditors to phase in the required reporting from RSI to basic.

[3] Estimates that do not lead to material misstatements are acceptable without guidance from the Board. (This footnote is taken from the exposure draft "Estimating the Historical Cost of General Property, Plant, and Equipment Amending Statements of Federal Financial Accounting Standards 6 and 23."

Staff adapted the wording from par. 13 in SFFAS 6, *Accounting for Property, Plant, and Equipment*, that discussed capitalization thresholds. Par. 13 reads "The Board believes that capitalization thresholds should be established by Federal entities rather than centrally by the Board. Because Federal entities are diverse in size and in uses of PP&E, entities must consider their own financial and operational conditions in establishing an appropriate capitalization threshold or thresholds. Once established, this threshold(s) should be consistently followed and disclosed in the financial reports."

3. Simplified the detailed pro forma transactions; removed excess detail on how values were derived.

This change was made to align with the previous change whereby the detailed asset valuation implementation guidance was removed. The transactions and pro forma financial statements in Appendix C were paired down to a more basic presentation, modeled after the transactions and pro forma financial statements from SFFAS 27, *Identifying and Reporting Earmarked Funds*, and SFFAS 31, *Accounting for Fiduciary Activities*. Excess detail on how to calculate and derive values was removed.

4. Removed the illustrative disclosure and RSI presentations.

This change was made to align with the previous two in keeping with the desire to remove excess detail. This approach is similar to SFFAS 29, *Heritage Assets and Stewardship Land*, which contained detailed disclosure requirements but no pro forma disclosures.

SFFAS 29, BfC par. 29 states "The Board also has avoided detailed illustrations and limited specific examples in the standard because preparers and auditors may attempt to strictly adhere to the illustrations." SFFAS 29 BfC also noted that the Board asked the AAPC to prepare a technical release to provide additional implementation guidance. Staff believes that this standard should be treated similarly because the Board has asked DOI (the only affected entity) to develop a methodology and is providing several years for the methodology to be improved upon before it becomes basic information.

5. Selected present value as the measurement method.

The board had considered present value as a potential measurement method while developing the original oil and gas ED. Paragraph A52 in the basis for conclusions of the original ED read as follows:

> A52. Present (or discounted) value of future cash flows – The present or discounted value of future cash inflows into which an asset is expected to be converted in due course of business less present values of cash outflows necessary to obtain those inflows. (SFAC 5, Par 67.e) An estimate of the 'present (or discounted cash) value' of the estimated federal royalty share appeared to be most appropriate because the asset will be

converted in future periods. However, the ‘present (or discounted cash) value’ attribute poses measurement challenges because:

a. The timing of future inflows is not reliably estimable.

b. The discount rate should be commensurate with the riskiness of the stream and each well might be viewed as having a unique level of risk.

c. Prices are subject to fluctuation, making the amount of future inflows volatile.

The timing cannot be reliably estimated because of the variable period of time from when a lease is signed until production begins (from 3 years to 20 years or more) and the variable period of time that a well will be productive. Thus, the estimated present value would be unreliable and, therefore, not cost-beneficial for valuing oil and gas reserves.

The DOI field test team stated that they believe their methodology for calculating estimated petroleum royalties based on a present value approach is more reliable and more accurate than the approach proposed in the original ED.

This change was made based on the board member’s reactions to DOI’s willingness to develop the methodology based on a present value method and work with the auditors to phase in the required reporting from RSI to basic. In addition, the representative for CBO, which had presented an alternative view to the original ED supporting fair value, generally supports DOI’s proposed methodology based on present value.

6. **Provided federal entities with the opportunity to compute the federal government’s estimated petroleum royalties by “multiplying the estimated quantity of proved oil and gas reserves under federal lands by the average first purchase price for oil or average wellhead price for gas and the effective average royalty rate by region” if it is not reasonably possible to estimate the present value of future federal royalty receipts on proved reserves.** Other methodologies are deemed acceptable.

   This change was made in keeping with the flexibility afforded to federal entities in developing the estimation methodology for valuing oil and gas natural resources. While DOI is working with their auditors on an acceptable estimation methodology, it may be determined that present value is not an acceptable method and the formula originally developed or something like it may be more reliable (see Table 1 on page 12 for staff’s analysis of DOI’s issues with the ED asset valuation methodology and proposed changes).

Providing flexibility to the preparers will prevent the need to continually update the underlying accounting standard.

7. **Permitted a change in methodology** (see paragraph 28). "Once established, the estimation methodology should be consistently followed and disclosed in the financial reports. If environmental or other changes would provide for the development of an improved methodology, the nature and reason for the change in methodology, as well as the effect of the change, should be disclosed."

   This change was made to allow for improvements to be made to the methodology without requiring an amendment to the underlying accounting standard. For example, if DOI implements an alternative methodology because they are unable to develop a methodology based on present value at this time, it would seem desirable for DOI to be able to switch to present value if at some point in the future, due to technological advancements or other developments, DOI becomes able to use the present value method.

8. **Incorporated SFFAS 33 guidance for displaying gains and losses from changes in assumptions and selecting discount rates.**

   This change was initiated by staff based on the selection of present value as the measurement method because it is in keeping with the principle of SFFAS 33. The original SFFAS 33 ED had proposed a broad scope; however, although in principle a broader application was desirable, the Board decided to limit the final standard to federal employee pension, ORB, and OPEB liabilities. This decision was based on the Board's desire to address more immediately its primary concern, which was to display the effect of assumption changes on employee compensation liabilities. Respondents had requested more guidance regarding how the standard would apply to other long-term assumptions; the Board believed that developing additional guidance would significantly delay implementation of SFFAS 33.

   Staff believes that it would be appropriate to apply the guidance in SFFAS 33 to long-term assumptions about oil and gas when utilizing present value as the measurement method.

9. **Updated the effective date of the standard to provide for a three-year phase-in from RSI to basic information.**

   This change was based on discussions with DOI at the October meeting, particularly DOI's willingness to develop the asset valuation methodology and work with the auditors to phase in the required reporting from RSI to basic over a period of two or three years and return to FASAB only on issues that could not be resolved with the auditors..

   The language for the proposed effective date was modeled after the exposure draft "Reporting Comprehensive Long-Term Fiscal Projections for the U.S. Government."

10. Moved the Illustration of the Components of Federal Oil and Gas Resources to an appendix by itself.

11. Updated the basis for conclusions.

12. Updated questions for respondents to request feedback on changes made to the original exposure draft.

13. [TBD based on discussion of other issues planned for February 2009 board meeting – fiduciary reporting, long-term vs. short-term liability classification, detailed component entity RSI, custodial reporting for other commodities, etc]

QUESTIONS FOR THE BOARD MEMBERS

<u>The two primary questions to be answered during this 105 minute session are:</u>

1. Does the Board agree or disagree with the level of detail that is included (or omitted) in the revised ED with respect to asset valuation guidance, pro forma transactions, illustrative disclosures and RSI presentations?
2. Does the Board agree or disagree that the scope of the revised ED should be broadened to address all natural resources?

<u>As time permits, staff will seek answers to the following secondary questions:</u>

3. Does the Board agree or disagree that present value should be selected as the primary measurement method?
4. Does the Board agree or disagree that the preparer should be permitted to select the measurement attribute or method from two or more options?
5. Does the Board agree or disagree that the preparer should be permitted to change the estimation methodology once one has been established?
6. Does the Board agree or disagree that the SFFAS 33 guidance for displaying gains and losses from changes in assumptions and selecting discount rates should be applied to long-term assumptions for oil and gas?
7. Does the Board agree or disagree with the phase-in of the requirements from RSI to basic?

SESSION WRAP-UP

- ❑ Have questions one and two above been answered?
- ❑ Does the Board agree or disagree with the next steps staff has outlined on pages two through four (the next steps will depend on whether an ED on just oil and gas is selected or if staff is to pursue an ED on all natural resources).

Table 1 – Staff analysis of DOI issues with ED asset valuation methodology and proposed changes from field test

Issue Perceived as a Potential Significant Challenge	Issue NOT Perceived as a Potential Significant Challenge
– Need to project how the proved reserves will be produced (assumes an exponential decline at a rate of the modeler's choice) – Need to estimate future oil and gas prices; very volatile; used oil and gas prices from OMB's economic assumptions – Continued reliance on EIA reporting; mitigated somewhat by congressional mandate to provide information on total proved reserves (not on federal lands only) – Need to use proxy of production to proved reserves; number can never be deemed reasonable unless tested out over a number of years (data for testing—seismic data or report of proved reserves under federal lands—does not exist) – Need to establish beginning asset balance based on proxy (see challenge above) – Methodology for recording depletion expense when significant adjustments and accruals occur that are related to other periods and/or nonattributed	– Further division of proved reserves by commodity and type (crude oil, lease condensate, and natural gas—wet after lease separation) and in the GOM, further by water depth of field – Use of wet gas only instead of estimating dry gas and NGPLs – Removal of transportation allowances from the regional average landed price to arrive at a regional average wellhead price – Selection of reasonable discount and inflation rates – Determination of adjustments needed to reflect royalty-free production – Selection of regions – Estimate for 21 months of production and exploration that will transpire between the effective date of the value estimate and the effective date of the reserve estimate

Tab A-1
Draft Revised Exposure Draft
Accounting for Federal Oil and Gas Resources

Federal Accounting Standards Advisory Board

Accounting for

Federal Oil and Gas Resources

Statement of Federal Financial Accounting Standards

Revised Exposure Draft

Written comments are requested by [date 60 days after issuance]

Month day, year

Working Draft – Comments from Respondents Are Not Requested on This Draft

THE FEDERAL ACCOUNTING STANDARDS ADVISORY BOARD

The Secretary of the Treasury, the Director of the Office of Management and Budget (OMB), and the Comptroller General, established the Federal Accounting Standards Advisory Board (FASAB or "the Board) in October 1990. FASAB is responsible for promulgating accounting standards for the United States Government. These standards are recognized as generally accepted accounting principles (GAAP) for the Federal Government.

An accounting standard is typically formulated initially as a proposal after considering the financial and budgetary information needs of citizens (including the news media, state and local legislators, analysts from private firms, academe, and elsewhere), Congress, Federal executives, Federal program managers, and other users of Federal financial information. The proposed standards are published in an Exposure Draft for public comment. In some cases, a discussion memorandum, invitation for comment, or preliminary views document may be published before an exposure draft is published on a specific topic. A public hearing is sometimes held to receive oral comments in addition to written comments. The Board considers comments and decides whether to adopt the proposed standard with or without modification. After review by the three officials who sponsor FASAB, the Board publishes adopted standards in a Statement of Federal Financial Accounting Standards. The Board follows a similar process for Statements of Federal Financial Accounting Concepts, which guide the Board in developing accounting standards and formulating the framework for Federal accounting and reporting.

Additional background information is available from the FASAB or its website:

- "Memorandum of Understanding among the General Accounting Office, the Department of the Treasury, and the Office of Management and Budget, on Federal Government Accounting Standards and a Federal Accounting Standards Advisory Board."

- "Mission Statement: Federal Accounting Standards Advisory Board", Exposure drafts, Statements of Federal Financial Accounting Standards and Concepts, FASAB newsletters, and other items of interest are posted on FASAB's website at: www.fasab.gov.

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Federal Accounting Standards Advisory Board

ISSUE DATE

TO: ALL WHO USE, PREPARE, AND AUDIT FEDERAL FINANCIAL INFORMATION

The Federal Accounting Standards Advisory Board (FASAB or the Board) is requesting comments on the revised exposure draft of a proposed Statement of Federal Financial Accounting Standards entitled, *Accounting for Federal Oil and Gas Resources*. Substantive changes have been made to the original exposure draft issued on May 21, 2007.

Specific questions for your consideration appear on page 1 but you are welcome to comment on any aspect of this proposal. If you do not agree with the proposed approach, your response would be more helpful to the Board if you explain the reasons for your position and any alternative you propose. Responses are requested by DUE DATE.

All comments received by the FASAB are considered public information. Those comments may be posted to the FASAB's website and will be included in the project's public record.

We have experienced delays in mail delivery due to increased screening procedures. Therefore, please provide your comments in electronic form. Responses in electronic form should be sent by e-mail to fasab@fasab.gov. If you are unable to provide electronic delivery, we urge you to fax the comments to (202) 512-7366. Please follow up by mailing your comments to:

Wendy M. Payne, Executive Director
Federal Accounting Standards Advisory Board
Mailstop 6K17V
441 G Street, NW, Suite 6814
Washington, DC 20548

The Board's rules of procedure provide that it may hold one or more public hearings on any exposure draft. No hearing has yet been scheduled for this exposure draft. Notice of the date and location of any public hearing on this document will be published in the *Federal Register* and in the FASAB's newsletter.

Tom L. Allen
Chairman

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Executive Summary

What is the Board proposing?

This exposure draft (ED) proposes accounting standards for federal oil and gas resources.[1] The proposed standards would result in the recognition of an asset and a liability. The asset would be referred to as "estimated petroleum royalties." The asset's value would be the royalty share of the federal oil and gas resources classified as "proved reserves."[2] The liability would be for the royalty share of the federal 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.[3]

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 would be recognized based on an annual valuation of the asset with an 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.

Transition to these proposed standards would require that the federal government's royalty share of oil and gas proved reserves be recognized as an asset as of the beginning of the reporting period in which the standards become effective. In addition, a liability for the portion that will be distributed to others would be established at the same time. The net effect of recognizing an asset and establishing a liability at the beginning of the reporting period would be a change in accounting principle that increases the entity's net position. 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).

The proposed standards would be effective as RSI for periods beginning after September 30, 2010, and as basic information for periods beginning after September 30, 2013, except where specifically designated as RSI. Earlier implementation is encouraged.

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[1] Federal Oil and Gas Resources: Oil and gas resources over which the federal government may exercise sovereign rights with respect to exploration and exploitation and from which the federal government has the authority to derive revenues for its use. Federal oil and gas resources do not include resources over which the federal government acts as a fiduciary for the benefit of a nonfederal party.

[2] A portion of the production value of proved oil and gas reserves are due the federal government from the lessee in accordance with the royalty rate contained in the lease agreement.

[3] Upon collection, the majority of the federal government's estimated petroleum royalties from the production of federal oil and gas proved reserves are distributed to states, other federal agencies, and the general fund of the U.S. Treasury in accordance with legislated allocation formulas.

How would this proposal improve federal financial reporting and contribute to meeting the federal financial reporting objectives?

Federal oil and gas resources represent federal assets. Accounting for and reporting information about these assets would enhance:

a. accountability for and stewardship over assets of the federal government;
b. consistency and understandability in accounting for assets of the federal government; and,
c. relevance, consistency, and comparability of information regarding revenue of the federal government.

Recognizing the federal government's royalty share of proved reserves as an asset on the balance sheet would provide transparency regarding the value and changes in value of these significant assets. Federal financial reports would be more relevant, consistent, and complete. Additional disclosures about federal oil and gas resources would provide comprehensive information about federal assets, reveal changes in the quantity and status of oil and gas resources, and make quantity information more accessible to users of financial information.

Bonus bid, rent, and royalty collections – currently treated as nonexchange revenue due to the absence of cost information – would be accounted for and reported in accordance with exchange revenue standards. This treatment would improve the comparability of revenue information.

Of the four objectives outlined in Statement of Federal Financial Accounting Concepts Statement (SFFAC) 1, *Objectives of Federal Financial Reporting*, the operating performance and stewardship objectives were identified as most important for natural resources reporting.

With respect to meeting the operating performance reporting objective, the proposed standard would provide information useful in evaluating the reporting entity's management of assets relating to oil and gas resources. This information would allow financial report users to monitor changes in royalty rates and

Operating Performance Objective

Federal financial reporting should assist report users in evaluating the service efforts, costs, and accomplishments of the reporting entity; the manner in which these efforts and accomplishments have been financed; and the management of the entity's assets and liabilities. Federal financial reporting should provide information that helps the reader to determine

– the costs of providing specific programs and activities and the composition of, and changes in, these costs;
– the efforts and accomplishments associated with federal programs and the changes over time and in relation to costs; and
– the efficiency and effectiveness of the government's management of its assets and liabilities.

Source: SFFAC 1

estimated reserve quantities, providing an indicator of how well the government's proved reserves were managed. In addition, the value of the estimated petroleum royalties at the end of each period would facilitate consideration of the potential cash flows from existing leases.

Currently, royalties from oil and gas leases are displayed on the statement of changes in net position with non-exchange revenue rather than on the statement of net cost with other exchange revenue. Presentation of revenues arising from oil and gas leasing activities as exchange revenue would assist users in understanding how the government's efforts and accomplishments were financed. The current practice of combining revenues derived from the sale of assets with revenues derived from taxation or other non-exchange sources may obscure the fact that the gains were obtained through the exchange of resources—proved reserves for a future stream of royalty payments.

Stewardship Objective

Federal financial reporting should assist report users in assessing the impact on the country of the government's operations and investments for the period and how, as a result, the government's and the nation's financial condition has changed and may change in the future. Federal financial reporting should provide information that helps the reader to determine whether

- the government's financial position improved or deteriorated over the period,
- future budgetary resources will likely be sufficient to sustain public services and to meet obligations as they come due, and
- government operations have contributed to the nation's current and future well-being.

Source: SFFAC 1

With respect to meeting the stewardship reporting objective, the proposed standard would provide information useful in assessing whether federal government operations have contributed to the nation's current and future well-being. Recognition of estimated petroleum royalties as an asset would make available the value of an asset that generates cash to finance government operations over time. This would inform users about the financial position of the government and whether it was improving or deteriorating over time. Information about potential oil and gas production and changes in potential production over time would allow users to consider how government operations and economic conditions have impacted the availability of oil and gas resources to future generations.

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Table of Contents

Executive Summary i

What is the Board proposing? i

How would this proposal improve federal financial reporting and contribute to meeting the federal financial reporting objectives? ii

Questions for Respondents 1

Introduction 3

Purpose 3

Materiality 3

Estimation Methodology 4

Effective Date 4

Proposed Standard 5

Scope 5

Definitions 5

Asset Recognition 6

Liability Recognition 8

Revenue and Expense Recognition 9

Future Royalty Rights Identified for Sale 10

Annual Valuation of Estimated Petroleum Royalties 10

Disclosures and Required Supplementary Information 11

Component Entity Disclosures 11

Component Entity Required Supplementary Information (RSI) 13

Consolidated Financial Report (CFR) of the United States Government Disclosures 14

Disclosure Requirements for Fiduciary Oil and Gas Resources 14

Implementation Guidance ... 14

Effect on Existing Standards ... 15

Effective Date ... 16

Appendix A: Basis for Conclusions ... 17

Project History ... 17

Overview of Federal Oil and Gas Resources ... 18

Conceptual Aspects of Federal Oil and Gas Resources as an Asset for Estimated Petroleum Royalties and a Liability for the Portion of Revenue to be Distributed to Others ... 22

Recognition Criteria ... 22

Asset Recognition ... 22

Liability Recognition ... 27

Reporting the Gains and Losses from Changes in Assumptions and Selecting Discount Rates ... 28

Future Rights to Royalty Streams Identified for Sale ... 28

Disclosures ... 29

Original Exposure Draft ... 29

Significant Changes Made to the Original Exposure Draft ... 34

Appendix B: Illustration of the Components of Federal Oil and Gas Resources ... 37

Appendix C: Pro Forma Transactions And Financial Statements ... 39

Appendix D: Abbreviations ... 47

Appendix E: Glossary ... 49

Questions for Respondents

The FASAB encourages you to become familiar with all proposals in the Statement before responding to the questions in this section. In addition to the questions below, the Board also would welcome your comments on other aspects of the proposed Statement.

The Board believes that this proposal would improve Federal financial reporting and contribute to meeting the Federal financial reporting objectives. The Board has considered the perceived costs associated with this proposal. In responding, please consider the expected benefits and perceived costs and communicate any concerns that you may have in regard to implementing this proposal.

Because the proposals may be modified before a final Statement is issued, it is important that you comment on proposals that you favor as well as any that you do not favor. Comments that include the reasons for your views will be especially appreciated.

The questions in this section are available in a Word file for your use at www.fasab.gov/exposure.html. Your responses should be sent by e-mail to fasab@fasab.gov. If you are unable to respond electronically, please fax your responses to (202) 512-7366 and follow up by mailing your responses to:

Wendy M. Payne, Executive Director
Federal Accounting Standards Advisory Board
Mailstop 6K17V
441 G Street, NW, Suite 6814
Washington, DC 20548

All responses are requested by [insert date].

Q1. The Board is proposing to provide federal entities with flexibility in developing the estimation methodology for valuing oil and gas resources due to the constantly changing economic and technical conditions. The detailed asset valuation implementation guidance contained in the original exposure draft (ED) issued on May 21, 2007, has been removed from this revised ED. Do you agree or disagree with the Board's position (see paragraphs 22 through 26 and A41)? Please explain the reasons for your position in as much detail as possible.

Q2. The Board believes that the method for valuing the federal government's estimated petroleum royalties should approximate the present value of future federal royalty receipts on proved reserves known to exist as of the reporting date. Do you agree or disagree with the Board's position (see paragraphs 23, 23, and A35 through A40)? Please explain the reasons for your position in as much detail as possible.

Q3. The Board is proposing to permit alternative measurement methods for valuing the federal government's estimated petroleum royalties if it is not reasonably possible to estimate the present value of future federal royalty receipts on proved reserves. Do you agree or disagree with the Board's position (see paragraph 27)? Please explain the reasons for your position in as much detail as possible.

Q4. The Board is proposing to permit federal entities to change its methodology for valuing the federal government's estimated petroleum royalties if environmental or other changes would provide for the development of an improved methodology. Do you agree or disagree with the Board's position (see paragraph 28)? Please explain the reasons for your position in as much detail as possible.

Q5. The Board believes that it would be appropriate to apply the guidance regarding reporting gains and losses from changes in assumptions and selecting the discount rates from SFFAS 33, *Pensions, Other Retirement Benefits, and Other Postemployment Benefits: Reporting the Gains and Losses from Changes in Assumptions and Selecting Discount Rates and Valuation Dates,* to long-term assumptions about oil and gas when using the present value method. Do you agree or disagree with the Board's position (see paragraphs 23, 25, 41, and A49 through A51)? Please explain the reasons for your position in as much detail as possible.

Q6. The Board is proposing to provide a three-year phase-in of the proposed requirements from RSI beginning with fiscal year 2011 to basic in fiscal year 2014. This period is provided to allow for the asset valuation methodology to be improved upon before an audit opinion is required. Do you agree or disagree with the Board's position (see paragraphs 53 and A72)? Please explain the reasons for your position in as much detail as possible.

Introduction

Purpose

1. Statements of Federal Financial Accounting Standards (SFFAS) 6, *Accounting for Property, Plant, and Equipment*; 8, *Supplementary Stewardship Reporting*; and 29, *Heritage Assets and Stewardship Land*, establish standards related to federal lands, but specifically exclude natural resources from the scope of those standards. Extensive federal oil and gas resources exist on public lands throughout the country and on the Outer Continental Shelf (OCS). Currently, federal financial reporting does not provide information about the quantity or value of these assets. In addition, royalty revenues are recognized but expenses are not recognized for the asset exchanged to produce those revenues.

2. The Board believes that federal oil and gas resources represent federal assets and accounting for and reporting information about these assets would enhance:

   a. accountability for and stewardship over assets of the federal government;
   b. consistency and understandability in accounting for assets of the federal government; and,
   c. relevance, consistency, and comparability of information regarding revenue of the federal government.

3. This Statement provides for a more complete accounting for oil and gas resources available to the federal government. Recognizing the federal government's royalty share of proved reserves as an asset on the balance sheet would provide transparency regarding the value and changes in value of these significant assets and results in information that contributes to meeting federal financial reporting objectives.

Materiality

4. The provisions of this Statement need not be applied to immaterial items. The determination of whether an item is material depends on the degree to which omitting or misstating information about the item makes it probable that the judgment of a reasonable person relying on the information would have been changed or influenced by the omission or the misstatement.

Estimation Methodology

5. The Board believes that the detailed estimation methodology for valuing oil and gas natural resources should be developed by federal entities rather than centrally by the Board. In an environment heavily affected by changes in prices, technological advancements, economic and operating conditions, and known geological, engineering, and economic data, estimation methodologies may need to be regularly updated to reflect changing economic and technological conditions.

Effective Date

6. The proposed standards are effective as RSI for periods beginning after September 30, 2010, and as basic information for periods beginning after September 30, 2013, except where specifically designated as RSI. Earlier implementation is encouraged.

Proposed Standard

Scope

7. This Statement applies exclusively to federal entities that report information about federal oil and gas resources in general purpose financial reports prepared in conformance with Federal Accounting Standards Advisory Board (FASAB) standards.

8. This Statement articulates a general principle that should guide preparers of general purpose federal financial reports in accounting for federal oil and gas resources.

9. The concepts of an asset and a liability contained in this document are consistent with those established in Statement of Federal Financial Accounting Concepts (SFFAC) 5, *Definitions of Elements and Basic Recognition Criteria for Accrual-Basis Financial Statements*. This Statement establishes accounting for assets and liabilities related to federal oil and gas resources that are not addressed by prior standards.

10. This Statement also amends SFFAS 7, *Accounting for Revenue and Other Financing Sources*, to account for and report bonus bid, rent, and royalty collections – currently treated as nonexchange revenue due to the absence of cost information – in accordance with exchange revenue standards.

Definitions

11. Definitions in paragraphs 12 through 16 are presented first in the proposed accounting standards because of their uniqueness in calculating the asset value of estimated petroleum royalties. Other terms shown in **boldface type** the first time they appear in this document are presented in the Glossary (see page 49). Reviewers of this document may want to examine all definitions before reviewing the proposed accounting standards and Basis for Conclusions.

12. **Federal Oil and Gas Resources**: **Oil** and **gas** resources over which the federal government may exercise sovereign rights with respect to exploration and exploitation and from which the federal government has the authority to derive revenues for its use. Federal oil and gas resources do not include resources over which the federal government acts as a fiduciary for the benefit of a non-federal party.

13. <u>Regional Average **First Purchase Price** for Oil:</u> The regional average first purchase price for oil is calculated by dividing the total regional **sales value** of oil produced from federal oil and gas resources in each associated region for the preceding twelve (12) months by the total regional sales volume of oil produced from federal oil and gas resources in each associated region for the preceding twelve (12) months.[4] All types of **crude oil streams** and **gravity bands** are aggregated for this calculation.

14. <u>Regional Average **Wellhead Price** for Gas</u>: The regional average wellhead price for gas is calculated by dividing the total regional sales value of gas produced from federal oil and gas resources in each associated region for the preceding twelve (12) months by the total regional sales volume of gas produced from federal oil and gas resources in each associated region for the preceding twelve (12) months.

15. <u>Effective Regional Average **Royalty Rate**</u>: The effective regional average royalty rate is calculated by dividing the royalty value (royalties) earned on the oil and gas proved reserves produced for each associated region for the preceding twelve (12) months by the total sales value of that production for the preceding twelve (12) months.

16. <u>Regional **Estimated Petroleum Royalties**</u>: Regional estimated petroleum royalties means the estimated end-of-period value of the federal government's royalty share of proved oil and gas reserves from federal oil and gas resources in each region.

Asset Recognition

17. Extensive federal oil and gas resources exist on public lands throughout the country and on the **Outer Continental Shelf** (OCS). These resources will provide economic benefits to the federal government through revenue from leasing activities and the collection of royalties on production. The federal government controls access to these resources.

18. Federal oil and gas resources are made up of three different components – proved reserves, technically recoverable resources, and undiscovered resources. See Appendix B: Illustration of the Components of Federal Oil and Gas Resources on page 37 for an illustration of the universe of federal oil and gas resources and a further breakdown of its components.

19. Information is available in varying degrees and with varying reliability for each component. While all of the federal oil and gas resources meet the

[4] A longer or shorter period than twelve (12) months may be deemed appropriate.

Comment: From DOI Field Test Team: Paragraph 15 – Effective Regional Royalty Rate - Suggest this include 'For which production data is available at the measurement date'. [Staff Note: Comment would probably also apply to pars. 13 and 14, which were added after the draft provided to DOI.]

Comment: From DOI Field Test Team: In general, we are in favor of the movement by FASAB to a less prescriptive methodology of valuing the asset that is based on a present value concept. This moves in the direction that we were urging in our response to the ED. Also, there are statements that restrict the asset recognition to proved reserves which is what we feel is mandatory.

While the simplified approach presented is well received and allows for significant latitude in many areas, we believe that in some instances the draft is written too broadly. Without more specific guidance on some of the key aspects of valuation and depletion, the DOI will likely be faced with extensive costs to implement, and likely audit issues and disagreements.

Comment: From DOI Field Test Team: Paragraph 16 does not correctly capture the terminology of the breakdown of Federal oil and gas resources, at least as we are familiar with them at MMS. A better description would be that Federal resources have two primary components, reserves (discovered resources) and undiscovered resources. Reserves can be further classified as proved, unproved probable, and unproved possible depending on the probability of them being recovered. Undiscovered resources can be further classified as economically recoverable (producible at specific price levels), technically recoverable (producible at current technology levels), and total resource endowment (estimated to exist irrespective of price and technology).

definition of asset, the Board does not believe that the information for other than proved reserves is sufficiently reliable to be recognized.

20. The federal government's estimated petroleum royalties from the production of federal oil and gas proved reserves shall be recognized as an asset on the balance sheet of the component entity that is responsible for collecting royalties. The value of the federal government's estimated petroleum royalties shall be computed based on the calculation of federal oil and gas proved reserves on a regional basis.

21. For purposes of this standard, the regions used in determining and reporting regional amounts or factors shall be collaboratively developed by all the component entities involved in oil and gas resource activities. Regions used in calculating Regional Estimated Petroleum Royalties and in applying this standard shall be consistent and aligned with regions used internally by the component entities in administering federal oil and gas resource activities.

22. The Board believes that the detailed estimation methodology for valuing oil and gas natural resources should be developed by federal entities rather than centrally by the Board.[5] In an environment heavily affected by changes in prices, technological advancements, economic and operating conditions, and known geological, engineering, and economic data, estimation methodologies may need to be regularly updated to reflect changing economic and technological conditions.

23. The estimates that are developed should approximate the **present value** of future federal royalty receipts on proved reserves known to exist as of the reporting date. The estimates should be based on the best information available at fiscal year-end, or as close to the fiscal year-end as possible.

24. Discount rates as of the reporting date for present value measurements of oil and gas assets and liabilities should be based on interest rates on **marketable Treasury securities** with maturities consistent with the cash flows being discounted as required for pension, other retirement benefits (ORB) and other postemployment benefits (OPEB) in SFFAS 33, *Pensions, Other Retirement Benefits, and Other Postemployment Benefits: Reporting the Gains and Losses from Changes in Assumptions and Selecting Discount Rates and Valuation Dates.*[6]

Comment: From DOI Field Test Team: Additionally, we noticed that the published EIA data is not mentioned in the ED as the source information serving as the basis for quantity, and without this element, the DOI would likely be faced with audit disagreements about the source of quantity information. We recommend that a paragraph be included citing DOE EIA proved reserves estimates as the bases for the calculations. Despite the limitations onshore, these estimates are still the best, most consistent, and in some cases only estimates for this purpose. Limitations on their direct application for this purpose can be overcome. Further, this can be accomplished from proved reserve estimates already published by DOE such that dependence on their cooperation is not mandatory for success.

'Earned revenue from production' is not adequately defined to provide for the use of available production data reported, without which the MMS would likely be faced with extensive costs and time constrains in the use of estimates, as we discussed extensively in our responses to the field test study. We believe more specificity would be a significant improvement in this area.

[5] Estimates that do not lead to material misstatements are acceptable without guidance from the Board.
[6] See SFFAS 33, paragraphs 28 through 32 for additional guidance.

25. The entity's estimates should reflect its judgment about the outcome of events based on past experience and expectations about the future. Estimates should reflect what is reasonable to assume under the circumstances. The entity's own assumptions about future cash flows may be used. However, the entity should review assumptions used generally in the federal government as evidenced by sources independent of the reporting entity, for example, those used by the Bureau of Economic Analysis for the National Income and Product Accounts and, if its assumptions do not reflect such data, an explanation of why it is inappropriate to do so should be disclosed.

26. The estimates of future federal royalty receipts on proved reserves known to exist as of the reporting date should be divided further by commodity and type (e.g., wet gas, **dry gas**, oil and **lease condensate**, onshore, offshore, etc.) and calculated separately if material differences would otherwise result. Each of the individual calculations should be summed together to arrive at the federal government's total estimated petroleum royalties.

27. If it is not reasonably possible to estimate the present value of future federal royalty receipts on proved reserves, then the value of the federal government's estimated petroleum royalties may be computed by multiplying the estimated quantity of proved oil and gas reserves under federal lands by the average first purchase price for oil or average wellhead price for gas and the effective average royalty rate by region. Other methodologies may be acceptable.

Comment: From DOI Field Test Team: Paragraph 27 - Alternate method - It is implied but not clear, that if using the alternate method, that method should also be discounted to present value. We suggest a brief clarifying sentence or blurb.

28. Once established, the estimation methodology should be consistently followed and disclosed in the financial reports. If environmental or other changes would provide for the development of an improved methodology, the nature and reason for the change in methodology, as well as the effect of the change, should be disclosed.

Liability Recognition

29. Upon collection, the majority of the federal government's estimated petroleum royalties from the production of federal oil and gas proved reserves are distributed to states, other federal agencies, and the general fund of the U.S. Treasury in accordance with legislated allocation formulas. The legislated allocation formulas constitute a present obligation of the component entity that is responsible for collecting royalties to provide assets to another entity, and the underlying legislation identifies the conditions under which these distributions will be made.

Comment: From DOI Field Test Team: Paragraph 29 - Present obligation - This would result in a long term liability, not a current one.

30. A liability for revenue distributions to others shall be recognized on the balance sheet of the component entity that is responsible for collecting royalties in conjunction with the recognition of an asset for estimated petroleum royalties. The amount of the liability shall be estimated based on the present value of the royalty share of the federal proved oil and gas reserves designated to be distributed to others, e.g., the states, the general fund of the U.S. Treasury and other federal agencies. For example, the average annual share of the revenue distributed to others over the preceding twelve (12) months may be an acceptable basis for estimating petroleum royalties to be distributed to others. Other methodologies may be acceptable.

Comment: From DOI Field Test Team: Paragraph 30 - Liability as present value - Suggest the text clarify that the corresponding liability should equal the estimated petroleum royalties asset value. By default it would represent a present value, and revising this text would make the provision much clearer.

31. The net effect of recognizing an asset and establishing a liability at the beginning of the reporting period would be a change in accounting principle that increases the entity's net position.

Revenue and Expense Recognition

32. **Bonus bid** and **rent** revenue relating to federal oil and gas resources shall be recognized as exchange revenue on the statement of net cost of the component entity that is responsible for collecting royalty revenue.[7] In addition, a liability and corresponding expense and/or transfer out for bonus bid and rent revenue distributions to others shall be recognized by the component entity that is responsible for collecting royalties in conjunction with the recognition of the bonus bid and rent revenue. The amount of the liability shall be the bonus bid and rent revenues designated to be distributed to others, e.g., the states, the general fund of the U.S. Treasury and other federal agencies. The corresponding expense and/or transfer out shall be recognized in a manner consistent with existing standards.

33. **Royalties** from the production of federal oil and gas proved reserves shall be recognized as exchange revenue on the statement of net cost by the component entity that is responsible for collecting the royalty revenue. At the same time, an amount equal to the royalty revenue shall be recognized as depletion expense on the statement of net cost of the component entity that is responsible for collecting the royalty revenue; and, the value of estimated petroleum royalties shall be reduced by the depletion expense amount.

[7] Per SFFAS 7, *Accounting for Revenue and Other Financing Sources*, paragraph 34.

Future Royalty Rights Identified for Sale

34. When rights to a stream of future royalties are identified for sale, the calculated value of those rights shall be disclosed in the notes as "future royalty rights identified for sale." The "future royalty rights identified for sale" shall not be revalued or reclassified to a different asset category on the balance sheet and no gain or loss shall be reported prior to the sale.

35. The calculated value disclosed for future royalty rights identified for sale shall be based on the specific **field** to be sold.

36. When the future royalty rights identified for sale are sold, the calculated value of the future royalty rights sold shall be removed from the estimated petroleum royalties account at the time of the sale. Any difference between this calculated value and the actual sales proceeds results in a net gain or loss.

37. The net gain or loss shall be reported on the statement of net cost of the component entity that is responsible for collecting royalties. In addition, if the sale produced a net gain, the liability and a corresponding expense and/or transfer-out for the revenue distributions to others shall be increased by an amount equal to the amount of the gain designated to be distributed to others, e.g., the states, the general fund of the U.S. Treasury and other federal agencies. If the sale produced a net loss, the liability and a corresponding expense and/or transfer-out for the revenue distributions to others shall be decreased by an amount equal to the amount of the loss, which will reduce future distributions to others.[8]

Annual Valuation of Estimated Petroleum Royalties

38. The estimated petroleum royalties asset shall be valued at the end of each year for financial statement reporting.

Comment: From DOI Field Test Team: Paragraph 38 - Suggest specifying fiscal year.

39. The calculated value of estimated petroleum royalties at year-end shall be compared to the existing book value of the estimated petroleum royalties asset. If the calculated value of the estimated petroleum royalties asset at year-end is greater than the book value,[9] the book value shall be increased to the new estimate and a gain shall be recorded on the statement of net cost. If the calculated value of the estimated petroleum royalties asset at

[8] An adjustment to "expense" would be made for distributions related to non-federal entities while an adjustment to "transfer-outs" would be made for distributions related to federal entities.
[9] The estimated petroleum royalties beginning balance would have been reduced by the amount expensed on the statement of net cost.

year-end is less than the book value, the book value shall be decreased to the new estimate and a loss shall be recorded on the statement of net cost.

40. In addition, if the calculated value of the estimated petroleum royalties asset at year-end is greater or less than the book value, the liability for revenue distributions to others shall be increased or decreased to the amount expected to be distributed.[10] If the revaluation resulted in a net gain, the liability and a corresponding expense and/or transfer-out for the revenue distributions to others shall be increased by an amount equal to the amount of the gain designated to be distributed to others, e.g., the states, the general fund of the U.S. Treasury and other federal agencies. If the revaluation resulted in a net loss, the liability and a corresponding expense and/or transfer-out for the revenue distributions to others shall be decreased by an amount equal to the amount of the loss, which will reduce future distributions to others.[11]

41. For estimates that are developed using present value, component entities should display gains and losses from changes in **long-term assumptions** used to measure assets and liabilities for oil and gas as a separate line item or line items on the statement of net costs as required for pensions, ORB, and OPEB in SFFAS 33.[12] (*Staff will explore the need for additional guidance on what would constitute a change in assumption for oil and gas vs. true gains and losses.*)

Disclosures and Required Supplementary Information

42. Notes to the financial statements are an integral part of the basic financial statements, essential for complete and fair presentation in conformity with generally accepted accounting principles for the federal government.

<u>Component Entity Disclosures</u>

43. The component entity responsible for reporting the federal government's estimated petroleum royalties on its balance sheet shall provide the following as note disclosures:

Comment: From DOI Field Test Team: Paragraph 43 - Note Disclosures - Based on the revised method used to value the asset, some of these disclosures would not be applicable, and not provide value added. They would be best revised to accommodate key and meaningful elements of the actual method used.

[10] For example, the average annual share of the revenue distributed to others over the preceding twelve (12) months may be an acceptable basis to estimate future distributions. Other methodologies may be acceptable.

[11] An adjustment to "expense" would be made for distributions related to non-federal entities while an adjustment to "transfer-outs" would be made for distributions related to federal entities.

[12] See SFFAS 33, paragraphs 19 through 27 for additional guidance.

a. A concise statement explaining how the management of federal oil and gas resources is important to the overall mission of the entity.

b. A brief description of the entity's stewardship policies for federal oil and gas resources. The stewardship policies for federal oil and gas resources shall describe the guiding principles established to: assess the oil and gas resource areas; offer those resources to interested developers; sell and assign **leases** to winning bidders; administer the leases; collect bonuses, rents, royalties, and royalty-in-kind; and distribute the collections consistent with statutory requirements, prohibitions, and limitations governing the entity.

c. A narrative describing future royalty rights identified for sale. The narrative shall provide the value of the rights identified for future sale, the location of the field(s) involved in the future sale, and the best estimate of when the rights would be sold.

d. A narrative describing and a display showing earned revenue reported by category for the reporting period shall be presented for offshore and onshore revenues for the following categories: royalty revenue earned for oil and gas, earned rent revenue, earned bonus bid revenue for leases, and total revenue from all the above categories.

e. A narrative describing and a display showing:

   i. the quantity of oil and gas for each reporting period;

   ii. the average of the Regional Average First Purchase Prices for oil and the average of the Regional Average Wellhead Prices for gas for each reporting period;

   iii. the average royalty rate for oil and gas for each reporting period;

   iv. the asset value for oil and gas by the commodities and types identified for use in calculating the federal government's total estimated petroleum royalties for each reporting period (see paragraph 26); and,

v. the value of estimated petroleum royalties at the end of each reporting period.

f. A narrative describing the estimation methodology used to calculate the value of the federal government's estimated petroleum royalties. At a minimum, the narrative explanation should include a "plain English" explanation of the measurement method (e.g., present value) and the significant assumptions incorporated into the estimate (e.g., interest rates used to calculate present value).

Component Entity Required Supplementary Information (RSI)

44. The component entity responsible for reporting the federal government's estimated petroleum royalties on its balance sheet shall provide the following as RSI:

a. A narrative describing and a display showing the most current and complete information available for **technically recoverable resources**. The information shall include the estimated quantity of offshore technically recoverable resources from federal oil and gas resources, the estimated quantity of onshore technically recoverable resources from federal oil and gas resources, the as-of-date for the information being presented, and a brief explanation of changes to the information from the previous reporting period.

b. A narrative describing and a display showing the following information for each region that was identified for use in calculating the federal government's total estimated petroleum royalties:

i. The **sales volume**, the sales value, the royalty revenue earned, and the **estimated value for royalty relief** produced from federal oil and gas resources for the reporting period shall be added together in each region and reported.

45. A narrative describing and a display showing the following historical information about proved oil and gas reserves from federal leases for each of the preceding ten calendar years: adjustments; net revisions; revisions and adjustments; net of sales and acquisitions; extensions; new field discoveries; new **reservoir** discoveries in old fields; total discoveries;

estimated production; proved reserves; and change from prior year. Definitions for these terms are contained in the Glossary under the subheading **"Historical Estimates of Proved Reserves."**

Consolidated Financial Report (CFR) of the United States Government Disclosures

46. The disclosure related to federal oil and gas resources shall provide:

    a. A concise statement explaining the nature and valuation of federal oil and gas resources.

    b. A narrative describing and a display showing:

        a. The quantity of oil and gas for each reporting period.
        b. The average of the Regional Average First Purchase Prices for oil and the average of the Regional Average First Wellhead Prices for gas for each reporting period.
        c. The average royalty rate for oil and gas for each reporting period.
        d. The asset value for oil and gas by the commodities and types identified for use in calculating the federal government's total estimated petroleum royalties for each reporting period (see paragraph 26).
        e. The value of estimated petroleum royalties at the end of each reporting period.

47. A reference to specific agency reports for additional information about oil and gas resources.

Disclosure Requirements for Fiduciary Oil and Gas Resources

48. Fiduciary activities are defined in SFFAS 31, *Accounting for Fiduciary Activities*. Information consistent with the requirements of paragraphs 17 through 41 of this document shall be presented as an integral part of the fiduciary activities Schedules of Fiduciary Activity and Net Assets. No additional disclosures or RSI are required by this standard.

Implementation Guidance

49. The federal government's estimated petroleum royalties shall be recognized as an asset as of the beginning of the reporting period in which the standards become fully effective. The estimated petroleum royalties shall be recognized on the balance sheet of the component entity responsible for

collecting royalties. In addition, an offsetting liability shall be recognized for the amount of revenues designated for distribution to others.

50. The cumulative net effect of adopting this proposed accounting standard shall be reported as a "change in accounting principle." The adjustment shall be made to the beginning balance of cumulative results of operations on the statement of changes in net position for the period that the change is made in accordance with SFFAS 21, *Reporting Corrections of Errors and Changes in Accounting Principles*. In the initial year of implementation, prior year information shall not be restated.

Effect on Existing Standards

51. This standard affects existing standards dealing with "bonus bid, rent, and royalty revenues" in SFFAS 7. As a result, paragraph 45 of SFFAS 7 is amended as follows:

> [45] Under exceptional circumstances, such as revenues from the auction of the radio spectrum ~~rents and royalties on the Outer Continental Shelf~~, an entity recognizes virtually no costs (either during the current period or during past periods) in connection with earning revenue that it collects.

52. In addition, paragraphs 275, 276, and 277 of SFFAS 7 are deleted.

> ~~[275.] MMS does not recognize a depletion cost for various reasons, including the fact that under present accounting standards natural resources are not recognized as an asset and depletion is not recognized as a cost. As a result, this exchange revenue bears little relationship to the recognized cost of MMS and cannot be matched against its gross cost of operations. Therefore, although the inflows are exchange revenue, they should not be subtracted from MMS's gross cost in determining its net cost of operations.~~

> ~~[276.] MMS collects rents, royalties, and bonuses and distributes the collections to the recipients designated by law: the General Fund, certain entities within the Government to which amounts are earmarked, the states, and Indian tribes and allottees. MMS collection activity for non-federal entities may meet the definition of fiduciary activity and, if so, should be accounted for in accordance with the requirements of SFFAS 31, Accounting for Fiduciary Activities. The amounts~~

~~of revenue should be recognized and measured under the exchange revenue standards when they are due pursuant to the contractual agreement.~~

~~[277.] The rents, royalties, and bonuses transferred to Treasury for the General Fund, or to other Government reporting entities, should be recognized by them as exchange revenue. However, neither the Government as a whole nor the other recipient entities recognize the natural resources as an asset and depletion as a cost. Therefore, this exchange revenue should not offset their gross cost in determining their net cost of operations. It should instead be a financing source in determining their operating results and change in net position.~~

Effective Date

53. The following phase-in of reporting requirements as basic information provides for full implementation for reporting periods beginning after September 30, 2013.

    a. This standard is effective for periods beginning after September 30, 2010.

    b. Information should be reported as RSI for the first three years of implementation (fiscal years 2011, 2012, and 2013).

    c. Beginning in fiscal year 2014, the required information should be presented as basic information, except where specifically designated as RSI (paragraphs 44 and 45).

    d. Earlier implementation is encouraged.

The provisions of this Statement need not be applied to immaterial items.

Appendix A: Basis for Conclusions

This appendix discusses some factors considered significant by Board members in reaching the conclusions in this Statement. It includes the reasons for accepting certain approaches and rejecting others. Individual members gave greater weight to some factors than to others. The standards enunciated in this Statement–not the material in this appendix–should govern the accounting for specific transactions, events, or conditions.

Project History

A1. The project began with the formation of a task force to conduct research. The task force produced a discussion paper in June 2000 entitled *Accounting for the Natural Resources of the Federal Government*. (See http://www.fasab.gov/reports.htm to access the report.) In 2002, the Board resumed active consideration of the issues raised by the task force after a deferral to address other issues.

A2. The Board was interested in determining whether values for federal natural resources, or some surrogate, should be capitalized and reported on the balance sheet. The Board members believed that capitalizing federal natural resources could increase accountability for their management and improve the comprehensiveness, relevance, and consistency of federal financial statements. The Board members agreed to address each type of natural resource (e.g., fluid leasable minerals such as oil and gas, solid leasable minerals such as coal and timber) in separate phases. Federal oil and gas resources were addressed first because of the literature available in other domains, the extensive historical information on federal lease programs and royalty collections, and the large amount of revenue earned in exchange for oil and gas resources.

A3. The Board indicated that the pertinent questions were (1) what, if anything, should be recognized as an asset; and, (2) what is the source and reliability of quantity information. They believed the source and the reliability of the information would have a bearing on where information should be reported.

A4. The extractive industries' activities for oil and gas can be divided into two categories—upstream activities and downstream activities. Upstream activities are divided into the following phases:

a. Prospecting[13]
b. Acquisition of mineral rights
c. Exploration
d. Appraisal and evaluation
e. Development
f. Production

A5. Downstream activities take place after the production phase of the upstream activities through to the point of sale.

A6. The national assessment of oil and gas resources performed by the federal government is similar to the prospecting phase of the extractive industries' upstream activities. It is the only activity performed by the federal government that is similar to the extractive industries' activities.

A7. The Board noted that, based on discussions about oil and gas lease activities in the private sector, new models for accounting and reporting the federal government's oil and gas activities would be needed because the current federal model is incomplete and federal activities are not similar to private sector activities.

Overview of Federal Oil and Gas Resources

A8. The *Framework for Components of Federal Oil and Gas Resources* (framework) presented on page 37 identifies the universe of federal oil and gas resources. The framework presents accounting standards requirements and the components of federal oil and gas resources (total resources). Total resources incorporate "original in-place" resources, that is, resources in the earth before human intervention.

A9. The accounting standards presented in the framework include current accounting standards and proposed accounting standards for each component of federal oil and gas resources. The components are those used in the industry. Information is available in varying degrees and with varying reliability for each component. The components are first separated into "undiscovered resources" and "discovered resources." Generally, undiscovered resources are not under lease, while, discovered resources are under lease.

[13] Prospecting usually involves researching and analyzing an area's historic geologic data; and, carrying out topographical, geological, and geophysical studies.

Undiscovered Resources

A10. The first major component of total resources is **undiscovered resources**. The undiscovered resources component is divided into the following subcomponents:

a. **undiscovered non-recoverable resources**
b. **undiscovered recoverable resources**
   i. **undiscovered conventionally recoverable resources**
   ii. **undiscovered economically recoverable resources**.

A11. Each component and subcomponent can be further divided between onshore and offshore resources. Onshore resources consist of resources on federal lands. Offshore resources consist of resources on the Outer Continental Shelf (OCS). This division between onshore and offshore resources is important operationally because the source and volume of information varies.

A12. There is no information available on undiscovered non-recoverable resources. These resources are not addressed or included in any type of assessment. Undiscovered non-recoverable resources are referred to as resources that are beyond conventional technologies to be estimated and are not assessed. However, in the realm of "original in-place" resources they may exist.

A13. Information on the two subcomponents of undiscovered recoverable resources is available for offshore oil and gas resources. This information is based on national assessments performed by the Minerals Management Service (MMS) approximately every 5 years, with updates on a yearly basis for certain geographic locations. The assessment considers recent geophysical, geological, technological, and economic information and uses a geologic **play** analysis approach for resource appraisal. Information on undiscovered conventionally recoverable resources and undiscovered economically recoverable resources is provided in the MMS assessment.

A14. For the onshore portion of undiscovered recoverable resources, the U.S. Geological Survey (USGS) formerly conducted national assessments. The last comprehensive national assessment was completed by the USGS in 1995, and since 2000 the USGS has been re-assessing basins of the U.S. that are considered to be priorities for the new assessment rather than assessing all of the basins of the U.S. As each basin is re-assessed, the assessment results are added to the assessment tables, and these new values replace the assessment results from 1995. The USGS assessment provides information on undiscovered conventionally recoverable resources but not on undiscovered economically recoverable resources like the MMS does.

A15. Under current FASAB accounting standards, there are no requirements to provide or present information about the undiscovered resource components in the financial statements. Under the proposed accounting standards, information about onshore and offshore undiscovered recoverable resources would be included in the technically recoverable resources and reported as required supplementary information (RSI). Information about technically recoverable resources has been gathered and maintained by the EIA in the past.

Discovered Resources

A16. The second major component of total resources is **discovered resources**. The discovered resources component is divided into the following subcomponents as follows:

a. **unproved reserves**
    i. **unproved possible reserves**
    ii. **unproved probable reserves**
b. proved reserves
    i. **proved undeveloped reserves**
    ii. **proved developed reserves**
        i) **proved developed non-producing reserves**
        ii) **proved developed producing reserves**
c. production

A17. Under current FASAB accounting standards, there are no requirements to provide or present information about the unproved reserves components in the financial statements.

A18. Quantitative information in relation to onshore and offshore proved reserves, including new discoveries, production, and adjustments is submitted to the EIA by oil and gas well operators once a year. The due date for operators to submit the information is April 15 for activities from the preceding calendar year.

A19. Under current accounting standards, the bonus bid, rent (earned on the lease until oil and gas production begins), and royalty revenue (earned on production) are accounted for as a custodial activity (i.e., an amount collected for others) by MMS-the collecting entity. The revenue and its distribution are reported on MMS's statement of custodial activities. Component entities receiving a distribution and the CFR of the United States government recognize the revenue as a financing source in their respective statement of changes in net position or statement of operations and changes in net position.

A20. Under the proposed accounting standards, information about onshore and offshore unproved reserves would be included in the technically recoverable resources and reported as RSI. Information about technically recoverable resources has been gathered and maintained by the EIA in the past.

A21. In addition, under the proposed accounting standards, the estimated federal royalty share of proved reserves would be recognized as estimated petroleum royalties by the component entity responsible for reporting the asset on its balance sheet. Also, royalty revenue earned would be recognized as revenue along with a depletion expense in equal amounts on the statement of net cost. Changes in the asset amount due to year-end valuation would be reported as a gain or loss on the statement of net cost of the component entity responsible for reporting the asset on its balance sheet. Also, collections for rent and bonus bids would be recognized as exchange revenue on the statement of net cost. Any expenses incurred to collect the rent and bonus bids would be included in the operating expenses on the statement of net cost. The CFR would include these amounts in the consolidated financial statements.

A22. There are no current requirements to provide or present information about the production of oil and gas in the financial statements. However, under the proposed accounting standards, historical information on the quantity and consumption of proved reserves, including the sales volume of proved reserves, the sales value of proved reserves, the amount of royalty revenue earned, and the estimated value for royalty relief would be provided as RSI.

A23. The illustration in Appendix B: Illustration of the Components of Federal Oil and Gas Resources provides a summary of the information presented in the preceding paragraphs. The shaded boxes in the illustration represent the availability of information as follows:

No quantity information available	
Technically recoverable resources quantity information provided by EIA[14]	

[14] Quantity information is published at the national level.

Proved reserves quantity information provided by EIA[15]	

The terms in the illustration in Appendix B are defined in the Glossary under the subheading *Definitions of Resource and Reserve Components and Subcomponents*.

Conceptual Aspects of Federal Oil and Gas Resources as an Asset for Estimated Petroleum Royalties and a Liability for the Portion of Revenue to be Distributed to Others

Recognition Criteria

A24. SFFAC 5, *Definitions of Elements and Basic Recognition Criteria for Accrual-Basis Financial Statements*, states that to be recognized as an element of the financial statements, an item must (a) meet the definition of an element of the financial statements and (b) be measurable. The term measurable means that a monetary amount can be determined with reasonable certainty or is reasonably estimable.[16]

A25. Measurement may require the use of estimates and approximations as well as an assessment, in a manner consistent with the attribute being measured, of the probability that future inflows or outflows of economic benefits or services will result from the item. Recognition decisions also incorporate the results of assessments of the materiality and benefit versus cost of recognizing the item measured. Thus, it is possible that an item that meets the basic recognition criteria would not be recognized due to measurement, materiality, or cost-benefit considerations.[17]

Asset Recognition

A26. Recognition of the federal government's estimated petroleum royalties from the production of federal oil and gas proved reserves as an asset is based on SFFAC 5, paragraphs 18 through 35.

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[15] [15] Quantity information is published at the national level.
[16] SFFAC 5, par. 5.
[17] SFFAC 5, par. 7.

A27. An asset for federal accounting purposes is a resource that embodies economic benefits or services that the federal government controls.[18]

A28. To meet the definition of an asset of the federal government, a resource must possess two characteristics. First, it must embody economic benefits or services that can be used in the future. Second, the government must control access to the economic benefits or services and, therefore, can obtain them and deny or regulate the access of other entities.[19]

Oil and Gas Resources as a Federal Asset

A29. First, the Board established which federal oil and gas resources were being considered. Appendix B: Illustration of the Components of Federal Oil and Gas Resources presents the oil and gas resources that were considered. The two major components are “undiscovered resources” and “discovered resources.” All of the federal oil and gas resources qualify as federal government assets because the government can obtain economic benefits and regulate the access of other entities as provided under federal law.

A30. Since all federal oil and gas resources controlled by the federal government are assets, the Board’s next step was to decide whether the federal oil and gas resources “asset” should be recognized on a federal component entity balance sheet. As noted in paragraph A24 above, the second criterion for recognition is that the asset “…be measurable.”

A31. Estimates of the quantity of oil and gas resources other than proved reserves have been available through EIA in the past. With this quantity information, a monetary measure is technically feasible and, therefore, the asset qualifies for consideration for recognition. However, the Board does not believe that the information is sufficiently reliable to be recognized in a cost-beneficial manner.

A32. SFFAC 1, *Objectives of Federal Financial Reporting,* provides the following with respect to reliability:

> 160. Financial reporting should be reliable; that is, the information presented should be verifiable and free from bias and should faithfully represent what it purports to represent. To be reliable, financial reporting needs to be comprehensive. Nothing material should be omitted from the information necessary to represent faithfully the underlying events and conditions, nor should anything be included that would likely cause the information to

[18] SFFAC 5, par. 18.
[19] SFFAC 5, par. 22.

be misleading to the intended report user. Reliability does not imply precision or certainty, but reliability is affected by the degree of estimation in the measurement process and by uncertainties inherent in what is being measured. Financial reporting may need to include narrative explanations about the underlying assumptions and uncertainties inherent in this process. Under certain circumstances, a properly explained estimate provides more meaningful information than no estimate at all.

A33. Concerning the proved oil and gas reserves from federal oil and gas resources, the Board believes that both the quantity and the estimated federal royalty share would be reliable. Thus, in this case, since the quantity of the estimated federal royalty share can be reliably estimated and converted to monetary terms, the Board believes the estimated federal royalty share of proved oil and gas reserves should be recognized on the balance sheet.

A34. The EIA information on other than proved reserves is derived from sporadic and incomplete national assessments and annual submissions by oil and gas producers. This makes it particularly uncertain. In addition, since these reserves are not currently under lease, determining the royalty share may be misleading since it is a current value measure but the underlying asset may be restricted and production may never occur. For those resources that are not restricted, production may occur but the timing and amount of royalties are very uncertain. Thus, applying the same measurement technique to other than proved reserves may not result in a value that represents what it purports to represent. Thus, federal oil and gas resources not yet in the 'proved reserves' category would not be recognized on the federal balance sheet due to concerns regarding reliability of the proposed measure. However, information on these quantities would be provided as RSI.

Measurement Attributes and Methods Considered

A35. Concerning the dollar amount to be recognized for the estimated federal royalty share of proved reserves, the Board considered various measurement attributes and methods, including the following:

A36. Historical cost (historical proceeds) – The amount of cash, or its equivalent, paid to acquire an asset, commonly adjusted after acquisition for amortization or other allocations. (SFAC 5, Par 67.a) 'Historical cost' was not a feasible option for valuing the oil and gas reserves because there is no 'historical exchange price' for the oil and gas reserves controlled by the federal government.

A37. Fair value – When market transactions are available, fair value is the same as market value. Fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. (FASB Statement of Financial Accounting Standards (SFAS) 157: Fair Value Measurements) Information needed to estimate fair value is not available as there are no current transactions between market participants involving the sale of the federal royalty share for proved oil and gas reserves. Nor are there current transactions between market participants for the sale of rights to comparable future revenue streams.

A38. Net realizable (settlement) value – The total non-discounted amount of cash, or its equivalent, into which an asset is expected to be converted in due course of business less direct costs, if any, necessary to make that conversion. (SFAC 5, Par 67.d) The 'net realizable value' (NRV) requires a reasonable estimate of future flows (receipts and costs) associated with converting assets to cash. However, the amount of the future flows of the federal royalty share for proved oil and gas reserves cannot be reliably estimated for various reasons. The amount cannot be reliably estimated due to volatile fluctuations in the first purchase price for oil and wellhead price for gas. Reasons for these variations include:

a. The permitting process for exploration, development, and production activities.
b. The lessee's budget.
c. Other projects the lessee is focusing on.
d. The geological make-up of the earth.
e. The depth of the water or the depth of the wells for offshore wells.
f. The uncertainties of each well.
g. New discoveries.
h. Improved technology.
i. The economy and price volatility.
j. Production incentives provided by the federal government.

A39. Present (or discounted) value of future cash flows – The present or discounted value of future cash inflows into which an asset is expected to be converted in due course of business less present values of cash outflows necessary to obtain those inflows. (SFAC 5, Par 67.e) An estimate of the 'present (or discounted cash) value' of the estimated federal royalty share appeared to be most appropriate because the asset will be converted in future periods. However, the 'present (or discounted cash) value' method poses measurement challenges because:

a. It is difficult to estimate the timing of future inflows.

b. The discount rate should be commensurate with the riskiness of the stream and each well might be viewed as having a unique level of risk.
c. Prices are subject to fluctuation, making the amount of future inflows volatile.
d. It is difficult to estimate the time from when a lease is signed until production begins (from 3 years to 20 years or more) and how long a well will be productive.

A40. Based on the above, the Board had previously determined that none of the measurement methods or attributes currently used in practice was a feasible measure of the estimated federal royalty share for proved oil and gas reserves. However, after reviewing the results of the field testing performed by the Department of the Interior (DOI) and talking with DOI representatives about the methodology that has been developed, the Board determined that present value might be a feasible measure if the challenges presented in paragraph A39 above can be reasonably overcome.

Asset Valuation Methodology

A41. The Board believes that the detailed estimation methodology for valuing oil and gas natural resources should be developed by federal entities rather than centrally by the Board. In an environment heavily affected by changes in prices, technological advancements, economic and operating conditions, and known geological, engineering, and economic data, estimation methodologies may need to be regularly updated to reflect changing economic and technological conditions. Sources of information that were once available to preparers may be replaced or become obsolete. On the other hand, new and more reliable data sources may become available. Permitting the preparers flexibility in developing an estimation methodology that keeps pace with the environment will prevent the accounting standard from becoming outdated.

Use of Regional Data to Value the Federal Asset "Estimated Petroleum Royalties"

A42. The Board believes that the most relevant, reliable, and cost-beneficial measurement of "estimated petroleum royalties" would be obtained by using regional information. The Board believes this approach would provide conservative, representative regional values of estimated petroleum royalties without having to calculate the value on a field-by-field basis. The Board believes it would not be practicable to make calculations on a field-by-field basis. There are more than 60,000 leases maintained by the DOI with approximately 115,000 producing wells.

Liability Recognition

A43. Recognition of royalty distributions to others as a liability is based on SFFAC 5 paragraphs 36 through 48.

A44. A liability is a present obligation[20] of the federal government to provide assets or services to another entity at a determinable date, when a specified event occurs, or on demand.[21]

A45. A liability of the federal government has two essential characteristics. First, a liability constitutes a present obligation to provide assets or services to another entity. Second, either a law or an agreement or understanding between the government and another entity identifies conditions or events that will determine when the obligation will be settled.[22]

A46. In paragraph 20, the Board proposes that the federal government's estimated petroleum royalties be recognized as an asset on the balance sheet of the component entity that is responsible for collecting royalties. The asset's value would be based on the royalty share of the federal oil and gas resources classified as "proved reserves." In addition to the royalties that the component entity collects on proved reserves that are produced, it also collects lease sale and rent revenue from federal government oil and gas leases. The component entity distributes nearly all of these proceeds to the general fund of the U.S. Treasury, other federal agencies, and states in accordance with legislated allocation formulas. The component entity also receives a very small portion of the revenue collected to fund its operations. The amount used to fund its operations is legislated by Congress as part of the component entity's annual appropriation. For example, the amount received by the component entity was approximately one percent (1%) of annual revenues collected in 2005.

A47. The Board considered and agreed that an offsetting liability should be recognized in conjunction with the recognition of an asset for estimated petroleum royalties. The Board believes an offsetting liability should be recognized because nearly all of the revenue from royalties, lease sales, and rent are ultimately distributed to the general fund of the U.S. Treasury, other federal agencies, and the states. As the proceeds are distributed, the liability would be reduced. In addition, upon consolidation, the portion of the liability related to other federal agencies and the general fund of the U.S. Treasury

[20] The term obligation is used in this Statement with its general meaning of a duty or responsibility to act in a certain way. It does not mean that an obligation of budgetary resources is required for a liability to exist in accounting or financial reporting or that a liability in accounting or financial reporting is required to exist for budgetary resources to be obligated.
[21] SFFAC 5, par. 39.
[22] SFFAC 5, par. 41.

would be eliminated so that the balance sheet for the government as a whole reports only the liability for amounts allocated to non-federal entities.

A48. The Board believes that if a liability was not established, the component entity's and the federal government's net position would be overstated.

Reporting the Gains and Losses from Changes in Assumptions and Selecting Discount Rates

A49. SFFAS 33, *Pensions, Other Retirement Benefits, and Other Postemployment Benefits: Reporting the Gains and Losses from Changes in Assumptions and Selecting Discount Rates and Valuation Dates*, requires that gains and losses from changes in long-term assumptions used to estimate federal employee pension, other retirement benefit (ORB), and other postemployment benefit (OPEB) liabilities should be displayed on the statement of net cost separately from other costs. This display provides more transparent information regarding the underlying costs associated with certain liabilities. SFFAS 33 also provides standards for selecting the discount rate assumption for pension, ORB, and OPEB liabilities.

A50. SFFAS 33 does not preclude entities from displaying or disclosing any information about the effect of changes in any assumptions with regard to other types of activities. The original SFFAS 33 ED had proposed a broad scope; however, although in principle a broader application was desirable, the Board decided to limit the standard to federal employee pension, ORB, and OPEB liabilities. This decision was based on the Board's desire to address more immediately its primary concern, which is to display the effect of assumption changes on employee compensation liabilities. Respondents had requested more guidance regarding how the standard would apply to other long-term assumptions; the Board believed that developing additional guidance would significantly delay implementation of SFFAS 33.

A51. The Board believes that it would be appropriate to apply the guidance in SFFAS 33 to long-term assumptions about oil and gas.

Future Rights to Royalty Streams Identified for Sale

A52. When rights to a future royalty stream are identified to be sold, the value of those rights should be disclosed as "future royalty rights identified for sale." Future royalty rights identified for sale should not be revalued or reclassified to a different asset category on the balance sheet because the point in time for the sale of the future royalty rights may be uncertain and the identified fields may continue to produce oil and/or gas and generate royalties. These two factors make it difficult to establish and maintain valuation information in advance of the sale. No gain or loss on the future royalty rights identified for sale should be calculated since the rights for sale are only disclosed and are not revalued and reclassified to a different asset category on the balance sheet. Disclosure of the approximate value at the balance sheet date alerts the reader to the pending sale and the potential value of the asset to be sold.

A53. The value of the disclosed future royalty rights identified for sale is based on the specific field identified for sale. Because the fields are known, this provides a more field specific value for the rights identified to be sold.

A54. At the time the future royalty rights identified for sale are sold, the calculated value of the future royalty rights sold would be calculated based on the specific field. An amount equal to this calculated value would be removed from the value of estimated petroleum royalties at the time of the sale. This calculation is used to reduce the estimated petroleum royalties since the values of a specific field are known and the value of the future royalty rights sold can be more accurately calculated, which would provide a more realistic gain or loss on the sale. In addition, the liability for revenue distributions to others should be adjusted by the amount of the gain or loss on the sale, if any, and reduced when the sale proceeds are distributed.

Disclosures

A55. The Board proposes that various types and amounts of information be disclosed in the notes or provided as RSI. For example, one proposed disclosure would require a narrative describing and a display showing earned revenue reported by category for the reporting period. That is, royalty revenue earned for oil and gas, earned rent revenue, earned bonus bid revenue for leases, and total revenue. The proposed RSI includes sales volume, the sales value, the royalty revenue earned, and the estimated value for royalty relief for oil and gas produced from federal oil and gas resources for the reporting period on a regional basis. Proposed RSI also includes a narrative describing and a display showing detailed historical information for the preceding ten calendar years.

Original Exposure Draft

A56. The original exposure draft (ED), *Accounting for Federal Oil and Gas Resources*, 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.

A57. Upon release of the original ED, notices and press releases were provided to The Federal Register, *FASAB News*, *The Journal of Accountancy*, *AGA Today*, *the CPA Journal*, *Government Executive*, *the CPA Letter*, *Government Accounting and Auditing Update*, the CFO Council, the Presidents Council on Integrity and Efficiency, Financial Statement Audit Network, the Federal Financial Managers Council, and committees of professional associations generally commenting on exposure drafts in the past.

A58. This broad announcement was followed by direct mailings or e-mails of the original ED to:

a. relevant congressional committees (Senate Committee on Energy and Natural Resources, Senate Committee on Finance, Senate Committee on Indian Affairs, House Committee on Financial Services, House Committee on Natural Resources);

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

c. public interest groups (National Congress of American Indians (NCAI) President and Area (Regional) Vice Presidents); and,

d. oil and gas industry companies/professional organizations ((World Petroleum Congress (WPC), American Petroleum Institute (API), Society of Petroleum Engineers (SPE), Ryder Scott Company, National Petroleum Council (NPC), International Energy Agency (IEA), British Petroleum (BP), Royal Dutch Shell, Chevron, Exxon Mobil)).

A59. To encourage responses, reminder notices were provided on September 12, 2007, and January 9, 2008, to the FASAB listserv. In addition, staff contacted professional associations and affected agencies directly.

Comment Letters

A60. Eight comment letters were received from the following sources:

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

A61. The following points present a high-level summary of the comments received:

a. The majority of respondents agreed with the overall concept of recognizing an asset for the federal government's natural resources and a liability for the related royalty revenues designated to be distributed to others.

b. Two of the eight respondents stated that a standard on federal natural resources should include all federal natural resources and not be limited to only oil and gas resources.

c. One of the eight respondents commented on the complex nature of the original ED.

d. No respondents supported the use of the probabilistic method of estimation as proposed in the alternative view of the original ED.

e. Two respondents supported the use of present value or fair value with discounting (similar to the alternative view proposal) instead of the valuation method as proposed in the original ED that utilizes the average first purchase or wellhead price.

f. The majority of respondents agreed that the numerous disclosures proposed in the original ED appeared excessive and might not pass a cost/benefit test.

g. There was general support for royalty relief disclosures.

h. Of the five respondents that directly addressed the question on fiduciary disclosures, four stated that the cost of such disclosures would outweigh any perceived benefits.

i. The majority of respondents supported the recommendation for more limited disclosures in the CFR. However, one respondent stated that because natural resources are sovereign assets, the major disclosures would more appropriately appear in the CFR and not agency financial statements.

A62. The Board did not rely on the number in favor or opposed to a given position. Information about the respondents' majority view is provided only as a means of summarizing the comments. The Board considered the arguments in each response and weighed the merits of the points raised.

Field Testing

A63. In addition to the comment letters received on the original ED, the Board also considered the results of a field test of the proposed standards performed by a DOI field test team. The field test team consisted of Minerals Management Service (MMS) Offshore Minerals Management Economics and Resource Evaluation experts and petroleum engineers; Bureau of Land Management petroleum engineers and resource evaluation experts; and MMS Custodial Reporting Branch senior accountants with expertise in financial reporting.

A64. Field tests are part of FASAB's due process and help FASAB to establish effective standards. Participating federal entities volunteer to go through the exercise of "implementing" the proposed standard as if it were in place and then provide feedback to FASAB regarding the process. Field tests can proactively identify potential problems related to the implementation of proposed standards and allow FASAB to gather valuable information about implementation costs.

A65. The field test team presented the Board with a number of significant considerations, including the lack of availability of quantity information on proved reserves under federal lands. The original ED had proposed that the valuation of oil and gas resources be based on information to be provided by the Energy Information Administration (EIA) on quantity of proved reserves under federal lands. However, this information has not been made available as of the date of this revised ED, and does not appear to be forthcoming.

A66. In addition to the reliance on proved reserves data required to be provided by EIA, the field test team noted a number of other concerns, including:

a. the need to divide proved reserves by type of commodity (e.g., crude oil, lease condensate, and natural gas) and compute the asset value separately;

b. the need to develop a methodology for determining what portion of all proved reserves fall under federal domain;

c. the need to exclude royalty relief volumes and estimate the value of commodities received in kind and delivered to the Department of Energy to fill the Strategic Petroleum Reserve;

d. the effect of intermediate production between the effective date of the reserves estimate and the effective date of the booked value;

e. the effect of estimates such as the royalty accrual and prior year production adjustments made in the current year;

f. how to distinguish between long and short term liabilities for the associated liability for revenue distributions to others;

g. appropriate treatment of interest payments related to oil and gas or other commodities other than oil and gas once the custodial provisions are deleted from SFFAS 7 (paragraphs 45, 275, 276, and 277);

h. the impact of material intragovernmental transactions and eliminations on the year-end reporting process; and,

i. the need to revise all, or almost all, of the existing posting models in the accounting system.

A67. The field test team also completed a field test questionnaire using a present value approach. This questionnaire included a lot of the same concerns as noted in paragraphs A65 and A66 above. In addition, the present value approach also incorporated present value calculations for factors such as the present value of royalties received over time, estimates of future gas prices, transportation allowances, and discount and inflation rates.

A68. In both estimates (the ED view as well as the present value view), the field test team used share of production as a proxy for share of proved reserves. One of the members expressed concerns about the use of production as a proxy for underlying reserves since it assumes (1) the same percentage of reserves are brought to market each year from all locations (or at least, on average between federal and non-federal) and (2) too much year to year variance in production patterns makes underlying reserve estimates fluctuate by an equal amount.

A69. Staff asked an oil and gas analyst at the Congressional Budget Office for his thoughts on the methodology. He responded that he understands the concern with the first assumption because it is likely that not the same fraction of reserves will be accessed in each year. However, he stated that averaging between federal and non-federal would control for some of that variance, though it is not possible to know just how much. He stated that this simplifying assumption is fairly reasonable given the approximate nature of the analysis. The analyst noted that with the second assumption, the variance might be eliminated or reduced by using a moving average rather than a year to year measure. For example, a 5-year or 10-year moving average of total federal production over total production would control some of the yearly differences between federal and non-federal.

A70. The field test questionnaires were extremely useful in helping the Board determine the focus of the current ED.

<u>Discussion with DOI Representatives</u>

A71. In addition to the Board's consideration of the comment letters received and the field test questionnaires, three members of the field test team and two representatives from the DOI Office of the Secretary met with the Board at the October 23, 2008, meeting to discuss issues raised in its comment letter on the original ED and the related field test questionnaires.

A72. At that meeting, the DOI representatives indicated that they would be open to having less detailed implementation guidance in the standard if they were given a longer implementation period (two to three years) with a phase-in from RSI to basic, and the ability to return to FASAB for implementation guidance if a reasonable methodology could not be agreed to by the auditors.

Significant Changes Made to the Original Exposure Draft

A73. The significant changes made to the original ED as a result of the Board's consideration of the comments received, the field test questionnaires, and discussions with DOI representatives are summarized below:

a. Removed specific reference to "proved oil and lease condensate, **natural gas plant liquids (NGPLs)**, and gas reserves"; now refer more broadly to "proved oil and gas reserves." Further breakdown by commodity and type of oil and gas will be considered by the federal entity as part of the estimation methodology.

b. Removed detailed asset valuation implementation guidance. Federal entities are provided flexibility in developing the estimation methodology for valuing oil and gas natural resources. In an environment heavily affected by changes in prices, technological advancements, economic and operating conditions, and known geological, engineering, and economic data, estimation methodologies may need to be regularly updated to reflect changing economic and technological conditions. The Board believes that the detailed estimation methodology for valuing oil and gas natural resources should be developed by federal entities rather than centrally by the Board.[23] The Board reached this conclusion based on discussions about recent changes that have occurred since the original ED was issued and the need to continually update the accounting standards as a result of volatile conditions in the oil and gas industry. The Board also considered DOI's willingness to develop the methodology and work with the auditors to phase in the required reporting from RSI to basic over a period of two or three years and return to FASAB only on issues that could not be resolved with the auditors.

c. Simplified the detailed pro forma transactions; removed excess detail on how values were derived.

d. Removed the illustrative disclosure and RSI presentations.

e. Selected present value as the measurement method.

f. Provided federal entities with the opportunity to compute the federal government's estimated petroleum royalties by "multiplying the estimated quantity of proved oil and gas reserves under federal lands by the average first purchase price for oil or average wellhead price for gas and the effective average royalty rate by region" if it is not reasonably possible to estimate the present value of future federal royalty receipts on proved reserves. Other methodologies are deemed acceptable.

g. Permitted a change in methodology (see paragraph 28). "Once established, the estimation methodology should be consistently followed and disclosed in the financial reports. If environmental or other changes would provide for the development of an improved methodology, the nature and reason for the change in methodology, as well as the effect of the change, should be disclosed."

h. Incorporated SFFAS 33 guidance for displaying gains and losses from changes in assumptions and selecting discount rates.

i. Updated the effective date of the standard to provide for a three-year phase-in from RSI to basic information.

j. Moved the illustration of the components of federal oil and gas resources to an appendix by itself.

[23] Estimates that do not lead to material misstatements are acceptable without guidance from the Board.

k. Updated the basis for conclusions.

l. Updated questions for respondents to request feedback on changes made to the original exposure draft.

m. [TBD based on discussion of other issues – fiduciary reporting, long-term vs. short-term liability classification, detailed component entity RSI, custodial reporting for other commodities, etc]

1 ## Appendix B: Illustration of the Components of Federal Oil and Gas Resources

<table>
<tr><td>Accounting Standards</td><td colspan="9">Components of Federal Oil and Gas Resources</td></tr>
<tr><td rowspan="5"></td><td colspan="3">Undiscovered Resources</td><td colspan="6">Discovered Resources</td></tr>
<tr><td rowspan="2">Undiscovered Non-Recoverable Resources</td><td colspan="4">Technically Recoverable Resources</td><td colspan="3" rowspan="2">Proved Reserves</td><td rowspan="2">Production</td></tr>
<tr><td colspan="2">Undiscovered Recoverable Resources</td><td colspan="2">Unproved Reserves</td></tr>
<tr><td rowspan="2"></td><td>Undiscovered Conventionally Recoverable Resources</td><td>Undiscovered Economically Recoverable Resources</td><td>Unproved Possible Reserves</td><td>Unproved Probable Reserves</td><td>Proved Undeveloped Reserves</td><td colspan="2">Proved Developed Reserves</td><td></td></tr>
<tr><td colspan="2"></td><td colspan="3"></td><td>Proved Developed Non-Producing Reserves</td><td>Proved Developed Producing Reserves</td><td></td></tr>
<tr><td>Current Accounting Standards</td><td colspan="3"></td><td colspan="5">Bonus Bid, Rent, Royalty Revenue accounted for as custodial activity and recognized as a financing source on the CFR Statement of Operations and Changes in Net Position</td><td></td></tr>
<tr><td>Proposed Accounting Standards</td><td></td><td colspan="2">Provide RSI
Information for Undiscovered Recoverable Resources</td><td colspan="2">• Recognize bonus bid and rent revenues as exchange revenue on SNC[24]
• Provide RSI Information for Unproved Reserves</td><td colspan="3">• Recognize federal royalty share on BS[25]
• Recognize bonus bid and rent revenue as exchange revenue on SNC
• Recognize royalty revenues as revenue and depletion expense on SNC
• Recognize gains/losses on SNC
• Provide disclosures for Proved Reserves</td><td>Provide RSI/ Disclosure Information – Quantitative and Financial</td></tr>
</table>

[24] statement of net cost
[25] balance sheet

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Appendix C: Pro Forma Transactions And Financial Statements

PLEASE NOTE: The sample accounting entries and financial statements in Appendix C illustrate pro forma accounting transactions pertaining to federal oil and gas resources and the resulting financial statements. Data used in the pro forma transactions are based on hypothetical numbers for purposes of simplification. These illustrative examples are not intended to provide guidance on determining the application of materiality.

The following pro forma transactions are compressed and simplified, and appropriately do not contain all of the detail associated with an event. For example, in transaction number two, the one-fifth bonus is invested until leases are accepted. Any interest accrued is refunded on bids subsequently rejected and returned. The illustration omits transactions internal to the entity. For example, transfers between sub-component entities are omitted.

Readers should not rely on the pro forma accounting transactions and resulting financial statements as a complete model for agency accounting. Certain omitted entries may be required in actual practice but are omitted since they are not required to understand the effect of the proposal on agency financial statements.

<u>At the beginning of the fiscal year for which the accounting standards for oil and gas resources are effective, the following transaction is recorded by the component entity responsible for collecting royalties.</u>

1. Record initial value of estimated petroleum royalties and the liability for revenue distributions to others.

Dr Estimated Petroleum Royalties	20,000	
Cr Prior Period Adjustment: Change in Accounting Principle		200
Cr Liability for Revenue Distribution to Others-Federal		14,000
Cr Liability for Revenue Distribution to States-Non-Federal		5,800

To record initial value of estimated petroleum royalties due to change in accounting principle and the liabilities for revenue distributions to state and local governments and other federal component entities. (The 1% expected to be returned to the entity responsible for making royalty collections increases its net position.)

<u>Other federal component entity entry:</u>

Dr Long-Term A/R for Oil and Gas-Federal	14,000	
Cr Prior Period Adjustment: Change in Accounting Principle		14,000

To book the asset by other federal entities for their respective interest in the estimated petroleum royalties.

2. Record payment of the one-fifth bonus bid amounts.

Dr Fund Balance with Treasury	2,000	
Cr Unearned Revenue		2,000

To record collection of the one-fifth bonus bids for the four bonus bids.

1

3. Record remaining payment by the successful bidder and the annual rental fee and the liability for revenue distributions to others.

Dr Unearned Revenue	1,000	
Dr Fund Balance with Treasury	10,500	
Cr Revenue from Rent		360,000
Cr Revenue from Bonus Bid		9,000

To record remaining bonus payment and the annual rental fee by the successful bidder.

2

Dr Revenue Designated for the States[26]	1,725	
Dr Transfers-Out	9,660	
Cr Liability for Revenue Distribution to Others-Federal		9,660
Cr Liability for Revenue Distribution to States-Non-Federal		1,725

To record the increase in the liability for the future revenue distributions to others.

3

<u>Other federal component entity entry:</u>

Dr Long-Term A/R for Gas and Oil-Federal	9,660	
Cr Transfer-In		9,660

To record the accrual of a transfer-in and a reduction in the long-term A/R.

4

4. Receive the annual rental fee from pre-existing leases and record the liability for revenue distributions to others.

Dr Fund Balance with Treasury	1,000	1,000
Cr Revenue from Rent		

To record rental payments on leases for the year.

5

Dr Revenue Designated for the States	150	
Dr Transfers-out	850	
Cr Liability for Revenue Distribution to Others-Federal		850
Cr Liability for Revenue Distribution to States-Non-Federal		150

To record the increase in the liability for the future revenue distributions to others.

6

<u>Other federal component entity entry:</u>

Dr Long-Term A/R for Gas and Oil-Federal	850	
Cr Transfer-In		850

To record the accrual of a transfer-in and a reduction in the long-term A/R.

[26] This and certain other titles were selected for illustrative purposes. The entity has the option of selecting another account title, such as grant, that may be more appropriate.

5. Refund unsuccessful bidders' bonus bid deposits.

Dr Unearned Revenue	500	
Cr Fund Balance with Treasury		500

To record refund of losing bonus bids.

The remaining pro-forma transactions and financial statements are presented as of the end of the federal government's fiscal year (FY).

6. Record earned royalty revenue and depletion expense.

Dr Accounts Receivable	600	
Cr Revenue from Royalties for Federal Oil and Gas Reserves		600

To record earned royalty revenue.

Dr Oil and Gas Depletion Expense	600	
Cr Estimated Petroleum Royalties		600

To record depletion expense for federal oil and gas resources.

7. Record collection of royalty revenue.

Dr Fund Balance with Treasury	400	
Cr Accounts Receivable		400

To record collection of royalty revenue.

8. Record distribution of bonus bid, rent, and royalty collections and the reduction in the liability for the revenue distributed to others.

Dr Liability for Revenue Distribution to Others-Federal	10,710	
Dr Liability for Revenue Distribution to States-Non-Federal	1,890	
Cr Fund Balance with Treasury		12,600

To record distribution of bonus bid, rent, and royalty revenue collections and the reduction in liabilities for revenue distribution to others.

Other federal entity entry:

Dr Fund Balance with Treasury	10,710	
Cr Long-Term A/R for Oil and Gas-Federal		10,710

To increase the fund balance with treasury and reduce the long-term accounts receivable for oil *and gas in relation to distributions received.*

9. Record sale of future royalty streams identified for sale and the related change in the liability for revenue distributions to others.

Dr. Fund Balance with Treasury	750	
Dr. Loss on Sale of Estimated Petroleum Royalties	150	
Cr. Estimated Petroleum Royalties		900

To record sale of future royalties.

Dr Liability for Revenue Distributions to Others- Federal	127	
Dr Liability for Revenue Distributions to States-Non-Federal	23	
Cr Revenue Designated for the States		23
Cr Transfers-Out		127

To record the reduction in the liabilities for the future revenue distributions to others, revenue designated for the States, and transfers-out as a result of the loss on the sale of estimated petroleum royalties

Dr Liability for Revenue Distributions to Others- Federal	756	
Dr Liability for Revenue Distributions to States-Non-Federal	135	
Cr Fund Balance with Treasury		891

To record the distribution of collections from the sale of revenue streams and the reduction in the liability for revenue distributions to others.

<u>Other federal entity entry:</u>

Dr. Fund Balance with Treasury	756	
Cr. Long-Term A/R for Oil and Gas-Federal		756

To increase the fund balance with treasury and reduce the long-term accounts receivable for oil and gas in relation to distributions received.

Dr. Transfers-In	127	
Cr Long-Term A/R for Oil and Gas-Federal		127

To decrease the transfers-in and long-term accounts receivable as a result of the loss on the sale of estimated petroleum royalties.

10. Record annual valuation of estimated petroleum royalties and the related change in the liability for revenue distributions to others.

Dr Estimated Petroleum Royalties	5,000	
Cr Gain on Revaluation of Estimated Petroleum Royalties[27]		5,000

To record revaluation of estimated petroleum royalties.

Dr Revenue Designated for the States	750	
Dr Transfers-Out	4,250	
Cr Liability for Revenue Distributions to Others-Federal		4,250
Cr Liability for Revenue Distributions to States-Non-Federal		750

To record the year-end increase in the liabilities for the future revenue distributions to others.

Other federal component entity entry:

Dr Long-Term A/R for Oil and Gas-Federal	4,250	
Cr Transfers-In		4,250

To book the revalued asset amount by other federal entities for their respective interest in the estimated petroleum royalties.

The pro forma financial statements that follow are illustrative of the departmental entries presented in this appendix. The “other federal component entity” entries and the consolidated financial statements of the United States Government are not illustrated.

[27] This gain will be illustrated on the statement of net cost as partially due to changes in assumptions. This display is further illustrated in SFFAS 33.

Pro Forma Financial Statements – for fiscal year ended 9/30/20XX

Balance Sheet

Assets	
Fund Balance with Treasury	$ 159
Accounts Receivable	200
Estimated Petroleum Royalties	23,500
Total Assets	$ 23,859
Liabilities	
Liability for Revenue Distributions to Others-Federal	17,167
Liability for Revenue Distributions to States-Non-Federal	6,377
Total Liabilities	23,544
Net Position	
Cumulative Results of Operations	315
Total Liabilities and Net Position	$ 23,859

Statement of Net Cost

Oil and Gas Resources Program	
Leasing Activities:	
Costs (Oil and Gas Depletion Expense)	$ 600
Less: Earned Revenue	(13,100)
Net Cost/(Revenue) from Leasing Operations	(12,500)
Loss/(Gain) on Revaluation of Estimated Petroleum Royalties	(3,000)
Less: Revenue Designated for the States	2,602
Less: Loss on Sale of Future Royalty Rights	150
Net Cost/(Revenue) for Program before (gain)/loss from changes in assumptions	$(12,748)
(Gain)/Loss on assumption changes:	
Discount rate assumption	(2,500)
Other assumptions	500
Net (gain)/loss on assumption changes	(2,000)
Net Cost/(Revenue) for Program	$(14,748)

Statement of Changes in Net Position

Beginning Net Position	$ 0
Adjustment: Change in Accounting Principle	200
Beginning Balance, as adjusted	200
Net Revenue for Program	14,748
Transfers In/(Out)	(14,633)
Ending Net Position	$ 315

Appendix D: Abbreviations

API	American Petroleum Industry
Bbl	Barrels
BLM	Bureau of Land Management
CFR	Consolidated Financial Report
CFR	Code of Federal Regulations
DOI	Department of Interior
ED	Exposure Draft
EIA	Energy Information Administration
FASAB	Federal Accounting Standards Advisory Board
FASB	Financial Accounting Standards Board
GAAP	Generally Accepted Accounting Principles
Mcf	Thousand Cubic Feet
MMS	Minerals Management Service
OCS	Outer Continental Shelf
NGPLs	Natural Gas Plant Liquids
RSI	Required Supplementary Information
SEC	Securities and Exchange Commission
SFAC	Statement of Financial Accounting Concepts
SFFAC	Statement of Federal Financial Accounting Concepts
SFAS	Statement of Financial Accounting Standards
SFFAS	Statement of Federal Financial Accounting Standards
U.S.	United States
USGS	U.S. Geological Survey

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Appendix E: Glossary

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Definitions of Resource and Reserve Components and Subcomponents

Provided below are definitions used by federal entities to describe oil and gas resource and reserve components and subcomponents. The source of these definitions is OCS Report MMS 2003-050 unless otherwise noted.

Resources estimated from broad geologic knowledge or theory and existing outside of known fields or known accumulations are undiscovered resources. Undiscovered resources can exist in untested prospects on unleased acreage, or on undrilled lease acreage, or in known fields. In known fields, undiscovered resources occur in undiscovered pools that are controlled by distinctly separate structural features or stratigraphic conditions.

The Mineral Management Service (MMS) and the U.S. Geological Survey (USGS) formerly conducted national assessments of undiscovered oil and gas resources together. The former was responsible for the offshore while the latter was responsible for onshore and state waters. The last such assessment was in 1995. MMS updates their assessment approximately every five years in accordance with the Department of Interior's five-year leasing program, with the last update in 2000. Since 1995, the USGS has not conducted an overall update for onshore and state waters, but has conducted assessments updates on a **basin** or area level.

The assessment considers recent geophysical, geological, technological, and economic information and uses a geologic play analysis approach for resource appraisal.

<u>Undiscovered Resources</u>

Undiscovered resources are **hydrocarbons** estimated on the basis of geologic knowledge and theory to exist outside of known accumulations. They are presumed to occur in unmapped and unexplored areas. The speculative and hypothetical resource categories comprise undiscovered resources. Undiscovered resources are classified as either “undiscovered non-recoverable resources” or “undiscovered recoverable resources”.

- Undiscovered Non-Recoverable Resources

The portion of undiscovered petroleum-initially-in-place quantities not currently considered to be recoverable. A portion of these quantities may become recoverable in the future as commercial circumstances change, technological developments occur, or additional data is acquired.

- Undiscovered Recoverable Resources

An assessment provides estimates of undiscovered recoverable resources in two categories for federal offshore oil and gas resources. However assessments for federal onshore oil and gas resources provide information for only one, the undiscovered, conventionally recoverable resources. Both are described below:

1. Undiscovered, conventionally recoverable resources: The portion of the hydrocarbon potential that is producible, using present or reasonably foreseeable technology, without any consideration of economic feasibility.

2. Undiscovered, economically recoverable resources: The portion of the undiscovered conventionally recoverable resources that is economically recoverable under imposed economic scenarios.

Discovered Resources

Once leased acreage is drilled and is determined to contain oil or gas under Code of Federal Regulations (CFR) Title 30, Part 250, Subpart A, Section 11, Determination of Well Producibility (hereinafter referred to as 30 CFR 250.11), the lease is considered to have discovered resources.

Identified resources are resources whose location and quantity are known or are estimated from specific geologic or engineering evidence and include economic, marginally economic, and subeconomic components.

Reserves

In accordance with the Society of Petroleum Engineers (SPE), the World Petroleum Congresses (WPC), and the American Association of Petroleum Geologists (AAPG), the definition for "reserves" and the following explanatory paragraphs are presented as follows[28]:

> "Reserves are those quantities of petroleum which are anticipated to be commercially recovered from known accumulations from a given date forward. All reserve estimates involve some degree of uncertainty. The uncertainty depends chiefly on the amount of reliable geologic and engineering data available at the time of the estimate and the interpretation of these data."

The relative degree of uncertainty may be conveyed by placing reserves into one of two principal classifications, either 1) unproved or 2) proved.

Unproved Reserves

After a lease qualifies under 30 CFR 250.11, the MMS Field Naming Committee reviews the new producible lease to assign it to an existing field or, if the lease is not associated with an established geologic structure, to a new field. Regardless of where the lease is assigned, the reserves associated with the lease are initially considered to be unproved reserves. Unproved reserves are based on geologic or engineering information similar to that used in estimates of proved reserves; but technical, contractual, economic, or regulatory uncertainties preclude such reserves from being classified as proved.

Unproved reserves may be divided into two subclassifications, possible and probable, which are similarly based on the level of uncertainty.

[28] WPC/SPE/AAPG Petroleum Reserves and Resources Definitions.

"Unproved possible reserves are less certain than unproved probable reserves and can be estimated with a low degree of certainty, which is insufficient to indicate whether they are more likely to be recovered than not. Reservoir characteristics are such that a reasonable doubt exists that the project will be commercial" (SPE, 1987). After a lease qualifies under 30 CFR 250.11, the reserves associated with the lease are initially classified as unproved possible.

"Unproved probable reserves are less certain than proved reserves and can be estimated with a degree of certainty sufficient to indicate they are more likely to be recovered than not" (SPE, 1987). Reserves in fields for which a schedule leading to a Development and Production Plan (DPP) has been submitted to the MMS have been classified as unproved probable.

Proved Reserves

"Proved reserves can be estimated with reasonable certainty to be recoverable under current economic conditions, such as prices and costs prevailing at the time of the estimate. Proved reserves must either have facilities that are operational at the time of the estimate to process and transport those reserves to market or a commitment or reasonable expectation to install such facilities in the future" (SPE, 1987). Proved reserves can be subdivided into undeveloped and developed.

Proved undeveloped reserves are classified proved undeveloped when a relatively large expenditure is required to install production and/or transportation facilities, a commitment by the operator is made, and a timeframe to begin production is established. Proved undeveloped reserves are reserves expected to be recovered from (1) yet undrilled wells, (2) deepening existing wells, or (3) existing wells for which a relatively large expenditure is required for recompletion.

Proved developed reserves are classified as proved developed when the reserves are expected to be recovered from existing wells (including reserves behind pipe). Reserves are considered developed only after necessary production and transportation equipment have been installed or when the installation costs are relatively minor. Proved developed reserves are subcategorized as producing or non-producing" (SPE, 1987). This distinction is made at the reservoir level and not at the field level.

- Any developed reservoir in a developed field that has not produced or has not had sustained production during the past year is considered to contain proved developed non-producing reserves. This category includes reserves contained in non-producing reservoirs, contained reserves behind-pipe, and reservoirs awaiting well workovers or transportation facilities.

- Once the first reservoir in a field begins production, the reservoir is considered to contain proved developed producing reserves, and the field is considered on production. If a reservoir had sustained production during the last year, it is considered to contain proved developed producing reserves.

Production represents the proved oil and gas reserves that were extracted from existing reserves.[29]

End of the terms in Illustration 1 that are defined under the subheading **Definitions of Resource and Reserve Components and Subcomponents**

- -

Historical Estimates of Proved Reserves

Acquisitions: The volume of proved reserves gained by the purchase of existing fields or properties, from the date of purchase or transfer.

Adjustments: The quantity which preserves an exact annual reserves balance within each State or State subdivision of the following form:

> These adjustments are the yearly changes in the published reserve estimates that cannot be attributed to the estimates for other reserve change categories because of the survey and statistical estimation methods employed. For example, variations as a result of changes in the operator frame, different random samples or imputations for missing or unreported reserve changes, could contribute to adjustments.

Change from Prior Year: the net change between proved reserves reported for the prior reporting period and proved reserves reported for the current reporting period.

Estimated Production: The volumes of oil and gas that are extracted or withdrawn from reservoirs during the report year.

Extensions: The reserves credited to a reservoir because of enlargement of its proved area. Normally the ultimate size of newly discovered fields, or newly discovered reservoirs in old fields, is determined by wells drilled in years subsequent to discovery. When such wells add to the proved area of a previously discovered reservoir, the increase in proved reserves is classified as an extension.

Net of Sales and Acquisitions: the net change in the quantity of reserve estimates, either positive or negative, as a result of reserves gained through purchase and deducted through sale during the report year.

New Field Discoveries: The volumes of proved reserves of crude oil, natural gas and/or natural gas liquids discovered in new fields during the report year.

New Reservoir Discoveries in Old Fields: The volumes of proved reserves of crude oil, natural gas, and/or natural gas liquids discovered during the report year in new reservoir(s) located in old fields.

[29] Adapted from Gas Energy Review, Gas Supply and Demand Committee, July 1995, Vol.23 No.7.

Proved Reserves: The total quantity of proved reserves which is calculated by adding the quantity of reserves reported as revisions and adjustment, net of sales and acquisitions, total recoveries and deducting estimated production during the report year.

Revisions: Changes to prior year-end proved reserves estimates, either positive or negative, resulting from new information other than an increase in proved acreage (extension). Revisions include increases of proved reserves associated with the installation of improved recovery techniques or equipment. They also include correction of prior report year arithmetical or clerical errors and adjustments to prior year-end production volumes to the extent that these alter reported prior year reserves estimates.

Revisions and Adjustments: the net change in the quantity of reserve estimates, either positive or negative, as a result of adding changes reported as revisions and adjustments during the report year.

Sales: The volume of proved reserves deducted from an operator's total reserves when selling an existing field or property, during the calendar year.

Total Discoveries: the total quantity of additional discovered reserves which is calculated by adding the quantity of reserves reported as a result of extensions, the quantity of reserves reported as a result of new field discoveries, and the quantity of reserves reported as a result of new discoveries in old fields during the report year.

End of the terms under the subheading **Historical Estimates of Proved Reserves**

- -

Other Definitions

Basin: The site of accumulation of a large thickness of sediments.[30]

Bonus Bid: Leases issued in areas known to contain minerals are awarded through a competitive bidding process. A bonus bid**,** as used in this standard, represents the cash amount successfully bid to win the rights to a lease.[31]

Crude oil is a mixture of hydrocarbons that exists in the liquid phase in natural underground reservoirs and remains liquid at atmospheric pressure after passing through surface separating facilities. Crude oil may also include: 1) small amounts of hydrocarbons that exist in the gaseous phase in natural underground reservoirs but are liquid at atmospheric pressure after being recovered from oil well gas in lease separators, and that subsequently are commingled with the crude oil stream without being separately measured; and, 2) small amounts of nonhydrocarbons produced with the oil.

[30] U.S. Geological Survey, Geologic Glossary.
[31] Glossary of Mineral Terms, Minerals Revenue Management, Minerals Management Service, U.S. Department of the Interior

Crude Oil Stream: Crude oil produced in a particular field or a collection of crude oils with similar qualities from fields in close proximity, which the petroleum industry usually describes with a specific name, such as West Texas Intermediate.

Dry Gas: The actual or calculated volumes of natural gas which remain after: 1. The liquefiable hydrocarbon portion has been removed from the gas stream (i.e., gas after lease, field, and/or plant separation) 2. Any volumes of nonhydrocarbon gases have been removed where they occur in sufficient quantity to render the gas unmarketable.

Estimated petroleum royalties means the estimated end-of-period value of the federal government's royalty share of proved oil and gas reserves from federal oil and gas resources.

Estimated Value for Royalty Relief: Existing statutes authorize the Minerals Management Service (MMS) to grant royalty relief to operators on the production of oil and gas resources from federal oil and gas leases. Royalty relief is the reduction, modification, or elimination of any royalty to operators to promote development, increase production, or encourage production of marginal resources on certain leases or categories of leases. The estimated value for royalty relief is the calculated approximation of royalty relief based on a formula developed by the Department of the Interior.

Federal Oil and Gas Resources: Oil and gas resources over which the federal government may exercise sovereign rights with respect to exploration and exploitation and from which the federal government has the authority to derive revenues for its use. Federal oil and gas resources do not include resources over which the federal government acts as a fiduciary for the benefit of a non-federal party.

Federal jurisdiction is defined under accepted principles of international law. The seaward limit is defined as the farthest of 200 nautical miles seaward of the baseline from which the breadth of the territorial sea is measured or, if the continental shelf can be shown to exceed 200 nautical miles, a distance not greater than a line 100 nautical miles from the 2,500-meter isobath or a line 350 nautical miles from the baseline.

Field is an area consisting of a single reservoir or multiple reservoirs all grouped on, or related to, the same individual geological structural feature and/or stratigraphic condition. There may be two or more reservoirs in a field that are separated vertically by intervening impervious strata or laterally by local geologic barriers, or by both. The area may include one lease, a portion of a lease, or a group of leases with one or more wells that have been approved as producible.

First purchase price is the actual amount paid by the first purchaser for crude oil as it leaves the lease on which it was produced.[32] A "first purchase" constitutes a transfer of ownership of crude oil during or immediately after the physical removal of the crude oil from a production property for the first time.

[32] EIA-182 Domestic Crude Oil First Purchase Report Instructions.

Gas: A mixture of hydrocarbon compounds and small quantities of various nonhydrocarbons existing in the gaseous phase or in solution with crude oil in natural underground reservoirs at reservoir conditions.

Gravity Bands: The density of oil compared to the density of water, i.e., the specific gravity of the oil. The gravity is measured in degrees by the American Petroleum Institute (API). Oil with a low number is less valuable than with a high number. For example, oil is classified as light, medium or heavy, according to its measured API gravity. Light crude oil is defined as having an API gravity higher than 31.1°API. Medium oil is defined as having an API gravity between 22.3°API and 31.1°API. Heavy oil is defined as having an API gravity below 22.3°API.

Hydrocarbon: An organic chemical compound of hydrogen and carbon in the gaseous, liquid, or solid phase. The molecular structure of hydrocarbon compounds varies from the simplest (methane, a constituent of natural gas) to the very heavy and very complex.

Lease: "Lease," as used in this standard, means any contract, profit-share arrangement, joint venture, or other agreement issued or approved by the United States under a mineral leasing law that authorizes exploration for, extraction of, and/or removal of oil or gas.[33]

Lease condensate: A mixture consisting primarily of pentanes and heavier hydrocarbons which is recovered as a liquid from natural gas in lease separation facilities. This category excludes natural gas plant liquids, such as butane and propane, which are recovered at downstream natural gas processing plants or facilities.

Long-term Assumptions: Assumptions are considered long-term if the underlying event about which the assumption is made will not occur for five years or more. If the event is one of a series of events the entire series should be considered the event and, thus, the payment may commence within one year but would be required to extend at least five years. Otherwise, the asset or liability would be classified as short-term.

Marketable Treasury Securities: Debt securities, including Treasury bills, notes, and bonds, that the U.S. Treasury offers to the public and are traded in the marketplace. Their bid and ask prices are quoted on securities exchange markets.

Natural gas plant liquids (NGPLs): Those hydrocarbons in natural gas that are separated as liquids at natural gas processing plants, fractionating and cycling plants, and, in some instances, field facilities. Lease condensate is excluded. Products obtained include ethane; liquefied petroleum gases (propane, butanes, propane-butane mixtures, ethane-propane mixtures); isopentane; and other small quantities of finished products, such as motor gasoline, special naphthas, jet fuel, kerosene, and distillate fuel oil.

Oil: A mixture of hydrocarbons that exists in the liquid phase in natural underground reservoirs and remains liquid at atmospheric pressure after passing through surface separating facilities.

[33] 30 U.S.C. §1702 (5).

Outer Continental Shelf: The federal Government administers the submerged lands, subsoil, and seabed lying between the seaward extent of the **States' jurisdiction** and the seaward extent of **federal jurisdiction**.[34]

Play: A group of **pools** that share a common history of hydrocarbon generation, migration, reservoir development, and entrapment.[35]

Pool: A discovered or undiscovered accumulation of hydrocarbons, typically within a single stratigraphic interval.[36]

Present Value: The value of future cash flows discounted to the present at a certain interest rate (such as the reporting entity's cost of capital), assuming compound interest.

Rent: Rent, as used in this standard, are annual payments, normally a fixed dollar amount per acre, required to preserve the rights to a lease while the lease is not in production. A rent schedule is established at the time a lease is issued.[37]

Reservoir: A porous and permeable underground formation containing an individual and separate natural accumulation of producible hydrocarbons (oil and/or gas) which is confined by impermeable rock or water barriers and is characterized by a single natural pressure system.[38]

Royalty: Royalty, as used in this standard, means any payment based on the value or volume of production which is due to the United States on production of oil or gas from the Outer Continental Shelf or federal lands, or any minimum royalty owed to the United States under any provision of a lease.[39]

Royalty rate: A proportionate interest in the production value of mineral deposits due the lessor from the lessee in accordance with a lease agreement.

Sales Value: The proceeds received for the sale of a product. Sales value is calculated by multiplying the sales volume by unit price.

Sales Volume: The volume, or quantity, of the product that is sold. The sales volume is measured in thousand cubic feet (mcf) for gas and in barrels (bbl) for oil.

States' jurisdiction is defined as follows:

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[34] Glossary of Mineral Terms, Minerals Revenue Management, Mineral Management Service, U.S. Department of the Interior.
[35] Glossary of Mineral Terms, Minerals Revenue Management, Minerals Management Service, U.S. Department of the Interior.
[36] Ibid.
[37] Glossary of Mineral Terms, Minerals Revenue Management, Minerals Management Service, U.S. Department of the Interior.
[38] Ibid.
[39] Adapted from 30 U.S.C. § 1702 (14).

- Texas and the Gulf coast of Florida are extended 3 marine leagues (9 nautical miles) seaward from the baseline from which the breadth of the territorial sea is measured.
- Louisiana is extended 3 imperial nautical miles (imperial nautical mile = 6080.2 feet) seaward of the baseline from which the breadth of the territorial sea is measured.
- All other States' seaward limits are extended 3 nautical miles (approximately 3.3 statute miles) seaward of the baseline from which the breadth of the territorial sea is measured.

Technically recoverable resources: For purposes of this standard, the term used to describe the total quantity of undiscovered recoverable resources and unproved reserves. Proved reserves are not included in the estimated quantity of technically recoverable resources.

Wellhead price is the value of the purchased natural gas at the mouth of the well. In general, the wellhead price is considered to be the sales price obtainable from a third party in an arm's length transaction. Posted prices, requested prices, or prices as defined by lease agreements, contracts, or tax regulations should be used where applicable.[40]

[40] Energy Information Administration Glossary, http://www.eia.doe.gov/glossary/glossary_w.htm.

Federal Accounting Standards Advisory Board
441 G Street NW, Suite 6814
Mail Stop 6K17V
Washington, DC 20548
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FAX 202-512-7366
www.fasab.gov

Tab A-2
Natural Resources History of Project and Key Decisions

Natural Resources

History of Project and Key Decisions

May 1995 - Present

May 1995 - Natural resources identified as a high priority project. Former executive director (Ron Young) announced that staff would begin developing an issue paper.

July 1995 - Staff presented first issue paper; Board requested more background information, including a review of relevant FASB standards.

September 1995 - Staff provided Board members with an informational paper on FASB SFAS 19, 25, 69 and 89.

November 1995 - SFFAS 6, *Accounting for Property, Plant, and Equipment* issued; only addressed surface land area, excludes natural resources due to complex issues involved.

January 1996 - Staff provided Board members with a paper that listed federal agencies and their responsibilities for natural resources; an updated set of issues; and, the type of information on natural resources currently available.

April 1996 - The Board determined that stocks of game, fisheries, and wildlife habitat would be excluded from the scope of the standard. Also, Board decided it is only interested in reporting information about natural resources contained on federal lands. Staff was directed to prepare a hierarchy of disclosure standards for all traditional natural resources, excluding timber. Staff was directed to prepare separate requirements for timber.

May 1996 - SFFAS 7, *Accounting for Revenue and Other Financing Sources* issued; excluded royalty revenue from SoNC even though exchange because there is no offsetting depletion expense. This remains an exception to the recognition of exchange revenue on the SoNC (along with the auction of the radio spectrum).

May 1996 (contd.) - Staff presented the Board with possible reporting requirements for a natural resources standard and proposed four categories of natural resources: (1) natural resources extracted, produced, and sold by a federal entity; (2) quantifiable lease program natural resources; (3) non-quantifiable lease program natural resources; and (4) timber. Concerned with relevance and reliability, the Board decided to create a task force to study the kinds of natural resources information currently available and to provide options for framing relevant information to be reported in federal financial reports.

June 1996 - SFFAS 8, *Supplementary Stewardship Reporting*, issued; only addressed surface land area, excluded natural resources from stewardship reporting due to complex issues involved.

September 1996 - Board approved formation of natural resources task force and related "Charge to Task Force" memorandum, noting that reporting a source of the country's wealth and its potential wealth for the future was important. Schuyler Lesher appointed as chair of task force. Executive Director Ron Young retired September 30, 1996.

January 1997 - Natural resources task force held its first meeting. The task force was made up of accountants, economists, geologists, and program experts from various federal entities and the private sector.

April 1997 - The task force chair presented revised scope of task force charge, stating that the project would include those extractable natural resources owned by the federal government or under federal stewardship and the electromagnetic spectrum, where a commercial market exists for the resource. This includes economic mineral resources (e.g., oil, gas, coal, gold, silver, sand, clay, gravel, etc) and the following renewable resources: timber, forage, and water for which the federal government owns the rights.

October 1997 - Mr. Lesher presented the Board with an update of the task force activities since January 1997, including natural resources addressed and the current view of natural resource "stages" (stocks and flows): conveyed/sold; available for sale; not available for sale; and unknown/undiscovered resources. The specific natural resources addressed within the scope of the project are: timber; outer continental shelf oil and gas resources; leasable minerals (e.g., oil, gas, coal, oil shale, geothermal resources, gilsonite, phosphate, potassium, potash, sodium); locatable minerals (e.g., gold, silver, nickel); mineral materials (e.g., sand, stone, gravel, pumice, and other volcanic stone, clay and rock); grazing rights; electromagnetic spectrum; and water rights. Mr. Lesher said the task force expected to have preliminary recommendations by December.

January 1998 - The task force chair presented a preliminary draft of a natural resources fact-finding paper. While the outline of the paper identified nine major sections, the paper addressed only three of the sections. Mr. Lesher said the task force expected to complete work on the remaining sections of the fact-finding paper in about 6 weeks.

Natural Resources

History of Project and Key Decisions

May 1995 - Present

April 1998 - Task force presented a revised paper that included a discussion on the general reporting principles, including asset reporting, accounting and reporting for revenue, and accounting and reporting for costs. The revised paper also contained a section on the impact of the proposed changes on current FASAB standards and a discussion on Indian natural resource assets held by the federal government in trust for Indian tribes and individuals.

October 1998 - FASAB staff continued to work with the task force to issue a final task force report. Several more meetings were held to discuss open issues such as whether natural resource exchange revenue that is collected without incurring matching costs should be reported in the Statement of Net Cost or as custodial revenue.

March 1999 - Natural Resources Task Force Draft Report issued from Mr. Lesher to the CFO Council and PCIE Members for comment. Comments were requested by May 3, 1999.

June 2000 - FASAB issues Discussion Paper "*Accounting for the Natural Resources of the Federal Government*" prepared by the FASAB Natural Resources Task Force. The report recommended stewardship reporting as the primary mechanism for reporting information on natural resources. Although the task force believed that the value of natural resources available for sale was important, it concluded that the balance sheet was not the most reliable or effective way to accomplish such reporting due to uncertainty over quantity and market price. Minority comments included in Appendix B of the report state that "resources used for remunerative purposes should be reported on the balance sheet and Statement of Net Cost." The full report is available at http://www.fasab.gov/pdffiles/natresrpt.pdf

December 2000 - The Board voted to eliminate the category RSSI - required supplementary stewardship information.

[Project deferred to address other issues]

October 2002 - After reviewing and discussing a revised project plan presented by staff, the Board approves work to commence on the current natural resources project.

December 2002 - Staff presented a revised project plan based on prior Board discussions. Staff also provided summarized comments received from several members since the October meeting, noting that these comments leaned toward recognition of natural resources as an asset. The Board agreed that staff would develop standards for oil and gas first and then apply the framework to other types of natural resources.

February 2003 - Staff presented a revised project plan that included the integration of possible revisions to the current FASAB reporting objectives. The Board directed staff to begin developing an ED with a BfC.

April 2003 - Staff provided a draft skeletal exposure draft and concluded that, although oil and gas meet FASAB's working definition of "asset," the resources do not meet the recognition criteria because they cannot be reliably measured. The board asked staff to continue their research on current reporting practices as well as options for measuring the oil and gas resources and come back to the Board for discussion.

June 2003 - The Board asked staff to look at how the proposed recognition of oil and gas resource collections and disbursements would affect an entity's Statement of Custodial Activities and prepare pro forma disclosures that could be included in entity financial reports. Staff was also asked to research the pros and cons for capitalizing oil and gas assessments (an assessment is an estimate of undiscovered oil and gas resources on the basis of geologic knowledge and theory to exist outside of known accumulations).

October 2003 - Staff presented revised proposed disclosure requirements for Board review. The Board directed staff to remove disclosure requirements for total number of leases and non-producing leases and reasons leases are non-producing, concluding that the information was not useful. Staff was also asked to obtain assessment cost information from MMS and provide it to the Board.

December 2003 - Staff informed the Board that MMS does not track assess-ment costs separately from other resource evaluation (RE) costs. In addition, total RE costs are immaterial in comparison to annual bonus bid, rent, and royalty collections. Staff sought approval of proposed oil and gas disclosures with no asset recognition due to the various uncertainties involved in measurability. The Board directed staff to pursue capitalization of the anticipated production stage revenue stream, which included researching accounting literature that deals with long-term contracting and leasing in relation to measurement and recognition criteria. This was the Board direction even though staff had initially concluded that quantities from expected oil and gas production were not estimable, due to the unpredictability of the economy, business decisions by the producers, and the advancement, or lack of it, in technology.

July 2004 - Staff presented a proposed valuation methodology and financial statement disclosures using current market value. The Board requested an expanded discussion on alternative measurement attributes. In addition, the Board requested that guidance be sought from the auditors to identify any potential barriers to auditing proved reserves.

December 2004 - Staff presented a revised BfC that included a discussion on many of the questions raised by members at the August 2004 meeting. Members requested additional research and explanation in a number of areas, including a detailed description of "average wellhead price," reliability of EIA proved oil and gas reserve quantities, accounting entries, disclosures, pros and cons of using the discounted cash flow methodology, average time over which oil and gas is extracted from a producing well, and whether bonus bids are proportionate to the value of the federal government's royalty share.

March 2005 - Staff presented another revised BfC to the Board members in which staff had proposed using the national average wellhead price. The Board asked staff to research whether it would be better to use the average wellhead price for each field. The Board also asked staff to perform more research on whether the amount should be discounted. All members, excepts Messrs. Reid and Farrell agreed that information on undiscovered resources should be reported as RSI. Board members decided that the term "estimated Federal royalty share" should be changed to "estimated petroleum royalties."

October 2005 - Staff provided a paper that described the valuation of the federal asset "estimated petroleum royalties" that was based on national average prices and royalty rates. The Board agreed with the staff proposed formulas except Mr. Torregrosa indicated that regional average prices and royalty rates should be used, especially for future revenue streams that had been identified for sale. Board members agreed that a requirement should be added in the standards to address royalty streams identified for sale.

March 2004 - Staff explained that previously, the EIA did not distinguish between the quantity of proved reserves from lands under federal jurisdiction and the quantity of proved reserves from other lands. However, the EIA was then tasked with the requirement to provide this information in its September 2004 reports. Therefore, because this information would be available, staff proposed that an estimated value for proved oil and gas reserves from lands under federal jurisdiction might be capitalized. The Board received information on measurability of proved reserves from MMS and EIA experts via a conference call. The Board agreed that staff should explore the possibility of capitalizing a value for proved oil and gas reserves and consider disclosing information about other classifications of oil and gas resources.

August 2004 - Staff presented a draft ED that proposed using current market value. The ED explained that net present value was eliminated from consideration as a measurement attribute because the period of time over which the money could be earned is not determinable, thereby inhibiting selection of an appropriate discount rate. The Board decided to use the average wellhead price to value cash inflows from oil and gas resources instead of current market value because the wellhead price is what the royalty payment is based on. The wellhead price, which is calculated by EIA, is the value for oil and gas at the mouth of the well and is considered to be the sales price to the initial purchaser without the addition of any other costs, such as transportation and insurance. The Board also decided to change the title of the proposed standards from "Reporting Requirements for Federal Oil and Gas Resources" to "Accounting for Federal Oil and Gas Resources." Staff provided members with a copy of the "Society of Petroleum Engineers (SPE) Standards Pertaining to the Estimating and Auditing of Oil and Gas Reserve Information."

August 2005 - Staff provided EIA and DOI responses to a number of open questions from the March meeting. In addition, a representative from EIA and a representative from DOI attended the meeting and responded to various member questions. The representatives recommended that the calculation for valuing the estimated petroleum royalties be straightforward and manageable. Staff was directed to continue developing the ED.

January 2006 - Staff presented a draft ED that included estimated quantity, price, and royalty rate information on a regional basis rather than at a national level. This was deemed to provide a more representative valuation. Staff also addressed future royalty rights held for sale in the revised ED. The Board provided a number of comments on the revised ED, including a request that pro forma accounting transactions, pro forma financial statements, and a discussion of the timing of the transactions be included.

March 2006 - The Board reviewed a revised draft ED and provided comments, including requesting that staff draft several questions for respondents that cover the level of information requested to be disclosed in the footnotes or displayed as RSI; the challenges posed by the use of the present value measurement attribute for measuring estimated petroleum royalties; and the use of reserves classified as proved, probable, and possible to calculate the value of the federal government's estimated petroleum royalties for capitalization on the balance sheet, instead of using only the proved reserves as proposed in the ED. The Board also requested that staff research the royalty relief program and provide additional information at the next meeting.

May 2006 - The Board reviewed a revised draft ED and an issue paper on the royalty-free production of oil and gas. Board members agreed that a requirement would be added in the ED to report the annual estimated value for royalty relief as RSI. In addition, they agreed that a question would be added to the request for comments section of the ED pertaining to this requirement. Board members also agreed to staff's recommendation that RSI reporting be required for technically recoverable resources as a whole versus delineating between unproved and undiscovered resources as that information was not readily available. Staff suggested that it begin working on coal for the next phase of the natural resources project. However, the Board directed staff to look at a group of mining materials to try to come up with a standard which has similar principles for a group of mining materials.

July 2006 - The Board reviewed a revised draft ED that included an alternative view from CBO that fair value should be used to value the federal government's natural resources instead of the proposed valuation methodology. There were no objections from Board members to include the CBO alternative view in the ED. The Board also decided to calculate the value of natural gas plant liquids (NGPL) separately from oil and lease condensate. This was the result of an issue raised by CBO that the average price per barrel of NGPL was significantly lower than the average price per barrel of oil and lease condensate. Board members also agreed with CBO's recommendation that the dry (processed) gas price would be used in calculating the value of estimated petroleum royalties for gas as opposed to the wet (unprocessed) gas price. This issue was raised because the proposed standards specified that proved reserves of natural gas would be measured as pipeline quality. The dry (processed) gas is the pipeline-quality gas that has had the liquids removed.

November 2006 - The Board asked staff to insert a question addressing the regional disclosure information in the Request for Comments section and to add text in the BfC addressing concerns regarding the proposed disclosures. The Board also tentatively agreed that a liability exists and should be recognized for the estimated petroleum royalties which the government is obligated to distribute to others in accordance with authoritative laws and regulations.

January 2007 - The Board reviewed the revisions to the ED that incorporate the recognition of a liability and clarify the questions for respondents and approved the circulation of a pre-ballot draft prior to the next meeting.

March 2007 - Staff presented the Board with a ballot ED; however, several more clarifying changes were requested to be made to the draft, including that a question on cost/benefit considerations be included in the Request for Comments and a more robust discussion about the current and proposed asset and liability definitions be added. The Board asked staff to make the changes discussed and circulate another pre-ballot draft.

May 2007 - An exposure draft entitled *Accounting for Federal Oil and Gas Resources* was issued for public comment on May 21, 2007. Comments on the proposals presented in the ED were requested by September 21, 2007. The Board requested that the proposal be field tested during the comment period.

September 2007 - Since the Board received a request for the comment period to be extended and only one comment letter had been received, the Board agreed to extend the comment period until January 11, 2008. Staff was asked to make a concerted effort to reach out to groups and experts to respond.

February 2008 - Eight comment letters were received through February 4, 2008. Based on the nature of the responses, the Board concluded that a public hearing was not necessary but may elect to follow up on the individual responses as needed. Long-time FASAB project manager Rick Wascak retired.

Natural Resources

History of Project and Key Decisions

May 1995 - Present

June 2008 - The board rejected staff's proposal to develop a comprehensive standard on all natural resources and directed staff to continue with the development of a final standard on oil and gas. Staff will invite DOI to appear before the board to discuss their alternative proposal from the fieldwork testing including why they requested an even lower level of detail than was prescribed in the standard as well as their thoughts on what a less prescriptive standard would mean to them and how it might apply to other resources under their domain. In addition, staff will research the reason the board decided to look at one resource at a time, review current SEC requirements, find out how the private sector currently reports private reserves, obtain revenue numbers on the different types of natural resources, and attempt to make contact with EIA to find out if and when another report on proved reserves under federal lands will be published.

October 2008 - After hearing from the DOI representatives regarding their experience during field testing of the May 2007 ED, the board members directed staff to draft a principles-based ED for their consideration.