

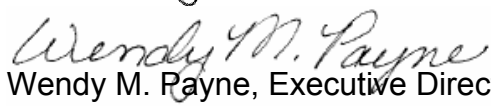


October 1, 2009

Memorandum

To: Members of the Board

From: 
Julia E. Ranagan, Assistant Director

Through: 
Wendy M. Payne, Executive Director

Subj: **Revised Exposure Draft: Accounting for Federal Oil and Gas Resources:
Comment Letters Received through September 30, 2009¹ – Tab D**

MEETING OBJECTIVE

The purpose of this session is to review comments received on the subject exposure draft (ED) as well as related staff analysis and recommendations to enable staff to work towards issuing a pre-ballot draft of the final standard by e-mail after the December meeting. Three specific issues for your consideration begin on page 37.

BRIEFING MATERIAL

- ☐ **Attachment 1**, beginning on page 9 of this memo, provides the staff summary to all responses to the questions for respondents on pages 1 – 4 of the ED. The staff summary presents:
 - a) Tally of Responses by Question begins on page 9
 - b) Quick Table of Responses by Question on page 13, and
 - c) Overall Summary by Question begins on page 14
- ☐ **Attachment 2**, beginning on page 17 of this memo, provides the full text of the comment letters organized by question and by respondent. This is a copy of all comment letter text without the letterheads and transmittal paragraphs and is intended for quick reference purposes; it is not necessary to read this attachment in addition to the comment letters.

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.

- ☐ **Attachment 3**, beginning on page 37 of this memo, contains the related staff analysis and recommendations.
- ☐ **Attachment 4**, beginning on page 61 of this memo, contains the complete set of comment letters in the order they were received.
- ☐ **Appendix 1** contains a copy of the July 2009 ED.

NEXT STEPS

December 2009 Meeting

- Review draft with changes from October 2009 meeting.
- Finalize wording.
- Provide pre-ballot draft after meeting via email.

January 2010

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

May 2010

- Issue final standard after sponsor review.

BACKGROUND

The July 2009 exposure draft (ED), *Accounting for Federal Oil and Gas Resources*, proposed accounting standards for federal oil and gas resources that would result in the recognition of an asset and a liability. The asset is referred to in the ED as “estimated petroleum royalties.” The asset’s value would be the royalty share of the federal oil and gas resources classified as “proved reserves.” The liability would be for the royalty share of the federal proved reserves designated to be distributed to non-federal entities, e.g., state governments. One board member believes that the value of federal oil and gas resources and annual changes therein should be reported as basic information in the notes, rather than recognized on the face of the financial statements.

When federal oil and gas resources are extracted, revenue and a depletion expense equal to the revenue due would be recognized by the federal government. When revenue collections are distributed, the component entity that is responsible for collecting royalties would recognize a transfer out for revenue distributions to federal entities and a reduction in the liability for revenue distributions to non-federal entities. Gains and losses would be recognized based on an annual valuation of the asset with an adjustment to the liability for revenue distributions to non-federal entities. 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 fully effective. In addition, a liability for the portion that will be distributed to non-federal entities would be established at the same time. The net effect of recognizing an asset and establishing a liability for revenue distributions to non-federal entities at the beginning of the reporting period would be a change in accounting principle that increases the entity's net position.

The proposed standards would be effective as required supplementary information (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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SUMMARY OF OUTREACH EFFORTS

The ED, *Accounting for Federal Oil and Gas Resources*, was issued July 6, 2009 with comments requested by September 8, 2009. Upon release of the exposure draft, notices and press releases were provided to:

- a) The Federal Register;
- b) *FASAB News*;
- c) *Journal of Accountancy*, *AGA Today*, *The CPA Journal*, *Government Executive*, *The CPA Letter*, and *Government Accounting and Auditing Update*;
- d) The CFO Council, the Council of Inspectors General on Integrity and Efficiency and the Financial Statement Audit Network; and
- e) Committees of professional associations generally commenting on exposure drafts in the past (e.g., Greater Washington Society of CPAs, AGA Financial Management Standards Board).

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

- a) Relevant congressional committees
 - 1. Senate Committee on Energy and Natural Resources
 - 2. Senate Committee on Finance
 - 3. Senate Committee on Indian Affairs
 - 4. House Committee on Financial Services
 - 5. House Committee on Natural Resources
- b) Public interest groups and think tanks
 - 1. National Congress of American Indians (NCAI), National and regional
 - 2. Alliance to Save Energy
 - 3. The Brookings Institution
 - 4. The Cato Institute
 - 5. Center on Budget and Policy Priorities
 - 6. Citizens Against Government Waste
 - 7. The Concord Coalition

8. The Heritage Foundation
 9. National Parks Conservation Association (NPCA)
 10. Natural Resources Defense Council (NRDC)
 11. OMB Watch
 12. Resources for the Future (RFF)
 13. Sierra Club
 14. The Urban Institute
 15. World Resources Institute (WRI)
- c) Respondents to the prior ED (or their successors)
1. Helene A. Baker, AGA TX OK Regional VP-Elect
 2. Christopher Osborne, EPA
 3. Robert Childree AGA, FMSB
 4. James Short DOD, (succeeded by Robert Hale in Comptroller position – contacts are DCFO Mark Easton or Assistant DCFO Dave Smith)
 5. Dan Fletcher, DOI
 6. Joseph Bakies (API, current contacts are Jim Williams or Paula Watkins)
 7. McCoy Williams (GAO/FMA succeeded by Jeanette Franzel)
 8. Dan Kovlak (GWSCPA chair succeeded by Andrew Lewis)
- d) Agencies that manage and / or account for federal natural resources
1. Department of the Interior (DOI)
 2. Department of Agriculture (USDA), Deputy CFO
 3. USDA Forest Service
 4. DOI Bureau of Land Management
- e) Oil and Gas Industry
1. World Petroleum Council (WPC)

2. American Petroleum Institute (API)
 3. Society of Petroleum Engineers (SPE)
 4. Ryder Scott Company
- f) Other
1. DOI, Office of the Special Trustee (OST)
 2. Energy Information Administration (EIA)
 3. Department of Energy, Deputy CFO
 4. Securities and Exchange Commission (SEC)
 5. U.S. Geological Service (USGS)
 6. Jeff Norris, KPMG (DOI financial statement audit partner)

In addition, the ED was publicized during the FASAB Update session at the Financial Statement Audit Network monthly meeting on July 21, 2009, and at the Department of the Treasury's 19th Annual Government Financial Management Conference on August 5, 2009.

To encourage responses, reminder notices were sent to our Listserv and each of the above individuals / organizations on August 20, 2009.

RESULT

As of September 30, 2009, we have received nine (9) responses from the following sources:

	FEDERAL (Internal)	NON-FEDERAL (External)
Users, academics, others		2
Auditors	1	
Preparers and financial managers	6	

The complete set of comment letters is provided at attachment 4. The comment letters include a table of contents and identify respondents in the order their responses are received. The comment letters appear as the final component of this memo to facilitate compilation and pagination. However, I encourage you to read the letters in their entirety before reading the staff summary below and analysis at Attachment 3.

If you require additional information or wish to suggest another alternative not considered in the staff paper, please contact me as soon as possible. If you have any questions or comments, please contact me by telephone at 202.512.7377 or by e-mail at ranaganj@fasab.gov.

Attachments (4)

Enclosure (1)

ATTACHMENT 1 – STAFF SUMMARY OF RESPONSES

Tally of Responses by Question

QUESTION	YES / AGREE	NO / DISAGREE	OTHER	NO COMMENT
Q1. The original exposure draft (ED) issued on May 21, 2007, contained detailed asset valuation implementation guidance for valuing federal oil and gas resources. As a result of feedback received from field testing efforts, the board has removed that detailed guidance from this revised ED and is instead proposing to provide federal entities with flexibility in developing the asset valuation estimation methodology due to the constantly changing economic and technical conditions. Do you agree or disagree with the board's position (see paragraphs 14 through 26, A47 and A48)? Please explain the reasons for your position in as much detail as possible.	4		3	2
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 as described in paragraphs 19 through 21. Discount rates as of the reporting date for present value measurements of federal 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. Do you agree or disagree with the board's position (see paragraphs 19 through 21 and A38 through A46)? Please explain the reasons for your position in as much detail as possible.	5		2	2
Q3. The board is proposing to permit an alternative measurement method 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 using the approach described in paragraphs 19 through 21. Specifically, the board is permitting a market-based fair value measurement consistent with the Financial Accounting Standards Board (FASB) Statement of Financial Accounting Standards 157, Fair Value Measurements. Do you agree or disagree with the board's position (see paragraphs 24 and A38 through A46)? Please explain the reasons for your position in as much detail as possible.	3	2	1	3

QUESTION	YES / AGREE	NO / DISAGREE	OTHER	NO COMMENT
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 paragraphs 25, 26 and A49 through A51)? Please explain the reasons for your position in as much detail as possible.	6	1		2
Q5. The board believes that it would be appropriate to provide guidance regarding reporting gains and losses from changes in assumptions and selecting the discount rates similar to that provided 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, 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 20, 40, and A64 through A66)? Please explain the reasons for your position in as much detail as possible.	5		1	3
Q6. SFFAS 31, Accounting for Fiduciary Activities, requires that agencies report on assets held in a fiduciary capacity. The Department of Interior (DOI) manages oil and gas resources on behalf of individual Indians and Indian tribes. This proposed standard – because it classifies oil and gas resources as assets – would result in additional information being disclosed for oil and gas assets managed in a fiduciary capacity. Note, however, that fiduciary reporting does not extend to inclusion of the additional disclosures or RSI that are proposed in this document for federal oil and gas resources. Thus, with respect to fiduciary activities, only disclosure of the assets, liabilities, and related inflows and outflows would result from this proposal. Some members have expressed concern that the costs may exceed the benefits of disclosing fiduciary assets and liabilities measured in conformance with this proposed standard. Since this proposal may significantly increase the fiduciary assets disclosed, we requested input on the cost-benefit of the requirement with respect to fiduciary activities in the	2	3	1	3

QUESTION	YES / AGREE	NO / DISAGREE	OTHER	NO COMMENT
<p>May 2007 ED. One respondent was in favor of the disclosures while four expressed their opinion that the information would most likely not be cost-beneficial. However, the board has not received any substantive information to enable it to make an informed decision regarding cost/benefit.</p> <p>Since the removal of the fiduciary oil and gas resource disclosure requirements would require an exception to the requirements of SFFAS 31, we are again requesting detailed input on the cost-benefit of the requirement with respect to fiduciary activities. See paragraph 46.</p>				
<p>Q7. The board is proposing to provide a three-year phase-in of the proposed requirements from required supplementary information (RSI) beginning with fiscal year 2011 to basic in fiscal year 2014. This transitional period is being 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 51 and A87)? Please explain the reasons for your position in as much detail as possible.</p>	5		1	3
<p>Q8. This Statement addresses accounting for federal oil and gas resources only. While the board may address accounting for other types of natural resources at some point in the future, the majority of the members acknowledge that it is not likely that a project devoted to other categories of natural resources will be marked as a high priority at future agenda-setting sessions due to their lesser significance. As a result, while not explicitly encouraging agencies to recognize other categories of natural resources, the board included paragraph 10 to explicitly state that this Statement does not preclude entities from recognizing or otherwise reporting information about other types of federally-owned natural resources. Do you agree or disagree that the potential risk that the inclusion of paragraph 10 might lead to inaccurate or inconsistent reporting of other types of natural resources is outweighed by the potential benefits to financial statement users (see paragraphs 10, A9 and A10)? Please explain the reasons for your position in as much detail as possible.</p>	2		4	3
<p>Q9. After a three-year transition period of reporting as RSI, the ED proposes to</p>	4	2		3

QUESTION	YES / AGREE	NO / DISAGREE	OTHER	NO COMMENT
recognize an asset on the balance sheet for the federal government's royalty share of federal oil and gas resources under lease (see paragraphs A29 through A37 for a discussion of factors regarding asset recognition considered by the board in reaching this conclusion). An alternative view prepared by Mr. Dacey proposes that the value of federal oil and gas resources and annual changes therein be reported as RSI for a three-year transition period and then disclosed as basic information in the notes, rather than recognized on the face of the financial statements. The notes would be part of an integrated disclosure that would include the discussion of all of the government's natural resources, including oil and gas resources that are not currently under lease as well as values and information concerning all other significant natural resources, such as coal, timber, and grazing rights. Do you agree or disagree with the alternative view (see paragraphs A89 through A92)? Please explain the reasons for your position in as much detail as possible.				

Quick Table of Responses by Question

#	Name	Organization	Category	Questions								
				1	2	3	4	5	6	7	8	9
1	Osman Masahudu	Forest Service	Federal – Preparer	O	O	--	D	--	--	--	--	--
2	Gerald Tucker	HUD - OCFO	Federal – Preparer	--	--	--	--	--	--	--	--	--
3	Robert Childree	AGA FMSB	Non-Federal – Other	A	A	D	A	A	A	A	A	D
4	Mark Easton	DOD - OCFO	Federal – Preparer	A	A	A	A	A	D	A	A	A
5	Stefan Silzer	EPA - OFM	Federal – Preparer	--	--	--	--	--	--	--	--	--
6	Jeanette Franzel	GAO	Federal – Auditor	A	A	A	A	A	D	A	O	A
7	Andrew Lewis	GWSCPA - FISC	Non-Federal – Other	A	A	O	A	A	A	A	O	D
8	Bert Edwards	Self	Federal – Preparer	O	A	A	A	A	D	A	O	A
9	Dan Fletcher	Dept. of Interior - CFO	Federal – Preparer	O	O	D	A	O	A	A	O	A

Agree – A	4	5	3	6	5	3	6	2	4
Disagree – D			2	1		3			2
Other – O	3	2	1		1			4	
No Comment – --	2	2	3	2	3	3	3	3	3

Overall Summary by Question

Information about the respondents' majority view is provided only as a means of summarizing the comments. Board members should consider the arguments in each response and weigh the merits of the points raised. (Note: The denominator for each topic is the number of respondents answering the related question with a yes or no. The denominator excludes those not addressing the topic or whose response was not a clear yes or no. Staff exercised judgment in determining whether a clear yes or no answer was provided.)

Two of the nine respondents did not provide comments on the ED. Of the remaining seven respondents:

- **Q1** – Of the seven respondents that commented on question 1, a **majority of respondents (4 of 7) agree** that federal entities should be provided with flexibility in developing the asset valuation estimation methodology. An additional respondent—the U.S. Department of the Interior (Interior)—agrees with the provision of flexibility with the caveat that a more detailed implementation guide be developed.
- **Q2** – Of the seven respondents that commented on question 2, a **majority of respondents (5 of 7) agree** with the board's selection of present value of future federal royalty receipts on proved reserves known to exist as of the reporting date as the preferred measurement method. An additional respondent—Interior—agrees with the preferred measurement method but notes that the proposed valuation from their field test questionnaire was based upon the Office of Management and Budget's (OMB) economic assumptions about future Treasury marketable security rates.
- **Q3** – Of the six respondents that commented on question 3, **half of respondents (3 of 6) agree** with the board's proposal to permit an alternative market-based fair value measurement consistent with FASB Financial Accounting Standards 157, *Fair Value Measurement*,² if it is not reasonably possible to estimate using present value. One of the respondents disagreed with the use of fair value based on FAS 157 because the oil and gas market is so volatile. A second respondent—Interior—agreed with the provision of an alternative measurement method but disagreed with the use of fair value based on FAS 157 because they do not think the asset should be measured at a market exit price since it is extremely unlikely that the asset would ever be sold.
- **Q4** – Of the seven respondents that commented on question 4, a **majority of respondents (6 of 7) agree** that federal entities should be permitted to change their methodology for valuing the federal governments estimated petroleum royalties if environmental or other changes would provide for the development of an improved methodology. One respondent disagreed on the basis that it could impair the government's ability to prepare consolidated financial statements for the federal government.

² FASB Accounting Standards Codification™ (ASC) 820.10

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- **Q5** – Of the six respondents that commented on question 5, a **majority of respondents (5 of 6) agree** that it would be appropriate to provide guidance regarding reporting gains and losses from changes in assumptions and selecting the discount rates similar to that provided in SFFAS 33. An additional respondent—Interior—agrees with the provision of guidance on reporting gains and losses with the caveat that a more detailed implementation guide be developed.
 - **Q6** – Of the six respondents that commented on question 6, **half of respondents (3 of 6) agree** with the disclosure requirements for oil and gas fiduciary activities. Two respondents disagree because they have cost / benefit concerns. One respondent disagrees partly because of cost / benefit concerns and partly because fiduciaries are generally not required by other standards-setters to value non-cash assets. It is important to note that Interior agreed with the disclosures and indicated that the information could be fairly readily reported.
 - **Q7** – Of the six respondents that commented on question 7, **all respondents (6 of 6) agree** with the three-year phase-in of information from required supplementary information (RSI) to basic. However, as noted in the summary of question 9 below, four of the six respondents would prefer that after the three-year phase-in period the information be presented as basic information in the notes rather than recognized on the face of the financial statements.
 - **Q8** – Of the six respondents that commented on question 8, there was not a consistent view among respondents. Two of the respondents agreed with the inclusion of paragraph 10 relating to other types of natural resources. One respondent does not believe that the standard provides enough detail to form a response. Another respondent prefers that the government explicitly require agencies to use valuation, accounting, and financial reporting methods consistent with the provisions of the final standard for all types of natural resources. Another respondent—Interior—provides some clarifying language that they believe would help fill a void in guidance that could lead to potentially inaccurate or inconsistent reporting.
 - **Q9** – Of the six respondents that commented on question 9, a **majority of respondents (4 of 6) agree** with the alternative view that after the three-year transition period as RSI, the value of federal oil and gas resources and annual changes be disclosed as basic information in the notes, rather than recognized on the face of the financial statements. One respondent disagreed with the alternative view because they support the eventual presentation of all natural resources on the face of federal financial statements. Another respondent disagreed with the alternative view on the basis that the quantity and value of oil and gas resources and related revenues and depletion expenses would be material to the financial statements of the entities reporting those items; therefore, the omission or misstatement of that information makes it probable that the judgment of a reasonable person relying on the information would have been changed or influenced.
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ATTACHMENT 2 – FULL TEXT OF ANSWERS BY QUESTION

Detailed Table of Answers and Comments by Question and by Respondents

<p>Question 1 – Valuation Flexibility</p> <p>The original exposure draft (ED) issued on May 21, 2007, contained detailed asset valuation implementation guidance for valuing federal oil and gas resources. As a result of feedback received from field testing efforts, the board has removed that detailed guidance from this revised ED and is instead proposing to provide federal entities with flexibility in developing the asset valuation estimation methodology due to the constantly changing economic and technical conditions. Do you agree or disagree with the board's position (see paragraphs 14 through 26, A47 and A48)? Please explain the reasons for your position in as much detail as possible.</p> <p>#</p>	
1	Forest Service agrees that the value of any given commodity is relative to supply and demand. It is difficult however, to determine the future value of oil and gas because there is a correlation between technical conditions and demand. It is possible that our reliance on oil and gas may be replaced by another resource (technological advancement) that is more efficient and environmentally friendly. (OTHER)
2	No comment (NO COMMENT)
3	The FMSB agrees as those federal entities who have been conducting asset valuation are in the best position to know what works for them and it would be too easy to omit a sound methodology. Trying to incorporate every valuation estimation methodology in use would make the document unwieldy. (AGREE)
4	The Department of Defense (DoD) concurs with this revision. We agree with the guidance proposed in the current Exposure Draft which provides agencies with the flexibility to determine appropriate and reasonable valuation methodologies. (AGREE)
5	No comment (NO COMMENT)
6	We agree with providing flexibility in the valuation estimation methodology. However, as discussed in our comments, we believe that such valuation information is more appropriately presented in the notes to the financial statements as part of an integrated disclosure of all federal natural resources rather than reported on the balance sheet. (AGREE)
7	FISC agrees with the flexibility provided in the current ED, and supports ongoing efforts by the FASAB to adopt 'principles-based' standards. FISC repeats our concerns expressed in our January 23, 2008 response to the initial ED (dated May 21, 2007) that actual journal entries are not necessary if properly described in the eventual standard. We believe that a FASAB Implementation Guide or Department of Treasury (Treasury) or Office of Management and Budget (OMB) directive should address journal entries to insure that entries meet Treasury's Standard General Ledger (SGL) requirements. (AGREE)
8	"Principles-based" accounting can - and undoubtedly will - produce enormous swings in the discounted present value of proven O & G [oil and gas] reserves for a number of reasons. We have already seen this in the "mark-to-market" experience in the past

Question 1 – Valuation Flexibility

two years for not readily salable securities.

(1) Currently, using the benchmark suggested of USG securities, most USG securities funds are earning less than 1% interest. This rate is extremely low due to the USG's various recession-fighting stimulus programs. Nobody believes that this low interest rate can or will continue. In fact many commentators are predicting substantial increases in the USG borrowing rate. The change in the discounted value with a change to, say, a 5-6% USG borrowing rate would cause a tremendous write-down in the value of discounted proven O & G reserves in future years.

(2) From time to time, the amount of royalties the USG collects and is remitted to states has changed. Currently, all states except Alaska receive 50% of all royalties (O&G and all other royalties), and Alaska gets 90%. Recent legislation increased the rates of royalties paid to adjacent coastal states for off-shore O & G royalties. Any changes in royalty rates will change the "phantom" estimated payable to states, perhaps substantially given the severe deficits facing all 50 states except Montana and North Dakota. With respect to amounts payable to the states for royalty sharing, I suspect that not a single state will report its "receivable" related to the estimated royalties payable by the USG.

(3) Proven reserves depend on the prevailing market rates for O & G. Market rates depend on the overall world economic status, the "find" rate of new reserves (gas rates are falling rapidly as new "finds" have occurred in the Appalachian states and elsewhere in the world, and oil rates may be impacted by the "find" recently announced by BP in the off-shore Gulf area southeast of Houston, TX). Technology could well reduce the cost to extract shale oil in the US west and the tar sands in Canada, both of which have estimates of oil (nobody knows if it is economically recoverable, but the tar sands are currently being extracted) greater than all proven reserves in the world according to some media reports. These swings are not controllable by the USG, but will impact the annual amounts of discounted O & G proven reserves.

(4) "Proven" can be immensely affected by uncontrollable situations such as hurricanes in the Gulf; local, state or Federal environmental laws and regulations; and, interruption of transportation (e.g., long-term pipeline damage via earthquake, flood, storm, or terrorism). I am not sure how this can be figured into the valuation methodology. **(OTHER)**

- 9 Interior generally agrees with the flexibility provided in developing the asset valuation estimation methodology, with the caveat that a more detailed implementation guide also be developed in the future. There are a number of details that, by their omission, could create a void in needed guidance that may prove problematic in the future. Additionally, over the years that the Statement has been under development, much research and verification has gone into the determination made by the board that EIA should be the authoritative source from which quantity information should be obtained. By crafting the Statement so that it no longer explicitly designates EIA as the source of quantity information, significant ambiguity could be cast upon preparers' decisions regarding valuation. Because the asset value will be a significant estimate, comprised of numerous assumptions, we believe the Statement should continue to explicitly designate EIA as the authoritative source for quantity information. We believe it is unlikely that EIA data as it currently is reported to the public will become unavailable in the foreseeable future. **(OTHER)**

Question 2 – Present Value Based on Interest Rates on Marketable Treasury Securities

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 as described in paragraphs 19 through 21. Discount rates as of the reporting date for present value measurements of federal 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. Do you agree or disagree with the board's position (see paragraphs 19 through 21 and A38 through A46)? Please explain the reasons for your position in as much detail as possible.

#	
1	Forest Service agrees we can estimate the value of royalties known to exist as of the reporting date. However, we need to take into consideration technical conditions that might have impact (positive or negative) on future values. (OTHER)
2	No comment (NO COMMENT)
3	The FMSB agrees as it is a reasonable basis, generally understood and already in widespread use throughout the federal government. Also, we found sample entries 6 through 11 in Appendix B to be very helpful with excellent explanations. (AGREE)
4	DoD concurs that the discount rate for any present value measurements of federal 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. DoD also concurs that the present value of future federal royalty receipts on proved reserves is an appropriate and reasonable valuation methodology, subject to the response to question 3. (AGREE)
5	No comment (NO COMMENT)
6	Yes, the method proposed for valuing estimated petroleum royalties allows sufficient flexibility in measurement methods and appears reasonable. Also, we caution that the board's current project on measurement attributes, when completed, may affect how requirements for applying measurement methods in current standards are applied. However, as discussed in our comments, we believe that such valuation information is more appropriately presented in the notes to the financial statements as part of an integrated disclosure of all federal natural resources rather than reported on the balance sheet. (AGREE)
7	FISC agrees with the current ED to require present value measurements as of the reporting date using discount rates from a common source, namely the marketable Treasury securities. Absent the explicit reference to a common source, FISC members expressed concerns that arbitrary or inconsistent determinations might be used by Federal agencies. As discussed in our response to questions 3 and 4, the current ED provides too much latitude by the preparers to use potentially contradictory methodologies for valuing natural resources. (AGREE)
8	I concur with the ED, but keep in mind that the Treasury borrowing rate can be influenced by many factors as included in the

Question 2 – Present Value Based on Interest Rates on Marketable Treasury Securities

	comment (1) to Question 1 above. (AGREE)
9	Interior generally agrees, although we had originally designed the valuation methodology to be based upon OMB's economic assumptions about future Treasury marketable security rates. (OTHER)

Question 3 – Alternative Measurement (Fair Value)

The board is proposing to permit an alternative measurement method 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 using the approach described in paragraphs 19 through 21. Specifically, the board is permitting a market-based fair value measurement consistent with the Financial Accounting Standards Board (FASB) Statement of Financial Accounting Standards 157, Fair Value Measurements. Do you agree or disagree with the board's position (see paragraphs 24 and A38 through A46)? Please explain the reasons for your position in as much detail as possible.

#	
1	No comment (NO COMMENT)
2	No comment (NO COMMENT)
3	The FMSB disagrees. We reviewed SFAS 157 and find that it is primarily designed for marketable securities. Oil and gas reserves would be a Level 1 asset, with an observable price. But we could not find any information on how to deal with volatile markets. Oil prices have varied between \$31 and \$126 in the past year alone, which is a 4:1 ratio. We did not see any guidance in SFAS 157 that helped determine what market price to use when the market is so volatile. It appears that the market price is arbitrarily set at the closing price on the last day of the fiscal year, which could be meaningless a month later. (DISAGREE)
4	<p>DoD concurs with this proposal. Specifically, we believe that either the present value of future federal royalty receipts or a market-based fair value measurement should be acceptable.</p> <p>However, we do not concur with the language currently in paragraph 24 of the Exposure Draft. This paragraph states that the alternative method described "may be acceptable if it is not reasonably possible" to estimate the present value of future federal royalty receipts on proved reserves. This language, especially the phrases "may be acceptable" and "not reasonably possible" does not clearly state that the alternative is acceptable while placing a high burden of proof on the agency before this alternative may be used. The basis for Conclusions indicates that the board considers either approach acceptable. If the intent of the board is that either approach is acceptable, then that intent should be clearly stated in the text of the standard. The presentation of limitations on the applicability of the alternate method merely creates opportunities for disagreements in judgment between preparers and auditors, which may effectively prevent the use of this alternative.</p>

Question 3 – Alternative Measurement (Fair Value)

	Again, DoD believes that either approach should be acceptable if adequately disclosed. This flexibility will be especially important if the provisions of the standard are applied to other less significant categories of natural resources as permitted by paragraph 10. (AGREE)
5	No comment (NO COMMENT)
6	Yes, the alternative method appears reasonable and allows sufficient flexibility for valuing federal estimated petroleum royalties if it is not reasonably possible to estimate present value of future federal royalty receipts on proved reserves using the methodology described in paragraphs 19-21. However, as discussed in our comments, we believe that such valuation information is more appropriately presented in the notes to the financial statements as part of an integrated disclosure of all federal natural resources rather than reported on the balance sheet. One of the reasons for our views is that such significant flexibility, in combination with paragraphs 25 and 26 of the ED, provides a potentially broad range of acceptable accounting bases and valuation methodologies and consequently is better presented in the notes to the financial statements. (AGREE)
7	FISC agrees that an alternative measurement method is appropriate due to the complexity and unique situations faced by different Federal agencies. However, FISC recommends that stronger or more explicit language be included in the final standard that would explain what circumstances or situations might make it 'reasonably possible' for a Federal agency to avoid use of the preferred measurement method. Further, FISC members advise that there is a significant disparity between the defined steps in the preferred measurement method and the open-ended reference in the ED to FASB's Statement of Financial Accounting Standards (SFAS) No. 157, Fair Value Measurements. FISC recommends that the final standard provide more definite reference to paragraphs, sections, or methods contained in SFAS No. 157 that would be acceptable to the board. (OTHER)
8	I concur with the ED. I do have concerns to citing FASB's SFAS 157 since it appears that this pronouncement will undergo continuing refinements, e.g., the recent FASB action to "soften" SFAS 157 for private commercial companies. (AGREE)
9	<p>Interior would generally agree with the latitude provided by permitting an alternative measurement method. However, in this instance we do not agree that measuring this federal asset using market based fair value is appropriate. We do not think the asset value should be measured at a market exit price, because it is extremely unlikely that it would ever be sold. Discounting at the public sector rate and valuing according to the expectation of future prices as proposed in the present value method is a much more accurate representation of the value of this federally owned asset.</p> <p>By adding this provision for alternative measurement using FAS 157, considerable uncertainty and potential inaccurate valuation has been explicitly added to the Statement, and expert respondents disagree with the premise.</p> <p>For example, FAS 157 provides for "Level 3 Inputs," being the lowest level in the allowable fair value hierarchy. Those inputs are considered 'unobservable inputs', and should be used to measure fair value when observable inputs are not available. They may be developed by the reporting entity, using its own data and reflecting the reporting entities own assumptions about the</p>

Question 3 – Alternative Measurement (Fair Value)

assumptions market participants would likely have in arriving at an exit price for the asset. Technically this could probably be done, but the valuation would be much less accurate or meaningful, potentially resulting in either a 'fire sale' or 'overvalued' estimate and greatly increasing the already volatile aspects of the asset value.

One must consider that the asset is comprised entirely of federally owned proved reserves. In practice, there is virtual certainty that volumes of oil and natural gas will be produced in the future, at least equal to the estimated volumes of proved reserves of oil and natural gas at any point in time. This is because new proved reserves are constantly being added as prospects are developed. Therefore, there is effectively a 100% chance that all proved reserves will eventually be produced, and there is no uncertainty on that matter. The only uncertainty would be the price in the future and how that production would emerge over time. If the government were to ever sell the assets, we would likely value them at today's price and discount them more or less heavily, to account for market risk, as FAS 157 suggests. But future cash flows from federally owned proved reserves are legislated, and thus not subject to risk factors otherwise found in the market and most importantly, the underlying assets are very unlikely to ever be sold.

Accordingly, Interior disagrees with adding the FAS 157 provision. We believe that the existing proposed present value methodology is the most appropriate measure for this unique federal asset. Also, this may have significant ramifications for other federally owned natural resources to which this Statement may be applied in the future. **(DISAGREE)**

Question 4 – Change in Methodology

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 paragraphs 25, 26 and A49 through A51)?

Please explain the reasons for your position in as much detail as possible.

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| 1 | Forest Service does not agree permitting federal entities to change their methodologies for valuing estimated federal petroleum royalties. FASAB needs to design a uniform standard methodology for the entire federal government in valuing estimated petroleum royalties. Allowing federal entities to use a different methodology could impair our ability to prepare consolidated financial statements for the federal government. (DISAGREE) |
| 2 | No comment (NO COMMENT) |
| 3 | The FMSB agrees. A change in accounting estimate that is effected by a change in accounting principle should be made only if the new accounting principle is justifiable on the basis that it is preferable from the viewpoint that the new accounting principle better captures the economic reality of the situation under consideration. That is, if an entity concludes that the pattern of consumption of the expected benefits of an asset has changed, and determines that a new depreciation method better reflects |

Question 4 – Change in Methodology

	that pattern, it may be justified in making a change in accounting estimate effected by a change in accounting principle. (AGREE)
4	DoD concurs with this proposal. Provided that adequate disclosure is made of the change in the accounting methodology, this proposal will ensure the presentation of the most meaningful information to users of financial reports. (AGREE)
5	No comment (NO COMMENT)
6	Yes, allowing a change in methodology is reasonable as long as the nature and reason for the change and its effect are properly disclosed. However, as discussed in our comments (including our response to question 4), we believe that such valuation information is more appropriately presented in the notes to the financial statements as part of an integrated disclosure of all federal natural resources rather than reported on the balance sheet. (AGREE)
7	FISC supports including the broad provisions of paragraph 25, allowing for an “improved methodology” based upon environmental or other changes. FISC believes that it is important that Federal agencies be provided the latitude to use the most accurate methodology for estimating future federal royalty receipts on proven reserves. (AGREE)
8	I concur with the ED. I do have concerns to citing FASB's SFAS 157 since it appears that this pronouncement will undergo continuing refinements, e.g., the recent FASB action to "soften" SFAS 157 for private commercial companies. (AGREE)
9	Interior agrees and appreciates the latitude to develop and provide the most accurate estimates possible. (AGREE)

Question 5 – Reporting Changes in Assumptions

The board believes that it would be appropriate to provide guidance regarding reporting gains and losses from changes in assumptions and selecting the discount rates similar to that provided 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, 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 20, 40, and A64 through A66)?

Please explain the reasons for your position in as much detail as possible.

1	No comment (NO COMMENT)
2	No comment (NO COMMENT)

Question 5 – Reporting Changes in Assumptions

3	The FMSB agrees. This will help government entities to provide better transparency, improve understandability of the reports by the interested stakeholders and provide guidance during times of high volatility. SFFAS 33 requires that gains and losses from changes in long-term assumptions used to estimate certain liabilities be displayed on the statement of net cost separately from other costs. The FMSB agrees that it would be appropriate to apply similar guidance similar to long-term assumptions about oil and gas in order to increase the usefulness of reported operating results when the volatility of projections might otherwise result in large variations in the valuation of oil and gas royalty revenues, oil and gas resource valuation and resulting gains and losses from year to year. Specific guidance and examples will provide continuity of guidance and procedures. (AGREE)
4	DoD concurs with the proposed guidance regarding reporting gains and losses from changes in assumptions. If the asset is to be presented on the Balance Sheet, the changes in asset value must be reflected in the financial statements, preferably on the Statement of Net Cost of Operations. These changes, although often material, are normally unrelated to the operation of the program. Clear disclosure of these amounts on the Statement of Net Cost would improve the quality of information provided to the user of the financial statements. (AGREE)
5	No comment (NO COMMENT)
6	It would be appropriate to present gains and losses from changes in long-term assumptions as a separate line item or items on the statement of net cost, if the valuation of oil and gas resources were placed on the balance sheet. However, as discussed elsewhere in this letter, we believe that such valuation information is more appropriately presented in the notes to the financial statements as part of an integrated disclosure of all federal natural resources rather than reported on the balance sheet. (AGREE)
7	FISC supports the financial statement presentation of gains and losses from changes in assumptions, but encourages the board to consider segregating unrealized gains and losses from operating results on the Statement of Net Cost. FISC believes that commingling unrealized gains and losses with operating results could confuse a reader of federal financial statements, and cause a reader to draw a false understanding of the annual operating costs or deficit of a Federal agency. The process of segregating unrealized transactions from operating results would parallel the board's proposal to separate the reporting of social insurance balances, as was proposed by the board in its recent exposure draft of a proposed standard, Accounting for Social Insurance, Revised. (AGREE)
8	I concur with the ED. I am very concerned that future Administrations may be encouraged to focus on the unrealized gains when interest rates decline, world market prices increase, new "finds" become "proven," or new technology permits previously uneconomic "finds" to now be extracted profitably and/or possible. The opposite focus on unrealized losses could well occur when the USG debt interest rates increase (a factor certainly sure to come during the next several years), "proven" reserves decline due to market price declines, increased environmental standards particularly in non-US areas, war or terrorism risks no longer sustaining continued extraction, etc. Thus, at least separating the unrealized gains and losses would decrease these

Question 5 – Reporting Changes in Assumptions

	tendencies. See response below to Question 9. (AGREE)
9	Interior agrees that this would be a reasonable approach in keeping with the similar development of a more detailed oil and gas implementation guide. (OTHER)

Question 6 – Fiduciary Activities

SFFAS 31, Accounting for Fiduciary Activities, requires that agencies report on assets held in a fiduciary capacity. The Department of Interior (DOI) manages oil and gas resources on behalf of individual Indians and Indian tribes. This proposed standard – because it classifies oil and gas resources as assets – would result in additional information being disclosed for oil and gas assets managed in a fiduciary capacity. Note, however, that fiduciary reporting does not extend to inclusion of the additional disclosures or RSI that are proposed in this document for federal oil and gas resources. Thus, with respect to fiduciary activities, only disclosure of the assets, liabilities, and related inflows and outflows would result from this proposal.

Some members have expressed concern that the costs may exceed the benefits of disclosing fiduciary assets and liabilities measured in conformance with this proposed standard. Since this proposal may significantly increase the fiduciary assets disclosed, we requested input on the cost-benefit of the requirement with respect to fiduciary activities in the May 2007 ED. One respondent was in favor of the disclosures while four expressed their opinion that the information would most likely not be cost-beneficial. However, the board has not received any substantive information to enable it to make an informed decision regarding cost/benefit.

Since the removal of the fiduciary oil and gas resource disclosure requirements would require an exception to the requirements of SFFAS 31, we are again requesting detailed input on the cost-benefit of the requirement with respect to fiduciary activities. See paragraph 46.

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1	No comment (NO COMMENT)
2	No comment (NO COMMENT)
3	The FMSB agrees from the viewpoint of maintaining consistency with SFFAS 31 and existing systems should make the cost benefit a moot point. However, we believe only those within DOI can provide the in-depth information or justification as to why the cost/benefit analysis would override providing the transparency to the individual Indians and Indian tribes who most benefit from disclosure of the information. (AGREE)
4	DoD does not concur with the proposal to report Fiduciary Natural Resource Assets. DoD does not see a benefit to this

Question 6 – Fiduciary Activities

	disclosure, since the data would be too summarized to provide meaningful information to fiduciary beneficiaries. However, since DoD does not have Fiduciary Natural Resource assets to report under this standard, the cost of developing that information cannot be estimated. (DISAGREE)
5	No comment (NO COMMENT)
6	We continue to have concerns about the costs versus the benefits of accumulating, preparing, and auditing information reported in the schedule of fiduciary activities. Requiring the Federal entities to disclose the value of oil and gas reserves for fiduciary activities will incur additional preparation and audit costs and result in information that is inconsistent with information currently reported to beneficiaries of these fiduciary activities. In addition, it will reflect only the value of reserves for which the entity has fiduciary responsibility, which may not represent all reserves owned by beneficiaries. For example, it would place a heavy burden on the Federal Government to put a value on what beneficiaries own. Therefore, for these reasons and the reasons discussed in the ED, such natural resources should be excluded from reporting as assets on the schedule of fiduciary net assets. Instead, fiduciary reporting of natural resources should consist of appropriate narrative describing the general nature and extent of such resources. (DISAGREE)
7	<p>FISC supports the current ED, which requires that assets, including oil and gas resources, which are held in a fiduciary capacity be reported in accordance with the provisions of SFFAS No. 31 using the valuation methods contained in the current ED (subject to the comments made in our answers to questions 3 and 4 above). Although we appreciate the concerns regarding cost-benefit considerations, comparability in reporting is vital, and inconsistently applied measurement methods for equivalent assets would be confusing to a reader of the financial statements.</p> <p>However, one of our members disagreed with this response. One member expressed concerns that there is no explanation in the ED as to why FASAB would depart from the private sector's recording of non-monetary assets held in trust, in accordance with the Uniform Principal and Income Act (the Act), which provides guidance on fiduciaries. According to this member, the Act is very clear that fiduciaries are responsible for assets received by them, but are not responsible for the value of non-cash assets (although they will normally report the value of readily marketable securities). Residences and real estate improvements, land and forestry holdings, and other assets are merely disclosed, but only rarely valued. Requiring U.S. government fiduciary funds to record the discounted value of proven reserves would be in conflict to practices under the Act and at odds with comparable fiduciaries outside of the United States Government. (AGREE)</p>
8	This is the ED requirement that I have the greatest concern with. Even though SSFAS 31 requires assets held in a fiduciary capacity to be reported, neither FASB (banks, investment companies, etc.) nor GASB generally require valuation of non-monetary assets. All 50 states and DC have adopted the principles of the Uniform Principal and Income Act, which provides guidance on fiduciaries. A few states already had incorporated the provisions of the Act in their laws prior to the first issuance of the Act, which is now in a second revised version. The Act is very clear that fiduciaries are responsible for assets received by them, i.e. initial transfer of assets, assets purchased during the trust existence, etc. Fiduciaries are not responsible for the value

Question 6 – Fiduciary Activities

of non-cash assets or even monetary assets not received (e.g., dividends and interest payments due, but not received), although they will normally report the value of readily marketable securities and disclose the non-receipt of investment returns. Residences and real estate improvements, land and forestry holdings, other assets are merely disclosed, but only rarely valued; in my consultations with commercial bank trust officials, almost all ask a depositor of non-monetary assets to waive any responsibility for current valuations due to the cost of such recurring appraisals. Requiring USG fiduciary funds (probably limited to Interior's two Indian Trust Funds) to record discounted value of proven reserves on land interests owned by individual Indians and Tribes will likely double the work of Interior. Further and importantly, there is no legal or fiduciary obligation of the USG to pay beneficiaries of the two Indian Trusts for such future discounted O & G royalties until they are received in cash. Currently - and for at least two years - Interior has regularly reported (1) land holdings and (2) "encumbrances" (i.e., surface and subsurface leases, rights-of-way, etc. on such holdings) in quarterly (individual Indians) and monthly (Tribes) fiduciary reports. This is what a private-sector fiduciary would do under the Act. These land holdings and any value for O & G (but excluding present value of surface farming and grazing leases, coal and other subsurface minerals) as well as monetary equivalent holdings are not the assets of the USG. While I am not an expert on commercial bank trust functions, I understand that their disclosures of asset holdings is limited to monetary equivalents and excludes non-monetary assets held in trust. Thus, I disagree with the ED in this respect since there is no explanation in the ED as to why FASAB would depart from the fiduciary practice in the private sector, which in almost all other respects requires all assets and liabilities to be recorded in the financial statements. **(DISAGREE)**

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| 9 | As with onshore proved reserves under federal domain, there is no authoritative published quantity information regarding oil and gas resources managed by Interior on behalf of individual Indians or Indian tribes. However, a similar method for estimating onshore proved reserves under federal domain could potentially be employed to estimate an asset value for this category of oil and gas reserves. Like the onshore federal value, it would be an estimate, subject to significant fluctuation and based upon numerous assumptions. Sufficient disclosure would be required to help readers understand amounts presented and their relationship to royalties ultimately received. By applying a similar methodology to the federal domain category, consistency could be fairly readily achieved. (AGREE) |
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Question 7 – Three-Year Phase-in

The board is proposing to provide a three-year phase-in of the proposed requirements from required supplementary information (RSI) beginning with fiscal year 2011 to basic in fiscal year 2014. This transitional period is being 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 51 and A87)? Please explain the reasons for your position in as much detail as possible.

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| 1 | No comment (NO COMMENT) |
|---|--------------------------------|

Question 7 – Three-Year Phase-in	
2	No comment (NO COMMENT)
3	The FMSB agrees as it allows sufficient time for any implementation questions to be addressed by the board, accommodates DOI's request and seems a reasonable phase-in period. (AGREE)
4	DoD concurs with the three-year phase in of the proposed requirements, as this phase-in period will permit agencies to test and refine asset valuation methodologies. This phase in period is necessary whether the information is presented in the basic Financial Statements, as proposed by the Exposure Draft, or in the Notes to the Financial Statements, as proposed by the alternative view. (AGREE)
5	No comment (NO COMMENT)
6	Phasing in the requirements is very important to the reporting of the oil and gas resources. However, for reasons discussed in our comments, we believe the value of federal oil and gas resources and annual changes therein should be disclosed as basic information in notes rather than recognized on the face of the financial statements. (AGREE)
7	FISC supports the proposed requirements of a phased-in reporting approach to allow key agencies sufficient time to address challenges in implementation of this ED, and to work with the auditors to develop an approach that allows for the agencies' methodologies to be reviewed by the auditors prior to inclusion in the basic financial statements or footnotes. (AGREE)
8	As indicated in Question Except for the FASAB ED's requirement for fiduciary funds, I agree with the ED. (AGREE)
9	Interior agrees with the three-year phase-in, and appreciates the additional time provided in the Statement to perform the significant and complex changes that will be necessary. Interior is optimistic that this should provide adequate time to resolve outstanding issues and should facilitate an orderly implementation to the Statement. (AGREE)

Question 8 – Paragraph 10 (Other Natural Resources)

This Statement addresses accounting for federal oil and gas resources only. While the board may address accounting for other types of natural resources at some point in the future, the majority of the members acknowledge that it is not likely that a project devoted to other categories of natural resources will be marked as a high priority at future agenda-setting sessions due to their lesser significance. As a result, while not explicitly encouraging agencies to recognize other categories of natural resources, the board included paragraph 10 to explicitly state that this Statement does not preclude entities from recognizing or otherwise reporting information about other types of federally-owned natural resources. Do you agree or disagree that the potential risk that the inclusion of paragraph 10 might lead to inaccurate or inconsistent reporting of other types of natural resources is outweighed by the potential benefits to financial statement users (see paragraphs 10, A9 and A10)? Please explain the reasons for your position in as much detail as possible.

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1	No comment (NO COMMENT)
2	No comment (NO COMMENT)
3	The FMSB does agree with the inclusion of paragraph 10 as the proposed standard needs to be specific in addressing the high-priority issues concerning accounting for federal oil and gas resources. We believe the issue of accounting for other types of natural resources, where material to the reporting entities, should be addressed as soon as practicable in the future, given the level of their significance. We have evidence that one agency had not updated some natural resource lease evaluations in over twenty years - which raises questions about its stewardship and the accuracy of its financial statements. It is likely that there are a number of smaller agencies with similar issues. Even a brief standard should address regular review and update of costing and valuation of all federal natural resources to ensure that the government is receiving fair remuneration. (AGREE)
4	<p>DoD concurs with the provision of paragraph 10 for other types of natural resource assets. This provision gives agencies the ability to recognize natural resource assets determined by the agency to be significant to the operations and financial position of the agency. The management and sale of Natural Resources are ancillary to most Federal agency missions and are generally immaterial to the agency from both a financial and operational stand point. Paragraph 10 gives management the responsibility for the determination of whether to recognize such assets. DoD believes this flexibility will result in presentation decisions most useful to users of Federal financial statements.</p> <p>In addition, DoD proposes that footnote disclosure of other types of Natural Resources in lieu of Balance Sheet recognition be clearly stated as permissible, even if this presentation (as described in the Alternative View) is not accepted for Oil and Gas Resources. (AGREE)</p>
5	No comment (NO COMMENT)

Question 8 – Paragraph 10 (Other Natural Resources)

6	We believe that the notes should have a comprehensive disclosure that would include an integrated discussion of all of the government's natural resources, including oil and gas resources that are not currently under lease as well as values and information concerning all other significant natural resources, such as coal, timber, and grazing rights. Such information should include, as appropriate, valuation of other types of natural resources under lease, unless they are not material. (OTHER)
7	<p>FISC understands the challenges faced by the board in balancing all of the matters on the board's agenda, and appreciates the concerns by board members that other projects will take precedence over additional standards covering other types of natural resources. However, FISC recommends that paragraph 10 include a statement that any additional types of natural resources reported by an agency use valuation, accounting, and financial reporting methods consistent with the provisions of the final standard, and that such methods be required for all types of natural resources.</p> <p>Further, FISC repeats our concerns expressed in our January 23, 2008 response to the initial ED that the board has not explained why capitalization is restricted solely for proved oil and gas resources, and why the reporting concept is not required for other "proven" assets (e.g., coal, uranium, gold, silver, zinc, and other metals, timber, other subsurface minerals, and even water). The ED, as written, provides no requirement or strong language to compel agencies to account for and report all "proven" resources. Absent such a requirement, the ED, as written, would not provide for a comprehensive reporting model for comparable assets. (OTHER)</p>
8	The ED does not require disclosures of estimated values of other natural resources - surface (timber, land itself), subsurface minerals, and even water itself. Therefore, it is not possible to form a concurring or disagreeing answer to this question. See answers to Question 1 above. Any expansion of the valuation to other types of natural resources should be essentially in concurrence with the O & G RSI and/or basic disclosures. (OTHER)
9	<p>Interior appreciates the latitude that the board is seeking to provide in this paragraph and believed that it aids in acknowledging the potential treatment of other natural resources. With some related clarification, it could substantially help to resolve potential confusion and help to ensure consistent reporting. However, as it is presented, it illustrates a significant void in authoritative guidance which inherently facilitates the risk of potentially inaccurate or inconsistent reporting.</p> <p>First, Interior believes that to remove any ambiguity in the intent of the paragraph, it should also indicate that application of the Statement is not mandatory for other federal natural resources. For example,</p> <p>"This statement does not preclude, <u>nor does it require,</u> entities recognizing or otherwise reporting information about other types of federally-owned natural resources."</p> <p>Second, the current Exposure Draft guidance on accounting for federal oil and gas assets is quite different from FASB guidance covering oil and gas accounting in the private sector. This was emphasized in the response to Question 3 regarding the application of a private sector standard to a federally owned asset such as oil and gas. To ensure that preparers and auditors</p>

Question 8 – Paragraph 10 (Other Natural Resources)

understand the relationship and application of this federal oil and gas Statement to other types of federal natural resources, we recommend that paragraph 10 be expanded to incorporate the intent from paragraph A10 into the formal governing Statement;

“...this Statement should be considered when applying SFFAS 34, *The Hierarchy of Generally Accepted Accounting Principles, Including the Application of Standards Issued by the Financial Accounting Standards Board*, to other types of federal natural resources.”

Third, paragraph 10 as presented creates a dichotomy for preparers and auditors in that there are numerous types of federal natural resources for which no significant costs are incurred in the production of revenue, such as coal royalties, or revenues from renewable resource leases. Accordingly, the preparer must infer that SFFAS 7 applies to these resources. SFFAS 7, paragraph 45 as proposed, contains the ‘custodial’ provision for circumstances where there is no significant cost incurred to earn exchange revenue. Interior believes that the Statement should provide clarifying guidance to determine when to apply this ‘custodial’ provision to natural resources, or if it should always apply when there is no significant cost incurred.

For example, with certain renewable energy revenues derived from technologies such as geothermal, wind, wave, or current, there is not a ‘depletable asset’ for which a depletion expense could be matched against revenue earned. Similar to the auction of the radio spectrum, addressed in the revised SFFAS 7 paragraph 45, there are virtually no costs incurred in connection with earning this revenue. Interior interprets this to mean that for these types of ‘non-depletable’ activities, custodial accounting would still apply under SFFAS 7. Because other federal natural resources cases may not be so clear cut and to assist preparers and auditors, Interior believes that the guidance in the Statement should clarify if or when certain characteristics such as depletion could or should determine if custodial provisions apply, or if they should always apply when no significant costs are incurred.

The obvious result is that for commodities such as coal, which is a depletable natural resource, custodial accounting may or may not apply, depending on whether SFFAS 7 includes depletable natural resources. If not covered, then by default it would be required to be valued and accounted for in a manner similar to federal oil and gas. The ‘optional’ clause in paragraph 10 would be moot. If the board intends that custodial accounting would apply, regardless if a natural resource is depletable or not, Interior recommends that this be explicitly stated in SFFAS 7, or the oil and gas Statement or implementation guide, to aid preparers and auditors in the proper and consistent treatment. **(OTHER)**

Question 9 – Alternative View (Note Disclosure)

After a three-year transition period of reporting as RSI, the ED proposes to recognize an asset on the balance sheet for the federal government's royalty share of federal oil and gas resources under lease (see paragraphs A29 through A37 for a discussion of factors regarding asset recognition considered by the board in reaching this conclusion). An alternative view prepared by Mr. Dacey proposes that the value of federal oil and gas resources and annual changes therein be reported as RSI for a three-year transition period and then disclosed as basic information in the notes, rather than recognized on the face of the financial statements. The notes would be part of an integrated disclosure that would include the discussion of all of the government's natural resources, including oil and gas resources that are not currently under lease as well as values and information concerning all other significant natural resources, such as coal, timber, and grazing rights. Do you agree or disagree with the alternative view (see paragraphs A89 through A92)? Please explain the reasons for your position in as much detail as possible.

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1	No comment (NO COMMENT)
2	No comment (NO COMMENT)
3	<p>The Introduction to the Exposure Draft states "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. [interpretive note: largely depletion]"</p> <p>We accept that the quantity and value of those assets and the royalty revenues, and [depletion] expenses that will be recognized for the asset exchanged to produce those revenues, would be material to the Financial Statements of the entities reporting those items (the omission or misstatement of that 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.)</p> <p>On that basis we disagree with the alternative view and agree with the ED proposal that the federal government's royalty share of federal oil and gas resources under lease be recognized as an asset on the balance sheet (after the 3 year transition period). However, to address the legitimate issues that Mr. Dacey has raised, we think that a discussion of all of the government's natural resources, including oil and gas resources that are not currently under lease as well as values and information concerning all other significant natural resources, such as coal, timber, and grazing rights should be provided in the Notes to the Financial Statements. We support the FASAB addressing issues of accounting for natural resources additional to those addressed by the current Exposure Draft as soon as practicable in the future, given the level of their significance. We are concerned that treating those additional natural resources only by note disclosure gives them the character of "contingent assets," while we do not believe they meet the criteria of being contingent, and that reliable estimates of their value can and should be made, with appropriate disclosure as to the methodology used. (DISAGREE)</p>
4	DoD concurs with the alternative view, including the transition period and footnote disclosure of the asset in lieu of Balance Sheet

Question 9 – Alternative View (Note Disclosure)

recognition of Natural Resource assets. While Balance Sheet recognition improves information available to users of financial statements regarding the assets managed by the agency, this recognition has a negative impact on the Statement of Net Cost (SNC). Specifically, the SNC is impacted by periodic changes in recognized value of the asset, distorting the activity resulting from the activities of the agency. These changes result from changes in interest rates and changes in amounts considered to be “proved reserves” offset by resources extracted and sold. Disclosure of Natural Resource assets in the Notes to the Financial Statements in lieu of Balance Sheet recognition would provide users of financial statements information regarding the value of the assets without the corresponding negative impact on the SNC. **(AGREE)**

5 No comment **(NO COMMENT)**

6 As discussed in the ED, we believe that the value of federal oil and gas resources and annual changes therein, consistent with the valuation basis discussed in the ED, should be disclosed as basic information in the notes rather than recognized on the face of the financial statements as proposed in this ED. The disclosures should include an integrated discussion of all of the federal government's natural resources, including oil and gas resources that are not currently under lease as well as values for resources under lease and similar information concerning all other significant federal natural resources, such as coal, timber, and grazing rights. This type of reporting would be similar to current reporting for stewardship assets. Such reporting in the notes would provide transparency as to the value and changes in value of these significant assets and result in information that contributes to meeting federal financial reporting objectives. As basic financial information, this information would be subject to audit. Similar to stewardship assets, FASAB could require a nonfinancial disclosure on the balance sheet that refers to the note without an asset dollar amount being shown.

The ED includes a discussion of the reasoning for reporting this information in the notes in paragraph A91. In summary,

- financial statement users should clearly understand the full extent of natural resources that are owned by the federal government and the valuation of the resources that are currently under lease and not be potentially misled by an amount on the balance sheet that represents only a portion of the federal government's natural resources,
- the current recognition of oil and gas royalties at the time of extraction when royalties are receivable relates the revenues to the period benefited and are matched with related costs incurred by the federal government; also, bonus bid and rent are recorded when receivable,
- the valuation of oil and gas resources is subject to significant annual fluctuations based on changing market prices for the resources and changes in quantities based on recoverability; such fluctuations would affect the federal government's net cost and net operating cost (thereby reducing the usefulness of reported operating results of the government's operations during the year); and the valuation would not likely reflect the value of the royalties to be received in future periods, and
- in addition to significant uncertainty inherent in the valuation methodology, the ED provides for significant flexibility in the basis used to calculate the valuation; consequently, such less certain information would be more appropriately reflected in

Question 9 – Alternative View (Note Disclosure)

	<p>the notes to the financial statements.</p> <p>Further, publicly traded enterprises that have significant oil and gas producing activities are required to disclose information on proved oil and gas reserve quantities and discounted future net cash flows as supplementary information, rather than record them on the balance sheet. (AGREE)</p>
7	<p>FISC supports the eventual presentation of natural resources on the face of federal financial statements. However, FISC repeats our concerns, expressed in response to question 8 above, that FASAB has not yet explained, in sufficient detail, its position of restricting capitalization to proved oil and gas resources and not mandating reporting of other types of natural resources. Selective recognition of assets by Federal agencies impairs the value of Federal financial reporting, and limits the usefulness of information contained within agency financial statements and the Consolidated Financial Report of the United States Government. (DISAGREE)</p>
8	<p>Since nobody "owes" the USG for discounted future proven O & G royalties, I concur with the minority view of Mr. Dacey. (AGREE)</p>
9	<p>Interior believes that this significant asset would best be disclosed as basic information in the notes, consistent with the approach recently expressed by Mr. Dacey in the alternative view. Interior believes that the board's objectives of enhanced accountability and increased information about the asset can be more efficiently and effectively achieved by disclosing the information in the notes rather than on the face of the financial statements.</p> <p>The proposed Statement as presented in the ED will require extensive and costly changes to existing Interior (specifically Minerals Management Service (MMS)) business processes, system requirements, and accounting events. These significant changes, impacts, and costs were presented in the previous field test questionnaires. Interior believes that the potential benefits of reporting depletion expense and the gain or loss on revaluation on the Statement of Net Cost do not provide the reader with more meaningful information than could be obtained through disclosure, and in fact may be confusing.</p> <p>For example, due to volatility in prices, quantity estimate revisions, and other factors, recording gains and losses on net cost may potentially mislead readers. In the MMS field test study, although the overall asset value declined over a year period, depletion expense recorded in the year exceeded the difference in the ending valuation, and required a gain on revaluation to be recorded. This gain would likely be misleading to the general reader, and renders the utility of the information questionable. Interior believes that disclosures regarding the asset valuation and royalties reported over a given span of time, combined with a discussion and presentation of any theoretical change due to revaluation of the estimated asset, would provide a clearer picture and would much more efficiently and cost effectively meet the board's objectives. (AGREE)</p>

Listing of Additional Comments from Respondents

#	Comment
1	One consideration that Forest Service did not see mentioned in the Exposure Draft is the impact of asset value due to legal or management constraints that limit or preclude access to those reserves. For example, Congress recently withdrew the Wyoming Range from all forms of mineral entry and thereby put trillions of cubic feet of gas off limits. As such it could be argued that there is no value for that resource. The Energy Policy and conservation Act mandated a study "Scientific Inventory of Onshore Federal Lands' Oil and Gas Resources and Reserves and the Extent and Nature of Restrictions' or Impediments to Their Development" which evaluated the effects of management constraints have on resource accessibility. Therefore, Forest Service is uncertain how those aspects can be reflected in the asset value of "proven reserves."
1	Another area that needs consideration is that, USSGL posting models and general ledger accounts are not mentioned anywhere in the draft. For example, transfer accounts or receipts between DOI and U.S Forest Service. U.S Forest Service needs to know the general ledger account to use to transfer funds between Forest Service and DOI and vice versa. It is explicit in the draft that transfer receipts would no longer be revenue to the recipient agency after the implementation of this draft however, transfer receipts would be treated as financing source instead of revenue to the recipient agency. U.S Forest Service needs to know what general ledger account to use, to record this transaction so that appropriate posting models as well as cross-walk would be established in our financial accounting system to handle the change.
4	<p>Overall, we agree with the valuation methodologies proposed in the Exposure Draft. We believe the proposed changes will improve the reporting of this revenue in Federal financial reports.</p> <p>We do, however, prefer the proposed alternative view in which the asset is disclosed in the notes to the financial statements in lieu of balance sheet recognition. Further, we believe that this Exposure Draft provides a reasonable foundation for the reporting of other types of natural resources assets.</p>
6	The FASAB's current efforts and deliberations on the presentation of oil and gas resources are an important step in recognizing the need for greater transparency in connection with the federal government's current financial condition and future fiscal path.
6	Consistent with the alternative view in the ED, we believe that the notes to the financial statements should include an integrated disclosure of all of the federal government's natural resources, including information on the value of resources under lease and changes therein, rather than recognize on the balance sheet only those resources that are valued because they are under lease. In addition, natural resources should be excluded from reporting on the schedule of fiduciary net assets.
7	In paragraph 21, FISC recommends that the phrase "why it is inappropriate to do so" should be replaced with something akin to "why the entity's own assumptions are a preferred method."

#	Comment
7	In paragraph 28, it is unclear why only expected payments of royalties to non-federal entities are recognized. Consideration should be given to the disclosure of expected payments of royalties to other federal components.
8	<p>I have an overriding comment on recording the present valuation of proven O & G reserves at a discounted value, using the apparently much favored "principles-based" accounting approach,</p> <p>(1) Oil and gas are not the only "proven" assets that the USG owns. How about "hard rock" minerals (coal, uranium and many other metals - gold, silver, etc., aggregates, timber, etc.)? How could the officials of an USG agency or its auditor agency concur that the financial statements are "fairly presented" when such other similar future recoverable assets are ignored? Timber alone would be the most significant asset of the US Forest Service, part of the US Department of Agriculture, and perhaps for the overall USDA. Present value of all the land held by various Interior agencies (Land Management, Reclamation, National Parks, Fish and Wildlife), USDA (Forrest Service), DOD (military installations), etc., is only valued is purchased relatively recently in the USG's history. Certainly, nobody would question the value of the purchase of Alaska ("Seward's Folly") in today's economy; the gold alone extracted from Alaska more than equaled its purchase price from Russia, and the continuing value of, O & G, gold and other metals, salmon fishery, and tourism value make this one of the most fortuitous purchased in our history. Consider the value of the Louisiana Purchase.</p> <p>(2) Practically all other future revenue streams of the USG, income taxes among them, are estimable with likely the same accuracy as discounted O & G proven reserves. I do not see any discussion why O & G are singled out for valuation and other assets are not. Disclosures now required for Social Security liabilities are net of the estimated FICA taxes to be paid by future workers and matching employer amounts.</p> <p>In summary, unless there is a total re-visiting of assets of the USG, recording the estimated discounted value of proven O & G reserves seems to be "counting the chickens before the eggs are laid."</p>
8	"Bottom Line" - In informal chats with USG and private sector individuals interested in FASAB GAAP, the overall conclusion is that FASAB may be "reaching" for assets to offset the increasingly accumulating deficit. Almost all the liabilities reported by the USG in its CFS have basis in fact, only the recording methodology may be arguable. Discounted proven O & G reserves seems to stand out as a potential asset, but subject to a multiplicity of uncontrollable factors, including some day the elimination of continuing to burn carbon fuels due to global warming treaties.
9	Overall, the U.S. Department of the Interior agrees with the intent of the proposed Statement, to enhance accountability and transparency, and provide readers of the Federal financial reports with greater information about the quantity and estimated value of assets that generate cash to finance government operations over time.

ATTACHMENT 3 – STAFF ANALYSIS AND RECOMMENDATIONS

Staff has summarized and analyzed the responses to the questions for respondents as well as other comments received. The staff's summary is intended to support your consideration of the comments and not to substitute for reading the individual letters. When feasible, staff provides a recommendation in response to issues identified.

Issue 1: Recognition in Financial Statements versus Disclosure in Notes

Respondents' Views

The majority of respondents (4 of 6) agreed with the alternative view that the value of federal oil and gas resources and annual changes therein be reported as RSI for a three-year transition period and then disclosed as basic information in the notes, rather than recognized on the face of the financial statements. The notes would be part of an integrated disclosure that would include the discussion of all of the government's natural resources, including oil and gas resources that are not currently under lease as well as values and information concerning all other significant natural resources, such as coal, timber, and grazing rights.

The reasons given by respondents for supporting the alternative view are as follows:

- While Balance Sheet recognition improves information available to users of financial statements regarding the assets managed by the agency, this recognition has a negative impact on the Statement of Net Cost (SNC). Specifically, the SNC is impacted by periodic changes in recognized value of the asset, distorting the activity resulting from the activities of the agency. These changes result from changes in interest rates and changes in amounts considered to be "proved reserves" offset by resources extracted and sold. Disclosure of Natural Resource assets in the Notes to the Financial Statements in lieu of Balance Sheet recognition would provide users of financial statements information regarding the value of the assets without the corresponding negative impact on the SNC (**comment letter #4**).
- As discussed in the ED, we believe that the value of federal oil and gas resources and annual changes therein, consistent with the valuation basis discussed in the ED, should be disclosed as basic information in the notes rather than recognized on the face of the financial statements as proposed in this ED. The disclosures should include an integrated discussion of all of the federal government's natural resources, including oil and gas resources that are not currently under lease as well as values for resources under lease and similar information concerning all other significant federal natural resources, such as coal, timber, and grazing rights. This type of reporting would be similar to current reporting for stewardship assets. Such reporting in the notes would provide transparency as to the value and changes in value of these significant assets and result in information that contributes to meeting federal financial reporting objectives. As basic financial information, this information would be subject to audit. Similar to stewardship assets, FASAB could require a nonfinancial disclosure on the balance sheet that refers to the note without an asset dollar amount being shown.

The ED includes a discussion of the reasoning for reporting this information in the notes in paragraph A91. In summary,

- financial statement users should clearly understand the full extent of natural resources that are owned by the federal government and the valuation of the resources that are currently under lease and not be potentially misled by an amount on the balance sheet that represents only a portion of the federal government's natural resources,
- the current recognition of oil and gas royalties at the time of extraction when royalties are receivable relates the revenues to the period benefited and are matched with related costs incurred by the federal government; also, bonus bid and rent are recorded when receivable,
- the valuation of oil and gas resources is subject to significant annual fluctuations based on changing market prices for the resources and changes in quantities based on recoverability; such fluctuations would affect the federal government's net cost and net operating cost (thereby reducing the usefulness of reported operating results of the government's operations during the year); and the valuation would not likely reflect the value of the royalties to be received in future periods, and
- in addition to significant uncertainty inherent in the valuation methodology, the ED provides for significant flexibility in the basis used to calculate the valuation; consequently, such less certain information would be more appropriately reflected in the notes to the financial statements.

Further, publicly traded enterprises that have significant oil and gas producing activities are required to disclose information on proved oil and gas reserve quantities and discounted future net cash flows as supplementary information, rather than record them on the balance sheet. **(comment letter #6)**

- Since nobody "owes" the USG for discounted future proven O & G royalties, I concur with the minority view of Mr. Dacey. **(comment letter #8)**
- Interior believes that this significant asset would best be disclosed as basic information in the notes, consistent with the approach recently expressed by Mr. Dacey in the alternative view. Interior believes that the board's objectives of enhanced accountability and increased information about the asset can be more efficiently and effectively achieved by disclosing the information in the notes rather than on the face of the financial statements.

The proposed Statement as presented in the ED will require extensive and costly changes to existing Interior (specifically Minerals Management Service (MMS)) business processes, system requirements, and accounting events. These significant changes, impacts, and costs were presented in the previous field test questionnaires. Interior believes that the potential benefits of reporting depletion expense and the gain or loss on revaluation on the Statement of Net Cost do not provide the reader with more meaningful information than could be obtained through disclosure, and in fact may be confusing.

For example, due to volatility in prices, quantity estimate revisions, and other factors, recording gains and losses on net cost may potentially mislead readers. In the MMS field test study, although the overall asset value declined over a year period, depletion expense recorded in the year exceeded the difference in the ending valuation, and required a gain on revaluation to be recorded. This gain would likely be misleading to the general reader, and renders the utility of the information questionable. Interior believes that disclosures regarding the asset valuation and royalties reported over a given span of time, combined with a discussion and presentation of any theoretical change due to revaluation of the estimated asset, would provide a clearer picture and would much more efficiently and cost effectively meet the board's objectives.

(comment letter #9)

Two respondents disagreed with the alternative view. The reasons given by respondents for rejecting the alternative view are as follows:

- The Introduction to the Exposure Draft states "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. [interpretive note: largely depletion]"

We accept that the quantity and value of those assets and the royalty revenues, and [depletion] expenses that will be recognized for the asset exchanged to produce those revenues, would be material to the Financial Statements of the entities reporting those items (the omission or misstatement of that 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.)

On that basis we disagree with the alternative view and agree with the ED proposal that the federal government's royalty share of federal oil and gas resources under lease be recognized as an asset on the balance sheet (after the 3 year transition period). However, to address the legitimate issues that Mr. Dacey has raised, we think that a discussion of all of the government's natural resources, including oil and gas resources that are not currently under lease as well as values and information concerning all other significant natural resources, such as coal, timber, and grazing rights should be provided in the Notes to the Financial Statements. We support the FASAB addressing issues of accounting for natural resources additional to those addressed by the current Exposure Draft as soon as practicable in the future, given the level of their significance. We are concerned that treating those additional natural resources only by note disclosure gives them the character of "contingent assets," while we do not believe they meet the criteria of being contingent, and that reliable estimates of their value can and should be made, with appropriate disclosure as to the methodology used. **(comment letter #3)**

- FISC supports the eventual presentation of natural resources on the face of federal financial statements. However, FISC repeats our concerns, expressed in response to question 8 above, that FASAB has not yet explained, in sufficient detail, its

position of restricting capitalization to proved oil and gas resources and not mandating reporting of other types of natural resources. Selective recognition of assets by Federal agencies impairs the value of Federal financial reporting, and limits the usefulness of information contained within agency financial statements and the Consolidated Financial Report of the United States Government. **(comment letter #7)**

Board Deliberations

When the board was deliberating on the exposure draft, members discussed recognition in the financial statements versus reporting as RSI. However, the specific option of disclosure in the notes to the financial statements was not part of recent discussions. Mr. Dacey's preference for disclosing the value of oil and gas resources in the notes to the financial statements did not arise until he presented an alternative view during the balloting of the ED.

Furthermore, the vote between RSI and basic (meaning recognition in the financial statements) was extremely close as evidenced by the following excerpt from the April 2009 meeting minutes (staff is including the full excerpt of the April 2009 discussion on flexibility and transition to basic because it shows how divided the board was in its opinion regarding RSI versus basic and is therefore important to the discussion and staff's recommendation):

Par. 24 Valuation Flexibility

Ms. Ranagan stated that she received a strong objection from Mr. Patton to the valuation flexibility permitted by par. 24 of the draft ED combined with the planned transition to basic. Ms. Ranagan suggested discussing the par. 24 valuation flexibility issue first if there were no objections from the members. Mr. Dacey asked if the members had discussed whether they were comfortable with fair value as an appropriate measurement basis for natural resources. Ms. Ranagan responded that the members had not discussed that and it would be part of the current discussion.

Mr. Allen asked for clarification of the distinction the issue paper is making between present value (PV) and fair value (FV). He noted that in his experience PV is one method for measuring FV but staff's issue paper and the ED seem to separate the two. The ED refers to PV or FV while he believes it should be framed as PV or "some other method for valuing FV."

Ms. Ranagan explained that the ED refers to PV or FV because the FAS 157³ approach to fair value approximates an exit value including assumptions about market risk while the PV approach in the ED specifically requires a risk-free discount rate. Therefore, the PV approach in the ED is not technically consistent with FAS 157 because of the use of an entity-specific risk free rate. Ms. Ranagan noted that staff would clarify the wording in the next draft.

³ Financial Accounting Standards Board Statement of Financial Accounting Standards (FAS) 157, Fair Value Measurements

Ms. Ranagan teed up the valuation flexibility issue for discussion by briefly summarizing the project's history regarding valuation guidance. Ms. Ranagan explained that the May 2007 ED provided very detailed valuation and implementation guidance. The Department of the Interior field tested the proposed guidance during the comment period and raised significant issues, particularly with the lack of available data required to comply with the standard. The field test team recommended a PV approach to measuring estimated petroleum royalties. The December 2008 revised draft ED contained the following more principles-based approach to valuation which allowed for the PV approach proposed by the field test team or the QxPxR⁴ formula exposed in the May 2007 ED as well as other methodologies:

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.

At the December 2008 meeting, a majority of the board members supported the PV approach proposed by the field test team but requested that staff remove the explicit reference to the QxPxR formula and soften the language to allow more flexibility.

Ms. Ranagan explained that staff had drafted the following valuation paragraph that provided broad flexibility that was included in the February briefing materials but natural resources was not discussed by the board at the February meeting due to the board's focus on long-term projections and social insurance:

The preferred measurement method for valuing the federal government's estimated petroleum royalties is the present value of future federal royalty receipts on proved reserves; however, another methodology may be acceptable if it is not reasonably possible to estimate present value.

Ms. Ranagan explained that since that time, Messrs. Dacey and Patton have expressed significant concern about providing both broad flexibility and a transition to basic information. To help alleviate those concerns, staff drafted the following paragraph that was included in the current revised draft ED:

The preferred measurement method for valuing the federal government's estimated petroleum royalties is the present value of future federal royalty receipts on proved reserves as provided in pars. 20 through 23; however, methods for measuring fair value may be acceptable if it is not reasonably possible to estimate present value.^[FN]

^[FN] FAS 157, *Fair Value Measurements*, provides a framework for measuring fair value.

Ms. Ranagan stated that, due to the significant concerns raised by Messrs. Dacey and Patton, staff would like the board to consider the compromise offered in the above paragraph which limits the valuation flexibility to the present value approach proposed in the ED and FAS 157 fair value measurement approaches. Ms. Ranagan directed the board's attention to the screen that displayed a graphic for recording the member's

⁴ quantity X price X rate (estimated quantity of proved oil and gas reserves under federal lands times the average first purchase price for oil or average wellhead price for gas times the effective average royalty rate by region)

responses in one of the following four quadrants:

- I – Flexibility / Transition to Basic
- II – Flexibility / RSI Indefinitely
- III – Limit to PV + FV / Transition to Basic
- IV – Limit to PV + FV / RSI Indefinitely

Ms. Ranagan noted that at the December board meeting, the majority of the members were in quadrant I, meaning the majority supported broad flexibility with a transition to basic after three years.

Mr. Allen asked if someone had asked for formal reconsideration of the issue. Ms. Ranagan responded that Messrs. Dacey and Patton had not requested a formal reconsideration; staff was proposing the issue for reconsideration because staff feels the concern is significant enough that it would lead to an alternative view. Ms. Ranagan noted that staff would like the board to either reaffirm its decision or come to a compromise that would avoid the need for an alternative view.

Mr. Farrell requested that Messrs. Dacey and Patton express their concerns to the group in more detail before he associates himself with a box.

Mr. Dacey responded that the language in the February revised draft ED provided substantial flexibility by permitting present value or, paraphrasing, “anything else you think is a good idea.” Mr. Dacey said he thought that was not a workable standard if it became basic information, that there should be a more discrete, specific standard for basic information. Mr. Dacey explained that he believes the flexibility is necessary because he does not believe the board will know exactly what can be delivered until DOI actually delivers it. Mr. Dacey said he thinks there should be flexibility because it is a new area and no one really understands what can be provided until they get into the details of the numbers and audit them. Mr. Dacey said going to FV expands that window of being flexible yet having a standard, but he is still concerned that the model that DOI can actually implement may be something other than FV. Mr. Dacey said he appreciates the move to FV because it broadens the flexibility while still having a standard, but he still has some concerns, although they are not as large as they were before.

Mr. Patton agreed with Mr. Dacey’s summary.

Mr. Allen asked Mr. Patton if he agreed with Mr. Dacey that he was less concerned about the transition to basic if the alternatives were limited to FV. Mr. Patton responded that he would be except that FV does not seem to be included in the underlying conceptual development of the standard. He said FV is only mentioned once the reader gets to par. 24 so he would expect to see some central development as to why FV is appropriate and then see PV as a recognized way of estimating FV. Mr. Patton said the ED is the reverse; it states PV and then attaches FV in passing.

Mr. Allen asked Ms. Ranagan to address Mr. Patton’s concern – why was the order reversed? Ms. Ranagan responded that the order was reversed because the board had supported the PV approach proposed by the DOI field test team and additional methods

for valuing FV via a FAS 157 approach was proposed by staff to limit the valuation flexibility. Ms. Ranagan noted that Mr. Patton is conceptually correct – PV does flow from FV.

Ms. Payne clarified that the draft ED is very explicit about the discount rate (“interest rates on marketable Treasury securities”), noting that while PV with that specified discount rate might fit the board’s notion of FV when it defines FV, use of an entity-specific risk-free discount rate does not fit FASB’s definition of FV because risk is part of the equation. If one does a PV calculation under FAS 157, one must consider the exit value for market participants; it makes a fairly sizable difference in most cases. Ms. Payne stated that since FASAB does not have its own definition of FV, which she believes FASAB should considering how the government interacts with the marketplace, she would not espouse the view that the PV approach proposed in the ED using the risk-free discount rate is FV.

Mr. Dacey said that if the PV approach proposed in the ED is not FV because of the use of a risk-free discount rate, the ED should clarify that the valuation alternatives would be limited to the proposed PV approach **or** FV. Staff stated that the alternatives would be clarified in the next draft.

Mr. Allen stated there is a general belief in the world that PV is a method of FV; therefore, staff needs to do a lot of work to develop this distinction in the ED starting with the summary and working throughout the document including in the standard and the basis for conclusions.

Ms. Payne responded that it is only the use of an entity-specific, risk-free discount rate that makes the proposed PV approach in the ED inconsistent with the FAS 157 definition of FV, not the concept of discounted cash flows. She said that staff could work on coming up with a term for that type of PV such as risk-free PV or entity-specific PV or something that would distinguish it from FV.

Mr. Allen said that the ED needs to be clearer to eliminate the confusion that he found every time he kept reading “PV or FV.” Ms. Payne replied that staff will clarify.

Mr. Dacey said he remains in quadrant II because he thinks the standard provides too much flexibility to become basic information. Mr. Dacey said he thinks the board should review what DOI comes up with and determine if it is acceptable and then issue a standard that makes it basic information.

Mr. Patton said staff’s recommendation was creative but it did not work for him; he would also be in quadrant II with Mr. Dacey.

Mr. Allen said he is less hung up on the methods than he is on the transition. He is concerned, like others, that if the standard does not say that it will become basic information, nothing will happen. Mr. Allen said later having to delay the transition to basic information would be preferable to leaving it as RSI indefinitely.

Mr. Patton proposed deleting the last two lines in par. 24 – “however, methods for measuring fair value may be acceptable if it is not reasonably possible to estimate

present value.”

Mr. Jackson said the last two lines are not necessary anyway because if something is not reasonably possible, one does not have to do it.

Mr. Schumacher said he thought that was in there to not give them a choice of not doing it. The preparer must do PV; if it is not possible to do PV, then the preparer must do FV.

Mr. Allen asked Mr. Torregrosa for his views.

Mr. Torregrosa responded that the alternative view pushed for FV because CBO wanted to be as broad as possible. They thought that applying PV to proved reserves made sense. CBO's major problem was that there was no discounting initially which CBO considers wrong. Mr. Torregrosa said he is fine with requiring PV using the risk-free discount rate; it is close enough for him.

Mr. Jackson asked what an obstacle to using PV might be.

Mr. Allen responded that he was concerned that DOI might not be able to actually deliver on their proposed method because they have indicated agreement with the previously proposed measurement approach in the past but later indicated that it was unworkable.

Mr. Torregrosa said that John Woods from EIA had said that there were sales of reserves in the private sector and CBO's thinking was that those sales could be used as a proxy for FV using Level II or Level III of the FAS 157 fair value hierarchy. Mr. Torregrosa said the field test team indicated that their PV approach would work and if the board wanted to limit it to PV [as proposed by Mr. Patton], that would probably be okay.

Ms. Ranagan responded that when the field test team came to speak with the board, they stated they were comfortable with their proposed PV approach but would like the two or three year implementation period so they would have time to work out any issues while the information was presented as RSI and come back to the board for further guidance, as needed. Ms. Ranagan noted that an analysis of the field test team approach showed that there were still some areas where hypothetical numbers were inserted by the field test team, indicating that they thought they could get the information but did not have time or resources to actually get/compute the information. Furthermore, the field test team had not consulted with their auditors on the proposed approach. The concern was that the board would have to reissue the standard if the proposed PV approach would not work; therefore, flexibility was recommended to avoid the need for further revisions.

Mr. Patton pointed out that if DOI came up with a methodology that the board did not particularly like, they would have to revisit it to strike it out.

Ms. Payne asked if it would be possible to provide flexibility during the RSI period and then limit valuation to one method when the information transitioned to basic; DOI would either have had to find a way to do PV or come back to the board. Mr. Dacey said he has tried to think of a way to do that but he couldn't because at the time the information becomes basic, there has to be a standard in place. If it is specific when it is RSI, you run the risk of having the auditors note that the RSI was not prepared in conformance

with the standard. Mr. Dacey said he would rather have them fix it and then finalize the standard rather than finalize the standard and then have to go back and fix it.

Ms. Kearney said that it seems to her that almost every option has drawbacks and ends up with board action at some point. She said it seems logical to her that the board should go ahead and be flexible and leave it as RSI. She noted that the board did something similar with social insurance and it wasn't favorable because there was a delay in audit guidance until the board made it permanent, but she does not see that problem with this standard. She said she agrees with Mr. Dacey that she would make it flexible and RSI indefinitely (quadrant II) because, ultimately, the board will probably be back in a few years discussing it again anyway.

Mr. Schumacher said he would be in favor of giving DOI the flexibility with the proposed PV approach or FV but he still believes the information should transition to basic and the board can always come back and extend the RSI period. Mr. Schumacher clarified that he is in quadrant III.

Mr. Jackson said he will put himself in quadrant II with Ms. Kearney and Messrs. Dacey and Patton.

Mr. Farrell said he is in the southwest box with Mr. Schumacher (quadrant III).

Mr. Steinberg responded that he is in quadrant III.

Mr. Torregrosa responded that he is in quadrant III.

Mr. Bell said he is in quadrant II because there are too many unknowns right now to transition to basic.

Mr. Allen responded that he is in quadrant III.

The poll resulted in a 5-5 split between quadrants II (flexibility / RSI Indefinitely) and III (PV + FV / Transition to Basic).

Mr. Allen asked where the majority was at the December meeting. Ms. Ranagan responded that the majority was in quadrant I (flexibility / transition to basic) in which there is currently no one.

Mr. Allen stated that unless a member was willing to change his or her vote, the wording would be based off of the original quadrant I vote because they did not have a majority vote to change it (a 5-5 vote would mean that the language would remain as previously presented based on the December meeting). However, Ms. Ranagan noted that while the members had directed staff to develop more flexible language, they had not deliberated on the actual language until this meeting, at which they were given the additional option of limiting the valuation alternatives to the proposed PV approach and methods for measuring FV that are consistent with FAS 157. Ms. Ranagan referred the members to the language that was developed for the February briefing materials and asked if any of the members strongly objected to being that flexible since no one voted to

be in quadrant I.

Mr. Allen said some members did not understand that wide open meant anything including historic cost; he said flexibility to him meant PV or some other method for measuring FV. Mr. Farrell countered that wide open is where all the members in quadrant II are right now—they are not limiting it to PV or some other method for measuring FV.

Mr. Jackson said he does not have a problem being in quadrant IV (PV + FV / RSI Indefinitely); he just does not want to have an absolute transition to basic.

Mr. Allen asked staff what the vote was when the board voted on RSI vs. transition. Ms. Ranagan responded that the majority voted for transition to basic [Staff Note: from December minutes: vote was 8 – 2 for transition to basic; Messrs. Dacey and Werfel were the only members to vote for RSI indefinitely].

Mr. Jackson asked if he was one of the members that voted for transition to basic. Ms. Ranagan responded that he was. Mr. Jackson replied that he would like to be true to his previous vote for transition to basic and since he does not know any other way that DOI would measure the asset other than the proposed PV approach or FV, he will change his vote to quadrant III.

Therefore, the final vote was 6 – 4 in favor of quadrant III (PV + FV / Transition to Basic).

Paragraph 24 Valuation Requirements

Flexibility	I	II Bell Dacey Kearney Patton
	III Allen Farrell Jackson Schumacher Steinberg Torregrosa	IV
Limit to PV + FV	Transition to Basic	RSI Indefinitely

Basic Recognition Criteria and Qualitative Characteristics

For an item to be recognized on the face of the financial statements, it must meet the definition of an element and be measurable.⁵ There has been little question that federal oil and gas resources meet the definition of an asset; the question is whether or not they are reasonably estimable.

In paragraph A37 of the basis for conclusions (BfC), the board states that “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 proved oil and gas reserves can be reliably estimated and converted to monetary terms (estimated federal royalty share), the board believes the estimated federal royalty share of proved oil and gas reserves should be recognized on the balance sheet.”

Some respondents disagree with the board that the value of federal oil and gas natural resources is reasonably estimable. SFFAC 1, *Objectives of Federal Financial Reporting*, defines financial reporting as the means of communicating with those who use financial information. SFFAC 1 goes on to state that for this communication to be effective, information in financial reports must possess the following six basic characteristics: understandability, reliability, relevance, timeliness, consistency, and comparability, referred to as “qualitative characteristics.” Several respondents argued that, because there is so much uncertainty and volatility surrounding the oil and gas market, the recognition of an asset as proposed in the ED would not sufficiently satisfy all of the basic qualitative characteristics necessary for effective communication of information.

Respondents provided the following examples of the volatility and uncertainty related to valuing oil and gas resources and the related liability for distributions to non-federal entities:

- Forest Service agrees that the value of any given commodity is relative to supply and demand. It is difficult however, to determine the future value of oil and gas because there is a correlation between technical conditions and demand. It is possible that our reliance on oil and gas may be replaced by another resource (technological advancement) that is more efficient and environmentally friendly. **(comment letter #1)**
- Oil prices have varied between \$31 and \$126 in the past year alone, which is a 4:1 ratio...It appears that the market price is arbitrarily set at the closing price on the last day of the fiscal year, which could be meaningless a month later. **(comment letter #3)**
- Currently, using the benchmark suggested of USG [U.S. government] securities, most USG securities funds are earning less than 1% interest. This rate is extremely low due to the USG's various recession-fighting stimulus programs. Nobody believes that this low interest rate can or will continue. In fact many commentators are predicting substantial increases in the USG borrowing rate. The change in the discounted value with a change to, say, a 5-6% USG borrowing rate would cause a tremendous write-down in the value of discounted proven O & G [oil and gas] reserves in future years. **(comment letter #8)**

⁵ SFFAC 5, par. 5.

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- From time to time, the amount of royalties the USG collects and is remitted to states has changed. Currently, all states except Alaska receive 50% of all royalties (O&G and all other royalties), and Alaska gets 90%. Recent legislation increased the rates of royalties paid to adjacent coastal states for off-shore O & G royalties. Any changes in royalty rates will change the "phantom" estimated payable to states, perhaps substantially given the severe deficits facing all 50 states except Montana and North Dakota. With respect to amounts payable to the states for royalty sharing, I suspect that not a single state will report its "receivable" related to the estimated royalties payable by the USG. **(comment letter #8)**
 - Proven reserves depend on the prevailing market rates for O & G. Market rates depend on the overall world economic status, the "find" rate of new reserves (gas rates are falling rapidly as new "finds" have occurred in the Appalachian states and elsewhere in the world, and oil rates may be impacted by the "find" recently announced by BP in the off-shore Gulf area southeast of Houston, TX). Technology could well reduce the cost to extract shale oil in the US west and the tar sands in Canada, both of which have estimates of oil (nobody knows if it is economically recoverable, but the tar sands are currently being extracted) greater than all proven reserves in the world according to some media reports. These swings are not controllable by the USG, but will impact the annual amounts of discounted O & G proven reserves. **(comment letter #8)**
 - "Proven" can be immensely affected by uncontrollable situations such as hurricanes in the Gulf; local, state or Federal environmental laws and regulations; and, interruption of transportation (e.g., long-term pipeline damage via earthquake, flood, storm, or terrorism). I am not sure how this can be figured into the valuation methodology. **(comment letter #8)**
 - Discounted proven O & G reserves seems to stand out as a potential asset, but subject to a multiplicity of uncontrollable factors, including some day the elimination of continuing to burn carbon fuels due to global warming treaties. **(comment letter #8)**
 - In the MMS field test study, although the overall asset value declined over a year period, depletion expense recorded in the year exceeded the difference in the ending valuation, and required a gain on revaluation to be recorded. This gain would likely be misleading to the general reader, and renders the utility of the information questionable. Interior believes that disclosures regarding the asset valuation and royalties reported over a given span of time, combined with a discussion and presentation of any theoretical change due to revaluation of the estimated asset, would provide a clearer picture and would much more efficiently and cost effectively meet the board's objectives. **(comment letter #9)**

Staff Concerns

While the actual method for calculating the approximate present value of future federal royalty receipts on proved reserves known to exist as of the reporting date is left up to the preparer and is not described in the proposed standard, FASAB staff continues to be concerned with the reliability of the proposed proxy that Interior included in its field test. Interior proposes to use the federal share of annual production of proved reserves as a

proxy for total proved reserves under federal lands. FASAB staff is concerned with the reliability of this number and was hoping that Interior's auditors would provide a response to the ED, but they did not.

Companies that produce oil and gas self-report data to DOI's Minerals Management Service (MMS) on the amount of oil and gas they produced and sold, the value of this production, and the amount of royalties owed. The accuracy of the data reported to MMS has been questioned by GAO in several recent reports and testimony.⁶ At a September 16, 2009, hearing before the House Committee on Natural Resources, GAO testified that oil and gas activity has generally increased in recent years, and Interior has, at times, been unable to meet its legal and agency mandated oversight obligations for verifying oil and gas production.⁷

Therefore, in staff's opinion, not only is the use of production as a proxy for quantity highly questionable in and of itself, there are questions surrounding the accuracy of the production data as well. However, because of the lack of reporting on proved reserves under federal lands, Interior must use some sort of estimation methodology to determine the quantity of proved reserves under federal lands, which is the primary factor in the valuation of the federal asset. Staff is concerned that if Interior's auditors are unable to satisfy themselves with respect to the proxy developed by Interior, Interior has limited options for estimating quantity.

Issue 1: Staff Recommendation

Staff acknowledges that note disclosure is never a substitute for recognition when the conditions warrant recognition. However, certain criteria must be met in order to warrant recognition. Staff agrees with the natural resources task force⁸ and the majority of respondents to the ED that recognition of oil and gas resources does not sufficiently satisfy all of the required criteria.

For the reasons discussed above, staff recommends that the board adopt the alternative view proposal that the value of federal oil and gas resources and annual changes therein be

⁶ For example, **Royalty-in-Kind Program:** MMS Does Not Provide Reasonable Assurance It Receives Its Share of Gas, Resulting in Millions in Forgone Revenue, [GAO-09-744](#), August 14, 2009; **Mineral Revenues:** MMS Could Do More to Improve the Accuracy of Key Data Used to Collect and Verify Oil and Gas Royalties, [GAO-09-549](#), July 15, 2009; **Oil and Gas Management:** Federal Oil and Gas Resource Management and Revenue Collection In Need of Stronger Oversight and Comprehensive Reassessment, [GAO-09-556T](#), April 2, 2009; **Oil and Gas Leasing:** Federal Oil and Gas Resource Management and Revenue Collection in Need of Comprehensive Reassessment, [GAO-09-506T](#), March 17, 2009; and, **Mineral Revenues:** Data Management Problems and Reliance on Self-Reported Data for Compliance Efforts Put MMS Royalty Collections at Risk, [GAO-08-560T](#), March 11, 2008.

⁷ **Federal Oil and Gas Management:** Opportunities Exist to Improve Oversight, [GAO-09-1014T](#)

⁸ In the June 2000 Natural Resources Task Force Discussion Paper (Accounting for the Natural Resources of the Federal Government; available online at <http://www.fasab.gov/pdf/natresrpt.pdf>), the Task Force concluded that balance sheet recognition was not the most effective or reliable method of communicating this information. Rather, this information should be reported in the notes to the financial statements and as stewardship information. Further, for entities with significant natural resources, a line with no dollar amount could be placed on the balance sheet to direct readers to the footnote reference.

reported as RSI for a three-year transition period and then disclosed as basic information in the notes, rather than recognized on the face of the financial statements. The notes would be part of an integrated disclosure that would include the discussion of all of the government's natural resources, including oil and gas resources that are not currently under lease as well as values and information concerning all other significant natural resources, such as coal, timber, and grazing rights.

Do you agree with staff's recommendation?

Issue 2: Other Natural Resources

Respondents' Views

Regarding the issue of whether the proposed standard should be applied to other types of natural resources beyond oil and gas proved reserves, there was not a consistent view among respondents. Two of the respondents agreed with the inclusion of paragraph 10 relating to other types of natural resources. One respondent does not believe that the standard provides enough detail to form a response. Another respondent prefers that the government explicitly require agencies to use valuation, accounting, and financial reporting methods consistent with the provisions of the final standard for all types of natural resources. Another respondent—Interior—provides some clarifying language that they believe would help fill a void in guidance that could lead to potentially inaccurate or inconsistent reporting.

Specific comments relating to the application of the oil and gas standard to other types of natural resources are as follows:

- We believe the issue of accounting for other types of natural resources, where material to the reporting entities, should be addressed as soon as practicable in the future, given the level of their significance. **(comment letter #3)**
- DoD proposes that footnote disclosure of other types of Natural Resources in lieu of Balance Sheet recognition be clearly stated as permissible, even if this presentation (as described in the Alternative View) is not accepted for Oil and Gas Resources. **(comment letter #4)**
- We believe that the notes should have a comprehensive disclosure that would include an integrated discussion of all of the government's natural resources, including oil and gas resources that are not currently under lease as well as values and information concerning all other significant natural resources, such as coal, timber, and grazing rights. Such information should include, as appropriate, valuation of other types of natural resources under lease, unless they are not material. **(comment letter #6)**
- The current ED provides too much latitude by preparers to use potentially contradictory methodologies for valuing natural resources. FISC recommends that paragraph 10 include a statement that any additional types of natural resources reported by an agency use valuation, accounting, and financial reporting methods consistent with the provisions of the final standard, and that such methods be required for all types of natural resources. The ED, as written, provides no requirement or strong language to compel agencies to account for and report all “proven” resources. Absent such a requirement, the ED, as written, would not provide for a comprehensive reporting model for comparable assets. **(comment letter #7)**
- Any expansion of the valuation to other types of natural resources should be essentially in concurrence with the O & G RSI and/or basic disclosures. **(comment letter #8)**

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- Interior appreciates the latitude that the board is seeking to provide in this paragraph and believed that it aids in acknowledging the potential treatment of other natural resources. With some related clarification, it could substantially help to resolve potential confusion and help to ensure consistent reporting. However, as it is presented, it illustrates a significant void in authoritative guidance which inherently facilitates the risk of potentially inaccurate or inconsistent reporting.

First, Interior believes that to remove any ambiguity in the intent of the paragraph, it should also indicate that application of the Statement is not mandatory for other federal natural resources. For example,

“This statement does not preclude, **nor does it require**, entities recognizing or otherwise reporting information about other types of federally-owned natural resources.”

Second, the current Exposure Draft guidance on accounting for federal oil and gas assets is quite different from FASB guidance covering oil and gas accounting in the private sector. This was emphasized in the response to Question 3 regarding the application of a private sector standard to a federally owned asset such as oil and gas. To ensure that preparers and auditors understand the relationship and application of this federal oil and gas Statement to other types of federal natural resources, we recommend that paragraph 10 be expanded to incorporate the intent from paragraph A10 into the formal governing Statement;

“...this Statement should be considered when applying SFFAS 34, *The Hierarchy of Generally Accepted Accounting Principles, Including the Application of Standards Issued by the Financial Accounting Standards Board*, to other types of federal natural resources.”

Third, Interior believes that the Statement should provide clarifying guidance to determine when to apply the ‘custodial’ provision in SFFAS 7, paragraph 45 to natural resources, or if it should always apply when there is no significant cost incurred. Interior believes that the guidance in the Statement should clarify if or when certain characteristics such as depletion could or should determine if custodial provisions apply, or if they should always apply when no significant costs are incurred. **(comment letter #9)**

Staff Analysis

There are several potential options to choose from regarding the issue of accounting for other natural resources:

Option 0 – Expand the oil and gas standard to provide specific standards for other types of natural resources.

Option 1 – Retain paragraphs 10, A9, and A10 as they are currently written.

Option 2 – Remove paragraphs 10, A9, and A10, and remain silent on the application of the oil and gas standard to other types of natural resources.

Option 3 – Remove paragraph 10 but retain paragraphs A9 and A10 with the exception of the last sentence in A10 that talks about paragraph 10.

Option 4 – Include the changes recommended by Interior (comment letter #9) or something similar to explicitly state that the standard does not require that it be applied to other natural resources, but the standard should be considered when applying SFFAS 34 to other types of natural resources.

Option 5 – Revise paragraph 10 to preclude federal entities from applying the oil and gas standard to other types of natural resources.

Option 6 – If in Issue 1, the board decides to continue to require recognition in the financial statements over note disclosure, revise paragraph 10 to permit note disclosures of the value of other natural resources, as suggested by comment letter #4.

Option 7 – If in Issue 1, the board decides to adopt the alternative view proposal that favors note disclosure over recognition in the financial statements, revise paragraph 10 to require similar note disclosures for other types of federal natural resources.

Option	Reference		Application to Other Types of Natural Resources				Form of Basic Info on Other Resources	
	Explicit	Implicit	Definite	Probable	Possible	Prohibited	Fin. Stmtns.	Notes
0	X		X				X	X
1	X			X			X	X
2		X			X		X	X
3	X				X		X	X
4	X			X			X	X
5	X					X		
6	X			X			X	X
7	X		X					X

Option 0 is listed as “0” because it is not really an option since the majority of the board already voted against expanding the oil and gas standard in favor of getting guidance out for oil and gas as soon as possible. It is listed here as an option primarily to document that decision.

Options 1 and 3 through 7 would make explicit mention of the application of the standard to other types of natural resources, either in the standard itself and the BfC (options 1, 4, 5, 6, and 7) or just the BfC (option 3). Option 2 would remain silent on the application of the oil and gas standard to other types of natural resources.

Option 7 would definitely result in broader application of the standard because that option would explicitly require federal entities to apply the guidance in the oil and gas standard to other types of natural resources.

Options 1, 4, and 6 would probably result in broader application of the standard because, although it would not be required, the standard would explicitly mention its potential applicability to other types of natural resources. Option 6 would also note that, although the

standard requires recognition for oil and gas resources, note disclosures would be permissible for other types of natural resources.

Option 2 might result in broader application of the standard through application of the GAAP hierarchy, but would not specifically call attention to that fact in the standard or the BfC.

Option 3 might result in broader application of the standard because its application would be specifically discussed in the BfC, which has non-authoritative standing.

Broader application would help to meet some of the objectives of federal financial reporting in a timelier manner, but may lead to inconsistent reporting of natural resources among federal entities. The development of an implementation guide by the AAPC could alleviate some of the inconsistency.

Option 5 would explicitly preclude federal entities from applying the guidance in the oil and gas standard to other types of natural resources. This would mean that guidance on reporting for additional types of natural resources beyond oil and gas would need to be put on the board's agenda as a future project. The board has previously acknowledged that the other types of natural resources are not material enough to arise to a priority project on the agenda in the distant future. This would result in separate treatment for oil and gas from all other types of natural resources for the foreseeable future.

Therefore, Option 5 would result in neither recognition of nor note disclosures about other types of natural resources beyond proved reserves of oil and gas. Option 7 would limit reporting about other types of natural resources to note disclosures, the same as would be applied to proved reserves of oil and gas if members accept staff's recommendation from Issue 1. All other options have the potential to result in recognition of and / or note disclosures about other types of natural resources.

Issue 2: Staff Recommendation

If in Issue 1, the board decides to adopt the alternative view proposal that favors note disclosure over recognition in the financial statements, then staff recommends option 7 because staff believes, under the three-year transition period, and with assistance from the AAPC if necessary, all federal entities could develop reliable, auditable note disclosures that would enhance the objectives of federal financial reporting.

If in Issue 1, the board decides to continue to require recognition in the financial statements over note disclosure, then staff recommends option 6 because, as noted in the above paragraph, staff believes, under the three-year transition period, and with assistance from the AAPC if necessary, all federal entities could develop reliable, auditable note disclosures that would enhance the objectives of federal financial reporting. Alternatively, if the board continues to favor balance sheet recognition for oil and gas proved reserves, one might also argue that recognition could be achieved for all types of natural resource assets with sufficient implementation guidance.

Do you agree with staff's recommendation?

Issue 3: Provision of FAS 157 Fair Value as Alternative Measurement Method

Respondents' Views

Half of respondents agreed with the board's proposal to permit an alternative market-based fair value measurement consistent with FASB Financial Accounting Standards 157, *Fair Value Measurement*,⁹ if it is not reasonably possible to estimate using present value. One of the respondents disagreed with the use of fair value based on FAS 157 because the oil and gas market is so volatile. A second respondent—Interior—agreed with the provision of an alternative measurement method but disagreed with the use of fair value based on FAS 157 because they do not think the asset should be measured at a market exit price since it is extremely unlikely that the asset would ever be sold.

Staff Analysis

There are several potential options to choose from regarding the issue of alternative measurement methods:

Option 0 – Maintain proposal to permit an alternative measurement method if it is not reasonably possible to estimate present value, but provide flexibility in the selection of the alternative measurement method

Again, Option 0 is listed as “0” because it is not really an option since the majority of the board already voted against the open-ended flexibility when it voted to limit the choices to present value and fair value. It is listed here as an option primarily to document that decision.

Option 1 – Maintain proposal to use fair value as an alternative measurement method if it is not reasonably possible to estimate present value; retain high-level reference to ASC 820.10 (i.e., FAS 157) at the standards level.

Option 1 would retain the original requirement from the ED, which would not address respondents' concerns about references to ASC 820.10. Respondents are concerned that ASC 820.10 does not specifically address volatile markets and is subject to ongoing revision and “softening” by FASB. In addition, one respondent does not like the “open-ended” reference to ASC 820.10 and prefers that the standard specifically reference the paragraphs, sections, or methods contained in ASC 820.10 that would be acceptable to the board. This option would also not address the concerns of one respondent—Interior—that does not believe it is appropriate to value oil and gas resources at fair value because it is extremely unlikely that the asset would ever be sold.

Option 2 – Maintain proposal to use fair value as an alternative measurement method if it is not reasonably possible to estimate present value; eliminate some flexibility by specifically referencing paragraphs, sections, or methods contained in ASC 820.10 that would be acceptable to the board.

⁹ FASB Accounting Standards Codification™ (ASC) 820.10

Option 2 would retain the original requirement from the ED and specifically address respondents' concerns about open-ended references to ASC 820.10. This option would not address the concerns about volatile markets and only partially addresses concerns about ongoing revision and "softening" of the standard by FASB. Furthermore, this option does not address the concern of one respondent—Interior—that does not believe it is appropriate to value oil and gas resources at fair value because it is extremely unlikely that the asset would ever be sold.

Option 3 – Maintain proposal to use fair value as an alternative measurement method if it is not reasonably possible to estimate present value; develop specific guidance on how to measure fair value when dealing with volatile markets.

Option 3 would retain the original requirement from the ED and specifically address respondents' concerns about references to ASC 820.10. This option would not address the concern of one respondent—Interior—that does not believe it is appropriate to value oil and gas resources at fair value because it is extremely unlikely that the asset would ever be sold. Furthermore, given FASAB's current conceptual framework project on measurement, staff does not believe it would be appropriate to develop separate fair value standards at this time.

Option 4 – Specify a different alternative measurement method than fair value.

Option 4, in staff's opinion, is not feasible because the board has not previously identified any other measurement attribute or method that would be acceptable beyond present value and fair value. Furthermore, while one respondent—Interior, which rejected fair value—has said that they would generally agree with the latitude provided by permitting an alternative measurement method, they have not identified an option other than present value.

Option 5 – Eliminate alternative measurement method and maintain present value of future federal royalty receipts on proved reserves known to exist as of the reporting date as the only possible measurement method.

Option 5, which would eliminate the alternative measurement method and maintain present value of future federal royalty receipts on proved reserves known to exist as of the reporting date as the only possible measurement method, would be feasible if the standard were limited to oil and gas natural resources and entities were not permitted to apply its guidance to other types of natural resources. Absent that limitation, staff does not believe that it would be prudent to eliminate an alternative measurement method (i.e., fair value) that may be more appropriate for renewable natural resources such as timber and grazing. If the measurement method were limited to present value, the standard would probably need to stipulate a reasonable time horizon for estimating present value of renewable natural resources unless an assumption of infinite were to be made.

Issue 3: Staff Recommendation

If the board decides to limit the standard to apply to only oil and gas resources and, in addition, prohibit entities from applying the standard to other types of natural resources through analogy, then staff recommends option 5 since the only preparer entity that would

be involved—Interior—strongly opposes being given the choice of fair value. The alternative was being provided primarily to enable Interior to comply with the standard if it finds it is not able to estimate present value.

If the board decides not to limit the standard to apply to only oil and gas resources, but instead either encourages or implies that federal entities should apply the oil and gas standard to other types of natural resources, then staff recommends option 1. Since the board has a current conceptual framework project on measurement, staff does not believe it would be appropriate to conclude at this time that ASC 820.10, as it is drafted, is not appropriate for the federal government, especially considering the growing use of fair value as an acceptable measurement attribute. Staff believes that the outcome of the measurement project may potentially affect the measurement of federal assets and liabilities in the future, but no conclusions have yet been reached.

Do you agree with staff's recommendation?

Other Issues

These issues will not be discussed unless a board member objects to staff's proposed resolution.

Fiduciary Activities

Since DOI, the preparer primarily responsible for reporting the information, did not express a cost / benefit concern in its most recent response, and the majority of respondents support the disclosures, staff proposes to retain the fiduciary disclosure requirements as they are in the ED.

Journal Entries

One respondent commented that "actual journal entries are not necessary if properly described in the eventual standard. We believe that a FASAB Implementation Guide or Department of Treasury (Treasury) or Office of Management and Budget (OMB) directive should address journal entries to ensure that entries meet Treasury's Standard General Ledger (SGL) requirements." **(comment letter #7)**

Staff notes that it is a long-standing practice of FASAB to provide entries where members feel it would help clarify the requirements in an illustrative manner. The journal entries are non-authoritative and are always preceded by a disclaimer that the entries are not to be relied upon as a complete model for agency accounting. It is generally well-known that actual journal entries are approved by the SGL Board.

Furthermore, another one of the respondents along with the preparer primarily responsible for accounting for oil and gas resources—Interior—has indicated that the entries are very helpful to them. Staff proposes to retain the journal entries as they are unless the board decides to adopt the alternative view proposal, at which time journal entries would not be applicable. **(comment letter #3 and discussions with MMS staff)**

Implementation Guide

One respondent—Interior—requested that a more detailed implementation guide be developed in the future. However, when Interior representatives met with the board during the October 2008 meeting, the board indicated that it would consider providing more detailed guidance only on the issues that Interior has been unable to resolve with its auditors during the RSI transition period. If the board decides to limit the standard to apply only to oil and gas resources, then staff proposes that no implementation guide be developed at this time.

If the board decides not to limit the standard to apply to only oil and gas resources, but instead either encourages or implies that federal entities should apply the oil and gas standard to other types of natural resources, then staff proposes that an implementation guide be developed by the AAPC that will improve consistency of reporting among all federal entities that report on natural resources.

Comments to Be Addressed in Draft Standard for December Meeting

Language in Paragraph 24

Two respondents requested more clarification of the language in paragraph 24, as follows:

- We do not concur with the language currently in paragraph 24 of the Exposure Draft. This paragraph states that the alternative method described “may be acceptable if it is not reasonably possible” to estimate the present value of future federal royalty receipts on proved reserves. This language, especially the phrases “may be acceptable” and “not reasonably possible” does not clearly state that the alternative is acceptable while placing a high burden of proof on the agency before this alternative may be used. The basis for Conclusions indicates that the board considers either approach acceptable. If the intent of the board is that either approach is acceptable, then that intent should be clearly stated in the text of the standard. The presentation of limitations on the applicability of the alternate method merely creates opportunities for disagreements in judgment between preparers and auditors, which may effectively prevent the use of this alternative. **(comment letter #4)**
- FISC recommends that stronger or more explicit language be included in the final standard that would explain what circumstances or situations might make it ‘reasonably possible’ for a Federal agency to avoid use of the preferred measurement method. **(comment letter #7)**

Staff will present proposed wording to the board for consideration at the December meeting along with the changes that are necessitated by decisions made at the October meeting.

Language in Paragraph 21

One respondent recommended that the phrase “why it is inappropriate to do so” in paragraph 21 be replaced with something akin to “why the entity’s own assumptions are a preferred method.”

Staff will present proposed wording to the board for consideration at the December meeting along with the changes that are necessitated by decisions made at the October meeting.

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**ATTACHMENT 4 – Revised Exposure Draft,
Accounting for Federal Oil and Gas Resources
Comment Letters**

#	Respondent	Affiliation	Page
1	Osman Masahudu	Dept of Agriculture, Forest Service	63
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Osman Masahudu
US, Forest Service
Financial Management Staff
Financial Policy and Standards

FASAB Exposure Draft – Accounting for Federal Oil and Gas Resources**U.S Forest Service Comments – Revised****August 25, 2009**

Q1. Forest Service agrees that the value of any given commodity is relative to supply and demand. It is difficult however, to determine the future value of oil and gas because there is a correlation between technical conditions and demand. It is possible that our reliance on oil and gas may be replaced by another resource (technological advancement) that is more efficient and environmentally friendly.

Q2. Forest Service agrees we can estimate the value of royalties known to exist as of the reporting date. However, we need to take into consideration technical conditions that might have impact (positive or negative) on future values.

Q3: No comment.

Q4. Forest Service does not agree permitting federal entities to change their methodologies for valuing estimated federal petroleum royalties. FASAB needs to design a uniform standard methodology for the entire federal government in valuing estimated petroleum royalties. Allowing federal entities to use a different methodology could impair our ability to prepare consolidated financial statements for the federal government.

Q5: No comment.

Q6: No comment.

Q7: No comment.

Q8: No comment.

Q9: No comment.

General Comments

1. One consideration that Forest Service did not see mentioned in the Exposure Draft is the impact of asset value due to legal or management constraints that limit or preclude access to those reserves. For example, Congress recently withdrew the Wyoming Range from all forms of mineral entry and thereby put trillions of cubic feet of gas off limits. As such it could be argued that there is no value for that resource. The Energy Policy and conservation Act mandated a study "Scientific Inventory of Onshore Federal Lands' Oil and Gas Resources and Reserves and the Extent and Nature of Restrictions' or Impediments to Their Development" which evaluated the effects of management constraints have on resource accessibility. Therefore, Forest Service is uncertain how those aspects can be reflected in the asset value of "proven reserves".

2. Another area that needs consideration is that, USSGL posting models and general ledger accounts are not mentioned anywhere in the draft. For example, transfer accounts or receipts between DOI and U.S Forest Service. U.S Forest Service needs to know the general ledger account to use to transfer funds between Forest Service and DOI and vice versa. It is explicit in the draft that transfer receipts would no longer be revenue to the recipient agency after the implementation of this draft however, transfer receipts would be treated as financing source instead of revenue to the recipient agency. U.S Forest Service needs to know what general ledger account to use, to record this transaction so that appropriate posting models as well as cross-walk would be established in our financial accounting system to handle the change.

Thank you for the opportunity to provide comments on the above exposure draft.

The Department of Housing and Urban Development does not have any comment on the above exposure draft.

Please direct any questions concerning our response to me at the number listed below.

Jerry Tucker
Director
Financial Policies and Procedures Division
Office of the Chief Financial Officer for Financial Management

September 4, 2009

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

Advancing
Government
Accountability

2208 Mount Vernon Ave
Alexandria, VA 22301

(703) 684-6931
(703) 548-9367 (fax)

Dear Ms. Payne:

On behalf of the Association of Government Accountants (AGA), the Financial Management Standards Board (FMSB) appreciates the opportunity to provide comments to the Federal Accounting Standards Advisory Board (FASAB or the Board) on its revised exposure draft on the proposed statement of federal financial accounting standards, *Accounting for Federal Oil and Gas Resources*. The FMSB, comprising 21 members with accounting and auditing backgrounds in federal, state and local government, academia and public accounting, reviews and responds to proposed standards and regulations of interest to AGA members. Local AGA chapters and individual members are also encouraged to comment separately. Our responses to the questions listed in the exposure draft follow

Q1. The original exposure draft (ED) issued on May 21, 2007, contained detailed asset valuation implementation guidance for valuing federal oil and gas resources. As a result of feedback received from field testing efforts, the Board has removed that detailed guidance from this revised ED and is instead proposing to provide federal entities with flexibility in developing the asset valuation estimation methodology due to the constantly changing economic and technical conditions. Do you agree or disagree with the Board's position (see paragraphs 14 through 26, A47 and A48)? Please explain the reasons for your position in as much detail as possible.

Response: The FMSB agrees as those federal entities who have been conducting asset valuation are in the best position to know what works for them and it would be too easy to omit a sound methodology. Trying to incorporate every valuation estimation methodology in use would make the document unwieldy.

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 as described in paragraphs 19 through 21. Discount rates as of the reporting date for present value measurements of federal 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. Do you agree or disagree with the Board's position (see paragraphs 19 through 21 and A38 through A46)? Please explain the reasons for your position in as much detail as possible.

Response: The FMSB agrees as it is a reasonable basis, generally understood and already in widespread use throughout the federal government. Also, we found sample entries 6 through 11 in Appendix B to be very helpful with excellent explanations.

Q3. The Board is proposing to permit an alternative measurement method 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 using the approach described in paragraphs 19 through 21. Specifically, the Board is permitting a market-based fair value measurement consistent with the Financial Accounting Standards Board (FASB) Statement of Financial Accounting Standards 157, *Fair Value Measurements*. Do you agree or disagree with the Board's position (see paragraphs 24 and A38 through A46)? Please explain the reasons for your position in as much detail as possible.

Response: The FMSB disagrees. We reviewed SFAS 157 and find that it is primarily designed for marketable securities. Oil and gas reserves would be a Level 1 asset, with an observable price. But we could not find any information on how to deal with volatile markets. Oil prices have varied between \$31 and \$126 in the past year alone, which is a 4:1 ratio. We did not see any guidance in SFAS 157 that helped determine what market price to use when the market is so volatile. It appears that the market price is arbitrarily set at the closing price on the last day of the fiscal year, which could be meaningless a month later.

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 paragraphs 25, 26 and A49 through A51)? Please explain the reasons for your position in as much detail as possible.

Response: The FMSB agrees. A change in accounting estimate that is effected by a change in accounting principle should be made only if the new accounting principle is justifiable on the basis that it is preferable from the viewpoint that the new accounting principle better captures the economic reality of the situation under consideration. That is, if an entity concludes that the pattern of consumption of the expected benefits of an asset has changed, and determines that a new depreciation method better reflects that pattern, it may be justified in making a change in accounting estimate effected by a change in accounting principle.

Q5. The Board believes that it would be appropriate to provide guidance regarding reporting gains and losses from changes in assumptions and selecting the discount rates similar to that provided 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*, 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 20, 40, and A64 through A66)? Please explain the reasons for your position in as much detail as possible.

Response: The FMSB agrees. This will help government entities to provide better transparency, improve understandability of the reports by the interested stakeholders and provide guidance during times of high volatility. SFFAS 33 requires that gains and losses from changes in long-term assumptions used to estimate certain liabilities be displayed on the statement of net cost separately from other costs. The FMSB agrees that it would be appropriate to apply similar guidance similar to long-term assumptions about oil and gas in order to increase the usefulness of reported operating results when the volatility of projections might otherwise result in large variations in the valuation of oil and gas royalty revenues, oil and gas resource valuation and resulting gains and losses from year to year. Specific guidance and examples will provide continuity of guidance and procedures.

Q6. SFFAS 31, *Accounting for Fiduciary Activities*, requires that agencies report on assets held in a fiduciary capacity. The Department of Interior (DOI) manages oil and gas resources on behalf of individual Indians and Indian tribes. This proposed standard – because it classifies oil and gas resources as assets – would result in additional information being disclosed for oil and gas assets managed in a fiduciary capacity. Note, however, that fiduciary reporting does not extend to inclusion of the additional disclosures or RSI that are proposed in this document for federal oil and gas resources. Thus, with respect to fiduciary activities, only disclosure of the assets, liabilities, and related inflows and outflows would result from this proposal.

Some members have expressed concern that the costs may exceed the benefits of disclosing fiduciary assets and liabilities measured in conformance with this proposed standard. Since this proposal may significantly increase the fiduciary assets disclosed, we requested input on the cost-benefit of the requirement with respect to fiduciary activities in the May 2007 ED. One respondent was in favor of the disclosures while four expressed their opinion that the information would most likely not be cost-beneficial. However, the Board has not received any substantive information to enable it to make an informed decision regarding cost/benefit.

Since the removal of the fiduciary oil and gas resource disclosure requirements would require an exception to the requirements of SFFAS 31, we are again requesting detailed input on the cost-benefit of the requirement with respect to fiduciary activities. See paragraph 46.

Response: The FMSB agrees from the viewpoint of maintaining consistency with SFFAS 31 and existing systems should make the cost benefit a moot point. However, we believe only those within DOI can provide the in-depth information or justification as to why the cost/benefit analysis would override providing the transparency to the individual Indians and Indian tribes who most benefit from disclosure of the information.

Q7. The Board is proposing to provide a three-year phase-in of the proposed requirements from required supplementary information (RSI) beginning with fiscal year 2011 to basic in fiscal year 2014. This transitional period is being 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 51 and A87)? Please explain the reasons for your position in as much detail as possible.

Response: The FMSB agrees as it allows sufficient time for any implementation questions to be addressed by the Board, accommodates DOI's request and seems a reasonable phase-in period.

Q8. This Statement addresses accounting for federal oil and gas resources only. While the Board may address accounting for other types of natural resources at some point in the future, the majority of the members acknowledge that it is not likely that a project devoted to other categories of natural resources will be marked as a high priority at future agenda-setting sessions due to their lesser significance. As a result, while not explicitly encouraging agencies to recognize other categories of natural resources, the Board included paragraph 10 to explicitly state that this Statement does not preclude entities from recognizing or otherwise reporting information about other types of federally-owned natural resources. Do you agree or disagree that the potential risk that the inclusion of paragraph 10 might lead to inaccurate or inconsistent reporting of other types of natural resources is outweighed by the potential benefits to financial statement users (see paragraphs 10, A9 and A10)? Please explain the reasons for your position in as much detail as possible.

Response: The FMSB does agree with the inclusion of paragraph 10 as the proposed standard needs to be specific in addressing the high-priority issues concerning accounting for federal oil and gas resources. We believe the issue of accounting for other types of natural resources, where material to the reporting entities, should be addressed as soon as practicable in the future, given the level of their significance. We have evidence that one agency had not updated some natural resource lease valuations in over twenty years - which raises questions about its stewardship and the accuracy of its financial statements. It is likely that there are a number of smaller agencies with similar issues. Even a brief standard should address regular review and update of costing and valuation of all federal natural resources to ensure that the government is receiving fair remuneration.

Q9. After a three-year transition period of reporting as RSI, the ED proposes to recognize an asset on the balance sheet for the federal government's royalty share of federal oil and gas resources under lease (see paragraphs A29 through A37 for a discussion of factors regarding asset recognition considered by the Board in reaching this conclusion). An alternative view prepared by Mr. Dacey proposes that the value of federal oil and gas resources and annual changes therein be reported as RSI for a three-year transition period and then disclosed as basic information in the notes, rather than recognized on the face of the financial statements. The notes would be part of an integrated disclosure that would include the discussion of all of the government's natural resources, including oil and gas resources that are not currently under lease as well as values and information concerning all other significant natural resources, such as coal, timber, and grazing rights. Do you agree or disagree with the alternative view (see paragraphs A89 through A92)? Please explain the reasons for your position in as much detail as possible.

Response: The Introduction to the Exposure Draft states "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. [interpretive note: largely depletion]"

We accept that the quantity and value of those assets and the royalty revenues, and [depletion] expenses that will be recognized for the asset exchanged to produce those revenues, would be material to the Financial Statements of the entities reporting those items (the omission or misstatement of that 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.)

On that basis we disagree with the alternative view and agree with the ED proposal that the federal government's royalty share of federal oil and gas resources under lease be recognized as an asset on the balance sheet (after the 3 year transition period). However, to address the legitimate issues that Mr. Dacey has raised, we think that a discussion of all of the government's natural resources, including oil and gas resources that are not currently under lease as well as values and information concerning all other significant natural resources, such as coal, timber, and grazing rights should be provided in the Notes to the Financial Statements. We support the FASAB addressing issues of accounting for natural resources *additional to* those addressed by the current Exposure Draft as soon as practicable in the future, given the level of their significance. We are concerned that treating those additional natural resources only by note disclosure gives them the character of "contingent assets", while we do not believe they meet the criteria of being contingent, and that reliable estimates of their value can and should be made, with appropriate disclosure as to the methodology used.

We appreciate the opportunity to comment on this document and would be pleased to discuss this letter with you at your convenience. No member objected to its issuance. If you have questions concerning the letter, please contact Anna D. Gowans Miller, CPA, AGA's director of research and staff liaison for the FMSB, at amiller@agacgfm.org or 703.684.6931 ext. 313.

Sincerely,



Robert L. Childree, Chair,
AGA Financial Management Standards Board

cc: William A. Morehead, Ph.D., CPA, CGFM
AGA National President

**Association of Government Accountants
Financial Management Standards Board**

July 2009 – June 2010

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COMPTROLLER

OFFICE OF THE UNDER SECRETARY OF DEFENSE
1100 DEFENSE PENTAGON
WASHINGTON, DC 20301-1100

SEP 08 2009

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

Dear Ms. Payne:

The Department of Defense's comments on the Exposure Draft, *Accounting for Federal Oil and Gas Resources*, are enclosed. Overall, we agree with the valuation methodologies proposed in the Exposure Draft. We believe the proposed changes will improve the reporting of this revenue in Federal financial reports.

We do, however, prefer the proposed alternative view in which the asset is disclosed in the notes to the financial statements in lieu of balance sheet recognition. Further, we believe that this Exposure Draft provides a reasonable foundation for the reporting of other types of natural resources assets.

My point of contact on this matter is Ms. Debra J. Carey. She can be reached at (703) 602-0155 or debra.carey@osd.mil.

Sincerely,

A handwritten signature in black ink, appearing to read "Mark E. Easton", written over a horizontal line.

Mark E. Easton
Deputy Chief Financial Officer

Enclosure:
As stated



**Accounting for Federal Oil and Gas Resources
Department of Defense Responses to Specific Questions**

Q1. The original exposure draft (ED) issued on May 21, 2007, contained detailed asset valuation implementation guidance for valuing federal oil and gas resources. As a result of feedback received from field testing efforts, the Board has removed that detailed guidance from this revised ED and is instead proposing to provide federal entities with flexibility in developing the asset valuation estimation methodology due to the constantly changing economic and technical conditions. Do you agree or disagree with the Board's position (see paragraphs 14 through 26, A47 and A48)? Please explain the reasons for your position in as much detail as possible.

A. The Department of Defense (DoD) concurs with this revision. We agree with the guidance proposed in the current Exposure Draft which provides agencies with the flexibility to determine appropriate and reasonable valuation methodologies.

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 as described in paragraphs 19 through 21. Discount rates as of the reporting date for present value measurements of federal 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. Do you agree or disagree with the Board's position (see paragraphs 19 through 21 and A38 through A46)? Please explain the reasons for your position in as much detail as possible.

A. DoD concurs that the discount rate for any present value measurements of federal 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. DoD also concurs that the present value of future federal royalty receipts on proved reserves is an appropriate and reasonable valuation methodology, subject to the response to question 3.

Q3. The Board is proposing to permit an alternative measurement method 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 using the approach described in paragraphs 19 through 21. Specifically, the Board is permitting a market-based fair value measurement consistent with the Financial Accounting Standards Board (FASB) Statement of Financial Accounting Standards 157, Fair Value

Measurements. Do you agree or disagree with the Board's position (see paragraphs 24 and A38 through A46)? Please explain the reasons for your position in as much detail as possible.

A. DoD concurs with this proposal. Specifically, we believe that either the present value of future federal royalty receipts or a market-based fair value measurement should be acceptable.

However, we do not concur with the language currently in paragraph 24 of the Exposure Draft. This paragraph states that the alternative method described "may be acceptable if it is not reasonably possible" to estimate the present value of future federal royalty receipts on proved reserves. This language, especially the phrases "may be acceptable" and "not reasonably possible" does not clearly state that the alternative is acceptable while placing a high burden of proof on the agency before this alternative may be used. The Basis for Conclusions indicates that the Board considers either approach acceptable. If the intent of the Board is that either approach is acceptable, then that intent should be clearly stated in the text of the standard. The presentation of limitations on the applicability of the alternate method merely creates opportunities for disagreements in judgment between preparers and auditors, which may effectively prevent the use of this alternative.

Again, DoD believes that either approach should be acceptable if adequately disclosed. This flexibility will be especially important if the provisions of this standard are applied to other less significant categories of natural resources as permitted by paragraph 10.

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 paragraphs 25, 26 and A49 through A51)? Please explain the reasons for your position in as much detail as possible.

A. DoD concurs with this proposal. Provided that adequate disclosure is made of the change in accounting methodology, this proposal will ensure the presentation of the most meaningful information to users of financial reports.

Q5. The Board believes that it would be appropriate to provide guidance regarding reporting gains and losses from changes in assumptions and selecting the discount rates similar to that provided 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, 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 20, 40, and A64 through A66)? Please explain the reasons for your position in as much detail as possible.

A. DoD concurs with the proposed guidance regarding reporting gains and losses from changes in assumptions. If the asset is to be presented on the Balance Sheet, the changes in asset value must be reflected in the financial statements, preferably on the Statement of Net Cost of Operations. These changes, although often material, are normally unrelated to the operation of the program. Clear disclosure of these amounts on the Statement of Net Cost would improve the quality of information provided to the user of the financial statements.

Q6. SFFAS 31, Accounting for Fiduciary Activities, requires that agencies report on assets held in a fiduciary capacity. The Department of Interior (DOI) manages oil and gas resources on behalf of individual Indians and Indian tribes. This proposed standard – because it classifies oil and gas resources as assets – would result in additional information being disclosed for oil and gas assets managed in a fiduciary capacity. Note, however, that fiduciary reporting does not extend to inclusion of the additional disclosures or RSI that are proposed in this document for federal oil and gas resources. Thus, with respect to fiduciary activities, only disclosure of the assets, liabilities, and related inflows and outflows would result from this proposal.

Some members have expressed concern that the costs may exceed the benefits of disclosing fiduciary assets and liabilities measured in conformance with this proposed standard. Since this proposal may significantly increase the fiduciary assets disclosed, we requested input on the cost-benefit of the requirement with respect to fiduciary activities in the May 2007 ED. One respondent was in favor of the disclosures while four expressed their opinion that the information would most likely not be cost-beneficial. However, the Board has not received any substantive information to enable it to make an informed decision regarding cost/benefit.

Since the removal of the fiduciary oil and gas resource disclosure requirements would require an exception to the requirements of SFFAS 31, we are again requesting detailed input on the cost-benefit of the requirement with respect to fiduciary activities. See paragraph 46.

A. DoD does not concur with the proposal to report Fiduciary Natural Resource Assets. DoD does not see a benefit to this disclosure, since the data would be too summarized to provide meaningful information to fiduciary beneficiaries. However, since DoD does not

have Fiduciary Natural Resource assets to report under this standard, the cost of developing that information cannot be estimated.

Q7. The Board is proposing to provide a three-year phase-in of the proposed requirements from required supplementary information (RSI) beginning with fiscal year 2011 to basic in fiscal year 2014. This transitional period is being 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 51 and A87)? Please explain the reasons for your position in as much detail as possible.

A. DoD concurs with the three-year phase in of the proposed requirements, as this phase-in period will permit agencies to test and refine asset valuation methodologies. This phase in period is necessary whether the information is presented in the basic Financial Statements, as proposed by the Exposure Draft, or in the Notes to the Financial Statements, as proposed by the alternative view.

Q8. This Statement addresses accounting for federal oil and gas resources only. While the Board may address accounting for other types of natural resources at some point in the future, the majority of the members acknowledge that it is not likely that a project devoted to other categories of natural resources will be marked as a high priority at future agenda-setting sessions due to their lesser significance. As a result, while not explicitly encouraging agencies to recognize other categories of natural resources, the Board included paragraph 10 to explicitly state that this Statement does not preclude entities from recognizing or otherwise reporting information about other types of federally-owned natural resources. Do you agree or disagree that the potential risk that the inclusion of paragraph 10 might lead to inaccurate or inconsistent reporting of other types of natural resources is outweighed by the potential benefits to financial statement users (see paragraphs 10, A9 and A10)? Please explain the reasons for your position in as much detail as possible.

A. DoD concurs with the provision of paragraph 10 for other types of natural resource assets. This provision gives agencies the ability to recognize natural resource assets determined by the agency to be significant to the operations and financial position of the agency. The management and sale of Natural Resources are ancillary to most Federal agency missions and are generally immaterial to the agency from both a financial and operational stand point. Paragraph 10 gives management the responsibility for the determination of whether to recognize such assets. DoD believes this flexibility will result in presentation decisions most useful to users of Federal financial statements.

In addition, DoD proposes that footnote disclosure of other types of Natural Resource assets in lieu of Balance Sheet recognition be clearly stated as permissible, even if this presentation (as described in the Alternative View) is not accepted for Oil and Gas Resources.

Q9. After a three-year transition period of reporting as RSI, the ED proposes to recognize an asset on the balance sheet for the federal government's royalty share of federal oil and gas resources under lease (see paragraphs A29 through A37 for a discussion of factors regarding asset recognition considered by the Board in reaching this conclusion). An alternative view prepared by Mr. Dacey proposes that the value of federal oil and gas resources and annual changes therein be reported as RSI for a three-year transition period and then disclosed as basic information in the notes, rather than recognized on the face of the financial statements. The notes would be part of an integrated disclosure that would include the discussion of all of the government's natural resources, including oil and gas resources that are not currently under lease as well as values and information concerning all other significant natural resources, such as coal, timber, and grazing rights. Do you agree or disagree with the alternative view (see paragraphs A89 through A92)? Please explain the reasons for your position in as much detail as possible.

A. DoD concurs with the alternative view, including the transition period and footnote disclosure of the asset in lieu of Balance Sheet recognition of Natural Resource assets. While Balance Sheet recognition improves information available to users of financial statements regarding the assets managed by the agency, this recognition has a negative impact on the Statement of Net Cost (SNC). Specifically, the SNC is impacted by periodic changes in recognized value of the asset, distorting the activity resulting from the activities of the agency. These changes result from changes in interest rates and changes in amounts considered to be "proved reserves" offset by resources extracted and sold. Disclosure of Natural Resource assets in the Notes to the Financial Statements in lieu of Balance Sheet recognition would provide users of financial statements information regarding the value of the assets without the corresponding negative impact on the SNC.

>>> <Gillam.Constance@epamail.epa.gov> 9/8/2009 2:12 PM >>>

Good afternoon.

On behalf of Stefan Silzer, the Acting Director of the Office of Financial Management, thank you for the opportunity to review the exposure draft, "Accounting for Federal Oil and Gas Resources." EPA has no comments on this draft.

Constance Gillam
Special Assistant to the Director
U.S. EPA Office of Financial Management
1200 Pennsylvania Avenue
Washington, D.C. 20460



G A O

Accountability • Integrity • Reliability

United States Government Accountability Office
Washington, DC 20548

September 8, 2009

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

Dear Ms. Payne:

The U.S. Government Accountability Office (GAO) is pleased to provide its comments on the Federal Accounting Standards Advisory Board (FASAB) Exposure Draft entitled Accounting for Federal Oil and Gas Resources, (ED). The FASAB's current efforts and deliberations on the presentation of oil and gas resources are an important step in recognizing the need for greater transparency in connection with the federal government's current financial condition and future fiscal path.

Consistent with the alternative view in the ED, we believe that the notes to the financial statements should include an integrated disclosure of all of the federal government's natural resources, including information on the value of resources under lease and changes therein, rather than recognize on the balance sheet only those resources that are valued because they are under lease. In addition, natural resources should be excluded from reporting on the schedule of fiduciary net assets.

The enclosure to this letter provides our responses to the questions set forth in the Exposure Draft. If you have any questions, please call me at (202) 512-2600 or Robert Dacey, Chief Accountant at (202) 512-7439.

Sincerely yours,

Jeanette Franzel
Managing Director
Financial Management and Assurance

Enclosure

Enclosure**GAO Responses to the Questions set forth in the Exposure Draft,
Accounting for Federal Oil and Gas Resources****Question 1:**

The original exposure draft (ED) issued on May 21, 2007, contained detailed asset valuation implementation guidance for valuing federal oil and gas resources. As a result of feedback received from field testing efforts, the Board has removed that detailed guidance from this revised ED and is instead proposing to provide federal entities with flexibility in developing the asset valuation estimation methodology due to the constantly changing economic and technical conditions. Do you agree or disagree with the Board's position (see paragraphs 14 through 26, A47 and A48)? Please explain the reasons for your position in as much detail as possible.

Response:

We agree with providing flexibility in the valuation estimation methodology. However, as discussed in our comments, we believe that such valuation information is more appropriately presented in the notes to the financial statements as part of an integrated disclosure of all federal natural resources rather than reported on the balance sheet.

Question 2:

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 as described in paragraphs 19 through 21. Discount rates as of the reporting date for present value measurements of federal 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. Do you agree or disagree with the Board's position (see paragraphs 19 through 21 and A38 through A46)? Please explain the reasons for your position in as much detail as possible.

Response:

Yes, the method proposed for valuing estimated petroleum royalties allows sufficient flexibility in measurement methods and appears reasonable. Also, we caution that the Board's current project on measurement attributes, when completed, may affect how requirements for applying measurement methods in current standards are applied. However, as discussed in our comments, we believe that such valuation information is more appropriately presented in the notes to the financial statements as part of an integrated disclosure of all federal natural resources rather than reported on the balance sheet.

Question 3:

The Board is proposing to permit an alternative measurement method 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 using the approach described in paragraphs 19 through 21. Specifically, the Board is permitting a market-based fair value measurement consistent with the Financial Accounting Standards Board (FASB) Statement of Financial Accounting Standards 157, *Fair Value Measurements*. Do you agree or disagree with the Board's position (see paragraphs 24 and A38 through A46)? Please explain the reasons for your position in as much detail as possible.

Response:

Yes, the alternative method appears reasonable and allows sufficient flexibility for valuing federal estimated petroleum royalties if it is not reasonably possible to estimate present value of future federal royalty receipts on proved reserves using the methodology described in paragraphs 19-21. However, as discussed in our comments, we believe that such valuation information is more appropriately presented in the notes to the financial statements as part of an integrated disclosure of all federal natural resources rather than reported on the balance sheet. One of the reasons for our views is that such significant flexibility, in combination with paragraphs 25 and 26 of the ED, provides a potentially broad range of acceptable accounting bases and valuation methodologies and consequently is better presented in the notes to the financial statements

Question 4:

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 paragraphs 25, 26 and A49 through A51)? Please explain the reasons for your position in as much detail as possible.

Response:

Yes, allowing a change in methodology is reasonable as long as the nature and reason for the change and its effect are properly disclosed. However, as discussed in our comments (including our response to question 4), we believe that such valuation information is more appropriately presented in the notes to the financial statements as part of an integrated disclosure of all federal natural resources rather than reported on the balance sheet.

Question 5:

The Board believes that it would be appropriate to provide guidance regarding reporting gains and losses from changes in assumptions and selecting the discount rates similar to that provided 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*, 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 20, 40, and A64 through A66)? Please explain the reasons for your position in as much detail as possible.

Response:

It would be appropriate to present gains and losses from changes in long-term assumptions as a separate line item or items on the statement of net cost, if the valuation of oil and gas resources were placed on the balance sheet. However, as discussed elsewhere in this letter, we believe that such valuation information is more appropriately presented in the notes to the financial statements as part of an integrated disclosure of all federal natural resources rather than reported on the balance sheet.

Question 6:

SFFAS 31, *Accounting for Fiduciary Activities*, requires that agencies report on assets held in a fiduciary capacity. The Department of Interior (DOI) manages oil and gas resources on behalf of individual Indians and Indian tribes. This proposed standard – because it classifies oil and gas resources as assets – would result in additional information being disclosed for oil and gas assets managed in a fiduciary capacity. Note, however, that fiduciary reporting does not extend to inclusion of the additional disclosures or RSI that are proposed in this document for federal oil and gas resources. Thus, with respect to fiduciary activities, only disclosure of the assets, liabilities, and related inflows and outflows would result from this proposal. Some members have expressed concern that the costs may exceed the benefits of disclosing fiduciary assets and liabilities measured in conformance with this proposed standard. Since this proposal may significantly increase the fiduciary assets disclosed, we requested input on the cost-benefit of the requirement with respect to fiduciary activities in the May 2007 ED. One respondent was in favor of the disclosures while four expressed their opinion that the information would most likely not be cost-beneficial. However, the Board has not received any substantive information to enable it to make an informed decision regarding cost/benefit. Since the removal of the fiduciary oil and gas resource disclosure requirements would require an exception to the requirements of SFFAS 31, we are again requesting detailed input on the cost-benefit of the requirement with respect to fiduciary activities. See paragraph 46.

Response:

We continue to have concerns about the costs versus the benefits of accumulating, preparing, and auditing information reported in the schedule of fiduciary activities. Requiring the Federal entities to disclose the value of oil and gas reserves for fiduciary activities will incur additional preparation and audit costs and result in information that is inconsistent with information currently reported to beneficiaries of these fiduciary activities. In addition, it will reflect only the value of reserves for which the entity has fiduciary responsibility, which may not represent all reserves owned by beneficiaries. For example, it would place a heavy burden on the Federal Government to put a value on what beneficiaries own. Therefore, for these reasons and the reasons discussed in the ED, such natural resources should be excluded from reporting as assets on the schedule of fiduciary net assets. Instead, fiduciary reporting of natural resources should consist of appropriate narrative describing the general nature and extent of such resources.

Question 7:

The Board is proposing to provide a three-year phase-in of the proposed requirements from required supplementary information (RSI) beginning with fiscal year 2011 to basic in fiscal year 2014. This transitional period is being 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 51 and A87)? Please explain the reasons for your position in as much detail as possible.

Response:

Phasing in the requirements is very important to the reporting of the oil and gas resources. However, for reasons discussed in our comments, we believe the value of federal oil and gas resources and annual changes therein should be disclosed as basic information in notes rather than recognized on the face of the financial statements.

Question 8:

This Statement addresses accounting for federal oil and gas resources only. While the Board may address accounting for other types of natural resources at some point in the future, the majority of the members acknowledge that it is not likely that a project devoted to other categories of natural resources will be marked as a high priority at future agenda-setting sessions due to their lesser significance. As a result, while not explicitly encouraging agencies to recognize other categories of natural resources, the Board included paragraph 10 to explicitly state that this Statement does not preclude entities from recognizing or otherwise reporting information about other types of federally owned natural resources. Do you agree or disagree that the potential risk that the inclusion of paragraph 10 might lead to inaccurate or inconsistent reporting of other types of natural resources is outweighed by the potential benefits to financial statement users (see paragraphs 10, A9 and A10)? Please explain the reasons for your position in as much detail as possible.

Response:

We believe that the notes should have a comprehensive disclosure that would include an integrated discussion of all of the government's natural resources, including oil and gas resources that are not currently under lease as well as values and information concerning all other significant natural resources, such as coal, timber, and grazing rights. Such information should include, as appropriate, valuation of other types of natural resources under lease, unless they are not material.

Question 9:

After a three-year transition period of reporting as RSI, the ED proposes to recognize an asset on the balance sheet for the federal government's royalty share of federal oil and gas resources under lease (see paragraphs A29 through A37 for a discussion of factors regarding asset recognition considered by the Board in reaching this conclusion). An alternative view prepared by Mr. Dacey proposes that the value of federal oil and gas resources and annual changes therein be reported as RSI for a three-year transition period and then disclosed as basic information in the notes,

rather than recognized on the face of the financial statements. The notes would be part of an integrated disclosure that would include the discussion of all of the government's natural resources, including oil and gas resources that are not currently under lease as well as values and information concerning all other significant natural resources, such as coal, timber, and grazing rights. Do you agree or disagree with the alternative view (see paragraphs A89 through A92)? Please explain the reasons for your position in as much detail as possible.

Response:

As discussed in the ED, we believe that the value of federal oil and gas resources and annual changes therein, consistent with the valuation basis discussed in the ED, should be disclosed as basic information in the notes rather than recognized on the face of the financial statements as proposed in this ED. The disclosures should include an integrated discussion of all of the federal government's natural resources, including oil and gas resources that are not currently under lease as well as values for resources under lease and similar information concerning all other significant federal natural resources, such as coal, timber, and grazing rights. This type of reporting would be similar to current reporting for stewardship assets. Such reporting in the notes would provide transparency as to the value and changes in value of these significant assets and result in information that contributes to meeting federal financial reporting objectives. As basic financial information, this information would be subject to audit. Similar to stewardship assets, FASAB could require a non-financial disclosure on the balance sheet that refers to the note without an asset dollar amount being shown.

The ED includes a discussion of the reasoning for reporting this information in the notes in paragraph A91. In summary,

- financial statement users should clearly understand the full extent of natural resources that are owned by the federal government and the valuation of the resources that are currently under lease and not be potentially misled by an amount on the balance sheet that represents only a portion of the federal government's natural resources,
- the current recognition of oil and gas royalties at the time of extraction when royalties are receivable relates the revenues to the period benefitted and are matched with related costs incurred by the federal government; also, bonus bid and rent are recorded when receivable,
- the valuation of oil and gas resources is subject to significant annual fluctuations based on changing market prices for the resources and changes in quantities based on recoverability; such fluctuations would affect the federal government's net cost and net operating cost (thereby reducing the usefulness of reported operating results of the government's operations during the year); and the valuation would not likely reflect the value of the royalties to be received in future periods, and
- in addition to significant uncertainty inherent in the valuation methodology, the ED provides for significant flexibility in the basis used to calculate the valuation; consequently, such less certain information would be more appropriately reflected in the notes to the financial statements.

Further, publicly traded enterprises that have significant oil and gas producing activities are required to disclose information on proved oil and gas reserve quantities and discounted future net cash flows as supplementary information, rather than record them on the balance sheet.



Greater Washington Society of CPAs and GWSCPA Educational Foundation

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September 8, 2009

Wendy Payne, Executive Director
Federal Accounting Standards Advisory Board
Mail Stop 6K17V
441 G Street, NW – Suite 6814
Washington, DC 20548

Dear Ms. Payne:

The Greater Washington Society of Certified Public Accountants (GWSCPA) Federal Issues and Standards Committee (FISC) appreciates the opportunity to provide comments on the Federal Accounting Standards Advisory Board's (FASAB or Board) revised Exposure Draft (ED) of the proposed standard, *Accounting for Federal Oil and Gas Reserves*.

FISC consists of 16 GWSCPA members who are active in accounting and auditing in the Federal sector. This comment letter represents the consensus comments of our members. Our responses to the ED question follows.

- Q1. The original exposure draft (ED) issued on May 21, 2007, contained detailed asset valuation implementation guidance for valuing federal oil and gas resources. As a result of feedback received from field testing efforts, the Board has removed that detailed guidance from this revised ED and is instead proposing to provide federal entities with flexibility in developing the asset valuation estimation methodology due to the constantly changing economic and technical conditions. Do you agree or disagree with the Board's position (see paragraphs 14 through 26, A47 and A48)? Please explain the reasons for your position in as much detail as possible.
- A1. FISC agrees with the flexibility provided in the current ED, and supports ongoing efforts by the FASAB to adopt 'principles-based' standards. FISC repeats our concerns expressed in our January 23, 2008 response to the initial ED (dated May 21, 2007) that actual journal entries are not necessary if properly described in the eventual standard. We believe that a FASAB Implementation Guide or Department of Treasury (Treasury) or Office of Management and Budget (OMB) directive should address journal entries to insure that entries meet Treasury's Standard General Ledger (SGL) requirements.
- 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 as described in paragraphs 19 through 21.

Discount rates as of the reporting date for present value measurements of federal 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. Do you agree or disagree with the Board's position (see paragraphs 19 through 21 and A38 through A46)? Please explain the reasons for your position in as much detail as possible.

- A2. FISC agrees with the current ED to require present value measurements as of the reporting date using discount rates from a common source, namely the marketable Treasury securities. Absent the explicit reference to a common source, FISC members expressed concerns that arbitrary or inconsistent determinations might be used by Federal agencies. As discussed in our response to questions 3 and 4, the current ED provides too much latitude by the preparers to use potentially contradictory methodologies for valuing natural resources.
- Q3. The Board is proposing to permit an alternative measurement method 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 using the approach described in paragraphs 19 through 21. Specifically, the Board is permitting a market-based fair value measurement consistent with the Financial Accounting Standards Board (FASB) Statement of Financial Accounting Standards 157, *Fair Value Measurements*. Do you agree or disagree with the Board's position (see paragraphs 24 and A38 through A46)? Please explain the reasons for your position in as much detail as possible.
- A3. FISC agrees that an alternative measurement method is appropriate due to the complexity and unique situations faced by different Federal agencies. However, FISC recommends that stronger or more explicit language be included in the final standard that would explain what circumstances or situations might make it 'reasonably possible' for a Federal agency to avoid use of the preferred measurement method. Further, FISC members advise that there is a significant disparity between the defined steps in the preferred measurement method and the open-ended reference in the ED to FASB's Statement of Financial Accounting Standards (SFAS) No. 157, *Fair Value Measurements*. FISC recommends that the final standard provide more definite reference to paragraphs, sections, or methods contained in SFAS No. 157 that would be acceptable to the Board.
- 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 paragraphs 25, 26 and A49 through A51)? Please explain the reasons for your position in as much detail as possible.
- A4. FISC supports including the broad provisions of paragraph 25, allowing for an "improved methodology" based upon environmental or other changes. FISC believes that it is important that Federal agencies be provided the latitude to use the most accurate methodology for estimating future federal royalty receipts on proven reserves.
- Q5. The Board believes that it would be appropriate to provide guidance regarding reporting gains and losses from changes in assumptions and selecting the discount rates similar to that provided 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*, 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 20, 40, and A64 through A66)? Please explain the reasons for your position in as much detail as possible.

- A5. FISC supports the financial statement presentation of gains and losses from changes in assumptions, but encourages the Board to consider segregating unrealized gains and losses from operating results on the Statement of Net Cost. FISC believes that commingling unrealized gains and losses with operating results could confuse a reader of federal financial statements, and cause a reader to draw a false understanding of the annual operating costs or deficit of a Federal agency. The process of segregating unrealized transactions from operating results would parallel the Board's proposal to separate the reporting of social insurance balances, as was proposed by the Board in its recent exposure draft of a proposed standard, *Accounting for Social Insurance, Revised*.
- Q6. SFFAS 31, *Accounting for Fiduciary Activities*, requires that agencies report on assets held in a fiduciary capacity. The Department of Interior (DOI) manages oil and gas resources on behalf of individual Indians and Indian tribes. This proposed standard – because it classifies oil and gas resources as assets – would result in additional information being disclosed for oil and gas assets managed in a fiduciary capacity. Note, however, that fiduciary reporting does not extend to inclusion of the additional disclosures or RSI that are proposed in this document for federal oil and gas resources. Thus, with respect to fiduciary activities, only disclosure of the assets, liabilities, and related inflows and outflows would result from this proposal.

Some members have expressed concern that the costs may exceed the benefits of disclosing fiduciary assets and liabilities measured in conformance with this proposed standard. Since this proposal may significantly increase the fiduciary assets disclosed, we requested input on the cost-benefit of the requirement with respect to fiduciary activities in the May 2007 ED. One respondent was in favor of the disclosures while four expressed their opinion that the information would most likely not be cost-beneficial. However, the Board has not received any substantive information to enable it to make an informed decision regarding cost/benefit.

Since the removal of the fiduciary oil and gas resource disclosure requirements would require an exception to the requirements of SFFAS 31, we are again requesting detailed input on the cost-benefit of the requirement with respect to fiduciary activities. See paragraph 46.

- A6. FISC supports the current ED, which requires that assets, including oil and gas resources, which are held in a fiduciary capacity be reported in accordance with the provisions of SFFAS No. 31 using the valuation methods contained in the current ED (subject to the comments made in our answers to questions 3 and 4 above). Although we appreciate the concerns regarding cost-benefit considerations, comparability in reporting is vital, and inconsistently applied measurement methods for equivalent assets would be confusing to a reader of the financial statements.

However, one of our members disagreed with this response. One member expressed concerns that there is no explanation in the ED as to why FASAB would depart from the private sector's recording of non-monetary assets held in trust, in accordance with the *Uniform Principal and Income Act* (the Act), which provides guidance on fiduciaries. According to this member, the Act is very clear that fiduciaries are responsible for assets received by them, but are not responsible for the value of non-cash assets (although they will normally report the

value of readily marketable securities). Residences and real estate improvements, land and forestry holdings, and other assets are merely disclosed, but only rarely valued. Requiring U.S. government fiduciary funds to record the discounted value of proven reserves would be in conflict to practices under the Act and at odds with comparable fiduciaries outside of the United States Government.

- Q7. The Board is proposing to provide a three-year phase-in of the proposed requirements from required supplementary information (RSI) beginning with fiscal year 2011 to basic in fiscal year 2014. This transitional period is being 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 51 and A87)? Please explain the reasons for your position in as much detail as possible.
- A7. FISC supports the proposed requirements of a phased-in reporting approach to allow key agencies sufficient time to address challenges in implementation of this ED, and to work with the auditors to develop an approach that allows for the agencies' methodologies to be reviewed by the auditors prior to inclusion in the basic financial statements or footnotes.
- Q8. This Statement addresses accounting for federal oil and gas resources only. While the Board may address accounting for other types of natural resources at some point in the future, the majority of the members acknowledge that it is not likely that a project devoted to other categories of natural resources will be marked as a high priority at future agenda-setting sessions due to their lesser significance. As a result, while not explicitly encouraging agencies to recognize other categories of natural resources, the Board included paragraph 10 to explicitly state that this Statement does not preclude entities from recognizing or otherwise reporting information about other types of federally-owned natural resources. Do you agree or disagree that the potential risk that the inclusion of paragraph 10 might lead to inaccurate or inconsistent reporting of other types of natural resources is outweighed by the potential benefits to financial statement users (see paragraphs 10, A9 and A10)? Please explain the reasons for your position in as much detail as possible.
- A8. FISC understands the challenges faced by the Board in balancing all of the matters on the Board's agenda, and appreciates the concerns by Board members that other projects will take precedence over additional standards covering other types of natural resources. However, FISC recommends that paragraph 10 include a statement that any additional types of natural resources reported by an agency use valuation, accounting, and financial reporting methods consistent with the provisions of the final standard, and that such methods be required for all types of natural resources.

Further, FISC repeats our concerns expressed in our January 23, 2008 response to the initial ED that the Board has not explained why capitalization is restricted solely for proved oil and gas resources, and why the reporting concept is not required for other "proven" assets (e.g., coal, uranium, gold, silver, zinc, and other metals, timber, other subsurface minerals, and even water). The ED, as written, provides no requirement or strong language to compel agencies to account for and report all "proven" resources. Absent such a requirement, the ED, as written, would not provide for a comprehensive reporting model for comparable assets.

- Q9. After a three-year transition period of reporting as RSI, the ED proposes to recognize an asset on the balance sheet for the federal government's royalty share of federal oil and gas resources

under lease (see paragraphs A29 through A37 for a discussion of factors regarding asset recognition considered by the Board in reaching this conclusion). An alternative view prepared by Mr. Dacey proposes that the value of federal oil and gas resources and annual changes therein be reported as RSI for a three-year transition period and then disclosed as basic information in the notes, rather than recognized on the face of the financial statements. The notes would be part of an integrated disclosure that would include the discussion of all of the government's natural resources, including oil and gas resources that are not currently under lease as well as values and information concerning all other significant natural resources, such as coal, timber, and grazing rights. Do you agree or disagree with the alternative view (see paragraphs A89 through A92)? Please explain the reasons for your position in as much detail as possible.

- A9. FISC supports the eventual presentation of natural resources on the face of federal financial statements. However, FISC repeats our concerns, expressed in response to question 8 above, that FASAB has not yet explained, in sufficient detail, its position of restricting capitalization to proved oil and gas resources and not mandating reporting of other types of natural resources. Selective recognition of assets by Federal agencies impairs the value of Federal financial reporting, and limits the usefulness of information contained within agency financial statements and the Consolidated Financial Report of the United States Government.

Other Comments

- In paragraph 21, FISC recommends that the phrase “why it is inappropriate to do so” should be replaced with something akin to “why the entity’s own assumptions are a preferred method.”
- In paragraph 28, it is unclear why only expected payments of royalties to non-federal entities are recognized. Consideration should be given to the disclosure of expected payments of royalties to other federal components.

This comment letter was reviewed by the members of FISC, and represents the consensus views of our members.

Very truly yours,



Andrew C. Lewis
FISC Chair

>>> <Bert_Edwards@ios.doi.gov> 9/9/2009 12:00 PM >>>

Wendy - I apologize for not getting to FASAB sooner with my thoughts. On July 24, 2009, the Appeals Court for the Federal Circuit issued its 11th (and we hope final) decision on the individual Indian trust litigation, and I have been devoted almost full-time to working with the new Interior officials, OMB, Congressional committees and others on the possible impact of the decision, which is very favorable to the US Government. I also apologize for the informality of an e-mail response to a FASAB "due process" document, but time is of the essence on getting this to you.

I have an overriding comment on recording the present valuation of proven O & G reserves at a discounted value, using the apparently much favored "principles-based" accounting approach,

(1) Oil and gas are not the only "proven" assets that the USG owns. How about "hard rock" minerals (coal, uranium and many other metals - gold, silver, etc., aggregates, timber, etc.)? How could the officials of an USG agency or its auditor agency concur that the financial statements are "fairly presented" when such other similar future recoverable assets are ignored? Timber alone would be the most significant asset of the US Forrest Service, part of the US Department of Agriculture, and perhaps for the overall USDA. Present value of all the land held by various Interior agencies (Land Management, Reclamation, National Parks, Fish and Wildlife), USDA (Forrest Service), DOD (military installations), etc., is only valued is purchased relatively recently in the USG's history. Certainly, nobody would question the value of the purchase of Alaska ("Seward's Folly") in today's economy; the gold alone extracted from Alaska more than equalled its purchase price from Russia, and the continuing value of, O & G, gold and other metals, salmon fishery, and tourism value make this one of the most fortuitous purchased in our history. Consider the value of the Louisiana Purchase.

(2) Practically all other future revenue streams of the USG, income taxes among them, are estimable with likely the same accuracy as discounted O & G proven reserves. I do not see any discussion why O & G are singled out for valuation and other assets are not. Disclosures now required for Social Security liabilities are net of the estimated FICA taxes to be paid by future workers and matching employer amounts.

In summary, unless there is a total re-visiting of assets of the USG, recording the estimated discounted value of proven O & G reserves seems to be "counting the chickens before the eggs are laid."

With respect to the various questions asked in the ED, I have the following comments.

Question 1 - "Principles-based" accounting can - and undoubtedly will - produce enormous swings in the discounted present value of proven O & G reserves or a number of reasons. We have already seen this in the "mark-to-market" experience in the past two years for not readily salable securities.

(1) Currently, using the benchmark suggested of USG securities, most USG securities funds are earning less than 1% interest. This rate is extremely low due to the USG's various recession-fighting stimulus programs. Nobody believes that this low interest rate can or will continue. In fact many commentators are predicting substantial increases in the USG borrowing rate. The change in the discounted value with a change to, say, a 5-6% USG borrowing rate would cause a tremendous write-down in the value of discounted proven O & G reserves in future years.

(2) From time to time, the amount of royalties the USG collects and is remitted to states has changed. Currently, all states except Alaska receive 50% of all royalties (O&G and all other royalties), and Alaska gets 90%. Recent legislation increased the rates of royalties paid to adjacent coastal states for off-shore O & G royalties. Any changes in royalty rates will change the "phantom" estimated payable to states, perhaps substantially given the severe deficits facing all 50 states except Montana and North Dakota. With respect to amounts payable to the states for royalty sharing, I suspect that not a single state will report its "receivable" related to the estimated royalties payable by the USG.

(3) Proven reserves depends on the prevailing market rates for O & G. Market rates depend on the overall world economic status, the "find" rate of new reserves (gas rates are falling rapidly as new "finds" have occurred in the Appalachian states and elsewhere in the world, and oil rates may be impacted by the "find" recently announced by BP in the off-shore Gulf area southeast of Houston, TX). Technology could well reduce the cost to extract shale oil in the US west and the tar sands in Canada, both of which have estimates of oil (nobody knows if it is economically recoverable, but the tar sands are currently being extracted) greater than all proven reserves in the world according to some media reports. These swings are not controllable by the USG, but will impact the annual amounts of discounted O & G proven reserves.

(4) "Proven" can be immensely affected by uncontrollable situations such as hurricanes in the Gulf, local, state or Federal environmental laws and regulations, interruption of transportation (e.g., a long-term pipeline damage via earthquake, flood, storm, or terrorism). I am not sure how this can be figured into the valuation methodology.

Question 2 - I concur with the ED, but keep in mind that the Treasury borrowing rate can be influenced by many factors as included in the comment (1) to Question 1 above.

Questions 3 and 4 - I concur with the ED. I do have concerns to citing FASB's SFAS 157 since it appears that this pronouncement will undergo continuing refinements, e.g., the recent FASB action to "soften" SFAS 157 for private commercial companies.

Question 5 - I concur with the ED. I am very concerned that future Administrations may be encouraged to focus on the unrealized gains when interest rates decline, world market prices increase, new "finds" become "proven," or new technology permits previously uneconomic "finds" to now be extracted profitably and/or possible. The opposite focus on unrealized losses could well occur when the USG debt interest rates increase (a factor certainly sure to come during the next several years), "proven" reserves decline due to market price declines, increased environmental standards particularly in non-US areas, war or terrorism risks no longer sustaining continued extraction, etc. Thus, at least separating the unrealized gains and losses would decrease these tendencies. See response below to Question 9.

Question 6 - This is the ED requirement that I have the greatest concern with. Even though SSFAS 31 requires assets held in a fiduciary capacity to be reported, neither FASB (banks, investment companies, etc.) or GASB generally require valuation of non-monetary assets. All 50 states and DC have adopted the principles of the Uniform Principal and Income Act, which provides guidance on fiduciaries. A few states already had incorporated the provisions of the Act in their laws prior to the first issuance of the Act, which is now in a second revised version. The Act is very clear that fiduciaries are responsible for assets received by them, i.e. initial transfer of assets, assets purchased during the trust existence, etc. Fiduciaries are not responsible for the value of non-cash assets or even monetary assets not received (e.g., dividends and interest payments due, but not received), although they will normally report the value of readily marketable securities and disclose the non-receipt of investment returns.. Residences and real estate improvements, land and forestry holdings, other assets are merely disclosed, but only rarely valued; in my consultations with commercial bank trust officials, almost all ask a depositor of non-monetary assets to waive any responsibility for current valuations due to the cost of such recurring appraisals. Requiring USG fiduciary funds (probably limited to Interior's two Indian Trust Funds) to record discounted value of proven reserves on land interests owned by individual Indians and Tribes will likely double the work of Interior. Further and importantly, there is no legal or fiduciary obligation of the USG to pay beneficiaries of the two Indian Trusts for such future discounted O & G

royalties until they are received in cash. Currently - and for at least two years - Interior has regularly reported (1) land holdings and (2) "encumbrances" (i.e., surface and subsurface leases, rights-of-way, etc. on such holdings) in quarterly (individual Indians) and monthly (Tribes) fiduciary reports. This is what a private-sector fiduciary would do under the Act. These land holdings and any value for O & G (but excluding present value of surface farming and grazing leases, coal and other subsurface minerals) as well as monetary equivalent holdings are not the assets of the USG. While I am not an expert on commercial bank trust functions, I understand that their disclosures of asset holdings is limited to monetary equivalents and excludes non-monetary assets held in trust. Thus, I disagree with the ED in this respect since there is no explanation in the ED as to why FASAB would depart from the fiduciary practice in the private sector, which in almost all other respects requires all assets and liabilities to be recorded in the financial statements.

Question 7 - As indicated in Question Except for the FASAB ED's requirement for fiduciary funds, I agree with the ED..

Question 8 - The ED does not require disclosures of estimated values of other natural resources - surface (timber, land itself), subsurface minerals, and even water itself. Therefore, it is not possible to form a concurring or disagreeing answer to this question. See answers to Question 1 above. Any expansion of the valuation to other types of natural resources should be essentially in concurrence with the O & G RSI and/or basic disclosures.

Question 9 - Since nobody "owes" the USG for discounted future proven O & G royalties, I concur with the minority view of Mr. Dacey. .

."Bottom Line" - In informal chats with USG and private sector individuals interested in FASAB GAAP, the overall conclusion is that FASAB may be "reaching" for assets to offset the increasingly accumulating deficit. Almost all the liabilities reported by the USG in its CFS have basis in fact, only the recording methodology may be arguable. Discounted proven O & G reserves seems to stand out as a potential asset, but subject to a multiplicity of uncontrollable factors, including some day the elimination of continuing to burn carbon fuels due to global warring treaties.

I realize that this is coming at the last minute. This response represents my personal views, and not necessarily those of the Department of the Interior.

Bert T. Edwards.



United States Department of the Interior

OFFICE OF THE SECRETARY
Washington, DC 20240

SEP 09 2009

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

Subject: FASAB Exposure Draft, *Accounting for Federal Oil and Gas Resources.*, dated May 21, 2007.

Dear Ms. Payne:

Attached is the Department of the Interior's consolidated response to the subject Exposure Draft.

If you have any questions or concerns please contact Don Geiger at 202-208-5542.

Sincerely,

Daniel L. Fletcher
Director
Office of Financial Management

Attachment

Overall, the U.S. Department of the Interior agrees with the intent of the proposed Statement, to enhance accountability and transparency, and provide readers of Federal financial reports with greater information about the quantity and estimated value of assets that generate cash to finance government operations over time.

Response to FASAB Questions for Respondents

Q1. The original exposure draft (ED) issued on May 21, 2007, contained detailed asset valuation implementation guidance for valuing federal oil and gas resources. As a result of feedback received from field testing efforts, the Board has removed that detailed guidance from this revised ED and is instead proposing to provide federal entities with flexibility in developing the asset valuation estimation methodology due to the constantly changing economic and technical conditions. Do you agree or disagree with the Board's position (see paragraphs 14 through 26, A47 and A48)? Please explain the reasons for your position in as much detail as possible.

Response: Interior generally agree with the flexibility provided in developing the asset valuation estimation methodology, with the caveat that a more detailed implementation guide also be developed in the future. There are a number of details that, by their omission, could create a void in needed guidance that may prove problematic in the future.

Additionally, over the years that the Statement has been under development, much research and verification has gone into the determination made by the Board that EIA should be the authoritative source from which quantity information should be obtained. By crafting the Statement so that it no longer explicitly designates EIA as the source of quantity information, significant ambiguity could be cast upon preparers' decisions regarding valuation. Because the asset value will be a significant estimate, comprised of numerous assumptions, we believe the Statement should continue to explicitly designate EIA as the authoritative source for quantity information. We believe it is unlikely that EIA data as it currently is reported to the public will become unavailable in the foreseeable future.

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 as described in paragraphs 19 through 21. Discount rates as of the reporting date for present value measurements of federal 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. Do you agree or disagree with the Board's position (see paragraphs 19 through 21 and A38 through A46)? Please explain the reasons for your position in as much detail as possible.

Response: Interior generally agrees, although we had originally designed the valuation methodology to be based upon OMB's economic assumptions about future Treasury marketable security rates.

- Q3. The Board is proposing to permit an alternative measurement method 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 using the approach described in paragraphs 19 through 21. Specifically, the Board is permitting a market-based fair value measurement consistent with the Financial Accounting Standards Board (FASB) Statement of Financial Accounting Standards 157, *Fair Value Measurements*.¹ Do you agree or disagree with the Board's position (see paragraphs 24 and A38 through A46)? Please explain the reasons for your position in as much detail as possible.

Response: Interior would generally agree with the latitude provided by permitting an alternative measurement method. However, in this instance we do not agree that measuring this federal asset using market based fair value is appropriate. We do not think the asset value should be measured at a market exit price, because it is extremely unlikely that it would ever be sold. Discounting at the public sector rate and valuing according to the expectation of future prices as proposed in the present value method is a much more accurate representation of the value of this federally owned asset.

By adding this provision for alternative measurement using FAS 157, considerable uncertainty and potential inaccurate valuation has been explicitly added to the Statement, and expert respondents disagree with the premise.

For example, FAS 157 provides for "Level 3 Inputs", being the lowest level in the allowable fair value hierarchy. Those inputs are considered 'unobservable inputs', and should be used to measure fair value when observable inputs are not available. They may be developed by the reporting entity, using its own data and reflecting the reporting entities own assumptions about the assumptions market participants would likely have in arriving at an exit price for the asset. Technically this could probably be done, but the valuation would be much less accurate or meaningful, potentially resulting in either a 'fire sale' or 'overvalued' estimate and greatly increasing the already volatile aspects of the asset value.

One must consider that the asset is comprised entirely of federally owned proved reserves. In practice, there is virtual certainty that volumes of oil and natural gas will be produced in the future, at least equal to the estimated volumes of proved reserves of oil and natural gas at any point in time. This is because new proved reserves are constantly being added as prospects are developed. Therefore, there is effectively a 100% chance that all proved reserves will eventually be produced, and there is no uncertainty on that matter. The only uncertainty would be the price in the future and how that production would emerge over time. If the government were to ever sell the assets, we would likely value them at today's price and discount them more or less heavily, to account for market risk, as FAS 157 suggests. But future cash flows from federally owned proved reserves are

¹ FASB Accounting Standards Codification™ (ASC) 820.10

legislated, and thus not subject to risk factors otherwise found in the market, and most importantly, the underlying assets are very unlikely to ever be sold.

Accordingly, Interior disagrees with adding the FAS 157 provision. We believe that the existing proposed present value methodology is the most appropriate measure for this unique federal asset. Also, this may have significant ramifications for other federally owned natural resources to which this Statement may be applied in the future.

- 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 paragraphs 25, 26 and A49 through A51)? Please explain the reasons for your position in as much detail as possible.

Response: Interior agrees and appreciates the latitude to develop and provide the most accurate estimates possible.

- Q5. The Board believes that it would be appropriate to provide guidance regarding reporting gains and losses from changes in assumptions and selecting the discount rates similar to that provided 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*, 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 20, 40, and A64 through A66)? Please explain the reasons for your position in as much detail as possible.

Response: Interior agrees that this would be a reasonable approach in keeping with the similar development of a more detailed oil and gas implementation guide.

- Q6. SFFAS 31, *Accounting for Fiduciary Activities*, requires that agencies report on assets held in a fiduciary capacity. The Department of Interior (DOI) manages oil and gas resources on behalf of individual Indians and Indian tribes. This proposed standard – because it classifies oil and gas resources as assets – would result in additional information being disclosed for oil and gas assets managed in a fiduciary capacity. Note, however, that fiduciary reporting does not extend to inclusion of the additional disclosures or RSI that are proposed in this document for federal oil and gas resources. Thus, with respect to fiduciary activities, only disclosure of the assets, liabilities, and related inflows and outflows would result from this proposal.

Some members have expressed concern that the costs may exceed the benefits of disclosing fiduciary assets and liabilities measured in conformance with this proposed standard. Since this proposal may significantly increase the fiduciary assets disclosed, we requested input on the cost-benefit of the requirement with respect to fiduciary activities in the May 2007 ED. One respondent was in favor of

the disclosures while four expressed their opinion that the information would most likely not be cost-beneficial. However, the Board has not received any substantive information to enable it to make an informed decision regarding cost/benefit.

Since the removal of the fiduciary oil and gas resource disclosure requirements would require an exception to the requirements of SFFAS 31, we are again requesting detailed input on the cost-benefit of the requirement with respect to fiduciary activities. See paragraph 46.

Response: As with onshore proved reserves under federal domain, there is no authoritative published quantity information regarding oil and gas resources managed by Interior on behalf of individual Indians or Indian tribes. However, a similar method for estimating onshore proved reserves under federal domain could potentially be employed to estimate an asset value for this category of oil and gas reserves. Like the onshore federal value, it would be an estimate, subject to significant fluctuation and based upon numerous assumptions. Sufficient disclosure would be required to help readers understand amounts presented and their relationship to royalties ultimately received. By applying a similar methodology to the federal domain category, consistency could be fairly readily achieved.

- Q7. The Board is proposing to provide a three-year phase-in of the proposed requirements from required supplementary information (RSI) beginning with fiscal year 2011 to basic in fiscal year 2014. This transitional period is being 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 51 and A87)? Please explain the reasons for your position in as much detail as possible.

Response: Interior agrees with the three-year phase-in, and appreciates the additional time provided in the Statement to perform the significant and complex changes that will be necessary. Interior is optimistic that this should provide adequate time to resolve outstanding issues and should facilitate an orderly implementation of the Statement.

- Q8. This Statement addresses accounting for federal oil and gas resources only. While the Board may address accounting for other types of natural resources at some point in the future, the majority of the members acknowledge that it is not likely that a project devoted to other categories of natural resources will be marked as a high priority at future agenda-setting sessions due to their lesser significance. As a result, while not explicitly encouraging agencies to recognize other categories of natural resources, the Board included paragraph 10 to explicitly state that this Statement does not preclude entities from recognizing or otherwise reporting information about other types of federally-owned natural resources. Do you agree or disagree that the potential risk that the inclusion of paragraph 10 might lead to inaccurate or inconsistent reporting of other types of natural resources is outweighed by the potential benefits to financial statement users (see paragraphs

10, A9 and A10)? Please explain the reasons for your position in as much detail as possible.

Response: Interior appreciates the latitude that the Board is seeking to provide in this paragraph and believed that it aids in acknowledging the potential treatment of other natural resources. With some related clarification, it could substantially help to resolve potential confusion and help to ensure consistent reporting. However, as it is presented, it illustrates a significant void in authoritative guidance which inherently facilitates the risk of potentially inaccurate or inconsistent reporting.

First, Interior believes that to remove any ambiguity in the intent of the paragraph, it should also indicate that application of the Statement is not mandatory for other federal natural resources. For example,

"This Statement does not preclude, nor does it require, entities recognizing or otherwise reporting information about other types of federally-owned natural resources."

Second, the current Exposure Draft guidance on accounting for federal oil and gas assets is quite different from FASB guidance covering oil and gas accounting in the private sector. This was emphasized in the response to Question 3 regarding the application of a private sector standard to a federally owned asset such as oil and gas. To ensure that preparers and auditors understand the relationship and application of this federal oil and gas Statement to other types of federal natural resources, we recommend that paragraph 10 be expanded to incorporate the intent from paragraph A10 into the formal governing Statement;

"...this Statement should be considered when applying SFFAS 34, *The Hierarchy of Generally Accepted Accounting Principles, Including the Application of Standards Issued by the Financial Accounting Standards Board*, to other types of federal natural resources."

Third, paragraph 10 as presented creates a dichotomy for preparers and auditors in that there are numerous types of federal natural resources for which no significant costs are incurred in the production of revenue, such as coal royalties, or revenues from renewable resource leases. Accordingly, the preparer must infer that SFFAS 7 applies to these resources. SFFAS 7, paragraph 45 as proposed, contains the 'custodial' provision for circumstances where there is no significant cost incurred to earn exchange revenue. Interior believes that the Statement should provide clarifying guidance to determine when to apply this 'custodial' provision to natural resources, or if it should always apply when there is no significant cost incurred.

For example, with certain renewable energy revenues derived from technologies such as geothermal, wind, wave, or current, there is not a 'depletable asset' for which a depletion expense could be matched against revenue earned. Similar to the auction of the radio spectrum, addressed in the revised SFFAS 7 paragraph

45, there are virtually no costs incurred in connection with earning this revenue. Interior interprets this to mean that for these types of 'non-depletable' activities, custodial accounting would still apply under SFFAS 7. Because other federal natural resource cases may not be so clear cut and to assist preparers and auditors, Interior believes that the guidance in the Statement should clarify if or when certain characteristics such as depletion could or should determine if custodial provisions apply, or if they should always apply when no significant costs are incurred.

The obvious result is that for commodities such as coal, which is a depletable natural resource, custodial accounting may or may not apply, depending on whether SFFAS 7 includes depletable natural resources. If not covered, then by default it would be required to be valued and accounted for in a manner similar to federal oil and gas. The 'optional' clause in paragraph 10 would be moot. If the Board intends that custodial accounting would apply, regardless if a natural resource is depletable or not, Interior recommends that this be explicitly stated in SFFAS 7, or the oil & gas Statement or implementation guide, to aid preparers and auditors in the proper and consistent treatment.

- Q9. After a three-year transition period of reporting as RSI, the ED proposes to recognize an asset on the balance sheet for the federal government's royalty share of federal oil and gas resources under lease (see paragraphs A29 through A37 for a discussion of factors regarding asset recognition considered by the Board in reaching this conclusion). An alternative view prepared by Mr. Dacey proposes that the value of federal oil and gas resources and annual changes therein be reported as RSI for a three-year transition period and then disclosed as basic information in the notes, rather than recognized on the face of the financial statements. The notes would be part of an integrated disclosure that would include the discussion of all of the government's natural resources, including oil and gas resources that are not currently under lease as well as values and information concerning all other significant natural resources, such as coal, timber, and grazing rights. Do you agree or disagree with the alternative view (see paragraphs A89 through A92)? Please explain the reasons for your position in as much detail as possible.

Response: Interior believes that this significant asset would best be disclosed as basic information in the notes, consistent with the approach recently expressed by Mr. Dacey in the alternate view. Interior believes that the Board's objectives of enhanced accountability and increased information about the asset can be more efficiently and effectively achieved by disclosing the information in the notes rather than on the face of the financial statements.

The proposed Statement as presented in the ED will require extensive and costly changes to existing Interior (specifically Minerals Management Service (MMS)) business processes, system requirements, and accounting events. These significant changes, impacts, and costs were presented in the previous field test questionnaires. Interior believes that the potential benefits of reporting depletion

expense and the gain or loss on revaluation on the Statement of Net Cost do not provide the reader with more meaningful information than could be obtained through disclosure, and in fact may be confusing.

For example, due to volatility in prices, quantity estimate revisions, and other factors, recording gains and losses on net cost may potentially mislead readers. In the MMS field test study, although the overall asset value declined over a year period, depletion expense recorded in the year exceeded the difference in the ending valuation, and required a gain on revaluation to be recorded. This gain would likely be misleading to the general reader, and renders the utility of the information questionable. Interior believes that disclosures regarding the asset valuation and royalties reported over a given span of time, combined with a discussion and presentation of any theoretical change due to revaluation of the estimated asset, would provide a clearer picture and would much more efficiently and cost effectively meet the Board's objectives.

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Tab D – Appendix 1

Revised Exposure Draft *Accounting for Federal Oil and Gas Resources* July 2009

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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 September 8, 2009

July 6, 2009

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.

Federal Accounting Standards Advisory Board

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Washington, DC 20548

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Federal Accounting Standards Advisory Board

July 6, 2009

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 begin 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. It should be noted that question nine (Q9) deals with an alternative view to recognition as an asset on the face of the basic financial statements (see alternative view in paragraphs A89 through A92). Responses are requested by September 8, 2009.

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 is referred to in this ED 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 non-federal entities, e.g., state governments.³ One Board member believes that the value of federal oil and gas resources and annual changes therein should be reported as basic information in the notes, rather than recognized on the face of the financial statements (see alternative view in paragraphs A89 through A92).

When federal oil and gas resources are extracted, revenue and a depletion expense equal to the revenue due would be recognized by the federal government. When revenue collections are distributed, the component entity that is responsible for collecting royalties would recognize a transfer out for revenue distributions to federal entities and a reduction in the liability for revenue distributions to non-federal entities. Gains and losses would be recognized based on an annual valuation of the asset with an adjustment to the liability for revenue distributions to non-federal entities. 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 non-federal entities would be established at the same time. The net effect of recognizing an asset and establishing a liability for revenue distributions to non-federal entities at the beginning of the reporting period would be a change in accounting principle that increases the entity’s net position.

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 non-federal party.

² A portion of the production value of proved oil and gas reserves are due to 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 state governments, other federal agencies, and the general fund of the U.S. Treasury in accordance with legislated allocation formulas.

The proposed standards would be effective as required supplementary information (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.

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

The federal government is accountable to the American citizens for proper stewardship of federal assets. 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. In addition, recognizing federal oil and gas resources on the government's balance sheet would enable the federal government to clearly communicate the effect of some of the legislative changes related to federal oil and gas resources to the taxpayers in the period that the changes are made (e.g., opening additional lands for leasing or increasing the percentage of royalties to be distributed to the states). Additional disclosures about federal oil and gas resources would provide comprehensive information about federal assets, reveal changes in the quantity and status of federal oil and gas resources, and make quantity information more accessible to users of financial information.

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

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 standards would provide information useful in evaluating the reporting entity's management of assets relating to federal oil and gas resources. This information would allow financial report users to monitor changes in royalty rates and 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 federal 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 federal 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 costs were incurred to generate the revenues—the federal government exchanged proved reserves for a future stream of royalty payments.

With respect to meeting the stewardship reporting objective, the proposed standards 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

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

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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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 September 8, 2009.

- Q1. The original exposure draft (ED) issued on May 21, 2007, contained detailed asset valuation implementation guidance for valuing federal oil and gas resources. As a result of feedback received from field testing efforts, the Board has removed that detailed guidance from this revised ED and is instead proposing to provide federal entities with flexibility in developing the asset valuation estimation methodology due to the constantly changing economic and technical conditions. Do you agree or disagree with the Board's position (see paragraphs 14 through 26, A47 and A48)? 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 as described in paragraphs 19 through 21. Discount rates as of the

reporting date for present value measurements of federal 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. Do you agree or disagree with the Board's position (see paragraphs 19 through 21 and A38 through A46)? Please explain the reasons for your position in as much detail as possible.

- Q3. The Board is proposing to permit an alternative measurement method 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 using the approach described in paragraphs 19 through 21. Specifically, the Board is permitting a market-based fair value measurement consistent with the Financial Accounting Standards Board (FASB) Statement of Financial Accounting Standards 157, *Fair Value Measurements*.⁴ Do you agree or disagree with the Board's position (see paragraphs 24 and A38 through A46)? 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 paragraphs 25, 26 and A49 through A51)? Please explain the reasons for your position in as much detail as possible.
- Q5. The Board believes that it would be appropriate to provide guidance regarding reporting gains and losses from changes in assumptions and selecting the discount rates similar to that provided 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*, 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 20, 40, and A64 through A66)? Please explain the reasons for your position in as much detail as possible.
- Q6. SFFAS 31, *Accounting for Fiduciary Activities*, requires that agencies report on assets held in a fiduciary capacity. The Department of Interior (DOI) manages oil and gas resources on behalf of individual Indians and Indian tribes. This proposed standard – because it classifies oil and gas resources as assets – would result in additional information being disclosed for oil and gas assets managed in a fiduciary capacity. Note, however, that fiduciary reporting does

⁴ FASB Accounting Standards Codification™ (ASC) 820.10

not extend to inclusion of the additional disclosures or RSI that are proposed in this document for federal oil and gas resources. Thus, with respect to fiduciary activities, only disclosure of the assets, liabilities, and related inflows and outflows would result from this proposal.

Some members have expressed concern that the costs may exceed the benefits of disclosing fiduciary assets and liabilities measured in conformance with this proposed standard. Since this proposal may significantly increase the fiduciary assets disclosed, we requested input on the cost-benefit of the requirement with respect to fiduciary activities in the May 2007 ED. One respondent was in favor of the disclosures while four expressed their opinion that the information would most likely not be cost-beneficial. However, the Board has not received any substantive information to enable it to make an informed decision regarding cost/benefit.

Since the removal of the fiduciary oil and gas resource disclosure requirements would require an exception to the requirements of SFFAS 31, we are again requesting detailed input on the cost-benefit of the requirement with respect to fiduciary activities. See paragraph 46.

- Q7. The Board is proposing to provide a three-year phase-in of the proposed requirements from required supplementary information (RSI) beginning with fiscal year 2011 to basic in fiscal year 2014. This transitional period is being 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 51 and A87)? Please explain the reasons for your position in as much detail as possible.
- Q8. This Statement addresses accounting for federal oil and gas resources only. While the Board may address accounting for other types of natural resources at some point in the future, the majority of the members acknowledge that it is not likely that a project devoted to other categories of natural resources will be marked as a high priority at future agenda-setting sessions due to their lesser significance. As a result, while not explicitly encouraging agencies to recognize other categories of natural resources, the Board included paragraph 10 to explicitly state that this Statement does not preclude entities from recognizing or otherwise reporting information about other types of federally-owned natural resources. Do you agree or disagree that the potential risk that the inclusion of paragraph 10 might lead to inaccurate or inconsistent reporting of other types of natural resources is outweighed by the potential benefits to financial statement users (see paragraphs 10, A9 and A10)? Please explain the reasons for your position in as much detail as possible.

- Q9. After a three-year transition period of reporting as RSI, the ED proposes to recognize an asset on the balance sheet for the federal government's royalty share of federal oil and gas resources under lease (see paragraphs A29 through A37 for a discussion of factors regarding asset recognition considered by the Board in reaching this conclusion). An alternative view prepared by Mr. Dacey proposes that the value of federal oil and gas resources and annual changes therein be reported as RSI for a three-year transition period and then disclosed as basic information in the notes, rather than recognized on the face of the financial statements. The notes would be part of an integrated disclosure that would include the discussion of all of the government's natural resources, including oil and gas resources that are not currently under lease as well as values and information concerning all other significant natural resources, such as coal, timber, and grazing rights. Do you agree or disagree with the alternative view (see paragraphs A89 through A92)? 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 result 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 federal oil and gas resources should be developed by federal entities. 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 these changing 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 Standards

Scope

7. This Statement applies to federal entities that report information about federal oil and gas resources in general purpose financial reports, including the consolidated financial report of the U.S. Government (CFR), in conformance with proposed Statement of Federal Financial Accounting Standards 34, *The Hierarchy of Generally Accepted Accounting Principles, Including the Application of Standards Issued by the Financial Accounting Standards Board*.⁵
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. This Statement also amends SFFAS 7, *Accounting for Revenue and Other Financing Sources*, to account for and report bonus bid, rent, and royalty collections in accordance with exchange revenue standards.⁶
10. Federal lands contain a variety of natural resources other than oil and gas that are not specifically addressed by this Statement. This Statement does not preclude entities from recognizing or otherwise reporting information about other types of federally-owned natural resources.

Definitions

11. Definitions in paragraphs 12 and 13 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 61). 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

⁵ SFFAS 34 was approved by the Board and sent to the principals for a 90-day review period; the Board expects to issue SFFAS 34 as final in July 2009.

⁶ These collections are currently treated as nonexchange revenue due to the absence of cost information.

not include resources over which the federal government acts as a fiduciary for the benefit of a non-federal party.

13. **Regional estimated petroleum royalties:** 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 and Measurement

14. 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.
15. Federal oil and gas resources are made up of two primary components – reserves and undiscovered resources. Reserves can be further defined as either proved or unproved while undiscovered resources can be further defined as either recoverable or non-recoverable. See *Illustration 1 – Components of Federal Oil and Gas Resources* on page 27 for an illustration of the universe of federal oil and gas resources and a further breakdown of its components.
16. Information is available in varying degrees and with varying reliability for each component. While all of the federal oil and gas resources meet the definition of an asset, the Board does not believe that the information for other than proved reserves is sufficiently reliable to be recognized.
17. An asset and corresponding revenue for the federal government's estimated petroleum royalties from the production of federal oil and gas proved reserves should be recognized by the component entity that is responsible for collecting royalties.
18. The Board believes that the detailed estimation methodology for valuing federal oil and gas resources should be developed by federal entities.⁷ 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 these changing conditions.

⁷ Estimates that do not lead to material misstatements are acceptable without guidance from the Board.

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19. 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.
 20. Discount rates as of the reporting date for present value measurements of federal 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.
 21. 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. While the entity's own assumptions about future cash flows may be used, 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. If the entity's own assumptions do not reflect data that is consistent with sources independent of the reporting entity, an explanation of why it is inappropriate to do so should be disclosed.
 22. The value of the federal government's estimated petroleum royalties should be computed based on the calculation of federal oil and gas proved reserves on a regional basis. For purposes of these standards, the regions used in determining and reporting regional amounts or factors should be collaboratively developed by all the component entities involved in federal oil and gas resource activities. Regions used in calculating regional estimated petroleum royalties and in applying these standards should be consistent and aligned with regions used internally by the component entities in administering federal oil and gas resource activities.
 23. 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.
 24. The preferred measurement method for valuing the federal government's estimated petroleum royalties is the present value of future federal royalty receipts on proved reserves using a risk-free discount rate as described in paragraphs 19 through 21; however, methods for measuring fair value that

are consistent with Statement of Financial Accounting Standards (SFAS) 157, *Fair Value Measurements*,⁸ may be acceptable if it is not reasonably possible to estimate present value of future federal royalty receipts on proved reserves using the methodology described in paragraphs 19 through 21.

25. 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. The net effect of a change in methodology after the initial year should be accounted for as a change in accounting estimate effected by a change in accounting principle.⁹
26. A change in accounting estimate should be accounted for in (a) the period of change if the change affects that period only or (b) the period of change and future periods if the change affects both. A change in accounting estimate should not be accounted for by restating or retrospectively adjusting amounts reported in financial statements of prior periods or by reporting pro forma amounts for prior periods.

Liability Recognition and Measurement

27. The majority of the federal government's estimated petroleum royalties from the production of federal oil and gas proved reserves are distributed to state governments, 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 obligation¹⁰ 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.
28. A long-term liability and corresponding expense for estimated petroleum royalty revenue distributions to non-federal entities (e.g., state governments)

⁸ FASB ASC 820.10

⁹ A change in accounting estimate effected by a change in accounting principle is a change in accounting estimate that is inseparable from the effect of a related change in accounting principle. An example of a change in estimate effected by a change in principle is a change in the method of depreciation, amortization, or depletion for long-lived, nonfinancial assets.

¹⁰ 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.

should be recognized by the component entity that is responsible for collecting royalties in conjunction with the recognition of an asset for estimated petroleum royalties.¹¹ The amount of the liability should be estimated based on the portion of the royalty share of the federal proved oil and gas reserves designated to be distributed to non-federal entities. For example, the average annual share of the revenue distributed to non-federal entities over the preceding twelve (12) months may be an acceptable basis for estimating petroleum royalties to be distributed. Other methodologies may be acceptable. The corresponding expense should be recognized in a manner consistent with existing standards.

29. The estimated portion of the liability for royalty revenue distributions to non-federal entities expected to be distributed within 12 months of the fiscal year-end may be classified as current.
30. The cumulative net effect of recognizing an asset and establishing a liability for revenue distributions to non-federal entities at the beginning of the reporting period for which these standards are fully effective should be reported as a "change in accounting principle" that increases the entity's net position. The adjustment should 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 should not be restated.

Revenue and Expense Recognition

31. **Bonus bid** and **rent** revenue relating to federal oil and gas resources should be recognized as exchange revenue on the statement of net cost of the component entity that is responsible for collecting royalties.¹² In addition, a liability¹³ and corresponding expense for bonus bid and rent revenue distributions to non-federal entities should be recognized by the component entity that is responsible for collecting royalties in conjunction

¹¹ At this time, the Board is requiring liability recognition for estimated petroleum royalty revenue to be distributed to **non-federal** entities. An estimate of the estimated petroleum royalty revenue to be distributed to **federal** entities should be disclosed (see par. 42f).

¹² Per SFFAS 7, *Accounting for Revenue and Other Financing Sources*, paragraph 34.

¹³ SFFAS 1, *Accounting for Selected Assets and Liabilities*, pars. 83-86, provides that other current liabilities may include unpaid expenses that are accrued for the fiscal year for which the financial statements are prepared and are expected to be paid within the fiscal year following the reporting date. Amounts of bonus bids and rent revenues to be distributed to non-federal entities may be classified as an other current liability consistent with SFFAS 1 if the definition is met.

with the recognition of the bonus bid and rent revenue. The amount of the liability should be the bonus bid and rent revenues designated to be distributed to non-federal entities, e.g., state governments. The corresponding expense should be recognized in a manner consistent with existing standards.

32. **Royalties** from the production of federal oil and gas proved reserves should 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 should 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 should be reduced by the depletion expense amount.¹⁴

Future Royalty Rights Identified for Sale

33. When rights to a stream of future royalties are identified for sale, the calculated value of those rights should be disclosed in the notes as “future royalty rights identified for sale.” The “future royalty rights identified for sale” should not be revalued or reclassified to a different asset category on the balance sheet and no gain or loss should be reported prior to the sale.
34. The calculated value disclosed for future royalty rights identified for sale should be based on the present value of future federal royalty receipts on proved reserves known to exist as of the reporting date for the specific **field** to be sold.
35. When the future royalty rights identified for sale are sold, the calculated value of the future royalty rights sold should 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.
36. The net gain or loss should 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 for the revenue distributions to non-federal entities should be increased by an amount equal to the amount of the gain designated to be distributed to non-

¹⁴ The principle that a liability is reduced when funds are distributed is established in other FASAB standards. When bonus bid, rent, and royalties are distributed, the liability for bonus bid, rent, and royalty distributions should be reduced.

federal entities, e.g., state governments. If the sale produced a net loss, the liability and a corresponding expense for the revenue distributions to non-federal entities should be decreased by an amount equal to the amount of the loss, which will reduce future distributions to others.

Annual Valuation of Estimated Petroleum Royalties

37. The estimated petroleum royalties asset should be valued at the end of each fiscal year for financial statement reporting.
38. The calculated value of estimated petroleum royalties at year-end should 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,¹⁵ the book value should be increased to the new estimate and a gain should be recognized on the statement of net cost. If the calculated value of the estimated petroleum royalties asset at year-end is less than the book value, the book value should be decreased to the new estimate and a loss should be recognized on the statement of net cost.
39. 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 non-federal entities should be increased or decreased to the amount expected to be distributed.¹⁶ If the revaluation resulted in a net gain, the liability and a corresponding expense for the revenue distributions to non-federal entities should be increased by an amount equal to the amount of the gain designated to be distributed to non-federal entities, e.g., state governments. If the revaluation resulted in a net loss, the liability and a corresponding expense for the revenue distributions to non-federal entities should be decreased by an amount equal to the amount of the loss, which will reduce future distributions to others.
40. For estimates that are developed using present value, component entities should display gains and losses from changes in **long-term assumptions** (i.e., discount rate and inflation rate) used to measure assets and liabilities for oil and gas as a separate line item or line items on the statement of net costs. See the pro forma illustration in Appendix B.

¹⁵ The estimated petroleum royalties beginning balance would have been reduced by the amount of depletion expense recognized during the year.

¹⁶ 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.

Disclosure Requirements and Required Supplementary Information

41. 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.

Component Entity Report Disclosures

42. The component entity responsible for collecting royalties should provide the following as note disclosures:
- 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 should 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, if applicable. The narrative should 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 revenue reported by category for the reporting period should be presented for offshore and onshore revenues for the following categories: royalty revenue for oil and gas, rent revenue, 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 23); and,
 - v. the value of estimated petroleum royalties at the end of each reporting period.
- f. A schedule of the total amount of estimated petroleum royalties to be distributed to other federal entities, by entity.
- g. A narrative describing and a display showing the reconciliation between the beginning and ending balances of the estimated petroleum royalties asset reported in the entity's balance sheet. The reconciliation is accomplished by adding to or subtracting from the beginning balance the dollar amounts of the following items: (1) revaluation gains and losses due to changes in quantity, price, royalty rates, and long-term assumptions (i.e., discount rate and inflation rate), (2) depletion, (3) sale of future royalty streams, and (4) other adjustments. Additional subcomponents may be presented. The narrative should include an explanation of the reasons for the changes in estimated petroleum royalties from one period to the next and be as brief as possible without detracting from understanding.

Component Entity Required Supplementary Information (RSI)

43. The component entity responsible for reporting the federal government's estimated petroleum royalties on its balance sheet should provide the following as RSI:
- a. 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., discount rates used to calculate present value, production decline curve, portion of proved reserves under federal lands, future oil and gas prices, inflation rates, etc).

- b. A reference to the source reports used to calculate the value of the federal government's estimated petroleum royalties.
- c. A narrative describing and a display showing the **sales volume**, the **sales value**, the royalty revenue, and the **estimated value for royalty relief** produced from federal oil and gas resources for the reporting period. To the extent that regional information is available and would contribute to understanding, provide the information for each region.
- d. A narrative describing other significant federal oil and gas resources that are not addressed by this Statement because they are not currently under lease (e.g., coastal plain of the Arctic National Wildlife Refuge). The narrative should be sufficient to enable the financial statement reader to gain an understanding of the full extent of federal oil and gas resources.

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Disclosures

- 44. The governmentwide entity should display gains and losses from changes in assumptions as a separate line item or line items on the statement of net cost after a subtotal for all other costs and before total cost.
- 45. The disclosure related to federal oil and gas resources should provide:
 - a. A concise statement explaining the nature and valuation of federal oil and gas resources.
 - b. 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 First 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 23).
 - v. The value of estimated petroleum royalties at the end of each reporting period.
 - c. A reference to specific agency reports for additional information about federal oil and gas resources.

Fiduciary Oil and Gas Resources Disclosures

46. Fiduciary activities are defined in SFFAS 31, *Accounting for Fiduciary Activities*. Information consistent with the requirements of paragraphs 14 through 40 of this document should 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 Statement.

Federal Receiving Entity Accounting and Reporting

47. Each federal entity that is required to receive a portion of the estimated petroleum royalties asset should disclose in the notes to its financial statements its relationship with the royalty revenue program and an estimate of the total amount of estimated petroleum royalties to be distributed to it over time by the component entity that is responsible for collecting royalties. The amount should be calculated by the component entity that is responsible for collecting royalties using the same measurement method that is used to value the asset.
48. As distributions are received from the component entity responsible for collecting royalties, the federal receiving entity should record a transfer in and a corresponding increase to fund balance.

Effect on Existing Standards

49. This Statement 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.

50. 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

51. The following phase-in of reporting requirements as basic information provides for full implementation for reporting periods beginning after September 30, 2013.
 - a. These standards are 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). Until such time that the information is presented as basic, information reported as RSI would be presented as part of a schedule of estimated petroleum royalties and not reported in the principal financial statements.

- c. Beginning in fiscal year 2014, the required information should be presented as basic information, except where specifically designated as RSI (paragraph 43).
- 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/pdffiles/natresrpt.pdf> 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 received in exchange for federal 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 (exploration and production activities) and downstream activities (transportation, refining, and marketing activities). Upstream activities can be divided into the following phases:

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- a. Prospecting¹⁷
 - 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 and can be divided into the following phases:
- a. Supply and trading
 - b. Shipping
 - c. Refining
 - d. Storage and distribution
 - e. Marketing and retail
- A6. The national assessment of federal 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.
- A8. This exposure draft (ED) is the Board's second request for comments on its proposed requirements for accounting for federal oil and gas resources. The Board released the original ED, *Accounting for Federal Oil and Gas Resources*, on May 21, 2007. Substantive changes have been made to the original ED as a result of the comments received. Discussions about the new requirements as well as the changes from the original requirements are disbursed throughout the remainder of this appendix.

Accounting for Other Types of Natural Resources

- A9. Federal lands contain a variety of natural resources that are not specifically addressed by this Statement, including coal, gold, and silver, as well as timber and grazing rights. Originally, the Board intended to address each category of

¹⁷ Prospecting usually involves researching and analyzing an area's historic geologic data and carrying out topographical, geological, and geophysical studies.

resources in separate phases as noted in paragraph A2. Although in principle a broader application was desirable to several Board members, the majority believes that the Board has already devoted a substantial amount of time to the oil and gas standard and developing additional guidance would significantly delay implementation of a broad standard. Therefore, since federal oil and gas resources represent the most significant portion of all federal natural resources, the majority of members felt it was important to begin recognizing them as soon as possible.

- A10. While the Board may address accounting for other types of natural resources at some point in the future, the majority of the members acknowledge that it is not likely that a project devoted to other categories of natural resources will be marked as a high priority at future agenda-setting sessions due to their lesser significance. Nonetheless, the majority of the members believe that the substance of the standards developed for federal oil and gas resources may serve as a good analogy for other categories of federal natural resources. Therefore, while this Statement does not specifically address other types of federal natural resources, the Board believes that this Statement should be considered when applying SFFAS 34, *The Hierarchy of Generally Accepted Accounting Principles, Including the Application of Standards Issued by the Financial Accounting Standards Board*, to other types of federal natural resources that agencies are considering for recognition and reporting. As a result, while not explicitly encouraging agencies to recognize other categories of natural resources, the Board included paragraph 10 to explicitly state that this Statement does not preclude entities from recognizing or otherwise reporting information about other types of federally-owned natural resources.¹⁸

Overview of Federal Oil and Gas Resources

- A11. Illustration 1, *Components of Federal Oil and Gas Resources* (illustration), presented on page 27 identifies the universe of federal oil and gas resources. The illustration 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.
- A12. The accounting standards presented in the illustration include current accounting standards and proposed accounting standards for each component of federal oil and gas resources. The components are those used in the

¹⁸ SFFAS 34, Paragraph 7 (see footnote 5 regarding issuance of SFFAS 34)

industry. Information is available in varying degrees and with varying reliability for each component. The components are first separated into “undiscovered resources” and “reserves.” Generally, undiscovered resources are not under lease, while reserves are under lease.

Undiscovered Resources

- A13. 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.**
- A14. 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.
- A15. 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.
- A16. 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.
- A17. 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.

- A18. Under current FASAB accounting standards, there are no requirements to provide or present information about the undiscovered resource components in the financial statements. Information about technically recoverable resources has been gathered and maintained by the Energy Information Administration (EIA) in the past. However, EIA no longer reports on the technically recoverable resources under federal lands. Therefore, as there is no reliable source for this type of information, federal reporting on onshore and offshore undiscovered recoverable resources is not required.

Reserves

- A19. The second major component of total resources is reserves. The reserves 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**
 - 1. **proved developed non-producing reserves**
 - 2. **proved developed producing reserves**
- A20. Under current FASAB accounting standards, there are no requirements to provide or present information about the unproved reserves components in the financial statements.
- A21. Under the accounting standards proposed in the original ED, information about onshore and offshore unproved reserves would be included in the technically recoverable resources and reported as RSI. However, as noted in par. A18, although information about technically recoverable resources has been gathered and maintained by the EIA in the past, EIA no longer reports on the technically recoverable resources under federal lands. Therefore, as there is

no reliable source for this type of information, federal reporting on unproved reserves is not required.

- A22. 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.
- A23. Under current accounting standards, the bonus bid, rent (collected on the lease until oil and gas production begins), and royalty revenue (collected on production) are accounted for as a custodial activity (i.e., an amount collected for others) by MMS, the collecting entity. The collections and their 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.
- A24. 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 due 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, revenue received from 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.
- A25. 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, information on the quantity and consumption of proved reserves, including the sales volume, the sales value, the amount of royalty revenue, and the estimated value for royalty relief would be provided as RSI.
- A26. On page 27, Illustration 1, entitled *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 ¹⁹	
Proved reserves quantity information provided by EIA ²⁰	

The terms in Illustration 1 are defined in the Glossary under the subheading *Definitions of Resource and Reserve Components and Subcomponents*.

¹⁹ Quantity information is published at the national level.

²⁰ Quantity information is published at the national level.

Illustration 1 – Components of Federal Oil and Gas Resources

Accounting Standards	Components of Federal Oil and Gas Resources							
	Undiscovered Resources				Reserves			
	Undiscovered Non-Recoverable Resources	Technically Recoverable Resources			Proved Reserves			
		Undiscovered Recoverable Resources		Unproved Reserves				
		Undiscovered Conventionally Recoverable Resources	Undiscovered Economically Recoverable Resources	Unproved Possible Reserves	Unproved Probable Reserves	Proved Undeveloped Reserves	Proved Developed Reserves	
							Proved Developed Non-Producing Reserves	Proved Developed Producing Reserves
Current Accounting Standards				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				
Proposed Accounting Standards				<ul style="list-style-type: none">Recognize bonus bid and rent revenues as exchange revenue on SNC²¹	<ul style="list-style-type: none">Recognize projected federal royalty share as asset on BS²²Recognize designated distributions to non-federal entities as liability on BSRecognize gains and losses from revaluation on SNCProvide disclosures for proved reserves	<ul style="list-style-type: none">Recognize royalty revenues as revenue and depletion expense on SNCProvide RSI/ Disclosure Information		

²¹ statement of net cost²² balance sheet

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 Non-Federal Entities

Recognition Criteria

- A27. 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.²³
- A28. 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.²⁴

Asset Recognition

- A29. 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.
- A30. An asset for federal accounting purposes is a resource that embodies economic benefits or services that the federal government controls.²⁵
- A31. 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.²⁶

Oil and Gas Resources as a Federal Asset

²³ SFFAC 5, par. 5.

²⁴ SFFAC 5, par. 7.

²⁵ SFFAC 5, par. 18.

²⁶ SFFAC 5, par. 22.

- A32. First, the Board established which federal oil and gas resources were being considered. *Illustration 1 – Components of Federal Oil and Gas Resources* on page 27 presents the federal oil and gas resources that were considered. The two major components are “undiscovered resources” and “reserves.” 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.
- A33. 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 A27 above, the second criterion for recognition is that the asset “...be measurable.”
- A34. Estimates of the quantity of technically recoverable oil and gas resources were available through EIA in the past. With this quantity information, a monetary measure was technically feasible and, therefore, the asset qualified for consideration for recognition. However, the Board does not believe that the information is sufficiently reliable to be recognized in a cost-beneficial manner.
- A35. 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. Therefore, 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.
- A36. 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 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.

- A37. 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 proved oil and gas reserves can be reliably estimated and converted to monetary terms (estimated federal royalty share), the Board believes the estimated federal royalty share of proved oil and gas reserves should be recognized on the balance sheet.

Measurement Attributes and Methods Considered

- A38. The FASAB's projects to reexamine and expand its conceptual framework include a project on measurement attributes (i.e., the aspect of an item that is measured, such as, for example, its historical cost or replacement cost) for reporting purposes. This project follows logically from SFFAC 5, which states that an item's being *measurable* is a criterion for recognition in the financial statements but does not address measurement attributes or measurement methods.
- A39. As is true of other components of an expanded conceptual framework, this project on measurement attributes is expected to result in a concepts statement for the future guidance of, primarily, the Board itself. The statement may include definitions and a discussion of the features of different measurement attributes as well as other concepts that should assist the Board in developing future standards. The statement also should assist preparers and auditors in selecting appropriate measurement attributes in the absence of FASAB standards, and it should help users understand the importance of the selection of different measurement attributes. However, the concepts statement would not set standards. For example, although it might discuss the advantages and disadvantages of particular attributes, it would neither require nor recommend the selection of particular attributes in specific circumstances, nor would it amend or supersede existing standards for the selection of measurement attributes or other measurement concepts.
- A40. While concepts to help guide the selection of appropriate measurement attributes should make a significant contribution to the Board's ability in the

future to enhance the consistency of standards for the benefit of preparers, auditors, and users of federal financial statements and financial reports, such guiding concepts do not need to be finalized prior to FASAB issuing additional standards. Therefore, while the project on measurement attributes is underway, the Board will need to continue to select the measurement attributes for each standard under deliberation.

- A41. 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:
- a. 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.
 - b. 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.
 - c. 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. The ‘net realizable value’ (NRV) requires a reasonable estimate of future flows (receipts and costs) associated with converting assets to cash.
 - d. 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.
- A42. After deliberating on the above attributes and methods, the Board decided that defining a measurement attribute in terms that are common to the oil and gas industry would be the best approach. Therefore, the Board proposed to use a regional average first purchase price for oil and lease condensate, a regional average first purchase price for **natural gas plant liquids (NGPLs)**, and a regional average wellhead price for gas to value federal estimated petroleum royalties. This measurement approach was included in the May 2007 ED.
- A43. Also included in the May 2007 ED was an alternative view from the Board member representing the Congressional Budget Office, expressing the view that fair value is the appropriate basis for valuing federal oil and gas resources.

At the time, the other Board members had rejected fair value because of the lack of current transactions between market participants involving the sale of the federal royalty share for proved oil and gas reserves.

- A44. In conjunction with the comment period on the May 2007 ED, the Board requested that the proposal be field tested by the Department of Interior (DOI). After reviewing the results of the field testing performed by DOI (see paragraphs A78 through A85) and talking with DOI representatives (see paragraphs A86 and A87) about the alternative methodology that it developed, the Board determined that 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. In addition, discount rates as of the reporting date for present value measurements of federal 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.
- A45. While present value is typically considered to be a method for measuring fair value, the present value measurement approach proposed in this ED is based on an entity-specific discount rate, specifically the interest rates on marketable Treasury securities, and does not consider the price that market participants demand for bearing the uncertainty inherent in the cash flows (i.e., neither the cash flows nor the discount rate is adjusted for a market risk premium). Under SFAS 157,²⁷ a fair value measurement should be determined based on the assumptions that market participants would use in pricing the asset. A measurement that does not include an adjustment for the market risk premium would not represent a fair value measurement since market participants would include one in pricing the petroleum royalties. Therefore, the present value measurement approach proposed in this ED is not a fair value measure consistent with SFAS 157.²⁸
- A46. There is some concern that DOI may not be able to implement and/or obtain a favorable audit opinion on the present value methodology that it proposed as a result of its field testing. To permit additional flexibility in the measurement methods for valuing federal estimated petroleum royalties, the Board has also determined that methods for measuring fair value that are consistent with SFAS 157²⁹ will be acceptable. Fair value incorporates the effects of uncertainty that are inherent in the cash flows expected in the future from oil

²⁷ FASB ASC 820.10

²⁸ Ibid

²⁹ Ibid

and gas activities, including the effects of the additional return demanded by market participants to assume the risk of that uncertainty. Therefore, the proposed standard provides for a measurement method that is based on either (1) the present value of future federal royalty receipts on proved reserves known to exist as of the reporting date using a risk-free discount rate without incorporating market risk, or (2) a market-based fair value measurement consistent with SFAS 157.³⁰

Asset Valuation Methodology

- A47. The Board believes that the detailed estimation methodology for valuing federal oil and gas resources should be developed by federal entities. 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 these changing 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 standards from becoming outdated.
- A48. EIA has been used as the source of information on proved reserves data in the past and may prove to continue to be the appropriate source for such information in the future. However, the Board has chosen not to explicitly designate EIA as the source of information; an explicit designation of the source of information would prevent the preparer from fully complying with the standards if the source were no longer available at some point in the future.

Change in Methodology after the Initial Year of Implementation

- A49. The net effect of a change in methodology after the initial year should be accounted for as a change in accounting estimate effected by a change in accounting principle.
- A50. Distinguishing between a change in an accounting principle and a change in an accounting estimate is sometimes difficult. In some cases, a change in accounting estimate is effected by a change in accounting principle. A change in accounting estimate effected by a change in accounting principle is a change in accounting estimate that is inseparable from the effect of a related change in accounting principle. One example of this type of change is a change in

³⁰ Ibid

method of depreciation, amortization, or depletion for long-lived, nonfinancial assets (hereinafter referred to as depreciation method). The new depreciation method is adopted in partial or complete recognition of a change in the estimated future benefits inherent in the asset, the pattern of consumption of those benefits, or the information available to the entity about those benefits. The effect of the change in accounting principle, or the method of applying it, may be inseparable from the effect of the change in accounting estimate. Changes of that type often are related to the continuing process of obtaining additional information and revising estimates and, therefore, are considered changes in estimates for purposes of applying this Statement.

- A51. Like other changes in accounting principle, a change in accounting estimate that is effected by a change in accounting principle may be made only if the new accounting principle is justifiable on the basis that it is preferable. For example, an entity that concludes that the pattern of consumption of the expected benefits of an asset has changed, and determines that a new depreciation method better reflects that pattern, may be justified in making a change in accounting estimate effected by a change in accounting principle.

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

- A52. 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

- A53. Recognition of royalty distributions to non-federal entities as a liability is based on SFFAC 5 paragraphs 36 through 48.

- A54. A liability is a present obligation³¹ of the federal government to provide assets or services to another entity at a determinable date, when a specified event occurs, or on demand.³²
- A55. 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.³³
- A56. In paragraph 17, 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 others (e.g., the general fund of the U.S. Treasury, other federal agencies, and state governments) 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 2005.³⁴
- A57. The Board considered and agreed that a liability for revenue distributions to others should be recognized in conjunction with the recognition of an asset for estimated petroleum royalties. The Board believes a liability for revenue distributions to others should be recognized because nearly all of the revenue from royalties, lease sales, and rent are ultimately distributed to others (e.g., the general fund of the U.S. Treasury, other federal agencies, and state governments). As the proceeds are distributed, the liability would be reduced.

³¹ 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.

³² SFFAC 5, par. 39.

³³ SFFAC 5, par. 41.

³⁴ The one percent was derived by dividing [Note 21. Custodial Distributions to MMS, Revenues to Fund Operations] by [Total Revenue on the Statement of Custodial Activity] for 2005.

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- A58. The Board believes that if a liability for revenue distributions to others was not established, the component entity's and the federal government's net position would be overstated.
- A59. Conceptually, it would be appropriate for the component entity to record a liability for the revenue to be distributed to both federal and non-federal parties. However, in its response to the field test questionnaires, the DOI field test team noted that each designated federal recipient would be required to record a corresponding receivable and transfer in their statements, with eliminations between entities to prevent double counting government wide. The field test team noted that this accounting becomes especially critical at quarter-ends and at fiscal year-end, where late adjustments required to accruals that are deemed related to federal oil and gas revenue will also require late adjustments by all downstream recipients, thus significantly hampering entities' ability to meet accelerated financial reporting due dates and potentially giving rise to audit findings.
- A60. Recognizing that the federal government's current environment results in a continuing strain on resources, the Board has become even more sensitive to developing accounting requirements that serve to provide meaningful information to financial statement users while trying to avoid requirements that are complied with merely for the sake of compliance.
- A61. The original ED requirements would result in each of the receiving federal entities recognizing an account receivable and a transfer in their financial statements for the initial asset entry. Then, as the asset is subsequently revalued or adjusted by DOI or its auditors, the receiving federal entities would need to adjust their accounts receivable and transfer accounts. In addition, the intragovernmental elimination entries would need to be adjusted as well. This would be a lot of last minute adjusting for amounts that would be eliminated from the CFR. However, if the receivable entries were not made, the receiving entities would not be including these assets in their financial statements. The Board reconsidered the value of having the federal component entities record the receivable and transfer in their financial statements.
- A62. Accounts receivable arise from claims to cash or other assets (SFFAS 1, par. 40). The purpose of recognizing accounts receivable for accrual-basis accounting is to recognize a resource that embodies economic benefits or services in the period that it becomes measurable (SFFAC 5, pars. 5 and 18). While the Board has decided that the estimated petroleum royalties asset upon which the receivable would be based can be reasonably estimated, it is doubtful that the federal receiving entity management would find much decision-useful information with the recognition of a receivable that would be extremely volatile and could not be relied upon for short or long-term budget
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decisions. In addition, it is doubtful that the financial statement users would find more value in recognition of a receivable on the face of the financial statement as opposed to a disclosure of an estimated amount in the notes to the financial statements. On the contrary, revaluations of the asset that result in large inflows or outflows to the receiving entity in any given year would require a detailed explanation to satisfy the user.

- A63. The Board revised the requirements from the original ED so that only a liability for revenue to be distributed to non-federal entities (e.g., state governments) is required to be recognized while each federal receiving entity must disclose in the notes to its financial statements its relationship with the royalty revenue program and an estimate of the total amount of estimated petroleum royalties to be distributed to it.

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

- A64. 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 and valuation date for pension, ORB, and OPEB liabilities.
- A65. 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 standards to federal employee pension, ORB, and OPEB liabilities. This decision was based on the Board's desire to address its primary concern, which is to display the effect of assumption changes on employee compensation liabilities. Since respondents had requested more guidance regarding how the standards would apply to other long-term assumptions, the Board believed that developing additional guidance would significantly delay implementation of SFFAS 33.
- A66. The Board believes that it would be appropriate to apply guidance similar to that provided in SFFAS 33 to long-term assumptions about oil and gas in order

to increase the usefulness of reported operating results when the volatility of projections results in large variations in annual net cost from year to year.

Future Rights to Royalty Streams Identified for Sale

- A67. 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.
- A68. 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.
- A69. 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 non-federal entities 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

- A70. 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 revenue reported by category for the reporting period. That is, royalty revenue for oil and gas, rent revenue, bonus bid revenue for leases, and total revenue. The proposed RSI includes sales volume, the sales value, the royalty revenue, and the estimated value for royalty relief for oil and gas produced from federal oil

and gas resources for the reporting period. This information would be presented for each region, to the extent that regional information is available and would contribute to understanding.

Original Exposure Draft

- A71. 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.
- A72. 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.
- A73. 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)).

A74. 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

A75. 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	

A76. 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 standards 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.
- A77. The Board did not rely on the number in favor of 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

- A78. 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.
- A79. 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 standards as if they 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.
- A80. 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 federal oil and gas resources be based on information to be provided by 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.
- A81. 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:

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- a. the desire 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 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.
- A82. 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 A80 and A81 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.
- A83. 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.
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- A84. 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.
- A85. The field test questionnaires were extremely useful in helping the Board develop the standards proposed in this ED.

Discussion with DOI Representatives

- A86. 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.
- A87. At that meeting, the DOI representatives indicated that they would be open to having less detailed implementation guidance in the standards 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

- A88. 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"; the revised ED refers 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 federal oil and gas 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 these changing conditions. The Board believes that the detailed estimation methodology for valuing federal oil and gas resources should be developed by federal entities.³⁵ 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. Removed the illustrative disclosure and RSI presentations.
- d. Selected present value using a risk-free discount rate as the preferred measurement method.
- e. Stated that the preferred measurement method for valuing the federal government's estimated petroleum royalties is the present value of future federal royalty receipts on proved reserves using a risk-free discount rate described in paragraphs 19 through 21; however methods for measuring fair value that are consistent with SFAS 157, *Fair Value Measurements*,³⁶ may be acceptable if it is not reasonably possible to estimate present value of future federal royalty receipts on proved reserves using the methodology described in paragraphs 19 through 21.
- f. Permitted a change in methodology (see paragraphs 25 and 26) that is to be accounted for as a change in estimate effected by a change in principle.
- g. Revised the component entity RSI disclosures.
- h. Revised the requirement to recognize a liability for revenue distributions to others (e.g., the general fund of the U.S. Treasury, other federal agencies, and state governments) to only recognize the portion of the revenue to be distributed to non-federal entities (e.g., state governments).

³⁵ Estimates that do not lead to material misstatements are acceptable without guidance from the Board.

³⁶ FASB ASC 820.10

- i. Included a discussion of the classification of the liability for revenue to be distributed to non-federal entities as long-term vs. short-term.
- j. Incorporated guidance for displaying gains and losses from changes in assumptions and selecting discount rates.
- k. Incorporated accounting and disclosure requirements for the federal receiving entities.
- l. Updated the effective date of the standards to provide for a three-year phase-in from RSI to basic information.
- m. Updated the basis for conclusions.
- n. Updated questions for respondents to request feedback on changes made to the original exposure draft.

Alternative View

- A89. Individual members sometimes choose to express an alternative view when they disagree with the Board's majority position on one or more points in a proposed standard. Alternative views discuss the precise point or points of disagreement with the majority position and the reasons therefore. The ideas, opinions, and statements presented in alternative views are those of the individual member alone. However, an individual member's alternative view may contain general or other statements that may not conflict with the majority position, and in fact may be shared by other members. The following material was prepared by Robert Dacey and is presented as an alternative view.
- A90. After a three-year transition period of reporting as RSI, the value of federal oil and gas resources and annual changes therein should be disclosed as basic information in the notes rather than recognized on the face of the financial statements as proposed in this ED. The disclosures should include an integrated discussion of all of the federal government's natural resources, including oil and gas resources that are not currently under lease as well as values for resources under lease and similar information concerning all other significant federal natural resources, such as coal, timber, and grazing rights. This type of reporting would be similar to current reporting for stewardship assets. Such reporting in the notes would provide transparency as to the value and changes in value of these significant assets and result in information that contributes to meeting federal financial reporting objectives. As basic financial information, this information would be subject to audit. Similar to stewardship

assets, FASAB could require a non-financial disclosure on the balance sheet that refers to the note without an asset dollar amount being shown.

- A91. Rationale for disclosing the information in the notes rather than on the face of the statements include the following:
- a. The federal government's financial statements should include an integrated disclosure of all of the federal government's natural resources, rather than recognizing on the balance sheet only those resources that are assigned a value because they are currently under lease. Absent such an integrated disclosure, users of the financial statements could be misled as to the full extent of the federal government's natural resources. For example, the value of oil and gas resources presented on the balance sheet would exclude potentially significant federally owned oil and gas resources located in areas that are either prohibited from leasing or not currently under lease in accordance with current government policy (e.g., the Arctic National Wildlife Refuge and certain areas of the Gulf of Mexico). Nonetheless, they are owned by the federal government and represent a valuable economic resource to the federal government. Also, the federal government has a stewardship responsibility for such assets.
 - b. The value of the natural resources in the financial statements is likely to be subject to significant annual fluctuations based on the changing market prices for the resource and changes in quantities based on recoverability. These fluctuations would occur even though the resources can only be extracted over a period of time, rather than in the short term after the end of the year. Such fluctuations could materially impact the net cost and net operating cost in the government's consolidated financial statements and reduce the usefulness of reported operating results of the government's operations during the year. Such fluctuations would require significant explanation that could be distracting to users. Similar types of concerns were expressed by the Board concerning fluctuations in actuarial liabilities due to changes in discount rates. Also, changes in oil and gas resources subject to royalties would immediately be reflected in revenues and net operating cost, rather than over the periods that such resources were extracted.
 - c. The valuation methodology in the exposure draft essentially capitalizes all future royalty revenues and shifts the recognition of revenues (gains) to the period the lease is signed. Collection of royalties will not result in any net revenue since an equal amount of depletion expense will be recognized. Consequently, the periods in which the resources are

extracted would not include any net operating results related to the actual royalty stream because the revenues, and gains/losses arising from changes in value and the passage of time, were recognized previously. As a result, the revenues would not be matched with the related costs and periods benefited.

- d. In addition to significant valuation uncertainty, the valuation methodology in the ED provides significant flexibility in the methodology used, including the ability of the preparer to significantly change the methodology based on environmental or other changes. Consequently, given this flexibility, reporting values for natural resources would be more appropriately reflected in the notes.
- A92. Similarly, for the reasons stated above, such natural resources should be excluded from reporting as assets on the schedule of fiduciary net assets. Instead, fiduciary reporting should consist of appropriate narrative describing the general nature and extent of such resources.

Appendix B: Pro Forma Transactions and Financial Statements

PLEASE NOTE: The sample accounting entries and financial statements in Appendix B 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. Budgetary and additional proprietary account entries would be made by the collecting entity to track and report on greater detail than is illustrated in this appendix. 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, such as transfers between sub-component entities. In addition, a greater degree of detail and certain reclassifications would occur in practice.

Readers should not rely on these 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.

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.

1. Record initial value of estimated petroleum royalties and the liability for revenue distributions to non-federal entities.

The initial value of estimated petroleum royalties used in this pro forma transaction is \$150,677,667, a hypothetical number used for illustrative purposes only. The actual value of the federal government's estimated petroleum royalties would be calculated on a regional basis and should approximate the present value of future royalty receipts on proved reserves known to exist as of the reporting date using a risk-free discount rate.

The illustrative pro forma entry to record the initial value of the federal government's estimated petroleum royalties as well as the liability for revenue to be distributed to non-federal entities is presented below. The asset's value would be the royalty share of the federal oil and gas resources classified as "proved reserves." The liability for revenue to be distributed to non-federal entities would be for the royalty share of the federal oil and gas resources classified as "proved reserves" designated to be distributed to non-federal entities, e.g., state governments. The proposed treatment of the distribution of revenue to non-federal entities creates a non-federal liability for the component entity responsible for collecting royalties.

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" in accordance with SFFAS 21, *Reporting Corrections of Errors and Changes in Accounting Principles*. The adjustment would be made to the beginning net position on the statement of changes in net position for the component entity responsible for collecting royalties in the period the change is made.

To obtain the value of the prior period adjustment, the total estimated petroleum royalties is multiplied by the average share of the revenue distributed to the component entity responsible for collecting royalties and other federal entities. For this illustration, 85 percent was used as the average annual share of the revenue distributed to federal component entities, including the 1%

expected to be retained by the federal component entity responsible for collecting royalties, based on the average distribution for 2005.³⁷ To record the liability for revenue to be distributed to non-federal entities, the total estimated petroleum royalties is multiplied by the average share of the revenue distributed to state governments and other non-federal entities. For this illustration, 15 percent was used as an average annual share of the revenue distributed to state governments and other non-federal entities based on the average distribution for 2005.³⁸ These calculations are presented below:

$$\begin{aligned} \$150,677,667 \times .85 &= \$128,076,017 \text{ (federal portion)} \\ \$150,677,667 \times .15 &= \$22,601,650 \text{ (non-federal portion)} \end{aligned}$$

Dr Estimated Petroleum Royalties	150,677,667	
Cr Prior Period Adjustment: Change in Accounting Principle		128,076,017
Cr Liability for Revenue Distribution to Others – Non-Federal		22,601,650

To record initial value of estimated petroleum royalties due to change in accounting principle and the liabilities for revenue distributions to non-federal entities (the 84% expected to be distributed to federal entities increases the net position of the entity responsible for making royalty collections until such time that the collections are distributed and recognized as a transfer out).

Transactions two through ten will be recorded throughout the fiscal year by the component entity responsible for collecting royalties and, in some cases, the receiving federal entity.

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

For a competitive lease sale, a notice of lease sale is published in the Federal Register. Each lease bid must include a payment for one-fifth of the bonus bid amount unless the bidder is otherwise directed by the Secretary. For purposes of this illustrative accounting event, four bonus bids were received with payment of the one-fifth bonus bid amount. Bonus bid number one was \$1,850, bonus bid number two was \$1,900, bonus bid number three was \$1,950, and bonus bid number four was \$2,000. The total payment relating to the four bonus bids was \$1,540 (bonus bid number one for \$370, bonus bid number two for \$380, bonus bid number three for \$390, and bonus bid number four for \$400) and was recorded with the following entry by the component entity responsible for collecting royalties.

Dr Fund Balance with Treasury	1,540	
Cr Unearned Revenue		1,540

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

³⁷ The 85 percent was derived by dividing [Note 21. Custodial Distributions to MMS, Revenues to Fund Operations] plus [Transfers-out to other federal component entities on the Statement of Custodial Activity] by [Total Revenue on the Statement of Custodial Activity] for 2005.

³⁸ The 15 percent was derived by dividing [Note 21. Payments to States] by [Total Revenue on the Statement of Custodial Activity] for 2005.

3. Record remaining payment by the successful bidder and the annual rental fee and the liability for revenue distributions to non-federal entities.

Payment of the unpaid balance of the bonus bid amount and the first year's rental fee are to be received from the successful bidder on the 11th business day after receipt of the lease forms by the successful bidder. The successful bid was bonus bid number four in the amount of \$2,000. The remaining four-fifths bonus bid of \$1,600 and the first year rental fee in the amount of \$360 is received. According to various legislative requirements, rental fees are required to be paid one year in advance and are recorded as revenue from rent when received because there is no obligation to refund unearned portions. The following entries are recorded by the component entity responsible for collecting royalties.

Dr Unearned Revenue	400	
Dr Fund Balance with Treasury	1,960	
Cr Revenue from Rent		360
Cr Revenue from Bonus Bid		2,000

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

The increase in the liability for revenue distributions to non-federal entities is calculated by multiplying the revenue from rent and bonus bid by the average share of the revenue distributed to state governments and other non-federal entities. For this illustration, 15 percent was used as the average annual share of the revenue distributed to state governments and other non-federal entities based on the average distribution for 2005.³⁹ This calculation is presented below:

$$\$2,360 \times .15 = \$354$$

Dr Revenue Designated for Others – Non-Federal ⁴⁰	354	
Cr Liability for Revenue Distribution to Others – Non-Federal		354

To record the increase in the liability for revenue distributions to non-federal entities.

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

For illustrative purposes, the total amount of annual rent collected for the year for offshore leases was \$193,274 and the rental fee for onshore leases was \$46,588 for a total of \$239,862. Since \$360 was previously received in connection with the new lease (see entry 3 above), the rental payments remaining are \$239,502 (\$239,862 less \$360). The following entry is recorded by the component entity responsible for collecting royalties.

Dr Fund Balance with Treasury	239,502	
Cr Revenue from Rent		239,502

To record rental payments on leases for the year.

³⁹ See footnote 38.

⁴⁰ 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.

The increase in the liability for the rent revenue to be distributed to non-federal entities is calculated by multiplying the revenue from rent by the average share of the revenue distributed to state governments and other non-federal entities. For this illustration, 15 percent was used as an average annual share of the revenue distributed to state governments and other non-federal entities based on the average distribution for 2005.⁴¹ This calculation is presented below:

$$\$239,502 \times .15 = \$35,925$$

Dr Revenue Designated for Others – Non-Federal	35,925	
Cr Liability for Revenue Distribution to Others – Non-Federal		35,925

To record the increase in the liability for revenue distributions to non-federal entities.

5. Refund unsuccessful bidders' bonus bid deposits.

Bonus bid deposits submitted by unsuccessful bidders are refunded to respective bidders after bids are opened, recorded, and ranked. Bonus bid number one in the amount of \$370, bonus bid number two in the amount of \$380, and bonus bid number three in the amount of \$390 for a total of \$1,140 are returned to respective bidders. The following entry is recorded by the component entity responsible for collecting royalties.

Dr Unearned Revenue	1,140	
Cr Fund Balance with Treasury		1,140

To record refund of losing bonus bids.

6. Record royalty revenue and depletion expense.

Royalty revenue should be recognized as exchange revenue by the component entity that is responsible for collecting the royalties. At the same time, an amount equal to the royalty collections should be recognized as depletion expense and the value of estimated petroleum reserves should be reduced by the depletion expense amount. Sales value and royalty payment information are due on or before the last of the month following the month the oil or gas produced from federal oil and gas resources was sold or removed from the lease. For example, oil or gas sold in June must be reported by July 31, the end of the following month.

For illustrative purposes, the total amount of royalty revenue for the fiscal year for offshore and onshore rental leases was used in this calculation. The royalty revenue during the fiscal year for offshore leases was \$3,563,922 and the royalty revenue during the fiscal year for onshore leases was \$852,331 for a total of \$4,416,253. The following entries are recorded by the component entity responsible for collecting royalties.

Dr Accounts Receivable	4,416,253	
Cr Revenue from Royalties for Federal Oil and Gas Reserves		4,416,253

To record royalty revenue.

⁴¹ See footnote 38.

Dr Oil and Gas Depletion Expense	4,416,253	
Cr Estimated Petroleum Royalties		4,416,253

To record depletion expense for federal oil and gas resources.

7. Record collection of royalty revenue.

Royalty payments are due on or before the last of the month following the month the oil or gas produced from federal oil and gas resources are sold or removed from the lease, unless lease terms state that royalties are due otherwise. A year-to-date total of royalty revenue collected is in the amount of \$4,048,232. The following entry is recorded by the component entity responsible for collecting royalties.

Dr Fund Balance with Treasury	4,048,232	
Cr Accounts Receivable		4,048,232

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 non-federal entities.

The component entity responsible for collecting royalty revenue is required to distribute the bonus bid, rent, and royalty revenue in accordance with authoritative formulas to recipients designated by law upon matching the revenue collections to specific leases. The component entity distributing bonus bid, rent, and royalty revenue from federal oil and gas resources should recognize the distribution to component entities in accordance with existing accounting standards. The federal component entity receiving the distribution should recognize the receipt as a transfer in when calculating its operating results. For purposes of this illustrative accounting event, the bonus bid collected was \$2,000, the rent collected was \$239,862, and the royalties collected was \$4,048,232, for total collections of \$4,290,094.

The bonus bid, rent, and royalty revenue collections distributed and the reduction in the liability for revenue distribution to non-federal entities is calculated in two parts. The first part is based on revenue collections designated as payments to non-federal entities while the second is based on collections designated as payments to other federal component entities. The revenue collections from bonus bid, rent, and royalties are multiplied by the average share of the revenue distributed to state governments and other non-federal entities to obtain the value of the collections to be distributed to non-federal entities. For this illustration, 15 percent was used as an average annual share of the revenue distributed to non-federal entities based on the average distribution for 2005.⁴² The revenue collections from bonus bid, rent, and royalties are multiplied by the average share of the revenue distributed to other federal component entities to obtain the value of the rent revenue to be distributed to other federal component entities. For this illustration, 84 percent was used as an average annual share of the revenue distributed to other federal component entities based on the average distribution for 2005.⁴³ These calculations are presented below:

⁴² See footnote 38.

⁴³ The 84 percent was derived by dividing [Transfers-out to other federal component entities on the Statement of Custodial Activity] by [Total Revenue on the Statement of Custodial Activity] for 2005.

$$\begin{aligned} \$4,290,094 \times .15 &= \$643,514 \\ \$4,290,094 \times .84 &= \$3,603,678 \end{aligned}$$

Dr Liability for Revenue Distribution to Others – Non-Federal	643,514	
Dr Transfers-Out	3,603,678	
Cr Fund Balance with Treasury		4,247,192

To record distribution of bonus bid, rent, and royalty revenue collections, the transfer out to other federal component entities, and the reduction in liabilities for revenue distribution to non-federal entities. (The remaining 1% is permanently retained by the entity responsible for making royalty collections).⁴⁴

Other federal entity entry:

Dr Fund Balance with Treasury	3,603,678	
Cr Transfer-in		3,603,678

To increase the fund balance with treasury and recognize a transfer-in for distributions received.

9. Disclose rights to future royalty streams identified for sale.

When rights to a future royalty stream are identified to be sold, the value of those rights should be disclosed as future royalty rights held for sale. They should be disclosed rather than reclassified because (1) the point in time for the sale of the future royalty rights may be uncertain or undecided and (2) the identified fields may continue to produce oil and/or gas and generate royalties. These two factors make it difficult to establish and maintain precise valuation information in advance of the sale. 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. The value of the rights identified for sale should be based on the present value of future federal royalty receipts on proved reserves known to exist as of the reporting date for each specific field identified for potential sale.

Future royalty streams from two specific oil fields have been identified to be sold sometime during the next fiscal year.

The estimated value of the future royalty stream identified to be sold from field number one is \$5,305 based on the following calculation: 1,000 barrels to be sold X \$42.44 per barrel per field number one first purchase price for oil X the 12.5% royalty rate for field number one.

The estimated value of the future royalty stream identified to be sold from field number two is \$3,245 based on the following calculation: 750 barrels to be sold X \$34.61 per barrel per field number two first purchase price for oil X the 12.5% royalty rate for field number two.

⁴⁴ See footnote 34.

10. Record sale of future royalty streams identified for sale and the change in the liability for revenue distributions to non-federal entities.

At the time the future royalty rights identified for sale are sold, the asset value is calculated based on the quantity of proved oil reserves involved in the sale, the first purchase price or the wellhead price for the field at the time of sale, and the royalty rate for the specific field. Any difference between the asset value of the future royalty rights sold and the sales proceeds results in a net gain or loss. The net gain or loss should be reported on the statement of net cost of the component entity responsible for collecting royalty revenue. For purposes of this illustrative accounting event, the rights to future royalty rights held for sale for field number one had an asset value of \$5,375 based on the following calculation: 1,000 barrels of proved oil reserves involved in the sale X \$43.00 per barrel per field number one first purchase price X the 12.5% royalty rate for field number one. The rights to a future royalty stream from field number one were sold for \$3,950. As a result, there is a loss of \$1,425 on the sale of the future royalty stream from field number one, which should be reported on the statement of net cost.

Dr. Fund Balance with Treasury	3,950	
Dr. Loss on Sale of Estimated Petroleum Royalties	1,425	
Cr. Estimated Petroleum Royalties		5,375

To record sale of future royalties.

The loss on the sale of estimated petroleum royalties is multiplied by the average share of the revenue distributed to state governments and other non-federal entities to obtain the reduction in the liabilities for revenue distributions to non-federal entities. For this illustration, 15 percent was used as an average annual share of the revenue distributed to state governments and other non-federal entities based on the average distribution for 2005.⁴⁵ This calculation is presented below:

$$\$1,425 \times .15 = \$214$$

Dr Liability for Revenue Distributions to Others – Non-Federal	214	
Cr Revenue Designated for Others – Non-Federal		214

To record the reduction in the liabilities and revenue designated for non-federal entities as a result of the loss on the sale of estimated petroleum royalties.

The collections from the sale of revenue streams are multiplied by the average share of the revenue distributed to state governments and other non-federal entities to obtain the value of the collections to be distributed to non-federal entities. For this illustration, 15 percent was used as an average annual share of the revenue distributed to non-federal entities based on the average distribution for 2005.⁴⁶ The collections from the sale of revenue streams are multiplied by the average share of the revenue distributed to other federal component entities to obtain the value of the rent revenue to be distributed to other federal component entities. For this illustration, 84 percent was used as an average annual share of the revenue distributed to other

⁴⁵ See footnote 38.

⁴⁶ See footnote 38.

federal component entities based on the average distribution for 2005.⁴⁷ These calculations are presented below:

	\$3,950 X .15 = \$593	
	\$3,950 X .84 = \$3,318	
Dr Transfers-Out	3,318	
Dr Liability for Revenue Distributions to Others – Non-Federal	593	
Cr Fund Balance with Treasury		3,911

To record the distribution of collections from the sale of revenue streams, the transfer out to other federal component entities, and the reduction in the liability for revenue distributions to non-federal entities. (The remaining 1% is permanently retained by the entity responsible for making royalty collections).⁴⁸

Other federal entity entry:

Dr. Fund Balance with Treasury	3,318	
Cr. Transfer-in		3,318

To increase the fund balance with treasury and recognize a transfer-in for distributions received.

At the end of each fiscal year, the following transaction is recorded by the component entity responsible for collecting royalties.

11. Record annual valuation of estimated petroleum royalties and the change in the liability for revenue distributions to non-federal entities.

The calculated value of the federal government's estimated petroleum royalties for financial statement reporting at year-end should be compared to the book value of estimated petroleum royalties at year-end. If the calculated value of estimated petroleum royalties at year-end is greater than the year-end book value,⁴⁹ the book value should be increased to the new estimate and a gain should be recorded on the statement of net cost of the reporting entity responsible for collecting revenue. If the calculated value of estimated petroleum royalties at year-end is less than the year-end book value, the book value should be decreased to the new estimate and a loss should be recorded on the statement of net cost of the reporting entity responsible for collecting royalty revenue. For illustrative purposes, the valuation of estimated petroleum royalties as of the year ended September 30 produced a gain of \$25,210,226 that is based on the following calculations.

The revaluation value of estimated petroleum royalties for federal oil and gas is hypothetically valued at \$171,466,265. The current value of estimated petroleum royalties (\$171,466,265) less the book value of estimated petroleum royalties (the initial value of estimated petroleum royalties at the beginning of the year (October) less depletion expense for estimated petroleum royalties through the end of the year (September 30), less the asset value of estimated petroleum

⁴⁷ See footnote 43.

⁴⁸ See footnote 34.

⁴⁹ The estimated petroleum royalties beginning balance would have been reduced by the amount of depletion expense recognized during the year.

royalties sold), equals the net gain to be recorded:

$$\$171,466,265 - (150,677,667 - 4,416,253 - 5,375) = \$25,210,226$$

Dr Estimated Petroleum Royalties	25,210,226	
Cr Gain on Revaluation of Estimated Petroleum Royalties		25,210,226

To record revaluation of estimated petroleum royalties.

Gains and losses from changes in long-term assumptions (i.e., discount rate and inflation rate) used to measure assets and liabilities for federal oil and gas should be displayed as a separate line item or line items on the statement of net costs. For this illustration, changes in the discount rate assumption accounted for \$200,500 of the gain on revaluation while changes in other assumptions accounted for a \$500 loss, resulting in a net gain of \$200,000 due to changes in assumptions. See the pro forma illustration on page 59.

To record the increase in the liability for the revenue distributions to non-federal entities, the amount that the total estimated petroleum royalties was increased due to revaluation is multiplied by the average share of the revenue distributed to state governments and other non-federal entities. For this illustration, 15 percent was used as an average annual share of the revenue distributed to state governments and other non-federal entities based on the average distribution for 2005.⁵⁰ This calculation is presented below:

$$\$25,210,226 \times .15 = \$3,781,534$$

Dr Revenue Designated for Others – Non-Federal	3,781,534	
Cr Liability for Revenue Distributions to Others – Non-Federal		3,781,534

To record the year-end increase in the liabilities for the revenue distributions to non-federal entities (the 84% expected to be distributed to federal entities increases the net position of the entity responsible for making royalty collections until such time that the collections are distributed and recognized as a transfer out).

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

⁵⁰ See footnote 38.

The following pro forma financial statements are illustrative of the presentation of basic information. Until such time that the information is presented as basic, information reported as RSI would be presented as part of a schedule of estimated petroleum royalties and not reported in the principal financial statements.

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

(For Illustrative Purposes Only)

Balance Sheet

Assets

Fund Balance with Treasury	\$ 42,941
Accounts Receivable	368,021
Estimated Petroleum Royalties	171,466,265
Total Assets	<u>\$ 171,877,227</u>

Liabilities

Liability for Revenue Distributions to Others – Non-Federal	25,775,142
Total Liabilities	<u>25,775,142</u>

Net Position

Cumulative Results of Operations	<u>146,102,085</u>
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Total Liabilities and Net Position

\$ 171,877,227

Statement of Net Cost

Oil and Gas Resources Program

Leasing Activities:	
Costs (Oil and Gas Depletion Expense)	\$ 4,416,253
Less: Revenue	<u>(4,658,115)</u>
Net Cost/(Revenue) from Leasing Operations	(241,862)
Loss/(Gain) on Revaluation of Estimated Petroleum Royalties	(25,010,226)
Less: Revenue Designated for Others – Non-Federal	3,817,599
Less: Loss on Sale of Future Royalty Rights	<u>1,425</u>
Net Cost/(Revenue) for Program before (gain)/loss from changes in assumptions	<u>\$ (21,433,064)</u>

(Gain)/Loss on assumption changes:	
Discount rate assumption	(200,500)
Other assumptions	500
Net (gain)/loss on assumption changes	<u>(200,000)</u>
Net Cost/(Revenue) for Program	<u>\$(21,633,064)</u>
<u>Statement of Changes in Net Position</u>	
Beginning Net Position	\$ 0
Adjustment: Change in Accounting Principle	<u>128,076,017</u>
Beginning Balance, as adjusted	128,076,017
Net Revenue for Program	21,633,064
Transfers In/(Out)	<u>(3,606,996)</u>
Ending Net Position	<u>\$ 146,102,085</u>

(For Illustrative Purposes Only)

Appendix C: Abbreviations

ASC	FASB Accounting Standards Codification™
Bbl	Barrels
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

Appendix D: Glossary

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.

Undiscovered Resources

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 are 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.

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 follows⁵¹:

“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.

“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.

⁵¹ WPC/SPE/AAPG Petroleum Reserves and Resources Definitions.

"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.

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

Other Definitions

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.

Basin: The site of accumulation of a large thickness of sediments.⁵²

Bonus Bid: Leases issued in areas known to contain minerals are awarded through a competitive bidding process. A bonus bid, as used in this Statement, represents the cash amount successfully bid to win the rights to a lease.⁵³

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 stream⁵⁴ without being separately measured; and, 2) small amounts of nonhydrocarbons produced with the oil.

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

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

⁵² U.S. Geological Survey, Geologic Glossary.

⁵³ Glossary of Mineral Terms, Minerals Revenue Management, Minerals Management Service, U.S. Department of the Interior (Glossary of Mineral Terms)

⁵⁴ A crude oil stream is 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.

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.

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.

Fair Value: Value determined by bona fide bargain between well-informed buyers and sellers, usually over a period of time; the price for which a PP&E item can be bought or sold in an arm's length transaction between unrelated parties; value in a sale between a willing buyer and a willing seller, other than in a forced or liquidation sale; an estimate of such value in the absence of sales or quotations.

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.⁵⁵ 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.

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.

⁵⁵ EIA-182 Domestic Crude Oil First Purchase Report Instructions.

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 Statement, 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.⁵⁶

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.

Net of Sales and Acquisitions⁵⁷: 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.

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.

⁵⁶ 30 U.S.C. §1702 (5).

⁵⁷ Acquisitions are the volume of proved reserves gained by the purchase of existing fields or properties, from the date of purchase or transfer.

Outer Continental Shelf (OCS): 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**.⁵⁸

Play: A group of **pools** that share a common history of hydrocarbon generation, migration, reservoir development, and entrapment.⁵⁹

Pool: A discovered or undiscovered accumulation of hydrocarbons, typically within a single stratigraphic interval.⁶⁰

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.

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.

Regional Estimated Petroleum Royalties: 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.

Rent: Rent, as used in this Statement, 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.⁶¹

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.⁶²

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.

⁵⁸ Glossary of Mineral Terms.

⁵⁹ Ibid.

⁶⁰ Ibid.

⁶¹ Ibid.

⁶² Ibid.

Royalty: Royalty, as used in this Statement, 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.⁶³

Royalty-in-kind: A program operated under the provisions of the Mineral Leasing Act of 1920 and the Outer Continental Shelf Lands Act of 1953. The federal government, as lessor, may take part or all of its oil and gas royalties “in kind” (a volume of the commodity) as opposed to “in value” (money). Under the oil royalty-in-kind program, the government sells oil at fair market value to eligible refiners who do not have access to an adequate supply of crude oil at equitable prices. The Minerals Management Service conducted a gas royalty-in-kind pilot program in 1995, entering into contracts to sell selected Gulf of Mexico natural gas by competitive bid to gas marketers. Two additional oil and gas pilot programs began in 1998, and a third gas pilot program began in 1999.⁶⁴

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

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:

- 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 Statement, 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.

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

⁶³ Adapted from 30 U.S.C. § 1702 (14).

⁶⁴ Glossary of Mineral Terms.

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.

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.⁶⁵

⁶⁵ Energy Information Administration Glossary, http://www.eia.doe.gov/glossary/glossary_w.htm.

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