Federal Accounting Standards Advisory Board

June 4, 2009

Memorandum

To: Members of the Board

From: Julia E. Ranagan, Assistant Director

Through: Wendy M. Payne, Executive Director

Subj: Natural Resources – Tab E[1]

OVERALL MEETING OBJECTIVE

The purpose of this 90-minute session is to reach consensus on the changes incorporated into the enclosed **pre-ballot draft** revised exposure draft (ED) on *Accounting for Federal Oil and Gas Resources* so that staff can work towards a ballot draft.

SPECIFIC MEETING OBJECTIVES

Staff would specifically like to receive the board's response to the question on page 4 and approval to provide a ballot draft following the meeting via email.

BRIEFING MATERIAL

The following documents are attached to this transmittal memorandum:

- Attachment 1 – A staff discussion paper of the changes made to the revised exposure draft since the April 2009 board meeting on page 4; and,
- Attachment 2 – Issue Papers No. 2, Fiduciary Reporting Requirements (Updated), beginning on page 7, and No. 8, Accounting for Other Types of Natural Resources, beginning on page 16.

In addition, the following materials are included following the transmittal memorandum:

- Enclosure 1 – Pre-Ballot Draft Revised ED, *Accounting for Federal Oil and Gas Resources*
- Enclosure 2 – Natural Resources History of Project and Key Decisions

[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.

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

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

You may electronically access all of the briefing material at http://www.fasab.gov/meeting.html (the reference material is located at http://www.fasab.gov/pdffiles/tabfnr_reference.pdf).

NEXT STEPS

June 2009 Following Meeting

- Provide a ballot draft that incorporates final member comments via email after the meeting.

July 2009

- Issue a revised exposure draft with comments due by late August / early September 2009.

October 2009 Meeting

- Discuss comments received on revised exposure draft.

December 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 May 2007 exposure draft (ED), *Accounting for Federal Oil and Gas Resources*, proposed accounting standards for federal oil and gas resources. The proposed standards would result in the recognition of an asset and a related liability. The asset would be referred to as "estimated petroleum royalties" and would present the royalty share of the federal oil and gas resources classified as "proved reserves." The asset's value would be calculated by multiplying the estimated quantity of proved oil and lease condensate, natural gas plant liquids (NGPLs), and gas reserves by the effective average royalty rate for each quantity and by the average per unit price for each quantity. An alternative approach to valuing estimated petroleum royalties is fair value. CBO believes that fair value is feasible and preferable. CBO's alternative view proposed that fair value be derived from market transactions or discounted cash flows.

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

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

Additional information about federal oil and gas resources not classified as proved reserves would be disclosed in notes to the financial statements or reported as required supplementary information (RSI). The proposed standards would be effective for periods beginning after September 30, 2009 (fiscal year 2010), with early implementation permitted.

Based on the results of field testing and comments received from respondents, the Board is proposing several significant changes to the ED requirements discussed above which will require re-exposure.

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

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

Attachments

CHANGES MADE SINCE THE APRIL 2009 REVISED ED

The following changes have been made to the draft revised ED since the April 2009 version:

1. **Incorporated board member comments on the April 2009 draft revised ED.**

   Various editorial and other changes were made to incorporate comments on the April 2009 draft revised ED received from Messrs. Steinberg and Patton.

2. **Clarified discussion of the present value and fair value measurement methods.**

   Staff added a discussion in the basis for conclusions on the difference between the present value measurement method using a risk-free discount rate proposed as the primary measurement method in the ED and market-based fair value measurements that are consistent with FAS 157, *Fair Value Measurements*. In addition, staff clarified the distinction in various places in the ED. See discussion in **paragraphs A36 through A44** and the clarifications in **questions 2 and 3** and **paragraph 24** in the pre-ballot draft revised ED at Enclosure 1.

3. **Added a question to address the disclosure requirements for fiduciary oil and gas resources.**

   Despite repeated follow-up inquiries via telephone and email, staff has not received a response from DOI to enable the board to make an informed decision regarding cost-benefit of the disclosure requirements for fiduciary oil and gas resources. Since the removal of the fiduciary oil and gas resource disclosure requirements would require an exception to the requirements of SFFAS 31, staff proposes to again request detailed input on the cost-benefit of the requirement with respect to fiduciary activities. See updated **Issue Paper No. 2** at Attachment 2 for more information and **question 6** and **paragraph 48** in the pre-ballot draft revised ED at Enclosure 1.

4. **Incorporated discussion of other types of natural resources to help alleviate some of the concerns of minority members who voted to expand the ED to cover accounting for all types of natural resources.**

   Since the majority of the board members voted to limit the scope of the ED to oil and gas, staff does not propose to incorporate additional types of natural resources into the revised ED. However, staff did incorporate several changes to help alleviate some of the concerns of the minority members. See **Issue Paper No. 8** at Attachment 2 for more information and **paragraphs 10**, **43d**, and **A2** in the pre-ballot draft revised ED at Enclosure 1.

5. **Updated the basis for conclusions accordingly.**

QUESTION FOR THE BOARD MEMBERS

Do you object to any of the changes made to the pre-ballot draft revised ED? If so, please explain the reasons for your objection and offer alternative solutions.

Tab E
Attachment 2 –
Issue Papers

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Issue Paper No. 2: Fiduciary Reporting Requirements (Updated)

April 2009 Draft ED Requirements

The April 2009 draft of the revised exposure draft (ED) on *Accounting for Federal Oil and Gas Resources* contained the following proposed fiduciary reporting disclosure requirements that were carried forward from the May 2007 ED.

Disclosure Requirements for Fiduciary Oil and Gas Resources

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

DOI Response to Current Draft ED Requirements

In its comment letter, DOI stated that:

> "The Department has verified that currently, EIA does not publish numbers related to proved reserves on Indian lands. Further, the Department only receives a small portion of royalties related to Indian leases, which are disbursed at once to OST for subsequent funds management and distribution to beneficiaries. Accordingly, there is not a verifiable data source from which the Department could estimate an asset value. While estimates can always be developed, the validity of the data could likely be proved to be incorrect, and would be a very broad estimate at best.
>
> We believe it would not be cost-beneficial to require such disclosures relating to fiduciary assets, liabilities, and related inflows and outflows. We explain the basis for our belief below.
>
> First, the FASAB made it clear in a letter dated October 5, 2006, that disaggregated financial information was not required to be presented in a fiduciary note disclosure. Specifically, the Board stated:
>
> "*In developing Federal accounting standards, among FASAB's responsibilities is to support cost effective implementation of its standards. To this end, FASAB considers alternative approaches so that a standard's demand on resources is balanced against the benefits to be gained from the standard. In the particular case of Indian Trust funds, the Board believes the costs to implement proposed SFFAS 31 by developing accruals for receivables at the beneficiary ownership level, as some have suggested, would greatly outweigh the benefits of reporting fiduciary activities conducted by DOI (in the event that SFFAS 31 were to be finalized). The Board did not intend proposed SFFAS 31 to establish a requirement for such highly disaggregated financial reports.*
>
> *Instead, neither existing standards nor proposed SFFAS 31 require disaggregated financial information to be presented in a note disclosure. To this end, the accrual of fiduciary activities should be implemented as a single aggregate accrual that supports information presented in the schedule of net assets and fiduciary activity in a note to the Department's financial statements."*

Unfortunately, this Exposure draft would require just that; disaggregated accrual and asset information. Per paragraph 34, specific information regarding estimates of reserves, and inflows and outflows, would require research down to the lease level in order to determine the split between tribal and individual Indian ownership. Additionally, further analysis would be necessary to distinguish between leases on tribal land where the payments are made directly to the tribal entity and do not flow through the U.S. government. This would defeat the purpose of a single aggregate accrual and be very costly to implement as well as requiring an information system to obtain and track this data.

Secondly, there are many components to Indian trust assets and activities. Required disclosure of oil and gas assets as well as the inflows and outflows would put an undeserved emphasis on this activity in the note disclosure, especially since oil and gas revenues typically encompass only approximately 25% of revenues (similar to farming and grazing, forestry, and land sales). With a number of non-monetary assets held by Indian and tribal beneficiaries, such as land, timber, coal, and other minerals, disclosure of estimated values of oil and gas assets could lead to questions regarding land valuation as well as other non-monetary asset valuations mentioned above. If we are showing oil and gas asset valuation, why are we not showing land asset valuation, or other asset valuations, etc? It creates a dichotomy between oil and gas and other non-monetary trust assets.

Where will additional disclosure requirements end with respect to fiduciary note disclosure? We request removal of paragraph 34 as unnecessary, costly, and in direct conflict with Board issued guidance and the intent of SFFAS 31."

Comments from Respondents to May 2007 ED

Question 5a: Do you believe it is cost-beneficial to require disclosure of the value of estimated fiduciary petroleum royalty assets, liabilities, and related inflows and outflows? Please explain the basis for your beliefs.

Yes, Supportive of Fiduciary Asset Disclosures (Amount / Level TBD)

Comment Letter # 3, Association of Government Accountants Financial Management Standards Board

We believe that accounting standards should be consistent. Based on that premise, the disclosure for fiduciary petroleum royalty assets should be disclosed. The amount and/or level of disclosure could be made after considering (1) cost of getting that information versus its usefulness and (2) the overall "additional" amount of information and disclosure provided by the proposed standard. We also think it is also important to report assets held for the benefit of Indian tribes and individual Indians, particularly in light of difficulties in such reporting related to other Indian assets.

No, Not Supportive of Fiduciary Asset Disclosures

Comment Letter # 4, Office of the Under Secretary of Defense, Department of Defense

We have not performed a cost benefit analysis to support a response to this question. However, reference question 3 above, the cost of the information appears to outweigh the benefit.

[Response to question 3: No. RSI should not extend to the Regional breakdowns exemplified in Table 1. This information does not appear relevant to the Stewardship Objective of determining whether the government's financial position has improved or deteriorated over time, nor does it appear relevant to the Operating Performance Objective to determine the efficiency and effectiveness of the government's management of its assets and liabilities. In this regard, the cost of the information appears to outweigh the benefit.]

<u>Comment Letter # 5, Office of the Secretary, Department of the Interior</u>

See section above titled "DOI Response to Current Draft ED Requirements" for DOI's response to the question.

<u>Comment Letter # 7, Government Accountability Office</u>

[W]e have concerns about the costs versus the benefits of accumulating, [p]reparing, and auditing information required by paragraph 34 to be reported in disclosures for fiduciary activities. Requiring the Federal entities to disclose the value of oil and gas reserves for fiduciary activities will incur additional 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.

The Board should obtain specific information from the management of affected entities concerning the costs of developing and reporting the RSI and fiduciary information, and should reconsider the requirements of the ED based on this information. Further, the Board should clearly document the basis for its determination of whether such information is appropriate for general purpose financial statements and whether it can be prepared and audited at a reasonable cost in relation to its usefulness.

<u>Comment Letter # 8, Greater Washington Society of CPAs</u>

The Uniform Principal and Income Act, enacted by at least 43 states limits responsibility of a fiduciary to cash received, invested and disbursed, and prudent holding of non-cash assets. While SFFAS 31 will require disclosure of land assets held in the two Indian Trust Funds, it will be extraordinarily difficult to record proved oil and gas resources in the financial statements of the two Indian Trust Funds, and certainly a challenge for a November 15 completion of the audits thereof. The number of oil and gas leases on Indian lands (approximately 55 million acres – 45 million tribally-owned and 11 million owned by individual Indians) is disproportionately large since the individual holdings are small compared to other Federal Government leases on its own holdings.

FISC concurs that extension of reporting of oil and gas leases and valuing the proved reserves related thereto would cost far more than any useful information provided therewith. Interior now reports undivided and divided land interests owned by tribes and individual Indians and leases thereon (exploratory, producing and non-producing) in quarterly statements to the tribal and individual account holders.

This can be seen in the following data taken from the Mineral Management Service web site. (This information has either been taken directly from the web site or has been derived from information taken from the website.)

MMS Summary of Oil and Gas Lease Data Producing and Non-Producing Leases – Fiscal Year 2007

	American Indian Leases	**Total Federal Government Leases**
Number of Leases	4,119*	63,610
Percentage of Total Leases	6.1%	93.9%
Leased Acreage	2,069,459**	91,595,981**
Percentage of Leased Acreage	2.2%	97.8%
Average Acreage Per Lease	502	1,440
Total Oil & Gas Royalties	$317,735,000	$9,256,032,000
Percentage of O & G Royalties	3.3%	96.7%

*Many of these leases cover lands jointly owned by one or more tribes and many undivided individual Indian interests.

**67,792,121 (74.0%) Federal Government acres are non-producing vs. 152,971 (7.4%) non-producing Indian acres.

Question 1: As stated in DOI's comment letter on the May 2007 ED, why does DOI believe the disclosure would need to be disaggregated? How would it be disaggregated? The methodology that is used to develop the number may require more detailed research, but the proposed standard does not require the information that is disclosed in the note to be disaggregated.

Question 2: SFFAS 31, par. 12, states that "Fiduciary assets may include assets other than cash, e.g., real or personal property held temporarily pending disposition, or held long-term in a fiduciary capacity." There does not seem to be disagreement over whether natural resources on trust lands meet the definition of fiduciary assets. The issue is whether the costs of disclosing fiduciary assets measured in conformance with this proposed standard exceed the benefits to be achieved. In order for the board to consider the perceived benefits against the costs, please provide an estimate of what it would cost to disclose the value of estimated fiduciary petroleum royalty assets, liabilities, and related inflows and outflows.

Staff Analysis and Recommendation

SFFAS 31, par. 12, states that "Fiduciary assets may include assets other than cash, e.g., real or personal property held temporarily pending disposition, or held long-term in a fiduciary capacity." There does not seem to be disagreement over whether natural resources on trust lands meet the definition of fiduciary assets. The issue is whether the cost of disclosing fiduciary assets and liabilities measured in conformance with this proposed standard exceed the benefits to be achieved.

This file was sent to the DOI representative on January 8, 2009, and January 15, 2009. The DOI representative replied that DOI would not be able to talk to staff regarding the issue until mid-February at the earliest.

Staff had not received a response by mid-March and again forwarded this issue paper to the DOI representative on March 17, 2009 and left a voice message for him. Staff again did not receive a response.

Staff was informed by MMS personnel that the DOI representative was no longer employed at DOI and his position had been filled by a new employee. On May 5, 2009, staff forwarded the file to Dan Fletcher, Director and DCFO, DOI's Office of Financial Management, requesting a response by May 14, 2009. On May 21, 2009, staff was contacted by the new representative, stating that DOI was busy preparing for compliance with the fiduciary activities standard and asbestos technical bulletin and would not be able to provide a response at this time.

Therefore, since the Board has not received any substantive information to enable it to make an informed decision regarding cost-benefit, staff recommends that the board retain the disclosure requirements for fiduciary oil and gas resources from par. 48 of the April 2009 draft ED until FASAB receives further cost information from DOI in order to make an informed decision. In addition, staff recommends that the Board go ahead with the release of the revised ED and include the following question for respondents to once again formally request detailed cost-benefit information:

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 48.

Evolution of the Disclosure Requirements for Fiduciary Oil and Gas Resources

The Natural Resources Task Force Discussion Paper, *Accounting for the Natural Resources of the Federal Government*, issued in June 2000, stated that "One member of the task force from Interior also believes that there must be more detailed reporting to tribes and individual Indians regarding trust lands and resources, including information on earned revenue and, if estimable, quantity and value of natural resources available for sale."

The December 2002 FASAB board meeting minutes for the natural resources session includes the following brief discussion of fiduciary assets: "Mr. Jacobson [FASAB General Counsel] asked how this project would relate to mineral rights on Indian lands. Chairman Mosso explained that Indian assets would be reported on some sort of fiduciary balance sheet and the FASAB standards would be followed to account for them."

The October 2003 staff memo contained the following note: "This proposed standard is silent with respect to disclosures related to fiduciary oil and gas activities (e.g., American Indian). Staff is working to ensure that the fiduciary activities standards – currently under review – result in the same disclosures for fiduciary oil and gas activities as proposed here for federally owned oil and gas activities. Staff believes that disclosures for fiduciary oil and gas activities are best presented as an integral part of the fiduciary activities disclosures."

A December 2005 version of the ED contained the following proposed requirement:

> Fiduciary Oil and Gas Resources Disclosures
>
> 47. Fiduciary oil and gas activities should be presented as an integral part of the fiduciary activities disclosures.

The final ballot draft of SFFAS 31, *Accounting for Fiduciary Activities*, was approved at the March 30, 2006 board meeting. Reporting on fiduciary natural resources was not explicitly mentioned in that standard.

A May 2006 version of the ED contained the following revised proposed requirement:

> Disclosure Requirements for Fiduciary Oil and Gas Resources
>
> 29. Fiduciary activities are defined in SFFAS 31. Fiduciary oil and gas ~~activities~~ information consistent with the foregoing requirements should be presented as an integral part of the fiduciary activities disclosures.

A July 2006 version of the ED contained the following revised proposed requirement and a related question for respondents:

> Disclosure Requirements for Fiduciary Oil and Gas Resources
>
> 28. Fiduciary activities are defined in SFFAS 31, *Accounting for Fiduciary Activities*. ~~Fiduciary oil and gas i~~Information consistent with the foregoing requirements for asset valuation should be presented about estimated petroleum royalties managed through fiduciary activities as an integral part of the fiduciary activities disclosures.

<u>Question for Respondents</u>

5. SFFAS 7 (amended by SFFAS 27 for earmarked funds) requires that agencies report on assets held in a fiduciary capacity (see par. 83 to 87). The Board recently approved but has not yet released SFFAS 31, *Accounting for Fiduciary Activities*. SFFAS 31 will supersede SFFAS 7 with respect to fiduciary activities but continues the requirement to report on assets held in a fiduciary capacity. The Department of Interior (the department) manages oil and gas resources on behalf of individual Indians and Indian tribes. Currently, the department does not include any information regarding fiduciary oil and gas resources in its disclosures. 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 required supplementary information that are proposed for Federal oil and gas resources. Thus, only disclosures of the assets 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 generally accepted accounting principles. Since this proposal may significantly increase the fiduciary assets qualifying for disclosure by the department, we are requesting input on the cost-benefit of the requirement with respect to fiduciary activities. (See paragraph 28)

A November 2006 version of the ED contained the following revised proposed requirement and question for respondents:

<u>Disclosure Requirements for Fiduciary Oil and Gas Resources</u>

33. Fiduciary activities are defined in SFFAS 31, *Accounting for Fiduciary Activities*. Information consistent with the foregoing requirements ~~for asset valuation~~ should be presented ~~about estimated petroleum royalties managed through fiduciary activities~~ as an integral part of the fiduciary activities ~~disclosures~~ <u>Schedules of Fiduciary Activity and Net Assets. No additional disclosures or RSI are required</u>.

<u>Question for Respondents</u>

5. <u>Statement of Federal Financial Accounting Standards (</u>SFFAS<u>)</u> 7 (<u>as</u> amended ~~by SFFAS 27 for earmarked funds~~) requires that agencies report on assets held in a fiduciary capacity (see par. 83 to 87). The Board recently ~~approved but has not yet released~~ <u>issued</u> SFFAS 31, *Accounting for Fiduciary Activities*. SFFAS 31 will supersede SFFAS 7 with respect to fiduciary activities but continues the requirement to report on assets held in a fiduciary capacity. The Department of Interior ~~(the department)~~ manages oil and gas resources on behalf of individual Indians and Indian tribes. ~~Currently, the department does not include any information regarding fiduciary oil and gas resources in its disclosures.~~ 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 <u>RSI</u>~~required supplementary information~~ that are proposed for Federal oil and gas resources. Thus, only disclosures of the assets 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 generally accepted accounting principles. Since this proposal may significantly increase the fiduciary assets qualifying for disclosure by the department, we are requesting input on the cost-benefit of the requirement with respect to fiduciary activities. (See paragraph ~~28~~33)

a. Do you believe it is cost-beneficial to require disclosure of the value of fiduciary oil and gas resources? Please explain the basis for your beliefs.

The final May 2007 ED contained the following revised proposed requirement and question for respondents:

Disclosure Requirements for Fiduciary Oil and Gas Resources

34. Fiduciary activities are defined in SFFAS 31, *Accounting for Fiduciary Activities*. Information consistent with the ~~foregoing~~ requirements of paragraphs 16 through 29 and 37 through 45 of this document ~~should~~ shall be presented as an integral part of the fiduciary activities Schedules of Fiduciary Activity and Net Assets. No additional disclosures or RSI are required.

Question for Respondents

5. Statement of Federal Financial Accounting Standards (SFFAS) 7, *Accounting for Revenue and Other Financing Sources* (as amended), requires that agencies report on assets held in a fiduciary capacity ([footnoted]SFFAS 7, paragraphs~~see par.~~ 83 to 87). The Board recently issued SFFAS 31, *Accounting for Fiduciary Activities*. SFFAS 31 will supersede SFFAS 7 with respect to fiduciary activities but continues the requirement to report on assets held in a fiduciary capacity. The Department of Interior (DOI) manages oil and gas resources on behalf of individual Indians and Indian tribes. This proposed standard – because it classifies oil and gas resources as assets – would result in additional information being disclosed for oil and gas assets managed in a fiduciary capacity. Note, however, that fiduciary reporting does not extend to inclusion of the additional disclosures or RSI that are proposed in this document for Federal oil and gas resources. Thus, with respect to fiduciary activities, only disclosures of the assets, liabilities, and related inflows and outflows would result from this proposal.

Some Board members have expressed concern that the costs may exceed the benefits of disclosing fiduciary assets and liabilities measured in conformance with ~~generally accepted accounting principles~~this proposed standard. Since this proposal may significantly increase the fiduciary assets ~~qualifying for disclosure by the department~~disclosed, we are requesting input on the cost-benefit of the requirement with respect to fiduciary activities. ~~(~~See paragraph 3~~3~~4).

a. Do you believe it is cost-beneficial to require disclosure of the value of ~~fiduciary oil and gas resources~~estimated fiduciary petroleum royalty assets, liabilities, and related inflows and outflows? Please explain the basis for your beliefs.

Issue Paper No. 8: Accounting for Other Types of Natural Resources

April 2009 Draft ED Requirements

The April 2009 draft of the revised exposure draft (ED) on *Accounting for Federal Oil and Gas Resources* contained the following proposed amendments to existing standards that were carried forward from the May 2007 ED, revised only to update the paragraph numbers.

Effect on Existing Standards

44. 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.

45. 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.~~

DOI Response to Current Draft ED Requirements

In its comment letter, DOI stated that:

> **Rescissions of SFFAS 7 Provisions for Royalty Activity as Custodial**
> The ED includes text rescinding provisions in SFFAS 7 related to royalty activity and its treatment as custodial. The disparity in accounting treatment resulting from the Standard covering only oil and gas would result in the capitalization of only oil and gas, while other commodities would not be capitalized. As a result, other commodities would not be covered under any FASAB provisions. We are presuming that all commodities not covered under the ED would continue to be treated as custodial, according to established provisions in SFFAS 7, pars. 45, 275, 276, and 277. We recommend that implementation be delayed until all commodities and related business activities are addressed. Otherwise, we request that the Statement clearly provide for these other commodities, and allow current practices related to them to continue as custodial under existing guidance in SFFAS 7 until they are addressed.

Board Member Views on Accounting for Other Types of Natural Resources

At the December 2008 board meeting, the majority of the board members voted to continue to limit the scope of the ED to oil and gas and not address accounting for other types of natural resources. The following table summarizes the views of each of the board members (or their representatives) at the December meeting:

Member	Like Level of Detail?	Modify par. 27?	Keep as Oil and Gas Only?	Keep as RSI for three years and then basic?
Patton		[Delete]	X	X
Schumacher	X	*	X	X
Dacey	X (if permanent RSI)		[broaden]	[permanent RSI]
Werfel	X (if permanent RSI)		X	[permanent RSI]
Allen	X	X	[broaden]	X
Reid	X		[broaden]	X
Torregrosa	X	X	X	X
Steinberg	X	*	X	X
Farrell	X	X	[broaden]	X
Jackson	X	X	X	X

Many of the members that supported limiting the scope to oil and gas stated that since oil and gas natural resources represent the most significant portion of all natural resources, it was important to begin recognizing them as soon as possible.

FASAB Staff Analysis and Recommendation

FASAB staff does not agree with DOI that the proposed amendments to SFFAS 7 would result in other commodities no longer being addressed by SFFAS 7. The amendment to par. 45—striking the reference to rents and royalties on the Outer Continental Shelf—merely serves to remove rent and royalty revenue from the example and replace it with revenues from the auction of the radio spectrum. The concept of par. 45 remains – if an entity recognizes virtually no costs (either during the current period or during past periods) in connection with earning revenue that it collects, then it should recognize the revenue as a financing source on its statement of operations (if retained) or as custodial activity (if collected for others) and not as exchange revenue on the statement of net cost.

Any revenue that was previously reported as custodial activity under the provisions of par. 45 would continue to be reported as custodial activity after the proposed amendments, except for the oil and gas rents and royalties because they would no longer match the concept of par. 45 ("entity recognizes virtually no costs") since depletion cost is proposed to be recognized on the statement of net cost.

Furthermore, removing the three related paragraphs from SFFAS 7, Appendix B: Guidance For The Classification Of Transactions, that are specifically addressing oil and gas rents and royalties does not have any impact on the accounting for other types of natural resources. Therefore, staff recommends that the proposed amendments to SFFAS 7 remain.

In addition, since the majority of the board members voted to limit the scope of the ED to oil and gas, staff does not propose to incorporate additional types of natural resources into the revised ED. However, staff does propose the following changes to help alleviate some of the concerns of the minority members:

> Staff proposes including the following paragraph in the scope section:
>
> 10. Federal lands contain a variety of natural resources that are not specifically addressed by this Statement, including oil and gas resources that are not under lease, coal, gold, and silver, as well as timber and grazing rights, among other uses. This Statement does not preclude entities from reporting any information about other types of federally-owned natural resources.
>
> In addition, at the specific request of Mr. Dacey, staff proposes including the following additional disclosure as part of the component entity RSI requirements:
>
> 43d. A narrative describing other significant 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.
>
> Furthermore, staff proposes adding another sentence to par. A2 in the basis for conclusions to state that additional categories of natural resources may be addressed in a future project.

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 oil and gas resources. <u>Additional categories of natural resources may be addressed in a future project.</u>

Federal Accounting Standards Advisory Board

Accounting for

Federal Oil and Gas Resources

Statement of Federal Financial Accounting Standards

Revised Exposure Draft

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

Month day, year

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

THE FEDERAL ACCOUNTING STANDARDS ADVISORY BOARD

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

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

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

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

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

Federal Accounting Standards Advisory Board
441 G Street, NW, Suite 6814
Mail stop 6K17V
Washington, DC 20548
Telephone 202-512-7350
FAX – 202-512-7366
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Federal Accounting Standards Advisory Board

ISSUE DATE

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

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

Specific questions for your consideration 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. Responses are requested by DUE DATE.

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

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

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

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

Tom L. Allen
Chairman

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Executive Summary

What is the Board proposing?

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

When 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.

Comment: From H. Steinberg

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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.

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

[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.

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 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 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 oil and gas resources, and make quantity information more accessible to users of financial information.

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

Of the four objectives outlined in Statement of Federal Financial Accounting Concepts Statement (SFFAC) 1, *Objectives of Federal Financial Reporting*, the operating

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

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 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 oil and gas leases are displayed on the statement of changes in net position with non-exchange revenue rather than on the statement of net cost with other exchange revenue. Presentation of revenues arising from oil and gas leasing activities as exchange revenue would assist users in understanding how the government's efforts and accomplishments were financed. The current practice of combining revenues derived from the sale of assets with revenues derived from taxation or other non-exchange sources may obscure the fact that 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 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.

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

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Table of Contents

Questions for Respondents

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

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

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

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

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

All responses are requested by [insert date].

Q1. The original exposure draft (ED) issued on May 21, 2007, contained detailed asset valuation implementation guidance for valuing 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 18 through 23, A45 and A46)? 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 using a risk-free discount rate as provided in paragraphs 19 through 21.

Comment: Staff revised to clarify that proposed method is present value **using a risk-free discount rate**. See BfC pars. A36 through A44 for detailed discussion.

Deleted: present value of future federal royalty receipts on proved reserves known to exist as of the reporting date

Do you agree or disagree with the Board's position (see paragraphs 19 through 21 and A36 through A44)? 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 a risk-free discount rate. Specifically, the Board is permitting a market-based fair value measurement consistent with Financial Accounting Standards 157, *Fair Value Measurements*. Do you agree or disagree with the Board's position (see paragraphs 24 and A36 through A44)? Please explain the reasons for your position in as much detail as possible.

Deleted: s

Deleted: present value of future federal royalty receipts on proved reserves

Comment: Staff revised to clarify distinction between PV **using a risk-free discount rate** and market-based FV measurements. See BfC pars. A36 through A44 for detailed discussion.

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 A47 through A49)? 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 A62 through A64)? Please explain the reasons for your position in as much detail as possible.

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Comment: Per request from H. Steinberg

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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.

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Comment: Staff inserted question on disclosure requirements for federal fiduciary activities to again request cost-benefit information – see Issue Paper No. 2, Fiduciary Reporting Requirements (Updated), at Attachment 2 for more information.

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 48.

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 A85)? Please explain the reasons for your position in as much detail as possible.

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

Effective Date

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

Proposed 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*.[4]

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 – currently treated as nonexchange revenue due to the absence of cost information – in accordance with exchange revenue standards.

10. Federal lands contain a variety of natural resources that are not specifically addressed by this Statement, including oil and gas resources that are not under lease, coal, gold, and silver, as well as timber and grazing rights, among other uses. This Statement does not preclude entities from reporting any 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

[4] 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.

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Comment: Staff incorporated reference to SFFAS 34 because GAAP incorporates more than just FASAB standards.

Deleted: Federal Accounting Standards Advisory Board (FASAB) standards

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

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Comment: Staff inserted to help alleviate some concerns about accounting for other natural resources – see Issue Paper No. 8, Accounting for Other Types of Natural Resources, at Attachment 2 for more information.

authority to derive revenues for its use. Federal oil and gas resources do not include resources over which the federal government acts as a fiduciary for the benefit of a non-federal party.

13. **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 Appendix B: Illustration of the Components of Federal Oil and Gas Resources on page 45 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 oil and gas natural resources should be developed by federal entities rather than centrally by the Board.[5] In an environment heavily affected by changes in prices, technological advancements, economic and operating conditions, and known geological, engineering, and economic data, estimation

Comment: Per T. Allen request to explicitly state that revenue is offsetting credit to asset recognition

Deleted: as an asset on the balance sheet of

Deleted: 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.

Deleted: <#>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 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.¶

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

methodologies may need to be regularly updated to reflect changing economic and technological conditions.

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 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 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

Comment: Deleted footnote previously read: "See SFFAS 33, paragraphs 28 through 32."

Comment: Removed references to SFFAS 33 per H. Steinberg

Deleted: as required for pension, other retirement benefits (ORB) and other postemployment benefits (OPEB) in SFFAS 33, *Pensions, Other Retirement Benefits, and Other Postemployment Benefits: Reporting the Gains and Losses from Changes in Assumptions and Selecting Discount Rates and Valuation Dates*

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Comment: This is not a new paragraph. Staff moved from par. 17 and old par. 18 to improve flow (see deletion on prior page).

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 described in paragraphs 19 through 21; however, methods for measuring fair value that are consistent with FAS 157, *Fair Value Measurements*, may be acceptable if it is not reasonably possible to estimate present value of future federal royalty receipts on proved reserves using a risk-free discount rate.

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.[8]

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. 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 legislated allocation formulas constitute a present

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Comment: Staff revised to clarify distinction between PV **using a risk-free discount rate** and market-based FV measurements. See BfC pars. A36 through A44 for detailed discussion.

Comment: Deleted footnote previously read: "FAS 157, Fair Value Measurements, provides a framework for measuring fair value."

Deleted: present value

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Comment: Deleted footnote as a result of inquiry from R. Kearney about precedence and T. Allen direction to delete references that do not provide additional substantive information

Comment: Deleted footnote previously read: "Statement of Financial Accounting Standards (SFAS) 154, *Accounting Changes and Error Corrections (as amended)*, pars. 2e and 19-21."

Deleted: [9]

[8] 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.

obligation[10] 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) 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.

Comment: Footnote added per request from H. Steinberg that the standard be more specific regarding distributions to federal entities.

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 royalty revenue.[12] In

[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.

addition, a liability[13] 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 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 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.

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[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.

[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.

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-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.

[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.

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 C.

Comment: Deleted reference to SFFAS 33 and made more explicit per request from H. Steinberg

Comment: Deleted footnote previously read: "See SFFAS 33, paragraphs 19 through 27."

Deleted: as required for pensions, ORB, and OPEB in SFFAS 33

Deleted: [17]

Disclosures 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 Disclosures

42. The component entity responsible for reporting the federal government's estimated petroleum royalties on its balance sheet 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.

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Comment: Request by H. Steinberg

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Comment: Deleted pro forma reconciliation per request from H. Steinberg to describe the reconciliation in a narrative format rather than prescribe the presentation

Comment: Staff moved requirement for narrative explanation from old paragraph 43b (previously RSI) because it seemed to duplicate some of this disclosure requirement.

Deleted: balances:¶
¶
Beginning asset balance ... [1]

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 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.

Deleted: <#>An explanation of the significant components of the change in estimated petroleum royalties from one year to the next, the amounts associated with each type of change, and the reasons for the changes. The reasons should be explained as briefly as possible without detracting from understanding. Significant components of the change in estimated petroleum royalties include, but are not limited to, changes in quantity, price, royalty rates, discount rates, and inflation rates.¶

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Comment: This RSI requirement was moved to disclosure requirements on the prior page (see par. 42g).

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Comment: From H. Steinberg

Comment: Per request from B. Dacey that a disclosure of the existence of federal oil and gas resources that are not covered by this standard be required

Federal Receiving Entity Accounting and Reporting

44. 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 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.

Deleted: The present value of the average annual share of the revenue distributed to each entity over the preceding twelve (12) months may be an acceptable basis for estimating the petroleum revenues to be distributed. Other methodologies may be acceptable.

Comment: Staff clarified to ensure consistency.

45. 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.

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

46. 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.

Comment: Per request from H. Steinberg to remove references to SFFAS 33.

Deleted: See the pro forma illustration in Appendix B of SFFAS 33.

47. 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 oil and gas resources.

Disclosure Requirements for Fiduciary Oil and Gas Resources

48. Fiduciary activities are defined in SFFAS 31, *Accounting for Fiduciary Activities*. Information consistent with the requirements of paragraphs 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.

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 oil and gas resources. Additional categories of natural resources may be addressed in a future project.

Comment: Staff inserted to help alleviate some concerns about accounting for other natural resources – see Issue Paper No. 8, Accounting for Other Types of Natural Resources, at Attachment 2 for more information.

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:

a. Prospecting[18]
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 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.

Overview of Federal Oil and Gas Resources

A9. The *Illustration of the Components of Federal Oil and Gas Resources* (illustration) presented on page 45 identifies the universe of federal oil and gas

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

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.

A10. 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 industry. Information is available in varying degrees and with varying reliability for each component. The components are first separated into "undiscovered resources" and "discovered resources." Generally, undiscovered resources are not under lease, while, discovered resources are under lease.

Undiscovered Resources

A11. 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**.

A12. 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.

A13. 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.

A14. 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.

A15. 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.

A16. 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.

Discovered Resources

A17. The second major component of total resources is **discovered resources**. The discovered resources component is divided into the following subcomponents as follows:

a. **unproved reserves**
   - i). **unproved possible reserves**
   - ii). **unproved probable reserves**

b. proved reserves
   - i). **proved undeveloped reserves**
   - ii). **proved developed reserves**
     1. **proved developed non-producing reserves**
     2. **proved developed producing reserves**

c. production

A18. Under current FASAB accounting standards, there are no requirements to provide or present information about the unproved reserves components in the financial statements.

A19. 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. A16, 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.

A20. 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.

A21. 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.

A22. 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.

A23. 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.

A24. The illustration in Appendix B: Illustration of the Components of Federal Oil and Gas Resources provides a summary of the information presented in the preceding paragraphs. The shaded boxes in the illustration represent the availability of information as follows:

No quantity information available	
Technically recoverable resources quantity information provided by EIA[19]	
Proved reserves quantity information provided by EIA[20]	

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

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

Recognition Criteria

A25. 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.[21]

[19] Quantity information is published at the national level.
[20] Quantity information is published at the national level.
[21] SFFAC 5, par. 5.

A26. 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.[22]

Asset Recognition

A27. 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.

A28. An asset for federal accounting purposes is a resource that embodies economic benefits or services that the federal government controls.[23]

A29. 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.[24]

Oil and Gas Resources as a Federal Asset

A30. First, the Board established which federal oil and gas resources were being considered. Appendix B: Illustration of the Components of Federal Oil and Gas Resources presents the oil and gas resources that were considered. The two major components are "undiscovered resources" and "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.

Comment: Staff changed to make consistent with previous change to par. 15.

Deleted: discovered resources

A31. 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 A25 above, the second criterion for recognition is that the asset "…be measurable."

[22] SFFAC 5, par. 7.
[23] SFFAC 5, par. 18.
[24] SFFAC 5, par. 22.

A32. Estimates of the quantity of technically recoverable oil and gas resources was 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.

Comment: Staff clarified because EIA has never provided quantity information on undiscovered, non-recoverable resources.

Deleted: other than proved reserves

A33. 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.

A34. 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.

A35. 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

A36. 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.

A37. 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 import 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.

A38. 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.

Deleted: <#>Concerning the dollar amount to be recognized for the estimated federal royalty share of proved reserves, the Board considered various measurement attributes[25] and methods, including the following:¶
¶
<#>Historical cost (historical proceeds) – The amount of cash, or its equivalent, paid to acquire an asset, commonly adjusted after acquisition for amortization or other allocations (SFAC 5, par. 67). 'Historical cost' was not a feasible option for valuing the oil and gas reserves because there is no 'historical exchange price' for the oil and gas reserves controlled by the federal government.¶
¶
<#>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 (SFAS 157, par. 5). Information needed to estimate fair value is not available as there are no current transactions between market participants involving the sale of the federal royalty share for proved oil and gas reserves. ¶
¶
<#>Net realizable (settlement) value – The total non-discounted amount of cash, or its equivalent, into which an asset is expected to be converted in due course of business less direct costs, if any, necessary to make that conversion (SFAC 5, Par 67). The 'net realizable value' (NRV) requires a reasonable estimate of future flows (receipts and costs) associated with converting assets to cash. However, it may be difficult to reliably estimate the amount of the future flows of the federal royalty share for proved oil and gas reserves due to volatile fluctuations in the first purchase price for oil and wellh ... [2]

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Comment: Staff added A36 through A44 discussion based on T. Allen and J. Patton request to clarify the distinction being made between PV and FV and the basis for selecting them as the measurement methods.

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A39. 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:

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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.

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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.

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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.

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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.

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A40. 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.

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A41. 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 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.

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A42. 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

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paragraphs A75 through A82) and talking with DOI representatives 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 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.

A43. 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. FAS 157 emphasizes that fair value is a market-based measurement, not an entity-specific measurement. Under FAS 157, a fair value measurement should be determined based on the assumptions that market participants would use in pricing the asset. As a basis for considering market participant assumptions in fair value measurements, FAS 157 establishes a fair value hierarchy that prioritizes the inputs to valuation techniques used to measure fair value into three broad levels. The FAS 157 fair value hierarchy gives the highest priority to quoted prices (unadjusted) in active markets for identical assets (Level 1) and the lowest priority to unobservable inputs (Level 3). Level 2 inputs are inputs other than quoted prices included within Level 1 that are observable for the asset, either directly or indirectly. Therefore, the present value measurement approach proposed in this ED is not a fair value measure consistent with FAS 157.

A44. 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 FAS 157 will be acceptable. Fair value incorporates the effects of uncertainty that are inherent in oil and gas reporting. 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 or (2) a market-based fair value measurement consistent with FAS 157.

Asset Valuation Methodology

A45. The Board believes that the detailed estimation methodology for valuing oil and gas natural resources should be developed by federal entities rather than centrally by the Board. In an environment heavily affected by changes in prices, technological advancements, economic and operating conditions, and known geological, engineering, and economic data, estimation methodologies may need to be regularly updated to reflect changing economic and technological conditions. Sources of information that were once available to preparers may be replaced or become obsolete. On the other hand, new and more reliable data sources may become available. Permitting the preparers flexibility in developing an estimation methodology that keeps pace with the environment will prevent the accounting standards from becoming outdated.

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A46. 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.

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Comment: Deleted per comment from H. Steinberg

Deleted: in an attempt to prevent the standards from becoming outdated if EIA were to stop reporting the minimum information necessary to calculate the estimated petroleum royalties asset. In addition to dating the standards,

Change in Methodology after the Initial Year of Implementation

A47. 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.

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A48. 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 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.

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<#>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

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Comment: Staff combined pars. A48 and A49 to eliminate a duplicate sentence.

Comment: Staff deleted references to SFAS 154 that do not provide additional substantive information.

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A49. 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.

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Deleted: (SFAS 154, par. 21)

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

A50. 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.

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Liability Recognition

A51. Recognition of royalty distributions to non-federal entities as a liability is based on SFFAC 5 paragraphs 36 through 48.

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A52. A liability is a present obligation[26] of the federal government to provide assets or services to another entity at a determinable date, when a specified event occurs, or on demand.[27]

A53. 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.[28]

[26] 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.
[27] SFFAC 5, par. 39.
[28] SFFAC 5, par. 41.

A54. 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.[29]

A55. 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.

A56. 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.

A57. 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 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.

Comment: Staff deleted sentence because it is no longer applicable since there is no liability being recognized for future distributions to federal entities.

Deleted: In addition, upon consolidation, the portion of the liability related to other federal agencies and the general fund of the U.S. Treasury would be eliminated so that the balance sheet for the government as a whole reports only the liability for amounts allocated to non-federal entities.

[29] 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.

A58. 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.

A59. 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.

A60. 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 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.

A61. 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

A62. 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.

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A63. 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.

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Comment: Per H. Steinberg

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A64. 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.

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Comment: Per comment from H. Steinberg to delete references to SFFAS 33.

Future Rights to Royalty Streams Identified for Sale

A65. 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

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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.

A66. 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.

A67. 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

A68. 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.

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Comment: Per H. Steinberg

Original Exposure Draft

A69. 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.

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A70. 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.

A71. 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)).

A72. 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.

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Comment Letters

A73. Eight comment letters were received from the following sources:

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

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A74. 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.

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A75. 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

A76. 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.

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A77. 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.

A78. The field test team presented the Board with a number of significant considerations, including the lack of availability of quantity information on proved reserves under federal lands. The original ED had proposed that the valuation of oil and gas resources be based on information to be provided by 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.

A79. In addition to the reliance on proved reserves data required to be provided by EIA, the field test team noted a number of other concerns, including:

a. the 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.

A80. 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 A78 and A79 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.

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A81. 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.

A82. 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.

A83. The field test questionnaires were extremely useful in helping the Board determine the focus of the current ED.

Discussion with DOI Representatives

A84. 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.

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A85. 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

A86. 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:

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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 oil and gas natural resources. In an environment heavily affected by changes in prices, technological advancements, economic and operating conditions, and known geological, engineering, and economic data, estimation methodologies may need to be regularly updated to reflect changing economic and technological conditions. The Board believes that the detailed estimation methodology for valuing oil and gas natural resources should be developed by federal entities rather than centrally by the Board.[30] 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

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

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; however methods for measuring fair value that are consistent with FAS 157, *Fair Value Measurements*, may be acceptable if it is not reasonably possible to estimate present value of future federal royalty receipts on proved reserves using a risk-free discount rate.

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).

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

n. Updated the basis for conclusions.

Deleted: present value of future federal royalty receipts on proved reserves

Comment: Staff updated to be consistent with new par. 24.

Deleted: may be acceptable if it is not reasonably possible to estimate present value.

Comment: Deleted per H. Steinberg request to delete references to SFFAS 33.

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

Deleted: <#>[TBD based on discussion of other issues – fiduciary reporting, custodial reporting for other commodities, etc] ¶

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

<table>
<tr><td>Accounting Standards</td><td colspan="9">Components of Federal Oil and Gas Resources</td></tr>
<tr><td rowspan="5"></td><td colspan="3">Undiscovered Resources</td><td colspan="6">Discovered Resources</td></tr>
<tr><td rowspan="2">Undiscovered Non-Recoverable Resources</td><td colspan="4">Technically Recoverable Resources</td><td colspan="3" rowspan="2">Proved Reserves</td><td rowspan="2">Production</td></tr>
<tr><td colspan="2">Undiscovered Recoverable Resources</td><td colspan="2">Unproved Reserves</td></tr>
<tr><td rowspan="2"></td><td>Undiscovered Conventionally Recoverable Resources</td><td>Undiscovered Economically Recoverable Resources</td><td>Unproved Possible Reserves</td><td>Unproved Probable Reserves</td><td>Proved Undeveloped Reserves</td><td colspan="2">Proved Developed Reserves</td><td></td></tr>
<tr><td colspan="2"></td><td colspan="3"></td><td>Proved Developed Non-Producing Reserves</td><td>Proved Developed Producing Reserves</td><td></td></tr>
<tr><td>Current Accounting Standards</td><td colspan="3"></td><td colspan="6">Bonus bid, rent, royalty revenue accounted for as custodial activity and recognized as a financing source on the CFR statement of operations and changes in net position</td></tr>
<tr><td>Proposed Accounting Standards</td><td></td><td colspan="2"></td><td colspan="2">• Recognize bonus bid and rent revenues as exchange revenue on SNC[31]</td><td colspan="3">• Recognize projected federal royalty share on BS[32]
• Recognize gains/losses on SNC
• Provide disclosures for Proved Reserves</td><td>• Recognize royalty revenues as revenue and depletion expense on SNC
• Provide RSI/ Disclosure Information</td></tr>
</table>

[31] statement of net cost
[32] balance sheet

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Appendix C: Pro Forma Transactions and Financial Statements

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

The following pro forma transactions are compressed and simplified, and appropriately do not contain all of the detail associated with an event. 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.

Comment: Per H. Steinberg

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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.[33] 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.[34] These calculations are presented below:

$150,677,667 X .85 = $128,076,017 (federal portion)
$150,677,667 X .15 = $22,601,650 (non-federal portion)

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).

Deleted: and to other federal component entities

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Comment: Staff added to clarify that increase in net position is only until collections are distributed.

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.

[33] 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.
[34] The 15 percent was derived by dividing [Note 21. Payments to States] by [Total Revenue on the Statement of Custodial Activity] for 2005.

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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.[35] This calculation is presented below:

$2,360 X .15 = $354

Dr Revenue Designated for Others – Non-Federal[36]	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 received in connection with the new lease, 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.

[35] See footnote 34.
[36] 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.[37] This calculation is presented below:

$239,502 X .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.

[37] See footnote 34.

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.[38] 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.[39] These calculations are presented below:

[38] See footnote 34.
[39] 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.

$4,290,094 X .15 = $643,514
$4,290,094 X .84 = $3,603,678

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).[40]

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 estimated quantity of proved reserves, the first purchase price for oil or the wellhead price for gas, and the royalty rate 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.

[40] See footnote 29.

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.[41] 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.[42] 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

[41] See footnote 34.
[42] See footnote 34.

federal component entities based on the average distribution for 2005.[43] 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).[44]

Comment: Staff added narrative explaining calculation to be consistent with other pro forma entries.

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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,[45] 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 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 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 royalties sold),

[43] See footnote 39.
[44] See footnote 29.
[45] The estimated petroleum royalties beginning balance would have been reduced by the amount of depletion expense recognized during the year.

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[46]		25,210,226

To record revaluation of estimated petroleum royalties.

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.[47] This calculation is presented below:

$25,210,226 X .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 85% 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)

Comment: Staff added to clarify that increase in net position is only until collections are distributed.

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.

Deleted: This display is further illustrated in SFFAS 33.

46 This gain will be illustrated on the statement of net cost as partially due to changes in assumptions.
47 See footnote 34.

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	$ 171,877,227
Liabilities	
Liability for Revenue Distributions to Others – Non-Federal	25,775,142
Total Liabilities	25,775,142
Net Position	
Cumulative Results of Operations	146,102,085
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	(4,658,115)
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	1,425
Net Cost/(Revenue) for Program before (gain)/loss from changes in assumptions	$ (21,433,064)

(Gain)/Loss on assumption changes:	
Discount rate assumption	(200,500)
Other assumptions	500
Net (gain)/loss on assumption changes	(200,000)
Net Cost/(Revenue) for Program	$(21,633,064)

Statement of Changes in Net Position	
Beginning Net Position	$ 0
Adjustment: Change in Accounting Principle	128,076,017
Beginning Balance, as adjusted	128,076,017
Net Revenue for Program	21,633,064
Transfers In/(Out)	(3,606,996)
Ending Net Position	$ 146,102,085

(For Illustrative Purposes Only)

Appendix D: Abbreviations

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

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Appendix E: Glossary

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Definitions of Resource and Reserve Components and Subcomponents

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

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

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

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

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.

Discovered Resources

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

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

Reserves

In accordance with the Society of Petroleum Engineers (SPE), the World Petroleum Congresses (WPC), and the American Association of Petroleum Geologists (AAPG), the definition for "reserves" and the following explanatory paragraphs are presented as follows[48]:

> "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.

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

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

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

Proved Reserves

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

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

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

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

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

Production represents the proved oil and gas reserves that were extracted from existing reserves.[49]

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

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Other Definitions

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

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

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

Basin: The site of accumulation of a large thickness of sediments.[50]

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.[51]

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

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

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[49] Adapted from Gas Energy Review, Gas Supply and Demand Committee, July 1995, Vol.23 No. 7.
[50] U.S. Geological Survey, Geologic Glossary.
[51] Glossary of Mineral Terms, Minerals Revenue Management, Minerals Management Service, U.S. Department of the Interior (Glossary of Mineral Terms)

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 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.

Comment: Staff added from consolidated glossary in Pronouncements, As Amended.

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.[52] 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.

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.[53]

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.

[52] EIA-182 Domestic Crude Oil First Purchase Report Instructions.
[53] 30 U.S.C. §1702 (5).

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

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

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

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.

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**.[54]

Play: A group of **pools** that share a common history of hydrocarbon generation, migration, reservoir development, and entrapment.[55]

Pool: A discovered or undiscovered accumulation of hydrocarbons, typically within a single stratigraphic interval.[56]

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.[57]

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.[58]

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[54] Glossary of Mineral Terms.
[55] Ibid.
[56] Ibid.
[57] Ibid.

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.

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.[59]

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.[60]

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:

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[58] Ibid.
[59] Adapted from 30 U.S.C. § 1702 (14).
[60] Glossary of Mineral Terms.

- 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 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.[61]

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

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Page 15: [1] Deleted **Julia Ranagan** **5/26/2009 8:38 AM**

balances:

Beginning asset balance	**$XX,XXX**
Revaluation Gain / Loss Due to Changes in:	
Quantity	**XXX**
Price	**(XX)**
Royalty Rates	**XX**
Assumptions	
Discount Rate	**X,XXX**
Inflation Rate	**XXX**
Less:	
Depletion	**(XXX)**
Sale of future royalty streams	**(XX)**
Ending asset balance	**$XX,XXX**

This reconciliation should provide all material components of the changes in the estimated petroleum royalties asset consistent with the components identified in the table immediately above, if applicable. Additional sub-components may be presented. The line item for revaluation gains and losses should be broken out into sub-components for changes in quantity; price; royalty rates, if applicable; and assumptions (i.e., discount rate and inflation rate).

Page 28: [2] Deleted **Julia Ranagan** **5/27/2009 8:12 AM**

Concerning the dollar amount to be recognized for the estimated federal royalty share of proved reserves, the Board considered various measurement attributes1 and methods, including the following:

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

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 (SFAS 157, par. 5). Information needed to estimate fair value is not available as there are

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1 Measurement attribute – the traits or aspects of an element that can be quantified in monetary units with sufficient reliability (adapted from Statement of Financial Accounting Concepts (SFAC) 5: *Recognition and Measurement in Financial Statements of Business Enterprises, as amended,* par. 65).

no current transactions between market participants involving the sale of the federal royalty share for proved oil and gas reserves.

Net realizable (settlement) value – The total non-discounted amount of cash, or its equivalent, into which an asset is expected to be converted in due course of business less direct costs, if any, necessary to make that conversion (SFAC 5, Par 67). The ‘net realizable value’ (NRV) requires a reasonable estimate of future flows (receipts and costs) associated with converting assets to cash. However, it may be difficult to reliably estimate the amount of the future flows of the federal royalty share for proved oil and gas reserves due to volatile fluctuations in the first purchase price for oil and wellhead price for gas.

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

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

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

Natural Resources

History of Project and Key Decisions

May 1995 - Present

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

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

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

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

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

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

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

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

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

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

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

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

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

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

Natural Resources

History of Project and Key Decisions

May 1995 - Present

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

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

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

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

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

[Project deferred to address other issues]

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

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

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

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

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

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

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

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

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

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

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

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

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

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

January 2006 - Staff presented a draft ED that included estimated quantity, price, and royalty rate information on a regional basis rather than at a national level. This was deemed to provide a more representative valuation. Staff also addressed future royalty rights held for sale in the revised ED. The Board

Natural Resources

History of Project and Key Decisions

May 1995 - Present

provided a number of comments on the revised ED, including a request that pro forma accounting transactions, pro forma financial statements, and a discussion of the timing of the transactions be included.

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

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

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

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

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

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

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

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

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

Natural Resources

History of Project and Key Decisions

May 1995 - Present

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

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

December 2008 - The board members unanimously supported continuing efforts to issue an ED. The members directed staff to retain the scope of the ED as oil and gas only, preserve the level of detail in the draft ED, delete the formula in the previously exposed ED (quantity X price X royalty rate), and keep the effective date as drafted (three year phase-in from RSI to basic with a date certain). Staff will incorporate those changes and address additional issues (fiduciary reporting, liability classification, component entity RSI, reporting for other commodities, showing gains and losses on the component entity SoNC, and reporting changes in assumptions) while working towards a pre-ballot revised ED for the April 2009 meeting.

February 2009 - Due to the board's primary focus on long-term projections and social insurance, the natural resources project was not discussed at the February meeting.

April 2009 - The board voted to limit the valuation flexibility to either the proposed present value approach (using a risk-free discount rate) or a method for measuring fair value that is consistent with FAS 157, *Fair Value Measurements*. Members reaffirmed their previous decision to transition to basic after a period of three years as RSI.