

Memorandum

SFFAS 38 Review

August 4, 2022

To: Members of the Board
From: Sherry L. Lee, Senior Analyst
Thru: Monica R. Valentine, Executive Director
Subject: **Review of SFFAS 38 Requirements** (Topic G)

INTRODUCTION

Staff began research on the reporting requirements of Statement of Federal Financial Accounting Standards (SFFAS) 38, *Accounting for Federal Oil and Gas Resources*, and Technical Bulletin (TB) 2011-01, *Accounting for Federal Natural Resources Other than Oil and Gas*. The objective of the review is to facilitate Board discussions on the reporting requirement left open in SFFAS 38 as to whether the information required should transition to basic information as financial statement recognition or note disclosure, or if the requirements should remain as RSI. The attached analysis explains staff's initial research findings.

For this topic discussion, staff is seeking the Board's feedback on the initial research conducted by staff on natural resources reporting.

REQUEST FOR FEEDBACK BY August 15, 2022

Please review the attached Staff Analysis. Staff requests responses to the ensuing questions by **August 15, 2022** in the Staff Analysis (Attachment).

Please submit responses to Sherry L. Lee at LeeSL@fasab.gov with a cc to Monica Valentine at ValentineM@fasab.gov.

NEXT STEPS

Staff will continue its research on the topic based on Board decisions at the August meeting.

ATTACHMENT

Staff Analysis



Staff Analysis

SFFAS 38 Review

August 4, 2022

BACKGROUND

On April 13, 2010, the Board issued Statement of Federal Financial Accounting Standards (SFFAS) 38: *Accounting for Federal Oil and Gas Resources*¹. SFFAS 38 requires federal entities to report the following in Required Supplementary Information (RSI), as part of a discussion of all significant federal oil and gas resources under the entity's management,

- The value of the federal government's estimated petroleum royalties from the production of federal oil and gas proved reserves in a schedule of estimated federal oil and gas petroleum royalties, and
- The value of estimated petroleum royalty revenue designated for others to be reported in a schedule of estimated federal oil and gas petroleum royalties to be distributed to others.

In addition, on July 6, 2011, the Board issued Technical Bulletin (TB) 2011-1: *Accounting for Federal Natural Resources Other Than Oil and Gas*. TB 2011-1 clarifies that federal entities should report the federal government's estimated royalties and other revenue from federal natural resources that are under lease, contract, or other long-term agreement and are reasonably estimable as RSI, consistent with the guidance in SFFAS 38. SFFAS 38, as amended, was effective for periods beginning after September 30, 2012, and Technical Bulletin was effective for periods beginning after September 30, 2013. At the time the guidance was issued, it was the Board's intent that the information transition to basic information after being reported as RSI for a period of three years. However, the Board wanted to have more information on the reliability of the valuation methodology before making a final decision. Prior to the conclusion of the three-year RSI period, the Board planned to make a determination as to whether the information would transition to basic information as financial statement recognition or note disclosure. The Board also acknowledged that new information might become available that would warrant continued reporting as RSI.

The Board last discussed the requirements of SFFAS 38 in April 2014 when the reassessment of SFFAS 38 was moved from a research project (2012 – 2013) to a potential project (2014 – 2018) in the FASAB Annual Report. During the April 24, 2014 Board meeting, the Chair, Mr. Allen, asked members to name their highest priorities

¹ For the history of the Board deliberations on natural resources, follow this link: <https://fasab.gov/projects/archived-projects/natural-resources/>.

from among the potential projects and the natural resources project was not rated as a high priority. Natural resources was then moved from a research project to the list of potential projects from 2014 – 2018.

The objective of a potential research project is to facilitate Board discussions on the reporting requirement left open in SFFAS 38 as to whether the information required in SFFAS 38 and TB 2011-1 should transition to basic information as financial statement recognition or note disclosure, or if the requirements should remain as RSI. Staff's goal would be to research the existing valuation methodologies used by the federal preparers to comply with SFFAS 38 and the potential challenges and benefits associated with a transition to basic.

SUMMARY OF STAFF REVIEW

SFFAS 38 and TB 2011-1 require reporting the value of the federal government's estimated royalties from the production of federal natural resources. The Department of Interior's (DOI's) valuation methodology for oil and gas royalties relies on the Department of Energy's Energy Information Administration (EIA) published oil and gas proved reserves to estimate royalty receipts from the future production of the federal portion of the proved reserves. DOI's valuation methodology for coal is based on estimated royalty receipts from future production of internally developed federal recoverable reserves.

Staff's review is intended to facilitate the board discussion to address whether the information required in SFFAS 38 and TB 2011-1 should transition to basic information as financial statement recognition or note disclosure or if the requirements should remain as RSI. Staff has also included in this document current natural resource reporting requirements of various standard setting bodies and the Securities and Exchange Commission (SEC) as reference.

OUTREACH EFFORTS

DOI is responsible for managing the nation's oil, gas, and coal and the related revenues on federal lands. Accordingly, DOI reports the requirements in SFFAS 38 and TB 2011-1 for the federal government. DOI bureaus and offices responsible for natural resources reporting include the following:

- **Bureau of Land Management (BLM)** – Manages the nation's surface land and its energy and mineral resources.
- **Bureau of Ocean Energy Management (BOEM)** – Manages access to and the exploration and development of the nation's offshore resources.
- **Office of Natural Resources Revenue (ONRR)**, a component of Departmental Offices under Office of the Secretary of DOI – Manages the collection and distribution of revenues from federal onshore and offshore mineral leases.

- **Office of Financial Management (PFM)** under Office of the Secretary of DOI – Is responsible for DOI consolidated financial reporting.

To gain an understanding of DOI's valuation methodologies and challenges, staff met with BLM, BOEM, ONRR, and PFM in May and July 2022. Attendees included subject matter experts in financial reporting, internal controls, natural resources management, and revenue management.

DOI's estimates of future oil and gas royalties rely on proved reserves published by EIA. Therefore, Staff met with EIA in April 2022 to gain an understanding of its methodology for developing national oil and gas reserve estimates. Staff also reached out to independent auditors to gain an understanding of audit procedures related to third party sources.

CURRENT ROYALTY VALUATION METHODOLOGIES

Federal Oil and Gas Royalty Valuation Methodology

According to SFFAS 38,

- Paragraph 17: "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."
- Paragraph 18: "Discount rates as of the reporting date for present value measurements of federal oil and gas resources should be based on interest rates on marketable Treasury securities with maturities consistent with the cash flows being discounted."
- Paragraph 19: "The entity's estimates should reflect its judgment about the outcome of events based on past experience and expectations about the future".
- Paragraph 20: "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."
- Paragraph 21: "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."

DOI Relies on Third-Party Data Published by the EIA

DOI reports the estimated present value of future federal royalty receipts on estimated proved reserves by (1) oil and lease condensate and (2) natural gas, wet after lease separation, on a regional basis. DOI's valuation methodology for oil and gas petroleum royalties is based on oil and gas proved reserves published annually by EIA. The report is developed from survey results submitted by oil and gas operators and it provides proved reserves of oil and gas by state. The EIA report is not subject to audit.

DOI Estimates the Federal Portion of Proved Reserves

As the EIA estimates only provide for federal offshore oil and gas proved reserves and do not separate federal and non-federal for onshore oil and gas proved reserves, DOI estimates the federal portion of each state's oil and gas proved reserves by applying the fraction of the state's production from federal lands to total production from that state during the year. The total estimated federal onshore and offshore proved reserves are then adjusted for each region for changes in the 21-month period from the effective date of the EIA report to the reporting date by applying 3-year historical averages of the changes in proved reserve relative to production in each region. The resulting estimated total federal proved reserves by region as of the reporting date are projected over 30 years to simulate when oil and gas would be produced, taken into account the unique characteristics of each region.

DOI Uses OMB Guidance to Forecast and Discount Royalties

To estimate the future royalties from the projected production of oil and gas, DOI applies the 11-year price estimates that the Office of Management and Budget (OMB) developed for the President's Budget of the financial reporting fiscal year², which are nominal level prices based on future contract averages and expected inflation. Beyond the 11-year period for offshore estimates, prices in the DOI projections are assumed to continue at constant growth rates as in the last year of the OMB forecasts. For onshore estimates, DOI uses the relationship between (a) OMB's 11-year price forecasts and (b) EIA's price forecasts in reference and low oil price case scenarios in EIA's Annual Energy Outlook³ during the 11-year window to forecast prices beyond the 11-year period.

DOI calculates gas price projections for each region based on the proportion of gas-related revenue received in the last three years for offshore and the most recently completed fiscal year data updated with sales data as of March 1 of the financial reporting year for onshore.

Effective royalty rates are calculated for each region based on the prior 3-year average royalty rates for offshore and 1-year royalty for onshore. DOI then estimates the present value of these future royalties by discounting the revenue streams back to the reporting date using OMB's estimates of future 30-year Treasury bill rates for offshore and a weighted average of the U.S. Treasury yield curve from trading dates for the most recently completed fiscal year for onshore.⁴

² For the most recent President's Budget, follow this link [President's Budget | The White House](#).

³ For the most recent Annual Energy Outlook, follow this link [Annual Energy Outlook 2022 - U.S. Energy Information Administration \(EIA\)](#).

⁴ For complete DOI reporting on oil and gas, refer to pages 134 to 142 of DOI's FY 2021 Agency Financial Report at this link: [FY 2021 Agency Financial Report | U.S. Department of the Interior \(doi.gov\)](#).

Figure 1 is DOI's FY 2021 presentation of the schedule of estimated federal oil and gas petroleum royalties from proved reserves and schedule of estimated federal oil and gas petroleum royalties to be distributed to others.

Figure 1

Schedule of Estimated Federal Oil and Gas Petroleum Royalties from Proved Reserves Asset Present Value as of September 30, 2021 (in thousands)						
Offshore ¹	Gulf of Mexico	Pacific ²				Total
Oil and Lease Condensate	\$ 29,525,972	\$ 1,297,848				\$ 30,823,820
Natural Gas, Wet After Lease Separation	2,237,548	91,502				2,329,050
Total Offshore	\$ 31,763,520	\$ 1,389,350				\$ 33,152,870

¹ Offshore royalties include OCSLA Section 8(g) royalties

² Pacific royalties include royalties from Alaska Federal OCS proved reserves.

Onshore	East Coast (PADD 1)	Midwest (PADD 2)	Gulf Coast (PADD 3)	Rocky Mountain (PADD 4)	West Coast (PADD 5)	Total
Oil and Lease Condensate	\$ 74	\$ 3,213,158	\$ 11,791,043	\$ 4,028,905	\$ 823,942	\$ 19,857,122
Natural Gas, Wet After Lease Separation	1,934	782,593	7,073,608	11,931,734	265,083	20,054,952
Total Onshore	\$ 2,008	\$ 3,995,751	\$ 18,864,651	\$ 15,960,639	\$ 1,089,025	\$ 39,912,074

Total Offshore and Onshore 2021	
Total Oil and Lease Condensate	\$ 50,680,942
Total Natural Gas, Wet After Lease Separation	22,384,002
Total Offshore and Onshore	\$ 73,064,944

Schedule of Estimated Federal Oil and Gas Petroleum Royalties to be Distributed to Others as of September 30, 2021 and 2020 (in thousands)		
	FY 2021	FY 2020
Other Federal Bureaus and agencies		
Department of the Treasury	\$ 34,746,007	\$ 34,682,904
Interior - Reclamation Fund	14,529,825	12,642,700
Other Federal Bureaus and agencies	2,937,584	2,054,234
States and Others	20,851,528	21,215,999
Total Estimated Petroleum Royalties to be Distributed to Others	\$ 73,064,944	\$ 70,595,837

Federal Coal Royalties Valuation Methodology

According to DOI, coal is a significant natural resource other than oil and gas that meets the reporting requirements in TB 2011-1. Consistent with the requirements in TB 2011-

1, DOI reports the present value of future federal royalty receipts on estimated recoverable coal reserves that are under lease, contract or other longer-term agreements. DOI's estimated coal royalties are based on the Bureau of Land Management's estimates of recoverable reserves developed with input from coal-managing offices, adjusted from the effective date of the estimates to the reporting date. The resulting recoverable reserves are then projected over 30 years to simulate when the reserves would be produced. Future royalties are then calculated by applying future price estimates and effective royalty rates, adjusted for transportation and other costs. The present value of the future royalties are calculated by applying OMB's estimates of future 30-year Treasury bill rates.⁵

Figure 2 is DOI's FY 2021 presentation of the schedule of estimated federal coal royalties and the schedule of estimated federal coal royalties to be distributed to others.

Figure 2

Schedule of Estimated Federal Coal Royalties Asset Present Value as of September 30, 2021 (in thousands)					
	Powder River Basin ¹	Colorado	Utah	All Other ²	Total
Total Coal	\$ 6,653,550	\$ 586,483	\$ 157,569	\$ 753,692	\$ 8,151,294

Schedule of Estimated Federal Coal Royalties Asset Present Value as of September 30, 2020 (in thousands)					
	Powder River Basin ¹	Colorado	Utah	All Other ²	Total
Total Coal	\$ 6,216,539	\$ 642,444	\$ 264,456	\$ 766,667	\$ 7,890,106

Schedule of Estimated Federal Coal Royalties to be Distributed to Others as of September 30, 2021 and 2020 (in thousands)		
	FY 2021	FY 2020
Other Federal Bureaus and agencies		
Department of the Treasury	\$ 896,642	\$ 867,912
Interior - Reclamation Fund	3,260,518	3,156,042
States and Others	3,994,134	3,866,152
Total Estimated Coal Royalties to be Distributed to Others	\$ 8,151,294	\$ 7,890,106

⁵ For complete reporting on coal, refer to pages 143 to 146 of DOI's FY 2021 Agency Financial Report at [FY 2021 Agency Financial Report | U.S. Department of the Interior \(doi.gov\)](#).

OTHER STANDARD SETTERS' AND REGULATORY AGENCY REQUIREMENTS FOR REPORTING NATURAL RESOURCES

Financial Accounting Standards Board (FASB)

FASB's Financial Accounting Standards (FAS) 69, *Disclosures about Oil and Gas Producing Activities*, requires publicly traded companies with significant oil and gas activities to report, as supplementary information, proved oil and gas reserve quantities and a standardized measure of discounted future net cash flows related to oil and gas proved reserve quantities, in addition to capitalized costs and costs incurred related to oil and gas property acquisition, exploration, development, and producing activities.⁶

Government Accounting Standards Board (GASB)

In GASB Statement 62, under Paragraph 526, it states that the Board considered FASB's FAS 19, *Financial Accounting and Reporting by Oil and Gas Producing Companies*, and FAS 69, *Disclosure about Oil and Gas Producing Activities*, rarely applicable to state and local governments and therefore excluded from incorporation into the GASB literature.⁷

Securities and Exchange Commission (SEC)

The SEC in 17 Code of Federal Regulations Subpart 229.1200, *Disclosure by Registrants Engaged in Oil and Gas Producing Activities*, requires oil and gas companies to report proved reserves and the present value of the estimated future oil and gas revenues, less direct expenses, as supplemental information to the financial statements. Oil still in the ground is not considered an asset until it is extracted and produced.⁸

International Financial Reporting Standards (IFRS)

IFRS 6, *exploration for and Evaluation of Mineral Resources*, mainly addresses financial reporting of costs incurred for exploration for and evaluation of mineral resources including oil and gas. However, there are no reserve disclosure requirements under IFRS.⁹

IPSASB International Public Sector Accounting Standards Board

⁶ For additional details on FAS 69, following this link [Summary of Statement No. 69 \(fasb.org\)](https://www.fasb.org/summary-of-statement-no-69).

⁷ For additional details on GASB Statement 62, follow this link [Pronouncements \(gasb.org\)](https://www.gasb.org/pronouncements).

⁸ For additional details on 17 CFR Subpart 229.1200, follow this link [17 CFR Subpart 229.1200 - Disclosure by Registrants Engaged in Oil and Gas Producing Activities | CFR | US Law | LII / Legal Information Institute \(cornell.edu\)](https://www.cornell.edu/lil/legal-information-institute/17-cfr-subpart-229-1200-disclosure-by-registrants-engaged-in-oil-and-gas-producing-activities).

⁹ Follow this link for additional details on IFRS 6 [IFRS - IFRS 6 Exploration for and Evaluation of Mineral Resources](https://www.ifrs.org/standards/standards-detail/IFRS-6-Exploration-for-and-Evaluation-of-Mineral-Resources).

The IPSASB published the Consultation Paper, *Natural Resources*, in May 2022, which is open for comment until October 2022. The Consultation Paper includes the IPSASB's preliminary views on issues related to the recognition, measurement, presentation, and disclosure of natural resources, using examples of subsoil resources, water, and living resources. The IPSASB's preliminary view is that guidance on exploration and evaluation expenditures, as well as development costs, should be provided based on the guidance from IFRS 6, *Exploration for and Evaluation of Mineral Resources*, which does not require the reporting of oil and gas reserve information.¹⁰

Question for the Board:

1. Do members believe that a research project to review the existing reporting requirements of SFFAS 38 is appropriate?
2. If so, do members agree with staff's next steps to continue researching the topic to assist with Board deliberations?
3. Do members wish to share any other observations or views regarding the Board's assessment of the current SFFAS 38 requirements?

¹⁰Follow this link [Consultation Paper, Natural Resources | IFAC \(ipsasb.org\)](https://www.ipsasb.org/consultation-paper-natural-resources) for additional detail on the IPSASB Consultation Paper.

MEMBER COMMENT FORM
TOPIC G – Natural Resources
August 2022 Board Meeting

Member Instructions:

For each question, please include your name and provide your comments/edits.

Question for the Board:

1. Do members believe that a research project to review the existing reporting requirements of SFFAS 38 is appropriate?

Member Name: Click or tap here to enter text.

Comment:

Click or tap here to enter text.

Question for the Board:

2. If so, do members agree with staff's next steps to continue researching the topic to assist with Board deliberations?

Member Name: Click or tap here to enter text.

Comment:

Click or tap here to enter text.

Question for the Board:

3. Do members wish to share any other observations or views regarding the Board's assessment of the current SFFAS 38 requirements?

Member Name: Click or tap here to enter text.

Comment:

Click or tap here to enter text.