United States Department of the Interior

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Executive Director
Federal Accounting Standards Advisory Board
441 G Street, NW
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Washington, DC 20548

RE: FASAB Exposure Draft, Accounting for Federal Oil and Gas, dated 21 May 2007

The Department of the Interior (Department) appreciates the opportunity to provide comments on the proposed Statement of Federal Financial Accounting Standards, *Accounting for Federal Oil and Gas Resources*. The Department, the Minerals Management Service (MMS), and the Bureau of Land Management (BLM) also appreciate the unique opportunity to participate in a field test study to consider and develop a potential alternative valuation methodology, gather information on the effects of the proposed Statement, and develop material for a possible Implementation Guide.

Experts engaged on the field test study team (Team) included economists, petroleum engineers, resource evaluation experts and accountants with MMS Offshore Minerals Management (OMM), MMS Custodial Reporting Branch (CRB), MMS Minerals Revenue Management (MRM), and BLM, Inspection and Enforcement. Based on the Team's results, formal responses to FASAB's questions below are attached in enclosures A, B, and C.

On behalf of the Team, the Department respectfully offers the following observations and comments, as requested in the FASAB's formal "*Request for Comments*." All of the comments below are more fully addressed in the field test (enclosures B and C) provided to the Board.

Overall, we agree with the intent of the proposed Statement, to enhance accountability and provide readers of Federal financial reports with greater information about the quantity and estimated value of assets that generate cash to finance government operations over time. Moreover, there is a considerable amount of complexity and some uncertainty related to certain components of this estimate. Establishing quality data and systems are critical to having meaningful data and this will take time.

Disclosure Requirements for Fiduciary Oil and Gas Resources

With regard to paragraph 34 of the Exposure Draft (ED), the Department wishes to reemphasize the position that the documentation requirements for fiduciary activities should not include disaggregated financial information as the gathering of such information would be labor intensive, is not readily available, and conflicts with the position the Board presented to the Department. This position is also consistent with that presented in the October 5, 2006, FASAB letter to the Secretary of the Interior. In that letter, the FASAB members stated "neither existing standards nor proposed SFFAS 31 require disaggregated information to be presented in a note disclosure." The FASAB members further state:

> "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. FASAB did not intend the DOI to either develop or report accruals at the beneficiary ownership level for purposes of its financial statements, and FASAB does not believe that it would be reasonable to interpret or implement SSFAS 31, once issued and effective, in that manner."

Accordingly, we ask the Board to strike this paragraph in the final version of the standard and reaffirm its aforementioned position with respect to the disclosure requirements for Fiduciary Oil and Gas Resources. In addition, the Department cannot currently determine quantity information for Indian Lands nor the beneficiary participation in our program at an aggregated level.

Valuation

The Team reached consensus that the most appropriate method for valuing the asset 'estimated proved reserves' is neither the view presented in the exposure draft, nor the alternative view, but rather a modified alternative method, called the 'present value method'. This valuation method, based upon the deterministic model for ascertaining quantity, is presented in detail in the field test questionnaire (Enclosure C). It is considered a superior method because the value of total proved reserves at any point in time must include a factor to account for the reserves that cannot be extracted and recognized as revenue at the measurement date. By estimating production declines, potential additions, and estimated depletion, the net estimated present value of the asset will provide the readers with a more realistic picture of the assets value at the financial reporting date.

Accounting Treatment

The proposed Statement as presented in the ED would require extensive and costly changes to existing business processes, system requirements, and accounting models, regardless of the valuation method selected. These changes, impacts and costs are presented in detail in the field test questionnaires for both the ED view (Enclosure B) and the Present Value view (Enclosure C). As well, many of the proposed requirements could lead to potentially negative ramifications, such as the collecting and recipient entities inability to meet accelerated financial reporting due dates and related issues potentially giving rise to audit findings.

We believe that the Board's objectives can be more efficiently and effectively achieved by making some modifications to the proposed accounting treatment and related provisions described and detailed in the field test questionnaires.

For example, we believe that reporting depletion expense and the gain on revaluation on the Statement of Net Cost does not provide the reader with more meaningful information. In the field study, although the overall asset value declined over a year period, depletion expense recorded in the year exceeded the straight difference in the ending valuation, and required a gain on revaluation to be recorded. This gain would likely not be reflected in subsequently published Energy Information Agency (EIA) data. For the reader, we believe that disclosures regarding the asset valuation and royalties reported over a given span of time, combined with financial statement presentation of any custodial gain or loss on revaluation would provide an equally clear picture of the overall asset and will more efficiently and cost effectively meet the Board's objectives.

Accordingly, we recommend that the asset be capitalized as a custodial asset, that custodial accounting for royalty and related activity be continued, and that the asset be revalued annually with the associated gain or loss recorded on the Statement of Custodial Activity. Other reporting objectives can be efficiently accomplished with associated disclosures.

<u>**Commodities Covered in the Proposed Standard**</u>
The Statement as proposed provides guidance on the valuation and accounting for oil and gas, and does not address other commodities reported and collected by MMS, such as solid minerals. This means that different accounting treatment and models would be required for oil and gas and all other commodities, and any other activity currently classified as custodial. The Department strongly recommends that implementation be delayed until all commodities and related business activities are addressed. This standard will require significant business process and system modification that would require two separate accounting operations systems if segregated.

<u>**Rescissions of SFFAS 7 Provisions for Royalty Activity as Custodial**</u>
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, pp. 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.

<u>**New Accounting Treatment, SGL Accounts and Accounting Models Required**</u>
In discussions with United States Government Standard General Ledger (USSGL) staff, new accounts and posting models will need to be developed, approved, and incorporated into Department of the Treasury (Treasury) financial statement guidance. For example, some transfer accounts will involve transfers from a clearing to a special fund, some with and some without budget authority. Also, there is no established methodology or need for recording equity in a general fund or a clearing account. Accordingly, the details of implementation will require significant effort to be developed. Until formal Treasury approved accounts and models are in place, we can not engage the system contractor on the cost of the modifications to accounts and models needed

for implementation. Adequate time is requested for Statement implementation, to facilitate this significant and costly effort.

New Fund or Reporting Exception Required

Currently, MMS/MRM records royalty and related activity by posting to clearing account F3875. Amounts are received from the public and distributed to other federal entities through this account. To capture and report on the capital asset, a new fund would be required, or an exception granted to report this activity, including equity, in the clearing account. While Treasury is in the midst of prohibiting or limiting use of the F3875 clearing account, a waiver request is in process for MRM royalty activity and Treasury has indicated that it will likely be granted. Historically, Treasury and OMB required that MRM use this clearing account for their royalty and related activity, and it is hard-coded throughout the royalty accounting system (MRMSS).

Recommended Depletion Method

As a result of timing issues related to royalty reporting, and the use of estimates and accruals in revenue figures, the field test questionnaire provides a detailed discussion of factors requiring clarification in the Statement. The recommended method would be to record depletion based upon royalty reporting lines received and accepted for the preceding twelve sales months for which royalty production data is available at fiscal year end. This would preclude the need to include estimates in the depletion calculations, which may not relate to oil or gas, and would represent a realistic value of true asset depletion based on actual royalty reporting. This method would likely yield a more accurate picture of current asset depletion over a year time period. This method would also provide the ability, with sophisticated queries and reports, to derive the detailed information the ED requires from actual royalty reports, such as commodity type, region, onshore vs. offshore and other necessary details.

Timing and Availability of Published EIA Data

The ED view proposes to base values on, "...the most recent survey conducted by the EIA, issued no more than twelve (12) months before the end of the reporting period..." However, the most recent published EIA reserve estimates available to calculate the value would likely be a full 21 months prior to the financial reporting date. Accordingly, we recommend the ED be worded to base valuation simply on the most recent survey available from EIA.

Onshore quantities of proved reserves fall under multiple layers of ownership. Information on onshore estimated proved reserves under federal domain is presently not published by EIA. In order to obtain onshore quantity, estimation methods had to be employed. The Team reached agreement on the estimation methodology described in the field test questionnaire (Enclosure B), and determined that in the absence of specific information, this would be an acceptable method to use for implementation as well.

Ideally, EIA estimates of offshore proved reserves would need to be divided according to commodity (crude oil, lease condensate, and natural gas – wet after lease separation), and, in the Gulf of Mexico (GOM), further for each commodity by the water depth category of the field. For example, the proved reserves estimates for oil and lease condensate would further have to be divided into proved reserves from fields in water depths less than 400 meters and proved reserves from fields in water deeper than 400 meters. The water depth subdivision at 400 meters is to facilitate the calculations using the appropriate royalty rate. For pre-2007 GOM leases, those in water shallower than 400 meters have a one-sixth royalty rate and those in deeper than 400 meters have a one-eighth royalty rate. Beginning with GOM leases sold in 2007, all have a one-sixth royalty rate, regardless of water depth. Proved reserves from other Federal OCS Regions would not need to be divided according to water depth for those regions, as they generally have a single royalty rate per Region.

The Department strongly recommends that an agreement be reached with the Department of Energy (DOE)/EIA to provide the necessary proved reserves data in the appropriate form and format for this or any method adopted for the reserves valuation. Alternatively, the Department has devised a means for estimating the proportions of EIA proved reserves for the GOM applicable to royalty rates of one-sixth and one-eighth. This has been accomplished by applying the water depth proportions from the most recent proved reserves estimates to the published proved reserve estimates from EIA.

Lead Time for Implementation

If the Statement is implemented as proposed, new accounting treatments and significant changes to existing Treasury models and business processes will require additional time. As discussed in the field test questionnaire of the ED view (Enclosure B), the performance of a 12 month 'look back' of certain activity implies that changes to certain business process would have to be implemented at least one year prior to implementation. Additionally, it would take at least one year after new models are designed and approved to develop, script, test and implement the revisions to system processes. Depending on the timing of any revisions to the proposed Statement, the Department requests that ample lead time be provided.

Conclusion

In conclusion, we would again like to thank the Board for the opportunity to conduct the field test studies and to provide input, expertise, and comments on the Exposure Draft. We believe that information derived from these studies will help to craft a meaningful yet efficient and cost effective Standard that will enhance accountability for this federal asset.

Again, thank you for the opportunity to respond to these questions. If you need any additional information, please contact me or Ernest Goebel at (202) 208-4701.

Sincerely,

Daniel L. Fletcher
Director, Office of Financial Management

Enclosures