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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

Question 6 - This is the ED requirement that I have the greatest concern with. Even though SSFAS 31 requires assets held in a fiduciary capacity to be reported, neither FASB (banks, investment companies, etc.) or GASB generally require valuation of non-monetary assets. All 50 states and DC have adopted the principles of the Uniform Principal and Income Act, which provides guidance on fiduciaries. A few states already had incorporated the provisions of the Act in their laws prior to the first issuance of the Act, which is now in a second revised version. The Act is very clear that fiduciaries are responsible for assets received by them, i.e. initial transfer of assets, assets purchased during the trust existence, etc. Fiduciaries are not responsible for the value of non-cash assets or even monetary assets not received (e.g., dividends and interest payments due, but not received), although they will normally report the value of readily marketable securities and disclose the non-receipt of investment returns.. Residences and real estate improvements, land and forestry holdings, other assets are merely disclosed, but only rarely valued; in my consultations with commercial bank trust officials, almost all ask a depositor of non-monetary assets to waive any responsibility for current valuations due to the cost of such recurring appraisals. Requiring USG fiduciary funds (probably limited to Interior's two Indian Trust Funds) to record discounted value of proven reserves on land interests owned by individual Indians and Tribes will likely double the work of Interior. Further and importantly, there is no legal or fiduciary obligation of the USG to pay beneficiaries of the two Indian Trusts for such future discounted O & G royalties until they are received in cash. Currently - and for at least two years - Interior has regularly reported (1) land holdings and (2) "encumbrances" (i.e., surface and subsurface leases, rights-of-way, etc. on such holdings) in quarterly (individual Indians) and monthly (Tribes) fiduciary reports. This is what a private-sector fiduciary would do under the Act. These land holdings and any value for O & G (but excluding present value of surface farming and grazing leases, coal and other subsurface minerals) as well as monetary equivalent holdings are not the assets of the USG. While I am not an expert on commercial bank trust functions, I understand that their disclosures of asset holdings is limited to monetary equivalents and excludes non-monetary assets held in trust. Thus, I disagree with the ED in this respect since there is no explanation in the ED as to why FASAB would depart from the fiduciary practice in the private sector, which in almost all other respects requires all assets and liabilities to be recorded in the financial statements.

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

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

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

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

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

Bert T. Edwards.