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September 21, 2007

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

Dear Ms. Payne:

The Association of Government Accountants (AGA) Financial Management Standards Board (FMSB) appreciates the opportunity to provide comments on the proposed Statement of Federal Financial Accounting Standards, *Accounting and Financial Reporting for Federal Oil and Gas Resources* by the Federal Accounting Standards Advisory Board (the Board) The FMSB, comprising 22 members with accounting and auditing backgrounds in federal, state and local government, academia and public accounting, reviews and responds to proposed standards and regulations of interest to AGA members. Local AGA chapters and individual members are also encouraged to comment separately.

Overall, we think the proposed statement is appropriate as it enhances accountability of federal government assets and worth. We do have a concern with the large volume of new and additional data that will now be reported/disclosed and the efforts and resources needed to obtain and report that data and hope that the Board will take this into consideration when they finalize the standard.

We also urge the Board to consider communicating with the GASB concerning development of this guidance. If the federal agencies have to recognize the liability for the royalties they will be distributing, should the GASB be taking action to decide (specific to these revenue flows) how to recognize such distributions on the state side?

The FMSB has the following specific comments. They are drafted as responses to the questions posed in the exposure draft, which are reproduced here in italic script.

Q.1 The proposed standards would provide for recognition of the Federal government's royalty share of proved oil and lease condensate, NGPLs, and gas reserves. These reserves are subcomponents of the total oil and gas resources of the Federal government. The Board's proposal for quantifying the Federal government's royalty share of proved reserves is to use a single best estimate of recovering reserves based on known geological, engineering, and economic data. This approach is known in the oil and gas industry as the deterministic method. This method would exclude reserves other than proved reserves. In contrast, a probabilistic method of estimation uses the known geological, engineering, and economic data to generate a range of estimates and their associated probabilities of recovering reserves. It would include more than proved reserves.
Which of the following two options would you prefer?

i. Capitalize estimated petroleum royalties from the proved reserves based on the deterministic method as proposed in the ED.

ii. Capitalize estimated petroleum royalties from proved reserves, probable reserves, and possible reserves based on the methodology proposed in the alternative view.

Please explain the reasons for your preference. If you prefer a different basis for determining the quantity of reserves, please explain the alternative you propose and why you prefer it.

The FMSB fully supports the proposal that a Federal Financial Accounting Standard (FFAS) should to be in place for Federal Oil and Gas Resources. Oil and Gas Resources should also be included in the Federal Financial Statements.

We agree with Option i, which is to capitalize estimated petroleum royalties from proved reserves based on the deterministic method as proposed in the ED. We need to be conservative with our asset recognition. Many large oil companies treat their reserves on their 10Ks using the proven reserve method. How they account for exploration costs depends on whether they are a large or small company. Large companies like Exxon Mobil use successful efforts to account for its exploration and production activities, where a small company uses the full cost concept.

As described in the ED, information to implement the probabilistic method is not readily available, or even available at all. Using proven reserves provides the "best" estimate of oil and gas reserves, at least those for which the federal government can generate revenues in the foreseeable future. We think financial decisions using possible reserves would not be useful to management.

The Board needs to consider what decisions will be made based on the reported data and not make complying with the final standard too cost prohibitive.

In addition to the proved reserves shown in the financial statement, there should be a footnote in the accounting policy section explaining the reserves if they are probable (para A74b) and material in nature. The rationale for this position is that there is at least a 50 percent probability that the quantities actually recovered will eventually be proved probable reserves, so the material amount should be annotated in notes to the financial statements.

Q2. The Board proposes to value the Federal government's royalty share of proved reserves based on average regional prices and effective average regional royalty rates experienced during the 12 months preceding the balance sheet date. See paragraphs 16 through 19 and 37. Also, see paragraphs A48 through A53 for a discussion of measurement attributes that were considered and paragraphs A79 through A113 for a discussion of the valuation approach proposed. An alternative approach to valuing estimated petroleum royalties is fair value. Fair value is the price that would be received for an asset or paid to transfer a liability in a transaction between market participants at the measurement date. One Board member believes that fair value is feasible and preferable. See the alternative view beginning at paragraph A119. The Board member believes that fair value could be derived from market transactions or discounted cash flows. The view of the majority of the Board members is that fair value would not produce a more reliable valuation than the valuation method proposed in this ED due to the challenges in adopting a fair value method.

Which method do you believe is most appropriate for valuing estimated petroleum royalties?

i. Value the royalty share of proved reserves based on average regional prices and effective average regional royalty rates experienced during the 12 months preceding the balance sheet date.

ii. Value estimated petroleum royalties using the alternative view fair value method.

Please explain the reasons for your preference. If you prefer a different method for valuing estimated petroleum royalties, please describe the method you propose and why you prefer it.

We fully support Option i which is to value the royalty share of proved resources based on the average regional prices and effective regional royalty rates experienced during 12 months preceding the balance sheet date. The rationale for supporting this position is that other assets on the balance sheet are reported using historical costs. Thus, reporting them at an average regional price would be more reliable than reporting them at Fair Market Value. It is appears to be the most cost-effective method to use for valuation and the suggestion for calculating the related liability was very reasonable.

One member preferred a different method, something like the fair value or market price method. In some ways, this is like valuing securities, they have to be "marked to market" periodically, in this case, it would be annually. He thought in the ED there was a lack of discounting for future revenue streams and that each of the definitions of average regional sales prices seemed to lead to a misleading resulting value for oil and gas reserves. The average regional price is defined as the average of the first purchase prices. That does not seem to take into account market changes since the time of the first purchase and is therefore unrealistic. Depending on market fluctuations, this could either overvalue or undervalue the reserves. In addition, the assumption is being made that all of the oil and gas will be taken over a very short time period. In fact, oil and gas will be taken from the earth over a period of a year, thus the need for discounting or some other method to recognize the time value of money.

Q3. Some Board members believe that the amount of information proposed to be disclosed in the notes and provided as RSI is excessive. See the disclosure and RSI requirements presented in paragraphs 30 through 34 and Appendix D for a complete review of all proposed disclosures and RSI.

Do you believe that each item of information, whether disclosed in the notes or provided as RSI, is necessary to meet reporting objectives and is cost-beneficial to provide? Particularly, consider Table 1 on pages 68 and 69 and Table 2 on pages 70 and 71. It would be helpful if specific information that respondents believe could be deleted or added were identified. How would each item of information be used for decision-making or assessing the financial position of the Federal government? Please explain the reasons for your position and any alternative you propose.

It appears that an excessive amount of information is being provided for the general reader of these statements. Normally, for readers requiring the level of information being presented, other more readily and timely sources would be available. Since this information would be provided in annual statements, it would be of minimum value to the real decision makers who would likely not wait for annual information. However, while it seems to us that a great deal of information is being proposed for disclosure, we would rely on management experts from the Department of the Interior or other agencies to closely examine the usefulness of the proposed disclosures. We do think that the item on page 8 is not useful since it does not relate to the assets or liabilities recorded in the financial statements.

As to the general public desiring this level of information, it is doubtful that they would fully comprehend what is being presented. The six pages of information presented would be more than the general reader would likely want to know. However, they likely would find it informative that the Federal Government and three agencies within the government are involved in these types of activities, and the general overall explanation of the activities.

As far as whether the level of information is what decision makers really need, that question should be specially addressed to those within the three agencies and possibly those in the private sector that are familiar with these type of operations.

Q4. The proposed standards would require that an estimated value for royalty relief be reported as RSI. The Minerals Management Service (MMS) has a variety of royalty relief programs. Royalty relief is the reduction, modification, or elimination of any royalty to promote development, increase production, or encourage production of marginal resources on certain leases or categories of leases. See paragraphs A90 through A94 for additional information regarding MMS royalty relief programs.

a. *Do you believe that a monetary value for royalty relief should be reported as RSI? Please explain the reasons for your position.*
b. *Do you believe the quantity of production for which relief was granted during the reporting period should be reported as RSI? Please explain the reasons for your position.*

If the amount of detail in the proposed RSI is not reduced (see question 3 above), then it does appear logical to disclose a value for the royalty relief.

Q5. 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.[1] *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 disclosure 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 this proposed standard. Since this proposal may significantly increase the fiduciary assets disclosed, we are requesting input on the cost-benefit of the requirement with respect to fiduciary activities. See paragraph 34.

a. *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.*

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.

[1] SFFAS 7, paragraphs 83 to 87.

Q6. The proposed standards would require the component entity to provide extensive disclosures and RSI. However, the Consolidated Financial Report (CFR) of the United States government would be required to include limited disclosures and no supplementary information. See paragraphs 31 through 33. These divergent reporting requirements are consistent with SFFAC 4, Intended Audience and Qualitative Characteristics for the Consolidated Financial Report of the United States Government. SFFAC 4 provides that the CFR should be highly aggregated and offer references to other reports.

a. *Do you believe that the CFR disclosure requirements should be limited as proposed? Please explain the basis for your beliefs.*

We fully support that limited disclosure and no supplementary information be included in the Consolidated Financial Report (CFR). The CFR, by its nature, should reflect information at the highest level. Realistically, senior management decisions will normally not be based on this information contained in the CFR. With adequate references as to where the detailed information could be obtained, decision makers at various levels would be able to obtain the level of information they would need to address their question. If this level of detail were included for each line of the CFR, the report would be so voluminous that it would literally be incomprehensible.

Q7. This proposal includes accommodations intended to reduce the cost or burden of implementation. These accommodations are identified below along with the alternatives considered and rejected by a majority of the members. Please comment on any accommodation that you believe is not appropriate or that you believe does not sufficiently reduce the cost or burden of the proposal.

a. *Asset recognition is limited to proved reserves. However, the Board believes that other than proved reserves (e.g., unproved reserves and undiscovered resources) also are assets. See paragraphs A43 through A47 and A73 through A78.* Agree
b. *The valuation technique provided relies on readily available information. However, fair value, which would require additional information, may be a more appropriate valuation technique. See paragraphs A48 through A545.* As noted above, one member believes that fair value or something like fair value is a better valuation method.
c. *This proposal requires use of existing sales volume and sales value information to determine an average price for end of period valuation. Use of market prices as of the end of the reporting period was considered. In addition to the relative cost of obtaining market values, the Board does not believe the valuation would be improved. See paragraph A82.* As noted above, one member is concerned that the proposed method of using first purchase price is unrealistic in that it does not consider changes in market pricing.
d. *Information to calculate effective royalty rates is readily available and the proposal provides for their use in valuing estimated petroleum royalties. An alternative considered was the use of statutory provisions for certain types of leases. See paragraph A101.* Agree
e. *Regional data is readily available and the proposal provides for its use in valuing estimated petroleum royalties. An alternative considered was the use of field by field data. See paragraphs A56 and A101.* Agree

We think the question is "who and what" is going to use all this information? What kind of decisions does the Board anticipate will be made based on the disclosed and reported data? If the Board anticipates that this "new" information will be extremely important to decision making, then more detailed and exact (i.e. include estimates and not just proved) disclosure is likely merited. Otherwise, the amount of detail could be limited and estimates and conservative approaches that are less costly and less "intimidating" (i.e., in regard to the quantity of information, which could be overwhelming) could be used.

We appreciate the opportunity to comment on this exposure draft and would be pleased to discuss this letter with you at your convenience. No member objected to its issuance. If you have questions on the letter, please contact Anna D. Gowans Miller, CPA, AGA's Director of Research and staff liaison for the FMSB, and facilitator for this project, at amiller@agacgfm.org or (703) 562-0087.

Sincerely,

Robert L Childree

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

cc: Richard L. Fair, CPA
AGA National President

Association of Government Accountants
Financial Management Standards Board

July 2007 – June 2008

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