DEPARTMENT OF THE INTERIOR
OFFICE OF INSPECTOR GENERAL
Royalty Initiatives Group

EVALUATION REPORT

MINERALS MANAGEMENT SERVICE ROYALTY-IN-KIND OIL SALES PROCESS

Report No. C-EV-MMS-0001-2008 **May 2008**

United States Department of the Interior

Office of Inspector General
Washington, DC 20240

May 30, 2008

Memorandum

To: C. Stephen Allred
Assistant Secretary for Land and Minerals Management

From: Earl E. Devaney
Inspector General

Subject: Royalty-In-Kind Oil Sales Process (Report No. C-EV-MMS-0001-2008)

I am pleased to provide you with the first Evaluation Report prepared by the Office of Inspector General's (OIG) new Royalty Initiatives Group. This evaluation was conducted as a result of work performed by the Royalty Initiatives Group while assisting in the OIG investigation into allegations of misconduct in the Royalty-In-Kind (RIK) Program.

During the investigative assist, we discovered that modifications to oil sale contracts were made without clear criteria, and that the modifications appeared to inappropriately benefit the oil companies. While our evaluation determined that these practices have been largely corrected, governing criteria is still lacking throughout much of the RIK oil sales process.

We have made six recommendations that parallel and expand upon those recommendations made by the Subcommittee on Royalty Management in their Report to the Royalty Policy Committee.

We would appreciate being apprised of the actions the MMS takes on our recommendations so we may track the status of their implementation. The results of this evaluation will be reported to Congress in our semiannual report, as required by the Inspector General Act, as amended.

Please provide a written response to this report by June 30, 2008. The response should be sent to:

Mr. Robert Romanyshyn
Assistant Inspector General for Audits
U.S. Department of the Interior
Office of Inspector General
1849 C Street, NW, MS 5341
Washington, DC 20240

The response should state concurrence or nonconcurrence with the findings and recommendations, including specific reasons for any nonconcurrence. It should also provide information on actions taken or planned, target dates, and titles of the officials responsible for implementation.

We thank MMS, and particularly the RIK staff, for their cooperation and assistance. If you have any comments or questions regarding this report, please do not hesitate to contact me at (202) 208-5512.

Attachment

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Abbreviations

ETB	Expected Transportation Bid
FAR	Federal Acquisition Regulation
FCC	Federal Communications Commission
IFO	Invitation for Offer
MAB	Minimum Acceptable Bid
MMS	Minerals Management Service
MRM	Minerals Revenue Management
OIG	Office of Inspector General
RIK	Royalty-in-kind
RIV	Royalty-in-value
RPC	Royalty Policy Committee
SOL	Office of the Solicitor
SPR	Strategic Petroleum Reserve

Cover photo courtesy of U.S. Department of Energy.

Why We Performed This Evaluation

In recent years, the multi-billion dollar royalty program of the Minerals Management Service (MMS) has been under increased scrutiny by various organizations, including the U.S. Congress and the Government Accountability Office. Areas of concern include the viability of collecting royalties in-kind and whether the Royalty-In-Kind (RIK) Program has maintained or exceeded the revenues that would have been received had the royalties been collected in-value.

While assisting in an Office of Inspector General (OIG) investigation initiated in 2006, the Royalty Initiatives Group found that the RIK Program had modified oil sale contracts without clear criteria, and that the modifications appeared to inappropriately benefit the oil companies. We reviewed 72 contracts comprising 718 individual bid packages awarded to companies during 2001 to 2006. Of the 718 bid packages awarded, 121 were modified, but only 3 of these modifications favored the government. While we did not do an in-depth analysis, we estimate the value of the modified bid packages not in favor of the government to be approximately $4.4 million.

The RIK Program has considerable public interest and given the high visibility of the program and its large dollar impacts, we evaluated controls to ensure the effectiveness and fairness of the RIK oil sales process. We performed our work in accordance with the *Quality Standards for Inspections* issued by the President's Council on Integrity and Efficiency (see Appendix B for our methodology).

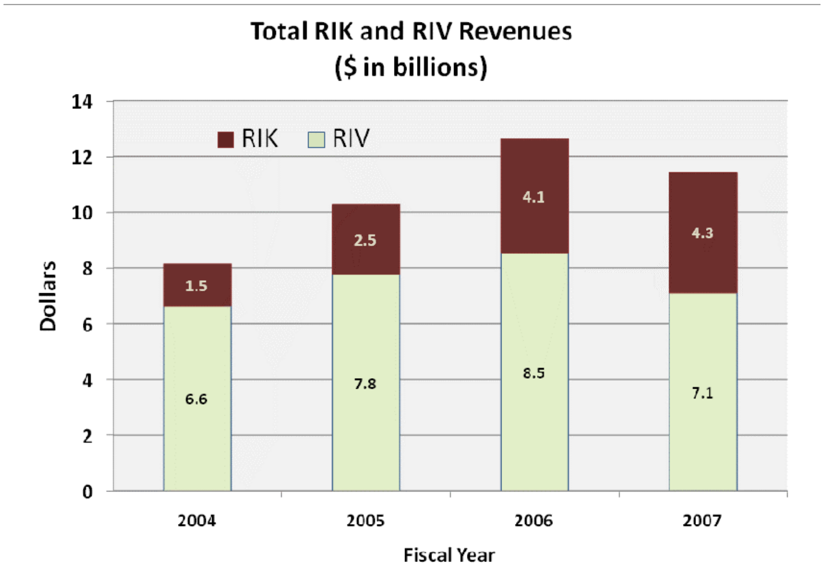
Background of the RIK Program

MMS' Minerals Revenue Management Program (MRM) is responsible for collecting, accounting for, and distributing revenues received from minerals produced from federal and Indian lands. In FY2007, MRM collected over $11.4 billion in mineral revenues (including bonuses, rents, and royalties) and administered more than 67,000 leases. In exchange for the right to produce minerals, companies pay MMS a royalty which is typically a one-sixth or one-eighth share of the production. In its discretion, MMS may receive the royalties in cash (royalty-in-value or RIV) or as the actual product (royalty-in-kind). Traditionally, most royalties were received in-value. Beginning in the mid 1990's, however, MMS implemented pilot projects to explore the feasibility of taking royalties in-kind. According to MMS, the pilots proved successful and subsequently, the RIK Program became fully operational in 2004.

The oil and gas industry has long been a proponent of the government taking royalties in-kind. The advantages include less audit oversight because the in-kind method eliminates disputes between MMS and industry concerning the valuation of the product. Under RIK, MMS only needs to verify that operators deliver the correct volume of oil and that MMS receives proper payment when selling the oil. MMS also claims that administrative costs are reduced and that revenue collections are increased for the government.

Located in the MRM offices in Lakewood, Colorado, the RIK Program operates with about 50 personnel and a $19 million annual administrative cost budget. Because collecting royalties in-kind requires MMS to function similar to a company by managing the actual physical flow of oil and gas, MMS chose to design the program similar to industry. Accordingly, the RIK Program has three main sections: 1) the Front Office markets the RIK Program to industry, analyzes properties for the viability of taking the royalties in-kind, and sells the oil; 2) the Mid-Office is responsible for ensuring that companies are financially capable of participating in the program; and 3) the Back Office is responsible for ensuring that MMS receives the correct volumes and proper payment. However, the RIK Program does not have the same business objective as industry, which is to maximize revenues. Rather, the RIK Program operates under a revenue-neutral mandate contained in the Energy Policy Act of 2005, which stipulates that revenues collected as RIK only need to equal or exceed what would otherwise be collected in RIV.

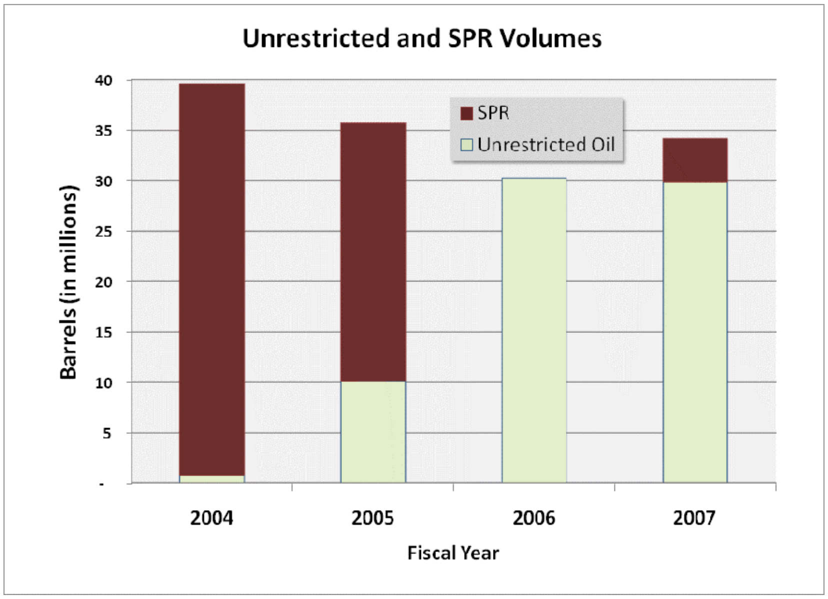
The following graph illustrates the growth of mineral royalties, including oil, gas, and coal, taken in-kind versus in-value since FY2004.



RIK Oil Sales

The Front Office is organized into separate natural gas and crude oil units. Our evaluation, which covered the oil sales process, primarily addressed activities of the Crude Oil Front Office.

The RIK Program concentrates on production from offshore leases, where about 70 percent of oil is taken in-kind. Several sales of royalty oil are held each year (see Appendix C for a flowchart describing the sales process in more detail). At the discretion of RIK, a sale may be held for the purpose of filling the nation's Strategic Petroleum Reserve (SPR) or a sale may be "unrestricted" in which the oil is destined for the open market. In an unrestricted sale, companies bid to purchase the oil. In an SPR sale, companies bid to transport the oil and RIK coordinates with the Department of Energy (who manages the SPR) to have the oil delivered at designated locations. *[Note: RIK also manages a separate program to supply small refiners with oil, however, the Small Refiners Program was not part of our evaluation.]* In FY2007, RIK sold about $1.7 billion in unrestricted oil and transferred oil valued at $306 million to the SPR. The following graph illustrates the volumes taken in-kind since FY2004 for the SPR and unrestricted sales.



During our evaluation, the Subcommittee on Royalty Management, appointed by the Secretary of the Interior, issued a report "Report to the Royalty Policy Committee: Mineral Revenue Collection from Federal and Indian Lands and the Outer Continental Shelf" (RPC Report) on various programs within Minerals Revenue Management, including RIK. We considered these findings and recommendations and generally agree with the conclusions. The recommendations in this report complement and expand on those of the RPC.

What We Found

Our evaluation found that MMS has taken some important and necessary steps to enhance the overall performance and effectiveness of its RIK Program. For example, MMS conducted an internal review of RIK and management accepted all recommendations. MMS also responded positively to most recommendations contained in the RPC Report that related to RIK and developed a draft action plan for implementing the report's recommendations. We believe that these initiatives, some of which will take time to fully implement, will eventually result in a better RIK Program.

Additionally, in response to findings from the OIG investigation of the RIK Program that began in 2006, MMS promptly responded to make necessary management changes. Specifically, MMS:

- Replaced the former RIK Program Manager to provide better leadership.
- Enacted some policies to begin improving the RIK sales process.
- Improved documentation and strengthened review, which have addressed concerns related to contract modifications.

Although RIK is taking steps toward improvement, our review determined that weaknesses in the program still exist.

Business Practices Do Not Ensure Fairness or Effectiveness

The integrity of the RIK oil sales process is undermined by poor business practices. Without detailed guidance to govern its operations, the RIK business environment falls short in two critical areas - fairness and effectiveness.

Procedures for the pre-award, award, and modification processes are not fully documented. This can lead to inconsistent treatment of companies and potential favoritism, both real and perceived. The current process appears to have much flexibility, which may result in some gains for the RIK Program, but at the possible cost of not playing fair with all potential bidders. Further, ineffective business practices cause lapses in needed controls. For example,

- RIK allows companies to revise bids. Explanations for bid revisions were not always provided. These revisions were still being submitted to MMS one to two days after the bid deadline date and even on the award day. We found it difficult to determine from the documentation whether the bid revisions were initiated by MMS or were company-identified errors.

- Access to electronic bid information is not controlled and therefore, presents a security risk. Bids and spreadsheets containing bid information are not password protected and are posted on a shared network drive which can be accessed by all RIK employees.

- RIK has been inconsistent in awarding bids. That is, factors other than price may influence the award, such as increasing the number of program participants in an effort to diversify the sales portfolio. For example, in the January 2008 sale two tied bids were submitted on one offer package. Instead of asking the companies to increase their bids in a procedure known as a "refresh," RIK awarded the bid to the company that otherwise would not have won any packages in that sale. For another package in the same sale, however, two close bids were submitted but RIK did conduct a refresh. Such *ad hoc* decisions may lead to the perception of subjectivity and favoritism in awarding contracts.

- Awards did not always beat the Minimum Acceptable Bid (MAB) or the Expected Transportation Bid (ETB). The justifications for not awarding better than the MAB and ETB were not sufficiently documented or were incorrect. For example, the rationale for some of those awards stated that the bids beat the MAB/ETB when in fact they did not.

- The OIG investigation found that RIK staff had inappropriate relationships with industry that could compromise their objectivity. RIK personnel still meet individually with industry representatives. Guidance governing these relationships should be clearly set forth in written policy.

- In the past, initial bids were accepted after the bid deadline date and time. This has since been addressed through a new procedure which was followed during the sale we attended in January 2008. However, as described above, revised bids are still accepted after the bid deadline date and time.

Companies Are Not Held Accountable for Failing to Follow Bidding Instructions

Companies did not follow required bidding instructions. The Invitation for Offer (IFO) explains how companies are to submit bids and the components associated with each bid package. Our review found that:

- Companies did not consistently submit bids to the designated person listed on the IFO. In many cases, Front Office staff received the bids simultaneously with the designated bid acceptance official. In one instance, the bids were sent to two individuals who were no longer assigned to RIK.

- Asset Managers act as quality assurance for the companies, allowing companies to revise erroneous bids if certain aspects of the bid are missing, such as a transportation cost. These revisions are not always in the government's favor.

- Companies sometimes failed to bid to the nearest $.0001 as required by the IFO and RIK did not always clarify this requirement with the companies. RIK recently issued procedures requiring the Bid Acceptance Official to contact the company if a bid does not meet this condition.

- In some cases, companies did not submit bids on the required Offer Sheet. RIK was inconsistent in requiring companies to resubmit bids correctly.

The instances described above are not isolated, as most, if not all, occur at each sale. There is no consequence to the company for failure to follow bidding instructions. This could appear to an outsider that RIK caters to companies and does not manage a fair process.

Minimum Acceptable Bid Errors

We found numerous errors in the calculations of the MAB and the ETB which could affect decision making when awarding oil packages. The MAB is a value formulated by the Front Office that is evaluated against bids to ensure that the values received for RIK crude oil awarded to purchasers are at least as high as those that would have been received under RIV. For the SPR, an ETB is developed to provide a basis for analyzing transportation bids and assurance that the transportation charges for RIK crude oil awarded to shippers are reasonable and a good value for the government.

We reviewed the MAB and ETB for accuracy and security. We identified the following deficiencies:

- Formula errors on the Excel spreadsheets used to calculate the MAB and ETB.
- Instances in which the RIK used the wrong tariff rates in the calculations.
- Tariffs and other aspects of the MAB and ETB were not fully supported.
- The electronic MAB and ETB spreadsheets were not password protected and could be viewed and potentially changed by any RIK employee.

Although the errors noted above would not have changed the outcome of the sales, the risk of an incorrectly awarded bid exists if RIK does not strengthen its quality assurance. Additionally, the MAB is supposed to be reviewed by several individuals before a sale, including the Front Office Supervisor, Chief Risk Officer, Deputy Program Director, and the Portfolio Analyst. We found little evidence in the sales files that this was occurring.

The reliance on manual input increases the risk of error. Software specific to oil marketing would likely help streamline the process. However, if Excel continues to be used, more advanced functions would allow the Front Office to better optimize Excel's capabilities.

Procurement Office Removed from Process

Until December 2007, the oil sales were transacted by a Contracting Officer assigned to RIK but who reported to MMS' Western Area Service Center Procurement Branch. The Contracting Officer received bids; reviewed sales documentation, such as the IFO; and reviewed and signed transaction confirmations and amendments. In November 2007, the Department's Office of the Solicitor (SOL) determined that oil sales did not have to follow Federal Acquisition Regulation (FAR) requirements. As a result, all sales contract functions are now performed solely within RIK. The Procurement Office's involvement in the oil sales process is now limited to an advisory role, removing the independent oversight that the Procurement Office previously provided.

Sales Files Not Complete

Sales files did not consistently contain information necessary to support business decisions. For example, the files did not contain:

- Information regarding company eligibility, including credit limits.
- Evidence the IFO was reviewed or approved for each sale.
- Evidence of peer review (quality check) by Front Office staff.

Without written guidelines to administer the RIK Program operations, the Program subjects itself to unnecessary scrutiny and potential challenge. Transparency is crucial to promoting the legitimacy and credibility governing all aspects of the RIK oil sales process and the overall RIK Program. Clear guidance would help the public and stakeholders better understand RIK processes, would assist in alleviating the perception that the process could be invalid or unfair and would improve the effectiveness of the oil sales process.

The RPC Report recommended that MMS:

- Issue new or revised regulations and/or guidelines to provide greater transparency for MMS business practice. (MMS is in the preliminary planning stages with a target date of December 2010).

- Compile and publish a guidebook of policies and procedures to be made available to the public. (MMS stated the corrective action is underway with a target date of November 2008.)

- Implement a systematic and detailed procedure for handling bid documents to ensure security and integrity. (This action is underway with a target date of December 2008.)

We envision taking these recommendations a step further with the creation of a detailed operating manual which should contain all the policies, procedures, and work instructions that comprise the way RIK carries out all business operations. Ideally an operating manual would contain all the information required for new and existing employees to access for training and reference purposes. The MMS' Outer Continental Shelf (OCS) Leasing Process Handbook (Leasing Handbook) serves as a good model for the RIK. We envision an even more detailed manual that guides the oil sales process.

Recommendation

1. Develop a comprehensive operations manual to guide the Crude Oil Front Office similar to the Leasing Handbook developed by the Offshore Minerals Management program. The RIK operations manual should address the selection of properties, solicitation, bidding, award, and amendment processes. This manual should also address, at a minimum, the issues identified in Appendix D.

Enhance Legal Review and Heed Legal Advice

RIK operates its multi-billion dollar oil sales program with little regard for legal advice. RIK has not sought legal counsel on critical and fundamental contract documents, and in one case disregarded legal advice intended to protect the government's interests. As a result, sales contracts may not be enforceable and could put the program in peril.

Contract documents consist of the General Terms and Conditions, Invitation for Offer, and the Transaction Confirmation[1]. In October 2007, the Procurement Office requested a legal review of the Oil General Terms and Conditions from the Department's Office of the Solicitor (SOL). The document was reviewed to determine if the interests of the government were protected. The SOL found that since the documents came from industry the contract language was more favorable to industry than to the government and responded with numerous concerns to the Procurement Office. The SOL also found that certain paragraphs "provided significant risk to the United States and are inconsistent with accepted contract law generally."

[1] *General Terms and Conditions* – called the "base contract," this document is signed by the companies prior to pre-qualification to participate in an oil sale.
Invitation for Offer - contains the details of the solicitation such as contract terms; bid submission deadlines; award dates; credit and prequalification requirements; transporting and scheduling terms; and the offer sheet.
Transaction Confirmation – the agreement that includes the basic information related to the bid packages awarded, such as the performance period, volumes, price, and any special terms.

The Procurement Office provided the SOL's opinions to RIK; however, RIK has taken no action to address the SOL's concerns. RIK management has stated that they dispute some of the concerns in the opinion and are hiring an attorney who will focus on the RIK Program and will conduct the legal review of contract documents. *[Note: In fact, the SOL has established a unit dedicated to MMS royalty issues.]* In the meantime, one SPR delivery sale and one unrestricted sale have occurred since the opinion was rendered.

Other issues identified during our review that support the immediate need for legal review include:

- Inconsistent language was used for the amendment provision in the IFO. Of the five unrestricted sale IFOs reviewed, only two had the same language.

- Companies do not always sign the transaction confirmation. Of the 36 transaction confirmations we reviewed, 16 (44 percent) were not signed by the company. MMS includes a statement on the transaction confirmation that the agreement is binding if not signed and returned, or discrepancies noted, within 2 business days from receipt. Since this document has not been reviewed by the SOL, it could put the RIK Program at risk for unenforceable contracts.

Ultimately, these contracting documents should already have been through a legal review since RIK began using them about seven years ago. Even though there have been no ramifications from the absence of a legal review of the contract documents, the oil lease issues from 1998 and 1999 illustrate why adequate legal review of documents is critical. *[Note: In 1998 and 1999, MMS' review process of oil leases which included the Office of the Solicitor failed to identify that critical price threshold language was missing from Gulf of Mexico oil and gas leases. The threshold provision would require oil and gas companies to pay royalties when oil and gas prices reached a certain level (1,032 leases issued without price thresholds and 570 remain active). Since leases were missing this critical provision, the MMS may lose billions of dollars in royalty revenue.[2]]* Poorly written legal documents subject the government's interests to great risks.

RIK Operating Without Contracting Governance

The SOL has determined that the FAR does not apply to the sales of royalty oil. As a result, RIK has no framework of contracting law or regulations to guide the process. Without a framework, the oil sales contracting process cannot be administered consistently and does not have the structure necessary to manage a multi-billion dollar program.

[2] In 2007, the OIG issued "Investigative Report on the Lack of Price Thresholds in Gulf of Mexico Oil and Gas Leases" which focused on how MMS omitted the price thresholds from oil and gas leases. In the same year, the GAO issued a report (GAO-07-590R) addressing the fiscal impacts of not including the lease thresholds.

Recommendations

2. Obtain legal review of all existing contract documents and implement changes as appropriate.

3. In consultation with the SOL and the Procurement Office, develop guidelines for oil sales contracting and implement guiding principles and processes. Specifically, RIK should either identify whether there is existing guidance, or in the absence of existing guidance, identify aspects of the FAR or any other contract-related regulations that could be adapted to the process to provide greater control.

Staffing and Business Continuity Concerns

Poor personnel planning has created a weak foundation for the RIK Program, putting the entire oil sales process at risk. Sudden or unanticipated absences of Asset Managers would likely disrupt business operations.

In the last 18 months, the Oil Front Office has been operating without sufficient staff. In 2006, two Asset Managers and the Front Office Supervisor were detailed out of the RIK Program pending the results of the aforementioned OIG investigation. The loss of several knowledgeable staff required less experienced staff to take on additional workloads. This short staffing may have contributed to the errors and inconsistencies that we found in sales documents as well as a lack of internal peer reviews. Further, the RIK Program was not always marketed to all potential participants, which may have reduced the number of bidders and thereby decreased the oil sale revenues.

With the addition of an Asset Manager in March 2008 for a total of four, the current staffing level is the minimum number necessary to accomplish the workload. The Front Office supervisor position is currently vacant, requiring the Deputy RIK Program Manager to fulfill the responsibilities. The primary duties of the Front Office staff include identifying and converting properties from RIV to RIK, marketing and transacting oil sales, and scheduling flow of the oil. In industry, the marketing and scheduling functions are separate duties – the RIK Asset Managers are performing double duty.

Further, Asset Managers must stay knowledgeable about the market and maintain their expertise. RIK has not developed training plans for its Asset Managers which would be beneficial in ensuring the staff stays at the highest competency possible.

Business Continuity Is At Risk in the Sudden Absence of Staff

Asset Managers specialize in oil types extracted from certain properties and become “experts” in those specific properties. There is no knowledgeable backup capacity. As a result, the loss of one experienced Asset Manager could significantly disrupt program operations. In addition, the potential for fraud, collusion, and compromised independence is raised because of the lack of cross-training and rotation of staff.

Staffing levels should enable staff to conduct peer reviews and receive cross-training in order to develop knowledgeable backup capacity. Rotating properties among Asset Managers periodically would also enhance independence and objectivity.

In response to the RPC Report, RIK is developing a personnel plan due to be completed by July 2008. However, the personnel plan recommended by RPC only covers flexibility in hiring, compensation comparisons, and specialized ethics training. Our findings indicate that MMS should expand this plan to include other key areas.

Recommendation

4. In a comprehensive staffing plan, RIK should address staffing needs, position qualifications, and training. This plan should also include rotation of responsibility for properties on a periodic basis to foster objectivity and independence, and cross-training of staff to ensure business continuity in the Oil Front Office.

Alternative Sales Options

Other Sales Methods

The RPC Report recommended that MMS compare the RIK Program to other public and private sector efforts towards marketing in-kind royalties and publish a program cost comparison. RPC also recommended that MMS evaluate the benefits and costs of alternative auction types and develop a pilot program to test alternatives. MMS' action plan has the program cost comparison to be completed by September 2009 and the evaluation of alternative auction types is underway to be completed by April 2010.

Consistent with the RPC Report, we evaluated several alternative commodity sales methods used by international, federal, and state entities. Of those we evaluated, the Federal Communications Commission's (FCC) auction process presents the best alternative for RIK oil sales. The FCC utilizes a simultaneous multiple round auction process to sell licenses for the electromagnetic spectrum. All auctions publish the minimum acceptable bid to participants and all bidding is conducted online using a secured website.

FCC has found many benefits from using the auction process to sell its licenses. Since 1994, the FCC has found auctions to be fair, objective, open and transparent. Auctions have also increased the revenue received from the licenses sales. Overall the auction process has proven to be the most economically efficient method used to sell licenses and has provided the best overall process. While MMS has evaluated the FCC process and identified some good business practices, it has not adopted or tested the auction process in the RIK oil sales process.

As an alternative to the FCC auction process, an outside marketing agent, similar to the one used by the Alberta, Canada RIK program, might provide the market expertise and potentially reduce administrative costs to RIK.

Using Longer Term Contracts

Longer term sales contracts could also reduce the administrative costs of operating the RIK sales program. For most sales, RIK uses short term contracts of about six months. RIK does award one-year contracts for its Pacific properties and obtains better bids compared to the six-month term. Another entity we evaluated, the State of Alaska, uses a five year renewable contract. This simple change may alleviate the heavy workloads for the Front Office Staff, reduce overall program administration costs, and would likely increase revenues.

Recommendations

5. RIK should implement a pilot project to evaluate the viability of other sales methods, such as the FCC's simultaneous multiple-round auction or an outside marketing agent.

6. To reduce the workload and administrative costs, RIK should use longer term oil sales contracts.

Summary of Recommendations

Number	Recommendation	Page Number
1	Develop a comprehensive operations manual to guide the Crude Oil Front Office similar to the Leasing Handbook developed by the Offshore Minerals Management program. The RIK operations manual should address the selection of properties, solicitation, bidding, award, and amendment processes. This manual should also address, at a minimum, the issues identified in Appendix D.	7
2	Obtain legal review of all existing contract documents and implement changes as appropriate.	9
3	In consultation with the SOL and the Procurement Office, develop guidelines for oil sales contracting and implement guiding principles and processes. Specifically, RIK should either identify whether there is existing guidance, or in the absence of existing guidance, identify aspects of the FAR or any other contract-related regulations that could be adapted to the process to provide greater control.	9
4	In a comprehensive staffing plan, RIK should address staffing needs, position qualifications, and training. This plan should also include rotation of responsibility for properties on a periodic basis to foster objectivity and independence, and cross-training of staff to ensure business continuity in the Oil Front Office.	10
5	RIK should implement a pilot project to evaluate the viability of other sales methods, such as the FCC's simultaneous multiple-round auction or an outside marketing agent.	11
6	To reduce the workload and administrative costs, RIK should use longer term oil sales contracts.	11

Methodology

We evaluated controls over the solicitation, award, and modification of oil sales contracts managed by the RIK Program. We focused our efforts on fiscal years 2007 and 2008 oil sales and the current control environment. In the two fiscal years reviewed there were two SPR delivery sales and five unrestricted oil sales. The Small Refiner Program was excluded from our review. We performed this evaluation from November 2007 through March 2008.

IFO Number	SPR or Unrestricted	Sales Date	Volume Awarded (barrels)
1435-02-07-RP-27856	Unrestricted	11/2/2006	53,615
M07PX14931	Unrestricted	2/8/2007	41,750
M07PX14955	Unrestricted	5/3/2007	13,800
M07PX14988	Unrestricted	8/2/2007	8,510
MMS-RIKOIL-2008-UNR-001	Unrestricted	1/30/2008	29,050
		Total	**146,725**
M07PX14954	SPR	5/3/2007	45,430
M08PX15014	SPR	11/1/2007	66,730
		Total	**112,160**
Grand Total			**258,885**

We performed the following steps during the evaluation:

- Gained an understanding of the RIK oil sales process by obtaining applicable policies, procedures, and other pertinent documentation related to the RIK Program.

- Reviewed oil sale records and other RIK Program data. We selected an unrestricted sale and an SPR sale to test the controls.

- Interviewed various MMS employees, including RIK Program managers and staff, the Procurement Office Manager and Contracting Officer, and the Chief Risk Officer.

- Interviewed officials representing the DOI Office of the Solicitor and reviewed legal opinions related to the RIK Program.

- Interviewed representatives from KPMG and GAO to coordinate our efforts and discuss status of ongoing reviews.

- Attended the January 2008 RIK Program’s unrestricted crude oil sale at the MMS offices located in Lakewood, Colorado.

- Reviewed the MAB and ETB for accuracy, including accurate formula computations; accurate tariff, surcharge, buy/sell, and line loss rates. We also looked at the tariff rates to ensure that valid rates were being used (i.e. active rates versus expired rates).

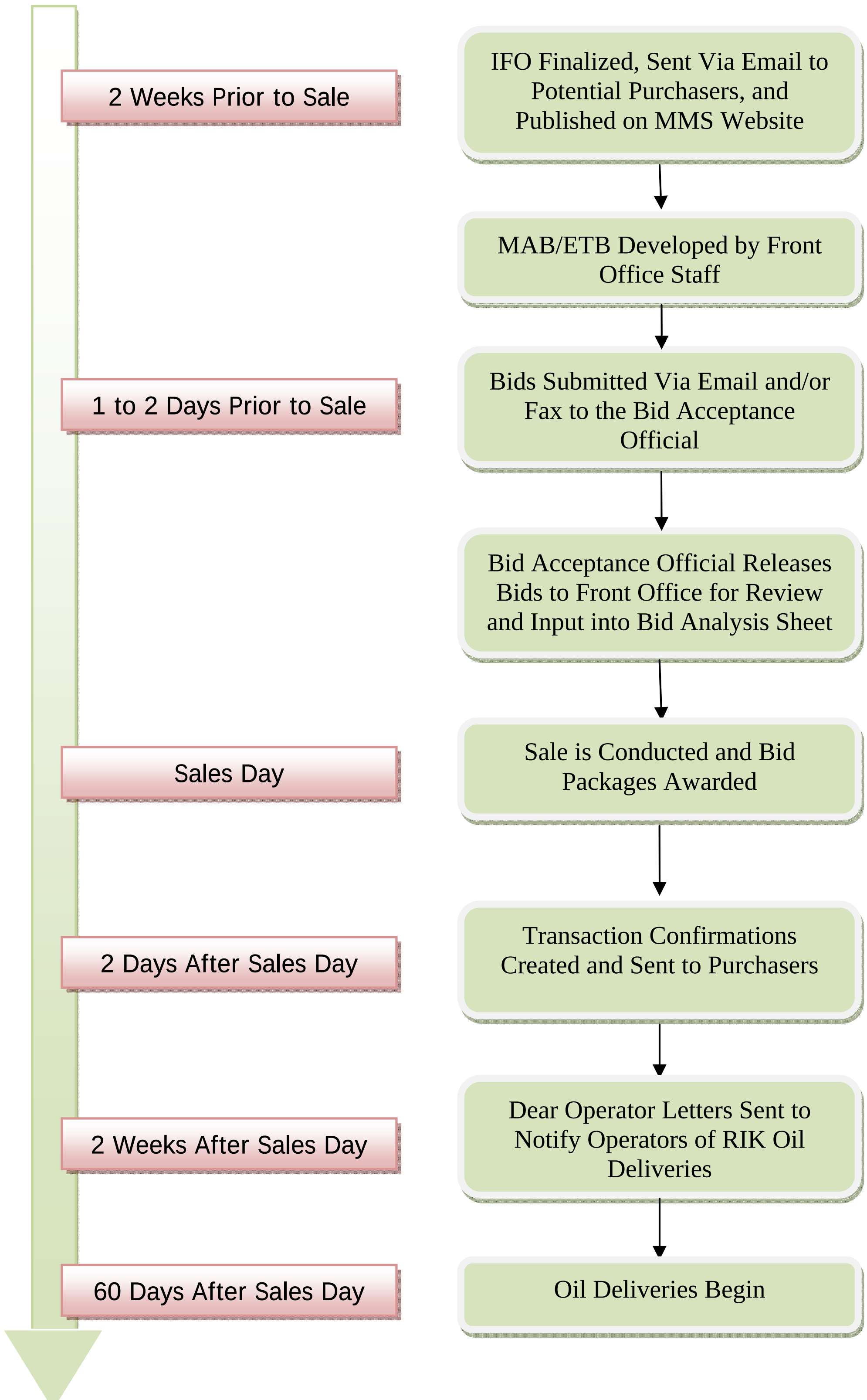
- Evaluated the following federal agencies, state governments, the Canadian government, and other entities to identify potential best sales practices:

    - MMS Offshore Minerals Management Program (lease sales). We attended the March 2008 Outer Continental Shelf oil and gas lease sale held in New Orleans, Louisiana.
    - Bureau of Land Management (helium sales)
    - Federal Communications Commission (sale of electromagnetic spectrum rights)
    - U.S. Forest Service (timber sales)
    - Bonneville Power Administration; Western Area Power Administration (electric power sales)
    - Alberta, Canada; States of Alaska and Texas; University of Texas (oil and gas RIK programs)

The Office of Inspector General has not previously examined the RIK Program's oil sales process.

The evaluation was conducted in accordance with the *Quality Standards for Inspections* issued by the President's Council on Integrity and Efficiency.

Oil Sales Process Flowchart



Areas to be Addressed by Operations Manual

The following table provides areas identified during the evaluation that should be included in an operations manual. This list is not all-inclusive, but provided in this report as a tool to assist MMS in developing more specific guidelines.

AREA	PROCESS
Property Selection	• Method applied to identify potential properties to convert to RIK.
Solicitation	• Development of the Invitation for Offer (IFO).
Bids	• Circumstances in which companies are allowed to revise bids and required supporting documentation.
Minimum Acceptable Bid	• Minimum Acceptable Bid methodology. o Description of the components of the MAB. o Method to obtain component information. o Quality assurance procedures.
Award	• Justifications for awarding the oil packages and ensure proper support for the decision is documented. • Criteria for awarding properties if not based on best bid or in the case of a virtual tie. • Guidelines for refreshing bids, including deadlines to submit refreshes and circumstances to not continue with a bid refresh.
Amendments	• Transportation charges that are and are not acceptable for an amendment. • Required supporting documentation for amendments. • Procedures for non-amendment changes and appropriate support.
Security	• Process to ensure access to all sales folders is controlled and proper justification is required to allow access.
Personnel	• Roles and responsibilities of all individuals involved in the process. • Guidance on RIK staff meeting individually with company representatives. • Identify required peer reviews and what the peer reviews specifically entail.
Other	• Quality assurance checklist for each sale. • Required documentation to be maintained in sales folders to support business decisions for each oil sale.

Report Fraud, Waste, Abuse, and Mismanagement

Fraud, waste, and abuse in government concerns everyone: Office of Inspector General staff, Departmental employees, and the general public. We actively solicit allegations of any inefficient and wasteful practices, fraud, and abuse related to Departmental or Insular Area programs and operations. You can report allegations to us in several ways.

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