

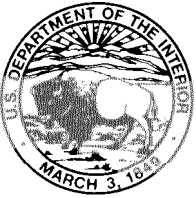


**U.S. Department of the Interior
Office of Inspector General**

SPECIAL REPORT

**BIENNIAL REPORT ON THE
FEDERAL ROYALTY MANAGEMENT SYSTEM
FOR FISCAL YEARS 1994 AND 1995**

**REPORT NO. 97-I-408
FEBRUARY 1997**



United States Department of the Interior

OFFICE OF INSPECTOR GENERAL
Washington, D.C. 20240

FEB 19 1997

Memorandum

To: The Secretary

From: Wilma A. Lewis
Inspector General

Subject: Biennial Report on the Federal Royalty Management System for Fiscal Years
1994 and 1995 (No. 97-I-408)

This is the sixth biennial report issued by the Office of Inspector General. This report was prepared in accordance with Section 302(b) of the Federal Oil and Gas Royalty Management Act of 1982, which requires the Office of Inspector General to conduct a biennial audit of the Federal Royalty Management System and report the results to the Congress and the Secretary of the Interior. We prepared this report based on the results of 11 audit reports that were issued by the Office of Inspector General and 1 audit report issued by the General Accounting Office during the biennial period.

Based on our audits of the Royalty Management System, we concluded that the Minerals Management Service had made significant progress in implementing the recommendations from the Task Force on Royalty Compliance and that the Bureau of Land Management had discontinued the rental rate reduction for oil and gas leases issued before 1987. These changes, made during the past 2 years, should enhance royalty collections. However, the Service needs to make **further** improvements in the following areas: (1) documenting royalty settlement negotiations; (2) monitoring transportation and processing allowance deductions; (3) **verifying** operator compliance with requirements to accurately and promptly report production and sales quantities; and (4) managing offshore oil and gas lease abandonment. The Bureau needs to make improvements in the following areas: (1) developing and implementing its oil and gas Inspection and **Enforcement** Program Strategy and providing oversight of its bonding and well-abandonment requirements and practices; (2) providing oversight of common carrier pipeline requirements in California; and (3) managing onshore oil and gas leasing activities. The 12 audit reports had monetary impacts totaling over \$92 million on various aspects of the Royalty Management System: 7 relating to the Minerals Management Service (\$3 1 million) and 5 relating to the Bureau of Land Management (\$61 million). Overall, the reports made 28 recommendations to correct the deficiencies identified in these reports. The responsible agencies either concurred with or provided sufficient information to resolve all of the recommendations.

In terms of revenues, the Department of the Interior collected royalties, rents, and bonuses of \$4.3 billion in fiscal year 1994 and \$3.6 billion in fiscal year 1995. Part of these revenues were generated from Service, state, and tribal audits of royalty payers. Service audits of royalty payers resulted in the collection of royalties and the denial of refired requests totaling \$236.5 million (\$236.3 million in collections and \$.2 million in denials of **refund** requests) in fiscal year 1994 and \$173.3 million (\$1 73 million in collections and \$.3 million in denials of **refund** requests) in fiscal year 1995. State and tribal audits of royalty payers resulted in the collection of an additional \$31.3 million in fiscal year 1994 and \$42.3 million in fiscal year 1995.

This report does not make any new recommendations because each of the 12 audit reports contained specific recommendations to the appropriate Departmental officials at the time each report was issued. The Department has generally been responsive to the audit recommendations and has made the suggested improvements to the Royalty Management System. In addition, the Service provided a synopsis of its Royalty Management Program accomplishments during this biennial period, which we have included as Appendix 4.

cc: Assistant Secretary - Land and Minerals Management
Assistant Secretary - Indian **Affairs**

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INTRODUCTION

BACKGROUND

The Federal Oil and Gas Royalty Management Act of 1982 requires the Secretary of the Interior to establish comprehensive inspection, fiscal and production accounting, collection, and auditing systems. These systems are required to provide the capability to accurately determine oil and gas royalties, interest, fines, penalties, fees, deposits, and other payments owed and to collect and distribute such amounts in a timely manner.

To accomplish this requirement, the Secretary established the Royalty Management System and assigned specific responsibilities to the Minerals Management Service, the Bureau of Land Management, and the Bureau of Indian Affairs. Most of the royalty management functions were assigned to the Service's Royalty Management Program. The overall mission of the Program is to ensure proper determination, collection, and distribution of bonuses, rents, and royalties from Federal and Indian lands in a manner that maximizes incentives to the efficient management, production, and use of oil, gas, coal, and other mineral resources consistent with public health and safety, environmental, and public land use requirements. In addition, the Minerals Management Service is responsible for monitoring oil and gas production from Federal leases on the Outer Continental Shelf. The Bureau of Land Management is responsible for monitoring oil and gas production from onshore Federal and Indian leases, and the Bureau of Indian Affairs distributes mineral revenues to individual Indians and tribes.

The policies and procedures for the Royalty Management System are delineated in public laws and Departmental regulations, including the Allotted Indian Land Leasing Act of 1909, as amended; the Mineral Leasing Act of 1920, as amended; the Indian Mineral Leasing Act of 1938; the Minerals Leasing Act for Acquired Lands of 1947, as amended; the Outer Continental Shelf Lands Act of 1953, as amended; the Geothermal Steam Act of 1970; the Combined Hydrocarbon Leasing Act of 1981; the Indian Mineral Development Act of 1982; the Federal Oil and Gas Royalty Management Act of 1982; and the Federal Oil and Gas Leasing Reform Act of 1987.

OBJECTIVE AND SCOPE

The Federal Oil and Gas Royalty Management Act of 1982, Section 302(b), requires the Office of Inspector General to perform a biennial audit of the Federal Royalty Management System and to submit the results of such audit to the Congress and the Secretary. This biennial report of the Royalty Management System is the sixth of such reports and covers the biennial period of October 1, 1993, through September 30, 1995 (fiscal years 1994 and 1995).

The overall objective of this biennial review was to determine the Department's compliance with the Federal Oil and Gas Royalty Management Act of 1982. This was accomplished by the Office of Inspector General through its conduct of 11 audits: 6 on the Minerals Management Service and 5 on the Bureau of Land Management. Since the Royalty Management System consists of various components such as leasing, inspection, production and royalty accounting, royalty collection and distribution, and auditing, we selectively reviewed activities of these components. Factors such as materiality, degree of risk, prior audit coverage, and current information regarding the activity were considered in selecting the specific activities to be reviewed in this biennial period. We also considered the results of a General Accounting Office audit of offshore oil and gas resources issued during this biennial period. The reports included in this biennial report are listed in Appendix 1.

RESULTS OF BIENNIAL REVIEW FOR FISCAL YEARS 1994 AND 1995

Based on a review of the 12 Federal Royalty Management System audits conducted during the past 2 years, we concluded that the Minerals Management Service and the Bureau of Land Management had made improvements in the System that should increase royalty collections and improve payer/producer compliance with existing regulations. However, additional improvements are needed to adequately protect mineral resources and further enhance royalty collections. Specifically, the Service needs to improve the following areas: (1) preparing documentation of royalty settlement negotiations; (2) monitoring transportation and processing allowance deductions; (3) verifying operator compliance with requirements to accurately and promptly report production and sales quantities; and (4) managing offshore oil and gas lease abandonment. The Bureau needs to make improvements in the following areas: (1) implementing its Inspection and Enforcement Program Strategy and providing oversight over bonding and well-abandonment requirements and practices; (2) providing oversight of common carrier pipelines in California; and (3) managing onshore oil and gas leasing activities.

Of the 11 Office of Inspector General audit reports on the Royalty Management System issued during this period, a total monetary impact of about \$92.3 million was identified in 6 of the reports: \$59 million in potential additional royalties, \$3.8 million in funds to be put to better use, and \$29.5 million in lost royalties (see Appendix 2).

Regarding the 12 audit reports issued during this biennial period, 2 audit reports identified improvements made in the Royalty Management System, 2 audit reports presented the combined financial statements of the Bureau and the Service, and 8 audit reports identified improvements needed in the Royalty Management System. These reports included 28 recommendations, all of which are considered resolved (see Appendix 3). These reports are synopsized in Sections A and B.

A. IMPROVEMENTS MADE IN THE ROYALTY MANAGEMENT SYSTEM

Four Office of Inspector General reports noted that improvements had been made in the Royalty Management System. The Service made improvements by implementing recommendations made by the Task Force on Royalty Compliance. The Service also provided us with a synopsis (Appendix 4) of its accomplishments during fiscal years 1994 and 1995, citing improvements in royalty reporting, royalty collections, and automated systems. The Bureau implemented recommendations that eliminated the rental rate reductions on oil and gas leases issued before 1987. Both the Service and the Bureau improved the quality of their financial reports.

Implementation of Task Force Recommendations

In our audit report “Status of Recommendations From the Task Force on Royalty Compliance” (No. 95-I-545), we stated that the Service had made significant progress in implementing the 26 Task Force recommendations. The recommendations were designed to encourage voluntary payer/producer compliance by clarifying existing laws and regulations, fully integrating Royalty Management Program compliance activities, increasing the use of automated systems to determine royalty compliance, and developing measures for overall royalty compliance. The Service developed an action plan that included six areas of emphasis: management and policy, a pilot program to identify and resolve royalty reporting irregularities, enforcement, audit, regulations, and automated systems. The Service also identified 112 steps to implement the recommendations. We believe that the steps completed and planned to be completed by the Service will satisfactorily address all 26 Task Force recommendations. As such, the report did not contain any recommendations.

Rental Rate Reduction

In our audit report “Onshore Oil and Gas Rental Reduction, Bureau of Land Management” (No. 94-I-595), we recommended that the Bureau reevaluate the 1992 Oil and Gas Reduction Review for determining whether the rental rate reduction for leases issued before 1987 should be continued. The Bureau concurred with our recommendation; the reevaluation was completed; and the rental rate reduction was allowed to expire on February 29, 1996. We estimated the potential additional revenue for fiscal years 1994 through 1997 to be about \$26 million.

Financial Reporting

Based on our financial statement audits of the Service and the Bureau, we concluded that the combined financial statements were reliable in all material respects. The audit report “Minerals Management Service Financial Statements for Fiscal Years 1994 and 1995” (No. 96-I-631) presented an unqualified opinion regarding the financial operations of the Service. The audit found that the internal control structure in effect on September 30, 1995, was sufficient to safeguard assets against loss from unauthorized use or disposition; ensure that transactions were executed in accordance with laws and regulations; ensure that transactions were properly recorded, processed, and summarized; and provide reasonable assurance that any losses, noncompliance, or misstatements that are material to the financial statements would be detected. Our February 1995 report “Bureau of Land Management Combined Financial Statements for Fiscal Years 1993 and 1994” (No. 95-I-584) presented a qualified opinion on the Bureau’s financial statements because of issues regarding the Bureau’s accounting for property. However, the audit report “Bureau of

Land Management Combined Financial Statements for Fiscal Years 1994 and 1995 (No. 96-I-463) presented an unqualified opinion regarding the financial operations of the Bureau.

B. IMPROVEMENTS NEEDED IN THE ROYALTY MANAGEMENT SYSTEM

Seven Office of Inspector General audit reports and one General Accounting Office audit report indicated that improvements were still needed in the Federal Royalty Management System as follows:

- The Service needs to improve documentation of royalty settlement negotiations. Our September 30, 1996, report "Negotiated Royalty Settlements, Minerals Management Service" (No. 96-I-1264) stated that settlements were not always conducted in accordance with the "Minerals Management Service Settlement Negotiation Procedures." Specifically, the report stated that for 9 of the 10 settlements reviewed, there was no documentation for the estimated values of the issues concerning the underpayment of royalties to be negotiated, the arguments for reducing values of issues, and/or the reasons why the values of issues were reduced as a result of the negotiations. The report further stated that for one of the nine settlements, Indian tribes were not given the opportunity to exclude Indian issues from a global settlement and were not included in negotiations applicable to their leases. The report recommended that the Service Director ensure that Royalty Management Program personnel: (1) improve documentation of the settlement process; (2) obtain a written opinion from the Office of the Solicitor regarding the release of negotiation information to royalty payers; and (3) offer Indian tribes the opportunity to be specifically included or excluded from royalty settlement negotiations. The Service agreed with each of the recommendations, which we considered resolved but not implemented. The recommendations were referred to the Assistant Secretary for Policy, Management and Budget for tracking of implementation.

- The Service needs to improve its monitoring of oil and gas transportation allowances and gas processing allowances. Our August 18, 1994, report "Transportation and Processing Allowance Deductions, Minerals Management Service" (No. 94-I-1110) stated that royalty payers had deducted excess oil and gas transportation and gas processing allowances. Specifically, the report stated that payers deducted allowances that exceeded: (1) actual costs; (2) the maximum allowed percentages without the approval of the Service; and (3) 100 percent of the value of the product. In our report, we estimated that about \$27.17 million in additional payments may be owed the Government because of excess allowance deductions. This amount included \$783,000 of additional payments made to the Service as a result of excess allowance deductions identified during our audit. As such, the report recommended that the Service: (1) monitor allowance deductions; (2) notify royalty payers of allowance reporting differences; and (3) implement the Automated Allowance Tracking System to identify allowance deductions that exceeded regulatory limitations. The Service agreed with and implemented each of the three recommendations.

- The Service needs to secure compliance of all payers and operators with the requirements to accurately report Production and sales of oil and gas from Federal and Indian leases. Our September 30, 1996, report “Selected Activities of the Royalty Management System, Minerals Management Service” (No. 96-I-1255) stated that the Service did not have an adequate deterrent to ensure the accurate reporting of production and sales quantities. Title 30 of the Code of Federal Regulations requires Federal and Indian oil and gas lessees and operators to report, in an accurate, complete, and timely manner, the production and sale of oil and gas from leases and to pay the Government a royalty based on a rate established in the terms of the lease. These regulations, along with Section 109 of the Federal Oil and Gas Royalty Management Act of 1982, authorize the use of civil penalties and interest for those situations where royalties have been underpaid. However, as stated in the report, these remedies did not provide an adequate deterrent to ensure reporter compliance because the prescribed interest rates were low and it was difficult for the Service to implement the penalties effectively. The report further stated that the Service did not assess fees to recover its costs of resolving discrepancies that resulted from inaccurate reporting. In that regard, the Service’s volume comparison process, which compares sales volumes reported on the production report with sales volumes reported on the royalty report, generated more exceptions than the Service could resolve, which led to the establishment of a dollar threshold below which the Service did not research or resolve the exceptions. In our report, we estimated that the royalty value of these unresolved exceptions below the threshold was approximately \$1.7 million annually. We recommended that the Service: (1) pursue legislation which would authorize penalties for substantial underpayment of royalties; (2) recover the \$2.1 million it spends each year to resolve the discrepancies in reported sales volumes; and (3) reduce the backlog of unresolved exceptions that were over the threshold, which we estimated to have a royalty value of over \$21.2 million. The Service agreed with each of the recommendations, which we considered resolved but not implemented. The recommendations were referred to the Assistant Secretary for Policy, Management and Budget for tracking of implementation.

- The Service needs to improve its management of offshore oil and gas lease abandonment. The General Accounting Office’s May 11, 1994, report “Offshore Oil and Gas Resources” (No. GAO/RCED-94-82) stated that the Service had acted to protect the environment by: (1) limiting the use of explosives to remove abandoned structures in order to protect endangered sea turtles and (2) requiring that wells be plugged and lease sites cleared. However, the report stated that the Service had not encouraged the development of nonexplosive structure removal technologies which would eliminate or minimize environmental damage and did not have an overall strategy which targeted its limited resources to ensure that wells were properly plugged and abandoned and that lease sites were properly cleared when oil and gas production ended. The General Accounting Office recommended that the Secretary of the Interior direct the Director of the Service to: (1) encourage the use of nonexplosive technologies for removing offshore structures; (2) study the feasibility of mandating the use of nonexplosive technologies; (3) develop an inspection strategy to ensure proper plugging and abandonment of offshore wells; and (4) complete a

rulemaking to place time limits on the phase-in of increased bond limits and supplemental bonding. The Department of the Interior generally agreed with all four of the recommendations.

- The Service needs to address weaknesses noted in the Royalty Gas Marketing Pilot Program. Our May 20, 1996, report “Royalty Gas Marketing Pilot, Minerals Management Service” (No. 96-I-786) noted that the Service had demonstrated the feasibility of taking gas royalties in kind as an alternative to the royalty-in-value system. However, the report stated that weaknesses existed in the Pilot design, revenue collections, marketing strategies, and administrative controls that the Service should consider in studying the royalty-in-kind concept. At the time of our review, the Service was conducting its own evaluation of the Pilot, including determining whether savings could be realized in reduced administrative costs, reduced audit efforts, and avoidance of royalty appeals and litigation. Although the final results of these analyses were not available at the time of our review, Service officials said that significant benefits were not expected to be realized unless the gas royalty-in-kind program was implemented on a large scale, such as for all the leases in the Gulf of Mexico. No specific recommendations were made as a result of our review.

- The Bureau needs to improve its management of its oil and gas Inspection and Enforcement Program activities. Our September 30, 1996, report “Inspection and Enforcement Program and Related Activities, Bureau of Land Management” (No. 96-I-1267) stated that improvements were needed in the Inspection and Enforcement Program to more effectively accomplish production, drilling, and plugging inspections and that many wells were allowed to remain unplugged long **after** production activities had ceased. Specifically, according to the report, the Bureau inspected leases that had minimal or no production, over one-half of the production inspections reviewed were deficient in depth of coverage and quality of documentation, and many of the high priority well-drilling and well-plugging inspections were not conducted as required by the Bureau’s inspection strategy. As a result, the Program did not adequately ensure production accountability for oil and gas produced or regulatory compliance for well-drilling and well-plugging operations on Federal and Indian leases. The report also noted that none of the seven field offices reviewed had properly classified wells as shut-in or temporarily abandoned in their Automated Inspection Records Systems. As a result, some operators had gone out of business, and the Government was responsible for plugging the wells. Since 1991, the Government has plugged 31 orphan wells, at a cost of over \$1.6 million, and is presently liable for plugging over 300 additional orphan wells, at a cost estimated by the Bureau to exceed \$3 million. In addition, the Government may also be responsible for the cost of cleaning up contaminated groundwater and other damage to the natural resources caused by these unplugged wells. Our report contained 11 recommendations: 6 pertaining to the inspection program and 5 pertaining to the bonding program. The Bureau concurred with the 11 recommendations, which we considered resolved but not implemented. The recommendations were referred to the Assistant Secretary for Policy, Management and Budget for tracking of implementation.

- The Bureau needs to improve its management of onshore oil and gas leasing activities. Our March 20, 1995, report “Onshore Oil and Gas Leasing Activities, Bureau of Land Management” (No. 95-I-638) stated that changes in the Federal Oil and Gas Leasing Reform Act of 1987 could increase competition and revenues to the Bureau’s oil and gas leasing program. According to our report, the Bureau could have generated additional revenues of \$4,2 million annually if it had had the authority to charge noncompetitive leases a fee equivalent to the minimum bonus bid of \$2 an acre, which is a fee that is applicable to competitive leases. The report recommended that the Bureau inform the Congress, through a written report, of the opportunities to increase revenues from onshore oil and gas leasing by amending the Reform Act to require the payment of a fee equivalent to the minimum bonus bid for leases issued noncompetitively. The report also recommended that the Bureau establish formal procedures for periodically evaluating and adjusting rental fees and minimum bonus bid charges on onshore oil and gas leases to ensure optimum return to the Government. The Bureau concurred with the two recommendations, which were referred to the Assistant Secretary for Policy, Management and Budget for tracking of implementation.

- The Bureau needs to improve its management of common carrier pipelines in California. Our 1991 report “Enforcement of Common Carrier Statutes for Pipelines Crossing Federal Lands in California” (No. 91-I-503) stated that six intrastate pipelines which cross Federal lands functioned as private carriers in violation of their right-of-way easements. The report recommended that the Bureau ensure that regulations and requirements pertaining to common carrier pipelines are communicated to all oil companies that have operations in California. Our March 31, 1995, report “Followup Review of Enforcement of Common Carrier Statutes for Pipelines Crossing Federal Lands in California” (No. 95-I-728) stated that the Bureau had notified all oil companies which had operations in California of the common carrier requirements of the Mineral Leasing Act but that at least three of the major pipelines were still not operated as common carriers, even though they crossed Federal lands. The Bureau said that it would conduct inquiries into any complaint alleging that a right-of-way holder was not complying with the common carrier requirements. Since no independent oil producer had formally complained to the Bureau concerning the lack of pipeline access, the Bureau said that it had no authority to enforce common carrier requirements. The Bureau also said that it had requested an opinion from the Department of the Interior’s Solicitor on June 7, 1991, regarding the Bureau’s authority and responsibility concerning regulation of pipelines which cross Federal lands.

We recommended that the Bureau again request that the Solicitor promptly issue the opinion which the Bureau had requested on June 7, 1991, concerning the Bureau’s authorities and the limitations imposed by Section 28(r) of the Mineral Leasing Act. In an April 3, 1995 response to the Bureau’s request, the Associate Solicitor, Energy and Resources, stated that: (1) common carrier provisions apply to activities outside the boundary of the rights-of-way unless otherwise exempted; (2) the Department can “condition” the approval of a right-of-way grant on a pipeline company’s submission of rate or tariff schedules to the appropriate agency; and

(3) the Department can initiate proceedings to suspend or terminate right-of-way grants or request the U.S. Attorney to prosecute violations of the Mineral Leasing Act.

The impact on the Federal Government of companies operating as private carriers instead of common carriers is the potential underpayment of royalties. This occurs because the independent oil producers that use the pipelines generally have to sell their oil to pipeline owners at prices that are lower than prices offered by independent refiners. Consequently, royalties are paid on this undervalued oil. We estimated that Federal royalties in California may have been underpaid by as much as \$29.5 million from 1990 through 1993 and may continue to be underpaid as long as pipeline owners continue to operate as private carriers.

AUDIT REPORTS ISSUED

Report Number Title

OFFICE OF INSPECTOR GENERAL

MINERALS MANAGEMENT SERVICE

95-I-545	Status of Recommendations From the Task Force on Royalty Compliance
96-I-631	Minerals Management Service Financial Statements for Fiscal Years 1994 and 1995
96-I-1264	Negotiated Royalty Settlements, Minerals Management Service
94-I-1110	Transportation and Processing Allowance Deductions, Minerals Management Service
96-I-1255	Selected Activities of the Royalty Management System, Minerals Management Service
96-I-786	Royalty Gas Marketing Pilot, Minerals Management Service

BUREAU OF LAND MANAGEMENT

94-I-595	Onshore Oil and Gas Rental Rate Reduction, Bureau of Land Management
96-I-463	Bureau of Land Management Combined Financial Statements for Fiscal Years 1994 and 1995
96-I-1267	Inspection and Enforcement Program and Selected Related Activities, Bureau of Land Management
95-I-638	Onshore Oil and Gas Leasing Activities, Bureau of Land Management
95-I-728	Followup Review of Common Carrier Statutes For Pipelines Crossing Federal Lands in California

Report Number _____ Title _____

GENERAL ACCOUNTING OFFICE

MINERALS MANAGEMENT SERVICE

GAO/RCED-94-82 Offshore Oil and Gas Resources, Interior Can Improve
its Management of Lease Abandonment

**ESTIMATED DOLLAR IMPACT
OF REPORTS INCLUDED IN THE
BIENNIAL REPORT FOR FISCAL YEARS 1994 AND 1995**

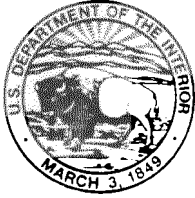
<u>Report Number</u>	<u>Audit Report Title</u>	<u>Potential Additional Revenues</u>	<u>Funds To Be Put To Better Use</u>	<u>Lost Revenue</u>	<u>Totals</u>
(Amounts in Millions)					
Minerals Management Service					
94-I-1110	Transportation and Processing Allowance Deductions	\$27.17*			\$27.17*
96-I-1255	Selected Activities of the Royalty Management System	1.70**	\$2.16**		3.86**
Bureau of Land Management					
94-I-595	Onshore Oil and Gas Rental Rate Reduction	26.00*	-		26.00*
95-I-638	Onshore Oil and Gas Leasing Activities	4.20**	-		4.20**
95-I-728	Followup Review of Common Carrier Statutes for Pipelines Crossing Federal Lands in California		-	\$29.50*	29.50*
96-I-1267	Inspection and Enforcement Program and Selected Related Activities	_____	<u>\$1.60*</u>	_____	<u>1.60*</u>
	TOTAL	<u>\$59.07</u>	<u>\$3.76</u>	<u>\$29.50</u>	<u>\$92.33</u>

* Multiyear

** Annual

STATUS OF PRIOR AUDIT REPORT RECOMMENDATIONS

<u>Addressee of Recommendations</u>	<u>Recommendations Made</u>	<u>Recommendations Concurred With/ Resolved</u>
Director, Minerals Management Service	9	9
Director, Bureau of Land Management	15	15
Secretary, Department of the Interior	<u>4</u>	<u>4</u>
Total	<u>28</u>	<u>28</u>



United States Department of the Interior

MINERALS MANAGEMENT SERVICE

Washington, DC 20240

JAN 16 1997

Memorandum

To: Assistant Inspector General for Auditing

Through: ~~For~~ Bob Armstrong
Assistant Secretary, Land and Minerals Management

Piet deWitt JAN 16 1997

From: Cynthia Quarterman *C Quarterman*
Director, Minerals Management Service

Subject: Biennial Report on the Federal Royalty Management System for Fiscal Years
1994 and 1995 [Report No. 97-I-December 1996]

We appreciate the opportunity to comment on the Biennial Report on our Royalty Management Program. We'd like to make a change in Appendix 4 in the first paragraph under Synopsis of Accomplishments--24 tribes should be 42 tribes. This change reflects the fact that we provide royalty services for 42 tribes.

I understand that your office has agreed to incorporate into this Biennial Report our January 2 response to the final audit report "Selected Activities of the Royalty Management System, Minerals Management Service" (No. 96-I-1255). In this response, we agreed with all three recommendations in the audit report, which should change Appendix 3 in the Biennial Report to read that all nine recommendations to Minerals Management Service have been resolved.

If you have any questions, please contact Bettine Montgomery at 208-3976.

MINERALS MANAGEMENT SERVICE
ROYALTY MANAGEMENT PROGRAM
FISCAL YEARS 1994 AND 1995
Synopsis of Accomplishments

The MMS collects, verifies, and distributes mineral revenues from Federal and Indian lands. In 1995, MMS distributed \$3.9 billion mineral revenues from approximately 104,000 leases to

38 States, 42 Tribes, 20,000 Indian allottees, the U.S. Treasury, and several Federal agencies.

MEASUREMENTS

On-time royalty reporting

In 1994 and 1995, reporters submitted 97 percent of all royalty lines on-time. An increase in the percentage of royalty report lines received by the due dates would indicate that timely reporting is increasing.

Royalty and production reporting accuracy

In 1994, reporters submitted 96.6 percent of royalty lines and 96.2 percent of all production lines correctly. In 1995, reporters submitted 97.5 percent of all royalty lines and 97.3 percent of all production lines correctly. An increase in the percentage of royalty and production report lines that clear fatal edits during initial processing indicates that reports are more accurate. Correct reporting means companies completed the forms correctly, not that all payments were properly calculated.

On-time disbursements to States

During 1994, RMP timely disbursed to States 98.9 percent of the dollars collected. During 1995, RMP timely disbursed to States 98.4 percent of the dollars collected. The slight decrease in timely disbursements to States during 1995 was due to a software problem that prevented automatic matching of payments and reports. During a 3-month period in 1995, payments and reports were matched manually.

Late disbursement interest paid to States

In 1994, RMP paid \$8,000 of interest to States at a rate of 8 percent. In 1995, RMP paid \$86,000 of interest to States at a rate of 9 percent. The decrease in on-time disbursements and the rising interest rate increased late disbursement interest paid.

OTHER SIGNIFICANT ITEMS

Electronic Commerce Technology Implementation

With the 1995 changes, RMP now offers various electronic reporting alternatives, including electronic data interchange, magnetic tape,

diskettes, and electronic mail. Electronic reporting decreases reporting error rates, minimizes delays and eliminates manual re-entry of data. Error-free reporting increases RMP's ability to timely disburse revenues to the recipients.

Audit Collections

From fiscal years 1982 to 1995, RMP audit efforts have resulted in additional revenue collections of about \$1.3 billion and \$141 million in refunds denied. These collections include over \$129 million from audits of company's gas contract settlements.

During 1995 RMP auditors collected over \$173 million in additional revenues and denied refund requests of almost \$324 thousand. The 6 Indian Tribes and 10 States, using funded audit authority, collected an additional \$39 million in revenues and denied refund requests of \$2.8 million. These collections included over \$56 million from contract settlements audits.

Volume Comparisons

During 1995 RMP collected over \$20 million from researching about 18,000 variances between production and sales volumes. The object of volume comparisons is to identify potential royalty underpayments by comparing production volumes reported by operators to sales volumes reported by royalty payors. In 1995, these comparisons achieved a collection to cost ratio of 15:1. In 1994, RMP collected \$19.2 million, achieving a collection to cost ratio of 13:1.

Alternative Dispute Resolution

Within its program to negotiate with mineral lessees over contentious and litigation-prone royalty issues discovered during audit, RMP expanded its use of the alternative dispute resolution mechanism during 1994. RMP successfully negotiated 44 settlements in 1994 valued at about \$280 million.

Common Reference Data Laboratory

As part of the National Performance Review, a reinvention team that included industry representatives, proposed to reengineer the oil and gas Payor Information Form (PIF). Implementing the team's recommendations will reduce the oil and gas PIF from two pages to one, streamline and simplify the data gathering processes and make completion of the form easier. Average document processing time was reduced by two thirds and staff resources by one third in a pilot test of the modified procedures. Annual savings should exceed \$700,000.

System Enhanced with More Capabilities

Expand and Upgrade Network: We are midway through a 2-year project to expand our dedicated wide-area network to the 17 State and Indian Tribal sites that have audit agreements with MMS. We provide equipment, installation support, and extensive training on RMP systems and applications. The upgraded network improves timely data access and communication between States, Indian Tribes, RMP staff and others. In addition to electronic communication, our customers can print system reports at their locations. Our systems staff provide remote problem

diagnosis and software installations.

RMP Query System: We have installed a client/server application system which is a powerful, easy-to-use tool that greatly enhances user ability to access and interact with RMP data. The query system features a set of standard queries and predefined reports. Our staff, and State and Indian customers can now access up to six years of mineral revenue data and all lease information residing on RMP data bases. Users can graphically display royalty, production or exception trends. Developing their own custom queries, users can transfer data to spreadsheets or databases for further analysis.

Computer Output Laser Disk (COLD): COLD and its companion imaging and workflow technologies are being introduced into the RMP work environment. The COLD system provides storage for over 300 reports generated by RMP systems. Users can view and retrieve information on selected reports from their workstations. The data can be printed, routed or stored. The RMP is also piloting a document imaging and workflow capability which will mirror established business processes and automate the flow of companion documents between individuals and work units. These technologies have great potential to improve information access, reduce paperwork and enhance individual productivity.

Royalty Policy Committee Established

During 1995 RMP established a 29-member committee, comprised of representatives from the Western Governors Association, Western States Land Commissioners Association, involved States, Indian Tribes and allottee associations, the minerals industry, the interested public and other federal agencies, to provide recommendations and guidance on royalty management policies and procedures. The committee established eight subcommittees to study the following issues: 1) royalty reporting and production accounting, 2) valuation, 3) audit, 4) appeals, settlements, and alternative dispute resolution, 5) non-conventional alternatives,

6) disbursements and net receipts sharing, 7) coal, and 8) phosphate, trona and other leasable solid minerals. As representatives of stakeholder groups most affected by mineral revenue practices, this special caucus of experts will serve an important role in advising RMP on issues related to management of the Nation's multi-billion dollar, federal and Indian minerals revenue program.

**ILLEGAL OR WASTEFUL ACTIVITIES
SHOULD BE REPORTED TO
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