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STATEMENT OF

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BEFORE THE

SENATE COMMITTEE ON ENERGY AND NATURAL RESOURCES

ON GEOLOGICAL SURVEY'S OIL AND GAS ROYALTY COLLECTION SYSTEM

Mr. Chairman and Members of the Committee:

We are pleased to be here today to discuss our review of Geological Survey's oil and gas royalty collection system--a system fraught with longstanding problems. Geological Survey is responsible for collecting the royalty income derived from oil and gas produced on Federal and Indian lands. Royalty collections have increased rapidly in recent years primarily because of substantial increases in oil and gas prices. Annual royalties are expected to be $4 billion in fiscal 1982 and could grow to $22 billion by fiscal 1990.

In our 1979 report entitled "Oil and Gas Royalty Collections--Serious Financial Management Problems Need Congressional Attention" (FGMSD-79-24, Apr. 13, 1979), we pointed out that Geological Survey was having great difficulty in accounting for and collecting Federal royalty income. On the basis of more recent work for the Subcommittee on Commerce, Consumer, and Monetary Affairs, House Committee on Government Operations, we have determined that these problems persist.

Geological Survey is not collecting all oil and gas royalties and, as a result, hundreds of millions of dollars may be going uncollected each year. Moreover, millions of dollars in royalty income are not collected when due, thus increasing the Government's interest costs. Until Geological Survey improves its financial management, there can be little assurance that all royalty income due from Federal and Indian lands is received.

We recognize that Geological Survey's task is complex and that it has had to deal with many factors beyond its control such as the proliferation of lease interests, varying royalty rates, and complex oil and gas valuation factors. Moreover, the monetary amounts Geological Survey is responsible for have grown tremendously in recent years.

Geological Survey is seeking to improve its financial management capabilities by developing a new royalty accounting system. Also, we are very encouraged by Secretary Watt's establishment of the Commission on Fiscal Accountability of the Nation's Energy Resources, which is charged with developing solutions to mineral management problems with focus on royalty accounting and oil thefts.

PERSISTENT MANAGEMENT PROBLEMS PREVENT ACCURATE COMPUTATION AND COLLECTION OF OIL AND GAS ROYALTIES

Since 1959, numerous General Accounting Office and Department of Interior audit reports have pointed out the need for improved management of Geological Survey's royalty collection system. For example, in our April 1979 report, we noted that Geological Survey was not collecting all the oil and gas royalty income due because

--lease account records contained numerous errors and omissions,

--unverified data was used to compute royalties, and

--collection procedures were inadequate.

Although Geological Survey has sought to respond to some of the recommendations contained in our report, management problems persist.

In our 1979 report, we stated that Geological Survey's lease account records contained numerous errors and data omissions and could not be relied on to determine the accuracy of royalty collections. As a result, Geological Survey and the oil and gas industry cannot use these records to determine if royalties were properly computed and paid.

The Geological Survey maintains lease account records for oil and gas leases on Federal and Indian lands. Royalties earned and payments made are recorded in the lease accounts maintained by Geological Survey's computer using data reported by the oil and gas companies. If the recorded amounts due and the royalties paid do not agree with each other, the computer, rather than clearing the account, will show a balance. Account balances normally result when the companies

--make an error in computing the amount of royalties owed or amounts paid,

--make an error in reports submitted and used to compute royalties owed or in paying royalties due,

--fail to pay royalties owed, or

--fail to report the data used to compute and record royalties owed or paid.

However, the Geological Survey has also created erroneous account balances by recording charges or payments in the wrong account and by making other clerical errors.

On July 31, 1978, the Geological Survey maintained 22,735 lease accounts. Of these accounts, only 6,569 did not have a balance. Of the accounts with a balance, 9,497 indicated that the amount paid was greater than the royalties due the Government. Although this condition can result from overpayments to the Government by the oil and gas companies, it occurred more frequently because royalties due the Government were understated when company reports were not received and charges were not properly entered in the accounts. The balance of these 9,497 accounts was $49.8 million. The remaining 6,669 accounts indicated that royalties of $38.8 million were due because the amount collected was less than the amount computed as due.

To determine the accuracy of these accounts, we reviewed 714 randomly selected lease accounts for June, July, and August 1977. We noted the following deficiencies which contributed to the inaccuracy of these basic accounting records.

--In 137 cases, royalty payments totaling $258,000 were recorded in the accounts without corresponding amounts being recorded as due.

--In 245 cases, royalties totaling $471,000 were recorded as due without corresponding royalty payments being recorded.

--In 469 cases, the royalties due did not equal the royalties paid. Royalties paid exceeded the amounts recorded as due by $122,000.

On the basis of recent follow-up work, we determined that lease accounts still are inaccurate. As of September 1980, 19,487 or 73 percent, of Geological Survey's 26,769 lease accounts had a balance. Of these, 9,962 accounts indicated that Geological Survey had been underpaid by $134 million; the remaining 9,525 accounts indicated, for the most part erroneously, that Geological Survey had been overpaid by $153 million.

Our follow-up analysis of 275 of the 714 lease accounts we had previously analyzed, for the 3 months ending June 30, 1980, showed that

--In 115 cases, royalty payments totaling $725,336 were recorded in the accounts without corresponding amounts being recorded as due.

--In 97 cases, royalties totaling $276,569 were recorded as due without corresponding royalty payments being recorded.

--In 174 cases, the royalties due did not equal the royalties paid. Royalties paid exceeded the amounts recorded as due by $119,226.

Because of the incomplete and inaccurate data entered in lease accounts, account statements could not be used to adequately manage royalty collections.

Moreover, Geological Survey relies almost entirely on unverified production and sales data reported by oil and gas companies to compute royalty payments due. It makes little effort to verify the accuracy of the data supplied. In fiscal 1980, Geological Survey audited only 5 percent of its lease accounts although past audits have proven beneficial. For example, as discussed in our 1979 report, Geological Survey's Metairie, Louisiana office completed eight audits during the 9-month period ending September 30, 1978. These audits yielded $7.5 million in additional Federal royalty income.

In addition to auditing, Geological Survey could reduce its reliance on unverified data by matching reported production data against reported sales data. By doing so, it could identify potentially serious data inconsistencies which indicate possible royalty payment shortfalls. Moreover, this approach could be further refined by having Geological Survey personnel, who periodically inspect well sites, verify reported production data. However, better data verification procedures alone will not resolve all of Geological Survey's financial management problems. It also needs to develop a viable royalty accounting system, which will assure that information reported is properly accounted for and that necessary controls are in place to assure the accurate and complete reporting of royalties.

Also, as noted in our prior report, Geological Survey was not receiving timely payments of royalties. In 1977, late payments amounted to $359 million. These payments were not received within the timeframes specified in leases because Geological Survey

--did not adequately enforce lease provisions calling for timely payment of royalties, and

--did not impose appropriate administrative fees or interest charges on those making late payments.

Based on our analysis of 275 lease accounts for the 3 months ending June 30, 1980, we project that late payments totaled $98 million for that quarter alone. Had these delinquent payers been assessed interest charges equal to the cost of Federal borrowing, they would have owed an additional $400,000 for the 3-month period alone. Unfortunately, Geological Survey did not take timely action on this problem, despite our earlier report.

In our prior report, we recommended that procedures be established to charge interest on late payments. Geological Survey, however, has been slow in implementing this recommendation. Interest was not charged on late payments applicable to offshore leases until September 1980. Further, procedures for charging interest on late payments made by onshore lease holders were not effective until March 31, 1981, and to date no interest has been collected for late payments on onshore leases.

GEOLOGICAL SURVEY IS MAKING AN EFFORT TO CORRECT ITS FINANCIAL MANAGEMENT PROBLEMS

In our 1979 report, we cited evidence indicating that the Geological Survey may not have been collecting as much as 7 to 10 percent of the royalties owed the Federal Government. This--the only such estimate we are aware of--is based on the experience of a private oil and gas company which audits oil and gas leases. Currently, Geological Survey by its own admission is not collecting over $1 million per day in royalties.

Geological Survey, recognizing that its accounting system was inadequate, formed a task force in October 1978 to recommend system improvements. In December 1978, the task force recommended that a new royalty accounting system be designed and implemented. That system is not yet operational and will not be fully operational for several years.

Geological Survey completed a feasibility study and cost/benefit analysis for a new system in March 1981. It plans to award a contract for design of the new system in September 1981. The system will be implemented in three phases over a 5-year period. The three phases consist of (1) the royalty accounting phase, (2) the production phase, which will permit the matching of production and sales data, and (3) the enhanced management phase which will center on developing quality review and management data.

Geological Survey currently estimates that the royalty accounting phase will be fully implemented in fiscal 1983, and the production phase by fiscal 1984. If the system is effective, Geological Survey should be able to better account for and control royalty payments. Until then, however, it seems that Geological Survey will be hard-pressed to fully carry out its royalty collection responsibilities.

Geological Survey does not plan to transfer existing account balances into the new royalty accounting system. Thus, besides actively working to develop the new system, Geological Survey also has to develop a plan for reconciling old accounts and identifying and collecting previously uncollected royalties. In

June 1981, Geological Survey announced that it plans to audit the 20 to 25 largest oil and gas companies, which account for over 80 percent of the royalties due. To assure that all royalties are being properly paid, it is imperative that a long term program be developed to provide for periodic auditing of lease accounts.

In closing, we would like to emphasize that the problems discussed above can only be corrected through a sustained high priority effort--one with long term top management involvement.

This concludes my prepared statement. We would be happy to respond to any questions.