D1627 118302

RESTRICTED — Not to be released outside the General Accounting Office except on the basis of specific approval by the Office of Congressional Relations.

REPORT BY THE

RELEASED

Comptroller General

OF THE UNITED STATES

Oil And Gas Royalty Accounting-- Improvements Have Been Initiated But Continued Emphasis Is Needed To Ensure Success

The Department of the Interior's royalty accounting system has been plagued with many serious financial management problems for over 20 years. The Department is currently making a serious effort to correct these problems by designing and implementing a new royalty accounting system.

The ongoing efforts--which include the design of the system as well as the implementation of the recommendations in GAO's October 1981 report and the recommendations of the Commission on Fiscal Accountability of the Nation's Energy Resources--provide the foundation for resolving the longstanding problems.

Congressional and executive branch oversight are needed to assure that the current impetus continues and that the development of the improved royalty accounting system stays on target.

118302

UNITED STATES GENERAL ACCOUNTING OFFICE

AFMD-82-55
APRIL 27, 1982

521834

Request for copies of GAO reports should be sent to:

U.S. General Accounting Office
Document Handling and Information
Services Facility
P.O. Box 6015
Gaithersburg, Md. 20760

Telephone (202) 275-6241

The first five copies of individual reports are free of charge. Additional copies of bound audit reports are $3.25 each. Additional copies of unbound report (i.e., letter reports) and most other publications are $1.00 each. There will be a 25% discount on all orders for 100 or more copies mailed to a single address. Sales orders must be prepaid on a cash, check, or money order basis. Check should be made out to the "Superintendent of Documents".

COMPTROLLER GENERAL OF THE UNITED STATES
WASHINGTON D.C. 20548

B-199739

The Honorable Edward Markey
Chairman, Subcommittee on Oversight
and Investigations
House Committee on Interior and
Insular Affairs

Dear Mr. Chairman:

Your July 13, 1981, letter requested that we evaluate the development of the new royalty accounting system and determine the extent to which it will improve the collection of royalties due from Federal and Indian lands. This report discusses our concerns about the development of the new system as well as covers our review of the Interior Department's efforts to solve its longstanding financial management problems.

On October 6, 1981, we testified before your Subcommittee on the status of our review at that time. We issued a followup report on October 29, 1981, showing that the royalty accounting problems we have been reporting on since 1959 not only persist but have become worse. 1/ And on January 21, 1982, the Commission on Fiscal Accountability of the Nation's Energy Resources--an independent Commission established by the Secretary of the Interior--issued a comprehensive report on the royalty accounting problems, including 60 recommendations for corrective action.

We worked closely with the Commission and testified before it on three occasions. The Commission recommended the strengthening of accounting for and control over royalties. Its proposals are in line with our prior recommendations.

On March 23, 1982, we testified before the Subcommittee on Interior, House Committee on Appropriations, in support of the Commission's report. Also testifying were the Secretary of Interior and the Chairman of the Commission. The Secretary pledged to implement the Commission's recommendations and indicated that correcting the longstanding financial management problems that have continually plagued royalty accounting would receive high priority.

It is of the utmost importance that the problems identified be corrected as soon as possible. Royalty collections have increased rapidly in recent years, primarily because of substantial increases in oil and gas prices. With oil prices decontrolled on January 28, 1981, this trend can be expected to continue. Based

---

1/"Oil and Gas Royalty Collections--Longstanding Problems Costing Millions," (AFMD-82-6).

on January 1982 estimates by the Interior Department, annual royalties are expected to be at least $5 billion in fiscal 1982 and could grow to about $15 billion by fiscal 1990.

Historically, a high priority has not been placed on collecting oil and gas royalties, and major problems have gone virtually unchecked for over 20 years. As a result, large sums may be going uncollected each year. Also, significant amounts of royalty income have not been collected when due, thus increasing the Government's interest costs.

The current royalty accounting system is in disarray. Oil and gas companies are essentially on an honor system to report accurately and pay royalties when due, and the Department has been unable to account for the information reported to it, much less to verify this information.

To its credit, Interior is attempting to correct these long-standing problems and has placed emphasis on the need for an effective royalty management program--emphasis that is long overdue. The Department is designing a new royalty accounting system and has awarded a contract for the design and implementation of the accounting phase. However, as we testified on October 6, since the design effort is still underway and the accounting phase will not be operational until January 1983, it is too early to tell whether the effort will be successful.

In our testimony, we also expressed concern that the Department had not adequately considered

--acquiring data on the number of leases and wells for which it is responsible,

--verifying the royalty computation,

--developing a comprehensive plan for audits and inspections, and

--planning of the production phase of the new system which will permit production and sales data to be matched.

Corrective action has since been taken or promised in each of these areas. Ongoing efforts to redesign the system, coupled with the implementation of the recommendations in our October 1981 report and in the January 1982 report of the Commission on Fiscal Accountability, provide the foundation for resolving the serious long-standing problems.

The problems confronting the Department of the Interior in this area, however, cannot be solved immediately. In today's environment of budget reductions and constraints, it is incumbent upon top agency management to ensure that the improved royalty management program receives the attention and resources it needs. Without the necessary people and money, the system for collecting royalties will not likely be improved.

In this regard, Interior needs to update its cost estimate for the royalty management program. The current cost estimate of $208 million to design and operate the new system over the next 10 years does not take into account significant changes in contractor services, computer equipment, and staffing, nor has the total cost of the planned production phase been considered. In addition, the cost increases in the auditing and lease inspection functions have not been estimated.

The Government cannot afford slippage in time or misdirection of resources in this effort. It is critical that the needs and costs be determined as early as possible. We believe that congressional and executive branch oversight are needed to assure that adequate resources are available and that the development of the improved royalty accounting system stays on target.

We therefore recommend that the Secretary of the Interior, no later than September 30, 1982, develop cost estimates, broken out by fiscal year and function, for the new royalty management program. This information, which should be furnished to cognizant congressional committees, should include milestones for implementation of specific system improvements and, as a minimum, should detail the cost of personnel, contractor services, and computer equipment for the

--design and implementation of the accounting, production, and enhanced management phases;

--performance of audits;

--lease inspection function; and

--reconciliation of existing lease account records.

Appendix I details our findings and recommendations on the development of the improved royalty accounting system. Appendix II gives the objectives, scope, and methodology of our review. Your July 13, 1981, letter is enclosed as appendix III.

As requested by your office, we did not obtain official agency comments. Unless you publicly announce its contents earlier, we plan no further distribution of this report until 7 days from its date. At that time, we will send the report to interested parties and make copies available to others upon request.

Sincerely yours,

Milton J. Socolar

Acting Comptroller General
of the United States

FINDINGS AND RECOMMENDATIONS ON THE DEPARTMENT OF THE INTERIOR'S ROYALTY ACCOUNTING SYSTEM

Historically, management has not placed a high priority on the collection of oil and gas royalties. Consequently, serious deficiencies in the collection system that were identified over 20 years ago persist today. As a result, large sums may be going uncollected each year. Also, significant amounts of royalty income have not been collected when due, thus increasing the Government's interest costs.

The Department of the Interior is finally making a serious effort to correct the longstanding financial management problems that have plagued royalty accounting. To be successful, these efforts must be given a high priority at all levels of Government.

ROYALTY ACCOUNTING SYSTEM NEEDS IMPROVEMENT

Since 1959, numerous GAO and Interior Department audit reports have pointed out the need for the Department to improve its royalty accounting system. In our April 1979 report, "Oil and Gas Royalty Collections--Serious Financial Management Problems Need Congressional Attention" (FGMSD-79-24, Apr. 13, 1979), we recommended both short and long range solutions to the problems facing the Department. Our October 1981 followup report shows that the problems previously reported not only persist but have become worse ("Oil and Gas Royalty Collections--Longstanding Problems Costing Millions," AFMD-82-6, Oct. 29, 1981).

As our followup report points out, Interior still relies almost entirely on production and sales data reported by the oil and gas companies, making little effort to verify the accuracy of the data. In short, the oil and gas companies are essentially on an honor system to report royalties accurately and pay them in full when due. The Department must begin to determine what other sources of data are available among Government and State agencies and in the oil and gas industry that can be used to verify the data now received.

Compounding this situation is the breakdown of the automated royalty accounting system. Lease account records continue to be inaccurate and unreliable and thus cannot be used to determine if royalties are properly computed and paid. For instance, our analysis of 275 randomly selected lease accounts disclosed errors totaling over $1.1 million, which clearly indicates the seriousness of the problem the Department has faced in maintaining accurate lease account records. We have been reporting on the inaccuracy of lease account records since 1959.

Another longstanding problem centers on Interior's inability to ensure the timely collection of royalties. As far back as 1959, we reported that all royalty payments were not received when due.

Our recent analysis showed that annual royalties of about $390 million were paid late, costing the Government about $1.6 million in interest. In our April 1979 report, we called for interest to be charged on late payments, and although agreeing to do so, the Department has been slow in acting. As discussed in our October 1981 followup report, interest was not charged on late payments applicable to offshore leases until September 1980; instructions for charging interest on late payments were not provided to field offices handling onshore oil and gas leases until June 1981; and no interest was collected for onshore late royalty payments until July 20, 1981. Charging of interest should be used as an incentive to encourage oil and gas companies to keep their payments current.

In addition to establishing a reliable royalty accounting system, Interior must increase its auditing and monitoring of lease accounts, functions which continue to be ineffective in controlling royalty payments. In fiscal 1980, only 5 percent of the lease accounts were audited nationwide, even though those audits proved beneficial by leading to additional collections of over $7.7 million. In our October 1981 testimony, we called on the Department to explore the possibility of sharing its auditing and inspection responsibilty and of exchanging information on production and sales with the States. Audits often uncover information that has an effect on other leases, including State and private leases, and such information could be shared between Federal and State auditors.

THE DEPARTMENT OF THE INTERIOR IS TRYING TO CORRECT ITS FINANCIAL MANAGEMENT PROBLEMS

The Interior Department, recognizing that its existing accounting system was inadequate, formed a task force to determine the deficiencies in the system and to recommend a course of action for correcting them. The task force recommended that a new royalty accounting system be designed and implemented. The new system, which will not be fully operational for several years, is to be implemented in three phases: (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. Current estimates are that the first phase will be fully implemented by fiscal 1983 and the second phase by fiscal 1984.

As pointed out in our October 1981 testimony, many of the longstanding accounting problems have been considered in the preliminary design of the accounting phase. However, since the design and implementation of the accounting phase is not yet complete and the phase will not be operational until January 1983, we are unable to tell whether the problems will be solved.

In addition, during testimony we expressed concern that in developing the improved royalty accounting system, the Department appeared to have not adequately considered

--acquiring data on the number of leases and wells for which it is responsible,

--verifying the royalty computation,

--developing a comprehensive plan for audits and inspections, and

--planning of the production phase of the new system which will permit production and sales data to be matched.

Acquiring data on leases and wells

Before Interior can effectively control and monitor royalty collections, its system must have accurate, reliable, and timely information on the number of leases and wells for which it is responsible. Without such information, the agency has no assurance that all individuals who are responsible for paying royalties are in fact making payments. The Department, however, decided to prepare its lease master file--a list of leases and payors--from data in the existing system, data the agency is not certain is complete and accurate. If payors are not listed in the current system, they cannot be carried over to the new system data base. As we testified, to obtain information related to the total number of leases it is responsible for, Interior should consult with the Bureaus of Land Management and Indian Affairs. Unless it can maintain exact accountability for leases and payors, the agency will be hampered in its efforts to manage and monitor royalty collection.

In November 20, 1981, testimony before the Commission on Fiscal Accountability of the Nation's Energy Resources, Interior agreed that all leases might not be recorded in the new royalty accounting system. The agency acknowledged that in developing the data base for the new system, it occasionally received reports and payments for a partial lease interest. Interior said then it would consult with the Bureaus of Land Management and Indian Affairs as we had called for and agreed to try to expedite this effort.

The Department has since completed its review of leases on file with the Bureau of Land Management, but it does not plan to coordinate with the Bureau of Indian Affairs until late 1982. An agency official said that since the Bureau of Indian Affairs does not maintain a separate listing of producing leases, a lease-by-lease review would be required, a task for which the staff resources are not currently available.

Verifying the royalty computation

Besides determining who should pay royalties, Interior must also determine how much is due. In the current system, the amount of royalties due is computed and compared with the amount paid by the oil and gas companies. If properly used, this control can provide a means of identifying troublesome lease accounts and companies. As we testified on October 6, our review of the technical specifications for the new system and discussions with Department personnel indicated that the new royalty accounting system would no longer recompute the royalties owed. In its November 20 testimony, the Department subsequently testified that this control feature would be part of the new royalty accounting system, which satisfies our concern.

Developing comprehensive plans for audits and inspections

Another area of concern expressed in our October 1981 testimony was the lack of a comprehensive, systematic plan for (1) monitoring, reconciling, and auditing lease account records, (2) inspecting leases, and (3) verifying production and sales data. At that time, the Department had not developed such a plan for accomplishing these tasks, although the importance of inspections and audits as integral parts of royalty management had been recognized and although additional auditors, accounting technicians, and inspectors had been hired.

We were subsequently advised that an audit plan was finalized on February 3, 1982. Although we have not had an opportunity to review the plan, it should (1) identify the additional resources needed to accomplish the tasks, (2) provide for periodic reviews of lease accounts, and (3) continue coordination with the States to share the auditing function where possible.

We are also encouraged by Interior's testimony that the approximately 300 lease accounts showing an amount due the Government of $100,000 or more would be reconciled. A similar effort should also be undertaken to reconcile, to the extent possible, accounts with a credit balance--amounts owed by the Government--and to sample other accounts. We recognize the magnitude of the reconciliation problems, but the work done by the Office of the Wyoming State auditor clearly shows the importance of the work. In just a few months, underpayments of about $4 million were identified and collected.

The Department also indicated in its testimony that a plan for lease inspections would be developed but did not specify when. We were told later that the plan--which is just as important as the auditing plan--would be developed by May 1982. Recent hearings, before various congressional committees and the Commission on Fiscal Accountability, pointed out that the Department's inadequate lease inspections and monitoring have resulted in thefts and lease violations on Federal and Indian lands. The agency provided inadequate coverage--only about 60 inspectors to review the activities at about 44,000 producing wells--a ratio of 1 inspector for every 698 wells. The Department should devote additional resources to the inspection effort and explore the possibility of also sharing this function with the States.

Planning of the production phase

Another problem addressed in our October 6 testimony is Interior's planning for the production phase. This phase is extremely important because the total reliance on information reported by the oil and gas companies must be alleviated. The Department has an overall concept for the production phase but has not developed operational plans or considered how it will interface with other phases of the system. The contractor, in a letter accompanying its offer, stated that the production phase is critical to the improved royalty accounting system and is, itself, so complex in concept and so vaguely defined, that it requires total commitment by both the contractor and the Department of the Interior. In December 10, 1981, testimony before the Commission on Fiscal Accountability, the contractor acknowledged that the development of the production phase is still hampered by many unknowns.

In the request for proposal for the accounting phase, Interior also asked the contractor to determine the data requirements for the production phase, how the information will be used, and how it will interface with the accounting phase. It is the user's responsibility--in this instance, the Interior Department--to outline to the contractor the information needed to make the production phase a viable part of the improved royalty accounting system. For example, the agency must determine whether the production phase will make use of such information as run tickets and meter readings. In addition, it must define how the accuracy of the reported product value will be determined.

Interior officials pointed out that Department personnel are working closely with the system contractor and stated that requirements for the production phase have not been defined because Interior does not want to constrain the contractor's creativity. The Department has hired a consultant to monitor the contractor's progress and to ensure that all milestones are met, and said it will determine the final design of the production phase based on the contractor's recommendations.

Although these actions will help ensure the success of the redesign effort, we are still concerned that the requirements for the production phase have not been sufficiently defined. The most important step in developing a system is determining the requirements, and in our view, it is critical that the Interior Department, as the user, better define its needs. Not only must problems be identified and defined, agency officials must also agree on the scope of the system. Planning is all important in developing and designing an accounting system; a system that is not well planned is not likely to be effective. In its development of the new royalty accounting system, the Department must address the problems in the current system as well as gain control over the data reported by the oil and gas companies.

COMMISSION RECOMMENDS CHANGES IN ROYALTY MANAGEMENT

The Secretary of the Interior established the Commission on Fiscal Accountability of the Nation's Energy Resources in July 1981 because of concerns over the direction of royalty management. The Commission was charged with developing solutions to the mineral management problem, focusing on oil and gas royalty accounting.

The Commission thoroughly examined the royalty management problems and concluded that royalty accounting is in disarray and needs overhauling. In its January 21, 1982, report, the Commission made approximately 60 recommendations for improving royalty collections due from Federal and Indian lands and called for sweeping changes in the organization and direction of royalty management. The Commission addressed the need to:

--Improve internal controls to assure all royalties are collected.

--Improve lease security to preclude the theft of oil from Federal and Indian lands.

--Increase lease inspections and impose sanctions for lease violations.

--Share information and royalty management functions with the States and Indians.

--Remove responsibility for royalty management from the Geological Survey and establish it as a separate entity under the Secretary of the Interior.

These recommendations are discussed in greater detail below.

On March 23, 1982, we testified in support of the Commission's report before the Subcommittee on Interior, House Committee on Appropriations. The Secretary of the Interior also testified in support of the Commission's report. The Secretary pledged to implement the Commission's recommendation and indicated that correcting the longstanding financial management problems that have continually plagued royalty accounting would receive high priority.

Improvements needed in internal controls

The Commission concluded that the present royalty accounting system lacks the basic internal controls needed to assure that royalties are paid when due. The Commission also found that Interior has no systematic means of determining when production begins and, therefore, is unable to ascertain if all royalty payments are received. To preclude the recurrence of such events, the Commission recommended that Interior require that it be notified immediately when production begins on a lease. Also, it recommended that failure to notify the Department should result in a severe penalty. In addition, to assure that all royalties due are collected, the Commission recommended the development of (1) secondary sources of information to verify the volume of production data reported by the oil and gas companies and (2) standardized procedures by which the value of reported production can be determined for the computation of royalties due. These recommendations are in line with our previous proposals for corrective action.

Improvements needed in site security

The Commission concluded that site security on Federal and Indian leases is extremely lax and, as a result, oil is being stolen. The Commission recommended that primary responsibility for site security be placed on the lessee and that each lessee be required to develop a site security plan. Further, it recommended that the Interior Department develop minimum requirements which all security plans must incorporate. In addition, it called for all purchasers to be required to maintain documentation identifying those from whom the oil was purchased--evidence is presently not required. We support these recommendations.

Strengthening sanctions for lease violations

Besides weaknesses in internal controls and site security, the Commission also concluded, as have we, that the lease inspection function was inadequate. Further, it found that sanctions for lease violations are minimal and, even so, rarely imposed and are, therefore, ineffective.

Lease inspections should be an integral part of the financial management structure and should help prevent the theft of oil from Federal and Indian lands. The Commission found, however, that this is not the case. It concluded that too few staff are devoted to the lease inspection function and that inspection results are not shared with accounting. Such a sharing of information would assist in verifying production and would highlight any royalties due that may not have been collected. As a result of its findings, the Commission recommended (1) an increase in the frequency of lease inspections and in the number of inspectors and (2) the reporting of inspection results to the royalty accounting office. We support the Commission in this effort, having long called for such action.

Besides the need to improve inspections, the Commission also reported that the existing sanctions imposed for lease violations are insufficient. The Commission report states that "a lease operator or lessee can violate most site security and royalty accounting requirements with impunity." The Commission, therefore, recommended that the Secretary of the Interior seek legal authority to assess civil penalties for lease violations. The Commission also recommended that the agency exercise its authority to close down production and/or cancel a lease in cases where underpayment is recurring or when the potential for theft is serious. We again support the Commission's recommendations. We noted, however, that the Secretary of the Interior already has the legal authority to impose civil penalties, up to $10,000 for violation of offshore lease provisions. Comparable legislation for violation of onshore leases is, therefore, necessary.

Increased cooperation with States and Indian tribes

The States and Indian tribes have a definite interest in the collection of oil and gas royalties. The States receive 50 percent of the royalty income for oil and gas removed from Federal land within their borders, and the Indian tribes and individual Indian landowners receive all of the royalties collected on minerals removed from their lands.

In testimony before the Commission, the States and various Indian tribes expressed a desire to be more active in royalty management--both in site security and royalty collection. Recently, Interior entered into cooperative audit agreements with two States and it plans agreements with five more. The Commission recommended that this effort be expanded to included Indian tribes and the inspection function but concluded that the Federal Government should retain its oversight responsibility for Federal and Indian leases. As discussed on pages 2 and 4, we have called for audit and lease inspection functions to be shared with the States and for information on production and sales to be exchanged with the States.

The Commission also recommended that the Secretary of the Interior seek legislation establishing a self-sustaining fund that would reimburse the States and Indian tribes for the costs they incur in performing audits and inspections of lease activities. The Commission emphasized that the fund should not be used to pay the normal operating cost of the royalty management program, but rather to pay those costs incurred by the States and Indian tribes in performing audits or lease inspections or in enforcing lease regulations under cooperative or contractual agreements with the Federal Government. The costs incurred by the Government under these agreements could also be charged against the fund.

To establish the fund, the Commission recommended diverting one-half of one percent of royalties collected (onshore and offshore), after deduction of the windfall profit tax where applicable, before any funds are distributed to the States, Indians, or the U.S. Treasury. The yearly budget for the fund would require congressional approval.

In today's environment of budget constraints and reductions, funding of the royalty management program is an important consideration. Improving royalty accounting is not a short term proposition. A significant investment will be required in terms of new systems and additional personnel. The payoff, however, should easily offset these costs. Although we have not studied the proposal, the Commission's alternative is one way of funding this additional effort while providing for congressional oversight. The proposal provides for a sharing of the costs with the States and Indians. But most of the cost burden will fall on the Federal Government since about 75 percent of the royalty collections are related to offshore production for which the States and Indians do not receive a share of royalty income, whereas most of the royalty management problems requiring attention are related to onshore production.

Removal of royalty management
from the Geological Survey

Perhaps the most sweeping recommendation the Commission made was to remove the royalty management program from the Geological Survey. In considering possible alternatives, the Commission felt that the royalty management program should be removed because of the Geological Survey's longstanding failings in managing the program--those outlined in our reports going back to 1959.

Because of the revenues involved, the Commission felt that the financial management aspects of the program needed a different perspective--something it did not believe could be accomplished if the program remained in a scientifically oriented organization such as the Geological Survey. Raising the status of the royalty management program was seen as one way of obtaining top quality financial managers. On January 19, 1982, an order was issued by the Secretary of the Interior removing the royalty management functions from the Geological Survey and establishing royalty management as a separate entity.

We have previously recommended that Interior evaluate the need to consolidate mineral management responsibilities. 1/ The organizational changes adopted by the Interior Department in establishing its new Minerals Management Service is consistent with this recommendation.

Our experience has shown that Federal agencies have experienced problems in designing and implementing financial management systems because management attention has been insufficient. In some cases, agencies have spent tens of millions of dollars developing systems which do not adequately work after years of development. Slippages and cost overruns are commonplace. To prevent the improved accounting system from succumbing to the problems encountered by other agencies in designing and implementing systems, a sustained, high priority effort must be put forth. Regardless of whether the function is carried out by a scientifically or a financially oriented organization, an effective accounting and financial reporting system will result only if top agency management remain involved.

1/"Minerals Management at the Department of the Interior Needs Coordination and Organization" (EMD-81-53, June 6, 1981).

SYSTEM COST ESTIMATES NEED UPDATING

Our prior recommendations and the Commission's report provide the foundation for correcting the financial management problems that have plagued royalty accounting for over 20 years. An important area of consideration for the successful implementation of these recommendations is the availability of funds--especially in a period of budget reductions and constraints.

In March 1981 a feasibility study for the new royalty accounting system was completed. That study estimated that the cost of operating the royalty management program would be $208 million over 10 years. This estimate must now be updated. More accurate cost information is available on the cost of the new system--such as the actual cost for contractor services and computer equipment--and proposed personnel staffing estimates have been significantly revised. In addition, the preliminary design of the production phase is not yet complete; when it is, it could represent significant additional costs--costs which are not fully considered in the original cost estimate.

The feasibility study assumed a personnel level of 302 positions by fiscal 1983. This estimate has been revised and current projections now call for 419 positions for the royalty management program by fiscal 1984--an increase in projection of almost 40 percent. However, the increase is even greater since the 419 positions do not include additional lease inspectors or total staffing for the production phase.

The analysis of production information, although considered in the feasibility study, was not portrayed as a major phase of the proposed system, and specific costs for its development were not detailed in the study. An Interior official acknowledged that the March 1981 study considered only input and processing of production reports the agency currently receives, and not the possible inclusion of run tickets or sales receipts which are being considered for use in evaluating the production quantities reported by the oil and gas companies. Another official acknowledged that the total cost of the production phase cannot be estimated until the contractor completes a preliminary design, which is scheduled for March 1982.

The estimated cost for operating the royalty management program must be revised. Overall cost projections have not been updated since March 1981, even though there have been significant changes in cost since that time. In addition, the total estimated cost of designing and implementing the production phase must also be determined.

CONCLUSIONS

The current royalty accounting system is totally inadequate to effectively manage the collection of billions of dollars of royalties due from Federal and Indian leases. Ongoing efforts to redesign the system, coupled with implementation of the recommendations in our October 1981 report and in the January 1982 report of the Commission on Fiscal Accountability, should provide the foundation for resolving the serious longstanding problems.

The problems confronting the Department of the Interior in this area, however, cannot be solved immediately. In today's environment of budget reductions and constraints, it is incumbent upon top management to ensure that the improved royalty management program receives the attention and resources it needs. Without the the necessary people and money, the system for collecting royalties will not likely be improved. In this regard, Interior needs to update its cost estimates for the royalty management program. The current cost estimate does not take into account significant changes in cost that have occurred since the original study was completed.

The Government cannot afford slippage in time or misdirection of resources in this effort. It is critical that the needs and costs be determined as early as possible. We believe that congressional and executive branch oversight are needed to assure that adequate resources are available and that the development of the improved royalty accounting system stays on target.

RECOMMENDATION TO THE SECRETARY OF THE INTERIOR

We, therefore, recommend that the Secretary, no later than September 30, 1982, develop cost estimates, broken out by fiscal year function, for the new royalty management program. This information, which should be furnished to cognizant congressional committees, should include milestones for implementation of specific system improvements and, as a minimum, should detail the cost of personnel, contractor services, and computer equipment for the

--design and implementation of the accounting, production, and enhanced management phases;

--performance of audits;

--lease inspection function; and

--reconciliation of existing lease account records.

OBJECTIVES, SCOPE, AND METHODOLOGY

The Chairman, Subcommittee on Oversight and Investigations, House Committee on Interior and Insular Affairs, requested that we evaluate the development of the new royalty accounting system and determine to what extent it will improve the collection of royalties due from Federal and Indian leases. This review was performed in accordance with GAO's Standards for Audit of Governmental Organizations, Programs, Activities, and Functions.

The primary objective of our review was to ascertain whether the serious financial management problems discussed in our prior reports 1/ were addressed in the improved royalty accounting system design and if the system would improve the collection of royalties.

We conducted our review at the Geological Survey Headquarters in Reston, Virginia and at the Geological Survey's Lakewood Accounting Center in Lakewood, Colorado.

At the time of our review, the improved royalty accounting system was being designed and developed and, therefore, our review was limited to the review and analysis of the documentation related to the proposed system. This documention included

--functional and technical specifications for the accounting phase of the improved system,

--contractor proposals and the resulting contract for the design and implementation of the accounting phase and for the preliminary design of the production phase, and

--other management contracts that provide for various support services.

We also reviewed pertinent laws, regulations, policies, and procedures. We interviewed Department of the Interior officials responsible for the planning, design, and implementation of the new accounting system and those responsible for the accounting, auditing, and inspection functions. We also paid close attention to the proposed system's ability to properly account for and collect future, as well as past, royalty payments.

As requested by the Chairman, we did not obtain official agency comments. However, the matters covered in the report were discussed with Department of the Interior and Office of the Inspector General officials and their comments were considered in preparing the report.

1/"Oil and Gas Royalty Collections--Serious Financial Management Problems Need Congressional Attention" (FGMSD-79-24, Apr. 13, 1979) and "Oil and Gas Royalty Collections--Longstanding Problems Costing Millions" (AFMD-82-6, Oct. 29, 1981).

COMMITTEE ON INTERIOR AND INSULAR AFFAIRS
U.S. HOUSE OF REPRESENTATIVES
WASHINGTON, D.C. 20515

July 13, 1981

The Honorable Milton J. Socolar
Acting Comptroller General
U.S. General Accounting Office
441 G Street, N.W.
Washington, D.C. 20548

Dear Mr. Socolar:

Since 1959 numerous General Accounting Office and Department of the Interior audit reports have discussed the need for improved management of Geological Survey's royalty collection system. These reports have pointed out the possibility that hundreds of millions of dollars in royalties are not being collected. Furthermore, the reports have disclosed that additional millions of dollars in royalties are not being collected when due, thus increasing the government's borrowing cost.

In a 1979 report to the Congress entitled "Oil and Gas Royalty Collections -- Serious Financial Management Problems Need Congressional Attention" (FGMSD-79-24, 13 April 1979), GAO pointed out that the Geological Survey was having great difficulty accounting for and collecting royalties. In addition, your 13 April 1981 testimony indicated that the Geological Survey's financial management problems that existed 20 years ago are still extant.

In an effort to correct its many longstanding financial management problems the Geological Survey is developing a newly designed royalty accounting system. My staff has discussed with representatives of your Accounting and Financial Management Division our concern as to whether the new system addresses the problems identified in previous GAO reviews. I should like your office to evaluate the new system and associated procedures, and ascertain to what extent it does in fact improve the management of royalty collections. The development effort for this new system is critical to the collection of potentially hundreds of millions of dollars, as well as the expenditure of additional millions for system development and implementation. For these reasons it will impact heavily on the Department of Interior budget authorization and appropriation process. Therefore, I would appreciate an interim briefing by 15 September 1981 and a final report by 1 February 1982.

Sincerely,

Ed Markey

EDWARD J. MARKEY
Chairman
Subcommittee on Oversight
and Investigations
U.S. House of Representatives
818 House Annex #1
Washington, D.C. 20515

(901351)

AN EQUAL OPPORTUNITY EMPLOYER

UNITED STATES
GENERAL ACCOUNTING OFFICE
WASHINGTON, D.C. 20548

OFFICIAL BUSINESS
PENALTY FOR PRIVATE USE,$300

POSTAGE AND FEES PAID
U. S. GENERAL ACCOUNTING OFFICE

THIRD CLASS