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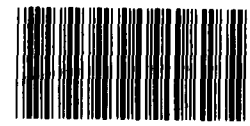

STATEMENT OF

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BEFORE THE

CHAIRMAN, SENATE COMMITTEE ON ENERGY AND NATURAL RESOURCES

ON

THE FEDERAL ENERGY AND MINERAL RESOURCES ACT OF 1982

Mr. Chairman and Members of the Committee:

We are here at your request to testify on S. 2305, a bill to improve the accounting and control for revenues due from Federal and Indian lands. The proposed legislation is in response to the recommendations made in a January 1982 report by the Commission on Fiscal Accountability of the Nation's Energy Resources--an independent Commission established by the Secretary of Interior to develop solutions to the minerals management problems that have continually plagued royalty accounting. We worked closely with the Commission and testified in support of their report on March 23, 1982, before the Subcommittee on Interior, House Committee on Appropriations.

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Historically, high priority has not been placed on the collection of oil and gas royalties. Serious deficiencies in the collection system that we identified over 20 years ago still persist today, with large sums going uncollected each year. In addition, significant amounts of royalty income have not been collected when due, thus increasing the Government's costs of borrowing.

The proposed legislation, combined with the Department of Interior's ongoing effort to design a new royalty accounting system and implementation of the recommendations in our prior reports as well as the Commission's report should provide the foundation for resolving the longstanding financial management problems. We support the legislation and I would like to discuss the major provisions of the bill, which if enacted, should improve royalty accountability.

NOTIFYING THE SECRETARY OF INTERIOR OF CHANGES IN LEASE STATUS

S. 2305 would require that the Secretary of Interior be notified when any new well on a lease begins production. Also, the bill would require that the lease holder notify the Secretary of any lease assignments, or changes in responsibilities for royalty payments and/or recordkeeping. We support these provisions.

Currently, Interior has no systematic way of knowing when new production begins on a lease. Further, the new royalty accounting system now being designed will not provide this information. Therefore, if an operator does not report production when it begins, royalty losses to the Federal Government, Indian tribes and the States could be substantial.

Requiring in law that the Government be notified when new production begins should go a long way to remedy this problem. To augment this notification requirement, we have previously recommended that Interior increase its use of lease inspections to determine when new wells start production.

Further, the bill's requirement that the Secretary be notified of lease assignments and changes in responsibilities for royalty payment and recordkeeping would provide the Department the information needed to maintain exact accountability of leases and payors from whom royalties are due. In our October 1981 report titled "Oil and Gas Royalty Collections--Longstanding Problems Costing Millions" (AFMD-82-6, Oct. 29, 1981), we pointed out that from time to time Interior has received royalty checks for which it is unable to identify the leases involved. This problem could be corrected through enactment of the proposed legislation.

IMPROVEMENTS NEEDED IN SITE SECURITY

The proposed legislation requires that each lessee develop a site security plan in conformance with the standards to be established by the Secretary of Interior. We support this proposal.

Site security for Federal and Indian lands has been extremely lax. The Department of Interior must take the lead in establishing minimal requirements, in designing an inspection strategy--a strategy that must be interfaced with accounting, as well as the industry to affect improved security.

An important element of site security is the lease inspection function. We have long called for the development of an inspection plan, and for field inspectors to assist accounting by determining

the reasonableness of inventory and sales data shown on production reports and reporting on discrepancies. Interior agreed and issued instructions requiring communication and assistance between field inspectors and accountants when inconsistent or questionable data are reported. However, even though the Department reported 28,283 field inspections during fiscal 1980, we found no indication that field inspectors and accountants have worked together to verify production data. Interior officials confirmed that this is rarely done and told us that accountants continue to accept the company reports as accurate.

Questions have also been raised about the quality of the lease inspections. The Interior Department's field inspecting and monitoring were severely criticized at hearings before the Senate Select Committee on Indian Affairs; the Subcommittees on Oversight and Investigations and Mines and Mining, House Committee on Interior and Insular Affairs; the Commission on Fiscal Accountability; and this Committee. It was pointed out that because of inadequate lease inspecting and monitoring, thefts and violations on Federal and Indian lands have gone undetected. The Department had only 60 inspectors to review activities at over 44,000 producing wells. This is not enough inspectors to provide adequate coverage. Violations are apt to occur and go undetected. Interior has indicated it will devote additional resources to the Inspection effort.

S. 2305 would also require that anyone transporting mineral resources from a Federal or Indian lease must maintain documentation showing from whom such resources were obtained. We

support this proposal. Currently, such documentation is not required. We have previously called for the use of runtickets as a means to verify the amount of reported production. We have recommended that Interior determine what use the production phase of the new royalty accounting system, now targeted for implementation in fiscal 1984, will make of runtickets as well as other sources to verify production.

The production phase is extremely important because of the need to alleviate the reliance on information reported by the oil and gas companies. The matching of production and sales data, which will be facilitated by the proposed bill's requirement to use runtickets, will enable the Department to identify situations where oil and gas produced was not properly accounted for. It would also provide the means to monitor lease activities and identify irregularities in reported production and/or sales, and can be used as an indication of the reasonableness of the reported data.

STRENGTHENING SANCTIONS FOR VIOLATIONS

S. 2309 stipulates that civil fines and penalties--up to $10,000 a day--can be assessed for failure to comply with the provisions of the bill. However, the bill as presently written does not provide for the assessment of these fines and penalties for the violation of lease provisions or any rules and regulations that may be issued pursuant to the bill. We suggest that the proposed legislation be amended to provide this. We note that the Secretary is currently authorized by the Outer Continental Shelf Lands Act of 1953 as amended (43 U.S.C. 1350) to assess

fines and pentalties in such instances for offshore leases. If amended, as we suggest, S. 2305 would provide the Secretary similar authority for onshore leases.

Sanctions for lease violations or for persistent serious underpayment of royalties are presently almost nonexistent. Further, those that are imposed, mostly for failure to file reports, are not imposed consistently. We have not examined in any detail the issue of sanctions for violations. However, there is no doubt that companies must have an incentive to comply with program requirements. More importantly, the Government must enforce its authority. Lease cancellations, for example, have not been pursued in cases of repeated violations. The use of sanctions is therefore a logical and practical means of ensuring programs regulations are adhered to.

RECORDKEEPING REQUIREMENTS EXPANDED

S. 2305 stipulates that all individuals associated with the lease must maintain and provide records as specified by the Interior Secretary. We support this requirement.

Presently, Interior does not have any express statutory authority giving it access to records of the lessee, lease interest holder, those engaged in developing the lease, and those transporting the mineral resources from the lease. The standard lease agreement grants the Department broad rights of access to all relevent books, accounts and records regarding the leased lands, including production records, but this authority does not go beyond the lessee. Enactment of S. 2305 would provide the Secretary the needed access authority, thereby strengthening accountability.

PROCEDURES FOR MAKING OFFSHORE REFUNDS REVISED

The proposed legislation would allow the Interior Secretary to refund or credit any overpayment made to the Government for an offshore lease without congressional approval once the Secretary is satisfied that more has been paid than was required. We support this change.

If enacted, refunds for onshore and offshore lease would be granted in the same manner. Under the current provisions of the Outer Continental Shelf Lands Act, a refund cannot be granted without notification of the Congress. The refund cannot be made until the Senate and the House has had 30 days of continuous session--which is normally more than 30 calendar days--to consider the request.

Preparing these requests are very time consuming and of questionable benefit. As discussed in our October 1981 report, in Interior's Metairie office--where most offshore leases are located--about 60 percent of the audit staffs' time is spent processing offshore refund requests. In fiscal 1980, 43 refund requests were received, while in the first 5 months of fiscal 1981, 56 requests were received. Changing the offshore refund policy would improve the Department's ability to monitor and audit the lease account records.

CHARGING INTEREST ON LATE ROYALTY PAYMENTS

S.2305 provides for charging interest on all late royalty payments in accordance with Treasury regulations. This is in line with comprehensive debt collection legislation introduced in the Senate "The Debt Collection Act of 1981" (S-1249) and under

consideration in various accompanying House bills which GAO supports. S.1249 calls for interest to be assessed at rates set by the Treasury quarterly. The legislation also provides for charges to cover additional costs of processing and handling delinquent claims, and a penalty charge, not to exceed 6 percent per annum, for failure to pay any debt more than 90 days past due.

The need to insure timely payment of royalties has been recognized by Interior which plans as part of its new royalty accounting system to use the computer to identify and assess late payment charges. If properly implemented, this should satisfy our longstanding recommendation calling for the computer identification of late payments.

INTEREST CHARGES TO BE SHARED

S.2305 would provide that all interest charges be distributed to the Government and the States in accordance with 30 U.S.C. 191. Presently the States do not share in the interest collected on late royalty payments.

The Government and the States share royalty collections on Federal lands at a rate established by law. Sharing of interest charges would be consistent with this policy. The proposed legislation, however, does not mention the sharing of interest charges with the Indians. We believe that consideration should be given to adding such a provision. Since the Government is collecting for the Indians as trustee and has no claim on the royalties, it would follow that any interest earned on such royalties would go to the trust beneficiary--the Indians.

Also, the bill provides that the funds would be distributed to the States as often an administratively convenient but at least on March 31 and September 30. Whether to pay States their share of royalties more rapidly is a policy matter. The Commission on Fiscal Accountability indicated that more rapid payment could be used as a financial incentive for shifting some of the royalty management work to the States. There is potentially tens of millions of dollars in interest involved. We suggest that the proposal be coordinated with the Department of Treasury and the costs and benefits carefully studied.

INCREASED COOPERATION WITH THE STATES AND INDIAN TRIBES

S.2305 provides for the Secretary to enter into cooperative agreements with the States and Indian tribes to share the royalty management functions. We support this provision.

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 on Fiscal Accountability, various States and 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 agreement with several States and plans agreements with others. The Commission recommended that this effort be expanded to include Indian tribes and the inspection function.

To alleviate reliance on unverified data, we have long called for the Department to determine what secondary sources of data are available among Government and State agencies and in the oil and gas industry. We have recommended that Interior explore the possibility of sharing its auditing and inspection responsibility, and of exchanging information on production and sales with the States.

ESTABLISHMENT OF SELF-SUSTAINING FUND

S.2305 provides for the establishment of a self-sustaining fund for the operation of the royalty management function. An amount not to exceed one percent of the royalties collected, after payment of the applicable windfall profit tax and prior to any distribution to the States, Indians or the Federal Government would be set aside for royalty management.

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. Gains, however, should easily offset costs. This alternative is one way of funding the additional effort.

Though the proposal provides for a sharing of the costs with the States and Indians, most of these costs will still fall on the Federal Government. About 75 percent of the royalty collections relate to offshore production for which the States and Indians do not receive a share of royalty income. At the same time, most of the royalty management problems requiring attention are related to onshore production.

In addition, it is unclear to us if the fund would cover the cost incurred by the Inspector General in the audit of oil and gas companies and the planned contract audit of the top 25 oil and gas companies that pay royalties to the Federal Government. Also, we are not certain whether these funds can be used for the cost incurred in the development and implementation of the new royalty accounting system and for lease inspections. Further, we are unclear as to whether the fund can be used to pay for costs incurred in any hearing or investigation conducted by the Interior Secretary under Section 6 of S. 2305. We suggest these matters be clarified prior to enactment of the bill.

We are also concerned that the proposed legislation may encumber the authority the Interior Secretary already has under 25 U.S.C. 413 to collect reasonable fees to cover the cost of any work performed for the Indians. The Committee may wish to amend section 20 of S. 2305 to provide that the Secretary's authority under 25 U.S.C. 413 is not affected by the enactment of the proposed legislation.

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