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GAO

Report to the Secretary of the Interior

June 1987

MINERAL RESOURCES

Timely Processing Can Increase Rent Revenue From Certain Oil/Gas Leases

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United States
General Accounting Office
Washington, D.C. 20548

Resources, Community, and
Economic Development Division

B-221397

June 18, 1987

The Honorable Donald P. Hodel
The Secretary of the Interior

Dear Mr. Secretary:

As you are aware, federal regulations require that onshore oil and gas leases that are subsequently determined to overlie a known geologic structure (KGS) are to have their rental rates increased.[1] As part of our ongoing effort to evaluate the adequacy of the Department of the Interior's mineral-related revenue collections, we reviewed the Bureau of Land Management's (BLM) procedures in two states to determine whether rental rates are increased in a timely manner for leases determined to overlie KGSs.

In summary, BLM does not have internal controls that ensure that such rental increases are processed consistently and in a timely manner. Although BLM's state offices in Colorado and Wyoming generally increased rental rates for leases determined to overlie KGSs, these increases were not made in a timely manner during calendar years 1984 and 1985. These delays resulted in lost revenue of $552,614. In addition, we found a few instances in the two states in which the rental rates had not been increased at all, causing an additional revenue loss of at least $15,123.

Background

BLM issues and administers onshore oil and gas leases and maintains the official lease records that contain information such as the lease status and the applicable rental rate under the authority of the Mineral Leasing Act of 1920 (30 U.S.C. 181 et seq.), as amended.[2] Once BLM issues a lease, the lease, which carries a 5- or 10-year fixed term, is subject to an annual rent at the rate specified in the lease. The rental rate for noncompetitively issued leases is generally $1 per acre but is increased to $2 per acre if any portion of the lease acreage is determined

[1] A known geologic structure is an accumulation of oil or gas discovered by drilling and determined to be productive; its boundaries include all land that overlies the productive area.

[2] BLM issues three types of leases: (1) competitive—lands within a productive area or a KGS are leased competitively under sealed bid; (2) over the counter—other lands not previously leased are leased noncompetitively "over the counter" to the first applicant submitting a nonrefundable $75 filing fee and the first year's rental payment in advance to BLM; and (3) simultaneous—as leases outside a KGS expire, BLM offers them under the simultaneous, or "lottery," system, whereby applicants submit a nonrefundable $75 filing fee and the first year's rental payment in advance and the lease is awarded to one randomly selected applicant.

to overlie a KGS. If the lease is subsequently drilled and oil or gas discovered, rent payments cease and production royalty payments begin.

Under Interior's procedures, once an oil or gas discovery is made on federal lands, BLM analyzes available geologic data—primarily oil company well data—to determine the boundaries of the KGS. After a BLM fluid minerals specialist makes a KGS determination, the initiating BLM office sends a memorandum to the BLM state office director advising him of the determination. The memorandum contains a legal description of lands involved so that state office personnel in the records branch can update land status maps and forward the memorandum to the adjudication branch. The adjudicators review land status maps and legal descriptions and analyze which leases are subject to rental rate increases. The adjudication branch subsequently sends notices of rental rate increases to lessees.

As of September 1986, 5,693, or 7 percent, of all nonproducing onshore federal oil and gas leases that had initially been issued noncompetitively were later determined to overlie a KGS, and rental rates were increased. In Colorado and Wyoming, 2,883, or 8.5 percent, of the federal oil and gas leases in those two states have had their rents increased because of a subsequent determination that they were overlying a KGS. These leases cover about 1.8 million acres in Colorado and Wyoming.

Interior's Inspector General evaluated the process for increasing rent on oil and gas leases determined to overlie KGSs at four BLM state offices, including Colorado and Wyoming. The Inspector General's March 1984 report found that those state offices had not promptly processed rent increases.[3]

Objectives, Scope, and Methodology

Our objectives were to determine (1) whether BLM had increased the rent on all leases determined to overlie KGSs and (2) whether BLM state offices had increased the rental rates in a timely manner after receiving notification of KGS determinations. To meet our objectives, we performed detailed audit work and analysis at BLM's Colorado and Wyoming state offices. These state offices, two of the offices reviewed by the Inspector General, contain more than 50 percent of the acreage overlying KGSs. We analyzed leases affected by KGS determinations during 1984 and 1985

[3] Administration of Nonproducing Mineral Leases, Bureau of Land Management (C-LW-BLM-08-83), Office of the Inspector General, Department of the Interior, Mar. 1984.

because these were the two most recent years for which data were available.

We interviewed officials at BLM's Colorado and Wyoming state offices and at BLM headquarters to determine procedures and internal controls for processing KGS rental rate increases. At those state offices, we also reviewed lease case files, regulations, and other related documents.

In Colorado we reviewed lease case files for all 64 nonproducing leases determined by BLM to overlie KGSs during 1984 and 1985. We were able to identify leases for which rental rate increases had not been processed at all and leases that had been processed in an untimely manner.

In Wyoming, because 1,155 nonproducing leases were found to overlie KGSs during calendar years 1984 and 1985, we relied on BLM's computerized system. We were able to use this system to estimate losses associated with leases for which the rental rate was eventually increased but which experienced delays.

However, we could not use this system to identify leases in Wyoming for which rental rates were not increased at all because BLM's computerized system contains information only on leases for which the required rental rate increases were eventually processed. Therefore, we randomly selected and reviewed 25 lease case files to determine if rental rates had been increased. However, on the basis of this limited sample, we could not project the total number of leases in the computerized system that had not had KGS rental rate increases or the associated rent that had not been collected. (For a more detailed description of our methodology, see app. I.)

We performed our review from July 1986 to January 1987 in accordance with generally accepted government auditing standards.

Rent Revenue Lost

Although BLM's state offices in Colorado and Wyoming generally increased rental rates for leases determined to overlie KGSs, these increases were not made in a timely manner during calendar years 1984 and 1985. These delays resulted in lost revenue of $552,614. In addition, we found instances in the two states in which the rental rates had not been increased at all, causing an additional revenue loss of at least $15,123. BLM did not have adequate internal controls, such as a specific time frame, to ensure that rental rate increases were processed promptly upon notification of KGS determinations. In addition, internal controls were inadequate to ensure that rental rate increases were processed for all leases affected by KGS determinations.

BLM Did Not Promptly Process All KGS Rent Increases

In February 1984 the Director of BLM issued an instruction memorandum directing state offices to process lease rental rate increases as expeditiously as possible after receiving notification of a KGS determination. We found, however, that BLM's Colorado and Wyoming state offices were not expeditiously processing such increases.

BLM's instruction memorandum was issued in response to Interior's Inspector General's finding that delays occurred in increasing rental rates after KGS determinations had been made. BLM's instruction memorandum, however, did not specify a time frame. The Inspector General's report had used 8 weeks as a reasonable time period for the BLM state offices to process rental rate increases after being notified of a KGS determination. During our review we discussed the 8-week time frame with BLM headquarters officials and state office staff responsible for processing KGS rental rate increases, and they agreed that the 8-week time frame is reasonable.

Of the 1,211 leases that had KGS rental rate increases, 1,166 required over 8 weeks to process. The average processing time frame was 4 times greater than 8 weeks, as shown in table 1. Not all of the leases that took more than 8 weeks to process resulted in lost rent revenue because some were still processed before the next annual rent payment was due.[4] However, of the 1,166 leases that took more than 8 weeks for processing, 520 resulted in $552,614 of lost rent revenue. This lost revenue cannot be retroactively recovered.

Table 1: Untimely Rent Increases and Lost Revenue

	Colorado	Wyoming	Total
Number of leases processed	56	1,155	1,211
Lease rent increases processed in over 8 weeks	55[a]	1,111	1,166
Average processing time (weeks)	41	36	
Range of untimely processing times (weeks)	10 to 116	9 to 120	
Untimely rent increases resulting in lost revenue	31	489	520
Lost revenue	**$40,227**	**$512,387**	**$552,614**

[a]This does not include 8 unprocessed leases.

[4]The KGS rental rate increase is not effective until the date of the first annual rent payment due 30 days after a lessee receives BLM notification.

Colorado and Wyoming BLM state officials responsible for increasing rental rates for leases determined to overlie KGSs, according to their statements, were not aware of the instruction memorandum directing state offices to expeditiously increase rents and notify lessees of the rent increases. Even if they had been aware of the instruction memorandum, adequate internal controls, such as a specific time frame to ensure that KGS rental rate increases were processed promptly, had not been established in the instruction memorandum.

BLM Did Not Increase Rental Rates for All KGS Leases

Federal regulations require that all noncompetitive leases that are determined to include lands overlying KGSs have their rental rates increased to $2 per acre. However, we found that BLM's Colorado and Wyoming state offices did not increase rental rates for some leases determined to overlie KGSs.

In those state offices, existing internal controls could not ensure that rents were increased for all leases affected by KGS determinations. BLM requires supervisory review of each KGS determination and resulting rental rate increase. However, procedures did not exist to ensure that all KGS determinations made by BLM fluid minerals specialists reached the appropriate branch within the state offices. BLM staff responsible for increasing rental rates on leases stated that they had no way of knowing if they had been notified of all KGS determinations. Similarly, no procedures existed to ensure that once the appropriate state office branch had been informed of KGS determinations, all affected leases received rent increases. In cases where KGS notifications had been received but lease rental rates were not adjusted, BLM staff attributed the oversight to human error.

Without adequate internal controls, BLM cannot ensure that its staff increases rental rates for all leases determined to overlie a KGS. For leases for which BLM does not increase rental rates, the revenue loss will continue to occur until the leases expire or begin paying royalties on production, because lessees are not obligated to pay the increased KGS rent until they receive notification from BLM.

We found that 8 (13 percent) of the 64 Colorado leases subject to KGS rental rate increases in our 2-year review period had not been increased. For these leases, $9,763 in rent revenue has been lost since 1984. In addition, our sample of 25 Wyoming leases showed that the rental rate for 1 lease had not been increased. For this lease, $5,360 has been lost since 1984. This limited sample is not projectable to all Wyoming leases, so we do not know whether any additional leases should have had their rents increased. These losses would have continued in subsequent years if we had not pointed out this oversight to the appropriate BLM officials.

Conclusions

Federal regulations require that rental rates be increased for leases found by BLM to overlie KGSs. The BLM state offices in Colorado and Wyoming, which contain about 50 percent of the land overlying KGSs, did not process most KGS rental rate increases promptly and did not increase rental rates on other leases, thus losing rent revenue. BLM's internal controls were inadequate to ensure that (1) state offices were informed of all KGS determinations, (2) rental rates were increased once state offices were informed, and (3) rental rate increases were processed in a timely manner.

Although Interior's Inspector General reported in March 1984 that delays had occurred in increasing rental rates after KGS determinations had been made, we found that this situation still exists. The Inspector General used 8 weeks as a reasonable time for processing KGS rental rate increases, and BLM officials agreed. A memorandum from the BLM Director instructed BLM state offices to expeditiously process KGS rental rate increases once KGS determinations had been made but specified no time frame for such processing. Furthermore, the BLM Colorado and Wyoming state office staff responsible for processing rental rate increases were not aware of the Director's memorandum. For 1,166 of the 1,211 leases we reviewed, BLM took longer than 8 weeks to increase the rental rates after being notified that the leases were overlying KGSs.

BLM did not increase some rental rates for leases overlying KGSs. Internal controls were inadequate to ensure that all KGS determinations reached the appropriate BLM state office branch and that all affected leases were increased. On leases for which rental rates are not increased, rent revenue is lost until those leases are no longer subject to rent payment, for example, when they expire or become subject to royalty payments.

For leases that were not processed before the next rent payment was due, $552,614 in rent revenue was lost. In addition, $9,763 in Colorado and at least $5,360 in Wyoming was lost because rental rates were not increased at all. This lost rent revenue cannot be retroactively recovered.

Recommendations

To preclude further lost rent revenue for leases overlying KGSs, we recommend that the Secretary of the Interior direct the Director of BLM to take the following actions:

- Establish adequate internal controls to ensure that BLM staff responsible for increasing rental rates are made aware of all KGS determinations. For example, such controls might include consecutive numbering of KGS determination memoranda and maintaining a log of all leases in processing.
- Establish a specific time frame for processing KGS rental rate increases, such as the 8-week time frame used by the Interior Inspector General, and ensure that responsible BLM staff are aware of the established time frame.
- Instruct each state office to determine if other leases subject to KGS determinations have not had rental rates increased as required and ensure that rental rates are increased appropriately.

These revised procedures should help ensure that rental rates are increased as soon as possible and that lessees are promptly notified.

Agency Comments

On March 13, 1987, we asked Interior to comment on a draft of this report. Interior responded to this request in an April 28, 1987, letter and then clarified its comments in subsequent discussions with us. Interior's letter and GAO's detailed response are included in appendix II. Generally, Interior agreed with the report's findings. Interior stated that current procedures for rental rate increases can be improved and said that corrective actions will therefore be taken.

Interior suggested minor changes in the data regarding Colorado leases. We have revised the report accordingly. In addition, Interior asked that we note that it had a larger KGS work load in 1984-85 than in other years. However, Interior offered no data to verify this assertion, and we found that in Colorado the number of leases affected by KGS determinations actually declined in 1984-85, compared to 1982.

As you know, 31 U.S.C. 720 requires the head of a federal agency to submit a written statement on actions taken on our recommendations to the Senate Committee on Governmental Affairs and the House Committee on Government Operations not later than 60 days after the date of the letter as well as to the House and Senate Committees on Appropriations with the agency's first request for appropriations made more than 60 days after the date of the report.

We will be sending copies of this report to the House and Senate committees and subcommittees having oversight and appropriation responsibilities for federal minerals leasing; the Office of Management and Budget; and other interested parties.

This work was conducted under the direction of James Duffus III, Associate Director. Other major contributors are listed in appendix III.

Sincerely,

J. Dexter Peach
J. Dexter Peach
Assistant Comptroller General

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Abbreviations

ALMRS	Automated Land and Mineral Record System
BLM	Bureau of Land Management
GAO	General Accounting Office
KGS	known geologic structure
RCED	Resources, Community, and Economic Development Division

Approach and Methodology

To accomplish our objectives we identified all KGS determination memoranda received by the Colorado and Wyoming BLM state offices during 1984 and 1985. We determined (1) when these notification memoranda were received, (2) whether any leases required rental rate increases, and (3) how long BLM took to notify the lessees of the increases.

To assess the timeliness of BLM state office processing of rent increases, we used 8 weeks as the criterion. This time frame was first used by Interior's Office of the Inspector General in its March 1984 report. The time frame allowed 4 weeks for state office processing, including mail delivery, and 4 weeks for the required 30-day advance notification to lessees before rent increases can go into effect. BLM headquarters and state officials responsible for processing rental rate increases agreed that the time frame is reasonable. We identified all rent increases that took more than 8 weeks to process and determined which of those missed a rent due date while they were in processing, resulting in a rent revenue loss. (Some rent increases may have taken longer than 8 weeks to process but did not have a rent due date fall during the processing period, resulting in no lost revenue.) We then calculated the rent revenue loss that resulted from this untimely processing. We defined rent revenue loss as the amount of increased rent that would have been collected had BLM processed the increases within 8 weeks.

For example, assume that for a nonproducing lease with an October 1 rent due date, the appropriate branch of the BLM state office received the KGS determination memorandum on July 31, 1984. Using 8 weeks as the criterion for timely processing, BLM should have processed the rent increase and notified the lessee by August 31, 1984. The rent increase would then have become effective on the next rent due date 30 days after notification or, in this case, on October 1, 1984. Now, assume that the lessee was not notified until 42 weeks after the appropriate branch of the BLM state office had received the KGS notification, which was the average processing time for the Colorado BLM state office. Because rent is paid annually, in this example the rent increase would not have become effective until October 1, 1985. The revenue loss for this example would be the increased rent not collected on the October 1, 1984, rent due date.

During 1984 and 1985 the Colorado BLM state office determined that a total of 64 nonproducing leases overlay KGSs. For these leases we reviewed lease case files to determine whether the rental rates had been increased and, if so, how long it took the state office to send notification to the lessees. Then we calculated the revenue lost because of untimely processing, as described above.

In Wyoming, because 1,155 nonproducing leases were subject to KGS rental rate increases during 1984 and 1985, it was impractical to review all the lease case files. Instead we used BLM's Automated Land and Mineral Record System (ALMRS) data to compute the total revenue impact.[5] To test ALMRS' accuracy we compared various data in ALMRS with the lease file data for our 25 sample leases and found that for leases showing rental rate increases on ALMRS, the data were correct. Because we looked only at certain ALMRS data relating to our review of KGS rental rate increases, our test of ALMRS data should not be interpreted as an overall assessment of ALMRS' reliability.

From this system we obtained the effective date of the KGS determination, the date that the rent was increased, the lease anniversary (rent due) date, and lease acreage. To calculate the amount of time between when the Wyoming BLM state office received KGS determinations and sent notification of rent increases to lessees, we added the dates of all KGS determination memoranda received by the state office to ALMRS data. For each lease, we calculated the processing time from the date the BLM state office received the KGS memorandum; to do so, we used the KGS memorandum date (plus 4 days for mail time between the district office and the state office) and the date the notification letter to the lessee was prepared. (Wyoming officials told us that for 43 of the 1,155 leases, the KGS memoranda were returned to the BLM district offices for additional information before the state office could begin processing rent increases. We therefore excluded these leases from our computation of untimely leases.) Where processing time exceeded the 8-week time frame, we computed lost revenue for those leases that passed a rent due date while the leases were in processing.

[5] ALMRS records, maintains, and retrieves federal land and mineral record information. It summarizes information from lease case files, such as land description, ownership, rental rates, and KGS status.

Comments From the Department of the Interior

Note: GAO comments supplementing those in the report text appear at the end of this appendix.

United States Department of the Interior

OFFICE OF THE SECRETARY
WASHINGTON, D.C. 20240

APR 28 1987

Mr. J. Dexter Peach
Assistant Comptroller General
U.S. General Accounting Office
441 G Street, N.W.
Washington, D.C. 20548

Dear Mr. Peach:

We have reviewed the subject report which evaluated the Bureau of Land Management's (BLM) procedures in two States during calendar years (CY) 1984 and 1985 to determine whether rental rates are increased in a timely manner for leases determined to overlie a known geological structure (KGS). The report found that internal controls in BLM were inadequate to ensure that such rental increases are processed in a timely manner and that these delays resulted in lost revenue. Losses in revenue were also found in a few instances where the rental rates were not increased at all.

To preclude further lost revenue, the report recommended the following actions:

(1) Establish adequate internal controls to ensure that BLM staff responsible for increasing rental rates are made aware of all KGS determinations.

(2) Establish a specific timeframe for processing KGS rental rate increases, i.e. 8 weeks, and ensure that BLM staff are aware of the established timeframe.

(3) Instruct each State Office to determine if other noncompetitive leases subsequently determined to be in a KGS have not had rental rates increased as required and ensure that rental rates are increased accordingly.

See comment 1.

While the Department generally agrees with the report's findings, there are several discrepancies and omissions which we feel should be noted and are discussed below.

The report found that 9 of the 66 Colorado leases subject to KGS rental rate increases in the 2-year period (CY 1984/85) had not been increased. However, the BLM Colorado State Office has determined that only two leases (C-27716 and C-28013) had never had their rental rates increased. These omitted notices were mailed on January 29, 1987.

The status for the remaining seven leases and an additional lease which needs clarification follows.

1. C-35258 notice was sent November 16, 1986. Same number as 8 on the list, however, the information is not the same.

2. C-27500 this was a producing lease which was not subject to rental until March 28, 1986, when it was returned to BRASS and subsequently terminated for non-payment of rental on October 1, 1986.

3. C-36035 notice sent March 31, 1986.

4. C-35528 notice sent November 18, 1986.

5. C-26950 THIS LEASE IS NOT IN A KGS. It is only within a Known Recoverable Coal Resource Area (KRCRA).

6. C-24281 lease expired October 31, 1986.

7. C-27770 lease expired August 31, 1986.

8. C-35258 same number as No. 1 above, however, the amounts shown do not agree.

The draft report should be amended so that the final version accurately reflects the status of these 9 Colorado leases.

See comment 2.

As mentioned above, the General Accounting Office (GAO) conducted their study during CY 1984 and 1985. However, the report fails to mention that during this time there was an intensive effort underway to review KGS areas and define new ones. As a result, within a short timeframe the oil and gas adjudication units received new KGS determinations involving thousands of leases. No additional funding for personnel or overtime was authorized to accomplish this increased work load. These factors obviously contributed to delays in processing rental rate increases. The report should note these circumstances so that the BLM's performance during this time period is not viewed as being typical or representative of their ability to issue rental rate increases under usual conditions.

The Department does agree that the current procedures for rental rate increases can be improved. Accordingly, we will take the following actions:

(1) An Instruction Memorandum is being prepared directing the field offices to begin entering KGS's into the BLM's automated Case Recordation System. This will improve the field staff's ability to keep abreast of changing KGS conditions and track a lease's KGS status.

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(2) A separate Instruction Memorandum is being prepared directing the field offices to take added measures to ensure that the staff responsible for increasing rental rates are made aware of all KGS determinations. Basically, the intent will be to improve communication between the geologists/engineers responsible for KGS determinations and the adjudicators responsible for increasing the rental rates. The field will also be directed to complete the rental rate increase process within 8 weeks, as suggested by GAO.

The same Instruction Memorandum will also instruct the field staff to recheck that all acreage which has subsequently been determined to be in a KGS has had a rental increase. If not, the field is to increase the rents immediately, taking into consideration the anniversary date to ensure that the next annual rent due reflects the increase. However, the field will be given the discretion to halt this process if after considerable effort it produces few or no results. Our concern is that such an effort may require several work months to complete and other priority work may suffer. Furthermore, the findings of the Colorado State Office indicate that this may not be as significant a problem as originally thought.

(3) The handbook for adjudicators is being revised to reflect an expedited process for rental rate increases. The revisions will also include the 8 week timeframe.

We believe these actions adequately respond to the report's recommendations and ensure that the Department will take prompt and effective action on rental rate increases.

Sincerely,

J Steven Griles

Assistant Secretary - Land and Minerals Management

The following are GAO's comments on the Department of the Interior's letter dated April 28, 1987.

GAO Comments

1. In discussions with Interior officials subsequent to their letter, they noted that, for various reasons, most of the "discrepancies" they initially cited in our Colorado lease data were not actually discrepancies. We did change our report to lower the number of untimely processed leases by one and the number of unprocessed leases by one. These changes had no substantive effect on our findings with which Interior agreed.

2. Colorado data that we have indicate that the number of leases affected by KGS determinations actually went down from 1982 to 1984-85. Interior provided no data in its letter to support its contention that KGS work load was unusually high in 1984-85. As noted in our report, BLM state office staff could not explain delays and omissions other than as due to human error, and they were unaware of prior BLM instructions regarding timely processing of KGS rental rate increases. We remain convinced that evidence indicates that lease rental rate increases could have been processed in a more timely manner in 1984-85.

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