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Briefing Report to the Chairman, Committee on Interior and Insular Affairs, House of Representatives

September 1987

MINERAL REVENUES

Interior's Control Over Oil and Gas Allowances

134176

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Resources, Community, and
Economic Development Division

B-228947

September 17, 1987

The Honorable Morris K. Udall
Chairman, Committee on Interior
and Insular Affairs
House of Representatives

Dear Mr. Chairman:

This briefing report responds to your request that we examine the Department of the Interior's controls over processing and transportation allowances for oil and gas leases on federal lands. In June 1987, we agreed with your staff to respond to several specific questions regarding Interior's approval and audit of allowances. We provided your staff with answers to these questions on July 21, 1987, and this briefing report presents the results of that briefing.

The ~~Federal~~ Oil and Gas Royalty Management Act of 1982 (Public Law 97-451) requires that Interior's Minerals Management Service (MMS) accurately account for, collect, and disburse all royalty revenue from mineral leases on federal lands. As part of this responsibility, MMS regulations allow lessees to deduct transportation and processing costs from the value of oil and gas in computing royalty payments.

MMS' method of controlling allowances was to have three parts: (1) prior approval of allowances that companies expect to claim, (2) computerized comparison of allowances approved with allowances claimed, and (3) audits to verify the validity of allowances deducted. However, MMS uses only prior approval of allowances and audits, and these have had limited scope and effectiveness.

As agreed with your office, we did not perform extensive audit work in responding to your specific questions; however, we have a number of observations about MMS' control over transportation and processing allowances. Prior approval of allowances by MMS does not effectively control allowances claimed because not all allowances are subject to prior approval, nor is the data submitted by the companies verified at this stage. Instead, MMS relies on its audit function to detect excessive allowances. However, because MMS first satisfies legislatively and departmentally directed audits, such as reviews of offshore royalty refund requests and resolving Inspector General audit findings, allowance audits have not been given high priority. In addition, rather than verifying data submitted by companies, audits of allowances have generally consisted of comparing allowances claimed with allowances approved. However, some allowances claimed have been verified as part of the legislatively and departmentally directed audits.

MMS has two initiatives underway that can affect control of allowances claimed. First, MMS has proposed new product valuation regulations that introduce more specific criteria than previously existed for calculating, approving, and reporting allowances. Second, MMS is considering implementing computerized monitoring to identify claimed allowances that warrant further review or audit. Because these actions have not been implemented, we do not know how MMS' controls on allowances will be affected.

Sections 1 through 3 of this briefing report provide an overview of allowances, including the approval and auditing processes MMS follows. Section 4 discusses recent MMS initiatives regarding control of allowances.

We interviewed officials and reviewed documents at MMS' Royalty Valuation and Standards Division and its Royalty Compliance Division. In addition, we visited three Royalty Compliance Division regional offices and four residency audit sites located in California, Colorado, Oklahoma, and Texas. We chose the residency audit sites because at least one was in each of MMS' three regional offices. As agreed, because of the limited time we had to respond to the specific questions that your staff provided to us, we did not test the accuracy of computer-generated data nor validate information provided by MMS. However, as requested by your office, we made certain observations from the factual information we collected. In accordance with your wishes, we did not request official agency comments on a draft of this report.

We plan no further distribution of this briefing report until 30 days from the date of this letter. If you have further questions, please contact me at (202) 275-7756. Major contributors to this briefing report are listed in appendix I.

Sincerely yours,

Peter W. Watson

for James Duffus III
Associate Director

C O N T E N T S

ABBREVIATIONS

GAO	General Accounting Office
MMS	Minerals Management Service
IG	Inspector General
RCD	Royalty Compliance Division
RVSD	Royalty Valuation and Standards Division

SECTION 1

OVERVIEW OF ALLOWANCES

PROCESSING AND TRANSPORTATION ALLOWANCES FOR OIL AND GAS

Question: What are processing and transportation allowances?

GAO Response

When oil and gas are produced at wells on federal lands, a willing buyer (market) may not be present. That is, the producer must often transport the oil and gas to a buyer and process the gas into its constituent products, such as butane, propane, and residue gas, in order to have a buyer.

Royalties are paid on the value of production. However, when no market is present at the wells, the value is not readily measurable. Therefore, the Department of the Interior permits producers to compute value of production by starting with sales value, which is readily determined, and deducting certain transportation and processing costs, as "allowances," to determine value of production, on which royalties are paid to the federal government.

As an illustration of a transportation allowance, suppose a producer of oil and gas on a federal lease must transport the oil through a pipeline to an oil refinery that is buying the oil. The most easily identifiable value of that oil is the price that the refinery pays. However, that is sales value, not the value of production at the well. Therefore, to determine the value of production, the producer subtracts the cost of transporting the oil through the pipeline from the sales value to derive the value of production. The producer then computes royalties owed to the federal government based on that derived value of production.

For a processing allowance, suppose the producer must process the gas into its constituent products, such as butane, propane, and residue gas, at a gas processing plant, in order to have a buyer for each of the products. The various products' prices are sales value, not value of production at the well. Therefore, to determine the value of production, the producer subtracts the cost of processing the gas at the gas processing plant from the total sales value of the products to derive the value of production, then computes royalties owed to the federal government.

LEGAL BASIS FOR ALLOWANCES

Question: What is the legal basis for allowances?

GAO Response

Interior's authority to lease onshore lands comes primarily from the Mineral Leasing Act, as amended, 30 U.S.C. 181 et seq., and the Mineral Leasing Act for Acquired Lands, as amended, 30 U.S.C. 351 et seq., while the authority to lease offshore lands comes from the Outer Continental Shelf Lands Act, as amended, 43 U.S.C. 1331 et seq. Lessees are obligated to pay, to the United States, royalties based on the value of the minerals produced. The Secretary of the Interior is authorized to prescribe rules and regulations necessary to carry out the purposes of the respective acts. Existing regulations permit lessees to deduct from sales value certain processing and transportation costs.

Legal Basis for Processing Allowances

Gas royalties are payable on the value of the gas as it is produced at the well. Gas may be produced in order to extract its constituent products, such as butane and propane. Because part of the sales value of the products is attributable to this process, Interior's regulations allow lessees to deduct processing costs from sales value to obtain value of production at the well before computing royalties due to the United States. This position has been supported by the courts.[1]

Interior regulations provide that

-- for onshore leases, royalty shall be paid on the value of the products, except not on two-thirds of the sales value of the natural gas liquids (products other than the residue gas). The exception is an allowance for the costs of processing. (30 C.F.R. 206.106.)

-- for offshore leases royalty shall be paid on the value of the products. A reasonable allowance for the costs of processing may be deducted from the sales value, not to exceed two-thirds of the value of the natural gas liquids (products other than the residue gas). (30 C.F.R. 206.152(a).)

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[1] United States v. General Petroleum Corp. of California, 73 F. Supp. 225 (S.D. Calif. 1946), aff'd sub nom., Continental Oil Co. v. United States, 184 F.2d 802 (9th Cir. 1950).

Legal Basis for Transportation Allowances

Lessees are allowed to deduct transportation costs from the sales value of oil and gas before computing royalties due to the United States. Although Interior's regulations do not specifically address transportation allowances, the regulations state that "other relevant matters" may be considered in determining the value of production for the purpose of computing royalty payments (30 C.F.R. 206.103 for onshore and 30 C.F.R. 206.150 for offshore). Interior considers transportation costs to be a "relevant matter." According to the U.S. Geological Survey Conservation Division Manual used by the Minerals Management Service (MMS), an onshore transportation allowance cannot exceed 50 percent of the product's sales value. No such limit exists for offshore allowances.

Interior's regulations have been supported by the courts, and their position in one case follows:

> "It has long been considered reasonable with respect to oil produced onshore or offshore to deduct a transportation allowance from the market value of the oil at the nearest open market to determine value at the wellhead where no market exists at the wellhead, the point where the oil would ordinarily be sold and delivered."[2]

In another case the court said:

> "It has been held that if there is no open market in the place where an article ordinarily would be sold, then the market value of such article in the nearest open market, less cost of transportation to such open market, becomes the market value of the article in question."[3]

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[2]Shell Oil Co., 88 I.D. 1,3 (1981).

[3]Same as footnote 1.

ALLOWANCE CONTROLS

Question: How does MMS control allowances?

GAO Response

MMS intended that three "lines of defense" would control allowances: (1) prior approval of allowances that companies expect to claim, (2) computerized comparison of allowances approved with allowances claimed, and (3) audits. However, MMS only uses prior approval and audits, and even these have had limited scope and effectiveness. (See fig. 1.1.)

Figure 1.1: Intended and Actual Allowance Controls

MMS' Intended Controls

Allowances approved	Computerized monitoring ("exception processing")	Audits conducted

MMS' Actual Controls

Allowances approved		Audits conducted

Prior approval of allowances by MMS' Royalty Valuation and Standards Division (RVSD) is not totally effective because MMS does not require that all allowances receive prior approval, and, when required, company data that are submitted are not verified by MMS. Computerized comparison of allowances approved with allowances claimed ("exception processing") has not been implemented by MMS because of insufficient computer capability. The third line of defense, audit by MMS' Royalty Compliance Division (RCD) of allowances claimed, has also not been totally effective because MMS' audit work has generally focused on other areas of the royalty program.

SECTION 2

PRIOR APPROVAL OF ALLOWANCES

APPROVAL PROCESS

Question: To what extent are allowances reviewed by MMS prior to their approval? That is, are all allowances reviewed before approval?

GAO Response

MMS' Payor Handbook, which is distributed to all royalty payors, states that no allowances may be taken without prior approval from MMS. However, MMS officials told us that they do not require that all allowances receive prior approval. Furthermore, allowances have been permitted based on retroactive approvals.

For processing allowances, approval is not required when the allowance is based upon a price specified in an arm's-length contract. However, the allowance claimed is subject to audit. All other processing allowances require prior approvals. These include non-arm's-length transactions such as when no contract exists, or when a gas producer has financial interest in the gas processing plant. In these instances, prior approval is required and is based on processing plant costs incurred. Approval is granted for a 2-year period. (See fig. 2.1.)

For transportation allowances, prior approval is not required when a buyer's posted product price, reduced by the transportation cost, is used, and no additional costs are incurred. All other transportation allowances require prior approval based upon arm's-length contracts, pipeline tariffs established by the Federal Energy Regulatory Commission, or non-arm's-length transactions, such as when the transportation system is owned by the producer. Approval is granted for a 1-year period. (See fig. 2.1.)

Figure 2.1: Allowances Requiring Approval from MMS

	Prior approval required	Prior approval not required
Processing	Non-arm's-length transactions.	Arm's-length contracts.
Transportation	Arm's-length contracts. Federally approved pipeline tariffs. Non-arm's-length transactions.	Posted price received for product reduced by transportation costs.

MMS PRIOR APPROVAL PROCEDURE

Question: What is the procedure that MMS uses to review allowances?

GAO Response

MMS' RVSD is responsible for allowance approvals and follows policies and procedures established by MMS and its predecessor, the U.S. Geological Survey Conservation Division. As shown in figure 2.2, the actual process MMS follows varies, depending on the type of data submitted.

Figure 2.2: Steps in MMS' Allowance Approval Process

After a written request by a royalty payor for prior allowance approval, MMS follows these general steps:

-- Obtains case file on prior year approvals.

-- Reviews data submitted by payor to determine if information is complete. If not, notifies payor by letter--permitting 60 days to respond.

-- Compares current submission with data from previous years and notes differences, if significant.

For arm's-length transportation allowances, checks current oil and gas directory to ensure that companies are not affiliated. Then ensures that deductions are authorized by regulation.

or

For actual cost calculations, compares expense data against the Conservation Division Manual's listing of allowable and unallowable costs. Then computes allowances using standard formulas.

-- Notifies payor of approved allowance and amount disapproved, if applicable.

When requests for processing allowance approvals are based upon actual costs incurred, RVSD personnel approve one rate for each gas processing plant. This rate is then used by each company with an ownership interest in the plant. If the gas plant has multiple owners, which is a common industry practice, each owner must individually submit required revenue and expense data to RVSD. When requests for transportation allowance approvals are based upon actual costs incurred, RVSD personnel approve a separate allowance for each transportation system interest owner. RVSD does not compute a composite rate for all owners, as is done for processing allowances.

RVSD reviews the company data submitted to determine that only allowable expenses are included and then computes the processing or transportation allowance based on data submitted by each owner. The allowance is calculated as a percentage representing the ratio of expenses and return on investment to the value of the product processed or the quantity of product transported.

While no differences exist in calculating onshore or offshore transportation allowances, different formulas are used to calculate onshore and offshore processing allowances. The major difference between the onshore and offshore formulas is in the return on investment factor. For onshore oil and gas, a lessee is allowed to deduct a rate of return on the undepreciated investment in the transportation system. The offshore method provides for a rate of return based on 15 percent of gross sales value of products produced at a plant, before taxes. The offshore formula provides a higher rate of return than the onshore method.

The onshore formula was developed by MMS' predecessor agency, the U.S. Geological Survey Conservation Division, but the offshore formula was later developed by MMS. When the onshore and offshore allowance approvals were consolidated under MMS' RVSD, both formulas continued in use, pending the publication of new regulations, which would provide one formula.

TOTAL OIL AND GAS ALLOWANCES APPROVED

Question: What is the total dollar value of approved allowances in effect during fiscal year 1986 compared with the total royalties collected?

GAO Response

According to RVSD records and discussions with RVSD officials, approved oil and gas allowances in effect during fiscal year 1986 totaled about $277 million, while MMS collected over $3.35 billion in oil and gas royalties. In fiscal year 1986, processing allowance approvals represented over three-fourths of total allowance approvals. (See table 2.1.)

Table 2.1: Approved Oil and Gas Allowances in Effect for Fiscal Year 1986[a]

Allowance type	Amount approved	Percent of total approvals
	(millions)	
Processing	$214.5	77
Transportation	62.7	23
Total	$277.2	

[a]Because processing allowances are approved for a 2-year period, the data for fiscal year 1986 have been adjusted to include the previous year's approvals. RVSD officials agree that this represents a more accurate picture of the total value of approved allowances in effect during fiscal year 1986.

Note: Royalties collected totaled $3.35 billion.

Approved allowances, however, do not equal allowances claimed because not all allowances require approval. MMS' Payor Handbook requires that each allowance be reported as a separate line item on the monthly "Report of Royalty and Sales Remittance" (MMS Form 2014). However, MMS officials said that some payors only report actual royalties paid and do not identify the allowance deductions as separate line items. In other words, those payors report their sales value net of allowances. For this reason, MMS officials told us that the actual amount of allowances deducted from the sales value of oil and gas before federal royalties are paid is not known.

MERITS OF PRIOR APPROVAL

Question: How good is MMS' procedure for approving allowances? Is MMS in essence rubberstamping allowances or is there a thorough review of each request?

GAO Response

RVSD officials believe that the allowance approval process serves as a deterrent to excessive allowances being claimed because companies know that allowance calculations are reviewed prior to approval.

RVSD disallows some percentage of allowances requested for prior approval when unallowable costs or other errors can be identified in the data submitted by companies. During fiscal year 1986, RVSD disallowed 8.6 percent of the total value of oil and gas allowance approvals requested by companies. However, more than $10 million of the $11.5 million in disapprovals occurred in just one request for approval. (See table 2.2.)

Table 2.2: Oil and Gas Allowances Disallowed During Fiscal Year 1986

Type of allowance	Amount disallowed	Amount approved
	(000)	(000)
Processing	$10,574[a]	$ 59,538
Transportation	950	62,722
Total	$11,524	$122,260

[a]Includes one disallowed request of more than $10 million.

Examples of reasons for disapprovals include:

- A company did not submit additional data requested by RVSD within the required 60-day period.
- A company incorrectly computed the rate of return on the undepreciated investment.
- A company used a rate of return on undepreciated investment in excess of the applicable prime rate.

However, the approval process cannot control allowances deducted from the sales value on which royalties are computed for several reasons: not all allowances require prior approval, approvals are based on unverified data, allowances approved are not compared to amounts claimed at the time royalty payments are received by MMS, and not all allowances are reported separately on the royalty reporting forms. As a result, MMS can only rely on the audit function as its primary defense against excessive allowances.

CONSISTENCY OF APPROVALS

Question: Is MMS consistent in approving allowances for companies in the various oil-producing states?

GAO Response

Based on discussions with RVSD staff and review of case files, the allowance approval process appears to be consistent for the various oil-producing states. RVSD approves allowances based on data submitted by companies without regard to state boundaries. In the few cases (29 out of 741 during 1986) where RVSD disapproved costs provided by companies, we found no trends indicating state differences. RVSD officials said that they follow the same procedures for prior approval of allowances regardless of what states are involved.

REGULATORY COMPLIANCE

Question: Are allowances which are approved by MMS in accordance with statutes and regulations?

GAO Response

The statutes give Interior discretion to set royalties based on the value of the minerals. Consistent with this authority, Interior's regulations define the lessee's right to claim a deduction from the sales value for the costs associated with processing and transportation. The regulations also establish limits on such deductions. Otherwise, the statutes and regulations do not specify how allowances are to be calculated or what approval process MMS must use. The RVSD approval process appears to enforce the regulatory limitations.

COST OF THE APPROVAL PROCESS

Question: What are the staff costs associated with approving allowances?

GAO Response

As shown in table 2.3, the salary costs charged to allowance approvals for fiscal year 1986 was $361,522.

Table 2.3: Staff Cost of the Approval Process for Fiscal Year 1986

Allowance	Salary costs
Processing	$ 73,900
Transportation	287,622
Total	$361,522

STAFF QUALIFICATIONS

Question: What are the qualifications of the people approving allowances?

GAO Response

The Transportation and Processing Branch within RVSD had 12 staff assigned to review requests for allowances. These people had a variety of experience in oil and gas accounting both in MMS and its predecessor agency, the U.S. Geological Survey. The staff included 1 supervisory accountant, 4 accountants, 1 engineer, 1 geologist, and 2 support staff. The remaining 3 positions were filled on a rotating basis by professional staff from other groups within RVSD.

SECTION 3

ALLOWANCE AUDITS

ALLOWANCE AUDIT METHODOLOGY

Question: After oil and gas companies send their royalty payments to MMS, what does MMS do in its audit function to verify the validity of allowances claimed?

GAO Response

According to RCD personnel, most allowance audits consist of comparing allowances claimed with allowances approved by RVSD. RCD auditors do not generally verify data on which an approval was based, unless such an audit is part of RCD's legislatively or departmentally directed workload. These other audits include: (1) reconciling Royalty Accounting System accounts, (2) reviewing offshore refund requests, (3) resolving Interior Inspector General (IG) audit findings, (4) following up on referrals received from the Bureau of Land Management and the Bureau of Indian Affairs, and (5) responding to special requests received from other MMS units and industry. For example, RCD has audited revenue and expense data, upon which allowance approvals were based, during follow-up reviews of the IG's gas processing plant audits and during offshore royalty refund request audits. In addition, RCD sometimes audits components of an allowance calculation although the allowance was not the focus of the audit. For example, RCD may audit production volumes or pricing, both of which are used to calculate allowance approvals.

AUDIT PROCEDURES MANUAL

Question: What manual of procedures is being used to audit allowances at the residency (company) audit sites?

GAO Response

We found the RCD Audit Procedures Manual available at each of the four MMS residency audit sites that we visited. However, it provides only general guidance concerning allowances. For example, according to the manual, "If manufacturing allowances have been permitted, inspect the MMS approval letter and related correspondence and review the accumulation or calculation of such costs to ascertain that the reported allowances are within the allowable limits." The manual refers to substantive audit procedures, but this more detailed guidance was never formally published. RCD officials said that other information had been distributed RCD-wide, including the Conservation Division Manual, a natural gas liquid products valuation paper, and an RVSD allowance calculation paper.

At the three regional offices (Houston, Lakewood, and Tulsa) and four residency sites we visited, we found miscellaneous guidance for auditing allowances, including approval and valuation criteria, a training manual, and audit plans. RCD's Houston regional manager pointed out that the reason we did not find the same guidance at each site was because the residencies we visited had not yet performed extensive allowance audits.

The RCD Division Chief said that the guidance available at the sites was adequate. According to RCD's Lakewood regional manager, MMS does not want to impose standardized audit procedures, but rather prefers designing individual audit plans as needed.

ALLOWANCE AUDIT COVERAGE

Question: To what extent has MMS audited allowances claimed?

GAO Response

According to MMS officials, self-initiated audits of processing and transportation allowances have not been given high priority because RCD must first satisfy legislative and departmental requirements to perform other types of audits, which took 85 percent of RCD's time in fiscal year 1986. Table 3.1 illustrates RCD's staff hour workload distribution for self-initiated and directed audits.

Table 3.1: RCD Workload

Audit type	Fiscal year 1986 Hours	Fiscal year 1986 Percent	Fiscal year 1987 (through June 30) Hours	Fiscal year 1987 (through June 30) Percent
Self-initiated	27,215	15	35,463	24
Directed	154,460	85	113,352	76
Total	181,675	100	148,815	100

Some detailed audits of allowances have been conducted as part of MMS' other audits. For example, RCD was required to assess and collect royalties resulting from Interior IG audits of gas processing plants. Between 1983 and 1985, the IG performed detailed audits of 10 offshore gas processing plants and estimated underpayments of $6.2 million. In order to collect this amount, RCD must further document the underpayments and issue demand letters for payment.

ALLOWANCE AUDITS CONDUCTED

Question: How many allowance audits have been conducted? What was the total value of allowance findings as compared to total audit findings?

GAO Response

Allowance audit findings entered on the MMS Royalty Audit Tracking System during fiscal years 1985 and 1986 are shown in tables 3.2 and 3.3. During fiscal year 1985, RCD audits reported $2.7 million in improper processing allowance deductions and $0.9 million in improper transportation allowance deductions. In fiscal year 1986, these improper processing and transportation allowance deductions amounted to $3.4 million and $0.2 million, respectively.

Table 3.2: Number of MMS Audits with Findings Reported During Fiscal Years 1985 and 1986

	Fiscal year 1985	Fiscal year 1986
Total number of audits with any findings	234	227
Audits with processing allowance findings (% of total)	13 (6%)	15 (7%)
Audits with transportation allowance findings (% of total)	3 (1%)	5 (2%)

Note: Audits listed include only those reporting dollar findings. Data include RCD follow-up on IG audits.

Table 3.3: Amount of MMS Audit Findings Reported During Fiscal Years 1985 and 1986

	Fiscal year 1985	Fiscal year 1986
Total findings	$139,429,665	$74,392,886
Amount of processing allowance findings (% of total)	$2,681,375 (2%)	$3,379,681 (5%)
Amount of transportation allowance findings (% of total)	$911,367 (1%)	$228,977 (0%)

Note: Data include RCD follow-up on IG audits.

According to RCD officials, allowance findings are probably larger than the reported amounts. This is because the tracking system contains data on audit findings by major type of violation. However, sometimes audit findings are consolidated under the code for the violation with the largest dollar finding. Because allowance findings are generally not large, they are often reported under other violation codes. Consequently, transportation and processing allowance findings are probably understated. Also, RCD may have audited companies and not found excessive allowances claimed. Consequently, the number of audits that MMS' audit tracking system reports as having allowance findings may understate the total number of audits in which allowances were reviewed.

PERSONNEL

Question: How many RCD auditors are available to audit processing and transportation allowances?

GAO Response

According to a June 30, 1987, RCD organization chart, RCD has 211 available positions, 200 of which are filled. Of the 200 staff, 160 are auditors located in the three regional audit offices. Of these, 45 were hired within the past year. RCD auditors are not specifically assigned to particular types of audits, such as of transportation and processing allowances.

FUTURE AUDIT WORK PLAN

Question: What is the future work plan for auditing allowances?

GAO Response

During fiscal year 1987, RCD programmed 2.6 (2 percent) of 135 total staff years for audits specifically for allowance audits. Of this, 2.3 staff years were for gas plant audits, 0.1 staff year was for transportation allowance audits, and 0.2 staff year was for processing allowance audits. In addition, other audits may have included reviews of allowances.

The fiscal year 1988 work plan was not available. However, officials at all audit sites we visited foresee a movement towards performing more allowance audits. According to RCD officials, departmentally required Royalty Accounting System account reconciliations were essentially completed at the end of the IG follow-up work. These officials believe that more staff time will be available for discretionary work, including allowance audits.

SECTION 4

ALLOWANCE-RELATED INITIATIVES

Question: What does MMS intend to do regarding allowance controls?

GAO Response

In addition to an expected increase in audit coverage, MMS has several initiatives that will affect its control over allowances. MMS is in the process of finalizing product valuation regulations that will change allowance approval and reporting requirements. In addition, when the Auditing and Financial System conversion to new computer hardware is complete, MMS may implement some form of computerized monitoring.

Draft regulations published in the Federal Register on August 17, 1987, proposed changes to how allowances are calculated, approved, and reported. MMS will no longer require that companies seek prior approval for allowances. Instead, companies will be required to file a report with MMS indicating that they plan to claim allowances. The allowance report is a standardized form that outlines the allowance calculation, revenue and expense data, and contract prices or tariffs on which the allowances will be based. The allowance report must be filed within 3 months after an allowance is first deducted from the sales value when computing a royalty payment. MMS officials told us that they could review the allowance report to ensure compliance with regulations and accuracy of the allowance calculation.

Allowance deductions will be required to be reported as separate line items on Form MMS-2014 (Report of Sales and Royalty Remittance). MMS will monitor the allowance deductions to ensure that deductions are reasonable and allowable.

MMS' System Improvement Panel recommended, among other things, that MMS establish a data base to monitor allowances claimed. The panel is comprised of representatives from states, Indian tribes, and industry and was appointed by Interior's Royalty Management Advisory Council to review and comment on the proposed royalty management program changes. The panel may also recommend that RCD utilize the Auditing and Financial System to identify audit targets. Both of these recommendations, if implemented, could increase MMS' control over allowances.

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