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STATEMENT OF
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BEFORE THE
CHAIRMAN, SUBCOMMITTEE ON INTERIOR
OF THE
HOUSE COMMITTEE ON APPROPRIATIONS
ON
THE REPORT OF THE COMMISSION ON FISCAL ACCOUNTABILITY
OF THE NATION'S ENERGY RESOURCES



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Mr. Chairman and Members of the Subcommittee:

We are pleased to be here to discuss the report of the Commission on Fiscal Accountability of the Nation's Energy Resources. We have worked closely with the Commission. Their report is an important step in solving the longstanding problems plaguing oil and gas royalty accounting.

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

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persist today, with large sums going uncollected each year. Also, significant amounts of royalty income have not been collected when due, thus increasing the Government's interest costs.

COMMISSION RECOMMENDS CHANGES
IN ROYALTY MANAGEMENT

The Commission made a thorough examination of the royalty management problems and concluded that royalty accounting is in complete disarray. In its report issued on January 21, 1982, the Commission made over 60 recommendations to improve the royalty collection system and called for fundamental 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 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 royalty management from the Geological Survey and establish it as a separate entity under the Secretary of Interior.

Improvements needed in
internal controls

The Commission concluded that the existing royalty accounting system lacks the basic internal controls needed to assure that all oil and gas royalties are collected when due. The Commission found that the Interior Department has no systematic means of determining when production begins, and, therefore, is unable to ascertain if all royalty payments are received. In short, companies are on their honor to report and pay royalties.

The Commission made a series of recommendations aimed at establishing accounting control. A requirement for advance notice of production start-up; systematic reconciliation of production and sales information; development of secondary sources of information to verify reported production; and reconciliation of existing lease accounts. We fully support the Commission's recommendations in this area. It is of utmost importance that accounting control be established.

Improvements needed in site security

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

Strengthening sanctions for
lease violations

The Commission also concluded, as we have, that the lease inspection function is inadequate, with only minimal staff involved and no coordination with the accounting office. Lease inspections should be an integral part of the financial management controls and can help prevent oil thefts.

The Commission recommended an increase in the number of inspectors and the frequency of lease inspections and called for the reporting of inspection results to the royalty accounting office. We support the Commission and have ourselves called for such action. We have also recommended the development of a comprehensive inspection plan to guide this effort.

The Commission found that sanctions for lease violations are rarely imposed, minimal in nature, and, therefore, ineffective. We have not examined in any detail the issue of sanctions for violations of lease security. However, we would suggest that companies should have an incentive to comply with program requirements, and that the Government must enforce its authority. Lease cancellations have not been pursued in cases of repeated violations. The use of sanctions is a logical and practical means for achieving these aims.

Increased cooperation with the
States and Indian tribes

The Commission recommended that the Interior Department increase cooperation with the States and Indian tribes in the auditing and inspection of lease activities. We agree. 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.

The Commission proposed that the Secretary of Interior seek legislation establishing a self-sustaining fund which would reimburse the States and Indian tribes for the costs they incur in performing audits and lease inspections under cooperative or contractual agreements with the Federal Government. The costs incurred by the Government under these agreements would also be charged against the fund which would be financed by diverting one-half of one percent of royalties collected (onshore and offshore), after deduction of the windfall profits 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. Gains, however, should easily offset 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. But though

the Commission's proposal, provides for a sharing of the costs with the States and Indians, most of these costs will 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.

Removal of royalty management
from Geological Survey

Perhaps the most sweeping recommendation the Commission made was to remove the royalty management program from 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, the Secretary of Interior issued an order removing royalty management functions from the Geological Survey and establishing a Minerals Management Service in the Interior Department.

As we understand it, the responsibilities of the Minerals Management Service may eventually go beyond accounting and collecting of oil and gas royalties, and may address the entire mineral management area. We have previously recommended that Interior evaluate the need to consolidate mineral management responsibilities. Establishment of the Minerals Management Service is consistent with this recommendation.

This concludes my statement. I will be happy to respond to any questions you or other members of the Committee may have.