

GAO

Report to the Chairman, Subcommittee on
Mining and Natural Resources, Committee
on Interior and Insular Affairs, House of
Representatives

November 1987

MINERAL REVENUES

Corps of Engineers Management of Mineral Leases



**Resources, Community, and
Economic Development Division**

B-229154

November 24, 1987

**The Honorable Nick J. Rahall, II
Chairman, Subcommittee on Mining
and Natural Resources
Committee on Interior and Insular Affairs
House of Representatives**

Dear Mr. Chairman:

In response to your March 26, 1987, request, we examined the administration of private mineral leases (hereafter referred to as mineral leases) acquired by the Ohio River Division (ORD) of the U.S. Army Corps of Engineers. Over the past 50 years, ORD has been buying land for its water resource projects, sometimes acquiring mineral rights. When such mineral rights had already been leased, ORD became the lessor, receiving rent and royalty payments under the terms of the existing leases and sharing the revenue from the leases with the states, which receive 75 percent. Until such leases were extinguished, either through expiration or negotiated settlement with lessees, ORD administered the leases. However, April 1985 Corps guidance directed that responsibility for lease administration be turned over to the Department of the Interior's Bureau of Land Management (BLM).

Your Subcommittee conducted hearings on Corps administration of mineral leases on April 9, 1987. At the hearings, the Corps agreed to determine whether the federal government owed any revenue from these mineral leases to the states, and the Corps and BLM agreed to report to you in June 1987. Based on your request letter and subsequent discussions with your staff, we addressed three questions:

- By not immediately turning over administration of mineral leases to BLM, did ORD or any other Corps division violate federal law?
- Did ORD monitor mineral leases for compliance with their terms and collect all rents and royalties due the federal government?
- Did the Corps distribute to the states their statutory shares of mineral revenues from ORD mineral leases?

Because ORD's Huntington District was administering all but 12 of the approximately 300 leases in ORD, we concentrated our efforts on that district. In summary, we found that:

- The Corps did not violate any federal law by administering mineral leases, because no laws exist that specify which agency should administer such leases. However, ORD did not comply in a timely manner with an April 1985 Corps regulation¹ that directed divisions to transfer mineral leases to BLM. In addition, at the time of our review, the Corps' Southwestern Division was administering a total of seven mineral leases.
- ORD's Huntington District generally followed Corps regulations requiring annual compliance inspections for leases, but according to Corps officials, these inspections were intended to emphasize environmental concerns and not whether lease payments were accurate. By using records maintained in lease files, however, inspectors were able to determine whether lease payments were made and the accuracy of some payments.
- The Corps had not fully shared with the states revenues from ORD leases, although it did make some payments to the states. However, on July 8, 1987, after ORD computed the amounts owed the states from mineral lease revenues in fiscal years 1979 through 1986, the states were paid their 75-percent shares.

Corps Administration of Acquired Leases

The Corps did not violate any laws by administering mineral leases, but ORD did not implement Corps regulations for transferring mineral lease administration to BLM in a timely manner. According to a Corps survey of its 10 divisions that acquire land, only ORD and the Southwestern Division administered any mineral leases.

Legality of Administering Mineral Leases

The Principal Deputy Assistant Secretary of the Army for Civil Works testified at the April 9, 1987, hearing that Corps administration of mineral leases was not a matter of law, but of Corps policy. A May 1987 opinion by the Corps chief counsel provided clarification. The opinion stated that neither the Mineral Leasing Act of 1920, as amended, (30 USC 181), which pertains to leasing on public domain lands, nor the Mineral Leasing Act for Acquired Lands, as amended, (30 USC 352), under which, in general, acquired lands are leased under the same terms and conditions as contained in the 1920 act, specify who is responsible for administering mineral leases.

We agree with the Corps. No law prohibits the Corps from administering mineral leases on lands acquired for its water projects.

¹The Corps uses the term "regulation" for its procedural guidance. As such, this regulation does not have the force and effect of law. Therefore, although ORD did not implement this regulation, this is not a violation of law or statutory regulation, but instead is a question of Corps management.

Number of Leases Administered by Corps

In a March 19, 1987, letter, Corps headquarters requested each of its 10 divisions that acquire land to report the number of mineral leases being administered. Only ORD and the Southwestern Division reported that they were administering mineral leases. ORD's Huntington District records indicated that the district was administering about 300 mineral leases. These leases had been acquired by the Corps between 1937 and 1987. Two other districts in ORD were administering a total of 12 mineral leases. The Corps' Southwestern Division reported that three of its districts were administering a total of seven mineral leases.

Corps Policy on Administering Leases

Prior to April 1985, the Corps had no specific policy stating whether it or BLM should administer mineral leases. Corps headquarters officials told us that they believed that the general practice was to transfer mineral leases to BLM when they were acquired.

The Corps adopted a policy for the administration of mineral leases in April 1985 by issuing Engineer Regulation 405-1-12. The regulation established a procedure for transferring responsibility for administering mineral leases to BLM and responsibility for collecting rent and royalty payments to Interior's Minerals Management Service (MMS). According to the chief of the Corps' Management and Disposal Division, the policy was intended to formalize what was already general practice. However, because Corps officials believed that this general practice was already fully taking place, the Corps did not aggressively verify that its new regulation was implemented. Also, according to the chief, at the time the new regulation took effect, Corps headquarters officials were not aware that ORD was administering about 300 mineral leases.

ORD's Huntington District did not promptly implement the April 1985 regulation because, according to the chief of the Huntington District Real Estate Division, his office had a heavy workload and was awaiting BLM issuance of instructions to the Corps on transferring the mineral leases. The Huntington District's administration of mineral leases was discussed at a February 4, 1987, meeting attended by ORD, BLM, and MMS officials. At that meeting, all parties agreed that mineral leases acquired by the Corps would be transferred to BLM "as expeditiously as possible," and that MMS would assume responsibility for collecting rent and royalty payments. On June 1, 1987, the transfer of Huntington District lease administration to BLM was essentially completed. MMS notified lessees that they should remit rent and royalty payments to MMS after August 31, 1987, for some leases and September 30, 1987, for others. One of the other two ORD districts and all three Southwestern Division districts

transferred all mineral leases to BLM by August 1987. One ORD district completed the transfer of its leases in October 1987.

ORD Procedures to Monitor Acquired Leases for Compliance and to Ensure Accuracy and Collection of Lease Payments

Annual compliance inspections of leases at Corps projects are required by Corps regulations. According to Corps officials, these inspections are principally to determine if the environment has been harmed. Inspectors may also review Corps records to determine whether royalties and rents have been paid. By reviewing lease files, inspectors could determine whether lease payments were made, but could not verify the accuracy of all payments. The accuracy of payments on leases with fixed payments was verified, but inspectors were unable to verify payments for leases receiving production-based royalties.

Our review of the Huntington compliance inspection log showed that the district inspected 111 of the 114 leases requiring inspection at least once during the period January 1986 through May 1987. For the leases we reviewed, we noted that comments on rent and royalty payments were sometimes made on the inspection reports as general observations.

ORD's Huntington District was administering various types of leases that specified differing payment methods. The leases included some requiring (1) fixed rents because they had no producing wells, (2) fixed rents for gas storage, (3) fixed royalty payments for producing wells, and (4) royalty payments based on production. About two-thirds of the revenue-producing leases required fixed payments, and about one-third required production-based royalty payments.

In our review of individual lease files maintained by the Huntington District, we found that the files contained rent and royalty collection records. This information enabled inspectors to verify the accuracy of payments on leases specifying fixed payments. The district generally did not obtain production data for leases, so inspectors were not able to verify the accuracy of payments for leases receiving production-based royalties, although they could determine that royalty payments had been made.

The Huntington District Real Estate Division Chief told us that he did not believe any further verification efforts were necessary. He told us that, given the small amount of royalties involved, additional verification of lease payments would not be an efficient use of Corps resources.

ORD Distribution of State Shares of Lease Revenues

Through its detailed review of collection records, ORD determined that from fiscal years 1979 through 1986, it had collected a total of \$803,882 in rents and royalties from mineral leases. However, these receipts had been treated in such a way that the four states involved (West Virginia, Kentucky, Ohio, and Pennsylvania) received shares only from rent revenue—a total of \$73,534. In July 1987 an additional \$529,376 from royalties collected from ORD leases during those same years was distributed to the states.

Payments to States From ORD Leases

The ORD Finance and Accounting Officer told us that before 1980, because of inconsistencies in accounting practices among ORD districts, some rent and royalty revenue had been deposited to an account, 75 percent of which was distributed to states according to the law, while some was deposited to another account and not distributed. He told us that, to ensure consistent accounting treatment of lease revenues, ORD made a 1980 accounting decision to deposit all rent revenue to one account and all royalty revenue to a different account. However, although the rent revenue account was distributed, the royalty revenue account was not distributed.

In May 1987 the Corps' chief counsel concluded that the law is ambiguous about distribution of royalties collected on mineral leases. In our opinion, the law requires that royalty as well as rent revenue be shared with the states. However, the issue is moot because the Corps established a policy to share all revenues from mineral leases.

To determine the states' shares of all revenue collected from fiscal years 1979—the earliest year for which detailed collection records were available—through 1986, ORD first had to determine the amount of rents and royalties collected from the mineral leases it administered. ORD's Finance and Accounting Center staff reviewed collection records prepared from October 1, 1978, through September 30, 1986; determined whether the records involved mineral lease rent or royalty payments; and classified payments according to projects. Collection amounts were checked against available summary records for accuracy. The result of this review was a summary, by account, of receipts at each project. Table 1 provides a summary, by fiscal year, of the total mineral lease collections in each of the four affected states.

Table 1: ORD Mineral Lease Collections

Fiscal year	Kentucky	Ohio	Pennsylvania	West Virginia	Total
1979	\$14,597	\$18,287	\$3,461	\$7,731	\$44,076
1980	26,880	22,185	3,395	8,071	60,531
1981	28,319	21,706	3,075	11,683	64,783
1982	30,833	7,981	3,146	27,348	69,308
1983	18,623	6,032	3,818	62,791	91,264
1984	22,879	4,671	6,450	89,628	123,628
1985	28,108	3,984	6,013	143,868	181,973
1986	20,147	2,838	5,787	139,547	168,319
Total	\$190,386	\$87,684	\$35,145	\$490,667	\$803,882

In accordance with the Corps chief counsel's decision on royalty payment distribution, payment was made to the states in July 1987 for 75 percent of the mineral lease revenue collected from Huntington District leases from fiscal years 1979 through 1986, less \$73,534 in rent revenue that had previously been distributed. Table 2 shows the July 1987 payments to the states.

Table 2: Payments to States for Previously Undistributed ORD Mineral Lease Collections

State	Payment
Kentucky	\$119,487
Ohio	65,196
Pennsylvania	21,307
West Virginia	323,386
Total	\$529,376

Pre-1979 Revenue and Interest Not Included in Payments to States

Officials in the four affected states in the Huntington District told us they had no way to judge the reasonableness of the amounts paid to their states. All acknowledged that their states had received the July 1987 payments. However, the chief clerk of the West Virginia state auditor's office expressed concern that payments did not include any amounts for collections prior to fiscal year 1979, nor did they include interest.

The ORD Finance and Accounting Officer told us that ORD could not document the proper amounts collected from mineral lease payments before fiscal year 1979 because the individual collection records had been destroyed. He explained that the records are generally placed in General

Services Administration storage and, in accordance with Army regulations, destroyed after 6 years and 3 months. He said that original records for fiscal years 1979 and 1980 should have also been destroyed, but were available because they had been inadvertently retained by the ORD Finance and Accounting Center.

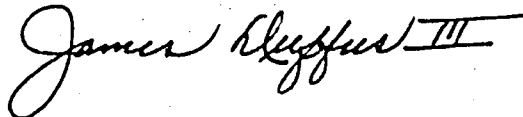
The ORD finance officer also told us that the payments to the states did not include interest because no authority exists for such payment. We agree because, generally, the federal government is not liable for interest on payments due other parties unless interest is expressly authorized by the pertinent statute or contract. The law covering distribution of revenue from the Corps' mineral leases does not specify that interest must be paid.

We conducted our review from April through August 1987. Our work was performed in accordance with generally accepted government auditing standards. Appendix I presents the objective, scope, and methodology used in the preparation of this report. As requested by your office, we did not obtain official agency comments on a draft of this report. However, we discussed the contents of this report with Corps officials, and they generally agreed with the facts presented.

As agreed, unless you publicly announce the contents of the report earlier, we plan no further distribution of this report until 30 days from the date of this letter. At that time, we will send copies to interested parties and make copies available to others on request.

If you have further questions, please contact me at (202) 275-7756. Major contributors to this report are listed in appendix II.

Sincerely yours,



James Duffus III
Associate Director

Objective, Scope, and Methodology

Our overall objective in this review was to provide information on the Corps' administration of mineral leases. To obtain a general understanding of the issues involved in Corps administration of mineral leases and the transfer of leases to BLM, we interviewed Corps officials at its headquarters and at ORD and its Huntington District. Because ORD's Huntington District was administering all but 12 of the approximately 300 leases in ORD, we concentrated our efforts on that district.

We contacted officials in BLM's Eastern States Office, headquarters, and Milwaukee, Wisconsin, District Office, and we also contacted MMS. We reviewed Corps and BLM reports that were submitted to the Subcommittee in June 1987, as well as other Corps documents.

To determine whether ORD violated any laws by administering mineral leases, we examined Corps regulations dealing with mineral leases, reviewed the Corps general counsel's May 1987 opinion on the legality of administering mineral leases, and researched pertinent laws and legislative history. To determine whether Corps administration of mineral leases was widespread, we obtained copies of and reviewed each response to the Corps' direction that each of its divisions that acquire land report on any mineral leases they were administering.

To determine what ORD did to monitor mineral leases and determine payment accuracy, we examined Corps guidance and interviewed ORD and Huntington District officials for clarification. We reviewed the Huntington District compliance inspection log for calendar year 1986 and for January through May 1987 to ascertain whether inspections were made. We examined selected lease files to see if compliance inspection reports indicated whether any payment verification had been made, and we interviewed Huntington District officials to determine more precisely the nature of compliance inspections and the extent to which payments were verified.

To verify the amounts ORD collected for rents and royalties, we discussed with ORD Finance and Accounting officials the process they used to develop that information and reviewed their workpapers. We obtained documentation of payments to the states for 75 percent of previously undistributed mineral lease revenue from fiscal years 1979 through 1986. We contacted officials of the four affected states in the Huntington District to verify that they had received the payments and to obtain their opinions on the adequacy of the amounts they received.

Major Contributors to This Report

**Resources,
Community, and
Economic
Development Division,
Washington, D.C.**

**James Duffus III, Associate Director, (202) 275-7756
Robert W. Wilson, Group Director
Leonard W. Ellis, Assignment Manager**

**Cincinnati Regional
Office**

**Daniel V. Loesch, Regional Management Representative
George J. Buerger, Evaluator-in-Charge
Jennifer C. Jones, Evaluator
John M. Ficociello, Writer-Editor**

**Office of the General
Counsel**

John McGrail, Attorney

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