

Report of Royalty Management and Delinquent Account Collection Activities Fiscal Year 1996

Royalty Management Program



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United States Department of the Interior

OFFICE OF THE SECRETARY
WASHINGTON, D.C. 20240

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Honorable Albert Gore, Jr.
President of the Senate
Washington, D.C. 20510

Dear Mr. President:

The enclosed annual report addresses royalty management and delinquent account collection activities for Federal and Indian mineral leases. The report is submitted under the provisions of section 302 of the Federal Oil and Gas Royalty Management Act of 1982 and section 602 of the Outer Continental Shelf Lands Act Amendments of 1978.

Sincerely,

Bob Armstrong
Assistant Secretary, Land and
Minerals Management

Enclosure

Report of Royalty Management and Delinquent Account Collection Activities Fiscal Year 1996

Royalty Management Program

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Please visit our Internet site at <http://www.mms.gov> for an on-line copy of this report, quarterly collection updates by commodity and state, and other mineral publications.

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**Fiscal Year 1996 Report of Royalty Management and Delinquent
Account Collection Activities**

INTRODUCTION

This report consolidates two separate reports previously submitted to members of Congress under section 302 of the Federal Oil and Gas Royalty Management Act of 1982 (FOGRMA) and section 602 of the Outer Continental Shelf Lands Act (OCSLA) Amendments of 1978.

Section 302 of FOGRMA requires the Secretary of the Interior to submit an annual report to Congress addressing efforts to implement the provisions of the Act for mineral leases on Federal and Indian lands. The Secretary, in consultation with the Senate Committee on Energy and Natural Resources and the House Committee on Natural Resources, determined that the Minerals Management Service (MMS) Royalty Management Program (RMP) would prepare an annual report addressing the following subjects:

- RMP accomplishments;
- Mineral revenue collections, escrow release, and disbursements;
- Auditing activities;
- Inspection and enforcement activities;
- RMP organization, functions, and structure; and
- Status of recommendations submitted by the Commission on Fiscal Accountability of the Nation's Energy Resources (the Linowes Commission).

Section 602 of the OCSLA Amendments of 1978 requires a similar report addressing delinquent royalty account collection efforts and new auditing and accounting procedures designed to ensure accurate and timely payment of royalties and net profit shares. The report addresses activities during the preceding 2 fiscal years for leases issued under any Act that regulates the development of oil and gas on Federal lands.

Consolidation of the FOGRMA and OCSLA reports eliminates redundancy in RMP accomplishment and audit narratives, provides a more concise document for review by members of Congress, and reduces preparation and printing costs.

I. ROYALTY MANAGEMENT PROGRAM ACCOMPLISHMENTS

The Department of the Interior and MMS continued efforts in Fiscal Year (FY) 1996 to improve accountability for the nation's mineral revenues and to improve service to the States, the Indian community, and industry. This report highlights significant program accomplishments and initiatives implemented during the year.

A. Federal Oil and Gas Royalty Simplification and Fairness Act

President Clinton signed the Federal Oil and Gas Royalty Simplification and Fairness Act (RSFA) on August 13, 1996, to improve the management of revenues from Outer Continental Shelf and Federal onshore mineral leases. This is the first major legislation affecting royalty management since FOGRMA was passed in January 1983. The new legislation provides:

- Definitions for enforcement actions;
- A 7-year statute of limitations for all royalty collections with limitations on industry liability, and a 33-month limit on all administrative appeals;
- Payment of interest on overpayments;
- Cost effective audit and collection activities;
- Repeal of outdated offshore refund requirements;
- Administrative relief to encourage continued oil and gas production from marginal properties; and
- The framework for additional delegations of royalty functions to States, subject to Secretarial discretion.

The MMS has identified several critical events that will be required to implement the provisions of RSFA. Completion of the events will be a complex process that may take up to 3 years.

The MMS has requested active participation from States and industry to provide information, opinions, and ideas to facilitate the implementation of RSFA. The MMS has conducted numerous outreach programs and workshops with constituents. Continued coordination will be important as the MMS pursues the following initiatives:

- Development of an aggressive schedule to draft and publish new regulations or revisions to current regulations affecting the royalty program;
- The design and execution of complex modifications to MMS automated systems and operational processes; and

- Revisions to reporting procedures and attendant payor guidance.

B. RMP Reengineering Project

The RMP undertook a compliance reengineering initiative in April 1996 to examine the current compliance strategy to determine the best approach for accomplishing future goals and objectives. The principal objective was to define and implement a cost-effective strategy to ensure that Federal and Indian mineral lease revenues are paid to MMS in an accurate, timely manner.

Enactment of RSFA in August 1996 materially changed many historic RMP operating assumptions as well as some fundamental Federal oil and gas financial activities. Although immediate changes in processes and systems must be made to implement the law, it is apparent that longer-term strategies, business processes, and aging systems must be addressed for RMP to be cost-effective and responsive to customer requirements.

The MMS announced on April 1, 1997, that the effort would expand beyond compliance reengineering to a comprehensive reengineering of all RMP core business processes. A Program Reengineering Office was established in RMP to manage and coordinate the initiative. The MMS assembled a group of senior RMP managers with diverse skills and disciplines to administer the project.

The initial redesign work, including prototype development and testing, will be accomplished through a multi-disciplinary team of MMS, State, and Tribal representatives, with technical contract assistance. Consultations with customers are expected to better define future business approaches and processes, and to encourage participation in prototype development, testing, and implementation.

The principal objective of the expanded initiative is to design, develop, and implement new core business processes, with supporting systems, for the 21st century. The systems and processes must be flexible and capable of meeting customer needs, including:

- Supporting the collection of royalties both in cash and in kind;
- Supporting delegated activities related to royalty administration;
- Empowering RMP to provide related financial services for other customers through franchising agreements; and
- Employing the use of a variety of methodologies to value production.

The initiative will include:

- Mapping core business processes as they now exist;
- Benchmarking with other organizations to determine optimal practices;
- Identifying customer needs and expectations;
- Redesigning business practices for improvement;
- Development and testing of new prototype designs; and
- Implementing redesigned processes.

The RMP will be guided by the following stretch goals in the development of new business practices:

- Provide revenue recipients with access to their funds within 24 hours of the due date; and
- Assure compliance with applicable laws, lease terms, and regulations for all leases in the shortest possible time, but no later than 3 years from the due date.

The RMP will pursue proactive communication to build consensus, obtain feedback and suggestions, and demonstrate progress in achieving goals. The strategy will be directed towards employees, companies, and organizations with a vested interest in the royalty management process. Communication will be fostered through electronic media such as the Internet, the Intranet, and E-mail bulletin boards, and through meetings with employees, the State and Tribal Royalty Audit Committee, Indian Tribes and allottees, royalty payors, and industry trade associations. The MMS is committed to cost reduction and improved service in the royalty program.

C. Royalty Policy Committee

The RMP established a 29-member Royalty Policy Committee (RPC) in FY 1995 as part of the Minerals Management Advisory Board to provide recommendations and guidance on royalty management policies and procedures. The RPC is composed of representatives from the Western Governors Association, Western States Land Commissioners Association, States, Indian Tribes and allottee organizations, the minerals industry, other Federal agencies, and interested members of the general public. The RPC designated eight subcommittees to study the following issues:

- Royalty reporting and production accounting;
- Valuation;

- Audit;
- Appeals, settlements, and alternative dispute resolution;
- Non-conventional alternatives;
- Disbursements and net receipts sharing;
- Coal; and
- Phosphate, trona, and other leasable solid minerals.

The eight subcommittees have presented either final or interim reports. The reports contain recommendations addressing major policy issues or ways to improve existing RMP operating procedures. The MMS is committed to implementing as many of these recommendations as feasible. The MMS is further evaluating the recommendations in the context of RSFA requirements.

D. Automated Systems Initiatives

Technology will continue to play a prominent role in the RMP mission. A brief description of some of the systems initiatives expected to contribute to improved service follow.

1. Electronic Commerce

The MMS continued its key role with industry and organizations such as the American Petroleum Institute (API) and the American National Standards Institute (ANSI) to develop national standards for the exchange of petroleum information. Over a period of several years, RMP employees worked on various committees with their peers in industry to develop a comprehensive set of Electronic Data Interchange (EDI) standards that were approved by ANSI.

Pilot projects with Amoco, Chevron, and other companies to test data formats, software, and telecommunications were successfully completed. Additional procedures have been developed and tested for electronic transmission of production and billing information. Some reporters do not have the systems capability or the reporting volume to economically implement EDI. The RMP developed other options to allow these reporters to submit data on preformatted diskettes or through electronic mail.

All of the technology to facilitate the electronic exchange of data is in place and has been fully tested. The RMP can electronically send or receive the following materials:

- Regulatory reports for royalty sales and production data; and

- Fund transfers for royalties, rents, bonus payments, and assessments.

Electronic commerce eliminates labor-intensive paper reporting as information flows between company systems and RMP computers with little or no human intervention. This reduces costs and improves the quality and timeliness of regulatory reporting. Approximately 72 percent of royalty report lines and 50 percent of required production report lines are now received through electronic commerce. Error rates and the attendant costs of analysis and error correction have declined. Error rates average about 6 percent for paper reports and only 1 percent for electronic submissions. Document turnaround and the ability to expedite communications is materially enhanced.

The technical infrastructure is in place in RMP to accommodate full implementation of electronic commerce. The RMP staff provides orientation, training, and technical support to interested companies. Comprehensive guides and handbooks are available to assist with reporting options, implementation, and points of contact within RMP for additional assistance.

2. Computer Output Laser Disk Technology

Computer Output Laser Disk (COLD) technology and its companion imaging and workflow technologies have been introduced into the RMP work environment to improve access to information, reduce paperwork, and enhance individual productivity. Under the former system, information from paper documents was entered into a mainframe computer which generated tapes that were then converted to microfiche by a private offsite contractor. After 2 or 3 days, the microfiche was returned to RMP where it was stored or mailed to Tribes, States, and Federal agencies.

Many reports generated by the mainframe computer are now automatically transferred to COLD where they are immediately accessible by employees through personal computers at their individual workstations. Data is available in minutes rather than days or weeks. The information may then be printed, routed, or stored in an electronic file folder.

Approximately 450 mainframe reports, or 40 percent of all reports, are available through COLD to more than 500 employees and customers at remote locations. Annual savings in microfiche processing costs total \$130,000. Additional efficiencies have been achieved by reduction in file room contractor personnel and quicker access to RMP source documents.

3. Network Infrastructure

A 2-year effort to upgrade the RMP wide-area network, known as the State and Tribal Royalty Audit Committee Network (STRACNET), was successfully completed in November 1996. On-line access is now provided to 16 State and Tribal sites that have cooperative audit agreements with RMP under sections 202 and 205 of FOGRMA. The RMP further provided laptop computers to representatives with the State of Louisiana to access RMP systems. Louisiana also maintains a cooperative audit agreement with RMP under section 205 of FOGRMA.

Each remote site and laptop user was provided equipment, installation support, and extensive training on RMP systems and applications. The enhancements improve data access and system responsiveness, and facilitate the rapid exchange and routing of information among States, Tribes, RMP staff, and others. The sites and laptop users can now access cc:Mail, MMS bulletin boards, the Intranet, the Internet, and Windows-based client/server applications. The 16 State and Tribal sites can further print system reports and obtain problem diagnosis and software installations from systems staff in Lakewood, Colorado.

Employees with RMP will visit each of the 16 State and Tribal sites in FY 1997 to install Windows 95 software, review network operations, and provide additional training. Visits are also planned with laptop users. Each individual workstation will soon become the primary access point for information exchange and services.

The RMP extended its network and online services to all 12 of its permanent audit residency sites by May 1997. These audit residencies are located in cities where many of the top royalty payors maintain accounting centers. Access to all network services was also provided to all mobile auditors through laptop computers and dialup connections.

4. RMP Query System

The RMP Query System (RQS) provides online access to historical royalty and reference data through a client/server environment. The RQS is available to RMP staff and to State and Tribal sites through STRACNET. Employees may access up to 6 years of royalty data and all lease information resident on RMP databases.

The RQS allows employees to display royalty and reference data trends with tables and graphs. The application features a set of standard queries and reports. Employees may also develop their own custom queries and transfer data to spreadsheets or databases for further analysis. The RQS is a powerful, user-friendly tool that enhances an employee's ability to access and interact with RMP data.

5. Automated Clearing House Payments

The MMS incorporated Automated Clearing House (ACH) improvements with the Mellon Bank of Pittsburgh and implemented a new ACH process with the PNC Bank of Pittsburgh. Both ACH processes are designed to handle all types of payments, including royalties, rents, bonuses, and assessments. The ACH processes accommodate large volumes of small-dollar transactions and are intended to reduce check-writing expenses and to confirm payment receipt electronically for both payors and MMS.

6. Production Accounting and Auditing System

The Production Accounting and Auditing System (PAAS) collected and processed monthly production data from the following leases in FY 1996:

- All Federal and Indian oil and gas leases;
- All Federal solid mineral leases; and
- Most Indian solid mineral leases.

Development of the Automated Front-End Enhancement (AFEE) continued in FY 1996. The AFEE will reduce the manual Auditing and Financial System (AFS)/PAAS exceptions identification effort, permitting employees to process more exceptions and to devote more time to correspondence followup with operators and payors. The exceptions involve discrepancies between sales volumes that payors report to AFS and production volumes that lease and agreement operators report to PAAS.

The AFEE will detect discrepancies and generate correspondence to operators. The correspondence will ask operators to verify production reports and to allocate production volumes to respective payors. The RMP will use the information to identify payors who may be under-reporting royalties. The AFEE will materially reduce the time required to manually research discrepancies and prepare correspondence.

The PAAS processed 4.5 million lines of data submitted by 2,700 operators in FY 1996. The lines represented production and disposition data on 22,890 onshore and 2,863 offshore leases and agreements, involving 87,048 onshore and 18,137 offshore wells. Error rates for operators reporting oil, gas, and solid mineral lease and agreement production were 2.8 percent in FY 1995 and 2.9 percent in FY 1996.

7. MMS Internet Home Page

The MMS established an Internet site on the World Wide Web (<http://www.mms.gov>) to provide current information to the public addressing MMS activities. The MMS home page is expanding to include press releases, statistical information, environmental studies information, oil and gas resource information, Federal Register notices, statutes and regulations governing MMS activities, policy documents, and appeals decisions. There are separate home page locations for RMP, the Offshore Program, and Offshore Regional Offices.

E. Improved Services to Indian Tribes and Allottees

The Department continues to emphasize its trust responsibilities with the Indian community. The RMP increased efforts in FY 1996 to improve communications and the delivery of mineral services to Indian Tribes and allottees.

1. Indian Minerals Steering Committee

The former Bureau of Indian Affairs (BIA)/Bureau of Land Management (BLM)/MMS Tripartite Steering Committee was reorganized in early 1994 into the Indian Minerals Steering Committee (IMSC) to provide the Department with a senior policy group to improve the management of Indian minerals. While the former Tripartite Steering Committee addressed both Federal and Indian mineral leasing, the IMSC concentrates efforts on Indian minerals management. The IMSC met four times in FY 1996, including a meeting in an area with a large concentration of Indian mineral owners to facilitate interaction with the Indian community. The IMSC addressed a variety of issues, including the following initiatives:

- The IMSC took action to institutionalize its outreach and educational programs within the three bureaus. The programs familiarize Indian mineral owners with the royalty and lease administration process.
- The IMSC is sponsoring an effort, led by MMS, to make explanation of royalty payment reports easier to use. The reports are submitted to individual Indian mineral owners.
- The IMSC began a pilot program to provide representatives from the three bureaus at a single location in Farmington, New Mexico, to offer assistance and resolve problems for Indian Tribes and allottees in the area. The proposal has evolved from a National Performance Review Reinvention Laboratory to test new techniques to manage Indian allottee minerals and to improve services and Departmental cooperation.

- The IMSC initiated new bureau efforts to improve the management of Indian solid minerals.
- The IMSC convened a round table discussion of Indian minerals management issues with representatives of mineral-producing Tribes and allottees. The IMSC subsequently pursued action items identified in the discussion.

2. RMP Office of Indian Royalty Assistance

The RMP created the Office of Indian Royalty Assistance (OIRA) in FY 1992 to foster coordination and communication with the Indian community. The OIRA is involved in policy and regulatory development, development of Indian initiatives, and involvement in settlements and litigation. Customer service is provided through offices located in Lakewood, Colorado; Farmington, New Mexico; and Oklahoma City, Oklahoma.

The OIRA continued participation in an educational project chartered by the IMSC in FY 1996. Indian mineral owner concerns are often based on misunderstandings and misinformation about the work performed by the Federal Government. The BIA, BLM, and MMS formed a training cadre to develop materials to better educate mineral owners. Three training modules were developed:

- Management of Indian leases;
- Management of lease operations and production; and
- Collection and payment of Indian royalties.

The OIRA conducted training sessions for representatives from each of the three bureaus in FY 1996. The training provided program knowledge and skills to enable the representatives to present the modules to the Indian community.

The RMP announced the inaugural Royalty Internship Program in FY 1996. The program is designed to assist minerals-producing Tribes who are considering self-governance or self-determination contracts, or Tribes who want to become more familiar with royalty management. Candidates must be permanent Tribal employees who can devote 50-100 percent of their time in the program for at least 6 months and who will remain Tribal employees after completion of their internship. The RMP will provide training in royalty accounting, report processing, exception resolution, audit, and valuation. The program will consist primarily of work assignments in one or more of the RMP operating Divisions. Three Tribes have expressed formal interest in the program and four other Tribes have requested additional information. The RMP will provide \$440,000 to fund the program in FY 1997.

The OIRA has a lead role in RMP implementation of the Tribal Self-Governance Act of 1994. The OIRA hosted informal meetings with Tribes in FY 1996 to discuss their interest in assuming RMP functions. The OIRA further assisted the Department negotiated rulemaking committee that will propose self-governance implementation regulations.

3. Indian Nonstandard Lease/Agreement Accounting

The MMS Director initiated accounting responsibility for Indian nonstandard leases and agreements in March 1988 in response to a systems improvement recommendation from the Royalty Management Advisory Committee. Nonstandard leases and agreements, issued under the Indian Mineral Development Act of 1982 (IMDA), include net profit share, joint venture, and any other arrangements negotiated by the Tribes that have a different structure from the standard bonus, rental, and royalty rate arrangement.

The nonstandard provisions of IMDA leases and agreements make it impractical to include them in AFS at this time. Personnel in the RMP Accounting and Reports Division use a microcomputer-based system to analyze and account for the unique accounting transactions negotiated by the Tribes. To ensure accurate reporting, employees in the RMP Compliance Verification Division manually sample nonstandard IMDA leases and agreements to compare oil and gas sales volumes reported to AFS by payors with production reported to PAAS by lease operators. The RMP continues to explore methods to convert nonstandard lease accounting from the current microcomputer-based system to AFS.

F. Valuation Determinations and Guidance

Employees with the RMP Royalty Valuation Division (RVD) continued to issue valuation determinations and to provide valuation guidance for fluid and solid minerals to Federal, State, Indian, and industry representatives in FY 1996.

1. Valuation Determinations

Personnel with RVD reviewed and approved 190 transportation and processing allowance requests in FY 1996. The employees further completed 285 formal valuation determinations, including technical opinions and assistance on compliance issues. Some of the more significant valuation issues addressed by the employees during the year include:

- Rescission of prior RMP approval to waive reporting requirements for non-arm's-length transportation factors;

- Valuation of diamondoids, a hydrocarbon found predominantly in Mobile Bay and the Norphlet formation off the coast of Alabama;
- Valuation of transportation and carbon dioxide removal costs for coalbed methane in the San Juan Basin, New Mexico, and southern Colorado;
- Quality bank valuation issues involving whether to include sulfur and gravity adjustments in determining royalty value;
- Valuation of native gas that is part of a gas storage unit;
- Determination of an extraordinary cost allowance for the Lost Cabin Gas Plant in Wyoming;
- Dual accounting requirements for gas sold under percentage-of-proceeds contracts; and
- The role of posted prices and affiliate sales in crude oil valuation.

2. Federal Gas Valuation Negotiated Rulemaking Committee

Informal discussions addressing gas valuation were initiated in December 1993, at the request of MMS constituents. The Secretary subsequently chartered the Federal Gas Valuation Negotiated Rulemaking Committee (Federal Committee) on June 27, 1994, to review policies and procedure used to value natural gas. The Federal Committee included representatives from MMS, States, major oil and gas companies, large and small independent producers, and marketing firms. Decisions and recommendations were reached by consensus, requiring the support of each member for approval. The Federal Committee operated under the Federal Advisory Committee Act, but generally followed the guidelines of the Negotiated Rulemaking Act. Meetings were held in a public forum, a record of each meeting was prepared, and a final report addressing Federal Committee recommendations was made available to the public.

The Federal Committee completed negotiations in February 1995 for payment of natural gas royalties produced from Federal leases. The negotiations focused on improving gas valuation under the following circumstances:

- Gas sold to affiliates;
- Gas produced from unitized and communitized leases; and
- Gas sold away from the wellhead under the new marketing environment created by Federal Energy Regulatory Commission (FERC) Order 636.

The MMS published a proposed rule in the Federal Register on November 6, 1995, containing the consensus recommendations from the Federal Committee to improve and simplify the payment of royalties and to reduce administrative costs for both the Federal Government and industry.

The comment period for the proposed rule ended February 5, 1996. Following review of the comments, MMS reconvened the Federal Committee on June 12-14, 1996, in Denver, Colorado, to evaluate five options for proceeding with further rulemaking. The MMS also reopened the public comment period to consider the options.

Federal Committee members evaluated the five options and developed five additional options for consideration. The Federal Committee reached agreement on several issues; however, a few major issues remain unresolved, including the comparison of index prices to gross proceeds and applying index prices to the wellhead volume of gas. The extended comment period closed August 19, 1996.

In February 1997, MMS completed a cost benefit analysis of the following three gas valuation options:

- Continued use of gross proceeds;
- Adoption of the Federal Committee consensus; or
- Development of an index factor.

The index factor would be a percentage computed on the difference between the average index price and the average gross proceeds received by index payors, including affiliate resales. The index factor would be computed after a deduction for transportation allowances in each index zone. The index factor could subsequently be either positive or negative due to the transportation deduction.

The results of the cost benefit analysis indicated that the Federal Committee consensus option would result in an annual loss of approximately \$20 million. The index factor would result in an annual increase of \$1 million.

The MMS decided not to issue a final rule based on the Federal Committee consensus for the following reasons:

- The natural gas market continues to experience significant change. The FERC conducted a conference in May 1997 to address market direction and regulation as a result of this change.
- The MMS believes its existing regulations are flexible and remain the appropriate means to address continued change in the natural gas market.

- The MMS does not believe that published indices for natural gas, with deductions for transportation allowances to the lease, are sufficiently developed to represent gross proceeds actually received for lease production.
- The results of the MMS cost benefit analysis indicate that the proposed rule does not achieve revenue neutrality, a primary goal MMS and the Federal Committee established in developing new regulations.

The MMS published a Notice in the Federal Register on April 22, 1997, explaining its decision and requesting comments on new options to value Federal gas. The options include the index factor and an option based on the royalty collection practice in Norway, where royalty values for crude oil are established by government price board. The Department would establish its own pricing board to determine prices for Federal gas and other appropriate commodities similar to the process used in Norway. The MMS remains committed to working with it's constituents to explore alternative means to value natural gas.

3. Indian Gas Valuation Negotiated Rulemaking Committee

The MMS published a Notice in the Federal Register on February 7, 1995, to establish the Indian Gas Valuation Negotiated Rulemaking Committee (Indian Committee). The goal of the Indian Committee was to publish regulations that would maximize royalty revenues for Indian Tribes and allottees consistent with the Secretary's discretion to establish value. The regulations would further satisfy industry concerns by clarifying and reducing information requirements to compute royalty in an accurate, timely manner.

The Indian Committee included representatives from MMS, BIA, Indian mineral owners, and the oil and gas industry. The representatives met 13 times and concluded negotiations in May 1996. The negotiations focused on improving gas valuation under the following circumstances:

- Gas sold under arm's-length and non-arm's-length contracts subject to the major portion requirements of Indian lease terms;
- Gas processed and subject to the dual accounting requirements of Indian lease terms; and
- Gas sold under percentage-of-proceeds contracts.

The Indian Committee agreed on a formula to value gas produced from Indian lands using available public spot market index prices and a factor for transportation. The price, derived from the formula, would be applied to wellhead gas volume and would satisfy the gross

proceeds and major portion calculations required by Indian lease terms. Transportation allowance forms would no longer be required. The Indian Committee designed a method that would provide lessees with an option of performing dual accounting in its current form or applying a percentage increase to the index formula value to satisfy the dual accounting requirement in Indian leases.

Lessees would continue monthly reporting of gross proceeds under the 1988 regulations for Indian lands with no valid spot market index. The MMS would calculate and provide the major portion value to lessees within 60 days of submission of royalties.

The MMS published a proposed rule in the Federal Register on September 23, 1996. The proposed rule represents recommendations from the Indian Committee and also contains two new forms for information collection on dual accounting and safety net values. The comment period on the proposed rule closed December 3, 1996.

The comment period was reopened to address the gross proceeds requirements in the proposed rule dealing with the issue of gas contract settlements. The subsequent comment period closed on April 4, 1997.

The Indian Committee met on March 26, 1997, and did not reach agreement on the rule's treatment of contract settlement proceeds. The MMS is conducting an economic impact analysis of the new rule. The MMS expects publication of a final rule in mid-1997 with an effective date in January 1998.

4. Revision of MMS Oil Royalty Valuation Rules

The MMS published an Advance Notice of Proposed Rulemaking in the Federal Register on December 20, 1995, requesting public comment on the use of posted oil prices to represent market value. The notice further requested ideas for alternative means of oil valuation. The MMS requested the comments to help determine if existing oil royalty valuation rules should be revised to better reflect current oil marketing. The comment period ended in March 1996.

Following a review of the comments, MMS assembled a team to draft proposed rules. The team included representatives from MMS, the State and Tribal Royalty Audit Committee, the Navajo Nation, and the Western States Land Commissioners. The MMS invited several companies and industry organizations to work with the team to write the proposed rules. Representatives from the firms and organizations declined the invitation, citing pending litigation concerning valuation issues. Some of the industry representatives did meet with the team, however, to provide background information concerning oil marketing.

The MMS published a proposed rule on Federal oil valuation for comment on January 24, 1997. The intent of the Federal rule follows:

- Reduce reliance on posted prices for royalty valuation;
- Reflect true market value;
- Provide a measure of certainty to all parties, and
- Provide maximum flexibility to adapt to changing market conditions.

Under the proposed Federal rule, oil royalty would continue to be measured by gross proceeds received by the lessee in true arm's-length transactions. Oil value would be based on new benchmarks in non-arm's-length transactions.

The benchmark for oil produced outside of California and sold to non-refiner affiliates would be based on the affiliate's arm's-length resale. The lessee, in the alternative, may base value on New York Mercantile Exchange (NYMEX) prices. Value for affiliated refiners would be based on a monthly average of daily NYMEX settled prices adjusted for location and quality differences. The benchmark for oil produced in California and sold to non-refiner affiliates would be based on the affiliate's arm's-length resale. The lessee, in the alternative, may base value on Alaska North Slope (ANS) spot prices. Value for affiliated refiners would be based on ANS spot prices adjusted for appropriate location and quality differences. The location and quality differences would be derived from published data and information collected by MMS. The proposed rule also associates royalty-in-kind oil valuation to NYMEX or ANS prices.

Public hearings on the proposed rule were conducted in Denver on April 15, 1997, and in Houston on April 17, 1997. The comment period closed May 28, 1997. Based on comments received in the public hearings, MMS published a supplemental proposed rule in the Federal Register on July 3, 1997. The comment period closed August 4, 1997. The MMS will consider comments received on both the proposed rule and the supplemental proposed rule in developing the final rule.

The MMS is developing a separate rule for valuing oil produced from Indian leases due to the unique terms in most Indian leases. The proposed Indian rule would value crude oil at the higher of the following:

- A NYMEX-based value;
- The lessee's or its affiliate's gross proceeds; or

- A 75 percent major portion value of arm's-length prices in the area.

Under the NYMEX option, location differences would be applied from the reservation boundary to the NYMEX pricing point.

Before drafting the current version of the rule, MMS convened a diverse group of Indian representatives to solicit their views. The MMS expects to publish a draft proposed Indian oil valuation rule by the summer of 1997.

5. Impact of FERC Order 636 on Gas Marketing

The MMS published a proposed regulation in the Federal Register on July 31, 1996, to clarify royalty implications of FERC Order 636. The proposed regulation identifies which cost components or other charges are deductible, or related to transportation, and which costs are not deductible, or related to marketing. Deductible transportation costs include firm demand charges, commodity charges, and wheeling costs. Non-deductible marketing costs include long-term storage, aggregator fees, and intra-hub title transfer fees.

The FERC issued Order 636 in April 1992 to enhance competition among suppliers and improve the industry's ability to compete effectively for new markets. The Order mandated that interstate pipelines separate their sales and transportation services, negating the advantage that a particular pipeline company would have in the sale of its own gas as opposed to the gas of other suppliers. Pipelines must provide open access transportation services equal in quality whether the gas is purchased directly from the pipeline company or from another source. Each pipeline was required to complete restructuring of its services by November 1, 1993.

The Order separated the following sales and transportation costs:

- Transmission;
- Storage;
- Production; and
- Gathering costs.

Transportation service components that were previously aggregated may now be separately identified in transportation contracts, and new transportation costs unique to FERC Order 636 have emerged. Some transportation service components reflect nondeductible costs of marketing.

The rulemaking proposed selected changes to the gas valuation regulations in conjunction with the proposed changes to the

transportation allowance regulations. The MMS recognizes that certain lessee gas transportation arrangements result in financial transactions that are not directly associated with the gas value. Such transactions may not have royalty consequences. The proposed rulemaking encourages lessees to request a value determination from MMS if the lessee is unsure if transactions result in additional royalty obligations.

The proposed rulemaking will apply to both arm's-length and non-arm's-length situations for valuing gas production and calculating transportation allowances. The proposed rulemaking provided a 60-day public comment period which ended September 30, 1996, and was extended to October 30, 1996. The MMS expects to publish a final rule in mid-1997.

6. Major Portion Initiatives

Indian lease terms and valuation regulations require the value of gas to be the higher of either gross proceeds or the highest price paid or offered for a major portion of gas produced from a field or area. Major portion prices are calculated and compared with prices reported by payors. The RMP issues a bill for additional royalties where appropriate. A summary of major portion initiatives completed through FY 1996 follows:

- **Oklahoma Indian Allottees.** The RMP performed a major portion analysis for allotted Indian leases under the jurisdiction of the BIA Anadarko Area Office. The effort resulted in the collection of approximately \$965,000 in additional royalties from 130 payors for the period 1986-90, and \$187,800 in royalties for the period 1991-92. The RMP is currently calculating major portion prices for Eastern Oklahoma for the period 1988-95 and for allotted Indian leases under the jurisdiction of the BIA Anadarko Area Office for the period 1993-95.
- **Southern Ute Tribe and Allottees.** The RMP performed a major portion analysis for the Southern Ute Indian Reservation, resulting in the collection of \$1,095,990 from 46 payors for the period 1987-91. The RMP performed a major portion analysis for the period 1984-86 and is currently performing a corresponding analysis for the period 1992-95. The RMP is assisting efforts of the Southern Ute Tribe to collect additional royalties for major portion analyses in various settlement negotiations.
- **Blackfeet Tribe and Allottees.** Representatives from RMP and the Blackfeet Tribe have agreed on a method to calculate major portion prices for the Blackfeet Reservation. Calculations are complete and RMP notified payors of additional royalties due for the period 1986-94. The RMP is assisting efforts of the Blackfeet Tribe to collect additional royalties in settlement negotiations.

- **Navajo Nation.** Representatives from RMP and the Navajo Nation agreed on a method to calculate major portion prices for gas produced on Tribal leases for the period January 1987 through February 1989. Calculations are complete and 16 payors have been notified of additional royalties due for the period. The Navajo Nation agreed to perform a major portion analysis for the period March 1989 through the current date.
- **Ute Mountain Ute Tribe.** Representatives from RMP and the Ute Mountain Ute Tribe are evaluating major portion prices from the Aneth and San Juan Basin Areas for the period 1987-95. The RMP calculated major portion prices for the Aneth and San Juan Basin Areas during that period.
- **Northern Ute Indian Tribe.** Representatives from RMP and the Northern Ute Indian Tribe have agreed on a method to calculate major portion prices for Northern Ute Indian Tribal leases. The RMP calculated major portion prices for the period 1988-95 and will notify payors of additional royalties due.
- **Shoshone and Arapaho Tribes.** The RMP worked with the Shoshone and Arapaho Tribes to analyze the methodology used by the Tribes to calculate major portion prices. The effort resulted in the collection of approximately \$90,000. The RMP will continue to assist the efforts of the two Tribes to collect additional royalties for major portion analyses.

7. Valuation Guidance Papers for Oil, Gas, and Coal

The RVD developed the following guidance papers addressing the valuation of oil, gas, and coal:

- Valuation Guidance for Auditing Crude Oil Premiums, June 24, 1996;
- Valuation Guidance for Auditing Affiliate Sales of Natural Gas, December 5, 1996; and
- Valuation Guidance for Auditing Affiliate Sales of Coal, December 5, 1996.

A "Dear Payor" letter, dated December 19, 1996, informed payors of the availability of these papers. The papers are located on the MMS Internet home page (<http://www.mms.gov>).

G. Other Regulatory Initiatives

1. Transportation and Processing Allowance Administrative Requirements

The MMS published a final rule in the Federal Register on February 12, 1996, with an effective date of March 1, 1996, to reduce administrative requirements to report oil, gas, and coal transportation and processing allowances on Federal leases.

The MMS formed a study group in April 1993 to evaluate the existing regulatory requirements for oil and gas allowances and to prepare recommendations for improvement. The study group consisted of representatives from the Council of Petroleum Accounting Societies, the State and Tribal Royalty Audit Committee, and MMS. The study group recommendations addressing oil and gas allowances were submitted in a report issued December 3, 1993. The MMS subsequently addressed coal allowances in a proposed rulemaking for oil, gas, and coal since regulatory filing requirements and sanctions apply to both categories of minerals.

The final rule incorporates many of the findings and conclusions of the study group. The regulations further contain clarification and changes based on MMS experience in administering allowances. The final rule will:

- Simplify oil, gas, and coal allowance reporting procedures;
- Eliminate allowance form filing for Federal mineral leases;
- Eliminate form-filing sanctions, allowance payback, and interest for late form filing for Federal leases;
- Allow the "netting" of oil and gas transportation costs on Form MMS-2014, Report of Sales and Royalty Remittance, under the following conditions:
 - The sale is arm's-length and the contract price is determined net of transportation costs, or
 - An onshore oil posted price bulletin lists transportation costs deducted from the posted price;
- Retain the current filing requirements for Indian leases;
- Retain the current rules regarding oil and gas allowance limitations; and
- Permit adjustments on Form MMS-2014 where payors may use estimates and then correct the estimates with actual figures.

The final rule imposes assessments under the following conditions:

- Interest on underpayment of royalties;
- Failure to obtain prior approval before exceeding allowance limits; and
- Reporting erroneous transportation and processing allowances which result in an underpayment of royalties.

Allowances improperly netted against royalties are subject to assessments up to 10 percent of the allowance netted, not to exceed \$250 per lease selling arrangement during a sales period. The change in Federal allowance procedures is expected to save an estimated \$500,000 annually in forms processing and billing that are no longer required.

2. Marginal Property Relief Under Section 7 of RSFA

Section 7 of RSFA provides that lessees may seek to either prepay future royalties or obtain accounting relief on marginal properties. The RSFA provides minimal guidance to define a marginal property. The law requires that accounting relief be made available within 1 year from enactment and that prepayment of royalty be available within 2 years. The RMP will develop implementing regulations for both marginal property alternatives.

The MMS conducted two marginal property workshops, on October 31, 1996, and January 24, 1997, with representatives from industry associations and State government organizations to obtain input on marginal property regulations. Representatives from RMP, Offshore Minerals Management, and BLM also participated. The representatives addressed the following issues:

- Defining criteria for marginal property status;
- Determining requirements to be addressed in regulations and agency guidelines; and
- Determining an effective way to establish criteria to be specified in the regulations and guidelines.

The MMS intends to issue a proposed rulemaking for accounting relief in the fall of 1997. A proposed rulemaking for prepayment of royalty will be issued at a later date.

3. Phosphate Valuation

The MMS recalculates phosphate value each year to compute phosphate royalty payments. The procedure, adopted in 1981, is based on

index adjustments of the Gross Domestic Product – Implicit Price Deflator. An index was used since the majority of phosphate production on Federal leases is consumed internally without open-market sales.

The MMS became concerned that the index may no longer reflect current market conditions. In March 1995, MMS solicited participation from representatives with Idaho, BLM, and industry to examine phosphate valuation. The representatives agreed that the phosphate valuation procedure should be reviewed.

The RPC established a Phosphate, Trona, and Other Leasable Solid Mineral Subcommittee in September 1995. A Phosphate Subcommittee was segregated from the original subcommittee in February 1996. The Phosphate Subcommittee, composed of representatives from industry, and Idaho State and county governments, met in April 1996. Personnel from MMS and BLM provided technical assistance. The representatives conducted a comprehensive analysis of phosphate economic and market trends, concluding that the current index procedure was not representative of phosphate values.

A revised methodology was submitted to the Phosphate Subcommittee on November 19, 1996. Subcommittee members reviewed the proposal and reconvened on January 22, 1997. The representatives were unable to reach unanimous agreement and forwarded their recommendations to the RPC.

The RPC reviewed the material and subsequently approved a recommendation on March 21, 1997, to revise Federal phosphate valuation procedures using a weighted composite of three phosphate-related indices published by the Bureau of Economic Analysis. The RPC forwarded the recommendation to the Secretary for review and approval on April 10, 1997.

4. Liability for Royalty Due on Federal and Indian Leases

The MMS published a proposed regulation in the Federal Register on June 9, 1995, in conjunction with a National Performance Review initiative, to develop a uniform policy to address liability issues. The proposed rulemaking would amend regulations to establish and clarify who is liable for unpaid or underpaid royalties, compensatory royalties, or other payments on Federal and Indian mineral leases. The MMS would amend the Payor Information Form (Form MMS-4025) to expressly provide that the payor agrees to pay any additional royalties owed on production from the lease. The rulemaking also clarifies circumstances when operators and other individuals are liable for underpayments and when liability is shared among other parties.

The clarification is required because payors, whom MMS has historically billed for unpaid or underpaid royalties, have

sometimes refused or been unable to pay these bills. This has occurred due to bankruptcy or when an interest in the lease may be assigned between the time the royalty obligation accrued and the time MMS discovers an underpayment and orders corrective action. The current payor often denies liability for the deficiency, asserting that MMS should identify and collect from the individual responsible for the original underpayment.

The proposed rulemaking is limited to the following types of leases:

- Leases that are in 100 percent Federal and Indian agreements with the same lessor, royalty rate, and fund code for distribution; and
- Leases that are not in approved Federal or Indian agreements.

The RMP extended the comment period for the rulemaking several times to accommodate interested parties. The RSFA, signed into law in August 1996, addresses the liability concept. The RMP is currently evaluating the effect of RSFA provisions on existing processes and procedures prior to amending the proposed regulations.

5. Administrative Offset Regulations

A proposal governing the collection of mineral revenues on Federal and Indian leases by administrative offset was published in the Federal Register on August 17, 1993. Many payors have interests in a number of leases. The rule would authorize MMS to apply a claim for a refund submitted by a payor on a lease against an outstanding obligation the payor may owe on another lease. This would preclude payment or credit of refunds when the payor owes additional revenues. The regulation would implement the provisions of the Debt Collection Act of 1982.

The original comment period closed on October 18, 1993, and was later extended to November 1, 1993. The RSFA, signed into law in August 1996, addresses administrative offset. The RMP is currently evaluating the effect of RSFA provisions on existing processes and procedures prior to amending the proposed regulations.

6. Limitations on Credit Adjustments

The MMS published a proposed regulation in the Federal Register on August 17, 1993, to limit credit adjustments for previous payments submitted on Federal onshore and Indian leases. Time constraints are in effect to submit credit adjustments for offshore leases under the provisions of OCSLA. Current regulations, however, do not provide time limitations to submit adjustments for Federal onshore and Indian leases.

Payors often submit credit adjustments many years after the original payment was made. The proposed rule will limit credit adjustments on Federal onshore and Indian leases to 5 years after the payment was due, without prior authorization.

The original comment period closed on October 18, 1993, and was later extended to November 1, 1993. The RSFA, signed into law in August 1996, addresses limitations on credit adjustments. The RMP is currently evaluating the effect of RSFA provisions on existing processes and procedures prior to amending the proposed regulations.

7. Collection of Mineral Revenues

The U.S. Treasury (Treasury) published a rule on January 31, 1994, requiring Federal agencies to use electronic funds transfer (EFT) as the principal collection and disbursement system. The Treasury will allow other payment methods to be used whenever it is cost-effective, practical, and consistent with current statutory authority.

The MMS has used EFT since September 1984, and has increased EFT use throughout the past few years. Although MMS actively encourages EFT, the agency acknowledges that some collection and disbursement activities do not lend themselves to electronic commerce.

The MMS issued proposed rulemaking on April 19, 1996, to incorporate Treasury requirements and to clarify instructions to mineral payors for royalty, rent, bonus, and other revenue payments. The proposed rule affects only RMP collections. The proposed rulemaking addressed a number of issues, including:

- Definitions of relevant terms in the payment process;
- General instructions for EFT payments and for non-EFT payments for each category of payment;
- Submission of payment documents using EFT, the U.S. Postal Service, courier, and overnight mail;
- Due dates for mineral payments; and
- Interest charges and assessment of civil penalties for late payments.

The comment period closed June 18, 1996, and was extended to July 19, 1996. The final rule was published in the Federal Register on April 22, 1997, with an effective date of May 22, 1997.

8. Solid Minerals Payor Handbook

The RMP published a revised Solid Minerals Payor Handbook on March 31, 1997. The handbook contains instructions to report and pay solid mineral royalties, including the use of the Solid Minerals Payor Information Form and the Report of Sales and Royalty Remittance. The handbook further provides valuation information for coal, sodium, phosphate, and other commodities.

9. Geothermal Payor Handbook

The RMP published the Geothermal Payor Handbook on February 20, 1997, providing a definitive explanation of valuation regulations that became effective January 1, 1992. The Handbook further provides examples of different valuation situations.

H. Civil Penalties

Section 109 of FOGRMA provides for civil penalties to ensure the prompt collection of all oil and gas revenues due from Federal and Indian mineral leasing. Civil penalties were first assessed in FY 1985.

The RMP opened 39 civil penalty cases in FY 1996 and closed 24 of those cases during the year. There were 21 cases open at the end of FY 1996. Fifteen of those cases were opened in FY 1996 and six cases were opened in prior fiscal years. The RMP continues efforts to resolve these actions.

I. Training Programs

The RMP continued a series of training programs in FY 1996 for RMP employees and constituents. The training is designed to increase awareness of regulatory and procedural requirements and to familiarize participants with issues affecting the minerals industry.

1. Payor Training

The RMP continued to provide 2-day training sessions to update industry payors concerning royalty reporting requirements, royalty payment requirements, automated and manual exception processing programs, and product valuation for oil, gas, geothermal, coal, and other solid mineral resources. The RMP conducted seven payor training seminars in FY 1996 attended by 263 participants representing 134 firms.

2. Operator Training

The RMP continued PAAS training for industry operators to explain Federal regulations, policy changes, and the proper method of reporting production. The RMP conducted five operator training sessions during the year attended by 108 participants representing 82 firms.

3. Allowance and Valuation Training

The RMP continued an outreach initiative designed to involve industry, States, and the Indian community in formulating valuation policy and guidance. The RMP conducted 14 training sessions in FY 1996 attended by 294 participants. A brief description of the presentations follows:

- **Solid minerals payor training.** The RMP conducted six seminars during the year attended by 72 participants. Two of the seminars were conducted for specific companies to address issues unique to the firms. Four seminars were conducted for MMS, State, and Indian auditors and interns, providing general solid mineral information.
- **FERC Order 636 training.** The RMP conducted two seminars attended by 22 representatives from the Navajo Nation and other Indian communities in New Mexico and Arizona. The training addressed FERC Order 636, gathering versus transportation, and dual accounting issues.
- **Auditor valuation training.** The RMP conducted six seminars attended by 200 MMS and Tribal auditors. The training addressed specific valuation policies and issues, including quality banks, BBB bond rate changes, crude oil premiums, sales to affiliates, section 6 leases, compression, extraordinary costs, coalbed methane, FERC Outer Continental Shelf (OCS) oil tariffs, FERC Order 636, and U-accounts/cash-outs.

4. Workforce Training

The RMP established a Training Advisory Committee in FY 1995 to satisfy the following objectives:

- Analyze the training requirements of the general workforce to meet strategic business goals;
- Outline both short- and long-term training plans; and
- Develop in-house courses presented by current employees and commercial vendors.

The RMP conducted 19 training programs in FY 1996 attended by 411 employees. Technical mineral courses included:

- Unitization agreements as a special leasing arrangement;
- Locating reference and production data through RMP automated systems;
- Orientation to FERC; and
- Orientation to the mineral functions of BIA and BLM.

Training courses provided through Federal and commercial vendors included:

- Effective presentation techniques;
- Effective negotiations;
- Effective writing;
- Training for instructors; and
- Retirement planning.

A subcommittee of the Training Advisory Committee developed a 360-Degree Supervisory Assessment Tool to gather data for training needs for RMP managers and supervisors. The 360-Degree Assessment Process is designed to gather confidential information from supervisors, peers, and employees who report directly to an individual. The information helps the individual to understand how others perceive their supervisory skills, strengths, and weaknesses. Results of the assessments will be available in FY 1997.

The subcommittee also developed an Accountant Occupational Training Plan that will be implemented in FY 1997. The training plan will consist of accounting, communication, writing, and technical mineral courses. The training will be provided to accountants in field offices and audit residencies in addition to Headquarters staff in Lakewood, Colorado. The majority of the RMP audit staff is located in cities where many of the top royalty payors maintain accounting centers. Additional training plans may be developed for other occupational series in the future.

II. MINERAL REVENUE COLLECTIONS AND DISBURSEMENTS

A. Mineral Revenue Collections

The Department collected over \$4.9 billion in mineral rents, bonuses, and royalties in FY 1996 from 72,000 Federal and Indian leases. This represents an increase of nearly \$1.3 billion, or 35.8 percent, from \$3.6 billion in collections in FY 1995 (table 1). The increase was primarily due to higher oil and gas prices during the year, increased offshore oil and gas sales volumes, and additional revenues from offshore oil and gas competitive lease sales. Indian revenues addressed in this report are collected and processed by MMS from leases on Tribal lands and allotments, or collected by the Indian community and reviewed by MMS for accuracy.

Offshore oil and gas royalties increased 51.9 percent, or nearly \$1.1 billion, in FY 1996 (table 1). Domestic oil prices are materially influenced by the international market. The Department of Energy (DOE) advises that low world inventories and high demand in the United States, Europe, and the developing nations of Asia caused oil prices to rise in FY 1996. Higher prices and demand stimulate production. The Gulf of Mexico reported a significant rise in oil sales volume during the year as a result of the start of production in the Mars Field in July 1996 and the completion of new production facilities in the Auger Field.

Domestic gas prices are governed by competition in U.S. and Canadian energy markets because gas, unlike oil, is not easily transported between countries outside North America. The DOE reports that gas inventories reached a 20-year low in December 1995 and continued to fall throughout the winter months due to unusually cold weather in much of the East and Midwest. Higher demand coupled with diminished supply caused gas prices to rise over 30 percent during the year. Gas sales volume rose in the Gulf of Mexico and offshore California to accommodate the increased demand.

Federal onshore royalties declined 2.1 percent and Indian royalties fell 4.9 percent in FY 1996 (table 1). A decline in coal royalties offset gains in both oil and gas royalties on Federal and Indian lands. The DOE advises that the expected increase in western coal prices as a result of the Clean Air Act of 1990 has not materialized. Advances in mining productivity have served, instead, to reduce coal prices. Coal prices for electric utility companies fell to their lowest level since 1979.

Offshore bonuses and rents rose 67.7 percent, from \$416.5 million in FY 1995 to \$698.7 million in FY 1996 (table 1). The growth in revenues from competitive lease sales is attributed to advances in three-dimensional seismology, innovations in horizontal drilling, improved underwater techniques, recent subsalt discoveries in the

Gulf of Mexico, and increased competition by independent producers in shallow water properties in the Gulf.

Federal onshore bonuses and rents fell \$16.2 million during the year (table 1). Much of the decline occurred in Wyoming. Officials with BLM advise that a large number of oil and gas parcels were offered through competitive lease sales in the southwestern part of the State in FY 1995. Fewer parcels were offered statewide in FY 1996 with limited interest in the southwestern fields.

Collections from rents on Indian leases totaled \$913,000 in FY 1996 (table 1). Indian rent collections have averaged approximately \$1 million in recent years.

Table 1. Comparison of mineral revenue collections, FY 1995-96 (in thousands)				
	<u>FY 1995</u>	<u>FY 1996</u>	<u>Difference</u>	<u>Percent</u>
Offshore Federal Lands				
Royalties.....	\$2,031,384	\$3,086,402	\$1,055,018	51.9
Bonuses and Rents...	<u>416,542</u>	<u>698,685</u>	<u>282,143</u>	67.7
Subtotal.....	\$2,447,926	\$3,785,087	\$1,337,161	54.6
Onshore Federal Lands				
Royalties.....	\$ 877,328	\$ 858,577	\$ (18,751)	(2.1)
Bonuses and Rents...	<u>137,009</u>	<u>120,779</u>	(<u>16,230</u>)	(11.8)
Subtotal.....	\$1,014,337	\$ 979,356	\$ (34,981)	(3.4)
Indian Lands				
Royalties.....	\$ 152,275	\$ 144,878	\$ (7,397)	(4.9)
Rents.....	<u>1,044</u>	<u>913</u>	(<u>131</u>)	(12.5)
Subtotal.....	\$ 153,319	\$ 145,791	\$ (7,528)	(4.9)
TOTAL.....	\$3,615,582	\$4,910,234	\$1,294,652	35.8
Total Royalties.....	\$3,060,987	\$4,089,857	\$1,028,870	33.6
Total Bonuses & Rents.	\$ 554,595	\$ 820,377	\$ 265,782	47.9

Bidders in offshore competitive lease sales must deposit one-fifth of the bonus payment into an escrow account pending award of the lease. The one-fifth deposit and accrued interest are returned to unsuccessful bidders. Interest in the escrow account from accepted bids totaled nearly \$1.4 million in FY 1996 (table 2). Settlement payments to offshore States under the provisions of the OCSLA Amendments of 1978 totaled \$45.5 million (tables 2 and 5).

**Table 2. Mineral revenue collections, escrow release, and settlement payments, FY 1996
(in thousands)**

	<u>Royalties</u>	<u>Bonuses & Rents</u>	<u>Other Revenues</u>	<u>Total</u>
Collections				
Offshore Federal Lands..	\$3,086,402	\$698,685	\$ ---	\$3,785,087
Onshore Federal Lands...	858,577	120,779	---	979,356
Indian Lands.....	<u>144,878</u>	<u>913</u>	---	<u>145,791</u>
Subtotal.....	\$4,089,857	\$820,377	\$ ---	\$4,910,234
Offshore Payments				
Escrow Release.....	\$ ---	\$ ---	\$ 1,361	\$ 1,361
Settlement Payments.....	---	---	<u>45,500</u>	<u>45,500</u>
Subtotal.....	\$ ---	\$ ---	\$46,861	\$ 46,861
TOTAL.....	\$4,089,857	\$820,377	\$46,861	\$4,957,095

B. Mineral Revenue Disbursements

Revenues are generally reported to RMP on the last business day of the month. The RMP generally disburses revenues in the month following receipt. Collection and disbursement totals for a fiscal year will vary because revenue collected in September, the last month in a fiscal year, will not be disbursed until October, the first month of the next fiscal year.

The Department disbursed over \$4.9 billion from mineral leasing in FY 1996 to the States, to a number of designated special-purpose accounts administered by Federal agencies, and to the General Fund of the Treasury (table 3). The BIA distributed Indian lease revenues to the appropriate Indian Tribes and allottees. Formulas for these disbursements are governed by legislation and regulations.

States share in revenues collected from Federal mineral leases within their respective boundaries or from lands within 3 miles of the seaward boundary of their coasts. Nearly \$548 million in royalties, rents, bonuses, and settlement payments were distributed to the States from offshore and onshore mineral leasing in FY 1996 (tables 3, 4, and 5). Payments to the Historic Preservation Fund, the Land and Water Conservation Fund, and the Reclamation Fund special-purpose accounts amounted to nearly \$1.4 billion. The General Fund of the Treasury received nearly \$2.9 billion. Indian revenues directed to Tribal governments and individual allotment owners totaled nearly \$145.8 million (table 3).

**Table 3. Disbursement of mineral lease revenues, FY 1996
(in thousands)**

Offshore Federal Revenues		
Historic Preservation Fund.....	\$ 150,000	
Land & Water Conservation Fund.....	896,906	
State Shares (7 States).....	89,871	
U.S. Treasury: General Fund.....	<u>2,695,171</u>	
Subtotal.....		\$3,831,948
Onshore Federal Revenues		
Reclamation Fund.....	\$ 350,264	
State Shares (35 States).....	457,754	
U.S. Treasury: General Fund.....	<u>171,338</u>	
Subtotal.....		979,356
Indian Revenues		
Tribes and Allottees.....		<u>145,791</u>
TOTAL.....		\$4,957,095

**Table 4. Distribution of onshore mineral revenues
to 33 States by the Minerals Management Service
and the Bureau of Land Management, FY 1996
(in thousands)**

Alabama.....	\$ 197	Nebraska.....	14
Alaska.....	4,670	Nevada.....	5,759
Arizona.....	41	New Mexico.....	118,596
Arkansas.....	920	North Dakota.....	2,370
California.....	26,015	Ohio.....	165
Colorado.....	34,563	Oklahoma.....	1,720
Florida.....	27	Oregon.....	66
Idaho.....	2,159	Pennsylvania.....	22
Illinois.....	79	South Dakota.....	634
Kansas.....	1,094	Texas.....	648
Kentucky.....	112	Utah.....	34,116
Louisiana.....	943	Virginia.....	90
Michigan.....	702	Washington.....	468
Minnesota.....	6	West Virginia.....	197
Mississippi.....	551	Wisconsin.....	1
Missouri.....	1,205	Wyoming.....	<u>199,333</u>
Montana.....	20,271		
		TOTAL.....	\$457,754

Section 8(g) of the OCSLA Amendments of 1978 provided that the States were to receive a "fair and equitable" division of revenues generated from the leasing of lands within 3 miles of the seaward boundary of a coastal State that contains one or more oil and gas pools or fields underlying both the OCS and lands subject to the jurisdiction of the State. The States and Federal Government, however, could not agree on the meaning of the term "fair and equitable." Revenues generated in the 3-mile boundary were subsequently placed into an escrow fund beginning in August 1979. Revenues from the Beaufort Sea in Alaska were placed in a second escrow fund under section 7 beginning in December 1979.

Congress resolved the dispute over the meaning of "fair and equitable" in the OCSLA Amendments of 1985, Public Law 99-272. The law provided for the following distribution of revenues to the States under section 8(g):

- Escrow funds disbursed during the period FY 1986-87;
- A series of annual settlement payments to be disbursed to the States over a 15-year period from FY 1987 through FY 2001; and
- Recurring annual disbursements of 27 percent of royalty, rent, and bonus revenues received from each affected State's 8(g) zone.

Congress passed a second law, Public Law 100-202, permitting distribution of section 7 escrow funds to Alaska in FY 1988. Seven States received nearly \$89.9 million in FY 1996 under the provisions of the two acts, including nearly \$44.4 million in OCS royalties, rents, and bonuses, and \$45.5 million in settlement payments (table 5).

**Table 5. Distribution of offshore royalties, rents, bonuses, and settlement payments to seven States, FY 1996
(in thousands)**

	<u>Royalties, Rents, & Bonuses</u>	<u>Settlement Payments</u>	<u>Total</u>
Alabama.....	\$10,324	\$ 490	\$10,814
Alaska.....	148	9,380	9,528
California.....	4,736	20,230	24,966
Florida.....	10	---	10
Louisiana.....	17,242	5,880	23,122
Mississippi.....	406	140	546
Texas.....	<u>11,505</u>	<u>9,380</u>	<u>20,885</u>
TOTAL.....	\$44,371	\$45,500	\$89,871

III. RMP UNDERPAYMENT DETECTION PROGRAMS

The accurate determination and collection of mineral revenues require both voluntary compliance by payors and sophisticated RMP audit and exception identification programs designed to detect the underpayment of revenues. Collections from audits, refund denials, and exception programs fell from \$256.1 million in FY 1995 to \$72.9 million in FY 1996. Collections from the RMP audit program were at record levels in FY 1994-95. The decline in revenues in FY 1996 is primarily attributed to fewer settlements of outstanding audit issues during the year.

Cumulative collections from the inception of the first of the underpayment detection programs in October 1981 through the end of FY 1996 totaled nearly \$1.9 billion.

A. Determination of Royalties Owed to the Federal Government

Multiple lease ownership, the complexity of royalty calculations, and erroneous payor reporting contribute to difficulties in determining the amount of royalties owed to the Federal Government.

1. Multiple Lease Ownership

The number of producing and nonproducing oil and gas leases on the RMP database increased 1.4 percent, from 69,594 at the end of FY 1995 to 70,536 at the end of FY 1996. The number of producing oil and gas leases on the AFS database increased from 25,394 at the end of FY 1995 to 25,493 at the end of FY 1996 (table 6). The increase is primarily associated with Federal offshore and onshore oil and gas competitive lease sales.

Ownership of many oil and gas leases is often divided and subdivided, resulting in multiple payors for a single lease. The average number of active oil and gas payors reporting each month to AFS remained relatively stable at approximately 2,100 payors during the period FY 1995-96 (table 6).

The average number of oil and gas royalty lines processed each month reflected, in part, the modest increase in oil and gas producing leases during the 2-year period. The RMP processed 277,950 lines per month in FY 1995 and 280,936 lines per month in FY 1996 (table 6).

Revenue sources and selling arrangements establish the source of the product sold and the buyer or seller of the product. Both the number of active revenue sources and the number of active selling arrangements remained relatively stable during the period FY 1995-96. Active revenue sources totaled 53,853 in FY 1995 and

55,176 in FY 1996. Active selling arrangements equaled 143,631 in FY 1995 and 145,689 in FY 1996 (table 6).

The RMP must adjust payor database records each time there is a change in payor responsibility. The RMP averaged 3,465 adjustments per month in FY 1995 and 3,219 adjustments per month in FY 1996, reflecting the fluid nature of the energy industry (table 6). This is down significantly from nearly 4,200 adjustments RMP averaged per month during the period FY 1993-94. The decline in payor and lease database adjustments in the last 2 years is attributed to recent modifications in procedures. Personnel with RMP now make one collective adjustment for similar transactions. For example, one database adjustment is now entered for multiple changes to revenue sources and selling arrangements affecting a single payor. Separate database adjustments would formerly have been made for each individual change to a revenue source or selling arrangement affecting the payor. This has materially reduced report volume and resources required to enter the adjustments.

Table 6. Factors associated with multiple lease ownership, FY 1995-96

	<u>FY 1995</u>	<u>FY 1996</u>
Oil and Gas Leases at End of Fiscal Year		
Producing Leases.....	25,394	25,493
Nonproducing Leases.....	<u>44,200</u>	<u>45,043</u>
Total.....	69,594	70,536
Active Oil and Gas Payors Each Month.....	2,114	2,128
Average Oil and Gas Lines Processed Each Month.....	277,950	280,936
Active Revenue Sources.....	53,853	55,176
Active Selling Arrangements.....	143,631	145,689
Average Payor and Lease Database Changes Each Month.....	3,465	3,219

2. Royalty Determinations

The amount of royalty due is determined by applying the proper royalty rate to the volume and value of the commodity reported by the payor. Royalty rates may be expressed as flat rates or variable

rates, such as step-scale and sliding-scale. Royalties may be paid in value (cash) or in kind (a volume of the commodity), in accordance with lease contract terms, mineral leasing laws, and attendant Federal regulations.

The nature of oil and gas production commingling, processing, and marketing makes it difficult to determine if the sales reported represent the full royalty liability. It is often difficult to allocate production to the various leases and to determine the effects of processing and transportation allowances on the royalty liability.

Unit agreements, in which holders of different leases agree to develop the area as a single entity and to allocate production, account for a substantial percentage of the oil and gas produced from Federal leases. These agreements introduce additional problems due to the potential imbalance between a payor's entitled share of the production and actual sales.

3. Erroneous Reporting

Industry complexities contribute to difficulties associated with royalty and account status determination. The AFS edits industry-reported information and rejects certain incorrect data. The rejected information is not processed until the mistake is corrected. Employees with RMP contact the payor to correct errors whenever possible.

An aggressive RMP training program with industry representatives, in conjunction with liquidated damage assessments for erroneous reporting, has resulted in a relatively low AFS error rate. The annual average AFS error rate of 2.5 percent in FY 1995 fell to 2.4 percent in FY 1996.

B. Audit Initiatives and Programs

Effective audit programs are essential to the proper identification and collection of royalties. The RMP continued aggressive audit programs to pursue unpaid and underpaid royalties in FY 1995 and FY 1996.

1. Contract Settlements

Price volatility occurring since the early 1980's has caused many gas purchasers and a few coal purchasers to negotiate settlements of existing sales contracts with mineral producers. The settlements may include price reductions for sales, changes in quantity commitments and other contract terms, or contract termination.

Producers often receive cash payments from the purchasers as an incentive to settle the contract. The settlement payments raise complex valuation issues. Audit determinations are necessary to verify that Federal and Indian leaseholders accurately calculate and pay royalties attendant to revenues from contract settlements.

The MMS has identified over 3,500 contract settlements totaling nearly \$18 million. Approximately two-thirds of the settlements involve Federal and Indian lands, and require audit. The MMS began auditing these settlement contracts in FY 1993. The audits should be complete by FY 1999.

2. Crude Oil Pricing

A Department interagency team, including MMS representatives, completed a report in May 1996 addressing California crude oil pricing. The report concluded that companies often received premiums and bonuses higher than posted prices for California crude oil production; however, the companies continued a practice of calculating crude oil royalty payments based on posted prices.

Under the gross proceeds concept for determining royalties due on Federal and Indian leases, royalty should have been paid on the premiums and bonuses received. As a result, MMS initiated detailed audits of the top 20 crude oil royalty payors in California in FY 1996. The MMS expanded audit coverage of this issue to include crude oil royalty payors outside California beginning in FY 1997.

3. Audit Collections and Refund Denials

Collections through the RMP audit programs for additional royalties, late-payment interest assessments, and liquidated damages fell from \$172.4 million in FY 1995 to \$29.2 million in FY 1996 (table 7). Collections during the period FY 1994-95 were the highest in MMS audit history. Revenues fell in FY 1996 as a result of fewer settlements of outstanding audit issues. The RMP auditors reviewed and disapproved \$324,000 in refund requests in FY 1995 and \$1 million in FY 1996 (table 7).

The RMP worked with 7 Tribes and 10 States during the period FY 1995-96 that have funded cooperative agreements or funded delegations of authority with the Department. Funding for the agreements and the delegations is provided under the authorization in FOGRMA. The State and Tribal auditors collected royalties and other charges amounting to \$40.1 million in FY 1995 and \$9.5 million in FY 1996 (tables 7 and 8). State and Tribal auditors further reviewed and disapproved \$2.8 million in refund requests in FY 1995. No requests were disapproved during FY 1996 (table 7).

The combined RMP, State, and Tribal compliance activities resulted in collections and refund denials of \$215.6 million in FY 1995 and \$39.7 million in FY 1996 (table 7). The reason for the decline was again due to fewer settlements of outstanding audit issues in FY 1996.

Cumulative revenues from the inception of the audit program on October 1, 1981, through September 30, 1996, totaled nearly \$1.4 billion. Refund denials for the same period equaled an additional \$144.7 million.

Table 7. Additional royalties, interest, and damages collected, FY 1995-96 (in thousands)

	<u>FY 1995</u>	<u>FY 1996</u>
RMP Audits		
Royalties Collected.....	\$167,299	\$21,655
Interest & Liquidated Damages.....	<u>5,130</u>	<u>7,550</u>
Total Collections.....	\$172,429	\$29,205
Refund Denials.....	\$ 324	\$ 1,006
State and Tribal Audits		
Royalties Collected.....	\$ 24,165	\$ 6,530
Interest & Liquidated Damages.....	<u>15,911</u>	<u>2,987</u>
Total Collections.....	\$ 40,076	\$ 9,517
Refund Denials.....	\$ 2,805	\$ -0-
Combined Collections & Refund Denials..	\$215,634	\$39,728

4. State and Tribal Audits

The RMP maintained cooperative agreements that provided audit funding during the period FY 1995-96 to 7 Indian Tribes and 10 States under the authority provided in sections 202 and 205 of FOGRMA. Cooperative agreements under section 202 were in effect at the end of FY 1996 with the following Tribes:

- Blackfeet
- Jicarilla Apache
- Navajo Nation
- Shoshone and Arapaho
- Southern Ute
- Ute
- Ute Mountain Ute

Cooperative agreements under section 205 were in effect at the end of FY 1996 with the following States:

- California
- Colorado
- Louisiana
- Montana
- New Mexico
- North Dakota
- Oklahoma
- Texas
- Utah
- Wyoming

The cooperative agreements with the Navajo Nation, California, Colorado, Montana, New Mexico, North Dakota, Utah, and Wyoming include audits of geothermal steam, coal, and other solid mineral leases, including sodium, potassium, and phosphate. The cooperative agreements with California, Louisiana, and Texas include the audit of royalties from leases issued under section 8(g) of the OCSLA Amendments of 1985. The RMP maintained an unfunded Memorandum of Understanding with Alaska to share audit information during both FY 1995 and FY 1996.

**Table 8. Collections resulting from
cooperative and delegated audits, FY 1995-96
(in thousands)**

	<u>FY 1995</u>	<u>FY 1996</u>
Funded Agreements		
California.....	\$ 926	\$ 2,088
Colorado.....	1,619	175
Louisiana.....	6	2,678
Montana.....	4,268	531
New Mexico.....	725	429
North Dakota.....	4,413	431
Oklahoma.....	324	145
Texas.....	57	34
Utah.....	3,699	1,104
Wyoming.....	23,828	989
Blackfeet.....	4	---
Jicarilla Apache.....	617	---
Navajo Nation.....	987	117
Shoshone and Arapaho.....	108	481
Southern Ute.....	1,115	302
Ute.....	---	13
Ute Mountain Ute.....	185	---
Unfunded Agreements		
Jicarilla Apache.....	---	---
TOTAL.....	\$42,881	\$9,517

Lease and company audits were performed for leases located within the respective State and Tribal boundaries. Funded and unfunded State and Tribal audit efforts generated additional royalties and refund denials totaling \$42.9 million in FY 1995 and \$9.5 million in FY 1996 (tables 7 and 8).

C. Exception Identification Programs

The RMP continued a series of automated and manual programs designed to assess and collect revenues for late payments, failure to report, erroneous reports, improper recoupments, and improper adjustments submitted by payors and operators. Revenue collections fell 18 percent, from \$40.5 million in FY 1995 to \$33.2 million in FY 1996 (table 9).

Collections of interest, liquidated damages, improper recoupments, and royalties from the inception of the different programs through the end of FY 1996 totaled approximately \$362.6 million.

1. AFS/PAAS Exceptions

The RMP continued to correct discrepancies, or exceptions, between sales reported to AFS by payors and production reported to PAAS by lease and agreement operators in FY 1996. Personnel in the RMP Compliance Verification Division processed 20,277 exceptions during the year, including 15,277 exceptions that required written correspondence with operators.

Revenues from comparisons of sales reported to AFS and corresponding production reported to PAAS fell \$1.9 million, from \$20.3 million in FY 1995 to \$18.4 million in FY 1996 (table 9). The decline was primarily a result of employee furloughs due to a lapse in appropriations during part of the first and second quarters of FY 1996.

Royalty collections from the AFS/PAAS exceptions program totaled over \$182.5 million from the origin of the program in FY 1985 through the end of FY 1996.

2. AFS Exceptions

The AFS exceptions identification program promotes accurate and timely reporting and payment. The program detects:

- Late payment of royalties, rents, and bills;
- Insufficient estimated royalty payments; and

- Discrepancies between payments and financial lease terms for rents, bonuses, advance royalties, and minimum royalties.

The RMP issues bills for interest when payments are received after the due dates and when advance estimated royalty payments are insufficient compared to actual royalties paid at a later date. Interest collections fell from \$14.9 million in FY 1995 to \$11.3 million in FY 1996 (table 9). Payors submitted a greater volume of payments by due dates in FY 1996, resulting in fewer assessments for interest. The RMP has collected \$156.3 million in interest from the beginning of the program in FY 1985 through the end of FY 1996.

The RMP first issued bills for discrepancies associated with financial lease terms in May 1992. The effort generated nearly \$2 million in FY 1995 and over \$1.9 million in FY 1996 (table 9). Collections since the inception of the program total \$8.1 million.

3. Allowance Exceptions

All transportation and processing allowances deducted from royalties are subject to RMP review. The RMP has continued to improve efforts to monitor these deductions from the inception of the first automated program in FY 1992.

- **Automated Allowance Tracking System.** The Automated Allowance Tracking System reviewed oil and gas transportation and gas processing allowance forms filed by payors. The MMS Director placed a moratorium on filing violations in the first quarter of FY 1994; however, collections for bills issued before the moratorium resulted in \$595,000 in FY 1995 (table 9). No collections were made in FY 1996 as a result of the moratorium. The RMP collected over \$5.7 million for failure to file or late filing of allowance forms from the origin of the program in FY 1992 through the end of FY 1996.

The MMS amended allowance regulations effective March 1, 1996. The changes eliminated allowance form filing requirements and associated sanctions for Federal oil, gas, and coal leases only. There will subsequently be no further collections from the automated allowance tracking system.

- **Allowance Limit Exception Processing.** The RMP currently employs a sophisticated Allowance Limit Exception Processing (ALEP) program to analyze deductions. The RMP implemented ALEP in the fourth quarter of FY 1994 to detect payors who exceed regulatory allowance limits. The automated program reviews royalty reports submitted by payors to determine compliance with regulatory allowance limits. Bills are issued when allowances exceed 99 percent of royalties due, and notification letters are issued when allowances are greater than the regulatory allowance limit

but are less than 99 percent of royalties due. Each month, ALEP reviews new royalty report lines to determine if the payor has corrected identified exceptions.

If the payor submits a corrected royalty report to resolve the problem, a credit is automatically generated and the exception is closed. If the payor attempted to resolve the problem but is still not in compliance, ALEP generates a credit for the original bill and issues a new bill for any outstanding dollar amount.

The program detected millions of dollars of allowance limit violations during the period March 1988 through FY 1996. The RMP is developing a procedure to monitor collections resulting from exceptions detected by ALEP.

4. Liquidated Damage Assessments

The RMP formerly issued bills for liquidated damage assessments when royalty or production reports were received after the due date or were submitted with errors. The assessments were in addition to interest on the amount paid late.

Effective October 1, 1995, RMP changed its assessment policy for late and incorrect reporting. Under the new policy, RMP no longer charges reporters for filing late royalty or production reports. In addition, reporters will normally not be charged for incorrect royalty and production reporting unless the overall error rate RMP calculates for a given month exceeds the FY 1995 average error rate of approximately 3 percent. While assessments for late reporting will cease, RMP will continue to assess interest when payments are late.

Collections from late and erroneous royalty reports through AFS generated \$430,000 in FY 1995 and \$4,000 in FY 1996 (table 9). Many of the collections in FY 1995 were from bills issued prior to October 1, 1995. Collections from the beginning of the program in FY 1987 through the end of FY 1996 totaled nearly \$2.6 million.

Collections from operators for late or erroneous production reports through PAAS totaled \$336,000 in FY 1995 and less than \$500 in FY 1996 (table 9). Again, many of the collections in FY 1995 were from bills issued prior to October 1, 1995. Liquidated damage collections totaled over \$1.8 million from the inception of the program in FY 1989 through the end of FY 1996.

5. OCS Recoupments

Section 10 of OCSLA required a payor to file a request with RMP for a recoupment of an overpayment within 2 years of the original

payment. The RMP must provide 30 days' notification to Congress before approving the recoupment. Payors who take a recoupment without authorization are contacted by RMP and must explain the recoupment within 30 days. Failure to respond to the notification or to justify the recoupment results in an assessment to recover the unauthorized amount.

Under the provisions of RSFA, payors will no longer be required to file a request for a recoupment with RMP. This provision will apply to payment receipt dates after August 12, 1996.

Collections fell from \$752,000 in FY 1995 to \$416,000 in FY 1996 (table 9). Collections from improper recoupments totaled over \$2.4 million from the origin of the program in January 1992 through FY 1996.

6. Indian Recoupments

Payors who take a recoupment of an overpayment on an Indian lease cannot recoup more than 50 percent of the monthly revenue payment on an allotted lease or 100 percent of the monthly revenue payment on a Tribal lease. Collections from improper Indian recoupments fell from \$522,000 in FY 1995 to \$209,000 in FY 1996 (table 9). Payors reported more recoupments correctly in FY 1996, resulting in fewer assessments.

Collections from Indian recoupments totaled over \$1.2 million from the beginning of the program in FY 1992 through FY 1996.

7. Improper Adjustments

The RMP compares every credit line submitted by a payor with the most recent payment line. Payors who submit a credit line that does not match the original payment line must repay the credit amount. Collections from improper adjustments remained relatively stable at \$580,000 in FY 1995 and \$542,000 in FY 1996 (table 9).

Collections from improper adjustments totaled nearly \$1.5 million from the inception of the program in FY 1993 through FY 1996.

8. Royalty Rate Monitoring

The RMP calculates a royalty rate from monthly sales information provided by payors. The calculated royalty rate is compared with the royalty rate in the lease. If the calculated rate from the payor is lower than the lease rate, RMP notifies the payor of the error and provides 90 days to correct the mistake. The RMP bills payors for additional royalties based on the higher lease rate if

the payor does not correct the error. The RMP collected \$106,000 in FY 1995 and \$366,000 in FY 1996 from this effort (table 9).

Collections from the inception of royalty rate monitoring in FY 1994 totaled \$472,000.

Table 9. Revenues collected from exception identification programs, FY 1995-96 (in thousands)

	<u>FY 1995</u>	<u>FY 1996</u>
AFS/PAAS Exceptions.....	\$20,305	\$18,370
AFS Exceptions		
Interest Exceptions from Late Payments and Insufficient Estimates.....	\$14,860	\$11,349
Lease Term Exceptions.....	<u>1,984</u>	<u>1,934</u>
Subtotal.....	\$16,844	\$13,283
Allowance Exceptions.....	\$ 595	\$ ---
Liquidated Damage Assessments		
Payor Royalty Reports from AFS.....	\$ 430	\$ 4
Operator Production Reports from PAAS..	<u>336</u>	<u>---</u>
Subtotal.....	\$ 766	\$ 4
OCS Recoupments.....	\$ 752	\$ 416
Indian Recoupments.....	\$ 522	\$ 209
Improper Adjustments.....	\$ 580	\$ 542
Royalty Rate Monitoring.....	\$ 106	\$ 366
TOTAL.....	\$40,470	\$33,190

D. Delinquent Accounts Receivable

A receivable is established in AFS whenever RMP receives a royalty report or issues a bill. The office originating the bill submits a demand letter to the Debt Collection Section in the RMP Office of Enforcement explaining the basis for the assessment and a request for a Bill for Collection. Personnel in the Debt Collection Section enter the billing information into AFS and send the bill and the

demand letter to the payor. An account receivable is considered delinquent when the bill is not paid by the due date.

Employees with the Debt Collection Section monitor the status of accounts receivable and initiate actions to secure payment on delinquent accounts. These actions may include:

- First and second followup collection notices to payors with delinquent invoices;
- Demands for payment from lessees of record;
- Requests to BIA, BLM, or MMS offshore offices to collect against lease sureties and to cancel delinquent leases; and
- Notices of noncompliance and assessment of civil penalties to payors.

A microcomputer in the Debt Collection Section uses data downloaded from AFS to produce the first and second followup collection notices. Subsequent collection actions have been automated to enable employees to issue more actions in a shorter period of time to obtain payment.

Table 10. Actions to secure payment on delinquent accounts, FY 1995-96

	<u>FY 1995</u>	<u>FY 1996</u>
First Followup Notices.....	2,329	1,547
Second Followup Notices.....	1,194	866
Demands for Collection to Lessees of Record.....	240	198
Requests to BIA, BLM, and MMS Offshore Offices for Lease Surety Collections.....	313	252
Notices of Noncompliance for Failure to Pay.....	-0-	-0-

The number of demands for collection to lessees of record declined from 240 in FY 1995 to 198 in FY 1996 (table 10). The decline is due to a lower volume of bills issued through exceptions identification programs and the effectiveness of settlement actions.

Requests to BIA, BLM, and MMS offshore offices for lease surety collections fell from 313 requests in FY 1995 to 252 requests in FY 1996 (table 10).

The number of delinquent billed accounts receivable declined 28.4 percent, from 2,079 at the end of FY 1995 to 1,489 at the end of FY 1996 (table 11). A delinquent account includes any bill that has not been paid by the due date. The decline in account activity is primarily due to the termination of a number of bills for minor amounts in an effort to streamline the billing process for both the Federal Government and industry.

The value of delinquent accounts secured by surety remained relatively stable at \$99.5 million in FY 1995 and \$100.3 million in FY 1996 (table 11). Accounts in this category are primarily bills that have been appealed or are in litigation, where payors have posted a surety instrument guaranteeing payment if the issue is decided in the Department's favor.

The value of delinquent accounts not secured by surety rose from \$17 million in FY 1995 to \$23.2 million in FY 1996 (table 11). The increase is attributed to a number of new bills issued through the royalty-in-kind program. Unsecured delinquent accounts include unpaid bills in the early stages of collection (first and second followup notices) and bills for which enforcement actions have been taken, including calling the lease surety and proceeding with legal action involving the Solicitor and the Department of Justice. Attempts to collect some unsecured bills are suspended because of administrative actions in process.

**Table 11. Delinquent accounts activity, FY 1995-96
(revenues in millions)**

	<u>FY 1995</u>	<u>FY 1996</u>
Number of Delinquent Accounts		
Receivable (Bills Not Paid by Due Date).....	2,079	1,489
Value of Delinquent Accounts		
Receivable for Which Surety Has Been Posted.....	\$99.5	\$100.3
Value of Delinquent Accounts		
Receivable for Which No Surety Has Been Posted.....	\$ 17	\$ 23.2

IV. INSPECTION AND ENFORCEMENT

A. Onshore

1. BLM Inspection and Enforcement Program

The BLM nationwide Inspection and Enforcement (I&E) Program is designed to achieve the following objectives:

- Oil and gas produced from or allocated to Federal and Indian leases will be properly handled, measured, and reported;
- All drilling, producing, and abandonment operations will comply with approved operating plans for the protection of the environment, natural resources, and public health and safety; and
- All identified violations will be corrected.

The I&E Program is implemented by an I&E Strategy (Strategy) issued by the Washington Headquarters. The Strategy identifies inspection priorities based on budget limitations, manpower constraints, and program emphasis determined by BLM management. The BLM State Offices develop their inspection plans using guidance provided in the Strategy. The plans identify the priority of inspection items.

The current Strategy, implemented in FY 1991, provides for a balance in production, drilling, and abandonment inspections, with emphasis on both environmental protection and production accountability. Production accountability is provided through increased visual inspections of operator measurement actions and the review and comparison of measurement and production records. The Strategy also places more emphasis on protecting the environment through greater inspection coverage of drilling and abandonment operations. The BLM has improved Indian trust oversight through a balanced inspection program and strengthened production accountability.

The BLM Automated Inspection Records System (AIRS) records results and work hours used in performing inspections. The BLM is developing a new system, the Automated Fluid Minerals Support System, to replace AIRS. A prototype of the new system is currently being tested in the field.

The Department is evaluating the delegation of BLM inspection and enforcement responsibilities on Federal onshore lands to interested States under the provisions of section 205 of FOGPMA, as revised by RSFA. Meetings with representatives from States, industry, and the Interstate Oil and Gas Compact Commission are being conducted to discuss issues.

2. Program Review

The BLM State Offices administer quality assurance responsibilities through Technical Procedures Reviews. Two offices provide Washington Headquarters oversight:

- The Management Improvement/Evaluation Team provides bureau-wide oversight for program implementation and management; and
- The Fluids Group provides oversight, technical assistance, and guidance.

3. BLM Certification and Training Programs

The BLM implemented an Inspector Certification Program in FY 1987. The program ensures that inspectors and their supervisors are experienced in oil and gas industry practices and understand BLM oil and gas regulations in order to conduct independent inspection and enforcement of industry activities. The BLM has identified 141 positions that require certification under the program. Training in drilling and production inspections has been completed for most of the positions. A work group continues to evaluate the Inspector Certification Program and will recommend changes where appropriate.

The BLM began production and drilling training programs in February 1982. The Production Course addresses production accountability and site security. The Drilling Course addresses safety and environmental protection. No sessions were held in FY 1996 due to budget constraints. A total of 677 students representing States, Indian Tribes, BIA, BLM, MMS, the National Park Service, and the U.S. Forest Service have attended these courses during the past 15 years.

The BLM developed a new course in FY 1991, "I&E for Managers," designed to provide supervisors with the tools and information necessary to administer the I&E Program. The course provides direct training with oil- and gas-producing equipment and resolution of I&E management problems. No sessions were conducted in FY 1996. A total of 48 managers have attended the course during the past 6 years.

4. FOGRMA Regulations

The BLM began a process in FY 1996 to reform its regulations under the provisions of Executive Order 12866 dated September 30, 1993. The process is designed to provide clear, concise regulations that are easy to understand. The regulations will further be performance-based where appropriate. The first major rulemaking employing this process has been developed and may be published for

public comment in FY 1997. The proposal will include most of the separate operational rulemaking previously initiated, and will incorporate performance standards contained in all Onshore Oil and Gas Orders.

A summary of current rulemaking activities that are not part of the reform process follows:

- **Proposed rulemaking (43 CFR 3100/3160), Drainage Protection.** The BLM has drafted proposed rulemaking that will establish the date of the lessee's responsibility to protect against drainage; set a profit threshold; allocate the burden of proof to determine if drainage is occurring; and specify the responsibilities of multiple interest owners. The proposed rule may be published for public comment in FY 1997.
- **Proposed rulemaking (43 CFR Group 3200), Geothermal Resources Leasing and Operations.** The BLM completed the development of proposed rulemaking in FY 1996 to revise and consolidate all geothermal resources leasing and operating provisions into a single set of regulations. The proposed rulemaking was published for public comment in the Federal Register on October 8, 1996.
- **Notice of request for information and suggestions regarding an incentive for producers of marginal gas from Federal leases (43 CFR 3103.4-1), Waiver, Suspension, or Reduction of Rental, Royalty, or Minimum Royalty.** The notice was published in the Federal Register on March 5, 1996. The notice solicits comments to determine if royalty rate reduction would stimulate the recovery of gas from Federal leases. The BLM will conduct outreach meetings to assist in the preparation of proposed rulemaking for public review and comment if responses to the notice support a rate reduction.

5. Cooperative Agreements Under Section 202 of FOGPMA

The BLM published a final rule for the creation of cooperative oil and gas inspection and enforcement agreements with States and Tribes in the Federal Register on January 25, 1991, with an effective date of February 25, 1991.

The Bureau maintained cooperative agreements in FY 1996 for oil and gas inspection and enforcement on Tribal lands with the Ute Mountain Ute Tribe in Colorado, the Jicarilla Apache Tribe and Navajo Nation in New Mexico, and the Assiniboine Sioux Tribe in Montana. Current agreements provide 50 percent of funding; however, proposed regulations are being drafted that would provide complete funding. An approved agreement with the Southern Ute Tribe in Colorado remained inactive throughout the year.

Proposals continue to be negotiated with the Shoshone and Arapaho Tribes of the Wind River Reservation in Wyoming for a cooperative agreement and with the Absentee Shawnee Tribe in Oklahoma for a self-determination contract.

Under the provisions of RSFA, States are no longer eligible for cooperative agreements under section 202 of FOGRMA. An unfunded Memorandum of Understanding agreement with Colorado for inspection and enforcement on Federal oil and gas leases in certain limited operational areas remained in effect during FY 1996.

6. Delegations of Authority Under Section 205 of FOGRMA

Rules implementing the delegation of oil and gas inspection and enforcement responsibilities to States under section 205 of FOGRMA were published in the Federal Register on July 17, 1987, with an effective date of August 17, 1987. No State has submitted a request for a delegation of authority under these regulations.

The BLM has no current plans to revise the existing delegation of authority regulations. The BLM is conducting meetings, however, with representatives from States, industry, and the Interstate Oil and Gas Compact Commission to discuss significant issues related to the transfer of authority to conduct the Federal I&E Program.

7. FY 1996 Inspections and Enforcement Actions for Noncompliance

The BLM completed 51,244 inspection activities in FY 1996. This represents a decline of 7,402 inspection activities, or 12.6 percent, from 58,646 inspection activities completed in FY 1995. The reduction is attributed to fewer personnel available for field inspections and other related budget constraints.

Inspection activities resulted in 5,695 enforcement actions in FY 1996, down 8.4 percent from 6,215 actions in FY 1995. The decline is attributed to a lower volume of inspection activities and to continued voluntary compliance by industry. The BLM made assessments totaling \$79,750 under the Mineral Leasing Act, as amended, in 134 cases of noncompliance. No civil penalties were assessed under section 109 of FOGRMA.

8. Production Accounting for Onshore Oil and Gas Leases

The transfer of responsibility from BLM to MMS for the collection of onshore oil and gas production data began in FY 1988. All operators were submitting production reports exclusively to MMS by October 16, 1989.

The MMS edits the reports using well, lease, and operator data submitted from the BLM AIRS database. Production data are compiled and transmitted electronically to BLM. The BLM and MMS developed and implemented an automated system, Monthly Report of Operations, to provide field inspectors with production data to compare with observations made during onsite inspections.

B. Offshore

1. MMS Offshore Inspection Program

The MMS developed the Offshore Inspection Program (OIP) to promote safe and pollution-free operations on the OCS, ensure fair and consistent inspections, and verify operator compliance with agency requirements. Offshore Minerals Management personnel continued the following OIP improvements in FY 1996:

- A workgroup continues to revise the National Potential Incident of Noncompliance (PINC) list and inspection guidelines. The PINC list identifies all potential violations of MMS field operation regulations used by MMS officials in the inspection of offshore facilities. The current effort includes reviewing crane PINC's, eliminating redundant items, and combining items when possible.
- The MMS initiated a project that will develop a methodology to assess the relative risk of all offshore facilities. The priority and frequency of MMS inspections will be based on this risk assessment. The project will examine risk factors associated with operator performance and the type of operations conducted by the facility. Some of the general risk factors include:
 - The type of incidents occurring on a facility;
 - History of operator noncompliance with regulations;
 - Information relating to the operator profile;
 - Type of production;
 - Type of facility; and
 - Location of the facility.

The MMS will inspect facilities with a higher risk more frequently than facilities with a lower risk. The program should be implemented in late FY 1997 or early FY 1998.

- An Offshore Minerals Management team is revising OCS Civil/Criminal Penalty Program policy and regulations. The new policy, issued January 1996, clearly defines the types of violations that warrant civil/criminal penalty review. The new regulations will be written in plain English, using a "question/answer" format. The proposed rule was published in the Federal Register on December 19, 1996.
- Progress continued on the Safety and Environmental Management Program (SEMP) concept. Under the concept, a lessee or operator will prepare a SEMP plan that describes policies and procedures to ensure safety and environmental protection while conducting oil, gas, and sulfur operations on the OCS.

The API developed a recommended practice (RP-75) to address SEMP in a document entitled, "Recommended Practices for the Development of a Safety and Environmental Management Program for Outer Continental Shelf Operations and Facilities." The MMS has requested voluntary compliance with the recommended practice. The MMS and API have developed a survey to be administered annually to measure compliance among companies operating on the OCS. The MMS also began to work with offshore operators to develop a brief set of commonly-defined, universally-applied safety and environmental measures of performance.

2. Offshore Inspection Activity

The MMS conducted 11,538 inspections of drilling, production, pipeline, measurement, site security, well completion, well workover, and abandonment operations during FY 1996. The effort included 10,607 inspections in the Gulf of Mexico Region and 931 inspections in the Pacific Region. There were no offshore operations to inspect in the Alaska Region in FY 1996.

V. RMP ORGANIZATION, FUNCTIONS, AND STRUCTURE

A. Federal Resources

The RMP budget consists of two subactivities:

- Mineral Revenue Valuation and Operations, providing resources for collection and distribution of mineral revenues; computer and related high-technology systems development and operation; and valuation determinations and allowance monitoring.
- Mineral Revenue Compliance, providing resources for audit and other verification of mineral leases on Federal offshore, Federal onshore, and Indian lands; outreach to Indian Tribes and allottees; and development and administration of RMP enforcement programs.

Operations for these activities are centralized in RMP Headquarters in Lakewood, Colorado. The RMP maintains several field offices and audit residencies outside the Headquarters. The majority of the audit staff is located in cities where many of the top royalty payors maintain accounting centers. Approximately half of the Indian outreach staff is located in areas with large Indian populations. Total resources allocated to RMP in FY 1996 included \$70 million, funding a staff effort of 638 Federal employee workyears. Additional work performed by contract staff is addressed below.

The RMP provided funds for audit agreements and other direct support for 7 Tribes and 10 States in FY 1996. The direct support included telecommunication and automated data processing (ADP) enhancements to improve the interaction of Tribes and States with RMP systems and databases. The RMP devoted nearly \$7 million to the cooperative audit program during the year.

B. Contract Support

Contractors provided support for royalty management ADP and financial services in Lakewood, Colorado, in FY 1996. A brief description of major activities and obligated budget amounts for each contractor follows:

1. American Management Systems Operations Corporation, Inc.

The MMS awarded an ADP contract to the American Management Systems Operations Corporation, Inc. on June 21, 1991, with an effective date of August 1, 1991. The firm performed the following ADP functions in FY 1996:

- Operations support for AFS, the Business Information System (BIS), the Interagency Database Verification System, PAAS, and the RMP wide-area network;
- Development and maintenance of a client/server environment and associated client/server applications;
- Software maintenance for AFS and PAAS;
- Software development for on-line access to solid minerals data; and
- Operation of the mainframe computer and VAX minicomputer.

The MMS obligated approximately \$7.6 million against the contract in FY 1996, funding 147 contractor workyears.

2. Source One Management, Inc.

The MMS awarded an accounting support services contract to Source One Management, Inc., a Small Business Administration 8(a) contractor, effective February 1, 1993. The contractor performed the following financial services in FY 1996, the third option year of the contract:

- Verification of AFS-generated prebills from manual and automated exception processing to calculate and mail interest and liquidated damage bills to payors;
- Review and verification of PAAS reference and application data, and file maintenance;
- Research and analysis of Common Reference Database information;
- Correction of selected errors contained in data submitted by operators on production reports; and
- Review and monitoring of the allowance tracking system for oil and gas transportation and processing allowances.

The MMS obligated approximately \$4.4 million against the contract in FY 1996, funding 102 contractor workyears.

3. ViON Corporation

The MMS modified the contract with ViON Corporation in October 1995, exercising the option period for maintenance of the Hitachi EX-90 mainframe computer, and exercising the option to purchase additional equipment. The contract provides for additional upgrades over the

8-year systems life of the contract. The MMS obligated \$143,640 in FY 1996.

4. Decision One Corporation

The MMS awarded a contract to Bell Atlantic Business Systems Services, Inc., in October 1995, for maintenance of IBM ADP hardware. The contract provides for 1 base year and 4 option years. The company changed its name to Decision One Corporation in April 1996. The MMS obligated \$49,694 in FY 1996.

VI. STATUS OF THE LINOWES COMMISSION RECOMMENDATIONS

The Linowes Commission submitted 60 recommendations in January 1982 to improve the management of the Nation's energy resources and to prevent a loss of revenues owed the Federal Government, the States, and Indians. The Department had implemented 54 of the 60 recommendations by the end of FY 1990.

The remaining six recommendations were found to be impractical after extensive review and analysis:

- **Operator of record.** The recommendation involved designation of an "Operator of Record" for each lease who would maintain all royalty records from the lease and reconcile payments to production reports on a monthly basis. The Department withdrew consideration of the concept following receipt of unfavorable comments from a Notice published in the Federal Register.
- **Sixty-day payment for gas.** The recommendation would have permitted payment of natural gas royalties within 60 days from the end of the sales month. Analysis revealed that the cost to the Federal Government, States, and Tribes would be prohibitive due to lost revenue that would result from an additional 30 days in the payment cycle.
- **Undocumented oil.** The Department was asked to seek legislation to prohibit the purchase of undocumented oil. Purchasers, including refiners, would be required to maintain documentation tracing the purchase of the product to a specific lease or unit.

The recommendation was not considered feasible due to the imposition of record requirements on industry. Nearly 80 percent of crude oil produced in the United States is derived from sources other than Federal and Indian mineral leases. The RMP auditors examine the source of oil from Federal and Indian lands as a function of the audit process. This satisfies the intent of the recommendation.

- **Windfall Profit Tax (WPT).** The recommendation would have relieved RMP of the responsibility for calculating and paying WPT on royalty-in-kind transactions and would have required industry to calculate, withhold, and pay WPT on all crude oil sold from Federal leases. The Internal Revenue Service would have provided oversight.

The MMS elected to retain the WPT responsibility due to the cost and record requirements that would be imposed on industry, and the cost associated with the development of a new reporting system in MMS. Congress repealed the WPT on August 23, 1988.

- **Increased royalty rate.** The recommendation would have employed a minimum royalty rate of 16 2/3 percent on new or renegotiated

leases. Internal and external studies were inconclusive. The Department elected not to pursue an increased rate.

The BLM amended regulations effective in September 1992 to establish conditions under which owners or operators of stripper oil well properties could obtain a reduced royalty rate. The action is intended to encourage operators to place marginal or uneconomical wells back in production. A Department of Energy study concluded that annual domestic oil production could increase by 4.7 million barrels.

- **Self-sustaining fund/levy.** The Secretary sought legislation during the period FY 1985-88 to establish a self-sustaining fund that would pay the costs of audits and inspections, and reimburse States and Indian Tribes for their efforts through cooperative agreements. Legislation was not enacted during the 4-year period.

GLOSSARY

ACH – Automated Clearing House. A computerized financial system operated to effect the electronic transfer of funds between banks. ACH is designed to accommodate a large volume of small-dollar transactions. Payors remit payments to ACH and the funds become available to the recipient the following day.

ADP – Automated data processing.

AFEE – Automated front-end enhancement. A computer systems enhancement developed by the Minerals Management Service to automate the front-end processes to detect potential discrepancies, or exceptions, between sales volumes reported to the Auditing and Financial System by payors, and sales or transfer volumes reported to the Production Accounting and Auditing System by lease or agreement operators. System-generated worksheets and automated correspondence to operators help resolve exceptions by identifying payors who may be under reporting royalties.

AFS – Auditing and Financial System. A computer system application operated by the Minerals Management Service for collecting and disbursing royalties from producing leases and rents from nonproducing leases on Federal and Indian lands.

AIRS – Automated Inspection Records System. A computer system application operated by the Bureau of Land Management for storage and retrieval of oil and gas inspection and enforcement records.

ALEP – Allowance Limit Exception Processing. An automated program developed by the Minerals Management Service that employs royalty reports submitted by payors to determine compliance with regulatory allowance limits.

ANS – Alaska North Slope. A spot sale price index associated with oil produced in Alaska that is sold predominantly to Los Angeles and San Francisco refiners.

ANSI – American National Standards Institute. A national coordinating body of representatives from industry and government dedicated to developing voluntary standards for various industries.

API – American Petroleum Institute. A trade association representing all segments of the petroleum industry from exploration through marketing. API is the largest association in the petroleum industry.

Assistant Secretary-Land and Minerals Management – An executive who serves under the Secretary of the Interior and exercises Secretarial direction and supervision over the Bureau of Land Management, the Minerals Management Service, and the Office of Surface Mining Reclamation and Enforcement.

BIA – Bureau of Indian Affairs. A Federal agency within the Department of the Interior responsible for facilitating the full development of the human and natural resource potential of Indian and Alaskan Native people to manage their own affairs under a trust relationship with the Federal Government.

BIS – Business Information System. A computer system application operated by the Minerals Management Service. BIS is an enhanced version of the former State and Tribal Support System and is compatible with the post-Business Systems Planning Implementation architecture. BIS provides States, Indian Tribes, and other Federal agencies with access to Auditing and Financial System data and selected Production Accounting and Auditing System data.

BLM – Bureau of Land Management. A Federal agency within the Department of the Interior that administers public lands and natural resources. BLM programs provide for the protection, orderly development, and use of the public lands and resources under principles of multiple use and sustained yield.

Cash-out – Pipeline provisions require that shippers maintain pipeline receipts and deliveries within certain daily or monthly tolerances. Shippers are required to cash-out accumulated imbalances for over-delivered and under-delivered production.

CFR – Code of Federal Regulations. A codification of the general and permanent rules published in the Federal Register by the executive departments and agencies of the Federal Government.

COLD – Computer output on laser disk. An automated process that copies mainframe reports to optical storage and allows users to access and manipulate the reports and data online as soon as they are produced.

Department – Department of the Interior. A Cabinet-level department in the Executive Branch of the Federal Government responsible for the administration of most of the nationally owned public lands and natural resources. The Department is further responsible for American Indian reservation communities and for individuals who live in Island Territories under U.S. administration.

DOE – Department of Energy. A Cabinet-level department in the Executive Branch of the Federal Government responsible for coordinating a comprehensive and balanced national energy plan. DOE is responsible for long-term research and development of energy technology; marketing Federal power; energy conservation; the nuclear weapons program; and a central energy data collection and analysis program.

EDI – Electronic data interchange. A process designed to exchange information electronically to reduce paper report volume, reduce

errors and expedite error correction, and provide a more current database.

EFT – Electronic funds transfer. The automated exchange of funds between computer systems which eliminates the necessity for the physical exchange of cash, checks, or other forms of money.

Federal Committee – Federal Gas Valuation Negotiated Rulemaking Committee. A committee chartered by the Secretary of the Interior with representatives from the Minerals Management Service, States, and industry to develop proposals to improve and simplify the valuation and payment of royalties from natural gas produced from Federal leases.

FERC – Federal Energy Regulatory Commission. An independent agency created through the Department of Energy Organization Act in 1977. FERC regulates the transportation of natural gas in interstate commerce; the transportation of oil by pipeline in interstate commerce; the transmission and wholesale sales of electricity in interstate commerce; the licensing of private, municipal, and state hydroelectric projects; and provides oversight of related environmental matters.

FOGRMA – Federal Oil and Gas Royalty Management Act of 1982, 30 U.S.C. 1701 et seq. Public Law 97-451 enacted to ensure that royalties from oil and gas produced from Federal and Indian lands and the Outer Continental Shelf are properly collected and accounted for under the direction of the Secretary of the Interior.

FY – Fiscal year. A period of time used for accounting purposes. The Federal Government recognizes a fiscal year that begins October 1 of one year and ends September 30 of the following year.

I&E – Inspection and Enforcement Program. A Bureau of Land Management program designed to ensure that oil and gas production on Federal and Indian leases is accurately reported by the lessee and verified by the Bureau of Land Management. The program further ensures that all drilling, producing, and abandonment operations comply with approved operating plans and that all violations are corrected.

IMDA – Indian Mineral Development Act of 1982, 25 U.S.C. 2101 et seq. An act that permits Indian Tribes to enter into certain agreements for the disposition of Tribal mineral resources and for other purposes.

IMSC – Indian Minerals Steering Committee. A senior policy forum of officials from the Bureau of Indian Affairs, Bureau of Land Management, and Minerals Management Service established by the Department of the Interior to improve the management of Indian minerals.

Indian Committee – Indian Gas Valuation Negotiated Rulemaking Committee. A committee chartered by the Secretary of the Interior

with representatives from the Minerals Management Service, the Bureau of Indian Affairs, Indian mineral owners, and industry. The committee was established to develop proposals that will maximize royalty revenues from natural gas for Indian Tribes and allottees consistent with the Secretary's discretion to establish values. The proposals will further satisfy industry concerns by clarifying and reducing information requirements to compute royalty in an accurate, timely manner.

Linowes Commission – Commission on Fiscal Accountability of the Nation's Energy Resources. A Commission that submitted 60 recommendations in January 1982 to improve management of the Nation's energy resources and to prevent a loss of revenues owed the Federal Government, the States, and Indians. The Commission's work led to the creation of the Minerals Management Service and enactment of the Federal Oil and Gas Royalty Management Act of 1982.

MMS – Minerals Management Service. A Federal agency within the Department of the Interior that administers the Offshore Minerals Management Program and the Royalty Management Program. The Offshore Minerals Management Program is responsible for the Outer Continental Shelf leasing program and for ensuring that exploration and production of the Nation's offshore mineral resources is conducted in a safe manner with concern for the environment. The Royalty Management Program is responsible for the accurate and timely determination, collection, and distribution of royalties from Federal and Indian lands, and bonuses and rents from Federal lands.

National Performance Review – An initiative introduced by President Clinton and Vice President Gore to "reinvent" work processes within the Federal Government. The initiative is designed to make Government operate more efficiently at a lower cost.

Net profit share lease – An Outer Continental Shelf lease that provides for payment to the United States of a percentage share of the net profits for production of oil and gas from the tract. The percentage share may be fixed in the notice of the lease sale or may be a variable of the bid, depending on the bidding system used for the lease sale.

NYMEX – New York Mercantile Exchange. The world's largest physical commodity exchange used primarily for hedging price risk associated with the energy and metals industries.

OCS – Outer Continental Shelf. All submerged lands seaward and outside the area of lands beneath navigable waters. Lands beneath navigable waters are interpreted as extending from the coastline 3 nautical miles into the Arctic Ocean, the Atlantic Ocean, the Pacific Ocean, and the Gulf of Mexico, excluding the coastal waters off Texas and western Florida. Lands beneath navigable waters are interpreted as extending from the coastline 3 marine leagues into the Gulf of Mexico off Texas and western Florida.

OCSLA – Outer Continental Shelf Lands Act of 1953, as amended, 43 U.S.C. 1331 et seq. An act that establishes procedures for U.S. jurisdiction over Outer Continental Shelf lands and authorizes the Secretary of the Interior to issue exploration permits and mineral leases for oil, gas, sulfur, and other mineral resources on those lands. The Secretary is authorized to implement alternative bidding systems, including net profit share leases, to promote development of marginal oil and gas deposits. Significant amendments were enacted into the original law in 1978 and 1985. See **Net profit share lease.**

OIP – Offshore Inspection Program. A program developed by the Minerals Management Service to promote safe and pollution-free operations on the Outer Continental Shelf, ensure fair and consistent inspections, and verify operator compliance with agency requirements.

OIRA – Office of Indian Royalty Assistance. An office within the Minerals Management Service responsible for providing royalty assistance and conducting an outreach program to ensure Royalty Management Program coordination and communication with Indian Tribes and allottees as part of the Secretary of the Interior's trust responsibility to Indian mineral owners.

PAAS – Production Accounting and Auditing System. An integrated system of both automated and manual applications operated by the Minerals Management Service to collect production and other operational data, and to ensure that royalties are paid on 100 percent of reported production.

PINC – National Potential Incident of Noncompliance List. A listing of all potential violations of Minerals Management Service field operation regulations used by agency officials in the inspection of offshore facilities.

Quality bank – A mechanism instituted by a pipeline system operator to calculate and effect monetary adjustments among shippers of different gravities and qualities of liquid hydrocarbons in a common carrier pipeline.

RMP – Royalty Management Program. A program administered by the Minerals Management Service responsible for the accurate and timely determination, collection, and distribution of royalties from Federal and Indian lands, and bonuses and rents from Federal lands.

Royalty Management Advisory Committee – A former committee, composed of representatives from States, Indian Tribes, and the minerals industry, that addressed significant Royalty Management Program issues and provided advice to the Secretary of the Interior on matters that concerned participants in the royalty management process.

RPC – Royalty Policy Committee. A committee established in 1995 as part of the Minerals Management Advisory Board to provide recommendations and guidance on royalty management policies and

procedures. RPC is composed of representatives from the Western Governors Association, Western States Land Commissioners Association, States, Indian Tribes and allottee organizations, the minerals industry, other Federal agencies, and interested members of the general public.

RQS – Royalty Management Program Query System. A computer system application operated by the Minerals Management Service providing online access to historical royalty and reference data through a client/server environment. RQS provides access to standard reports, graphs, customized queries and reports designed by individual clients, and other systems applications.

RSFA – Federal Oil and Gas Royalty Simplification and Fairness Act, 110 Stat. 1700. Public Law 104-185 enacted to amend the Federal Oil and Gas Royalty Management Act of 1982 and revise Minerals Management Service procedures in several respects.

RVD – Royalty Valuation Division. A Division of the Minerals Management Service Royalty Management Program responsible for assuring that royalty reported and paid, for production removed from Federal and Indian lands, is based on proper value. RVD is further responsible for establishing and maintaining regulatory policy and procedural standards to provide a consistent basis for value determination.

Secretary – Secretary of the Interior.

SEMP – Safety and Environmental Management Program. A program in which offshore operators develop a plan describing the company's overall safety and pollution prevention policies and procedures. The purpose of the program is to reduce the risk and occurrence of accidents and pollution associated with offshore oil and gas drilling and production operations through active risk management.

STRACNET – State and Tribal Royalty Audit Committee Network. A Royalty Management Program wide-area network designed to facilitate data access and the rapid exchange of information between States, Tribes, and Royalty Management Program personnel. STRACNET currently provides on-line access to 16 State and Tribal sites that have cooperative audit agreements under sections 202 and 205 of the Federal Oil and Gas Royalty Management Act of 1982. Laptop computers have also been provided to Louisiana representatives who maintain a cooperative audit agreement under section 205 of the Federal Oil and Gas Royalty Management Act of 1982.

Strategy – Inspection and Enforcement Strategy. A Bureau of Land Management plan that identifies mineral inspection priorities for the fiscal year based on resource availability and program emphasis.

Treasury – Department of the Treasury. A Cabinet-level Department in the Executive Branch of the Federal Government responsible for the

financial resources of the United States. The Treasury is responsible for regulating national banks, determining international economic policy, collecting income taxes and customs duties, reporting Government daily financial transactions, and manufacturing coins and bills for circulation.

U-account – Unauthorized account gas. Gas delivered to the pipeline in excess of the volume producers nominate for purchase. This excess is also referred to as overbalance gas.

WPT – Windfall Profit Tax. An excise tax on a windfall profit from taxable crude oil removed from the premises of Federal leases after February 29, 1980. The tax applies only to production from wells in the United States or its possessions. Congress repealed the tax on August 23, 1988.

**APPENDIX
STATISTICAL HIGHLIGHTS**

Mineral Revenue Collections, FY 1995-96 (In Thousands)

	<u>FY 1995</u>	<u>FY 1996</u>	<u>Difference</u>
By Land Category			
Federal Offshore Lands	\$2,447,926	\$3,785,087	\$1,337,161
Federal Onshore Lands	1,014,337	979,356	(34,981)
Indian Lands	<u>153,319</u>	<u>145,791</u>	<u>(7,528)</u>
TOTAL	\$3,615,582	\$4,910,234	\$1,294,652
By Revenue Source			
Total Royalties	\$3,060,987	\$4,089,857	\$1,028,870
Total Bonuses & Rents	<u>554,595</u>	<u>820,377</u>	<u>265,782</u>
TOTAL	\$3,615,582	\$4,910,234	\$1,294,652

Mineral Revenue Disbursements, FY 1995-96 (In Thousands)

	<u>FY 1995</u>	<u>FY 1996</u>	<u>Difference</u>
Offshore Federal Lands			
Historic Preservation Fund	\$ 150,000	\$ 150,000	\$ ---
Land & Water Conservation Fund	896,987	896,906	(81)
State Shares (7 States)	75,468	89,871	14,403
U.S. Treasury: General Fund	<u>1,371,539</u>	<u>2,695,171</u>	<u>1,323,632</u>
Subtotal	\$2,493,994	\$3,831,948	\$1,337,954
Onshore Federal Lands			
Reclamation Fund	\$ 367,284	\$ 350,264	\$ (17,020)
State Shares (35 States)	477,544	457,754	(19,790)
U.S. Treasury: General Fund	<u>169,509</u>	<u>171,338</u>	<u>1,829</u>
Subtotal	\$1,014,337	\$ 979,356	\$ (34,981)
Indian Lands			
Tribes and Allottees	\$ 153,319	\$ 145,791	\$ (7,528)
TOTAL	\$3,661,650	\$4,957,095	\$1,295,445

Audit Collections and Refund Denials, FY 1995-96 (In Thousands)

	<u>FY 1995</u>	<u>FY 1996</u>	<u>Difference</u>
Royalty Management Program	\$172,753	\$30,211	\$(142,542)
State and Tribal	<u>42,881</u>	<u>9,517</u>	<u>(33,364)</u>
TOTAL	\$215,634	\$39,728	\$(175,906)

Exceptions Identification Programs, FY 1995-96 (In Thousands)

	<u>FY 1995</u>	<u>FY 1996</u>	<u>Difference</u>
AFS/PAAS Exceptions	\$20,305	\$18,370	\$(1,935)
AFS Exceptions	16,844	13,283	(3,561)
Allowance Exceptions	595	---	(595)
Liquidated Damage Assessments . .	766	4	(762)
OCS Recoupments	752	416	(336)
Indian Recoupments	522	209	(313)
Improper Adjustments	580	542	(38)
Royalty Rate Monitoring	<u>106</u>	<u>366</u>	<u>260</u>
TOTAL	\$40,470	\$33,190	\$(7,280)

**Audit and Exceptions Identification Collections,
Program Inception Through FY 1996 (In Millions)**

	<u>Total</u>
Audit Program, FY 1982-96	\$1,512.5
AFS/PAAS Exceptions, FY 1985-96	182.5
AFS Exceptions, FY 1985-96	164.4
Allowance Exceptions, FY 1992-96	5.7
Liquidated Damage Assessments, FY 1987-96	4.4
OCS Recoupments, FY 1992-96	2.4
Indian Recoupments, FY 1992-96	1.2
Improper Adjustments, FY 1993-96	1.5
Royalty Rate Monitoring	<u>0.5</u>
TOTAL	\$1,875.1

Delinquent Accounts, FY 1995-96 (Revenues in Millions)

	<u>FY 1995</u>	<u>FY 1996</u>	<u>Difference</u>
Delinquent Accounts	2,079	1,489	(590)
Value of Accounts With Surety . .	\$99.5	\$100.3	\$0.8
Value of Accounts Without Surety*	\$17.0	\$ 23.2	\$6.2

*The RMP is aggressively pursuing action on these accounts.

Oil and Gas Leases, Payors, and Lines Processed, FY 1995-96

	<u>FY 1995</u>	<u>FY 1996</u>	<u>Difference</u>
Oil and Gas Leases			
Producing	25,394	25,493	99
Nonproducing	<u>44,200</u>	<u>45,043</u>	<u>843</u>
TOTAL	69,594	70,536	942
Active Oil and Gas Payors	2,114	2,128	14
Oil & Gas Lines Processed Monthly	277,950	280,936	2,986



As the Nation's principal conservation agency, the Department of the Interior has responsibility for most of our nationally owned public lands and natural resources. This includes fostering sound use of our land and water resources; protecting our fish, wildlife, and biological diversity; preserving the environmental and cultural values of our national parks and historical places; and providing for the enjoyment of life through outdoor recreation. The Department assesses our energy and mineral resources and works to ensure that their development is in the best interests of all our people by encouraging stewardship and citizen participation in their care. The Department also has a major responsibility for American Indian reservation communities and for people who live in island territories under U.S. administration.



As a bureau of the Department of the Interior, the Minerals Management Service's (MMS) primary responsibilities are to manage the mineral resources located on the Nation's Outer Continental Shelf (OCS), collect revenue from the Federal OCS and onshore Federal and Indian lands, and distribute those revenues.

Moreover, in working to meet its responsibilities, the **Offshore Minerals Management Program** administers the OCS competitive leasing program and oversees the safe and environmentally sound exploration and production of our Nation's offshore natural gas, oil and other mineral resources. The MMS **Royalty Management Program** meets its responsibilities by ensuring the efficient, timely and accurate collection and disbursement of revenue from mineral leasing and production due to Indian tribes and allottees, States and the U.S. Treasury.

The MMS strives to fulfill its responsibilities through the general guiding principles of: (1) being responsive to the public's concerns and interests by maintaining a dialogue with all potentially affected parties and (2) carrying out its programs with an emphasis on working to enhance the quality of life for all Americans by lending MMS assistance and expertise to economic development and environmental protection.