

**STATEMENT OF
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UNITED STATES DEPARTMENT OF THE INTERIOR
COMMITTEE ON APPROPRIATIONS
SUBCOMMITTEE ON INTERIOR, ENVIRONMENT AND RELATED
AGENCIES
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Mr. Chairman and Members of the Subcommittee, thank you for the opportunity to appear before you today to discuss the President's Fiscal Year (FY) 2012 budget request for the Department of the Interior's Office of Natural Resources Revenue (ONRR).

ONRR Background

Last year, Secretary of the Interior Ken Salazar spearheaded an aggressive effort to reform the Department's oil and gas leasing and revenue management programs. On May 19, 2010, Secretary Salazar issued Secretarial Order 3299 directing the separation of responsibilities previously performed by the Minerals Management Service (MMS) and reassigning those responsibilities to three separate organizations: the Office of Natural Resources Revenue (ONRR), the Bureau of Ocean Energy Management (BOEM), and the Bureau of Safety and Environmental Enforcement (BSEE). ONRR was established in the Office of the Secretary under the Assistant Secretary for Policy, Management and Budget on October 1, 2010, pursuant to Secretarial Order No. 3306.

The ONRR collects, accounts for, analyzes, audits, and disburses revenues associated with energy and mineral leasing on the Outer Continental Shelf (OCS) and onshore Federal and American Indian lands. The ONRR fulfills part of the Department's Indian trust responsibility by serving as a trustee of the mineral revenue assets generated from Indian trust properties and as an advocate for the interests of Indian mineral owners. The ONRR collects and disburses approximately \$10 billion in annual revenues to the U.S. Treasury, five Federal agencies, 38 states, 41 American Indian tribes, and about 30,000 individual Indian mineral owners.

The reorganization of ONRR took place as planned and without disruption, thus reducing the potential for internal mission conflicts, mitigating the risks of organizational change, and allowing greater focus on specific opportunities to improve our management of mineral revenues, our human capital focus, and our communications with other offices. Since moving to the Office of the Secretary, ONRR has worked closely with the Assistant Secretary of Policy, Management and Budget to enhance the organization's ability to collect every dollar due, make accurate on-time payments, and earn public trust.

The reorganization presented an opportunity for ONRR to initiate a top to bottom review as the office strives to continue its efforts to improve the management and oversight of the royalty and revenue collection and disbursement activities for the Department. This effort facilitated a strategic review to assess potential improvements and develop a strategic framework for implementing current and future initiatives.

The ONRR is now proactively investing resources in implementing strategic priority initiatives that will allow us to achieve our three strategic outcomes:

- Collecting every dollar due from companies and ensuring they timely comply with laws, regulations, and lease terms.
- Disbursing and distributing accurate revenues and data to States, Tribes, Indian mineral owners, U.S. Treasury, and others.
- Restoring ONRR's credibility with the public.

Improving Mineral Revenue Collection Activities

Because ONRR is entrusted with an important fiduciary role, we value the continued oversight we receive from the Government Accountability Office (GAO), the Office of Inspector General (OIG), and other external organizations.

Since FY 2003, ONRR has been the subject of 40 external audits, evaluations, and reviews and 80 internal control reviews. ONRR is working diligently to implement needed reforms, and many previous external recommendations have already been implemented. Fiscal Year 2012 funding is critical to facilitate the implementation of many of the remaining internal and external audit recommendations.

In February 2011, GAO identified the Department of the Interior's Management of Federal Oil and Gas Resources in its High-Risk Series report. The report sites three "shortcomings" in Interior's revenue collection policies to ensure that 1) the Federal Government receives a fair return on its oil and gas resources (so called "government take"), 2) Interior completes its production verification inspections, and 3) Interior's data on production and royalties are consistent and reliable.

The first two items are a responsibility shared with the Bureau of Land Management and the Bureau of Ocean Energy Management, Regulation and Enforcement. ONRR has a strong working relationship with BLM and BOEMRE, which we are continuing to foster and promote. ONRR is participating with BLM and BOEMRE in conducting studies of oil and gas revenues – or “government take” – under different management regimes, and these studies should be completed and published later this year. ONRR also plans to cooperate with BLM and BOEMRE to complete a Departmental feasibility study on the use of automated production metering systems, allowing production data to be electronically sent to the government for production verification analysis.

The GAO's third item relates to the accuracy of royalty and production data that ONRR collects from industry. We agreed with GAO when they first raised this issue in 2008

and have been working diligently to implement improvements in the quality of company-reported royalty and production data. Several of ONRR's FY 2012 Budget Initiatives relate directly to GAOs' recommendations.

The GAO identified 50 DOI recommendations in their high risk report. ONRR is responsible for 11 of the 50 recommendations. The ONRR continues to make progress in implementing these recommendations.

The ONRR enforces existing laws that Congress created to ensure fair return for publically-owned minerals. It's important to note that although companies report their own royalty and production data, ONRR has a sophisticated accounting and detection system and a comprehensive risk-based audit and compliance program to target underpayments and to ensure that royalties do not go uncollected.

On average, over the last 5 years, our audit and compliance program collected payments of approximately \$110 million annually from companies. These amounts represent companies' underpayments in their initial reporting, which were discovered through ONRR's compliance activities. Our audit program has been strengthened in recent years as the direct result of funding from the Committee for additional auditors. We have been very successful in recruiting and retaining highly qualified auditors to augment our audit program. In addition, ONRR has a strong partnership with the OIG and the U.S. Attorney's Office to jointly pursue companies that intentionally underpay mineral royalties due on Federal and Indian lands.

FY 2012 President's Budget Request

The budget for the Department includes \$506.3 million for the components of the former Minerals Management Service to continue the reorganization and reform efforts of both offshore energy development activities and mineral revenue management. The FY 2012 budget request for ONRR is \$147.9 million, a \$38.7 million increase over the FY 2010 enacted level after adjusting for funding transferred from the former MMS. The request reflects the transfer of funding from BOEMRE to ONRR including \$89.4 million in program funding and \$19.9 million in funding for general administration. While this level of funding represents a significant increase, it provides an appropriate level of funding to ensure that the Department effectively implements critical revenue management reforms. This request funds the organization's fixed costs, returns anticipated reorganization efficiencies and administrative savings, and replaces mandatory RIK receipts used in prior years with direct appropriations needed to transition royalty in-kind (RIK) activities to ONRR's in-value processes. It also provides the resources needed to implement the reforms highlighted by recent GAO and OIG reports. It allows ONRR to enhance revenue collection activities by directing resources to our audit, oversight and enforcement, data mining, systems.

Royalty in Kind (RIK) Transition (+\$13,498,000; [58] FTE transitioned): The ONRR's FY 2012 budget request supports the orderly transition from receiving royalties in the form of oil and natural gas, or in-kind, to receiving royalties on a cash basis, or in-value.

The Secretary announced the termination of the RIK program on September 16, 2009, and ONRR immediately initiated an orderly shutdown, transitioning in-kind properties to in-value. Because all RIK oil and natural gas sales contracts have expired, the royalties owed are now paid on an in-value basis. The ONRR is expanding compliance and auditing activities for the increase in in-value royalties, by transitioning 58 FTE previously focused on in-kind mineral revenues to in-value compliance activities.

As a result of the transition, revenue receipts from RIK sales are no longer available to fund program management expenses. These receipts were previously used to support ONRR's RIK-related costs for financial accounting, audit and compliance, IT systems, executive direction staff, and other RIK-related administrative costs. All of these costs will remain as in-value costs after the transition. Therefore, in FY 2012 ONRR is requesting an additional \$13.5 million in discretionary appropriations to replace RIK receipts used in prior years.

While this request appears to be an increase in discretionary appropriations, the net change to the Treasury is zero. These activities were previously funded with RIK receipts, the value of which is now being deposited into the Treasury as in-value receipts, thus directly offsetting this requested appropriations increase. This request ensures the consistent funding level required to maintain ongoing compliance oversight capabilities for royalty payments that ONRR will now collect through the traditional royalty in-value processes, and to sustain the overall return to the American people from mineral revenue collections.

BOEMRE to Office of the Secretary Reorganization Transfer and Administration (+\$10,124,000; +3 FTE): The Department requests \$10.1 million to implement the reorganization of ONRR and institute oversight reforms as recommended by independent assessments recently completed and currently underway. Reorganizing and integrating ONRR within the Office of the Secretary with minimal disruption is critical to ensuring the full and fair receipt of royalties owed by producers.

Implementation of the reorganized ONRR will include utilizing outside management consultants with specific expertise in revenue management structures to inform the development of controls and procedures. Mitigation strategies will be developed to address the implementation issues and an accelerated implementation plan will be developed. After the migration is complete, ONRR will undertake an organizational effectiveness analysis to identify opportunities to improve performance operational areas.

Equally important will be the impact of the planned migration on completing modifications to address recommendations from the OIG, GAO, and Royalty Policy Committee. Many of the modifications involve transferring operations for improving the Mineral Revenue Management Support System, the primary data system currently used to collect royalties. System improvements, in addition to providing ONRR the capability to respond to external recommendations, will provide greater assurance that ONRR is accurately collecting royalties owed, and will consequently improve disbursement processes. Once ONRR has detected and corrected revenue errors, the efficiency of

audits and compliance reviews will increase because personnel will be able to focus efforts on complex issues including pricing contracts, transportation and processing issues, and other areas not currently detectable by automated compliance tools.

Production Measurement/Inspection (+\$7,343,000; +18 FTE): The ONRR is requesting \$7.34 million and 18 new production and measurement inspectors, chemical engineers, and petroleum engineers to enhance capabilities to perform production verification, gas plant inspections, and meter inspections on offshore rigs/platforms and production facilities. The funding will also cover associated inspection costs, such as helicopters for offshore site inspections, facilities, equipment, and ongoing training. This request directly addresses GAO concerns related to production verification. The requested additional resources will create greater capability to verify offshore production reporting and accurately and timely collect every royalty dollar due.

Expand State and Tribal Audit Program (+\$2,255,000; +1 FTE): The FY 2012 request includes an increase of \$2.26 million from the FY 2010 enacted level for ONRR's delegated and cooperative audit program with states and Indian tribes. The State and Tribal Audit Program, authorized by Sections 202 and 205 of the Federal Oil and Gas Royalty Management Act of 1982 (FOGRMA), as amended, is integral to ONRR compliance activities and a vital part of the ONRR mission. Through this program, Tribes are empowered to perform audits on tribal mineral royalties within their reservation and States perform audits on Federal leases within their boundaries and within the Section 8(g) zone of the Outer Continental Shelf (OCS). In FY 2012, ONRR anticipates fully funding agreements with 10 states and 8 tribes including a new Hopi Tribal agreement. These 18 agreements encompass lands producing a high percentage of all state and tribal mineral revenues and ONRR will rely on these states and tribes to perform compliance activities on an estimated \$3.3 billion in royalty payments. Historically, for every dollar spent for the delegated and cooperative audit program, the states, tribes, and U.S. Treasury received approximately \$4.00 in additional compliance collections. However appropriations in recent years have not kept pace with the growth or ongoing costs of this program. This has resulted in reduced funding for the agreements and ONRR's diversion of funds from other compliance activities to maintain program capacity.

Data Mining (+\$1,980,000; +12 FTE): This ONRR request includes \$1.98 million and 12 FTE to perform data mining reviews addressing earlier detection of missing or inaccurate royalties. This request also directly addresses GAO concerns related to the reliability and consistency of company-reported data. Current technology and system capabilities have opened new avenues for ONRR to identify and analyze erroneous data on a real-time basis. The ONRR has initiated a small-scale data mining effort as a second level screening process to increase the accuracy of company-reported data before it is subjected to compliance reviews and ultimately to audit. During FY 2012, this funding will allow the Department to hire additional analysts to expand data mining functions, addressing recent external recommendations, and providing earlier detection of missing or inaccurate royalties.

Ensure Proper Royalties Paid on Transported and Processed Natural Gas

(+\$1,850,000; +11 FTE): The ONRR is requesting \$1.85 million and 11 new FTE to increase its ability to ensure proper royalties are paid on transported and processed natural gas by providing reliable and timely access to gas index and location differential data for use in valuation. This request directly addresses GAO concerns related to the reliability and consistency of company-reported data. New positions will include petroleum engineers, chemical engineers, economists, auditors, analysts, technicians and related administrative support. With more than 200 gas plant systems processing gas from Federal leases, 100 different index points for gas, and over 500 pipeline systems transporting gas, these new resources will allow ONRR to: 1) gather and maintain natural gas index values; 2) determine location and quality differentials; 3) unbundle transportation fees for use in compliance risk determinations for gas plants and transportation systems, including examining gas plant efficiencies; and 4) perform reviews and audits of gas plants and transportation systems.

Integration of Compliance Tools (+\$1,717,000; 0 FTE): The FY 2012 request includes a \$1.72 million increase to fund the second year of a two-year effort to implement and integrate mineral revenue compliance tools. This request addresses several overlapping recommendations from the OIG, the Royalty Policy Subcommittee, and ONRR's Strategic Business Planning initiative. Currently, the ONRR uses several independent compliance tools to track workload, work progress, audit and compliance review findings and collections, and performance metrics. Establishing and maintaining workload information in these tools is manually intensive and often duplicative in nature. Due to the variety of independent compliance tools, outside reviews noted difficulties in accessing requested data, inconsistencies between tools, gaps in information, and duplication of manual data entry across separate tools. This funding will allow the ONRR to implement a fully automated and integrated suite of compliance tools which will provide one reliable and consistent source for automated, consolidated and integrated compliance planning, analysis, tracking, performance accomplishment, and records management data. The suite of automated tools will be scalable and flexible to ensure long-term usefulness and future adaptability.

Audit and Oversight (+\$1,550,000; +10 FTE): The FY 2012 request includes an increase of \$1.55 million and 10 FTE with expertise as certified internal auditors and fraud examiners. This new group is an integral element of the ONRR reorganization which will perform internal reviews and investigations to ensure that procedures and performance are effective. The ONRR will also establish an independent oversight board to oversee and provide advice in this area.

Fixed Costs (+\$423,000; 0 FTE): A fixed costs increase of \$439,000 is fully funded within this request.

Reorganization Efficiencies and Budget Changes (-\$1,483,000; 0 FTE): The request includes a decrease of \$1.48 million resulting from savings from operational efficiencies derived from the BOEMRE/ONRR.

Administrative Cost Savings: (-\$600,000; 0 FTE): In support of the President's commitment to fiscal discipline and spending constraints, ONRR is participating in an aggressive Department-wide effort to curb non-essential administrative spending related to travel, relocation, strategic sourcing, and information technology consolidation. In accordance with this initiative, ONRR's justification assumes \$600,000 in savings in FY 2012 against actual FY 2010 expenditures.

Mandatory Proposals in the FY 2012 Budget

The Budget includes several mandatory proposals that directly relate to ONRR's revenue management activities:

Repeal of Authorities to Accept Royalty Payments in Kind

The Administration proposes to solidify a recent Departmental reform terminating the Royalty-in-Kind program by repealing all Interior authorities to accept future royalties through this program. This change will help increase confidence that future royalty payments will be properly accounted for. The budget does not assume savings from this change because the Administration does not anticipate restarting the program; however, if enacted, this proposal would provide additional certainty that a new Royalty-in-Kind program would not be initiated at some point in the future.

Geothermal Revenue Sharing with Counties

The Administration proposes to repeal Section 224(b) of the Energy Policy Act of 2005. Prior to passage of this legislation, geothermal revenues were split between the Federal government and States, with 50 percent directed to States, and 50 percent to the Federal Government. The Energy Policy Act changed this distribution beginning in 2006 to direct 50 percent to States, 25 percent to counties, and for a period of five years, 25 percent to a new Geothermal Steam Act Implementation Fund managed by the Bureau of Land Management. In 2010, Congress enacted appropriations language that stopped the allocation of revenues to this Geothermal Fund. Under the current Continuing Resolution, payments to counties have been reinstated through 2011. The repeal of Section 224(b) will permanently discontinue payments to counties, thus restoring the disposition of Federal geothermal leasing revenues to the historical formula of 50 percent to the States and 50 percent to the Federal Government. This results in estimated savings of \$7 million in 2012 and \$74 million over ten years.

Net Receipts Sharing

The Administration proposes to make permanent the current arrangement for sharing the cost to administer energy and mineral receipts, beginning in FY 2013. Under current law, States receiving significant payments from mineral revenue development on Federal lands also share in the costs of administering the Federal mineral leases from which the revenue is generated. In FY 2012, this net receipts sharing change would be implemented as an offset to the Interior Appropriations Act, consistent with the proposal adopted in 2010 and continued under the FY 2011 Continuing Resolution. Permanent implementation of net receipts sharing is estimated to generate savings of \$44 million in 2013 and \$441 million over ten years.

Conclusion

The ONRR's FY 2012 Budget provides resources for implementation of critical revenue management reforms to enhance our revenue collection processes. As we continue to move forward to execute our mission, and at the same time, transform as an organization, we are committed to seeking new methods to enhance our royalty management program. Mr. Chairman, thank you for the opportunity to testify. I will be pleased to answer any questions you may have.