Response to Written Statement Submitted by
The Project on Government Oversight
To the Royalty Policy Committee
November 6, 2006

POGO Statement:

To refresh your memory, at the last meeting, Ms. Lucy Denett of the MMS described the situation:

> "She explained that we have a good working relationship, but periodically we do not agree on certain things—whether it is policy, funding, etc.—but those things arise, and we work through them. Ms. Denett stated that she was extremely disappointed when STRAC chose to involve the media and congressional committees in our debates, especially when it was done in reference to the New York Times article. STRAC sent several letters critical of MMS to the MMS Director, to her, and to the congressional committees. The concerns revolve around three issues—funding, compliance processes, and the automated system."

Since that time, Ms. Denett and other officials at the Department of Interior have been in the process of attempting to gut the State and Tribal Royalty Audit Committee, apparently in order to silence their criticisms and their ability to collaborate toward their shared goals. MMS has done so by refusing to reimburse states and tribes for their three national meetings, a meeting schedule which has been in place for more than 20 years. MMS has also declared that it will set the STRAC's meeting agendas and monitor all of STRAC's meeting discussions, essentially making it into a puppet organization.

In other words, despite the fact that the overwhelming majority of STRAC members requested that their organization continue in its tradition of 3-4 national meetings per year, MMS has indicated that it will rule against their wishes.

MMS Response:

Contrary to POGO's allegations, our recent actions regarding STRAC meetings are designed to improve the effectiveness of the partnership.

In a recent meeting in Alaska, MMS announced to its State and Tribal compliance partners that we will be working on improving the effectiveness of our joint meetings. The MMS will fund one national meeting annually at a central location, as well as regional and topical meetings. The national meeting will address issues common to all states and Tribes. Numerous members of STRAC, in various discussions and meetings with MMS, have indicated support regarding these changes and have suggested others.

On October 17, 2006, the MMS met with STRAC officers including two at large members regarding the frequency and structure of future STRAC meetings; the communication of compliance issues with STRAC; the Internal Quality Control and STRAC Peer Reviews;

recalculation of the Continuing Professional Education hours for STRAC meetings; and the proprietary data clause under the State and Tribal contracts. At this meeting, STRAC officers informed MMS that they were in the process of evaluating future STRAC meeting topics. The MMS and STRAC agreed that we would work together and schedule a teleconference to discuss future agendas and dates for an audit managers meeting, the annual STRAC meeting, and topical and regional meetings for the upcoming Fiscal Year. In addition, MMS agreed to provide STRAC updates at future meetings on issues such as the Minerals Revenue Management Strategic Business Plans, the new compliance system enhancements, the Negotiated Valuation Agreement Manual, and the Compliance Information Management System.

Also, STRAC does not speak for the States and Tribes, collectively, as a committee. This is confirmed by our experience in consulting with the STRAC organization for input and participation on teams regarding compliance, valuation, or system issues, etc. The STRAC members have consistently asserted that their input only represents the views of their respective state or tribe.

POGO Statement:

In addition, the STRAC was founded primarily for just this purpose -- to provide a check on failures at the Department of Interior to adequately collect what is owed to states and Indian tribes.

MMS Response:

MMS is not aware of any statute that grants oversight authority over the Department of the Interior to STRAC.

Congress passed the Federal Oil and Gas Royalty Management Act of 1982 (FOGRMA), which became law in January 1983. FOGRMA authorized the Department of the Interior to enter into cooperative agreements with Indian tribes and states under section 202 of FOGRMA and to delegate audit authority to states under section 205 of FOGRMA. Under a cooperative agreement, an Indian tribe or state is permitted to conduct inspections, audits, and investigations of activities on their respective Indian or Federal lands.

In late 1984, several states and Indian tribes petitioned for Delegations of Authority and Cooperative Agreements, respectively, under authority granted by FOGRMA. These petitions were granted by the Secretary of the Interior in 1985. Subsequent involvement between States and Tribes, MMS, BLM, General Accounting Office (GAO), Interior Inspector General (IG), U.S, Congressional members and staff, and other Federal officials and agencies produced the realization that this group of delegations needed a name. Thus, during the February 1986 quarterly meeting the attending State and Tribal delegations adopted the name, State and Tribal Royalty Audit Committee (STRAC). Today, there are 11 states and 7 Indian tribes operating under delegations or cooperative agreements. Although the STRAC structure includes officers (a chair and two vice chairs) to conduct the meetings, it is not a recognized organization under the Federal Advisory Committee

Act; therefore there is no formal requirement of meeting frequency or procedures and no official charter or bylaws exist.

POGO Statement:

Members of the STRAC to whom I have spoken believe that the MMS is retaliating against them for voicing their concerns about the new "compliance review" system which the MMS is now in the process of forcing them to use.

Members of Congress have also noted that MMS' actions appear to be retaliatory in a recent letter. The notes from your last meeting support this view point as MMS clearly voiced its displeasure with the states and tribes publicly raising their concerns. Yet, the STRAC had been raising these concerns privately for several years to no avail.

In fact, preliminary information from an investigation being conducted by the Department of Interior Inspector General (IG) suggests there is merit in the concerns that have been raised by the STRAC about the new compliance review system. A forthcoming report by the IG will certainly shed light on the issue.

MMS Response:

MMS finds it interesting that POGO alleges to have preliminary information regarding a internal draft report that the Office of Inspector General (OIG) has issued to the Minerals Management Service for review and comment.

While we cannot reveal the details of OIG's draft report at this time, we can say that the OIG concluded that MMS compliance reviews are a legitimate tool for evaluating the reasonableness of company-reported royalties.

Over the past few years, MMS and STRAC have had an ongoing dialogue regarding compliance reviews. The MRM compliance reviews are designed to determine if the royalties received are in reasonable compliance with the laws, lease terms, and regulations. Compliance reviews apply a series of tests to the volume, royalty rate, value, and allowances to determine if royalty payments are reasonable on a property basis. The central issue regarding compliance review is "compliance coverage." With over 27,000 producing Federal and Indian mineral leases under our jurisdiction, there are simply too many properties to rely on the traditional audit approach alone. In order for us to optimize compliance coverage, other approaches are necessary, in combination with audit. Compliance reviews enable the government to cover a larger percentage of royalties paid than by using audits alone.

Compliance reviews have helped MMS cover more properties and complete compliance work more contemporaneously. The MMS has established goals under the Government Performance and Results Act (GPRA) to complete compliance work within 3 years. In fiscal year 2006, MMS completed compliance work on 72.5 percent of revenues within our 3-year goal. If MMS were to rely on audit alone, it would severely restrict the number of

properties that could be covered. Because of our fiduciary responsibilities to the American taxpayer, it is important to validate compliance on a larger and larger percentage of properties and revenue dollars and to do it as expeditiously as possible. These principles are the foundation of the GPRA goals MMS has established.

We have found that:

- Compliance reviews, using automated analysis, are less costly than traditional audits, which rely heavily on manual review of source documents; and
- Compliance reviews have resulted in at least $225 million additional collections from unpaid and underpaid royalties since FY 2001.

The MMS has not abandoned audits nor reduced the rigor of its overall compliance program. In fact, by utilizing the compliance review process to target audits on systemic issues MRM significantly improves the effectiveness of the audit program.

POGO Statement:

In addition, last week, the House Government Reform Committee announced a greatly expanded Government Accountability Office (GAO) investigation aimed at further examining compliance review. In their request letter to the GAO, the Committee's fourth and fifth research request items are on point to this discussion (APPENDIX D):

> "4. Analyze the cost and effectiveness of information technology systems developed and employed by the Minerals Management Service to gather production data and conduct compliance audits. This analysis should include:
>
> a. A review of contracts entered into by the Minerals Management Service and other parties to develop information technology systems, whether these systems met the specifications required by the contract, and, if applicable, why systems did not meet any specifications.
>
> b. A comparison of the effectiveness of national systems to collect such data and other systems employed by state and territorial auditing entities, if such systems exist.
>
> c. A review of the extent to which information technology systems developed by MMS contain automated functions that enable auditors to systematically analyze production volumes reported by lessees with other data bases containing similar information.
>
> 5. Analyze the compliance and enforcement efforts of the Minerals Management Service related to royalty collection, including a comparison of the frequency of enforcement actions, such as issue and demand letters, over time."

MMS Response:

The MMS welcomes a review of the effectiveness and accuracy of our royalty collection systems, and will cooperate fully with a review by the Government Accountability Office

(GAO). We are confident that the review will show that MMS is accurately and efficiently collecting the royalties due to the Federal government per existing statutes and regulations. We also welcome any constructive suggestions that we can use to further strengthen our program to ensure that we continue to collect the proper royalties due on public assets.

POGO Statement:

Finally, as was pointed out in my recent written testimony to the House Government Reform Committee, audit and compliance review dollar collections have dropped substantially in the past four years: "In the four years from 2002 to 2005, MMS's auditing and compliance program collected an average $48 million annually, less than half the average $115 million collected annually in the division's first 20 years."

MMS Response:

The amounts of additional revenues MMS collects as the result of compliance activities tend to fluctuate year-to-year. In most cases, the collections applicable to compliance activity in one year will be reflected one or more years later, depending on whether the cases were resolved by voluntary payment, litigation, or settlement.

The POGO makes an arbitrary comparison of the average of the last 4 years of collections compared to the previous 20 years. The POGO even acknowledges that its average for the 20-year period from FY 1982 - FY 2001 is skewed by including large settlements collected from FY 1998 to FY 2001.

If a comparison is made of the average annual collections for the past 6 years (FY 2000-FY 2005), $120 million, to the average annual collections for the previous 18 years (FY 1982 to FY 1999), $127 million, the difference is insignificant.

Likewise, if the comparison were to fairly exclude the anomalous large settlements ($400 million) from FY 1998 to FY 2001, the average annual collections for FY 1982 to FY 2001 is $95 million, compared to $78 million for FY 2001 to FY 2005.

The POGO failed to report to the Committee several relevant facts regarding the quality and rigor of MMS's audit and compliance program:

- Over the past 4 years (FY 2002 to FY 2005), the MMS and State and Tribal auditors have completed 1,214 audits. That compares to 784 audits completed for the 4-year period (FY 1998 – FY 2001).

- In November 2005, an independent certified public accounting firm issued a clean audit opinion of MMS's audit program with no material weaknesses, and no reportable conditions. In its opinion, the accounting firm stated:

"In our opinion, the system of quality control for the Federal Audit Function of MMS in effect for the 2-year period ending December 31, 2004, has been designed to meet

the requirements of the quality control standards established by the Comptroller General of the United States for a Federal Government audit organization and was complied with during the 2-year period ending December 31, 2004, to provide MMS with reasonable assurance of conforming with applicable auditing standards, policies, and procedures."

POGO Statement:

In addition, I should note that I have been told by several individuals that MMS sent an email to members of the STRAC informing them that providing what was called "confidential" information to the news media may be a violation of agreements held between MMS and the states and tribes. This email sounded like an awkward attempt by the MMS to intimidate and silence states and tribes.

MMS Response:

Recently, confidential information the Government disclosed in STRAC meetings surfaced in the media. In response, MMS sent a letter to all States and Tribes and an email to MMS employees involved in the compliance and enforcement process reminding them of their obligation to safeguard confidential and/or proprietary information obtained under your agreement. Such disclosures not only violate the express terms and conditions of the Cooperative Agreements and of the regulations governing employees' conduct, but also limit our ability to be able to continue an open exchange of internal policy and confidential information with STRAC.

The Federal Government considers the open exchange of confidential and/or proprietary information with and between States and Tribes crucial for the effective execution of investigation, audit and reporting responsibilities under Sections 202 and 205 of the Federal Oil and Gas Royalty Management Act of 1982.

POGO Statement:

Without an independent voice, STRAC will be significantly less able to bring forward legitimate concerns about failures at the Department of Interior to protect the interests of Native Americans and the taxpayer.

MMS Response:

As stated above, MMS is not aware of any statute that grants oversight authority over the Department of Interior to STRAC. In fact, the only authority granted to States and Tribes with respect to Federal and Indian minerals revenues is to audit those revenues under delegated and cooperative agreements with the Minerals Management Service.

United States Department of the Interior

MINERALS MANAGEMENT SERVICE
Washington, DC 20240

OCT 10 2006

Ms. Lisa Dockter
Chairperson
State and Tribal Royalty Audit
Committee
P.O. Box 1500
14933 Highway 172
Ignacio, CO 81137

Dear Ms. Dockter:

Thank you for your letter dated September 27, 2006, following-up on the teleconference that Minerals Management Service (MMS) hosted on September 12, 2006, between representatives from MMS and its state and Tribal audit partners, including yourself.

As part of MMS' continuing commitment to working closely with states and Tribal delegations and my agreement, at the September 12 teleconference, to meet with you face to face, MMS has already scheduled that meeting. As you know, MMS has set the meeting for October 17, 2006, at the Denver Federal Center located in Lakewood, CO. As promised, we will discuss the items raised at the teleconference that you reiterated in your September 27 letter.

I look forward to meeting with you and other representatives from the states and Tribal delegations.

Sincerely,

Lucy Querques Denett

Lucy Querques Denett
Associate Director
Minerals Revenue Management

cc: STRAC members

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United States Department of the Interior

MINERALS MANAGEMENT SERVICE
Washington, DC 20240

SEP 22 2006

The Honorable Carolyn B. Maloney
House of Representatives
Washington, D.C. 20515

Dear Ms. Maloney:

I appreciate the opportunity to respond to your August 31, 2006, letter containing questions about the changes Minerals Management Service (MMS) recently announced regarding meetings with the State and Tribal Royalty Audit Committee (STRAC). We are pleased that the MMS received positive responses from numerous members of STRAC regarding these changes.

Since the first cooperative agreement was signed with the State of Wyoming in 1981, MMS has held regular meetings with state and tribal representatives to discuss issues of mutual importance. The relationship among MMS and states and tribes has highlighted partnerships as well as contractual obligations. In a recent meeting in Alaska, MMS announced to its state and tribal compliance partners that we will be working on improving the effectiveness of our joint meetings. Ms. Denett indicated to the STRAC that MMS will fund one national meeting annually at a central location, as well as regional and topical meetings as needed. The national meeting will address issues common to all states and tribes.

Regional and topical meetings will focus on issues specific to a given region of the country. These meetings will provide additional benefits to all parties and enhance communication among MMS and the delegations. States and tribes have also requested training on specific issues which are difficult to address in a national meeting, but will be an integral part of our regional sessions. For example, once the final rule implementing the geothermal provisions of the Energy Policy Act of 2005 is published, MMS will hold a topical meeting with those states that have Federal geothermal production to provide training on the rule and to coordinate our compliance efforts. Discussing this topic at a national meeting is not productive when very few states and no tribes are affected. An additional advantage of holding meetings in the region or in state and tribal offices is that it will offer more state and tribal employees the ability to participate in these sessions and minimize travel costs.

Scheduling one meeting of all state and tribal audit managers per year will make the meetings more efficient and focused while preserving taxpayer dollars. The cost of a full STRAC meeting is approximately $50,000. The MMS funds all meetings for all

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participants. The MMS will continue its practice of coordinating with state and tribal delegations in preparing the agenda. For many years, representatives from the Office of Inspector General have regularly attended the STRAC meetings, and they will continue to be invited.

The Federal Oil and Gas Royalty Management Act of 1982 (FOGRMA) tasks the Department of the Interior "with effectively utilizing the capabilities of the states and Indian tribes in developing and maintaining an efficient and effective Federal royalty management system." Title II of this same statute enabled the Secretary of the Interior to enter into cooperative agreements with states and Indian tribes to carry out inspections and audits on Federal and Indian mineral leases within their respective state or reservation.

The Associate Director of Minerals Revenue Management, Lucy Querques Denett, shares my views of the importance of states and tribes participating with the Department of the Interior to fulfill the Secretary's statutory responsibilities. Through partnerships with the states and tribes MMS has greatly expanded its ability to manage the Nation's mineral resources.

Our recent decision to reduce the number of national STRAC meetings in favor of a regional meeting approach was made to promote efficiency and effectiveness in future program operations. I can assure you that this decision was not made in retaliation to any STRAC concerns or criticism of the MMS. STRAC member states and tribes are an important and integral part of the MMS national compliance and audit program. We value STRAC insights and recommendations on ways to improve mineral revenue operations. We at the MMS have always made every effort to address STRAC concerns, as well as any program criticism, and we will continue to do so in partnership with STRAC members.

I want to share some information regarding STRAC as an entity. This committee is not an organization under the Federal Advisory Committee Act; therefore, there is no formal requirement of meeting frequency or procedures. Also, STRAC does not speak for the states and tribes, collectively, as a committee. This is confirmed by our experience in consulting with the STRAC organization for input and participation on teams regarding compliance, valuation, or system issues, etc. The STRAC members have consistently asserted that their input only represents the views of their respective state or tribe.

In summary, our decision to restructure the type and number MMS/STRAC meetings to include regional and topical sessions was based on sound business principles. This decision will strengthen the compliance and audit program, encourage more open communication with states and tribes, and reduce costs. We will continue to work closely with states and tribal delegations to ensure that our robust and aggressive compliance and audit program collects the correct amount of royalties due from energy production that occurs on Federal and tribal lands.

If I can be of further assistance, please do not hesitate to call me at (202) 208-3500 or call Ms. Lyn Herdt, Chief, MMS, Office of Congressional Affairs, at (202) 208-3502. An identical letter is being sent to each signer of your letter.

Sincerely,

R. M. "Johnnie" Burton
Director

cc: State and Tribal Managers and/or Revenue Departments
Governors and Tribal Chairpersons

United States Department of the Interior

MINERALS MANAGEMENT SERVICE
Washington, DC 20240

SEP 22 2006

The Honorable Maurice Hinchey
House of Representatives
Washington, D.C. 20515

Dear Mr. Hinchey:

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In summary, our decision to restructure the type and number MMS/STRAC meetings to include regional and topical sessions was based on sound business principles. This decision will strengthen the compliance and audit program, encourage more open communication with states and tribes, and reduce costs. We will continue to work closely with states and tribal delegations to ensure that our robust and aggressive compliance and audit program collects the correct amount of royalties due from energy production that occurs on Federal and tribal lands.

If I can be of further assistance, please do not hesitate to call me at (202) 208-3500 or call Ms. Lyn Herdt, Chief, MMS, Office of Congressional Affairs, at (202) 208-3502. An identical letter is being sent to each signer of your letter.

Sincerely,

R. M. "Johnnie" Burton
Director

cc: State and Tribal Managers and/or Revenue Departments
Governors and Tribal Chairpersons

United States Department of the Interior

MINERALS MANAGEMENT SERVICE
Washington, DC 20240

SEP 22 2006

The Honorable George Miller
House of Representatives
Washington, D.C. 20515

Dear Mr. Miller:

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Sincerely,

R. M. "Johnnie" Burton
Director

cc: State and Tribal Managers and/or Revenue Departments
Governors and Tribal Chairpersons

United States Department of the Interior

MINERALS MANAGEMENT SERVICE
Washington, DC 20240

SEP 22 2006

The Honorable Henry A. Waxman
House of Representatives
Washington, D.C. 20515

Dear Mr. Waxman:

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Sincerely,

R. M. "Johnnie" Burton
Director

cc: State and Tribal Managers and/or Revenue Departments
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MINERALS MANAGEMENT SERVICE
Washington, DC 20240

SEP 22 2006

The Honorable Raul Grijalva
House of Representatives
Washington, D.C. 20515

Dear Mr. Grijalva:

I appreciate the opportunity to respond to your August 31, 2006, letter containing questions about the changes Minerals Management Service (MMS) recently announced regarding meetings with the State and Tribal Royalty Audit Committee (STRAC). We are pleased that the MMS received positive responses from numerous members of STRAC regarding these changes.

Since the first cooperative agreement was signed with the State of Wyoming in 1981, MMS has held regular meetings with state and tribal representatives to discuss issues of mutual importance. The relationship among MMS and states and tribes has highlighted partnerships as well as contractual obligations. In a recent meeting in Alaska, MMS announced to its state and tribal compliance partners that we will be working on improving the effectiveness of our joint meetings. Ms. Denett indicated to the STRAC that MMS will fund one national meeting annually at a central location, as well as regional and topical meetings as needed. The national meeting will address issues common to all states and tribes.

Regional and topical meetings will focus on issues specific to a given region of the country. These meetings will provide additional benefits to all parties and enhance communication among MMS and the delegations. States and tribes have also requested training on specific issues which are difficult to address in a national meeting, but will be an integral part of our regional sessions. For example, once the final rule implementing the geothermal provisions of the Energy Policy Act of 2005 is published, MMS will hold a topical meeting with those states that have Federal geothermal production to provide training on the rule and to coordinate our compliance efforts. Discussing this topic at a national meeting is not productive when very few states and no tribes are affected. An additional advantage of holding meetings in the region or in state and tribal offices is that it will offer more state and tribal employees the ability to participate in these sessions and minimize travel costs.

Scheduling one meeting of all state and tribal audit managers per year will make the meetings more efficient and focused while preserving taxpayer dollars. The cost of a full STRAC meeting is approximately $50,000. The MMS funds all meetings for all

participants. The MMS will continue its practice of coordinating with state and tribal delegations in preparing the agenda. For many years, representatives from the Office of Inspector General have regularly attended the STRAC meetings, and they will continue to be invited.

The Federal Oil and Gas Royalty Management Act of 1982 (FOGRMA) tasks the Department of the Interior "with effectively utilizing the capabilities of the states and Indian tribes in developing and maintaining an efficient and effective Federal royalty management system." Title II of this same statute enabled the Secretary of the Interior to enter into cooperative agreements with states and Indian tribes to carry out inspections and audits on Federal and Indian mineral leases within their respective state or reservation.

The Associate Director of Minerals Revenue Management, Lucy Querques Denett, shares *my views* of the importance of states and tribes participating with the Department of the Interior to fulfill the Secretary's statutory responsibilities. Through partnerships with the states and tribes MMS has greatly expanded its ability to manage the Nation's mineral resources.

Our recent decision to reduce the number of national STRAC meetings in favor of a regional meeting approach was made to promote efficiency and effectiveness in future program operations. I can assure you that this decision was not made in retaliation to any STRAC concerns or criticism of the MMS. STRAC member states and tribes are an important and integral part of the MMS national compliance and audit program. We value STRAC insights and recommendations on ways to improve mineral revenue operations. We at the MMS have always made every effort to address STRAC concerns, as well as any program criticism, and we will continue to do so in partnership with STRAC members.

I want to share some information regarding STRAC as an entity. This committee is not an organization under the Federal Advisory Committee Act; therefore, there is no formal requirement of meeting frequency or procedures. Also, STRAC does not speak for the states and tribes, collectively, as a committee. This is confirmed by our experience in consulting with the STRAC organization for input and participation on teams regarding compliance, valuation, or system issues, etc. The STRAC members have consistently asserted that their input only represents the views of their respective state or tribe.

In summary, our decision to restructure the type and number MMS/STRAC meetings to include regional and topical sessions was based on sound business principles. This decision will strengthen the compliance and audit program, encourage more open communication with states and tribes, and reduce costs. We will continue to work closely with states and tribal delegations to ensure that our robust and aggressive compliance and audit program collects the correct amount of royalties due from energy production that occurs on Federal and tribal lands.

If I can be of further assistance, please do not hesitate to call me at (202) 208-3500 or call Ms. Lyn Herdt, Chief, MMS, Office of Congressional Affairs, at (202) 208-3502. An identical letter is being sent to each signer of your letter.

Sincerely,

R. M. "Johnnie" Burton
Director

cc: State and Tribal Managers and/or Revenue Departments
Governors and Tribal Chairpersons