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OIL AND GAS MANAGEMENT

Continued Attention to Interior's Revenue Collection and Human Capital Challenges Is Needed

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GAO Highlights

Highlights of GAO-13-647T, a testimony before the Subcommittee on Energy Policy, Health Care, and Entitlements, Committee on Oversight and Government Reform, House of Representatives

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Why GAO Did This Study

Interior issues permits for the development of new oil and gas wells on federal lands and waters; inspects wells to ensure compliance with environmental, safety, and other regulations; and collects royalties from companies that sell the oil and gas produced from those wells. In recent years, onshore and offshore federal leases produced a substantial portion of the oil and gas produced in the United States. In fiscal year 2012, Interior collected almost $12 billion in mineral revenues including those from oil and gas development, making it one of the largest nontax sources of federal government funds. Previous GAO work has raised concerns about Interior's management and oversight of federal oil and gas resources.

This testimony focuses on (1) Interior's oversight of offshore oil and gas resources, (2) Interior's collection of oil and gas revenues, and (3) Interior's progress to address concerns that resulted in its inclusion on GAO's High Risk List in 2011. This statement is based on prior GAO reports issued from September 2008 through March 2013.

GAO is making no new recommendations. Interior continues to act on the recommendations that GAO has made to improve the management of oil and gas resources. GAO continues to monitor Interior's implementation of these recommendations.

View GAO-13-647T. For more information, contact Frank Rusco at (202) 512-3841 or ruscof@gao.gov.

What GAO Found

Interior's oversight of offshore resources. In July 2012, GAO reported on changes to the Department of the Interior's oversight of offshore oil and gas activities in the Gulf of Mexico following the *Deepwater Horizon* incident. Specifically, GAO reported that Interior had established two new bureaus, separating resource management oversight activities from safety and environmental oversight activities. GAO also reported that new requirements and policy changes designed to mitigate risk of a well blowout or spill had initially required additional resources and increased permit approval times, but that approval times decreased as Interior staff and oil and gas companies became more familiar with the new requirements. GAO also found that Interior's inspections of offshore Gulf of Mexico drilling rigs and production platforms routinely identified violations, but that Interior's database was missing data on when violations were identified and corrected. GAO made 11 recommendations aimed at improving Interior's oversight activities. Interior generally agreed with the recommendations and plans to implement them.

Interior's collection of oil and gas revenues. In September 2008, GAO reported that Interior collected lower levels of revenues for oil and gas production in the deep water of the U.S. Gulf of Mexico than all but 11 of 104 oil and gas resource owners in other countries and some states. In July 2009, GAO reported on problems with Interior's efforts to collect data on oil and gas produced on federal lands, including missing and erroneous data. In March 2010, GAO reported that Interior was not taking needed steps to ensure that oil and gas produced from federal lands was accurately measured and was not consistently meeting its goals for oil and gas production verification inspections. GAO made numerous recommendations aimed at improving Interior's revenue collection policies, including oversight of production verification activities and controls on the accuracy and reliability of royalty data. Interior generally agreed with these recommendations and has implemented many of them.

Interior's oil and gas management on GAO's high risk list. In February 2011, GAO added Interior's management of federal oil and gas resources to its list of federal programs and operations at high risk for waste, fraud, abuse, and mismanagement or needing broad-based transformation. GAO added this high risk area because Interior (1) did not have reasonable assurance that it was collecting its share of revenues; (2) continued to experience problems hiring, training, and retaining sufficient staff to provide oversight and management of oil and gas operations; and (3) was engaged in a broad agency reorganization that could adversely impact its ability to effectively manage oil and gas during the crisis following the *Deepwater Horizon* incident. In February 2013, after Interior completed its reorganization, GAO narrowed the oil and gas high-risk area to focus on revenue collection and human capital challenges and is currently examining these issues. While Interior has begun to implement many of GAO's recommendations, it has yet to fully implement a number of others, including recommendations intended to (1) provide reasonable assurance that oil and gas is accurately measured, and that the public is getting an appropriate share of revenues, and (2) address its long-standing human capital issues.

DRAFT

Chairman Langford, Ranking Member Speier, and Members of the Subcommittee:

I am pleased to be here today to discuss the Department of the Interior's (Interior) management and oversight of federal oil and gas resources and collection of associated mineral revenues. Interior plays an important role in permitting the development of new oil and gas wells on federal lands and waters; inspecting those wells to ensure compliance with environmental, safety and other regulations; and collecting royalties from the companies that sell the oil and gas produced from those wells.

In recent years federal leases onshore and in offshore federal waters produced a substantial portion of the natural gas and oil produced in the United States. In 2012, onshore federal leases produced 13 percent of domestic natural gas and 5 percent of domestic oil, while in 2011 —the most recent year for which data are available—offshore federal leases produced almost 24 percent of domestic natural gas and over 6 percent of domestic oil. In fiscal year 2012, the federal government collected almost $12 billion in mineral revenues, including those from oil and gas produced from federal lands and waters, bonus bids for new oil and gas leases, and annual rents on existing leases.[1] Revenues from federal oil and gas are one of the largest nontax sources of federal government funds—and, as we have previously reported, improvements in the management of federal oil and gas resources could provide an important source of potential revenue enhancements as the government faces fiscal challenges.[2]

Several Interior bureaus are responsible for regulating the processes that oil and gas companies must follow when leasing, drilling, and producing oil and gas from federal leases. The bureaus are also responsible for ensuring that companies comply with all applicable requirements. Historically, Interior's Bureau of Land Management (BLM) managed onshore federal oil and gas activities, while the Minerals Management Service (MMS) managed offshore activities and collected royalties on federal leases.[3] In May 2010, in the aftermath of the *Deepwater Horizon* incident, the Secretary of the Interior announced plans to reorganize MMS

[1]Readily available data from Interior for nonroyalty revenue—such as rents and bonus bids—include revenue from all minerals, including oil and gas, coal, and other resources.

[2]GAO, *Opportunities to Reduce Potential Duplication in Government Programs, Save Tax Dollars, and Enhance Revenue*, GAO-11-318SP (Washington, D.C.: March 2011).

[3]MMS's Offshore Energy and Minerals Management oversaw offshore oil and gas activities, while its Minerals Revenue Management was responsible for royalty collections from both onshore and offshore federal leases.

and divide its responsibilities among separate bureaus. The Secretary stated that this division of responsibilities would help ensure that each of the newly established bureaus would have a distinct and independent mission. Since the reorganization, BLM continues to oversee onshore federal oil and gas activities, the Bureau of Ocean Energy Management oversees offshore oil and gas leasing, the Bureau of Safety and Environmental Enforcement reviews drilling permits and conducts inspections, and the Office of Natural Resources Revenue is responsible for collecting royalties on oil and gas produced from both onshore and offshore federal leases.

Interior's management of federal oil and gas activities has been a focus of a large body of our work over the past several years. In our resulting reports, we noted numerous weaknesses and challenges, and we made specific recommendations to Interior for addressing them. In February 2011, we added Interior's management of federal oil and gas resources to our list of federal programs and operations at high risk for waste, fraud, abuse, and mismanagement or needing broad-based transformation.[4] Since that time, Interior has taken significant steps to address identified weaknesses and modify its practices for managing oil and gas resources but, as of May 2013, many of our recommendations remained unimplemented.

In this context, my testimony today discusses findings from our past work on three broad areas: (1) Interior's oversight of offshore oil and gas resources, (2) Interior's collection of oil and gas revenues, and (3) Interior's progress to address concerns that resulted in its inclusion on our High Risk List in 2011. This statement is based on our extensive body of work on Interior's oil and gas leasing and royalty collection programs, including reports issued from September 2008 through March 2013. We conducted the performance audit work that supports this statement in accordance with generally accepted government auditing standards. Additional information on our scope and methodology is available in each issued product.

[4]GAO, *High-Risk Series: An Update*, GAO-11-278 (Washington, D.C.: February 2011).

Interior's Oversight of Offshore Oil and Gas Resources

In July 2012, we reported on changes Interior made to its oversight of offshore oil and gas activities in the Gulf of Mexico in the aftermath of the *Deepwater Horizon* incident.[5] Specifically, we reported that

- On October 1, 2011, Interior officially established two new bureaus, separating offshore resource management oversight activities, such as reviewing oil and gas exploration and development plans, from safety and environmental oversight activities, such as reviewing drilling permits and inspecting drilling rigs. Because the responsibilities of these new bureaus are closely interconnected, and carrying them out will depend on effective coordination, Interior developed memoranda and standard operating procedures to define roles and responsibilities and facilitate and formalize coordination.
- New safety and environmental requirements and policy changes designed to mitigate the risk of a well blowout or spill initially required Interior to devote additional resources and time to reviewing certain oil and gas exploration and development plans and drilling permits for oil and gas activities in the Gulf of Mexico. Specifically, these policy changes affected Interior's (1) environmental analyses, (2) reviews of oil and gas exploration and development plans, and (3) reviews of oil and gas drilling permits. Our analysis of drilling permit approval time frames found that approval times initially increased after the new requirements went into effect, but as both Interior staff and oil and gas companies became more familiar with these requirements, the review times decreased.
- Interior's inspections of offshore Gulf of Mexico oil and gas drilling rigs and production platforms from January 1, 2000, through September 30, 2011, routinely identified violations. However, Interior's database was missing data on when violations were identified, as well as when they were corrected for about half of the violations issued. As a result, Interior did not know on a real-time basis whether or when all violations were identified and corrected, potentially allowing unsafe conditions to continue for extended periods. During this same period, Interior issued approximately $18 million in civil penalty assessments. At the time of our report, Interior had begun implementing a number of policy changes to improve both its inspection and civil penalty programs—but

[5]GAO, *Oil and Gas Management: Interior's Reorganization Complete but Challenges Remain in Implementing New Requirements*, GAO-12-423 (Washington, D.C.: July 30, 2012).

had not assessed how these changes would affect its ability to conduct monthly drilling rig inspections.

- Interior continued to face challenges following its reorganization that may affect its ability to oversee oil and gas activities in the Gulf of Mexico. Specifically, Interior's capacity to identify and evaluate risks associated with drilling remained limited, raising questions about the effectiveness with which it allocated its oversight resources. Interior also experienced difficulties in implementing effective information technology systems, such as those that aid its reviews of oil and gas companies' exploration and development plans. It also continued to face workforce planning challenges, including hiring, retaining, and training staff. Moreover, Interior did not have current strategic plans to guide its information technology or workforce planning efforts.

Our July 2012 report resulted in 11 recommendations for specific improvements to Interior's oversight of offshore oil and gas activities, including those intended to improve its drilling inspection program and human capital planning. Interior generally agreed with our recommendations and has committed to implementing them.

Interior's Collection of Oil and Gas Revenues

Federal oil and gas resources generate billions of dollars annually in revenues that are shared among federal, state, and tribal governments; however, in several reviews over the past 5 years we found Interior may not be properly assessing and collecting these revenues.

In September 2008, we reported that Interior collected lower levels of revenues for oil and gas production in the deepwater of the U.S. Gulf of Mexico than all but 11 of 104 oil and gas resource owners in other countries, as well as in some states whose revenue collection systems were evaluated in a comprehensive industry study.[6] In addition, despite significant changes in the oil and gas industry over the past several decades, we found that Interior had not systematically reexamined how the U.S. government is compensated for extraction of oil and gas in over 25 years. We recommended Interior conduct a comprehensive review of the federal oil and gas fiscal system using an independent panel. After Interior initially disagreed with our recommendations, we recommended that Congress consider directing the Secretary of the

[6]GAO, *Oil and Gas Royalties: The Federal System for Collecting Oil and Gas Revenues Needs Comprehensive Reassessment*, GAO-08-691 (Washington, D.C.: Sept. 3, 2008).

Interior to convene an independent panel to perform a comprehensive review of the federal oil and gas fiscal system and establish procedures to periodically evaluate the state of the fiscal system. In response to that recommendation, Interior commissioned a study that compared the U.S. government's fiscal system with that of other resource owners. We are currently conducting work to assess how Interior plans to use the results of this study to inform decisions about its fiscal system.

Furthermore, we reported, in July 2009, on numerous problems with Interior's efforts to collect data on oil and gas produced on federal lands, including missing data, errors in company-reported data on oil and gas production, and sales data that did not reflect prevailing market prices for oil and gas.[7] As a result of its lack of consistent and reliable data on the production and sale of oil and gas from federal lands, Interior could not provide reasonable assurance that it was assessing and collecting the appropriate amount of royalties on this production. We made a number of recommendations to Interior to improve controls on the accuracy and reliability of royalty data. Interior generally agreed with our recommendations and has implemented the majority of them.

We also reported, in March 2010, that Interior was not taking the steps needed to ensure that oil and gas produced from federal lands was accurately measured.[8] For example, we found that neither BLM nor MMS had consistently met their agency goals for oil and gas production verification inspections, intended to examine, among other things, whether lessees were taking steps to ensure that the amount of oil and gas produced from federal lands and waters was being accurately measured. Without such verification, Interior cannot provide reasonable assurance that the public is collecting its share of revenue from oil and gas development. We also raised concerns over Interior's efforts to develop software to allow inspection staff to remotely monitor gas production. Specifically, we found that BLM's Remote Data Acquisition for Well Production program—a program designed to provide industry and government with common tools to validate production and to view production data in near real-time—had shown few results, despite 10 years of development and costs of over $1.5 million. Our March 2010

[7]GAO, *Mineral Revenues: MMS Could Do More to Improve the Accuracy of Key Data Used to Collect and Verify Oil and Gas Royalties*, GAO-09-549 (Washington, D.C.: July 15, 2009).

[8]GAO, *Oil and Gas Management: Interior's Oil and Gas Production Verification Efforts Do Not Provide Reasonable Assurance of Accurate Measurement of Production Volumes*, GAO-10-313 (Washington, D.C.: Mar. 15, 2010).

report identified 19 recommendations for specific improvements to oversight of production verification activities, including recommendations intended to strengthen BLM's production inspection program and its ability to obtain near real-time gas production data. Interior generally agreed with our recommendations; it has already implemented many of them and continues to work on the remainder.

Additionally, we reported, in October 2010, that Interior's data likely understated the amount of natural gas produced on federal leases, because the data did not quantify the amount of gas released directly to the atmosphere (vented) or burned (flared) during the production process.[9] This vented and flared gas represents lost royalties to the government and contributes to greenhouse gases. We recommended that Interior improve its data and address limitations in its regulations and guidance to reduce this lost gas. Interior generally agreed with our recommendations and is taking steps to implement them.

Interior's Oil and Gas Management on the High Risk List

In February 2011, we added Interior's management of federal oil and gas resources to our list of federal programs and operations at high risk for waste, fraud, abuse, and mismanagement or needing broad-based transformation.[10] We added Interior to the list because the department: (1) did not have reasonable assurance that it was collecting its share of revenue from oil and gas produced on federal lands; (2) continued to experience problems in hiring, training, and retaining sufficient staff to provide oversight and management of oil and gas operations on federal lands and waters; and (3) was engaged in a broad reorganization of both its offshore oil and gas management and revenue collection functions, leading to concerns about whether Interior could provide effective program oversight while undergoing such a broad reorganization. In the February 2013 update to our High Risk list,[11] we narrowed the federal oil and gas management high-risk area to focus on revenue collection and human capital challenges because Interior had completed its reorganization.

[9]GAO, *Federal Oil and Gas Leases: Opportunities Exist to Capture Vented and Flared Natural Gas, Which Would Increase Royalty Payments and Reduce Greenhouse Gases*, GAO-11-34 (Washington, D.C.: Oct. 29, 2010).

[10]GAO, *High-Risk Series: An Update*, GAO-11-278 (Washington, D.C.: February, 2011).

[11]GAO, *High-Risk Series: An Update*, GAO-13-283 (Washington, D.C.: February, 2013).

In order for GAO to remove the high-risk designation, Interior must successfully address the challenges we have identified, implement open recommendations, and meet its responsibilities to manage federal oil and gas resources in the public interest. While Interior recently began implementing a number of GAO recommendations, including those intended to improve the reliability of data necessary for determining royalties, the agency has yet to implement a number of other recommendations, including those intended to help the agency (1) provide reasonable assurance that oil and gas produced from federal leases is accurately measured and that the public is getting an appropriate share of oil and gas revenues and (2) address its long-standing human capital issues.

We are currently engaged in two reviews examining the remaining two high-risk issues. First, we are conducting a follow up review of Interior's collection of revenues from the production of oil and gas on federal lands and waters. As part of this review, we will examine Interior's progress, if any, in (1) ensuring the government is getting a fair return for federal oil and gas resources, (2) meeting agency targets for conducting oil and gas production verification inspections, and (3) providing greater assurance that oil and gas production and royalty data are consistent and reliable. Second, we are reviewing the extent to which Interior continues to face problems hiring, training, and retaining staff, and how any remaining problems affect Interior's ability to oversee oil and gas activities on federal lands and waters. As part of this effort, we will focus on the causes of Interior's human capital challenges, actions taken, and Interior's plans for measuring the effectiveness of corrective actions. In addition, while we have narrowed the focus of the high-risk area to revenue collection and human capital issues, we will, in the course of ongoing work on these issues, continue to consider Interior's reorganization and its affect on the agency's ability to oversee federal lands and waters.

In conclusion, Interior's management of federal oil and gas resources is in transition. Our past work has found a wide range of weaknesses in Interior's oversight of federal oil and gas resources, ultimately resulting in its inclusion on our High Risk List in 2011. Since then, Interior has successfully implemented many recommendations and resolved one of the three concerns that led to its inclusion on the high risk list—the challenges associated with its reorganization. We remain hopeful that Interior will continue to implement the many remaining recommendations we have made, thereby providing greater assurance of effective oversight of federal oil and gas resources.

Chairman Langford, Ranking Member Speier and Members of the Subcommittee, this concludes my prepared statement. I would be pleased to answer any questions that you or other Members of the Subcommittee may have at this time.

GAO Contact and Staff Acknowledgments

If you have any questions concerning this testimony, please contact me at (202) 512-3841 or ruscof@gao.gov. Contact points for our Offices of Congressional Relations and Public Affairs may be found on the last page of this statement. Other individuals who made key contributions include Jon Ludwigson, Assistant Director; Christine Kehr, Assistant Director; Janice Ceperich; Glenn Fischer; Cindy Gilbert; Alison O'Neill; and Barbara Timmerman.

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Frank Rusco is a Director in GAO’s Natural Resources and Environment team, leading work on a broad spectrum of energy and science issues, including federal oil and gas management; DOE’s energy, science, and loan programs; intellectual property rights issues; NRC oversight; and government-wide science programs and activities. Mr. Rusco holds both a master’s degree and doctorate in economics from the University of Washington in Seattle.