

WRITTEN TESTIMONY OF DENNIS ROLLER, AUDIT MANAGER FOR THE
NORTH DAKOTA STATE AUDITOR'S OFFICE – ROYALTY AUDIT SECTION
FOR THE "ROYALTIES AT RISK: ADMINISTRATION OF THE MINERALS
MANAGEMENT SERVICE" BEFORE THE COMMITTEE ON NATURAL
RESOURCES UNITED STATES HOUSE OF REPRESENTATIVES

MARCH 28, 2007

Mr. Chairman and members of the committee, I want to thank you for the opportunity for me to comment and share my views concerning the wide array of challenges faced by the Minerals Management Service and State and Tribal delegations.

Let me begin with a quick history of the North Dakota State Auditor's Office Royalty Audit Section (ND delegation). The ND delegation was created in 1982 under the authority of section 205 (205 delegation) of the Federal Oil and Gas Royalty Management Act of 1982 (FOGRMA). For the past 25 years, the ND delegation has performed compliance work on Federal mineral royalties paid in North Dakota, with some very successful results. I was an auditor for the ND delegation for over ten of those years and have been the audit manager for the ND delegation for the last three years.

As shown at Exhibit 1, the ND delegation from 1982 through 2001 collected over \$26.6 million in additional Federal royalties. During that same period, the costs of the ND delegation were less than \$4.2 million as shown at page 2 of Exhibit 1. That's almost \$6 of revenue for every \$1 spent. For all State's that had a 205 delegation for 1982 through 2001 the total additional royalty collections were over \$296.5 million, while costs were under \$58.5 million. Exhibit 1 does not include any 202 Tribal delegations (section 202 delegations under FOGRMA) of the collections or costs as several Tribes prefer not to share that information. However, the ND delegation believes that 202 Tribal delegations have had similar success. Exhibit 1 is only through 2001 as that is the last date through which the MMS has accurate collection information. I will go into greater detail on the Collections and Information Management System (CIMS) later. These successful collection figures represent only the direct collections. For example, the ND delegation findings often have a residual financial effect due to future royalty payments being calculated correctly.

Given the ND delegation's success in the past, I now would like to discuss some of the challenges the MMS is facing that are recently limiting the efficiency of the ND delegation.

The first area is the state of misreporting for the MMS 2014s, the payment reporting document, and the Oil and Gas Operations Report (OGOR), the production reporting document. With the re-engineered system that was put in place on November 1, 2001, the MMS changed the property numbering system used by companies to report the 2014s. The MMS also stopped doing any automated comparison of these two documents. Without any automated check, company reporting accuracy has deteriorated. Our audits now often entail a reconciliation of every single payment made by a company for the review period in order to determine what the company intended to report and pay.

This OGOR-2014 comparison process also was a recommendation of the Fiscal Accountability of the Nation's Energy Resources Committee of January 1982, commonly referred to as the Linowes Commission, which was the driving force for the creation of the MMS. Recommendation #5 of the internal controls section (Chapter 3) of the Linowes Commission report states "That the Federal royalty managers incorporate production data into the royalty management system in order to cross check the data with sales and royalty data for **all** leases each payment period." (emphasis added) The MMS did this comparison prior to implementation of the re-engineered system and per the 2001 MMS budget justification document, this comparison process collected \$56.2 million in additional FY98 royalties.

The deterioration of reporting has added a tremendous amount of hours to our audits. In order to combat this, the ND delegation requested the authority to perform volume and royalty rate automated verifications on October 1, 2005, as allowed for under the Federal Oil and Gas Royalty Simplification and Fairness Act of 1996 (FOGRSFA), see exhibits from the request at Exhibit 2. The ND delegation was denied that request on January 20, 2006. However, the ND delegation was later granted the ability to perform limited scope compliance reviews using the comparison tool the ND delegation developed. The ND delegation tool uses the OGOR reported sales and the two known factors in the royalty equation, the Federal Government's allocation percentage and the royalty rate, to compare to what the company reported as owed on the 2014. The only remaining royalty equation factor is the unit value, which includes allowances and transportation. The ND delegation has been performing these limited scope oil volume and royalty rate compliance reviews since October 1, 2006. Using this comparison, the ND delegation has discovered countless reporting issues, non payment issues, missing documents issues, two companies that just quit paying their Federal royalty obligation in ND and well over \$100,000 in additional royalties, not including the amount owed by the two companies that just quit paying, all at a cost of less than \$10,000. The ND delegation has taken on this comparison process at a time when funding has been reduced from 6 FTE to 4.5 FTE and for FY08 the MMS has stated they will only fund the ND delegation at 4 FTE.

What the ND delegation has been finding with our comparison process is that companies are willing to correct their reporting when it is brought to their attention. MMS is no longer bringing it to the companies' attention and in fact we have had a company tell us that it can't be reported wrong because the MMS hasn't notified them that it's wrong.

This issue goes to the core of having an effective royalty management program. Without correct reporting, the MMS does not know what their universe of receivables is and consequently can not compare that universe to what was actually received. This is a basic principle for any business.

A second major area is CIMS as I mentioned earlier. CIMS is the current MMS collection tracking system that was brought online January, 2006. The previous collection tracking system, CTS, was shut down in late 2001. The information in CTS agreed with the ND delegation's collection data. Four years later when CIMS comes online the data is inaccurate and incomplete. The MMS, on more than one occasion, has asked the delegations for help in correcting and reconciling CIMS. The ND delegation decided to use some of our limited resources to reconcile the CIMS information to our state data. After performing this reconciliation in mid 2006, it was determined that the

reports that the ND delegation can generate from CIMS are not accurate. The reports do not reflect all the collections in CIMS for the ND delegation and there is no way for the ND delegation to generate a correct report.

Thirdly, the MMS re-engineered system was not capable of calculating and billing late payment and additional royalty collection interest until May 2003. Today MMS says they are finally caught up on the back log of interest. However, the ND delegation has not received a correct report of the interest that has been billed from November 2001 through September 2006. The ND delegation did receive a report for interest from November 2001 through April 2006, but the report information was incorrect due to an error in the query.

On January 9, 2007, the MMS provided a report of interest for the quarter of October 1, 2006 through December 31, 2006. The ND delegation randomly reviewed two late payment interest billings from that report. For the first case, no late payment interest was actually owed. MMS billed late payment interest because the company misreported the sales month. The second case the ND delegation looked at was one for which the company claims they paid the royalty amount and MMS claims they didn't. This dispute centers on the matching or bookkeeping process the MMS has, a fourth area of concern. If a company reports on a 2014, that they owe \$100,000, but pays only \$90,000 the MMS matches the money as best they can. Normally the MMS would apply 90% to each of the detail lines of the \$100,000 report. In this case, the MMS determined that one sales month for one property for one product was not paid and thus billed the company interest for that one property, product, sales month. Putting aside the dispute over whether the amount initially was paid or not, the interest billing calculated the interest incorrectly. Interest remains a concern for the ND delegation as the ND delegation has no report of interest billings from November 2001 through September 2006 and is concerned with the accuracy of the billings for October 2006 through December 2006.

Once again, the Linowes Commission provided a useful guideline for the MMS matching problem. In the summary section of the report, the commission stated "The Federal government should perform an oversight role. It must not waste its limited resources on tasks that are the industry's responsibility. In managing royalty collection, it should not remain mired in bookkeeping details that rightly belong to the lessee." The commission went on to state "The oil and gas industry should carry out its obligation, as lessee, to pay royalties in full and on time. The industry, not the government, has primary responsibility for the detailed record keeping needed to assure that all royalties are paid."

To further demonstrate the extent of how MMS has moved away from putting the accounting responsibility on the companies, the ND delegation has not issued an order to perform restructured accounting in over 5 years. In the past, whenever the ND delegation encountered a systemic problem, a problem for every test month or every property covered by a contract, the ND delegation requested the company to pay the additional royalties for the test months and then to perform restructured accounting (recalculate) the royalties for all the non test months. The MMS no longer is willing to sign orders to perform restructured accounting so instead the ND delegation has to test all months or project the non tested months. Unfortunately, if a projection is used, the dispute becomes the projection method rather than if additional royalties are actually owed.

The ND delegation concerns surrounding the financial system don't end with the matching or bookkeeping issue. Within the last year, the ND delegation has identified where an audit collection was distributed to ND at less than the collection amount. The difference was not immaterial, but no explanation has been provided by the MMS for the difference. Another issue identified in the last six months is the MMS effectively borrowed ND's 50% share of the royalties for a property for up to three years and no explanation has been given. This issue is that several payments for ND's share of 2001 royalties for a property were backed out in October 2003, even though the company did not change their royalty reporting. Some of the amounts backed out were paid back three months later, some 12 months later and the final amounts were paid back 36 months later. Was the ND delegation paid late disbursement interest and how often has this occurred? Additional questions the ND delegation has not been provided answers for. Ideally the MMS financial system should be an automated process, but as MMS has recently stated to the delegations, there are way too many manual processes.

A fifth area that the ND delegation has found to be ineffective is MMS' Government Performance Result Act (GPRA) goals. The MMS goals are tied solely to reviewing a certain percentage of the revenue voluntarily paid by the companies. As the recent IG report points out, this goal results in only large companies being reviewed while there are hundreds of smaller companies that are never looked at. In fact, the ND delegation has found that it encourages the delegation to not look at companies that are severely underpaid. For example, the ND delegation put a company on our work plan that paid \$0 in Federal royalties during the review period. The ND delegation got 0% credit towards the goal. However, the ND delegation knew this company owed over \$100,000 of Federal royalties and had just failed to pay it.

Finally, the ND delegation has concerns about the working relationship between the MMS and the State and Tribal delegations. The delegation that has supported the MMS the most recently, has stated during STRAC (State and Tribal Royalty Audit Committee) only meetings that the limiting of the STRAC meetings to one a year by the MMS is in retaliation to STRAC going to congress with letters about MMS. At the last such STRAC only meeting, this delegation stated that it is a fact that the MMS is looking at legal ways of getting rid of STRAC. This is a great concern to the ND delegation as the State and Tribal delegations have had great success in collecting additional Federal royalties and protecting the United States Citizens mineral interests.

In closing, the delegations have been very successful in the past at collecting additional royalties owed from Federal lands. The ND delegation concurs with the recent IG report finding that the MMS management lacks reliable information to manage the compliance program. The collection information, CIMS is incomplete and inaccurate. The level of misreporting and non-reporting has drastically increased. Interest since November 2001 is still an unknown. The MMS is mired down in detailed bookkeeping which should be the responsibility of the industry. Goals encourage looking at high dollars and away from where it is likely that there is a significant percentage of additional royalties owed by a company. Finally, over the last five years the ND delegation has noticed a disturbing trend of the MMS in moving away from a partnership to a dictatorship in dealing with the delegations.

Thank you for the opportunity to provide written testimony to the Committee today. I will be happy to answer any questions you may have or provide further details and explanations surrounding any of these issues. My contact information is:

Dennis Roller
PH: 701-250-4682
FAX: 701-250-4686
Email: droller@nd.gov

DISCLOSURE REQUIREMENT
Required by House Rule XI, clause 2(g)
and Rules of the Committee on Resources

Dennis Roller
North Dakota State Auditor's Office - Royalty Audit Section
425 N. 5th Street – 3rd Floor
Bismarck, ND 58501
701-250-4682

Training:

I have had at a minimum 80 hours of continuing professional education (CPE) every two years for the past twelve years, as per compliance with the Government Auditing Standards (Yellowbook). At a minimum, 20 of those CPE hours were directly related to Federal royalties.

Professional licenses

Certified Public Accountant (CPA) State of North Dakota

Employment experience:

Federal mineral royalty auditor with the North Dakota State Auditor's Office for over 10 years under a Federal Oil and Gas Royalty Management Act of 1982 (FOGRMA) 205 contract with the Department of Interior. Federal mineral royalty audit manager of the North Dakota State Auditor's Office for the last three years under a Federal Oil and Gas Royalty Management Act of 1982 (FOGRMA) 205 contract with the Department of Interior.

Office Representing:

North Dakota State Auditor's Office

I have not received any Federal grant or contract.

Federal contracts with the Department of Interior which was received since October 1, 2000 by the organization which I represent at this hearing:

<u>Federal Fiscal Year</u>	<u>Grant # and Federal Agency</u>	<u>Grant Amount</u>
FFY01	DOI-205 Delegation Grant #1435-02-99-CA-40304	\$397,590.51
FFY02	DOI-205 Delegation Grant #1435-02-99-CA-40304	\$404,851.20
FFY03	DOI-205 Delegation Grant #1435-02-99-CA-40304	\$412,447.77
FFY04	DOI-205 Delegation Grant #1435-02-99-CA-40304	\$436,812.29
FFY05	DOI-205 Delegation Grant #0205CA40481	\$361,788.64
FFY06	DOI-205 Delegation Grant #0205CA40481	\$352,120.61
FFY07	DOI-205DelegationGrant#0205CA40481- budgeted	\$375,620.00