

TESTIMONY OF THE HONORABLE EARL E. DEVANEY
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BEFORE THE SUBCOMMITTEE ON ENERGY AND MINERAL RESOURCES
UNITED STATES HOUSE OF REPRESENTATIVES
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Mr. Chairman, members of the subcommittee, I want to thank you for the opportunity to appear before you today to discuss the recommendations arising from some of my office's recent work in the oil and gas royalties collection program, and my thoughts about how this program might be improved, including a stepped up oversight effort on the part of the Office of Inspector General (OIG).

For the past two years, the agency responsible for royalty collections on behalf of the Federal Government, the Minerals Management Service (MMS) of the Department of the Interior (DOI), has undergone intense scrutiny by the OIG and GAO, following revelations of systemic management and organizational failures. As you know, I testified before the House Subcommittee on Energy and Resources in September of 2006 and the full Committee on Natural Resources in February 2007; I have done the same before the Senate Committee on Energy and Natural Resources in January 2007. The history here is rich and disconcerting. Beginning with our audit of MMS' compliance review process, we found that while compliance reviews play a useful role in MMS' greater Compliance and Asset Management Program, they do not provide the same level of detail or assurance that a traditional audit provides, nor have they been utilized in the context of a well-designed, risk-based compliance strategy. Following this audit, we made recommendations for improving systems data reliability, strengthening the compliance review tools, and developing that missing risk-based strategy.

This audit was followed by a complex investigation into the failure of MMS to include royalty price thresholds in offshore oil leases in the Gulf of Mexico in 1998 and 1999. From this investigation, we recommended that all policy decisions that significantly alter the terms and conditions of the offshore and onshore oil/gas leases be memorialized in the form of an internal memorandum and compiled in one accessible repository, establish one person that is responsible for the entire Notice of Sale document, and prior to its final issuance, each lease should be legally reviewed by the Solicitor's Office.

Even while this investigation was ongoing, Secretary Kempthorne requested that we initiate another investigation into Minerals Revenue Management (MRM), a program within MMS that had had several *qui tam* cases filed against it by its own auditors. The

results of this investigation presented examples of a systemic dilemma in MMS – that of the bureau’s conflicting roles and relationships with the energy industry. It also hinted of a profound failure in the development of a critical MRM information technology (IT) system; it revealed a working environment in which poor communication, or no communication, compounded an already existing element of distrust; and it demonstrated a band-aid approach to holding together one of the Federal Government’s largest revenue producing operations. This report included recommendations to, among other things, rescind the 1977 “hardship” guidance and develop clear guidance to industry on interest calculations, develop a strategy to eliminate the interest collection backlog on an expedited basis, clarify guidance to industry on sub-sea transportation costs, foster better communication between the MMS audit and programmatic functions, and develop an enhanced ethics program designed specifically for the RIK program.

In addition, we discovered a number of other significant issues worthy of separate investigations, including ethics lapses, such as accepting gifts from and fraternizing with industry, program mismanagement and process failures. We currently have four investigations that remain ongoing. Because these latter investigations involve potential criminal violations, I am currently precluded from discussing them in any detail. Suffice it to say, Mr. Chairman, MMS has more than its share of royalty management issues, and has consumed more than its share of the OIG’s attention on these issues over the past two years.

In addition to his request for the *qui tam* investigation, Secretary Kempthorne separately requested a study by an independent bi-partisan panel co-chaired by Senators Bob Kerrey and Jake Garn, which reported to the Royalty Policy Committee. As our work regarding MMS concluded, we shared with this panel a compilation of recommendations that emanated from our efforts. The final report presented to the Royalty Policy Committee fundamentally incorporated the 22 recommendations made by the OIG thus far. We expect to build on these recommendations, as our remaining investigations come to conclusion.

Given the amount of work we have been doing in the royalties’ arena, it might be reasonable to conclude that we drew on a corps of subject-matter experts, familiar with the intricacies and nuances of royalty management. Rather, we grew our so-called “experts” from scratch and on the run. We recognized almost immediately, that the OIG would need to develop a royalties’ oversight unit, and build an expertise for the long term.

In December, Congress passed the Omnibus Spending Bill for FY 2008. Accompanying the bill was report language that instructed the OIG to develop a permanent capability to oversee MMS’ royalty function. We are in the process of doing just that. In the near term, we are standing up a modest Denver-based Royalty Oversight Office, consisting of six employees – four of which have already been filled by current OIG Staff, including the position of Director. The remaining two positions are expected to be recruited and on-board by May 2008. The members of this small office must first develop an understanding of royalties-related activities in MMS; we are also identifying training opportunities to cultivate their expertise, including observation and participation

in royalty audits conducted by States and Tribes. This group will soon complete the ongoing evaluation of MMS' Royalty-in-Kind (RIK) sales program for oil, and will then undertake an audit of MMS' processes for verifying volumes delivered as RIK, including, most importantly, oil destined for the Strategic Petroleum Reserve. Eventually, this unit would also verify that the recommendations we have made and those issued by the Royalty Policy Committee have been appropriately implemented.

In the longer term, we intend to develop the capacity to oversee all minerals-related activities managed by DOI from initial leasing of Federal and Indian lands to the final termination of those leases, which would include the management of those leases and the collection of royalty payments. Ultimately, we would like to expand our oversight coverage beyond MMS to the energy and minerals programs at the Bureau of Land Management and Indian Affairs, including oil, gas, and solid minerals.

Of course, to this vision is attached the very real need for continued funding to keep this unit operating, and to expand its capacity as it develops. I am quite confident, however, that the results that will be derived from this unit will more than pay for any increase in appropriations that we receive.

Mr. Chairman, I would be remiss if I failed to acknowledge the receptiveness and responsiveness of Secretary Kempthorne, Assistant Secretary Allred and MMS Director, Randall Luthi to our findings and recommendations. The challenge, however, comes in the effective implementation of those recommendations and in holding accountable those responsible for MMS' many past failings.

As we conclude the remaining investigations, I would be surprised to see all of the involved DOI employees prosecuted. Any that are not, however, will be forwarded to Assistant Secretary Allred for corrective administrative action. This will be the accountability test, the results of which, I am sure, the Subcommittee and I both await with great expectation.

That concludes my prepared remarks, Mr. Chairman. I would be happy to answer any questions you or the members of the Subcommittee might have.