



OFFICE OF  
**INSPECTOR GENERAL**  
U.S. DEPARTMENT OF THE INTERIOR



# **BIA NEEDS SWEEPING CHANGES TO MANAGE THE OSAGE NATION'S ENERGY RESOURCES**



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Memorandum

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Assistant Secretary – Indian Affairs

Michael Black  
Director, Bureau of Indian Affairs

From: Mary L. Kendall  
Deputy Inspector General

Subject: Final Evaluation Report – BIA Needs Sweeping Changes to Manage the Osage Nation's Energy Resources  
Report No. CR-EV-BIA-0002-2013

This memorandum transmits the findings of our evaluation of the Bureau of Indian Affairs' (BIA), Osage Agency's (Agency) management of the Osage Nation's oil and gas resources. We focused on BIA's effectiveness in managing the Osage Nation's mineral estate.

We found that the Agency's oil and gas management program is fundamentally flawed, thereby preventing the Agency from effectively managing the mineral estate. BIA can only reform the program through sweeping changes in how the Agency conducts oil and gas activities. Specifically, we found weaknesses in the Agency's oil and gas policies and procedures that guide critical activities affecting royalty payments. In addition, we determined that the Agency's system for accounting and leasing activities is inadequate and, as a result, Agency staff conducts many activities manually. Finally, we identified many competing interests in the Agency's oil and gas operations, including tribal beneficiaries, the Osage Nation Minerals Council, leaseholders and operators, and surface owners. These interests contribute to the complexity of managing the Osage Nation's mineral estate and put significant pressures on Agency staff.

We provide 33 recommendations that should improve the Agency's management of its oil and gas program. Five recommendations are resolved and implemented, thus requiring no further action. There are 27 recommendations that are resolved and not implemented. These are being forwarded to the Assistant Secretary for Policy, Management and Budget for tracking their implementation. One recommendation is unresolved. We will refer this recommendation to the Assistant Secretary for Policy, Management and Budget for resolution. We are encouraged by early reports of agency action toward hiring key personnel and working with the Office of Natural Resource Revenue to explore implementing some of our recommendations. We believe that if BIA implements all of our recommendations, the Agency's management of the Osage Nation's oil and gas program will become more effective.

The legislation creating the Office of Inspector General requires that we report to Congress semiannually on all audit, inspection, and evaluation reports issued; actions taken to implement our recommendations; and recommendations that have not been implemented.

We appreciate the cooperation and assistance of the BIA staff during our review. If you have any questions about this report, please contact me at 202-208-5745.

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## Results in Brief

We found systemic flaws at the Osage Agency (Agency), a unit of the Bureau of Indian Affairs' (BIA), that have created an ineffective program for managing the Osage Nation's mineral estate (oil, gas, and other reservation sub-surface minerals). Further, we found that the Osage Nation Minerals Council (Council), a tribal group which represents the headright holders (those owning a portion of the mineral estate), is exerting significant influence over the Agency, which inhibits the Agency's ability to manage the tribe's oil and gas program.

We focused our review on the Agency's effectiveness in managing the mineral estate. The Agency is required to obtain maximum royalty payments on behalf of the headright holders. We found that the Agency's oil and gas management program is fundamentally flawed, thereby preventing the Agency from effectively managing the mineral estate. BIA can only reform the program through sweeping changes in how the Agency conducts oil and gas activities. Specifically, we found weaknesses in many aspects of the Agency's oil and gas activities, including issues with policies and procedures, environmental compliance, planning and mineral resource management, and data management. A substantial cause for these deficiencies is poor oversight by a prior Agency superintendent, and insufficient staffing and training.

Further, we identified many competing interests in oil and gas operations, including tribal beneficiaries, the Council, leaseholders and operators, and surface owners. These interests contribute to the complexity of managing the Osage Nation's mineral estate and put significant pressures on Agency staff.

Poor oversight by Agency leadership is a major cause of these deficiencies, especially relating to oil and gas activities. Considering that interpretation of many of the regulations is left to the superintendent, this person should be proactive and knowledgeable in oil and gas issues. We recognize that there have been different appointees from the Eastern Oklahoma Regional Office and other Agency offices to superintendent and deputy superintendent, in an acting capacity, for most of fiscal year 2013.

Separate legislation specifically excludes the Osage Nation from other Indian oil and gas regulations. As a result, the Council has historically resisted assistance from the Bureau of Land Management, BIA, and the Office of Natural Resources Revenue, and continues to do so. We believe, however, that the Council is going beyond what it considers to be its unique status because of its exclusion from Indian oil and gas regulations. This effectively avoids more oversight and merely maintains the status quo with no incentive to opt into a more rigorous system of accountability.

We previously provided BIA with three Notices of Potential Findings and Recommendations. The BIA Director agreed with most of our recommendations.

He anticipated that newly proposed regulations would address many of our recommendations. Based on BIA's response, we revised some of the issues and recommendations in this report to address its concerns. We provide 33 recommendations to help correct the identified weaknesses and improve the Agency's management of the mineral estate.

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# Introduction

## Objective

We assessed the Bureau of Indian Affairs' (BIA), Osage Agency's (Agency) effectiveness in managing the Osage Nation's oil and gas program. Appendix 1 contains the details of the scope and methodology for this review.

## Background

The Osage Nation is a federally recognized tribe. Its headquarters and most of its members are located on the Osage Reservation in Pawhuska, OK. The Osage Tribe Allotment Act of 1906 (Act)<sup>1</sup> reserved the Osage Nation's mineral estate to the Osage Tribe and directed that the Tribe's "headright holders"<sup>2</sup> receive the estate's royalty revenues (see Appendix 2 for a history of the Osage Nation's mineral estate). The Osage Nation Minerals Council (Council) represents the headright holders.

The Act was the core authority for BIA to promulgate a unique set of rules in the Code of Federal Regulations (C.F.R.) governing Osage leasing: 25 C.F.R. part 226, "Leasing of Osage Reservation Lands for Oil and Gas Mining," which specifically excludes the Osage Nation from the Indian Mineral Leasing Act's regulations (25 U.S.C. § 396). The Osage Nation does not adhere to other mineral leasing acts or oil and gas regulatory laws.

The Agency operates under BIA's Eastern Oklahoma Regional Office, and oversees and provides services to the Osage Nation. The Osage Nation's mineral estate covers approximately 1.5 million acres in Osage County, OK. The combined oil and gas royalties in fiscal years (FYs) 2010 and 2011 were \$224 million.

Agency records indicate that the Osage Nation has 4,453 current leases with approximately 14,500 producing wells. Agency officials expect that operators will drill an additional 7,500 wells between FYs 2012 and 2027, generating \$13.6 billion in estimated royalties.

BIA filled the Agency's superintendent and deputy superintendent positions, in an acting capacity, for most of FY 2013. BIA announced the superintendent position on June 27, 2013, but due to low interest or unqualified applicants, BIA re-announced the position on September 11, 2013. BIA had not filled the permanent superintendent position by the end of our fieldwork, but has since done so. BIA hired a permanent deputy superintendent on November 3, 2013.

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<sup>1</sup> 34 Stat. 539 (June 28, 1906).

<sup>2</sup>"Headright" means the right to a portion of the proceeds of the Osage Mineral Estate, as provided by the 1906 Act and the tribal roll created pursuant to the 1906 Act. "Headright holder" means the lawful owner of any interest in headright, including fractional interests.

The Osage Nation received a \$380 million settlement in October 2011 from the U.S. Government because of alleged Government mismanagement of the Osage Nation's oil and gas mineral estate. As part of the terms of the settlement, the U.S. Department of the Interior (DOI) agreed to pursue negotiated rulemaking with the Osage Nation. The process resulted in newly proposed rules that revise regulations concerning the Osage Nation's oil and gas operations. The proposed rules were published for comment in the Federal Register in August 2013. DOI is currently reviewing and considering the comments before it finalizes the regulations.

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## Findings

We found weaknesses in many aspects of the Agency's oil and gas activities, including issues with policies and procedures, environmental compliance, planning and mineral resource management, and data management. A substantial cause for these deficiencies is poor oversight by a prior Agency superintendent and insufficient staffing and training.

The Agency is obligated to manage the program in the most prudent manner and in the best interest of the headright holders. We found, however, significant external influences over Agency policies and procedures that inhibit effective management, including resistance of additional oversight and accountability by the Council.

### **Sweeping Changes Needed in a Fundamentally Flawed Program**

The Agency's oil and gas management program is fundamentally flawed, thereby preventing the Agency from effectively managing the mineral estate. BIA can only reform the program through sweeping changes in structure, policies, procedures, and systems.

We found that the general mind-set of the Agency is that it cannot effect change in the Osage oil and gas program because it is bound by the 1906 Act and 25 C.F.R. part 226, which exclude the Osage Nation from other Indian oil and gas regulations. We found, however, that BIA has the ultimate responsibility to manage the Osage Nation's oil and gas program under the Act and 25 C.F.R. part 226, and it does have the authority to make changes to the program. Specifically, BIA can change 25 C.F.R. part 226 to mirror other Indian oil and gas regulations in many respects. Not only does BIA have the authority, but it also has the obligation to manage the Osage Nation's oil and gas resources effectively so that headright holders receive the best value for their oil and gas. In order to correct deficiencies, however, BIA will need to make significant changes to the program. These changes will ultimately be in the best interest of the Osage Nation and its headright holders.

In 1990, we reported similar deficiencies in the Agency's management of the Osage Nation's oil and gas program. The Agency has not corrected these deficiencies. As such, it still struggles with vague regulations, insufficient policies and procedures, an antiquated data system, and inadequate capabilities in oil and gas management.

In contrast, both the Bureau of Land Management (BLM) and the Office of Natural Resources Revenue (ONRR) have well-established regulations, policies and procedures, data systems, and capabilities proven effective for managing oil and gas programs throughout Indian Country. Nothing prohibits BIA from

delegating responsibilities for many of the Osage Agency’s functions by using interagency memoranda of understanding (MOUs) with BLM and ONRR for those agencies to use their expertise and perform specialized work while leaving ultimate responsibility and accountability with BIA.

Support for BLM and ONRR assistance, however, is divided in the Council. One Council member stated: “The Tribe and the Minerals Council want to keep Osage as a BIA-only operation. They do not want BLM or ONRR involvement.” This person further indicated that incorporating BLM and ONRR’s methods into the regulations is fine, but wants BIA to be the controlling authority.

Another Council member stated that he liked the idea of ONRR helping the Agency to better account for oil and gas, but does not want BLM involvement. He said that BLM is too strict on producers, and will drive the companies out of the county.

The Agency does not have appropriate segregation of duties for leasing, accounting, and inspecting. All of these functions are under Agency direction. In a similar, yet higher-level example, DOI found minimal segregation of duties to be highly ineffective at the former Minerals Management Service (MMS). It, therefore, divided MMS into three separate entities to ensure segregation of duties for leasing, accounting (royalty collecting), and inspecting. BIA could contract with BLM for inspections and ONRR for accounting. This would remedy this structural deficiency.

### **Recommendations**

We recommend that BIA:

1. Use its authority to correct program deficiencies by modifying 25 C.F.R. part 226 to mirror other Indian Country oil and gas regulations.
2. Enter into MOUs with BLM and ONRR so these agencies can perform essential oil and gas operations and accounting activities on BIA’s behalf.

## **The Agency has Nonexistent or Vague Policies and Procedures**

Effective internal and external policies and procedures are a necessary component to a functional oil and gas management program. Internal policies and procedures are needed for employees to consistently and correctly perform their duties. External guidance clarifies vague rules and regulations to oil and gas companies that interact with the Agency.

We found systemic problems with the following internal and external policies and procedures. This is a sweeping issue that affects the entire program.

### **The Agency Does Not Have Effective Internal Policies and Procedures** *Agency Procedures*

The Agency does not have official internal oil and gas policies and procedures, approved by the superintendent, that guide employees in their duties and responsibilities. We do not consider the Agency's manuals to be valid or useful because the manuals are incomplete, poorly written, not dated, and not approved by the superintendent.

#### **Recommendation**

We recommend that BIA:

3. Develop and implement official, comprehensive internal Agency policies and procedures that govern, guide, and regulate oil and gas activities.

### *Processing and Transportation Allowances*

Processing and transportation allowances reduce the royalties paid to the headright holders. Processing allowances are deductions by an operator for reasonable, actual costs incurred to process natural gas. Transportation allowances are deductions by an operator for reasonable, actual costs incurred to transport oil or gas. Lease documents approved by the Agency's superintendent do not address processing and transportation allowances. Currently, the Agency merely accepts the deductions companies report without question or verification.

#### **Recommendation**

We recommend that BIA:

4. Develop and implement internal policies and procedures directing the Agency to verify companies' allowances for royalty calculations, or restrict or disallow such allowances.

### **Non-Arm's-Length Sales**

The Agency may not be collecting the full royalties due on non-arm's-length gas sales, which are sales between affiliated parties that may have the same economic interests. A company may be considered an affiliate if the company controls, is controlled by, or is under common control of another company. This could include common ownership, common officers or directors, percentage of ownership, ownership by relatives, or other evidence of power to exercise control. Currently, companies are not required to report non-arm's-length sales. Accordingly, the Agency cannot readily identify these sales. Through historical

relationships with companies, Agency officials reported that they are aware that non-arm's-length sales occur on a significant number of leases. For example, the officials were aware of two contracts between affiliates that have 657 gas leases. The Agency, however, does not have any oversight or verification procedures for affiliated sales. Companies could therefore reduce their royalty payments by reducing the price paid by the affiliate and thereby reduce the gross proceeds or value used to calculate the royalty payment.

### **Recommendation**

We recommend that BIA:

5. Develop and implement internal policies and procedures for the Agency to oversee, identify, and verify non-arm's-length sales transactions.

#### *Applications for Permits to Drill*

The Agency performs minimal analyses for applications for permits to drill (APDs). BIA requirements are in the Fluid Mineral Estate Procedural Handbook; however, the Agency does not follow the Handbook. We compared the Agency's drilling permit requirements to those listed in BIA's Handbook and determined that the Agency, in contrast with BIA's management of other tribal mineral estates, does not—

- review a detailed drilling plan;
- review a detailed surface use plan of operations;
- require a well plat diagram that shows all leased lands and well locations;
- perform an onsite inspection; and
- require that the operator certify its effort to provide a surface plan of operations with the surface owner.

Regulations for the Osage Nation's oil and gas resources offer minimal requirements for drilling and do not specify standards for drilling approvals. Prudent management of drilling approvals, however, requires more analysis and diligence than the Agency currently conducts. For instance, BIA's Handbook includes a seven-step drilling permit approval process, but the Agency does not follow that process. Agency staff incorrectly stated that the Handbook does not apply to the Osage Nation. We noted, however, that the Handbook states that the Agency should complete the permit approval steps that BLM completes for Indian Country. The Handbook states: "NOTE FOR OSAGE: Osage conducts all activities normally the responsibility of BLM."

In response to our draft report, BIA clarified that even though the Handbook contains language regarding the Agency, it refers to the tripartite system of minerals management, which does not extend to the Osage mineral estate. We,

therefore, modified the language of recommendation 6 below to remove the reference to the Handbook.

We also noted that an Agency petroleum engineering technician (PET) reviews and approves drilling permits rather than the Agency’s petroleum engineer. While the PET may have extensive experience and knowledge, it is more appropriate that the staff’s petroleum engineer be involved in approving drilling activities because of the technical information involved in the permitting process. The position description for the petroleum engineer specifically states that the petroleum engineer “examines applications submitted by oil and gas lessees for authority to drill, plug, or do remedial work on existing wells, and recommends approval or disapproval to supervisor.” The position description for the PET does not mention reviewing or approving APDs.

### Recommendations

We recommend that BIA:

6. Develop and implement internal policies and procedures to enhance the Agency’s drilling permit review process in partnership with BLM; and
7. Develop and implement internal policies and procedures to require the Agency’s petroleum engineer to review and approve drilling permits.

### **The Agency Does Not Have Sufficient Supplemental External Guidance**

The C.F.R. (25 C.F.R. part 226) gives the Agency’s superintendent significant discretion for managing the oil and gas program. Inadequate guidance for oil and gas management has encouraged inconsistent practices by oil and gas operators and, in some cases, underpayment of royalties. Specifically, the regulations on natural gas processing and transportation allowances, gas royalties, and gas measurement are insufficient and unclear. Other oil and gas regulatory agencies provide supplemental guidance through Notices to Lessees or Onshore Orders where the Agency’s regulations are silent or unclear. Supplemental guidance could provide consistent interpretation of 25 C.F.R. part 226 and leave less discretion to the Agency superintendent.

#### *Gas Royalties*

Lessees underpay gas royalties when they are selling gas at less than market price. According to 25 C.F.R. § 226.11, royalties must be based on market price. The Agency, however, is not enforcing the regulations when it allows the lessee to pay less in royalties. For example, we reviewed one contract that allowed the lessee to pay royalties based on 25 to 75 percent of the market price (based on gas volume sold to the buyer). The contract specifically stated that the “buyer shall pay the

seller a percentage of the market price.” The lessee used the smaller percentage to pay royalties, rather than market price, thereby reducing the royalties paid to the headright holders.

We calculated almost \$47,000 lost in potential royalty payments from eight lessees during the month of January 2013 (see Appendix 3). These lessees paid \$178,569 in royalties. If the lessees had paid royalties based on the full market price, however, the royalty payments would have been \$225,221, a 26 percent increase in royalties to the headright holders. The potential royalties would be substantially higher since our analysis only covered 1 month.

In response to our NPFR, BIA stated that it disagreed with our preliminary finding and that it may not deviate from legal requirements in the C.F.R. Further, BIA states that its proposed regulations may address our concerns. Although the proposed regulations do provide more specific guidance than the present regulations, the problem still exists: the Agency is not enforcing the regulations.

### **Recommendation**

We recommend that BIA:

8. Make certain that lessees pay oil and gas royalties based on market price according to the current regulation, 25 C.F.R. § 226.11.

### *Gas Measurement*

Lessees measure gas inconsistently, and how they measure gas could lead to royalty underpayments. Most lessees measure gas based on both volume and energy content, which represents gas quality. Others measure gas strictly by volume, leaving out quality considerations. Doing so may allow lessees to pay less in royalties for a better quality gas than a lessee that includes a gas quality calculation.

The Federal regulations are vague or nonexistent for gas measurement. For example, the regulations do not specify how lessees should measure and report gas volume for royalty calculations. The Agency does not have external guidance, such as Notices to Lessees or Onshore Orders, to further clarify calculating gas royalties.

## Recommendation

We recommend that BIA:

9. Develop and implement supplemental Agency guidance that includes how lessees should measure gas and subsequently calculate royalties based on energy quality.

### *Processing and Transportation Allowances*

By accepting processing and transportation allowances that companies claim, the Agency may not be collecting the full amount of royalties for the Osage Nation's oil and natural gas. Federal regulation (25 C.F.R. § 226.11) allows for deductions based on the cost to process gas, but there is no further guidance on limitations, thresholds on the amounts of deductions, or what is included or excluded from processing allowances. Lease documents and the regulations are silent on oil and gas transportation allowances. As a result, the Agency accepts all allowances claimed by the companies.

We noted inconsistencies in how companies and the Agency interpreted and applied allowances, thereby making it difficult or impossible for the Agency to regulate them effectively. We found one company that has used the wrong regulations since 1977 to calculate transportation allowances. The company used ONRR's, or its predecessors', regulations, which do not apply to the Osage Nation. As a result, the Agency has allowed the company to continue to deduct transportation allowances, reducing its royalty payments to headright holders for over 35 years under the wrong regulations.

Furthermore, the Agency could not provide a comprehensive list of leases claiming these allowances or determine the full impact on royalties due to limitations by the Agency's information system.

## Recommendation

We recommend that BIA:

10. Develop and implement supplemental Agency guidance to 25 C.F.R. part 226 to help identify and verify companies' allowances for royalty calculations.

### **Revenues Lost due to Insufficient Tracking of Flaring**

The Agency does not sufficiently track gas flaring, which leaves the headright holders vulnerable to lost royalties from a wasted resource, and that also reduces air quality. Gas flaring occurs when operators release and burn off excess natural gas produced during drilling and oil extraction. This excess gas is a byproduct that

companies could sell and generate additional revenue. A necessary infrastructure, suitable market, and sufficient price structures must be in place, however, before flared gas becomes economically feasible.

One Council member stated: “Flaring has gone on for years and is a common practice.” He noted, however, that there is not always a pipeline to market the gas. Flaring is, therefore, a common practice, but “the issue of flaring and pricing flaring has been ignored.”

The Osage Nation’s regulations about gas flaring leave significant interpretation to the Agency superintendent. Specifically, 25 C.F.R. § 226.37 states: “The Superintendent shall have the authority to impose such requirements as he deems necessary to prevent waste of oil and gas and to promote the greatest ultimate recovery of oil and gas.” While some companies have requested approval from the superintendent to flare gas, the superintendent has not documented all flaring decisions. Agency personnel informed us that documented decisions are in the lease files, but they could not locate the decisions without manually searching each lease file.

In addition, some companies are not paying royalties on flared gas because they have not received appropriate guidance on how to value the gas. One company is reporting volumes on flared gas, but has refused to pay royalties on the gas. In January 2013, the Agency notified the company that the superintendent must approve flaring and the company must pay royalties on any gas flared. The company has yet to pay these royalties. Another company is holding \$50,000 for flaring royalties until it receives pricing guidance from the Agency.

The acting superintendent approved some instances of flaring; however, she did not give the Agency’s Accounting Branch this information to account for the royalties properly. The Agency, therefore, accepts whatever a company reports on price and volume for flared gas. We also found two instances in which a company is reporting flared gas but did not have an approval on file. No one at the Agency verifies approved flaring or certifies that companies with approval accurately report flaring.

## **Recommendations**

We recommend that BIA:

- I 1. Identify all companies that flare gas and verify that each company that flares gas has documented approval; and
- I 2. Develop and implement Agency policies and procedures to verify that companies properly report volumes on flared gas and pay appropriate royalties.

### **Bonds are Insufficient**

The Agency allows bank certificates of deposit (CDs) as bonding instruments, but current regulations do not. Using CDs increases the risk that the Agency may not have funds available should the CDs require liquidation for activities like plugging abandoned wells. According to 25 C.F.R. § 226.6, lessees must furnish corporate surety bonds with each lease. A surety bond is a third-party agreement to provide compensation should the lessee fail to perform specified acts, such as plugging and abandoning a well, within a stated period. The surety company assures the Agency that the lessee will perform a specified action or that the surety company fulfills the contract in the event of the lessee's default. In contrast, a CD is a promissory note issued by a bank and restricts CD holders from withdrawing funds on demand, but it is still possible for the holder to withdraw the money. We recognize that BLM uses CDs as bonding instruments for its oil and gas leases and that the proposed new regulations for the Osage Nation may allow CDs.

"Escrow agreements" accompany CDs. There are 392 CDs totaling \$5.05 million held in escrow for the Agency by banks. Escrow contract dates range from 1987 to 2013. Agency staff recollected that in the late 1980s, it became difficult to find bonding companies willing to underwrite oil and gas bonds, so the Agency approved a policy to accept bank CDs in escrow. Agency staff members were unable to locate this policy.

Agency escrow agreements specify that the bank will automatically reinvest CDs at maturity until the escrow agreement is terminated. We reviewed 20 of the 392 CDs and found one CD for \$5,000 that had matured in 2008. The accompanying escrow agreement included the automatic reinvestment clause, but the CD was not renewed. We are concerned that this CD's funds were remitted back to the lessee at maturity and are therefore not being reserved for Agency use should the need arise. The potential exists for other similarly matured CDs.

We also learned the Agency does not periodically verify CD funds, either by reviewing bank statements or by telephone verification with the issuing banks.

### **Recommendation**

We recommend that BIA:

13. Follow existing regulations requiring corporate surety bonds. If the proposed regulations allow using CDs, regularly review all escrow CDs to verify their maturity and replace matured CDs.

## **Agency Environmental Policy and Practice Has Exposed it to Litigation Risk**

Compliance with environmental laws protects the environment as well as the Osage Nation's resources. According to the National Environmental Policy Act (NEPA), Federal agencies are to "integrate environmental values into their decision-making processes by considering the environmental impacts of their proposed actions and reasonable alternatives to those actions."

A high-ranking Agency official commented: "Minerals Council members are not informed about the importance of environmental assessments. They may question why they need to be done. They note that we've been approving leases this way for years and question why they need to change the process."

DOI and the Agency are responsible, however, for managing the Osage Nation's lands appropriately; being accountable to Federal laws, rules, and regulations; and fulfilling their mission of stewardship. Central to those responsibilities is the NEPA, which requires agencies to evaluate whether a given Federal action will have a significant environmental impact.

The Agency currently relies on a single environmental assessment from 1979 for its Osage mineral leasing NEPA compliance. The fact that the Agency has not conducted any further NEPA review of these activities since its 1979 environmental assessment has exposed it to litigation risk under the NEPA. We have noted this litigation risk throughout the course of our evaluation, and now such lawsuits have been filed.

### **BIA is Currently in Litigation Over Its Alleged Non-Compliance With the National Environmental Policy Act**

As of the date of this report, the Department of Justice is actively litigating claims in the United States District Court for the Northern District of Oklahoma that allege the Agency's 1979 environmental assessment fails to sufficiently fulfill its NEPA procedural requirements. Because the question of the Agency's compliance with the NEPA is a matter of live litigation between the United States and its court opponents, with the matter ultimately to be settled by the court, we will only describe the facts as we know them rather than draw legal conclusions on these matters.

The Agency only completes a categorical exclusion during approval of the lease and does not evaluate the environmental impact of any actions beyond lease approvals. The Agency also does not currently conduct a site-specific environmental assessment for every APD. We selected a sample of 34 out of 749 APDs approved from FYs 2010 to 2013, and developed a list of 8 key components used by BLM and BIA to approve APDs. We reviewed 5 of the 34 APDs and concluded that environmental assessments were not completed for any of them.

Because the five APDs we examined had very limited information, we determined that we did not need to review additional APDs. As mentioned above, instead of conducting site-specific environmental assessments for each APD, the Agency relies on a 1979 environmental assessment covering all Osage mineral leasing activities in the aggregate, which the Department of Justice and BIA claim to be adequate under the NEPA.

BIA informed us that the Agency is working with BLM to prepare a new environmental impact statement under the NEPA, but it may be 5 years from completion. On July 15, 2014, the Agency’s acting superintendent sent a Notice to Lessees that requires applicants and lessees to work with the Agency to “prepare a draft environmental assessment (EA) for all future proposed actions requiring BIA approval,” which BIA will review to “evaluate the impacts of the environmental issues related to the proposed action.” As described in the notice, lessees would only be required to submit environmental assessments for “future proposed” actions. According to the Office of the Solicitor, however, the Council has filed an administrative appeal of this notice, which has consequently been stayed pending the outcome of that appeal.

**Recommendation**

We recommend that BIA:

- 14. Develop and implement oversight procedures to ensure compliance with the NEPA for all Osage Nation oil and gas activities.

**Agency Does Not Have Sufficient Environmental Staff**

The Agency has a critical need for permanent environmental staff. The highly technical and environmentally sensitive NEPA activities require a specialist with NEPA knowledge and expertise, who can focus on environmental issues essential to adhering to the NEPA. The Agency does not have a permanent environmental staff, and, as a result, the petroleum engineer, who is now eligible to retire, signs all categorical exclusions for the Agency. Having NEPA actions approved by non-environmental Agency personnel increases the risk of challenges and legal actions against the Agency’s NEPA actions. The Agency recognizes the need for additional staffing and has requested environmental protection staff.

**Recommendation**

We recommend that BIA:

- 15. Ensure that the Agency has permanent environmental staff to address the NEPA requirements.

## **Agency's Planning and Mineral Resource Management is Insufficient**

Sufficient strategic planning is necessary to ensure effective management of the Osage Nation's mineral estate.

### **The Overemphasis on Gauging**

The Agency places unjustified emphasis on measuring oil tank volumes, or "gauging," with minimal benefits. In addition, it has no strategy for gauging. One Council member said that the PETs simply drive around Osage County looking for full tanks without a strategy for gauging. Therefore, the process is inefficient. The Agency also identifies few differences between what companies report and the Agency's calculations. Finally, because the Agency conducts gauging at the tank, there is a higher risk of theft that would not be identified by present methods of gauging. For example, oil could be stolen before it reaches the storage tanks.

Some Council members place a greater emphasis on gauging over inspections. One Council member said the Agency is wasting its time doing lease inspections and is not doing enough gauging. The Council member indicated the Agency should do more gauging to benefit the headright holders because that is BIA's trust responsibility.

We reviewed all Agency gauging records for a 3-year period ranging from August 23, 2010, to August 20, 2013, and calculated the total variance. Out of 1,020 gaugings, we found companies overreported 250 barrels and underreported 193 barrels for a net of 57 more barrels of oil compared to Agency calculations. Companies, therefore, overreported volumes of oil and paid more royalties than they owed.

The Agency only requests corrections for underreporting when discrepancies reach a half-barrel or more. Of the 193 underreported barrels over the 3-year period, 119 fell within the half-barrel or more threshold. The Agency does not track corrections and, therefore, had no record of actually collecting the additional royalties. If the Agency had requested corrections for underreporting for the 119 barrels, it would have collected an additional \$11,000, totaling only about \$2,200 in royalties for the headright holders. The Agency had two, full-time staff members dedicated to gauging for the majority of the 3-year period, and that resulted in minimal benefits. In addition, Agency officials admitted they do not find many errors, and of those they do identify, the variances are usually caused by human error as opposed to intentional misreporting. We conclude, therefore, that gauging is ineffective and distracts from other activities that could provide more benefit to the headright holders.

The gauging process the Agency uses is inefficient. Of the 1,020 gaugings, the Agency gauged only 509 different tanks on 305 of its 4,453 leases, representing only 6.8 percent of the Osage Nation's leases. PETs gauged 1 tank 14 times in the 3-year period, and tanks on 1 lease 24 times in the same period. Since

performance measures require a particular number of tanks gauged per day, we believe PETs are encouraged to gauge a certain number of tanks as opposed to strategically selecting tanks.

In addition, gauging is inefficient due to the amount of time and effort it takes to complete gauging activities. To complete gauging activities, PETs gauge a tank when it is full and then return to the tank to determine if the purchaser picked up the oil. If the purchaser picked up the oil, the PET conducts a bottom gauge, which determines how much oil the purchaser removed, and then calculates the volume sold, which they compare to the company's run ticket (the source document for recording the amount of oil sold). From October 2012 to July 2013, only 8 percent of tanks checked were full and ready for gauging, but PETs only completed the gauging on 4 percent. This is an inefficient use of the PETs' time.

In response to our Notices of Potential Findings and Recommendations (NPFs), BIA wrote that a decreased emphasis in gauging is contrary to a court-approved settlement with the Osage Nation. We found, however, that the settlement agreement only requires the Agency to report its gauging activities. We believe, therefore, that the Agency can realign its efforts to more efficient and effective activities.

### **Recommendations**

We recommend that BIA:

16. Realign emphasis on gauging to other, more effective, oversight activities such as inspections, and instead of gauging for production verification, only gauge during inspections and for purposes of determining possible instances of fraud.
17. Reevaluate existing gauging practices and develop and implement a more efficient and effective gauging program, if the Agency continues to emphasize gauging. This could include risk-based gauging.

### **Poor Strategy for Lease Inspections**

We found that the Agency has no strategy or defined methodology for conducting quality inspections. Instead, it focuses on completing a specific number of inspections. The absence of a strategy and the poor quality of the inspections could result in underpaying royalties. An Agency official said that the Tribe does not care about inspections, only about gauging.

According to a BLM official, lease inspections are important because they can address a wide variety of issues or target specific issues. He said that BLM inspections are not just an activity where someone drives around a lease and looks around. Rather, he said, lease inspections cover important issues such as security,

environmental concerns, production, seal numbers on tanks, measurements, records review, and plugging and abandonment.

Without a strategy, the Agency may encourage inspections of small, easily accessible, simple leases, perhaps at the expense of higher-risk leases. Rather than inspecting leases according to an assigned, risk-based strategy, PETs select leases by driving around their assigned area and personally select leases to inspect. In contrast, BLM completes four kinds of lease inspections: drilling, production, abandonment, and surface. BLM also prioritizes its drilling, production, and abandonment inspections based on criteria such as high-priority drilling, high-priority plugging and abandonment, and Federal and Indian production cases with high risk factors.

In addition, Agency performance standards encourage lease inspection quantity over quality, and do not incorporate a risk-based strategy. According to the PET performance standards, to be fully successful, inspectors must inspect four to five leases per day for compliance with regulations, production volumes, applicable laws, lease terms, and environmental standards. PETs also must complete other duties, such as gauging, attending to landowner complaints, and cultural resource assessments. The amount of time it takes to conduct an effective lease inspection precludes conducting four to five lease inspections per day, and diverts staff from other responsibilities. A supervisory PET told us that depending on complexity, lease inspections could take anywhere from 1 hour to a full day or more, not including travel time.

We also found that many PETs appear unprepared to inspect leases effectively. Because they do not know which leases they are going to inspect, they do not bring documentation to the field such as site maps, production data, or flaring approvals. Inefficient preparation inhibits their ability to accurately check for compliance with lease terms.

Ineffective lease inspections can result in underpaying royalties. We interviewed a BLM petroleum engineer who visited the Osage Nation in October 2012 and witnessed oil and gas related inspections. He indicated that a potential for royalty underpayment exists for several reasons:

- Gas meters are not built or operated in accordance with industry standards.
- Gas sampling was not done in accordance with industry standards.
- Operators may have inappropriately taken deductions for use of produced oil or gas off lease without paying royalties.

Little training for Agency staff to conduct inspections, unenforceable regulations, insufficient staff, and an unclear inspection strategy could exacerbate problems.

## Recommendation

We recommend that BIA:

18. Identify all high-risk leases, develop and implement a risk-based strategy to annually inspect all high-risk leases, and include a plan to inspect all leases over a specified time.

### **Insufficient Lease Inspection Tracking**

The Agency's tracking information for lease inspections is insufficient. The Agency started a new tracking system in SharePoint as of January 2013. The system, however, only tracks instances of noncompliance. We found instances in which the Agency listed some leases twice and incorrectly recorded some items. For example, one lease was listed twice because it was recorded with a different lease number format. As a result, the status was listed as both "pending" with final notice and "open" with initial inspection. The Agency also incorrectly recorded the initial inspection dates.

The Agency also does not track information necessary to identify high-risk leases. For instance, the Agency does not identify the number of violations, days of noncompliance, fines levied, and the nature of violations, which the Agency could use to develop a lease inspection strategy.

## Recommendation

We recommend that BIA:

19. Upgrade the Agency's inspection management system to include all leases inspected and the risks associated with the leases.

### **Little Enforcement for Operator Noncompliance**

The Agency allows lessees to operate for a considerable length of time without addressing incidents of noncompliance identified during inspections. Examples of noncompliance include leaking pipelines, sloppy conditions, gates or fences in need of repair, and roads in need of repair. For example, we reviewed a lease inspection that took the Agency 309 days to get the operator to correct deficiencies identified during the initial inspection. In this case, the lease operator continued to operate for almost a year in violation of lease terms.

According to 25 C.F.R § 226.42, the Agency's superintendent can fine companies up to \$500 per day for noncompliance. Fines deter noncompliance and also act as an incentive for timely compliance with lease or Agency requirements when a noncompliance is identified.

Typically, PETs conduct an initial inspection and if they identify a deficiency, the Agency grants the company a specified time to make corrections. Agency personnel told us that the Agency assesses fines following the third visit, but we found that it might not assess fines for noncompliance until after the fourth inspection.

For one inspection we reviewed, the Agency conducted the initial inspection on November 29, 2011, and identified deficiencies. The Agency conducted a second inspection on January 27, 2012; a third inspection was completed on February 23, 2012; and a fourth inspection on May 10, 2012, indicated the company had not yet corrected the deficiencies. The Agency completed a fifth and final inspection on October 3, 2012, and found that the company had corrected the deficiencies. The Agency only fined the company \$300 per day for the 145 days from May 11, 2012, to October 3, 2012. The Agency sent a letter to the company November 9, 2012, assessing it a fine of \$43,500. If the Agency had fined the company \$300 per day starting November 29, 2011, when the deficiencies were first identified, the fine would have been \$92,700 (\$300 for 309 days). This resulted in potential lost revenue of \$49,200 (\$92,700 - \$43,500) (see Appendix 3).

### **Recommendation**

We recommend that BIA:

20. Develop and implement guidance to ensure the Agency consistently applies and levies fines in a timely manner.

### **Lease Termination Rarely Used to Enforce Lease Terms**

We found that the Agency does not always terminate leases for nondevelopment, nonproduction, or noncompliance with lease terms. When the Agency terminates leases for nondevelopment, nonproduction, or noncompliance, the parcels become available to other companies to lease the land, develop the lease, and thereby produce royalties for the headright holders. It is therefore important that the Agency timely and consistently terminate these leases.

The Agency may terminate leases if the company did not drill a well during the 2-year primary term, if there was no production during the primary term, or if a well has not produced for 6 months. Osage Suite (the Agency's oil and gas database), however, cannot identify leases that are in the primary term or that have not produced for 6 months. This information would allow PETs to visit the lease site and verify whether the leases are producing and complying with lease terms.

According to the Agency's supervisory PET, PETs discover leases qualifying for terminations by "word of mouth," are "hit and miss," and happen by "luck." For example, other interested parties may inform the Agency that a well is not

producing, or a PET may discover a lease needs termination while driving around his or her assigned area.

### **Recommendation**

We recommend that BIA:

21. Develop and implement an Agency action plan to identify and track leases that it should terminate for nondevelopment, nonproduction, and noncompliance with lease terms.

### **Ineffective Strategy for Plugging and Abandoning Wells**

We found that the regulations for plugging and abandoning wells leave significant discretion with the Agency superintendent. Specifically, 25 C.F.R. § 226.28 states that the “lessee shall not shut down, abandon, or otherwise discontinue the operation or use of any well for any purpose without the written approval of the superintendent. All applications for such approval shall be submitted to the superintendent on forms furnished by him/her.”

We learned that the Osage Nation has had a contract to plug wells (Public Law 93-638) and for the last 7 to 8 years has maintained a pool of money to plug wells. It initiates the plugging process by obtaining a list of wells that the Agency targets for plugging. The Agency has identified 1,401 wells for plugging. The Agency provides the plugging instructions, but the Council chooses which wells to plug. Agency staff members provided records indicating that 30 wells were plugged from January 2010 to July 2013. The Council used the pooled funds to plug 3 of the targeted 30 wells. Lessees plugged the remaining wells.

Lessees must provide bonds to cover plugging and abandoning, but the bonds typically used to pay for plugging and abandoning may not be enough to cover the costs. The Agency only requires a bond of \$5,000 per quarter section of a lease, which could contain multiple wells. A knowledgeable BLM individual told us that the wells on Osage Nation lands may cost \$10,000 to \$20,000 per well to properly plug and abandon. If this potential cost was applied to the 1,401 wells identified for plugging, BIA’s financial liability ranges from \$14 million to \$28 million.

We recommended in our NPF that the Agency identify all wells to be plugged and abandoned, and develop a prioritized, risk-based list of these wells. BIA disagreed with our recommendation, explaining that historically the Council has not plugged wells so that the wells can potentially be operated later as technology advances the ability to recover additional oil and gas. In addition, BIA responded that there is no statute or regulation requiring the Secretary of the Interior to establish a plugging program, plug wells, or pay for plugging. Despite BIA’s argument, we are still making the recommendation because we know the Council actively plugs wells using the Public Law 93-638 contract, and we know the

Agency has identified 1,401 wells for plugging. Even though there may not be a legal or regulatory requirement to do so, plugging and abandoning nonproducing wells decreases the risk of damage to the environment or injury to people. In addition, the cost of plugging and abandoning wells will most likely increase in the future, which will create an even larger financial liability.

### **Recommendation**

We recommend that BIA:

22. Develop and implement a strategy for the Agency to identify all wells to be plugged and abandoned, develop a prioritized list based on risk, and work with the Council to plug high-risk wells.

### **Agency has no Mineral Resource Assessment**

The Agency has not assessed the value of mineral resources on the Osage Nation's estate. A resource assessment is critical in allowing the Agency and the Council to develop an effective, long-term energy management strategy. A resource assessment would also quantify the Osage Nation's energy resources and allow the Osage to estimate how long the resources will generate revenue. A local geologist estimated that the estate was worth \$4 billion, based upon historical sale values of the land and not the available mineral resource. Agency officials expect that operators will drill an additional 7,500 wells between FYs 2012 and 2027, generating \$13.6 billion in estimated royalties. An accurate valuation of the estate would also help the Agency determine funding and staffing needs. Finally, knowing the resource quality and value would allow the Agency and Council to effectively develop the energy resources to maximize production.

The U.S. Geological Survey (USGS) can assist the Agency in completing this assessment at no cost to the Osage Nation. USGS researches and assesses the location, quantity, and quality of mineral and energy resources throughout the country. Its Energy Resources Program provides reliable and impartial scientific information on geologically based energy resources, such as oil and natural gas. It then uses the research to inform policymakers about energy resources and to manage energy resources on Federal lands. USGS has assessed sites including the San Juan Basin Province (New Mexico and Colorado) and the Bakken and Three Forks Formation (Montana and North Dakota).

BIA disagreed with our NPFR's recommendation to work with USGS to request a mineral resource assessment of the Osage Nation's mineral estate, but said it would facilitate contact between USGS and the Osage Nation if the Council requested it. We believe it would be in the best interest of the Agency to know the size and energy potential of the Osage Nation's mineral estate for long-term planning.

## Recommendation

We recommend that BIA:

23. Work with USGS's Energy Resources Program to request a mineral resource assessment of the Osage Nation's mineral estate.

## The Agency has Ineffective Data Management

Proper data management allows units to readily access important data records to effectively and efficiently manage the Agency's activities. This includes accounting systems, oil and gas lease records, electronic inventories of well locations, and copies of leases. Reliable and accurate data is critical to the Agency for informed decision making, planning, strategizing, and prioritizing energy activities.

### Ineffective Oil and Gas Royalty Reconciliations

The Agency does not have an effective process for completing oil reconciliations, which are used to verify that the royalty payment made by the purchaser has been correctly calculated and paid. It uses an overly complicated Excel spreadsheet to complete these reconciliations.

We found the spreadsheet so complex and poorly structured that we could not quantify the number, or dollar amount, of exceptions (differences between data identified in the reconciliation process) identified or resolved. The Agency identifies all exceptions manually by comparing the purchaser check detail to the purchaser's production data and enters the exceptions onto the Excel spreadsheet as a means of documenting the exceptions identified.

The Agency's oil reconciliation process consists of comparing purchaser reports to purchaser payments. Ideally, the Agency should reconcile its records to an independent information source, such as the lessee reports or third-party statements. Because the Agency does not verify the data with third-party reports, there is an increased risk of erroneous or fraudulent royalty information that could go undetected.

When the Agency did identify exceptions, it did not always complete follow-ups and resolutions. The Agency assigned an employee to follow up on unresolved exceptions, but the employee no longer performs this duty. As a result, the Agency recently reassigned an accounting technician whose job was to identify oil royalty exceptions, but not to reconcile them. The technician's new role is to begin the reconciliation process of unresolved exceptions dating back to 2011. As a result, there is currently no one identifying and reconciling current exceptions.

In addition, the Agency's gas reconciliation process is inefficient. It simply involves entering data from paper statements into another spreadsheet to verify

the math on the statements. These paper statements appeared to be statements from purchasers' electronic databases. The Agency's gas accounting technician manually entered the purchasers' data into an Excel spreadsheet to verify the calculations and the headright holders' royalty. The royalty amount, however, already appears on the paper statement. If the Agency kept this information electronically, the gas technician would only need to verify the equations.

Similar to oil, the Agency does not verify the gas data with third-party reports. Many third-party measurement reports, such as meter statements required for each well, are missing and not entered into the reconciliation process for gas production. In addition, the Agency does not compare third-party reports received and input into the spreadsheet against the purchaser or lessee data. This is inefficient and defeats the purpose of entering them into the reconciliation.

If the Agency finds an exception, its accounting staff will make the lessee resubmit a revised lessee statement to match what the purchaser submitted, thereby eliminating the purpose of comparing the differences and investigating the cause. Until the lessee submits the revised statement, the exception remains undocumented in the reconciliation spreadsheet. Thus, the lessee's statement serves no purpose in the reconciliation process.

We know that ONRR's royalty accounting system is robust and works primarily with electronically submitted data; including production, sales, and royalty data; directly from lessees and operators. Should the Agency use ONRR's system, it would eliminate the need to conduct many labor-intensive reconciliations and analyses. Using ONRR's system would also address several of the issues we identified in this section.

## Recommendations

We recommend that BIA:

24. Reconcile oil and gas exceptions to independent or third-party sources of information, and follow up and resolve any identified differences in a timely manner.
25. Enter into an MOU with ONRR to implement ONRR's electronic data system.

## Agency Does Not Have Accounting Reconciliation Thresholds

Accounting reconciliations are critical to error identification and royalty verification. When performing reconciliations, the Agency does not have a methodology for prioritizing the reconciliation work. As a result, Agency staff members spend time reviewing less significant exceptions (differences between data identified during the reconciliation process) rather than focusing on larger

exceptions. One Agency employee identifies and reconciles exceptions as little as 25 cents. As a result, it appears the Agency tries to review everything, but with limited staff, it cannot timely reconcile the identified problems.

For both oil and gas, we found that the Agency does not use materiality thresholds (a predetermined dollar amount or percentage that would trigger review and reconciliation) to determine which exceptions to review. One Agency official agreed that setting thresholds would be useful, but the Council believes that every penny matters when resolving exceptions. The official contended that the Agency does not have the choice to set thresholds, but we found there is no policy to prevent it from doing so.

We also identified an inefficient use of an Agency employee's time. The full-time job of one accounting technician requires entering oil lessee reports into Osage Suite. The Agency uses Osage Suite to document production totals, but it does not use the oil lessee report data for anything in the accounting process. Unless this effort is for a value-added purpose, such as reconciling the data to purchaser data, we believe this procedure is unnecessary.

### **Recommendations**

We recommend that BIA:

26. Develop and implement Agency sampling thresholds and follow up on any identified discrepancies in a timely manner.
27. Reconsider its practice of entering oil lessee reports into the Osage Suite system.

### **Osage Suite is Insufficient for Data Management**

We identified several issues with Osage Suite that prevent the Agency from effectively managing well and lease information. First, Osage Suite does not allow accurate input of all well data. For instance, the Agency can enter only four wells under each contract. A new contract number must be created if the lease has more than four wells. In addition, the Agency may list the four wells as different kinds of wells—oil, natural gas, casinghead gas (a byproduct of oil), or coal bed methane—which may be inaccurate.

Recording data in this manner is a problem because if one lease has many wells, the lease will be recorded under different lease numbers even though it is the same lease. In addition, wells may be listed in the system as one type when it is another type. As a result, the system is not reliable because it does not maintain an accurate listing of the types of wells.

Second, Osage Suite cannot account for “wet” gas (natural gas and natural gas liquids), which includes determining the correct price and volume for processed gas and natural gas liquids. The accounting technician must manually create entries into an Excel spreadsheet to separate and calculate processed gas and natural gas liquids. This increases the risk for error due to additional manual entry, and wastes time since a proper system would automate this function.

We also found that two purchasers submitted their production data electronically despite the fact that Osage Suite does not have external connections and cannot rely on data from external sources. The purchasers submitted their data by sending it to a third-party company. The third-party company then forwarded the information to a BIA information technology specialist outside of the Agency, who entered the data into the system. Agency personnel did not know how this data was entered into the system, an example of insufficient understanding and oversight of the process.

The Agency maintains that purchasers will not want to submit data electronically, but as noted, two purchasers have done so. Electronic submission eliminates much of the manual data entry by Agency personnel, which would reduce error and time required to process the data.

ONRR’s accounting system allows for direct electronic data input from lessees and operators. The system contains upfront edits to allow accurate data submission from the oil and gas companies. Lessees or operators, therefore, may be unable to submit electronic data if it includes incorrect pricing, incorrect royalty rates, or coding errors. The system also maintains multiple data elements that are not part of Osage Suite, including processing and transportation allowances, production data, flaring volumes, and other information necessary for accurate reviews.

### **Recommendation**

We recommend that BIA:

28. Enter into an MOU with ONRR to implement ONRR’s system to address the Agency’s database deficiencies.

### **Agency Does Not Verify Royalty Compliance**

The Agency does not conduct compliance reviews, audits, or data mining for royalty compliance. For example, we found that the Agency does not check compliance against the terms of individual gas contracts. It accepts whatever the purchaser reports. Since each gas contract is different and there are many elements stipulated in gas contracts that are critical in calculating gas royalties, the Agency should validate these elements against the calculations so that incorrect royalty payments can be detected.

As mentioned above, Osage Suite does not allow accurate input of data. In addition, the Agency does not have enough staff to complete these types of reviews. The Agency, therefore, does not have the ability to complete the compliance reviews, audits, or data mining necessary to verify royalty calculations.

ONRR, by comparison, conducts data mining, compliance reviews, and audits, which generate accurate production, sales, and royalty data. ONRR reported that for every dollar it spent on compliance activities from FYs 2009 to 2011, it returned almost \$4 to taxpayers. We believe ONRR's audit and compliance management capabilities would offer the Agency the highest level of royalty verification, and it would assure that headright holders receive the full amount of royalties for their oil and gas resources.

### **Recommendation**

We recommend that BIA:

29. Enter into an MOU with ONRR to conduct compliance reviews, audits, and data mining for royalty compliance and verification.

### **Agency Does Not Have Electronic Mapping for Backup**

The Agency does not have an electronic inventory of well locations and lease information. Historically, its employees have handwritten this information on a linen plat map (see Figure 1). In addition, the Agency has not updated its plat maps since its staff cartographer retired in June 2013. Manually plotted, hardcopy plat maps are a key source of Agency lease and well information.

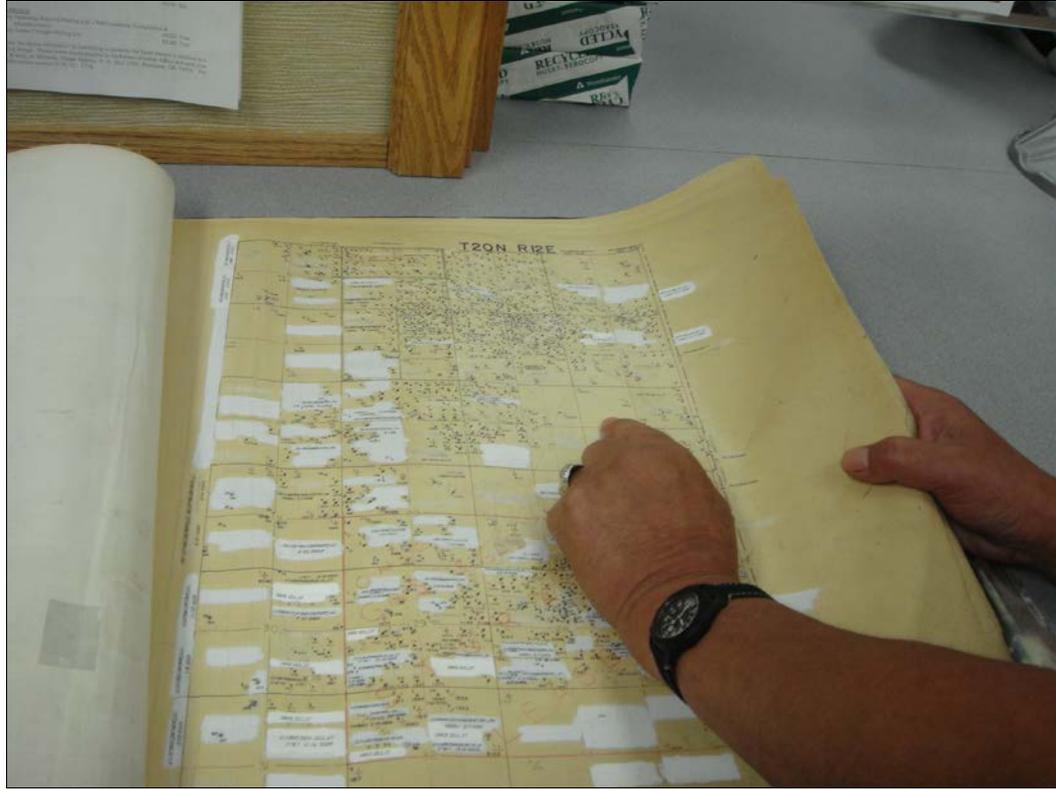


Figure 1. Linen plat map used to identify well locations and help maintain lease information.

Although plat maps are not the official record-keeping method for well data, the public frequently uses them to identify what tracts are available for leasing. The official records are based upon the lease files that contain well locations. As a result, the public and the Agency must look at numerous paper leases and drill records to identify the location of leases and wells. If the well and lease information is not kept up to date, this could lead to inefficiencies in identifying well locations and to significant problems in recreating the plat map if lost, destroyed, or stolen. One Council member said that tracts of land are sometimes nominated for lease or concession agreements, only to find that the tract is already in production.

A more efficient process would be to use an electronic format for data management. For example, DOI's Division of Energy and Minerals Development developed the National Indian Oil & Gas Evaluation & Management System (NIOGEMS) software application to assist energy- and mineral-producing Indian tribes in managing their energy and mineral resources. The application provides access to well locations, production, lease, agreement, and other natural resource data on Indian lands. The Division provides the software, data, training, and learning support at no cost to a requesting tribe and to Federal Government agencies. A high-level BIA official told us that Council members viewed a presentation of NIOGEMS but said the system "wasn't for them."

## Recommendation

We recommend that BIA:

30. Work with the Division of Energy and Minerals Development to implement the NIOGEMS program for electronic lease file management, and Agency lease and well mapping.

### **Lease Files not Appropriately Maintained**

We found that Agency staff was not able to locate lease files and documents we requested because the Agency does not adequately maintain them. The Agency is required to keep and maintain proper lease files. While the Agency has a system in place to track possession of lease files using a “checkout card” in each lease file, we found that the Agency does not use the checkout system. One Agency official explained that no one enforced the system, and over time, employees stopped using it.

Lease files are the official and only record. Since lease files are not kept electronically, then if lost, Agency personnel would have no way to recreate everything maintained in a file.

The Indian Affairs Records Management Manual (IARMM) requires each office within BIA to implement and administer an effective and efficient records management program to create, maintain, and dispose of records. We found that the Agency’s checkout system of lease records does not qualify as a records management program because it does not adequately maintain lease files and, therefore, does not comply with the IARMM.

## Recommendation

We recommend that BIA:

31. Develop and implement a records management program for Agency lease files to comply with the IARMM to include using the NIOGEMS program for electronic lease file management.

### **Poor System for Lease Sales Tract Nominations**

We found a risk that tracts nominated for lease sale could already be leased and erroneously advertised for sale. We found that procedures for identifying tracts nominated for lease sales are labor intensive. That is, the responsible employee must conduct numerous manual steps to verify that tracts of land are available prior to lease sales. These steps include—

1. searching Osage Suite by legal description;

2. reviewing a concession map to determine whether the tract is in the concession area;
3. reviewing the plat map; and
4. reviewing active lease files.

Furthermore, the Agency manually tracks all information related to tract nominations on a spreadsheet. In FYs 2010 through 2013, companies or individuals nominated 668 tracts for sale, but 155 tracts, or 23 percent, were not available for lease. Our review of the 155 tracts disclosed that—

- 38 percent were already leased to another individual or company;
- 32 percent were located within a concession area (an area that includes a large amount of leased acreage for more complex oil and gas exploration); and
- 15 percent had to be withdrawn because the tracts were nominated when the Council was negotiating a concession agreement.

Although the Agency did identify the unavailable tracts before the lease sales, by manually researching tract availability, Agency staff members were not efficiently processing available tracts. If tract nominations were kept electronically, then error risk would be significantly reduced and it would improve nomination processing. A more efficient and accurate tract management process would use an electronic format such as the NIOGEMS.

### **Recommendation**

We recommend that BIA:

32. Work with the Office of Indian Energy and Economic Development to implement the NIOGEMS program for the Agency's tract management.

### **Inaccurate Annual Reporting**

It is important for the Agency to maintain accurate acreage information so that both the Agency and the Council are aware of the acreage available for leasing. We found that Agency staff members manually compile annual lease statistics to identify the number of leases added and terminated and the leases' related acreage. Agency staff obtains the necessary information from Osage Suite and then manually prepare an annual report for the Regional Office. We learned, however, that the Regional Office has not asked for the report in 2 years. We reviewed the reports for FYs 2010 through 2013 and identified a calculation error by which the Agency overstated the total lease acreage by 38,572 acres. Manually compiling this information increases the risk of reporting errors.

## Recommendation

We recommend that BIA:

33. Automate its lease acreage data to ensure accurate information is available to the Agency and Council.

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# Conclusion and Recommendations

## Conclusion

The Osage Nation's mineral estate has the potential to generate billions of dollars of oil and gas royalties and provides annuity payments to headright holders. As noted in this report, BIA faces challenges to correct the deficiencies of a fundamentally flawed program. These deficiencies include inadequate oil and gas policies and procedures, problems in environmental compliance, poor planning and mineral resource management, and inefficient data management. A strong management emphasis from the Agency is needed to bring program consistency and guidance over the Osage Nation's oil and gas operations to ensure that headright holders receive the full royalties they are due.

## Recommendations Summary

We recommend that BIA:

1. Use its authority to correct program deficiencies by modifying 25 C.F.R. part 226 to mirror other Indian Country oil and gas regulations.

**BIA's Response:** BIA did not concur with this recommendation. As a result of the tribal trust settlement, BIA and other interested parties discussed mirroring other Indian Country oil and gas regulations to improve managing the minerals estate. The Council and other interested parties voiced concerns regarding making Osage mirror other Indian Country oil and gas regulations, and the Negotiated Rule Making Committee tried to balance these concerns with the need to improve the current regulations. The proposed rule, however, does include some regulations that would mirror BLM's and ONRR's regulations.

**OIG's Reply:** The changes and improvements BIA is undertaking as well as the rulemaking will lead to greater accountability and oversight, which is the intent of this recommendation. We, therefore, consider this recommendation resolved but not implemented. We will refer this recommendation to the Office of Policy, Management and Budget (PMB) to track implementation.

2. Enter into MOUs with BLM and ONRR so these agencies can perform essential oil and gas operations and accounting activities on BIA's behalf.

**BIA's Response:** BIA partially concurred with this recommendation. BIA is entering into an agreement with ONRR to perform the accounting activities on BIA's behalf. BLM will provide field inspection training for the Agency's PETs on properties within Osage County. In addition, four Agency PETs have completed BLM's certification course and the remaining seven are scheduled to complete the certification course in FYs 2015 and 2016.

**OIG's Reply:** BIA will be using ONRR's and BLM's technical expertise to improve the Agency's oil and gas program, which is the intent of the recommendation. We, therefore, consider this recommendation resolved but not implemented. We will refer this recommendation to PMB to track implementation.

3. Develop and implement official, comprehensive internal Agency policies and procedures that govern, guide, and regulate oil and gas activities.

**BIA's Response:** BIA partially concurred with this recommendation. While BIA stated that the Agency already has some existing internal policies and procedures, they did acknowledge that additional improvements and updates are needed.

**OIG's Reply:** Based on BIA's response we consider this recommendation resolved but not implemented. We will refer this recommendation to PMB to track implementation.

4. Develop and implement internal policies and procedures directing the Agency to verify companies' allowances for royalty calculations, or restrict or disallow such allowances.

**BIA's Response:** BIA concurred with this recommendation; however, BIA stated that it is premature to develop internal policies and procedures regarding verification of royalty allowances because the Department is currently considering a proposed rule that may address this recommendation.

**OIG's Reply:** Based on BIA's response we consider this recommendation resolved but not implemented pending the results of the negotiated rule making. We will refer this recommendation to PMB to track implementation.

5. Develop and implement internal policies and procedures for the Agency to oversee, identify, and verify non-arm's-length sales transactions.

**BIA's Response:** BIA concurred with this recommendation; however, BIA stated that it is premature to develop internal policies and procedures regarding non-arm's-length sales transactions because the Department is currently considering a proposed rule that could address this recommendation.

**OIG's Reply:** Based on BIA's response we consider this recommendation resolved but not implemented pending the results of the negotiated rule making. We will refer this recommendation to PMB to track implementation.

6. Develop and implement internal policies and procedures to enhance the Agency's drilling permit review process in partnership with BLM.

**BIA's Response:** BIA did not concur with this recommendation due to the original language of the recommendation which contained a reference to the Handbook. BIA clarified that the Handbook does not apply to the Agency. BIA is working, however, with BLM to identify processes and procedures that will improve the Agency's permitting process.

**OIG's Reply:** We consider this recommendation, as amended, resolved but not implemented. We agree that working in partnership with BLM will allow BIA to use BLM's technical expertise to improve the permitting process. We will refer this recommendation to PMB to track implementation.

7. Develop and implement internal policies and procedures to require the Agency's petroleum engineer to review and approve drilling permits.

**BIA's Response:** BIA concurred with this recommendation. The Agency has already implemented a policy requiring that all proposed APDs are reviewed by the petroleum engineer.

**OIG's Reply:** Based on BIA's response we consider this recommendation resolved and implemented.

8. Make certain that lessees pay oil and gas royalties based on market price according to the current regulation, 25 C.F.R. § 226.11.

**BIA's Response:** BIA concurred with this recommendation. The Agency has been working on back-audits and reconciliations to ensure that lessees are paying oil and gas royalties appropriately. In addition, once BIA has an agreement with ONRR in place to account for royalties, the system will be further improved.

**OIG's Reply:** Based on BIA's response we consider this recommendation resolved but not implemented. We will refer this recommendation to PMB to track implementation.

9. Develop and implement supplemental Agency guidance that includes how lessees should measure gas and subsequently calculate royalties based on energy quality.

**BIA's Response:** BIA concurred with this recommendation; however, BIA stated that it is premature to develop internal policies and procedures regarding gas measurement because the Department is currently considering a proposed rule that could address this recommendation.

**OIG's Reply:** Based on BIA's response we consider this recommendation resolved but not implemented pending the results of the negotiated rule making. We will refer this recommendation to PMB to track implementation.

10. Develop and implement supplemental Agency guidance to 25 C.F.R. part 226 to help identify and verify companies' allowances for royalty calculations.

**BIA's Response:** BIA concurred with this recommendation; however, BIA stated that it is premature to develop internal policies and procedures regarding allowances because the Department is currently considering a proposed rule that may address this recommendation.

**OIG's Reply:** Based on BIA's response we consider this recommendation resolved but not implemented pending the results of the negotiated rule making. We will refer this recommendation to PMB to track implementation.

11. Identify all companies that flare gas and verify that each company that flares gas has documented approval.

**BIA's Response:** BIA concurred with this recommendation. The Agency is reviewing lease files, performing site inspections, and has instituted a 24-hour public hotline for the public to use to report unapproved flaring, environmental concerns, or lease compliance issues. In addition, using ONRR's system to perform auditing and accounting of oil and gas will flag any discrepancies in the use of gas.

**OIG's Reply:** Based on BIA's response we consider this recommendation resolved but not implemented. We will refer this recommendation to PMB to track implementation.

12. Develop and implement Agency policies and procedures to verify that companies properly report volumes on flared gas and pay appropriate royalties.

**BIA's Response:** BIA concurred with this recommendation. BIA is working closely with ONRR in order to transition Osage's producing leases over to ONRR's automated reporting and verification system, which would address this issue.

**OIG's Reply:** Based on BIA's response we consider this recommendation resolved but not implemented. We will refer this recommendation to PMB to track implementation.

13. Follow existing regulations requiring corporate surety bonds. If the proposed regulations allow using CDs, regularly review all escrow CDs to verify their maturity and replace matured CDs.

**BIA's Response:** BIA concurred with this recommendation. The Osage Agency is now following the current regulations and no longer accepts CDs. The Agency sent a memo on September 9, 2014, clarifying that it will no longer accept CDs, letters of credit, or cash bonds.

**OIG's Reply:** Based on BIA's response we consider this recommendation resolved and implemented.

14. Develop and implement oversight procedures to ensure compliance with the NEPA for all Osage Nation oil and gas activities.

**BIA's Response:** BIA concurred with this recommendation. BIA stated that the Agency complies with NEPA with respect to oil and gas activities in Osage County and does carry out NEPA review with respect to current oil and gas activities. In addition, BIA is taking steps to strengthen oversight procedures with respect to environmental issues.

**OIG's Reply:** Based on BIA's response we consider this recommendation resolved but not implemented. We will refer this recommendation to PMB to track implementation.

15. Ensure that the Agency has permanent environmental staff to address the NEPA requirements.

**BIA's Response:** BIA concurred with this recommendation. In addition to historical NEPA compliance, the Agency hired an environmental protection specialist December 29, 2013, and is in the process of advertising an additional environmental protection specialist. The Office of Indian Energy and Economic Development (OIEED) also provided the Agency with two environmental contractors.

**OIG's Reply:** Based on BIA's response we consider this recommendation resolved and implemented.

16. Realign emphasis on gauging to other, more effective, oversight activities such as inspections, and instead of gauging for production verification, only gauge during inspections and for purposes of determining possible instances of fraud.

**BIA's Response:** BIA concurred with this recommendation. The Agency has engaged with BLM in understanding risk factors for wells and leases and will develop a risk-based strategy for the Agency's inspection and

enforcement program. This strategy will deploy inspection and enforcement resources that will be considerably more effective.

**OIG's Reply:** Based on BIA's response we consider this recommendation resolved but not implemented. We will refer this recommendation to PMB to track implementation.

17. Reevaluate existing gauging practices and develop and implement a more efficient and effective gauging program if the Agency continues to emphasize gauging. This could include risk-based gauging.

**BIA's Response:** BIA concurred with this recommendation. The Agency has hired additional PETs to perform gauging in Osage County. In addition, with the assistance of BLM, desktop operating procedures are being reviewed and revised to discern best management practices to include risk-based gauging.

**OIG's Reply:** Based on BIA's response we consider this recommendation resolved but not implemented. We will refer this recommendation to PMB to track implementation.

18. Identify all high-risk leases, develop and implement a risk-based strategy to annually inspect all high-risk leases, and include a plan to inspect all leases over a specified time.

**BIA's Response:** BIA concurred with this recommendation. The Agency is working on a strategy to identify all high-risk leases to ensure annual inspections are performed. This will include leases with re-occurring environmental issues, violations, spills, and other surface issues. The Agency is working in conjunction with BLM to identify the risk factors for the wells and leases and will develop a risk-based strategy for the inspection and enforcement program that will mirror BLM's protocol.

**OIG's Reply:** Based on BIA's response we consider this recommendation resolved but not implemented. We will refer this recommendation to PMB to track implementation.

19. Upgrade the Agency's inspection management system to include all leases inspected and the risks associated with the leases.

**BIA's Response:** BIA concurred with this recommendation. The Agency issued a policy on September 16, 2014, whereby all lease inspections performed within Osage County will be encoded into the lease inspection tracker. The tracker was modified to include compliance and non-compliance lease inspections.

**OIG's Reply:** Based on BIA's response we consider this recommendation resolved and implemented.

20. Develop and implement guidance to ensure the Agency consistently applies and levies fines in a timely manner.

**BIA's Response:** BIA concurred with this recommendation. The Agency has implemented a policy to assess penalties and fines associated with noncompliance to the lessee after the original notification of violation.

**OIG's Reply:** Based on BIA's response we consider this recommendation resolved and implemented.

21. Develop and implement an Agency action plan to identify and track leases that it should terminate for nondevelopment, nonproduction, and noncompliance with lease terms.

**BIA's Response:** BIA concurred with this recommendation. The Agency recently began generating periodic reports to identify leases that had no production for 6 consecutive months. The Agency provides notice to producers that have leases on this list. If there is no proof of production provided and a site inspection confirms that there is no production, the Agency will terminate the lease. With regard to termination of leases for noncompliance with lease terms (other than primary term), the Agency is developing internal enforcement guidelines and policies that will describe circumstances such as "significant noncompliance" that would warrant lease termination.

**OIG's Reply:** Based on BIA's response we consider this recommendation resolved but not implemented pending the development and implementation of internal guidelines and policies. We will refer this recommendation to PMB for implementation.

22. Develop and implement a strategy for the Agency to identify all wells to be plugged and abandoned, develop a prioritized list based on risk, and work with the Council to plug high-risk wells.

**BIA's Response:** BIA did not concur with this recommendation. The Council currently operates a program to plug certain wells (purging, danger to environment or health and public safety). In addition, BIA has met with the Oklahoma Environmental Resource Board to help remediate abandoned wells. The board will make a presentation at the Osage Minerals Forum in September of 2014 outlining its site restoration program, and will solicit areas to be remediated.

**OIG's Reply:** We consider this recommendation unresolved. While we acknowledge that the Council operates the program to plug and abandon the wells, the Agency provides the Council with the list of wells for plugging. Since the Agency's employees are in the field on a regular basis and the Agency develops the plugging instructions, we believe it would be best equipped to prioritize the wells. Since the Council only plugs and abandons a limited number of wells a year, it is even more important to have a prioritized list. As stated in the body of this report, even though there may not be a legal or regulatory requirement to do so, plugging and abandoning nonproducing wells decreases the risk of damage to the environment or injury to people. Therefore, BIA can and should still identify and prioritize its abandoned wells. In addition, according to BIA and Oklahoma Environmental Resource Board officials, a presentation outlining the boards site restoration program was not provided at the September 2014 Osage Minerals Forum. We will refer this recommendation to PMB for resolution.

23. Work with USGS's Energy Resources Program to request a mineral resource assessment of the Osage Nation's mineral estate.

**BIA's Response:** BIA concurred with this recommendation. In order to meet the intent of the recommendation, the Agency will be working with OIEED. Since OIEED has done preliminary work within Osage County and is configured to do countywide assessments, BIA stated that OIEED is better suited to provide the resource assessment in the shortest possible time.

**OIG's Reply:** Based on BIA's response we consider this recommendation resolved but not implemented. We will refer this recommendation to PMB to track implementation.

24. Reconcile oil and gas exceptions to independent or third-party sources of information, and follow up and resolve any identified differences in a timely manner.

**BIA's Response:** BIA concurred with this recommendation. The implementation of ONRR's accounting system will address this recommendation. ONRR will address royalty and production reporting, data mining, and compliance functions including auditing.

**OIG's Reply:** Based on BIA's response we consider this recommendation resolved but not implemented. We will refer this recommendation to PMB to track implementation.

25. Enter into an MOU with ONRR to implement ONRR's electronic data system.

**BIA's Response:** BIA concurred with this recommendation. BIA and ONRR are presently working on an agreement to utilize and implement ONRR's electronic data system, which will include automated production and accounting systems and compliance functions.

**OIG's Reply:** Based on BIA's response we consider this recommendation resolved but not implemented. We will refer this recommendation to PMB to track implementation.

26. Develop and implement Agency sampling thresholds and follow up on any identified discrepancies in a timely manner.

**BIA's Response:** BIA concurred with this recommendation. Once the transition to ONRR is complete, ONRR will use its established materiality and threshold policies to identify and follow up on discrepancies in a timely manner.

**OIG's Reply:** Based on BIA's response we consider this recommendation resolved but not implemented. We will refer this recommendation to PMB to track implementation.

27. Reconsider its practice of entering oil lessee reports into the Osage Suite system.

**BIA's Response:** While BIA concurred with this recommendation, BIA stated that the Agency must continue to utilize the Osage Suite in documenting those reports associated with reporting and accounting of royalties until such time that ONRR's accounting system is implemented.

**OIG's Reply:** Based on BIA's response we consider this recommendation resolved but not implemented. We will refer this recommendation to PMB to track implementation.

28. Enter into an MOU with ONRR to implement ONRR's system to address the Agency's database deficiencies.

**BIA's Response:** BIA concurred with this recommendation. BIA and ONRR are currently working to establish an agreement to implement ONRR's production and accounting systems and related compliance functionality.

**OIG's Reply:** Based on BIA's response we consider this recommendation resolved but not implemented. We will refer this recommendation to PMB to track implementation.

29. Enter into an MOU with ONRR to conduct compliance reviews, audits, and data mining for royalty compliance and verification.

**BIA's Response:** BIA concurred with this recommendation. As part of the transition to production and accounting with ONRR, the agreement will include the compliance function such as up-front editing of reporting data, data mining, compliance reviews, and audits.

**OIG's Reply:** Based on BIA's response we consider this recommendation resolved but not implemented. We will refer this recommendation to PMB to track implementation.

30. Work with the Division of Energy and Minerals Development to implement the NIOGEMS program for electronic lease file management, and Agency lease and well mapping.

**BIA's Response:** BIA concurred with this recommendation. The Agency has been working with OIEED, and OIEED is readying NIOGEMS for implementation at the Agency.

**OIG's Reply:** Based on BIA's response we consider this recommendation resolved but not implemented. We will refer this recommendation to PMB to track implementation.

31. Develop and implement a records management program for Agency lease files to comply with the IARMM to include using the NIOGEMS program for electronic lease file management.

**BIA's Response:** BIA concurred with this recommendation. The Agency has been working with OIEED, and OIEED is readying NIOGEMS for implementation at the Agency.

**OIG's Reply:** Based on BIA's response we consider this recommendation resolved but not implemented. We will refer this recommendation to PMB to track implementation.

32. Work with the Office of Indian Energy and Economic Development to implement the NIOGEMS program for the Agency's tract management.

**BIA's Response:** BIA concurred with this recommendation. BIA has been working with OIEED, and OIEED is readying NIOGEMS for implementation at the Agency.

**OIG's Reply:** Based on BIA's response we consider this recommendation resolved but not implemented. We will refer this recommendation to PMB to track implementation.

33. Automate its lease acreage data to ensure accurate information is available to the Agency and Council.

**BIA's Response:** BIA concurred with this recommendation. The Agency will ensure all mineral leases are encoded into Trust Asset and Accounting Management System (TAAMS) and the information is up to date and correct. This will include the first and last production date of all producing or nonproducing wells. The system will then be capable of producing a report of available acreage. In addition, an Osage-specific TAAMS module is being prepared for the Agency that will address some of the unique needs associated with the mineral estate.

**OIG's Reply:** Based on BIA's response we consider this recommendation resolved but not implemented. We will refer this recommendation to PMB to track implementation.

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# Appendix I: Scope and Methodology

## Scope

We evaluated the Bureau of Indian Affairs' (BIA) Osage Agency's (Agency) management of oil and gas activities on Osage Nation lands after learning of deficiencies in the Agency's management of the Osage Nation's oil and gas mineral estate from our Energy Investigations Unit. The Unit investigated alleged theft of natural gas from the estate. In addition, newspaper articles and emails provided to us from interested parties that have leases on the estate also alleged mismanagement. We specifically focused on preleasing, leasing, exploration, production, postproduction, financial accounting, and information technology.

## Methodology

We conducted this review from May 2013 through December 2013. During our review, we—

- reviewed relevant laws, regulations, policies, and procedures related to the Agency's oil and gas management program;
- examined prior reviews;
- analyzed program data;
- observed processes and reviewed documents;
- evaluated program processes, including preleasing, leasing, exploration, production, postproduction, financial, and information technology;
- examined internal controls;
- reviewed position descriptions;
- reviewed high-level data relating to oil and gas operations on Osage Nation lands; and
- obtained our Office of General Council's opinion on legal questions.

We also interviewed—

- Agency staff;
- U.S. Department of the Interior and BIA Eastern Oklahoma Region staff;
- Osage Tribal Council members and other stakeholders with an interest in oil and gas opportunities in Osage County, OK;
- Bureau of Land Management officials;
- Office of Natural Resources Revenue officials;
- Office of Information Operations officials; and
- Office of the Solicitor officials.

We visited or contacted the—

- BIA Eastern Oklahoma Regional Office, Muskogee, OK;
- BIA Osage Agency Office, Pawhuska, OK;

- BIA Headquarters, Washington, DC;
- BIA Office of Indian Energy and Economic Development, Lakewood, CO;
- BIA Office of Information Operations, Albuquerque, NM;
- Bureau of Land Management officials; Lakewood, CO, and Washington, DC;
- U.S. Department of the Interior, Office of the Solicitor, Washington, DC;
- Office of Natural Resources Revenue officials in Lakewood, CO, and Houston, TX; and
- Oklahoma Corporate Commission, Oil and Gas Conservative Division, Oklahoma City, OK.

The high monetary impact of oil and gas operations on Indian lands creates the potential for fraud and other illegal acts. In addition to this review, our Office of Investigations received a number of complaints regarding the Agency's management of oil and gas resources. Accordingly, we coordinated our activities and field visits with the Office of Investigations.

We conducted this evaluation in accordance with the Quality Standards for Inspection and Evaluation as put forth by the Council of the Inspectors General on Integrity and Efficiency. We believe that the work performed provides a reasonable basis for our conclusions and recommendations.

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## **Appendix 2: A History of the Osage Nation and its Mineral Rights**

The Osage Nation is a federally recognized tribe in the United States. Its tribal headquarters and most of its members are located on the Osage Reservation in Pawhuska, OK. By treaty in 1808, the Osage people ceded 52,480,000 acres of land in Arkansas and Missouri to the U.S. Government. In 1825, the Government forced the Osage people to move to an area along the southeast Kansas border. An Act of Congress on July 15, 1870, required that the remainder of the Osage lands in Kansas be sold, and the Tribe was relocated to Indian Territory in the Cherokee Outlet (now the Osage Reservation in Pawhuska, OK). The Osage people received \$7 million, which enabled them to purchase 1.4 million acres from the Cherokee Nation. The Osage Nation therefore became the only American Indian tribe to buy its own reservation.

Oil leasing on Osage Nation lands began as early as March 16, 1896, when the Secretary of the Interior granted a blanket lease to a private individual to produce oil in the entire Osage Reservation for 10 years. In 1905, there were 687,000 acres of the Osage Reservation under the control of sub-lessees, and \$2.69 million were disbursed in connection with the blanket lease. The rise in production over the next 10 years prompted Congress to pass the Osage Tribe Allotment Act (Act) on June 28, 1906.

The Act reserved the Osage mineral estate of the Osage Reservation to the Osage Nation and directed that the Osage Nation's headright holders receive the royalty revenues. Because of the Act, the Osage Nation operates under its own regulations (25 C.F.R. part 226, "Leasing of Osage Reservations Lands for Oil and Gas Mining").

A settlement agreement in 2011 between the U.S. Department of the Interior (DOI) and the Osage Nation required DOI to update 25 C.F.R. part 226 through negotiated rulemaking. DOI agreed to negotiated rulemaking with the Osage Nation to address means of improving the trust management of the Osage mineral estate, the Osage Tribal Trust Account, and other Osage Nation accounts. Federal Register, Volume 78, No. 167, issued on August 28, 2013, identified the proposed rule changes. DOI solicited comments on the proposed changes, and the comment period closed November 18, 2013. DOI is still reviewing the comments.

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## Appendix 3: Schedule of Monetary Impact

<b>Issue</b>	<b>Questioned Costs</b>
Potential lost royalties: Royalties lost from selling gas for less than market price	\$47,000
Uncollected royalties from flaring gas	\$50,000
Potential lost revenue from fines	\$49,200

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## **Appendix 4: The Bureau of Indian Affairs' Response to the Draft Report**

The Bureau of Indian Affairs' response to our draft report follows on page 48.



# United States Department of the Interior

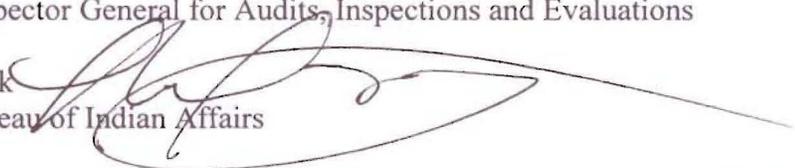
BUREAU OF INDIAN AFFAIRS  
Washington, DC 20240

SEP 26 2014

IN REPLY REFER TO

## Memorandum

To: Kimberly Elmore  
Assistant Inspector General for Audits, Inspections and Evaluations

From: Michael Black   
Director, Bureau of Indian Affairs

Subject: Report No. CR-EV-BIA-0002-2013 – Management of the Osage Nation's Energy Resources

Indian Affairs appreciates the opportunity to comment on the Office of Inspector General (OIG) Evaluation Report on the Management of the Osage Nation's Energy Resources (Report).

Following the recent settlement with the Osage Nation regarding management of their mineral estate, the Department initiated a Negotiated Rule Making to address the regulations at 25 C.F.R. 226 to improve the Bureau of Indian Affairs (BIA), and specifically the Osage Agency's (Osage Agency or Agency), ability to fulfill our duties in management of the estate, and address many of the issues and concerns identified in your report. In addition, the Director, BIA, has been conducting bi-annual consultations with the Osage Minerals Council in order to identify issues as well as brief the Council on actions being taken within the BIA to address identified shortfalls. This has included, but is not limited to, development of a business plan to assist in identification of staffing shortfalls within the Oil & Gas (O&G) section of the Osage Agency; development of an environmental "best practices" document in collaboration with the Environmental Protection Agency (EPA), which has included listening sessions to hear from stakeholders; implementation of a complaint tracking system, and training of inspectors thru the Bureau of Land Management (BLM) PET training program.

Most, if not all of the recommendations, within this evaluation have been identified and are in some state of solution implementation. Many of these issues were being addressed during the time the evaluators were conducting their evaluation, and although it is mentioned in some areas of the report, I don't believe that many of these efforts are recognized as being in some stage of implementation prior to issuance of the report.

Specific areas within the report narrative that we have comments on are outlined below:

**Page 5, Paragraph 4:** *We found that the general mind-set of the Agency is that it cannot effect change in the Osage oil and gas program because it is bound by the 1906 Act and 25 C.F.R. Part 226, which exclude the Osage Nation from other Indian oil and gas regulations.*

Although the Osage Nation is expressly excluded from other oil and gas laws and regulations, the Agency does believe it has the authority to institute reform and has been doing so over the last two years. The Agency has been developing new policies and procedures to strengthen management and administration, including for example, putting field workers through BLM PET training, adding staff resources, undertaking a negotiated rulemaking to improve management and administration of the minerals estate, and working with EPA on an environmental compliance handbook (currently pending with the agencies post a series of public listening sessions).

**Page 5, Paragraph 4:** *In order to correct deficiencies, however, BIA will need to make significant changes to the program.*

The Agency has been making significant changes in the program, as outlined above and in other comments, including for example, the development of a business plan to identify and address staffing needs and training.

**Page 5, Paragraph 5:** *The Agency has not corrected these deficiencies. As such, it still struggles with vague regulations, insufficient policies and procedures, an antiquated data system, and inadequate capabilities in oil and gas management.*

BIA is working on updating and expanding the Trust Asset and Accounting Management System (TAAMS) for lease tracking and is working on finalizing the mechanism to have Office of Natural Resources Revenue (ONRR) perform accounting and auditing. In addition, the Agency has been working over the last couple years on back audits to ensure royalty collection and compliance, has strengthened its lease compliance by adding a 24-hour hotline and tracking system to manage lease compliance issues and has been sending staff to trainings on various topics.

**Page 6, Paragraph 1:** *Nothing prohibits BIA from delegating responsibilities for many of the Osage Agency's functions by using interagency memoranda of understanding (MOUs) with BLM and ONRR for those agencies to use their expertise and perform specialized work while leaving ultimate responsibility and accountability with BIA.*

The statutes and regulations governing BLM and ONRR specifically exclude Osage. With respect to BLM, the statutory framework does not apply to Osage County and while BIA can borrow from the regulations that BLM utilizes, it must do so within the context of the 1906 Act and the regulations found at 25 C.F.R. Part 226. During the Negotiated Rulemaking, the Committee looked and has proposed that the BIA incorporate certain BLM standards and procedures in a Final Rule. Additionally, the BIA is currently working with ONRR and the Solicitor's Office to figure out how to partner with ONRR to utilize ONRR's system for accounting and auditing of royalty.

**Page 7, Paragraph 4:** *Processing and Transportation Allowances:*

The Agency has been aware of this issue and it was addressed by the Negotiated Rulemaking Committee. Proposed regulations 25 C.F.R. §§ 226.18 and 226.20 address and define the royalty

rate calculation for oil and gas. Oil must be valued, for royalty calculation purpose, using the higher of the average NYMEX daily price of oil at Cushing, OK for the month in which oil was sold adjusted for gravity; or the actual selling price as adjusted for gravity. The proposed regulations do not allow for an oil transportation allowance, and gas must be valued, for royalty calculation purposes, using the sold volumes, heating values and the ONRR Index Zone price published monthly. The proposed regulations then set a limit on gas processing allowance NTE 50 percent and further defines the allowable/non-allowable transportation and processing costs. In addition the proposed regulations, if approved would be incorporated into the standard leasing documents. This would allow the Agency to apply a verified methodology for accepting or disallowing said allowances, when permissible.

**Page 7, Paragraph 5:** *The Agency may not be collecting the full royalties due on non-arm's-length gas sales, which are sales between affiliated parties that may have the same economic interests.*

This section is not entirely accurate in that the current royalty paid is based on the highest posted price of oil by a major purchaser within Osage County. The Agency has been aware that there has been a concern related to non-arm's length transactions and the ability of a company to manipulate the price of oil within Osage County, thereby impacting royalty. However, the Agency also recognized changes to its regulations would be required to remedy these concerns. As such, the negotiated rulemaking committee undertook an evaluation of royalty and has proposed to use NYMEX at Cushing, which is a more widespread market indicator and less susceptible to manipulations, on which to base royalty for oil. The Proposed Rule also proposes to use the ONRR method for calculating gas royalties. As noted above, BIA is also working towards utilizing ONRR to perform all auditing and accounting functions and once that system is in place it will also help to reduce this concern.

**Page 8, Paragraph 2:** *BIA requirements are in the Fluid Mineral Estate Procedural Handbook; however, the Agency does not follow the Handbook.*

The BLM Fluid Minerals Handbook is tailored to specific statutory and regulatory requirements that are not applicable or workable in Osage County.

**Page 9, Paragraph 2:** *We also noted that an Agency petroleum engineering technician (PET) reviews and approves drilling permits rather than the Agency's petroleum engineer.*

The Agency had previously identified this as an area for improvement and has already developed and implemented internal policies and procedures for the petroleum engineer to review and approve applications for permits to drill.

**Page 9, Paragraph 4:** *Lessees underpay gas royalties because they are selling gas at less than market price. According to 25 C.F.R. § 226.11, royalties must be based on market price. The Agency, however, is not enforcing the regulations;*

This is not entirely accurate. The Agency had previously identified this as an issue as a result of the Tribal Trust Settlement. The Agency has been undertaking past reconciliations but is still working on bringing those audits/reconciliations current, including reconciliations for 2013.

**Page 10, Paragraph 4&5:** *Gas Measurement*

This section is incomplete in that it fails to recognize that gas measurement is an area that the Agency has known it needs improvement and is one of the issues that the Agency agreed to undertake in the negotiated rulemaking (as a result of the Tribal Trust Settlement). The Agency cannot make unilateral changes to requirements for gas measurement without a rulemaking. The Proposed Rule addresses this issue by requiring operators comply with BLM On-Shore Oil and Gas Order 5, which provides specific standards for gas measurement.

**Page 12, paragraph 1:** *The Agency does not sufficiently track gas flaring*

This section is incomplete in that the Agency has been working on this issue and it was raised during the negotiated rulemaking. The negotiated rulemaking committee discussed that better requirements for measurement of gas would increase accountability here, which was one reason why it proposed that the Department adopt BLM On-Shore Oil and Gas Order 5.

**Page 13, paragraph 1:** *The Agency allows bank certificates of deposit (CDs) as bonding instruments, but current regulations do not.*

The Agency has corrected this issue in a policy dated September 9, 2014, which makes clear that the Osage Agency is no longer accepting certificates of deposit (CDs)

**Page(S) 14 & 15:** *Agency is not in Compliance with Environmental Law; Agency does not comply with the National Environmental Policy Act.*

See Appendix "A" from the Solicitor's Office.

**Page 15, paragraph 4:** *The Agency has a critical need for permanent environmental staff.*

This information is not up to date. In December of 2013, the Agency hired an environmental protection specialist. The Osage Agency has also been working with the Indian Energy and Economic Development Office (OIEED) to secure two environmental contractors for Osage. As a result of staffing plans that were approved by main headquarters in the past year, the Agency is also in the process advertising for a second Environmental Protection Specialist. The Deputy Superintendent for the Osage Agency that was recently brought on board also has an environmental background and came from the EPA.

**Page 21, paragraph 2:** *We found that the Agency does not always terminate leases for nondevelopment, nonproduction, or noncompliance with lease terms.*

With respect to non-development, the Osage Agency has been taking the steps to utilize TAAMS to generate reports of leases with expiring primary terms, and once the system is fully functional,

the Agency will take appropriate actions to terminate those leases. With regard to nonproduction, the Osage Agency recently began generating periodic reports from the Osage Suite to identify leases that had no production for six (6) consecutive months. Notice is provided to producers with leases on this list. If there is no proof of production provided and a site inspection confirms that there is no production, the lease will be terminated. This responsibility has been identified for the Branch of Enforcement and Compliance. With regard to termination of leases for noncompliance with lease terms (other than primary term), the Osage Agency is developing internal enforcement guidelines and policies that will describe circumstances such as “significant noncompliance” that would warrant lease termination. Significant noncompliance (SNC) would likely include consideration of repeated instances of serious lease deficiencies that are not corrected and risk of harm to people or the environment.

**Page 29, paragraph 2:** *A more efficient process would be to use an electronic format for data management. For example, DOI’s Division of Energy and Minerals Development developed the National Indian Oil & Gas Evaluation & Management System (NIOGEMS) software application to assist energy- and mineral-producing Indian tribes in managing their energy and mineral resources. The application provides access to well locations, production, lease, agreement, and other natural resource data on Indian lands. The Division provides the software, data, training, and learning support at no cost to a requesting tribe and to Federal Government.*

The BIA is and has been working with OIEED to install NIOGEMS at Osage Agency. OIEED will be moving forward with implementation of NIOGEMS across Indian Affairs, including at the Osage Agency.

### **EVALUATION RECOMMENDATIONS:**

Indian Affairs provides the following responses to the report’s recommendations.

#### **Recommendation No. 1**

*Use its authority to correct program deficiencies by modifying 25 C.F.R. Part 226 to mirror other Indian Country oil and gas regulations.*

#### **Response:**

Indian Affairs Non-Concurs with Recommendation No. 1.

The Osage Nation is expressly exempted from oil and gas statutes governing other Indian lands. However, as a result of the Tribal Trust Settlement and in recognition of the need for improved management and administration of the Osage minerals estate, the BIA has completed the negotiated rulemaking to revise 25 C.F.R. Part 226 with the Osage Minerals Council and other interested parties. During this process the members of the Osage Minerals Council and other interested parties voiced concerns regarding making Osage mirror other Indian Country oil and gas regulations and the Negotiated Rule Making Committee tried to balance these concerns with the need to improve the current regulations. The Proposed Rule does include some regulations that would mirror BLM and ONRR regulations regarding oil and gas management and administration. For example proposed section 226.18 (b) (1) will adopt NYMEX pricing for the royalty rate of oil and proposed section 226.63 adopts the standards set forth BLM’s On-Shore Oil and Gas Order 5. The Proposed Rule was published in Federal Register on August 28, 2013

for public comment. Now that the public comment period has ended the Proposed Rule is currently under Departmental review.

See attachment 1 (Proposed Rule 25 C.F.R. Part 226)

Responsible Party: Assistant Secretary, Indian Affairs

Target Date: See attachment 1

### **Recommendation No. 2**

*Enter into MOUs with BLM and ONRR so these agencies can perform essential oil and gas operations and accounting activities on BIA's behalf.*

#### **Response:**

Indian Affairs concurs in part with this recommendation. BIA will be entering into an agreement with ONRR to perform the accounting activities on BIA's behalf.

The use of BLM under a MOU was extensively discussed within the Negotiated Rule Making Committee, which consisted of representatives from BLM, BIA, ONRR and the Osage Minerals Council. It was determined that due to the unique statutory and regulatory language that the Osage mineral estate operates under, that an MOU with BLM was not the best or most efficient avenue to pursue. While it is true that BLM currently performs oil and gas functions on Federal and Indian lands within Oklahoma, Texas and Kansas, we do not believe that BLM is staffed to handle the additional responsibilities of Osage County. Indian Affairs has provided additional funding to the Osage Agency for 4 FTE Petroleum Engineering Technicians for a total of 13 PETs for the agency. To ensure that the Osage Agency Petroleum Engineering Technicians (PETS) are properly trained, 4 PETs have completed the BLM Certification Course and the remaining 7 are scheduled to complete the certification course in FY15/16. In addition, BLM has committed to providing field inspection training for the Osage Agency PETs on properties within Osage County.

The Director of the Bureau of Indian affairs has been working in conjunction with ONRR to implement their accounting and reporting function for Indian Mineral at the Osage Agency. ONRR presented a proposal to the Director, Bureau of Indian Affairs on September 22, 2014 that will outline the multiyear phase in of implementation, timeline and associated cost.

Responsible Party: Director, Bureau of Indian Affairs

Target Date: The implementation to ONRR will be a multi-year phased approach beginning January 1, 2015 and scheduled for final completion of all aspects of the system on December 31, 2017.

### **Recommendation No. 3**

*Develop and implement official, comprehensive internal agency policies and procedures that govern, guide, and regulate oil and gas activities.*

**Response:**

Indian Affairs Concurs in part with Recommendation No. 3

The Osage Agency has existing internal agency policies and procedures that govern, guide and regulate oil and gas activities. However, there are improvements and updates that can be made to some of the internal policies and procedures. In the past, the Agency has been constrained by funding and resources, but in the last two years, the Agency's budget has been increased to provide additional funding to improve internal systems that will result in overall improvements to the management of the Osage mineral estate and lead to increased accountability within the Agency. For an example, the Osage Agency requested and has been granted the assistance of the OIEED to assist in the review of the present desktop operating procedures for Lease Management, Subsurface, Lease Compliance, and Environmental Protection. An industry contractor has been hired and tasked full time by OIEED to review the current operating procedures and in conjunction with Agency staff develop up to date manuals and procedures for Agency operation

Responsible Party: Superintendent, Osage Agency

Target Date: December 31, 2015

**Recommendation No. 4**

*Develop and implement internal policies and procedures directing the agency to verify companies' allowances for royalty calculations or restrict or disallow such allowances.*

**Response:**

Indian Affairs Concurs with Recommendation No. 4

While the Osage Agency concurs in this recommendation, it is premature to develop internal policies and procedures regarding verification of royalty allowances at this time. The Department is currently considering a Proposed Rule that may address this recommendation. Proposed regulations 25 C.F.R. §§ 226.18 and 226.20 addresses and defines the royalty rate calculation for oil and gas. Oil must be valued, for royalty calculation purpose, using the higher of the average NYMEX daily price of oil at Cushing, OK for the month in which oil was sold adjusted for gravity; or the actual selling price as adjusted for gravity. The Proposed Rule does not allow for an oil transportation allowance. With respect to gas, under the Proposed Rule, gas must be valued for royalty calculation purposes using the sold volumes, heating values and the ONRR Index Zone price published monthly. The Proposed Rule also sets a limit on gas processing allowance NTE 50 percent and further defines the allowable/non-allowable transportation and processing costs. In addition the Proposed Rule, if approved would be incorporated into the standard leasing documents. This would allow the Agency to apply a verified methodology for accepting or disallowing said allowances, if permissible. The Proposed Rule is still being considered by the Department and could be modified based on public comment.

Responsible Party: Director, Bureau of Indian Affairs  
Target Date: December 31, 2015

### **Recommendation No. 5**

*Develop and implement internal policies and procedures for the agency to oversee, identify, and verify non-arms' length sales transactions.*

#### **Response:**

Indian Affairs Concurs with Recommendation No. 5

While the Osage Agency concurs in this recommendation, it is premature to develop internal policies and procedures regarding non-arm's length transactions at this time. The Department is currently considering a Proposed Rule that may address this recommendation. Proposed regulation 25 C.F.R. § 226.18 (b) (1) establishes NYMEX daily pricing at Cushing Oklahoma for the price of a barrel of oil. This is different than the current regulation that uses the Highest Posted Price method of valuation. The Highest Posted Price is subject to manipulation through non-arms' length transactions. If proposed regulation section 226.18 is adopted by the Department, the use of NYMEX as an independent third party floor price benchmark will reduce the opportunity for price manipulation by establishing the minimum price independent of the payor. The ONRR calculated index zone price that is contemplated by the Proposed Rule will also provide the same protection for natural gas. Additionally, the ONRR Audit and Compliance process that will be implemented, expressly reviews and compares payor reported prices against actual receipts. Besides calculating and ordering payment for underpaid royalties, the ONRR system automatically flags penalties for payors who under report. These practices eliminates any advantage to non-arms' length transactions, removes the need to evaluate transaction affiliations and discourages under reporting.

Responsible Party: Director, Bureau of Indian Affairs  
Target Date: The implementation to ONRR will be a multi-year phased approached beginning January 1, 2015 and scheduled for final completion of all aspects of the system on December 31, 2017.

### **Recommendation No. 6**

*Develop and implement internal policies and procedures to enhance the agency's drilling permit (APD) review process by following BIA's Fluid Mineral Estate Procedural Handbook.*

#### **Response:**

Indian Affairs Non-Concurs to Recommendation No. 6

The BIA Fluid Mineral Estate Procedural Handbook contemplates the use of a tripartite system of minerals management, which includes BIA, BLM and ONRR. As noted above, the statutes and regulations that govern the use of BLM and ONRR do not currently extend to the Osage

mineral estate. Within the framework of the Handbook, BLM issues the APD's and the Handbook guidelines outline this process. The process, procedures and requirements (such as the Surface Use of Operations plan) are authorized primarily under Onshore Orders 1&2 which are not applicable under Federal Law for the Osage Mineral Estate (43 C.F.R. § 3164 specifically exempts Osage Oil and Gas Leases from Onshore Orders, in addition the Federal Oil and Gas Royalty Management Act (FOGRMA) 30 U.S.C. § 1702 (3) provides that such term does not apply to any lands subject to the provision of Section 3 of the Act of June 28, 1906 (34 Stat. 539). While it is true the Handbook states that the "Osage conducts all activities normally the responsibility of BLM" the Osage Agency must work within the framework of 25 C.F.R. Part 226 and not those of On-Shore Orders which govern the regulatory authority and process of BLM.

The Eastern Oklahoma Regional Office and the Osage Agency are currently working with local BLM staff at the Tulsa Field Office with regards to the APD process in order to identify processes and procedures that will improve the permitting process at the Osage Agency within current regulatory authority.

Responsible Party: Superintendent, Osage Agency  
Target Date: See attachment 2

#### **Recommendation No. 7**

*Develop and implement internal policies and procedures to require the agency's petroleum engineer to review and approve drilling permits.*

#### **Response:**

Indian Affairs Concurs with Recommendation No. 7

The Osage Agency has already implemented a policy requiring that all proposed applications for permits to drill are reviewed by the Petroleum Engineer. BIA considers this recommendation to be implemented (See attachment 3)

Responsible Party: Superintendent, Osage Agency  
Target Date: September 9, 2014 (see attachment 3)

#### **Recommendation No. 8**

*Make certain that lessees pay oil and gas royalties based on market price according to the current regulations 25 C.F.R. § 226.11.*

#### **Response:**

Indian Affairs Concurs with Recommendation No. 8

The Osage Agency previously identified this issue as an area of concern as a result of the Osage Tribal Trust Settlement and has been working on back audits/reconciliations to ensure that lessees are paying oil and gas royalties in accordance with 25 C.F.R. § 226.11. Once the BIA has an agreement with ONRR in place to perform royalty accounting functions, the system will be further improved.

Responsible Party: Director, Bureau of Indian Affairs.

Target Date: The implementation to ONRR will be a multi-year phased approach beginning January 1, 2015 and scheduled for final completion of all aspects of the system on December 31, 2017.

### **Recommendation No. 9**

*Develop and implement supplemental agency guidance that includes how lessees should measure gas and subsequently calculate royalties on energy quality.*

#### **Response:**

Indian Affairs Concurs with Recommendation No. 9

While the BIA concurs in this recommendation, it is premature to develop internal policies and procedures regarding gas measurements at this time. The Department is currently considering a Proposed Rule that would address this recommendation. The proposed regulation 25 C.F.R. §226.63 (a), (b) establishes that gas will be measured in accordance with the standards, procedures, and practices set forth in BLM On-Shore Oil and Gas Order 5 (measurement of Gas, and any amendments thereto).

Responsible Party: Director, Bureau of Indian Affairs

Target Date: December 31, 2015

### **Recommendation No. 10**

*Develop and implement supplemental agency guidance to 25 C.F.R. Part 226 to help identify and verify companies' allowances for royalty calculations.*

#### **Response:**

Indian Affairs Concurs with Recommendation No. 10

While the Osage Agency concurs in this recommendation, it is premature to develop internal policies and procedures regarding identifying and verifying companies' allowances for royalty calculations at this time. The Department is currently considering a Proposed Rule that may address this recommendation. The proposed regulation 25 C.F.R. § 226.18 clearly defines royalty rate allowances. In addition, BIA is working closely with ONRR in order to transition Osage producing leases over to the ONRR automated reporting and verification system, which would address this issue regardless of whether the Proposed Rule is adopted.

Responsible Party: Director, Bureau of Indian Affairs  
Target Date: The implementation to ONRR will be a multi-year phased approach beginning January 1, 2015 and scheduled for final completion of all aspects of the system on December 31, 2017.

### **Recommendation No. 11**

*Identify all companies that flare gas and verify that each company that flares gas has documented approval.*

#### **Response:**

Indian Affairs Concurs with Recommendation No. 11

The Osage Agency currently strives to ensure all flaring of gas is documented and approved. As a result of the recent negotiated rule making this issue was previously raised with the Osage Agency and the Agency continues to review lease files, perform site inspections, and has instituted a 24-hour public hotline for the public to use to report unapproved flaring, environmental concerns or lease compliance issues. The Osage Agency has created a tracking system for the hotline to ensure all calls are investigated and followed up on in a timely manner. In addition utilizing ONRR's system to perform auditing and accounting of oil and gas will flag any discrepancies in the use of gas. This concern will be further addressed if the proposed rule is adopted and operators are required to comply with BLM On-Shore Oil and Gas Order 5 with respect to the measurement of gas, as the new metering requirements will provide another check to identify discrepancies. In performing inspections of leases, the PET's report any flaring of gas, and letters are issued to the lessee and placed in the lease file. The Osage Agency is unaware of any unauthorized flaring of gas at this time.

Responsible Party: Superintendent, Osage Agency  
Target Date: December 31, 2015

### **Recommendation No. 12**

*Develop and implement agency policies and procedures to verify that companies properly report volumes on flared gas and pay appropriate royalties.*

#### **Response:**

Indian Affairs Concurs with Recommendation No. 12

While the Osage Agency concurs with the recommendation, it has already identified this concern and believes it is premature to address this recommendation. The Bureau is working closely with ONRR in order to transition Osage producing leases over to the ONRR automated reporting and verification system, which would address this issue. This concern will be further addressed if the Proposed Rule is adopted and operators are required to comply with BLM On-Shore Oil and Gas

Order 5 with respect to the measurement of gas, as the new metering requirements will provide another check to identify discrepancies.

Responsible Party: Superintendent, Osage Agency  
Target Date: The implementation to ONRR will be a multi-year phased approach beginning January 1, 2015 and scheduled for final completion of all aspects of the system on December 31, 2017.

### **Recommendation No. 13**

*Follow existing regulations requiring corporate surety bonds. If the proposed regulations allow using CDs, regularly review all escrow CDs to verify their maturity and replace matured CDs.*

#### **Response:**

Indian Affairs Concurs with Recommendation No. 13

The Osage Agency is following the current regulations and no longer accepts Certificates of Deposits (CDs). Osage Agency is only accepting bonds as identified in 25 C.F.R. § 226.6. The Agency has a listing of all CDs that have been accepted in the past, and in addition, during approval of assignments of these leases, they are ensuring that CDs are replaced with acceptable bonds. The proposed regulations are not final and are still being reviewed by the Department. If the Proposed Rule becomes final and allow for CDs, at that time the Osage Agency can consider the need for a process to review CDs and verify their maturity. We consider this recommendation to be implemented (see attachment 4)

Responsible Party: Superintendent, Osage Agency  
Target Date: September 9, 2014 (see attachment 4)

### **Recommendation No. 14**

*Develop and implement oversight procedures to ensure compliance with NEPA for all Osage Nation oil and gas activities.*

#### **Response:**

Indian Affairs Concurs with Recommendation No. 14

The Osage Agency complies with NEPA with respect to oil and gas activities in Osage County and does carry out NEPA review with respect to current oil and gas activities. In addition, BIA is taking steps to strengthen oversight procedures with respect to environmental issues. Moreover, to further improve this process, in November 2012, the Eastern Oklahoma Regional Office, BIA, and Osage Agency, BIA began work with BLM to include BIA oil and gas operations, see 25 C.F.R. Part 226, on the Osage Mineral Reservation in the BLM's Kansas, Oklahoma, and Texas Resource Management Plan and National Environmental Policy Act, 42 U.S.C. §§ 4321-4370f (NEPA) compliance effort. Coordinating with the BLM with respect to

BIA Osage oil and gas operations was determined appropriate in order to supersede and replace the 1979 Environmental Assessment. Public scoping for this effort was completed on January 31, 2014. The Environmental Assessment for Osage oil and gas activities will be completed in May 2015. If determined necessary, an Environmental Impact Statement will be completed by the end of December 2015. While the BLM and BIA NEPA work is on-going, the BIA on July 15, 2014, issued a Notice to all Mineral Lessees that in the interim (beginning August 12, 2014), Lessees would be required to prepare a draft site-specific Environmental Assessment for BIA approval to accompany all Applications for Permit to Drill. The Osage Agency Environmental Protection Specialist will review the Environmental Assessment (EA) to ensure that a Finding of No Significant Impact (FONSI) can be signed by the Superintendent before the commencement of oil and gas activities with Osage County.

Responsible Party: Superintendent, Osage Agency  
Target Date: December 31, 2015 (see attachment 5)

### **Recommendation No. 15**

*Ensure that the Agency has permanent environmental staff to address the NEPA requirements.*

#### **Response:**

Indian Affairs Concurs with Recommendation No. 15

In addition to historical NEPA compliance, the Osage Agency has hired an Environmental Protection Specialist as of December 29, 2013, and is in the process of advertising an additional Environmental Protection Specialist. The OIEED also provided the Osage Agency with two environmental contractors. BIA considers this recommendation implemented.

Responsible Party: Superintendent, Osage Agency  
Target Date: December 2013

### **Recommendation No. 16**

*Realign emphasis on gauging to other, more effective, oversight activities such as inspections, and instead of gauging for production verification, only gauge during inspection and for purpose of determining possible instances of fraud.*

#### **Response:**

Indian Affairs Concurs with Recommendation No. 16

Tank gauging is one portion of an effective Inspection and Enforcement (I&E) program. To restrict tank gauging to those activities associated with inspections and possible instances of fraud would compromise the ability of the Osage Agency to implement an effective production verification and production accountability program. The Agency has engaged with the BLM in understanding risk factors for wells/leases and will develop a risk based strategy for the I&E

program at the Agency. This strategy will deploy I&E resources in a manner that will provide an effective compliance program for all of the elements of an inspection and enforcement program as identified.

Responsible Party: Superintendent, Osage Agency  
Target Date: September 31, 2015

**Recommendation No. 17**

*Reevaluate existing gauging practices and develops and implements a more efficient and effective gauging program if the agency continues to emphasize gauging. This could include risk-based gauging.*

**Response:**

Indian Affairs Concurs with Recommendation No. 17

The Osage Agency has hired additional PETs to perform gauging within Osage County. Additional equipment such as vehicles, gauging boxes, gauging tools, as well as certified BLM training has been provided. Desktop operating procedures are being reviewed and revised with the assistance of BLM for best management practices to include risk based gauging.

Responsible Party: Superintendent, Osage Agency  
Target Date: August 30, 2015 (see attachment 6)

**Recommendation No. 18**

*Identify all high-risk leases, develop and implement a risk based strategy to annually inspect all high risk leases, and include a plan to inspect all leases over a specified time.*

**Response:**

Indian Affairs Concurs to Recommendation No. 18

The Osage Agency is working on a strategy to identify all high-risk leases to ensure that there are annual inspections performed. This listing will include those leases with reoccurring environmental issues, violations, spills, and other surface issues. The Osage Agency is working in conjunction with BLM to identify the risk factors for the wells/leases and will develop a risk-based strategy for the I&E program that will mirror the BLM protocol.

Responsible Party: Superintendent, Osage Agency  
Target Date: August 30, 2015

**Recommendation No. 19**

*Upgrade the agency's inspection management system to include all leases inspected and the risks associated with the leases.*

**Response:**

Indian Affairs Concurs to Recommendation No. 19

The Osage Agency currently has a lease tracking system in place. It is a component of the BIA-Osage Agency Environmental Complaint Tracking Site. The Environmental Complaint Tracking Site allows the Osage Agency to track all environmental complaints, spills and lease inspections from the time of the initial notification of complaint is received until the action has been closed out of the system and been properly addressed by BIA staff. Specifically, the Lease Inspection Tracker allows Agency employees to track all lease inspections throughout the resolution process for both inspections with deficiencies and those that did not find violations. The tracking system has the ability to track the lease inspection history and status information of all leases within the Osage Mineral Estate.

The Osage Agency issued a policy on September 16, 2014, whereby all lease inspections performed within Osage County will be encoded into the lease inspection tracker. The tracker has been modified to include compliance and non-compliance lease inspections. BIA considers this recommendation to be implemented (see attachment 7)

Responsible Party: Superintendent, Osage Agency  
Target Date: September 16, 2014 (see attachment 7)

**Recommendation No. 20**

*Develop and implement guidance to ensure the agency consistently applies and levies fines in a timely manner.*

**Response:**

Indian Affairs Concurs with Recommendation No. 20

The Osage Agency has implemented a policy to assess penalties and fines associated with non-compliance after the original notification of violations to the lessee. With the implementation of the Branch of Enforcement and Compliance, the Osage Agency is in a better position to insure that deficiencies are addressed, penalties assessed, and action is promptly taken for cancellation of non-compliant leases. BIA considers this recommendation to be implemented (see attachment 8)

Responsible Party: Superintendent, Osage Agency  
Target Date: September 18, 2014 (see Attachment 8)

## **Recommendation No. 21**

*Develop and implement an agency action plan to identify and tract leases that it should terminate for nondevelopment, nonproduction, and noncompliance with lease terms.*

### **Response:**

Indian Affairs Concurs with Recommendation No. 21

The Osage Agency previously identified this issue and has already implemented a process to notify the lessees of non-production within six months and to show cause why the lease should not terminate for lack of production. The Osage Agency recently began generating periodic reports from the Osage Suite to identify leases that had no production for six (6) consecutive months. Notice is provided to producers with leases on this list. If there is no proof of production provided and a site inspection confirms that there is no production, the lease will be terminated. This responsibility has been identified for the Branch of Enforcement and Compliance. With regard to termination of leases for noncompliance with lease terms (other than primary term), Osage Agency is developing internal enforcement guidelines and policies that will describe circumstances such as “significant noncompliance” that would warrant lease termination. Significant noncompliance (SNC) would likely include consideration of repeated instances of serious lease deficiencies that are not corrected and risk of harm to people or the environment. BIA considers this recommendation to be implemented (see attachment 9)

Responsible Party: Superintendent, Osage Agency  
Target Date: August 29, 2014 (see Attachment 9)

## **Recommendation No. 22 Item needs further review/strategy for plugging**

*Develop and implement a strategy for the agency to identify all wells to be plugged and abandoned, develop a prioritized list based on risk, and work with the Council to plug high-risk wells.*

### **Response:**

Indian Affairs Non-Concurs with recommendation No. 22

The Osage Mineral Council currently operates a program to plug certain wells (purging, danger to environment or health and public safety). The issue of abandoned and unplugged wells was raised during the negotiated rule as well as public comments received during the commenting period. It is under further review and assessment within the Bureau of Indian Affairs. In addition to this review and assessment, the Bureau of Indian Affairs has met with the Oklahoma Environmental Resource Board (OERB) to foster increased activity within Osage County with regards to their remediation of abandoned well sites. The OERB will be presenting at the Osage Minerals Forum in September of 2014 outlining their site restoration program and soliciting areas to be remediated. This is a service provided free of charge to the surface owner.

Responsible Party: Director, Bureau of Indian Affairs  
Target Date:

### **Recommendation No. 23**

*Work with USGS's Energy Resources Program to request a mineral resources assessment on the Osage Nations' mineral estate.*

#### **Response:**

Indian Affairs Concurs with Recommendation No. 23

In order to meet the intent of the recommendation the Osage Agency will be working with OIEED. Due to the fact they have done preliminary work within Osage County and are configured to do countywide assessments, it is felt they are better suited to provide the resource assessment in the shortest possible time. They will concentrate on areas of prospect within Osage County as well as formation assessments.

Responsible Party: OIEED  
Target Date: September 31, 2015

### **Recommendation No. 24**

*Reconcile oil and gas exception to independent or third party sources of information and follow up and resolve any identified difference in a timely manner.*

#### **Response:**

Indian Affairs Concurs with Recommendation No. 24

The implementation of ONRR accounting system will address this recommendation. ONRR will address royalty and production reporting, data mining and further compliance functions including auditing. The implementation will further provide a consistent level of trust-services across Indian country for the administration of mineral leases.

Responsible Party: Director, Bureau of Indian Affairs  
Target Date: The implementation to ONRR will be a multi-year approach beginning January 1, 2015 and scheduled for final completion of all aspects of the system on December 31, 2017.

### **Recommendation No. 25**

*Enter into an MOU with ONRR to implement ONRR's electronic data system.*

**Response:**

Indian Affairs Concur with Recommendation No. 25

BIA and ONRR are presently working on an agreement to utilize and implement their electronic data system, which will include automated production and accounting systems, as well as, compliance functions.

Responsible Party: Director, Bureau of Indian Affairs

Target Date: The implementation of ONRR will be a multi-year phased approach beginning January 1, 2015 and scheduled for final completion of all aspects of the system on December 31, 2017.

**Recommendation No. 26**

*Develop and implement agency sampling thresholds and follow up on any identified discrepancies in a timely manner.*

**Response:**

Indian Affairs Concur with Recommendation No. 26

Once the transition to ONRR is complete, ONRR will use its established materiality and threshold policies to identify and follow-up on discrepancies in a timely manner.

Responsible Party: Director, Bureau of Indian Affairs

Target Date: The implementation of ONRR will be a multi-year phased approach beginning January 1, 2015 and scheduled for final completion of all aspects of the system on December 31, 2017.

**Recommendation No. 27**

*Reconsider its practice of entering oil lessee reports into the Osage Suite system.*

**Response:**

Indian Affairs Concur with Recommendation No. 27

While the Osage Agency concurs in this recommendation, it must continue to utilize the Osage Suite in documenting those reports associated with reporting and accounting of royalties until such time that ONRR accounting system is implemented.

Responsible Party: Superintendent, Osage Agency

Target Date: The implementation of ONRR will be a multi-year phased approach beginning January 1, 2015 and scheduled for final completion of all aspects of the system on December 31, 2017.

### **Recommendation No. 28**

*Enter into an MOU with ONRR to implement ONRR's systems to address the agency's database deficiencies.*

#### **Response:**

Indian Affairs Concurs with Recommendation No. 28

BIA and ONRR are currently working closely together to establish an agreement to implement ONRR's production and accounting systems and related compliance functionality.

Responsible Party: Director, Bureau of Indian Affairs

Target Date: The implementation of ONRR will be a multi-year phased approach beginning January 1, 2015 and scheduled for final completion of all aspects of the system on December 31, 2017.

### **Recommendation No. 29**

*Enter into a MOU with ONRR to conduct compliance review, audits, and data mining for royalty compliance and verification.*

#### **Response:**

Indian Affairs Concurs with Recommendation No. 29

As part of the transition to production and accounting with ONRR, the agreement will include the compliance function such as up front editing of reporting data, data mining, compliance reviews and audits.

Responsible Party: Director, Bureau of Indian Affairs

Target Date: The implementation of ONRR will be a multi-year phased approach beginning January 1, 2015 and scheduled for final completion of all aspects of the system on December 31, 2017.

### **Recommendation No. 30**

*Work with the Division of Energy and Minerals Development to implement the NIOGEMS program for electronic lease file management and agency lease and well mapping.*

#### **Response:**

Indian Affairs Concurs with Recommendation No. 30

The Osage Agency has been working with OIEED and the NIOGEMS program is currently being readied for implementation at Osage Agency.

Responsible Party: Regional Director, Eastern Oklahoma  
Target Date: August 30, 2015

**Recommendation No. 31**

*Develop and implement a records management program for agency lease files to comply with IARMM to include using the NIOGEMS program for electronic lease file management.*

**Response:**

Indian Affairs Concurs with Recommendation No. 31

The Osage Agency has been working with OIEED and the NIOGEMS program is currently being readied for implementation at Osage Agency.

Responsible Party: Regional Director, Eastern Oklahoma  
Target Date: August 30, 2015

**Recommendation No. 32**

*Work with the Office of Indian Energy and Economic Development to implement the NIOGEMS program for the agency tract management.*

**Response:**

Indian Affairs Concurs with Recommendation No. 32

BIA is actively working with OIEED to implement the NIOGEMS program at the Osage Agency.

Responsible Party: Director, Bureau of Indian Affairs  
Target Date: August 30, 2015

**Recommendation No. 33**

*Automate its lease acreage data to ensure accurate information is available to the Agency and Council.*

**Response:**

Indian Affairs Concurs with Recommendation No. 33

The TAAMs is utilized by the Agency. The Agency will ensure all mineral leases are encoded into TAAMs and the information is up to date and correct. This will include the first and last production date of all producing or non-producing wells. The system will then be capable of producing a report of available acreage. In addition an Osage specific TAAMs module is being

prepared for Osage Agency that will address some of the unique needs associated with the mineral estate.

Responsible Party: Superintendent, Osage Agency  
Target Date: December 31, 2015

## Appendix 5: Status of Recommendations

Recommendations	Status	Action Required
Recommendations 7, 13, 15, 19, and 20	Resolved and implemented.	No further action is required.
Recommendations 1, 2, 3, 4, 5, 6, 8, 9, 10, 11, 12, 14, 16, 17, 18, 21, 23, 24, 25, 26, 27, 28, 29, 30, 31, 32, and 33	Resolved; not implemented.	We will refer these recommendations to the Assistant Secretary for Policy, Management and Budget for tracking their implementation.
Recommendation 22	Unresolved	We will refer this recommendation to the Assistant Secretary for Policy, Management and Budget for resolution.

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