U.S. Department of Energy
Office of Inspector General
Office of Audit Services

Audit Report

Management Controls over the Department of Energy's Uranium Leasing Program

OAS-M-08-05

January 2008

Department of Energy

Washington, DC 20585

January 23, 2008

MEMORANDUM FOR THE DIRECTOR, OFFICE OF LEGACY MANAGEMENT

FROM: George Collard
Assistant Inspector General
for NNSA and Energy Audits
Office of Inspector General

SUBJECT: INFORMATION: Audit Report on "Management Controls over the Department of Energy's Uranium Leasing Program"

BACKGROUND

The Department of Energy's Uranium Leasing Program was established by the Atomic Energy Act of 1954 to develop a supply of domestic uranium to meet the nation's defense needs. Pursuant to the Act, the Program leases tracts of land to private sector entities for the purpose of mining uranium ore. According to Department officials, one purpose of the Program is to obtain a fair monetary return to the Government. The Program is administered by the Department's Office of Legacy Management through a contractor. The uranium leases issued by the Department include two types of royalty payments: an annual royalty and a production royalty. The annual royalty is a flat rate and is paid to the Department whether production has occurred or not. The production royalty is based on a calculation of the value of the uranium ore that was produced by the mine.

The Department leased tracts of Federal land located in southwestern Colorado to various private sector companies. The most recent 10-year lease period was from 1996 to 2006, during which time the Department leased 13 active tracts of land. Industry interest in production recently increased due to higher uranium prices. Accordingly, in July 2007, the Department issued a final Programmatic Environmental Assessment on the upcoming 10-year lease period, in which it selected an "Expanded Alternative" that will result in the activation of 38 tracts of land. If production occurred on all 38 tracts, the Department estimated royalties could total $18 million a year. Since the Department is planning to issue new leases with the potential for increased royalties stemming from the Program's upcoming expansion, we initiated this audit to determine if the Department was effectively administering its Uranium Leasing Program.

RESULTS OF AUDIT

We found that the Department had not:

- Re-evaluated the methodology for calculating lease royalties since 1982, despite changing market conditions; and,

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- Collected final production royalty payments in a timely manner.

Royalty Payment Methodology

Although market conditions had changed significantly since 1982, the Department had not re-evaluated its method for calculating royalty payments. There had been an oversupply of uranium in the market and a long-term domestic industry decline in 1982, when the Department established its methodology. Since that time, the Department has used spot market prices to establish a stable price for uranium consistent with the domestic market value. However, the spot market no longer represents the majority of uranium transactions in the current domestic market. Specifically, according to the Department's Energy Information Administration, spot market prices represent only about 10 percent of domestic uranium purchases while 90 percent involve long-term contract pricing. In addition, Department and industry officials stated that the spot market price is volatile while the long-term price is more stable. Further, there is no longer an oversupply, but rather a uranium supply shortage expected to continue for the foreseeable future. Given the changed conditions, we raised the issue to the Department during the audit about the need to re-evaluate its methodology in order to better reflect the current market conditions. To its credit, the Department agreed to re-examine its methodology for calculating royalty payments.

Royalty Collections

The Department had not collected some final uranium leasing payments for over two years. While the agreements require that leaseholders make payments within twenty days after the end of the calendar month in which the ore was assayed, the Department's contractor had not requested payment from the leaseholders. As of September 2007, there were final royalties outstanding on production from March 2005 through February 2006 totaling more than $700,000, which represented about 17 percent of the royalties owed to the Department. The contractor administering the Program was not aware of the amount of final royalties owed until we brought this matter to his attention. According to the Department, the contractor had not focused on collecting royalty payments because of a significant increase in his workload associated with preparing for the upcoming leases.

Department Reviews

These situations occurred because the Department had not performed periodic Program management reviews that would have highlighted problems in the administration of the leases, including the need to revise the royalty payment methodology to reflect current market conditions and any imbalances between the contractor's workload and resources. In fact, the last in-depth Department review of the Program was in 1984.

Current and Future Importance

Without a revised royalty payment calculation methodology, the Department cannot assure that it is providing a fair return to both the Government and the leaseholders.

Also, since the collection of the final royalties we identified was not timely, the Government has thus far lost the opportunity to use these funds for other Federal programs. Moreover, in light of the Department's plans to expand the Program, corrective actions are necessary to more effectively administer the larger amount of future royalties likely to be generated.

RECOMMENDATIONS

We recommend that the Director, Office of Legacy Management, establish periodic Program reviews to ensure that the:

1. Royalty calculation methodology reflects current market conditions and provides an equitable return to both the Government and leaseholders; and,

2. Final royalties owed to the Department are collected in a timely manner.

MANAGEMENT REACTION AND AUDITOR COMMENTS

The Office of Legacy Management concurred with the report recommendations and indicated it was initiating corrective actions. Management's actions are responsive to the audit recommendations. Management's comments are included in their entirety in Attachment 2.

Attachments

cc: Under Secretary of Energy
Chief of Staff
Deputy Director, Office of Legacy Management, LM-1
Director, Legacy Management Office of Site Operations, LM-20
Deputy Director, Legacy Management Office of Site Operations, LM-20
Team Leader, Audit Liaison, CF-1.2
Audit Liaison, LM-10

Attachment 1

OBJECTIVE, SCOPE, AND METHODOLOGY

The audit was performed from April to September 2007 at the Department's Grand Junction Office located in Colorado. To accomplish our objective, we:

- Reviewed Uranium Leasing Program laws, regulations, policies and procedures;

- Reviewed documents and electronic spreadsheets used to establish the basis for royalty payments, provide payments to the Department, and track uranium production and royalties owed to the Department;

- Interviewed key Department and contractor personnel responsible for management and oversight of the Uranium Leasing Program; and,

- Reviewed prior Office of Inspector General and Government Accountability Office reports, and other related reports.

We conducted this performance audit in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objective. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objective. The audit included tests of controls and compliance with laws and regulations related to the Uranium Leasing Program. Because our review was limited, it would not necessarily have disclosed all internal control deficiencies that may have existed at the time of our audit. During the audit, we assessed the Department's compliance with the Government Performance and Results Act of 1993, as it related to the audit objective. We concluded that the Department had not established specific performance measures for the Uranium Leasing Program. We relied on computer processed data to accomplish our audit objective. We performed procedures to validate the reliability of the information as necessary to satisfy our audit objective. The Office of Legacy Management waived the exit conference.

Department of Energy
Washington, DC 20585

December 20, 2007

MEMORANDUM FOR George W. Collard
Assistant Inspector Genera
for Performance Audits
Office of Inspector General

FROM: Michael W. Owen
Director
Office of Legacy Management

Michael W. Owen

SUBJECT: Management Decision for Inspector General Report A07DN052 Audit of the Department of Energy's Uranium Leasing Program

The Office of Inspector General (OIG) issued the draft report on Audit No. A07DN052, "Management Controls over the Department of Energy's Uranium Leasing Program" of the Department of Energy's Uranium Leasing Program" on December 7, 2007.

The Office of Legacy Management (LM) agrees with the OIG's audit recommendations and provides the following response and corrective actions.

Recommendation 1:

Establish periodic program reviews to ensure that the royalty calculation methodology reflects current market conditions and provides an equitable return to both the Government and leaseholders:

Management Decision:

Concur

LM agrees with this recommendation. LM has rewritten its royalty calculation methodology to accommodate the current market conditions. All uranium leases will use this new methodology. The new calculation accounts for specific program requirements that provide a fair return for both the Government and leaseholder. LM will periodically review the calculation methodology to ensure it is up to date.

Recommendation 2:

Establish periodic program reviews to ensure that the final royalties owed to the Department are collected in a timely manner.

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Management Decision:

Concur

LM agrees with this recommendation. LM agrees that we did not collect 17% of the owed royalties in a timely manner in 2006 and 2007. During this period the workload priorities focused on completing the Uranium Leasing Programmatic Environmental Assessment and adequate operational review was not completed. LM did receive 83% of the owed royalties from the lessees in a timely manner and has met with the lessee, evaluated the remaining owed production royalties and the lessee transmitted a check on December 12, 2007, to LM covering the past due production royalties of $651,998. LM will actively manage the uranium leasing program and has instituted improved oversight program measures to assure all future royalty payments are timely.

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