



Independent Accountant's Report

The Board of Regents of
The University of Texas System:

We have examined the accompanying management's assertion that management of University Lands - West Texas Operations of the University of Texas (WTO) has maintained an effective internal control structure over the safeguarding of assets, the execution and recording of transactions in accordance with management's policies or procedures, and the preparation of the Statement of Deposits and Funds Transferred to the Permanent and Available University Funds in accordance with applicable laws and regulations as of August 31, 1996.

Our examination was made in accordance with Standards established by the American Institute of Certified Public Accountants and, accordingly, included obtaining an understanding of the internal control structure over financial reporting, testing, and evaluating the design and operating effectiveness of the internal control structure, and such other procedures as we considered necessary in the circumstances. We believe that our examination provides a reasonable basis for our opinion.

Because of inherent limitations in any internal control structure, errors or irregularities may occur and not be detected. Also, projections of any evaluation of the internal control structure over financial reporting to future periods are subject to the risk that the internal control structure may become inadequate because of changes in condition, or that the degree of compliance with the policies or procedures may deteriorate.

In our opinion, management's assertion that WTO has maintained an effective internal control structure over the safeguarding of assets, the execution and recording of transactions in accordance with management's policies or procedures, and the preparation of the Statement of Deposits and Funds Transferred to the Permanent and Available University Funds in accordance with applicable laws and regulations as of August 31, 1996 is fairly stated, in all material respects, based upon criteria established in "Internal Control--Integrated Framework" issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO).

In planning and performing our examination we noted, as disclosed in the accompanying management's assertion, that the annual reconciliation process was incomplete. We consider this to be a reportable condition, but not a material weakness, under standards established by the American Institute of Certified Public Accountants. Reportable conditions involve matters coming to our attention relating to significant deficiencies in the design or operation (in this case,

the operation) of the internal control structure that, in our judgment, could adversely affect the organization's ability to record, process, summarize and report financial data consistent with the assertions of management in the financial statements. A material weakness is a reportable condition in which the design or operation of one or more of the internal control structure elements does not reduce to a relatively low level the risk that errors or irregularities in amounts that would be material in relation to the financial statements may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions.

Deloitte & Touche LLP

DELOITTE & TOUCHE LLP

January 29, 1997

Academic Component Institutions
The University of Texas at Arlington
The University of Texas at Austin
The University of Texas at Brownsville
The University of Texas at Dallas
The University of Texas at El Paso
The University of Texas at San Antonio
The University of Texas at Permian Basin
The University of Texas at San Antonio
Institute of Texas Cultures
The University of Texas at Tyler



Health Component Institutions
The University of Texas at Dallas Health Science Center
The University of Texas Medical Branch at Galveston
The University of Texas Health Science Center at Houston
The University of Texas Health Science Center at San Antonio
The University of Texas M.D. Anderson Cancer Center
The University of Texas Health Center at Tyler

THE UNIVERSITY OF TEXAS SYSTEM

Office of Business Affairs

201 WEST SEVENTH STREET AUSTIN, TEXAS 78701-2981

Facsimile (512) 499-4573

January 27, 1997

R. D. Burck
(512) 499-4560

Management's Assertions

To Whom It May Concern:

Management of West Texas Operations (WTO) is responsible for establishing and maintaining an effective internal control structure. In fulfilling this responsibility, estimates and judgments by management are required to assess the expected benefits and related costs of control procedures. The objectives of our internal control system include providing management with reasonable, but not absolute, assurance that assets are safeguarded against loss from unauthorized use or disposition, and that transactions are accomplished in accordance with management's policies or procedures and recorded properly to permit the preparation of the Statement of Deposits and Funds Transferred to the Permanent and Available University Funds in accordance with applicable laws and regulations. WTO's internal control structure includes monitoring mechanisms and actions are taken to correct identified deficiencies. The structure includes a documented organizational structure, the division of responsibility, and established policies and procedures. In addition, UT System has adopted a code of conduct to foster a strong ethical climate.

There are inherent limitations in the effectiveness of any structure of internal control, including the possibility of human error and the circumvention or overriding of controls. Accordingly, even an effective internal control structure can provide only reasonable assurance with respect to operations of WTO. Further, because of changes in conditions, the effectiveness of an internal control structure may vary over time.

The System Audit Office (SAO) operates through the Business Affairs and Audit Committee of the Board of Regents. They provide oversight of the financial reporting process, the safeguarding of assets against unauthorized acquisition, use or disposition, and compliance with applicable laws and regulations. The Office of General Counsel (OGC) handles the legal areas. OGC is not under the control of the Office of Business Affairs of UT System. These offices perform or assist in joint efforts with WTO in the following activities which are a significant part of our control structure:

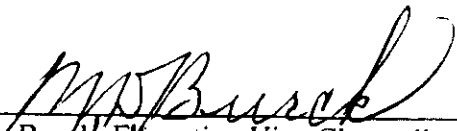
- Annual financial audit
- Company audits
- Field audits
- Review of gas plant examination working papers
- Review of policies and procedures
- Interpretations of statutes and lease provisions
- Assistance with lessee compliance matters
- Review and approval of legal instruments

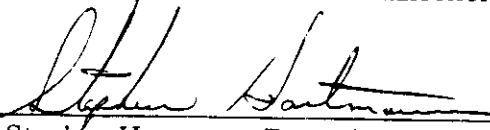
OGC and SAO regularly meet with WTO management, members of the Business Affairs and Audit Committee, members of the Board for Lease of University Lands, UT System General Counsel, and the Chancellor of the University of Texas System. In addition, they meet separately without WTO management representatives present. In these meetings, SAO primarily discusses the results of their audits, the adequacy of the internal control system, the quality of financial reporting, and the safeguarding of assets against unauthorized acquisition, use or disposition. OGC addresses WTO's compliance with applicable laws and regulations. OGC and SAO make presentations and answer questions at posted public meetings of the Business Affairs and Audit Committee, the Board of Regents of the University of Texas System, and the Board for Lease of University Lands. These meetings are designed to facilitate communications between these offices and the Business Affairs and Audit Committee, the Board for Lease of University Lands, the Board of Regents of UT System, UT System General Counsel, and the Chancellor of the University of Texas System and to assure the public that WTO is operating effectively.

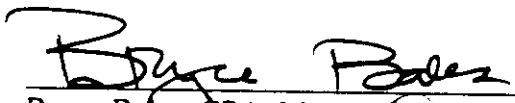
On November 8, 1996, the SAO issued an audit report on the revenue accounted for by WTO for FY 1996. The objectives of this audit were to determine whether FY 1996 University Lands revenue was fairly stated in the UT System accounting records and to examine and evaluate internal controls over the cash receipt and revenue accounting process. The overall opinion of the SAO was that revenues from WTO deposited to the Permanent University Fund and the Available University Fund for Fiscal Year 1996 are fairly stated in the University's accounting records. The SAO also noted one of the primary controls over oil and gas revenues, the annual reconciliation, has not yet been completed for the years ended August 31, 1994 to 1996. The annual reconciliation is a procedure of comparing the revenues which were due to be received for every lease for every month with the amount actually received.

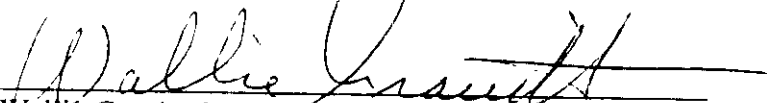
We have assessed the effectiveness of the internal control structure of WTO over financial reporting, operations, and compliance with applicable laws and regulations as of August 31, 1996. This assessment was based on criteria for effective internal control described in "Internal Control-Integrated Framework" issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). Based on this assessment, management believes that, as of August 31, 1996, its system of internal control over the safeguarding of assets, the execution and recording of transactions in accordance with management's policies or procedures, and the preparation of the Statement of Deposits and Funds Transferred to the Permanent and Available University Funds in accordance with applicable laws and regulations is effective and met those criteria. Management does not consider the incomplete annual reconciliation procedures, mentioned in the preceding paragraph, to be a material weakness.

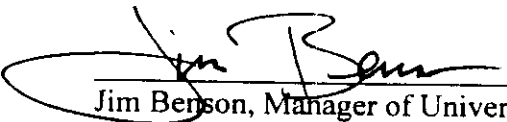
Deloitte & Touche, LLP was also engaged to report separately on WTO's internal control system of financial reporting, safeguarding of assets against unauthorized acquisition, use or disposition, and compliance with applicable laws and regulations. The report of the independent public accountants follows this statement.


R. D. Burck, Executive Vice Chancellor for Business Affairs


F. Stephen Hartmann, Executive Director of West Texas Operations


Bryce Bales, CPA, Manager of University Lands Accounting Office


Wallie Gravitt, Manager of Oil, Gas, Mineral, Interests


Jim Benson, Manager of University Lands Surface Interests

RDB:rjl
Enclosure

**Deloitte &
Touche LLP**



Buck

**UNIVERSITY OF TEXAS
LANDS ACCOUNTING OFFICE**

RESULTS OF THE INTERNAL ACCOUNTING CONTROL SURVEY

APRIL 4, 1997

**Deloitte Touche
Tohmatsu
International**

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SUMMARY OBSERVATIONS



April 30, 1997

Mr. R. D. Burck
Executive Vice Chancellor for Business Affairs
The University of Texas System
201 West Seventh Street
Austin, Texas 78701-2981

Dear Mr. Burck:

At your request we have performed a comparative survey of the accounting and internal control practices over royalty income from oil and gas leases at the University Lands - West Texas Operations of the University of Texas System (the "WTO") with similar practices used by the States of Louisiana, New Mexico, Wyoming and the Texas General Land Office (collectively, the "other states"). Our knowledge of the procedures in effect at WTO is based on our report dated January 29, 1997 on WTO's system of internal control. Our knowledge of the procedures in effect at the other states is based solely on a telephone survey we conducted with representatives of the other states. Attached to this letter is a blank copy of survey questions, along with the completed survey forms for each of the other states. The survey was designed to obtain information regarding key internal controls used by the other states in determining that all royalty income was properly recorded. The survey form also asked each of the other states to describe any other internal control they used to ensure that all royalty income was received.

Our summary observations regarding the comparative practices are as follows:

Operator Information

Receiving information from the operator is a valuable internal control which allows the establishment of general ledger accountability over the amount of royalty income to be received from the payor. The Texas General Land Office and WTO are the only agencies receiving production information directly from the operator for all leases. The other states receive information only from the payor.

Source Documentation for Production

Source documents (run tickets, delivery statements, etc.) provide additional assurance that royalties are being properly recorded and received based on actual production. Wyoming and WTO are the only agencies which require either the operator or payor to provide source documents to support reported production amounts. The Texas General Land Office intends to implement this procedure in the near future.

Comparison of Production Information with Other State Agencies

Comparing production amounts to information on file at the state regulatory agencies is an additional control over the completeness of royalty income. WTO and all other states compare the production amounts for which royalties were received with information reported by operators to their respective state regulatory agencies (agencies similar to the Texas Railroad Commission)

Control over Cash Receipts

Use of a lock box provides better control over cash receipts. New Mexico is the only state to use a lock box for the receipt of checks from the payors. All other state programs including WTO receive and handle checks within their offices. (WTO is prohibited by state law from using a commercial lock box, but does receive approximately 50% of receipts by electronic funds transfer which, for control purposes, is equivalent to a lock box.) Each of the states and WTO, however, have other procedures (dual participation in opening the mail, prelisting of cash receipts, etc.) designed to ensure that all cash received is deposited.

Take In-Kind Programs

Take in-kind programs historically have increased royalty revenues by creating competition among bidders for a higher price. WTO and the Texas General Land Office are the only agencies with significant take in-kind programs. The Texas General Land Office takes in-kind approximately 45% of its royalty oil and 37% of its royalty gas. Similar amounts for WTO are 60% of oil and 7% of gas.

Audits

Performing audits on operators and payors is a desirable internal control procedure because it tends to increase operator and payor compliance. Neither New Mexico nor Wyoming have a strategy for performing field audits or site visits of their payors. Both have the ability to perform a field audit if necessary, but feel this procedure is not vital to their internal accounting controls. New Mexico, however, is engaged in a strategy to perform an in-house audit on 100% of the non-arms length transactions from 1985-1995. Louisiana, the Texas General Land Office and WTO have developed a strategy for conducting field audits based on major revenue payors/fields, risk issues and input from surface lessors and other interested parties.

Processing Efficiencies

The survey form did not specifically request information about automated systems. Louisiana and New Mexico's, however, mentioned an automated process which is not currently in use at WTO. That process is receipt of a significant percent of production data by electronic data transmission.

Other Internal Controls

Each state was asked to list any other procedure they used which help ensure that all royalties are received. The following information was listed:

Texas General Land Office - active pursuit of market value issues, pricing litigation, contract settlements and re-engineering business processes.

Louisiana - monthly reports are generated which list properties with no income; leases with no income for 90 days are referred to volume audit section.

New Mexico - all entities who move oil and gas on state land must obtain a Production Unit Number (PUN) from another agency. The PUN is compared to leases on which royalties have been received and an exception report is generated if no income has been received; in addition, the payor must designate whether the transaction is an arms-length or a non-arms length purchase. (For arms-length transactions, production volumes are verified through the operator disposition reports which can be reconciled through the first transporter volume reports at designated points of disposition.)

WTO has similar procedures in effect for all items mentioned above except for the procedure in New Mexico where the payor must certify whether the transaction is an arms-length purchase.

This report is intended solely for the information of WTO and the University of Texas System and should not be used for any other purpose. However, this report is a matter of public record and distribution is not limited.

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It has been a pleasure to serve the University of Texas System through this project. If you have any questions or need further information please call William O. Strange, Partner, at (713) 756-2525.

Deloitte & Touche LLP
Deloitte & Touche LLP

APPENDIX A: BLANK SURVEY

OIL, GAS AND PLANT PRODUCTS SURVEY

UNIVERSITY OF TEXAS - LANDS ACCOUNTING OFFICE

INTERNAL ACCOUNTING CONTROL SURVEY - State of _____

General Information as of _____ (latest fiscal year-end--indicate date):

- Number of oil/gas mineral leases
 - Producing
 - Non-producing
- Number of oil/gas wells
 - Producing
 - Non-producing
- Number of oil/gas royalty checks received per month
- Number of employees involved in accounting for oil/gas royalties

Is information received directly from the operator regarding

- Quantity of oil, gas and/or plant products produced (or sold--indicate which or both)
- Do operators also supply copies of delivery or purchaser statements to support the quantity listed as sold
- Dollar value of production
- Is information at the 8/8 level and/or at the royalty percentage level
- Is a royalty rate verification performed. Is it manual or electronic.
- When is information due from operator
- Is information due monthly
- Is any information received electronically
- Is information recorded into a "permanent system"

- Are there information checks or edits before recording (what is checked)

Is the production information received from operators mentioned above later compared with other filings made by the operator to the state regulatory agency

- Indicate the extent of comparison, if not for all leases for all months
- How soon performed
- Is the comparison done manually or by computer
- Is the comparison done on a monthly, quarterly or annual basis
- Are immaterial differences ignored. If so, what is definition of immaterial.

Control Over Cash Receipts of Royalties from Purchasers/Payors

- Is a lock box used
- Are royalties checks received separate from other mail
- If not, is there dual participation in opening mail and check handling until a prelist of cash receipts or check log is prepared
- Are royalty checks handled singly at any point by persons who also post cash receipt entries

Is the Cash Receipt of Royalties from Purchasers/Payors compared with the information previously received from the operator

- Is comparison manual or by computer
- Is comparison done monthly, quarterly or annually
- How soon after receipt is comparison made (how long after the end of the monthly, quarterly or annual period before the comparison is complete)
- Is comparison by lease, or by purchaser/payor
- Are immaterial differences ignored (what is considered immaterial)
- Are purchasers/payors or operators charged interest for late payments

Take In-kind Program

Is there a “take in kind” program for

- oil
- gas
- plant products

What percent of total royalty production is sold under “take in kind” program

- oil
- gas
- plant products

What is basis for selecting leases for take in kind sales

- oil
- gas
- plant products

What is basis for selecting purchasers/payors for take in kind sales (negotiation, competitive bidding, etc.)

- oil
- gas
- plant products

Audits

Are operators and/or purchasers/payors audited by site visits

- How selected
- How often
- What information is checked

- Annual hours spent on auditing

What other procedures contribute to ensuring that all royalties that should be received are received. (Describe.)

APPENDIX B: SURVEY - STATE OF TEXAS (TEXAS GENERAL LAND OFFICE)

OIL, GAS AND PLANT PRODUCTS SURVEY

UNIVERSITY OF TEXAS - LANDS ACCOUNTING OFFICE

INTERNAL ACCOUNTING CONTROL SURVEY - State of Texas

General Information as of August 31, 1995 (latest fiscal year-end--indicate date):

- Number of oil/gas mineral leases:
 - Producing 2,109
 - Non-producing 891
- Number of oil/gas wells
Approximately 15,000. Wells are plotted on statewide maps, but are not tabulated at regular intervals.
 - Producing
 - Non-producing
- Number of oil/gas royalty checks received per month
Approximately 850 checks per month during fiscal '95. We are currently receiving approximately 1,000 per month. This is due to the increase in leasing during the past year and a half.
- Number of employees involved in accounting for oil/gas royalties

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Is information received directly from the operator regarding

- Quantity of oil, gas and/or plant products produced (or sold--indicate which or both)
Both quantity of oil, gas and/or plant products produced and sold are received.
- Do operators also supply copies of delivery or purchaser statements to support the quantity listed as sold
The GLO does not require this information. We are reviewing our process and will probably require this documentation in the near future.
- Dollar value of production
Yes.

- Is information at the 8/8 level and/or at the royalty percentage level
8/8 level, TIK is on a royalty percentage basis.
- Is a royalty rate verification performed. Is it manual or electronic.
Verification is performed manually.
- When is information due from operator
**Oil is due on the 5th day of the second month succeeding the month of production.
Gas is due on the 15th day of the second month succeeding the month of production.**
- Is information due monthly
Yes.
- Is any information received electronically
Yes.
- Is information recorded into a “permanent system”
Yes.
- Are there information checks or edits before recording (what is checked)
Yes. Header information, royalty percentage, and a calculation is performed of volume X price and value X royalty percentage. A check is also made that the operator is accounting for all production.

Is the production information received from operators mentioned above later compared with other filings made by the operator to the state regulatory agency

Yes. We compare volume information reported to the GLO to volume information reported to the Texas Railroad Commission. (All leases for all months)

- Indicate the extent of comparison, if not for all leases for all months
- How soon performed
During the fiscal year reconciliation.
- Is the comparison done manually or by computer
Manual
- Is the comparison done on a monthly, quarterly or annual basis
Annual
- Are immaterial differences ignored. If so, what is definition of immaterial
Yes. If the difference of volumes X price X royalty percentage is less than \$10.00 royalty due, it is ignored. However, if any disposition that should be reported is not, (i.e. lease use, vented/flared, etc.) we notify the operator this should be reported and royalty is due.

Control Over Cash Receipts of Royalties from Purchasers/Payors

- Is a lock box used
No. It is currently being considered.
- Are royalties checks received separate from other mail
No.
- If not, is there dual participation in opening mail and check handling until a prelist of cash receipts or check log is prepared
Yes.
- Are royalty checks handled singly at any point by persons who also post cash receipt entries
No.

Is the Cash Receipt of Royalties from Purchasers/Payors compared with the information previously received from the operator

Yes, during the annual reconciliation.

- Is comparison manual or by computer
Manual.
- Is comparison done monthly, quarterly or annually
Annually.
- How soon after receipt is comparison made (how long after the end of the monthly, quarterly or annual period before the comparison is complete)
This starts four to five months after the end of the fiscal year.
- Is comparison by lease, or by purchaser/payor
Comparisons/reconciliations are performed on a lease basis.
- Are immaterial differences ignored (what is considered immaterial)
If over the course of a fiscal year the royalty due is less than \$100.00 we will not issue a bill.
- Are purchasers/payors or operators charged interest for late payments
A 5% penalty on royalties received one to 30 days late.
A 10% penalty on royalties that are more than 30 days late.
The minimum penalty for each month is \$25.00.
Interest at a rate of 12% per year accrues on all delinquent royalties beginning 60 days after the due date.

Take In-kind Program

Is there a “take in kind” program for:

- oil **Yes.**
- gas **Yes.**
- plant products **No.**

What percent of total royalty production is sold under “take in kind” program

- oil **45%**
- gas **37%**
- plant products

What is basis for selecting leases for take in kind sales

- oil
 Bid price must be higher than current royalty price.
- gas
 Several factors are reviewed: amount of production; current royalty price; and location.
- plant products

What is basis for selecting purchasers/payors for take in kind sales (negotiation, competitive bidding, etc.)

- oil
 Competitive bid process.
- gas
 Competitive bids for spot sales are selected to purchase state gas based on the quantity used and price paid.
- plant products **N/A.**

Audits

Are operators and/or purchasers/payors audited by site visits

- How selected

The company selection process which has been used within the Royalty Audit division of the Energy Resources Program area was initially developed in 1985 at the inception of the field audit initiative. When this division was formed in 1985, the strategy for conducting on-site (field) audits with maximum revenue generation was to focus on the top 60 royalty payors to the GLO covering the periods of September 1980 to March 1985. It was recognized at the formation of the division that merely focusing on the top 60 payors should not be the only element in our company selection process. In 1986, the audit division incorporated other parameters including audit leads from reviews of GLO field inspectors. Since that time, we have also added those leads which come from the general public.

- How often

A specific time frame has not been established concerning the frequency of auditing a particular company. Only a few companies have received greater than one audit as we continue to focus on the top 60 royalty payors and other leads as outlined above.

- What information is checked

Every component which has an impact upon our royalty remittance: Volume, Price and interest factors. We review the field operations, the accounting operations, contract data, and all issues which we have found to be an area of concern as we have established our history (i.e., market value, contract settlements, etc.).

- Annual hours spent on auditing

Because of the aggressive stance the agency has taken on various issues which significantly impact our royalty payments (i.e., market value, oil litigation, contract settlements), the division is unable to expeditiously isolate hours that purely represent those devoted to our regular audit function. The auditing staff had dedicated hours to not only auditing, but also the numerous other initiatives which we as an agency have deemed appropriate and necessary in ensuring lease compliance and revenue enhancements.

What other procedures contribute to ensuring that all royalties that should be received are received. (Describe.)

In addition to the regular tasks associated with our leasing, royalty management and royalty audit functions, we pursue market value issues, pricing litigation, contract settlements, and are continually re-engineering to better our process.

APPENDIX C: SURVEY - STATE OF LOUISIANA

OIL, GAS AND PLANT PRODUCTS SURVEY

UNIVERSITY OF TEXAS - LANDS ACCOUNTING OFFICE

INTERNAL ACCOUNTING CONTROL SURVEY - State of Louisiana

General Information as of June 30 1996:

- Number of oil/gas mineral leases:
 - Producing **977**
 - Non-producing **705**
- Number of oil/gas wells
 - Producing **N/A, records not maintained due to number of unitizations.**
 - Non-producing **N/A, records not maintained due to number of unitizations.**
- Number of oil/gas royalty checks received per month
 350 payors with usually one check per payor.
- Number of employees involved in accounting for oil/gas royalties
 **23 in the Mineral Income Division (MID),
 total of 60 for the preservation and monitoring of lands.**

Is information received directly from the operator regarding:

- Quantity of oil, gas and/or plant products produced (or sold--indicate which or both)
 The MID receives a "royalty report" containing the sales volumes from the payor on a monthly basis. Depending upon the lease, the payor may be the lessee, the purchaser of production, or the operator. Volumes are not reported nor are royalties payable until the production has been sold. Production data is received by the office of Conservation (OOC) on a monthly basis. As the MID and the Office of Conservation share a database, the information is available to the MID upon request.
- Do operators also supply copies of delivery or purchaser statements to support the quantity listed as sold.
 No, neither operators, nor payors, are required to submit supporting documents for the amounts sold or produced. However, the OOC does require production data, as well as transport, storage, delivery and other source documents. The OOC then reconciles the various source documents to verify that the amounts reported are accurate.

- Dollar value of production
Yes, the royalty reports include volume, gross price and severance tax, less costs and are used to recalculate the net value.
- Is information at the 8/8 level and/or at the royalty percentage level
Yes, with some exceptions for specific circumstances.
- Is a royalty rate verification performed. Is it manual or electronic.
Royalty rate verification is performed automatically during the system edits process which occurs with the receipt of the royalty reports. Approximately 80% of the royalty reports are received monthly via magnetic tape and are downloaded to the LOMIS system. The remaining royalty reports are received manually and input in the system. The electronic royalty rate verification is performed upon input.
- When is information due from operator.
The information is due from the payor on the 25th of the month following disposition for oil, and on the 25th of the 2nd month for gas and gas products.
- Is information due monthly
Yes
- Is any information received electronically
The majority of the information is received via magnetic tape.
- Is information recorded into a "permanent system"
The MID uses the LOMIS mainframe system to accumulate and store all information related to the leases.
- Are there information checks or edits before recording (what is checked)
Yes, a series of checks and edits are performed every month automatically by the LOMIS system. The exception reports generated by this process are followed up on by the in-house audit section. After the checks and edits are performed all information is recorded to the system. All transactions which contain exceptions are held in suspense accounts until the exception is cleared and the amounts can be allocated to a specific account.

Is the production information received from operators mentioned above later compared with other filings made by the operator to the state regulatory agency

- Indicate the extent of comparison, if not for all leases for all months
The audit section has the capability to generate a report from LOMIS comparing the sales amounts recorded per the royalty report with the amount reported to the OOC. When generated, the auditors usually review quarterly intervals after the end of the year, and work to clear any exceptions noted. The comparison is generated on a lease basis. During the past few years only a small percentage of the leases have actually been reconciled.

- How soon performed
As close to year-end as possible.
- Is the comparison done manually or by computer
Report is generated by computer and the variances are cleared by the audit department.
- Is the comparison done on a monthly, quarterly or annual basis
Usually review on a quarterly basis.
- Are immaterial differences ignored. If so, what is definition of immaterial.
Anything less than \$50 is considered immaterial. However, the auditors have the ability to use their judgment in many cases. All write-offs are approved by the manager of the audit section.

Control Over Cash Receipts of Royalties from Purchasers/Payors

- Is a lock box used
No, checks are received in the regular mail and sorted by the mail department. However, approximately 80% of the payments are received via wire transfer.
- Are royalties checks received separate from other mail
No.
- If not, is there dual participation in opening mail and check handling until a prelist of cash receipts or check log is prepared
No, the mail department is staffed by one individual who sorts the mail and delivers it to the appropriate department. In the MID department, one individual is responsible for sorting the mail and preparing a list of checks received.
- Are royalty checks handled singly at any point by persons who also post cash receipt entries
No.

Is the Cash Receipt of Royalties from Purchasers/Payors compared with the information previously received from the operator

- Is comparison manual or by computer
The computer automatically balances the amount reported per the royalty report to the wire transfers received. The balancing is done at the payor level as one wire transfer is usually received per payor. In addition, the auditors are responsible for 70 payors each. One of their responsibilities includes investigating and resolving any differences in the amount received from that stated on the royalty report.
- Is comparison done monthly, quarterly or annually.
Comparison is performed nightly.

- How soon after receipt is comparison made (how long after the end of the monthly, quarterly or annual period before the comparison is complete)
- Is comparison by lease, or by purchaser/payor.
By payor.
- Are immaterial differences ignored (what is considered immaterial)
Auditor must resolve all differences.
- Are purchasers/payors or operators charged interest for late payments
Yes, flat rate of 10% of amount paid, not to exceed \$1,000. Legal interest and penalties are also required.

Take In-kind Program

N/A

Is there a “take in kind” program for:

- oil
- gas
- plant products

What percent of total royalty production is sold under “take in kind” program

- oil
- gas
- plant products

What is basis for selecting leases for take in kind sales

- oil
- gas
- plant products

What is basis for selecting purchasers/payors for take in kind sales (negotiation, competitive bidding, etc.)

- oil
- gas

- plant products

Audits

Are operators and/or purchasers/payors audited by site visits

- How selected

The goal is to audit the top 60 payors every 3 years. The top 60 payors represent approximately 80% of the gross revenue received by MID. Other factors such as risk, outstanding issues, and payment history also are considered when determining which companies to audit. MID also audits those companies not included in the group of top 60 payors if they deem it necessary.

- How often

Audits are performed annually.

- What information is checked

The auditors review field schematics, list of equipment in the field, purchase statements, sales contracts, affiliated sales and any other information deemed necessary to accomplish their objectives.

- Annual hours spent on auditing

Currently the field audit section has 6 FTEs. Of the 6 FTEs, 3 are located in Houston, 1 in Dallas, 1 in Tulsa and 1 in Baton Rouge. The 6 FTEs spend approximately 6240 hours a year auditing payors.

What other procedures contribute to ensuring that all royalties that should be received are received. (Describe.)

***Volume audit* - leases with no income for 90 days are referred to the volume audit section; this section is concerned with lease maintenance and releasing expired leases. Operates as a control to ensure all royalties due are received.**

***Monthly reports* - monthly reports are generated which list all properties with no income for that month.**

APPENDIX D: SURVEY - STATE OF WYOMING

OIL, GAS AND PLANT PRODUCTS SURVEY

UNIVERSITY OF TEXAS - LANDS ACCOUNTING OFFICE

INTERNAL ACCOUNTING CONTROL SURVEY - State of Wyoming

General Information as of June 30, 1995 (latest fiscal year-end--indicate date):

- Number of oil/gas mineral leases:
 - Producing 765
 - Non-producing 3,164
- Number of oil/gas wells
 - Producing
 - Non-producing
- Number of oil/gas royalty checks received per month 240
- Number of employees involved in accounting for oil/gas royalties 12.5

Is information received directly from the operator regarding:

- Quantity of oil, gas and/or plant products produced (or sold--indicate which or both)

The State Land and Farm Loan Office (LO) receives an M1 or M2 and an M4 detailing production and other information. The M1 includes the volume value, price and royalty amount and is used for individual leases where a unitization or other joint operating agreements are not involved. The M2 is the equivalent of the M1 for leases involving a unitization. The M2 also includes the track percentage for the lease that is included in the unitization. The M4 is received for each unit and details the monthly sales from the unit.

- Do operators also supply copies of delivery or purchaser statements to support the quantity listed as sold Yes
- Dollar value of production
 Yes, amount is then reconciled to the purchase statements.
- Is information at the 8/8 level and/or at the royalty percentage level

Information is submitted on the royalty percentage level and will be reconciled to the tract allocation for unitizations.

- Is a royalty rate verification performed. Is it manual or electronic.

Manual, royalty rate is verified against lease file and rates per the M1 or M2.

- When is information due from operator

All statements relating to oil are due in 30 days after month of production, and gas is due in after 60 days subsequent to the month of production.

- Is information due monthly

Yes, both purchase statements and the monthly sales reports are due monthly.

- Is any information received electronically

Currently, Amoco is the only payor which submits their monthly sales reports electronically. It is anticipated that additional payors will submit electronically in the future.

- Is information recorded into a "permanent system"

No, currently LO does not record their production statements to a permanent system. However, the royalty checks and the supporting detail that are received with payments are recorded into the computer system. State statute requires the payors to submit supporting detail for the amounts paid. Some payors submit the M1 or M2 as the supporting detail. In this case, the M1 or M1 are then input in the accounting system. In other cases a spreadsheet detailing production will usually be submitted and subsequently input into the permanent system.

- Are there information checks or edits before recording (what is checked)

Yes, to successfully input payment information into the permanent system, the amounts recorded must include a valid property ID# and lease #. The system will then recalculate the royalty percentage received based on the percentages stored in the system and the total volume reported with the payment. An exception report is created for all amounts kicked out during the edit process.

Is the production information received from operators mentioned above later compared with other filings made by the operator to the state regulatory agency

The Oil and Gas Conservation Commission (OGCC) receives all production volumes and values from the operators. The OGCC does not receive information on storage and transport volumes. The OGCC provides the LO access to the information submitted by the operators, usually in the form of printed out production reports.

- Indicate the extent of comparison, if not for all leases for all months

The LO does not have an established time frame for reviewing the amounts reported on the M1 or M2 with the amounts reported to the OGCC. However, when a comparison is made the scope usually includes all activity for the prior six months and will be performed for all leases.

- How soon performed

Ideally, the comparison will be performed six months after the date of production.

Is the comparison done manually or by computer

The comparison is a manual process consisting of a review of the production reports from the OGCC with the production reports from the LO.

- Is the comparison done on a monthly, quarterly or annual basis

Performed on a semi-annual basis.

- Are immaterial differences ignored. If so, what is definition of immaterial.

Yes, however, a materiality threshold has not been established.

Control Over Cash Receipts of Royalties from Purchasers/Payors

- Is a lock box used

No, all checks are received by the state office and sorted for the various state agencies within the building. The mail is then delivered to the LO and check is logged into a check log and copies are made of the check. The original check is then delivered to the state treasurer and the check copy is forwarded to accounting for entry.

- Are royalties checks received separate from other mail

No.

- If not, is there dual participation in opening mail and check handling until a prelist of cash receipts or check log is prepared

No, once received by the LO, one person handles all check sorting and prepares the check log.

- Are royalty checks handled singly at any point by persons who also post cash receipt entries

Yes, the person preparing the check log and sorting the check also performs data entry operations.

Is the Cash Receipt of Royalties from Purchasers/Payors compared with the information previously received from the operator

Yes, when the M1 and M2s are received the amount received is then added to the M1 or M2 for comparison purposes.

- Is comparison manual or by computer

The process is manual and consists of comparing the amounts recorded on the check detail report with the amounts stated on the M1 or M2.

- Is comparison done monthly, quarterly or annually

Comparison is performed on a monthly basis.

- How soon after receipt is comparison made (how long after the end of the monthly, quarterly or annual period before the comparison is complete)

Comparison is made approximately one month after the end of the period.

- Is comparison by lease, or by purchaser/payor

Comparison is by unit if a unitization is involved or a lease if not.

- Are immaterial differences ignored (what is considered immaterial)

Yes, however, immaterial would be less than \$5.

- Are purchasers/payors or operators charged interest for late payments

Yes, interest is charge for late payments and penalties are charged for improper or late reporting.

Take In-kind Program

The take-in-kind program involves one payor for a unitization containing 11 leases.

Is there a "take in kind" program for:

- oil **All TIK is in the form of oil.**
- gas
- plant products

What percent of total royalty production is sold under "take in kind" program

- oil **Less than 1%.**

- gas
- plant products

What is basis for selecting leases for take in kind sales

- oil
- **Currently, there is no consistent basis for taking oil in kind. The only participant in the program was a volunteer who was granted this opportunity because he was a small refiner in need of a stable supply of production to remain viable.**
- gas
- plant products

What is basis for selecting purchasers/payors for take in kind sales (negotiation, competitive bidding, etc.)

N/A

- oil
- gas
- plant products

Audits

Are operators and/or purchasers/payors audited by site visits

The Department of Audit performs field audits in concurrence with the federal audits. These audits consist of a review of all available information in the LO and a site visit.

- How selected **The companies to review are selected based a risk analysis.**
- How often **As necessary.**
- What information is checked **Amounts received by the OGCC are compared with amounts reported to the LO and compared with the findings of the site visit.**
- Annual hours spent on auditing **Unknown**

What other procedures contribute to ensuring that all royalties that should be received are received. (Describe.) **None noted.**

APPENDIX E: SURVEY - STATE OF NEW MEXICO

OIL, GAS AND PLANT PRODUCTS SURVEY

UNIVERSITY OF TEXAS - LANDS ACCOUNTING OFFICE

INTERNAL ACCOUNTING CONTROL SURVEY - State of New Mexico.

General Information as of June 30, 1996 (latest fiscal year-end--indicate date):

- Number of oil/gas mineral leases:
 - Producing **5,000**
 - Non-producing **2,960**
- Number of oil/gas wells
 - Producing **22,000 wells in which the state has an economic interest.**
 - Non-producing **Unknown**
- Number of oil/gas royalty checks received per month
Approximately 1 per payor or 500 per month.
- Number of employees involved in accounting for oil/gas royalties
4 from the tax department involved in data entry, 2 in the general accounting office and 20 in the royalty management division.

Is information received directly from the operator regarding:

Each month the payors submit an OGR-1 and OGR-2. The OGR-1 is similar to a remittance advice and is included with the payment. The OGR-2 represents their royalty report and is identified by the Production Unit Number ("PUN"). A production unit number is assigned to each common operator, common property name, pool or unitization.

- Quantity of oil, gas and/or plant products produced (or sold--indicate which or both)
The OGR-2 includes the following data elements:
PUN, Lease #, Product code, transaction code, arm's length transaction (yes, no), volume-BBL/MCF, volume-NGL gallon, BTU- content of gas, gross proceeds, deductions, state royalty, interest, NGL credit additions, lease credit no., lease credit amount.

- Do operators also supply copies of delivery or purchaser statements to support the quantity listed as sold
Additional source documents are not required, however, arms-length transactions can be verified through the OCD operator disposition reports (C115) which can be reconciled through the first transporter volume reports (C111 or C112) at designated points of disposition through the ONGARD system.
- Dollar value of production
Yes.
- Is information at the 8/8 level and/or at the royalty percentage level.
Information is submitted at the gross volume level on the OGR-2 and royalty is calculated from the data.
- Is a royalty rate verification performed. Is it manual or electronic.
The royalty rate verification is a fully automated function of the ONGARD computer system. After all information has been received electronically, or input, the ONGARD system recalculates the proceeds due the state using the royalty rate that is stored as a part of the permanent PUN file.
- When is information due from operator
The OGR-2 for both oil and gas are due in the State Land Office (SLO) on the 25th of the second month following production.
- Is information due monthly
Yes.
- Is any information received electronically
60% of all payors submit electronically and pay via wire transfer. The remaining payors submit manually completed forms which is subsequently input by the tax department.
- Is information recorded into a “permanent system”
Yes, all information received is stored in a permanent database within the ONGARD mainframe system.
- Are there information checks or edits before recording (what is checked)
Yes, the ONGARD system performs a number of edits and checks including verification of PUN #, remitter, and royalty verification prior to allocating the specific payments to the appropriate account. The system distinguishes between critical and non-critical errors. Production is allocated to specific accounts for non-critical errors and a letter is generated to be mailed to the payor. All amounts relating to critical errors are held in suspense accounts until the issue is resolved.

the production information received from operators mentioned above later compared with other
logs made by the operator to the state regulatory agency

Indicate the extent of comparison, if not for all leases for all months

Currently, the Audit & Compliance group is performing audits on amounts reported to the state office against what was reported per the OGR-2 for the prior 12 years. In the past, no reconciliation was performed. In the future, the reconciliation will be performed automatically by the ONGARD system and the Audit & Compliance group will only investigate exceptions. The automated system is projected to be operating within a year.

How soon performed

The automated system will be performed monthly.

Is the comparison done manually or by computer

Computer

Is the comparison done on a monthly, quarterly or annual basis

Monthly

Are immaterial differences ignored. If so, what is definition of immaterial.

Yes, the program is designed only to report differences greater than \$100.

Control Over Cash Receipts of Royalties from Purchasers/Payors

N/A. All payments are received and handled by the State Treasury and its fiscal agent for EFT funds (60%), or the Taxation and Revenue Department for checks and drafts (40%).

Is a lock box used

Are royalties checks received separate from other mail

If not, is there dual participation in opening mail and check handling until a prelist of cash receipts or check log is prepared

Are royalty checks handled singly at any point by persons who also post cash receipt entries

Are Cash Receipts of Royalties from Purchasers/Payors compared with the information previously received from the operator

A reconciliation is performed of the OGR-1s, the deposit slips, and the OGR-2. The OGR-1 is received with the payment by the state treasury and forwarded with the deposit slip to the SLO. A reconciliation is then performed between the three documents.

- Is comparison manual or by computer
Reconciliation is generated by the computer and reviewed manually by the in-house auditor.
- Is comparison done monthly, quarterly or annually
Report is generated daily.
- How soon after receipt is comparison made (how long after the end of the monthly, quarterly or annual period before the comparison is complete)
Any errors are detected within 10 to 15 days.
- Is comparison by lease, or by purchaser/payor
Comparison is performed on a payor basis.
- Are immaterial differences ignored (what is considered immaterial)
No, all differences are investigated.
- Are purchasers/payors or operators charged interest for late payments
Payors are required to pay up to 15% interest for late payments, however, no penalties are assessed.

Take In-kind Program **No, N/A.**

Is there a "take in kind" program for:

- oil
- gas
- plant products

What percent of total royalty production is sold under "take in kind" program

- oil
- gas
- plant products

What is basis for selecting leases for take in kind sales

- oil
- gas
- plant products

What is basis for selecting purchasers/payors for take in kind sales (negotiation, competitive bidding, etc.)

- oil
- gas
- plant products

Audits

Are operators and/or purchasers/payors audited by site visits

No, currently, the SLO does not perform on-site company audits or field audits.

- How selected
- How often
- What information is checked
- Annual hours spent on auditing

What other procedures contribute to ensuring that all royalties that should be received are received. (Describe.)

As a control to ensure the completeness of all activity on state lands, the SLO monitors activities on state lands whether they are leased or unleased. In addition, the state requires all entities who move oil and gas on state lands obtain the states authority. Upon granting of authority to move production the state generates a PUN. The PUN is then reconciled against the active leases managed by the state land office. An exception report is generated which notifies the SLO of any activity where an OGR-2 has not been received.