EXECUTIVE DIGEST

OIL AND NATURAL GAS PRODUCTION REPORTING

INTRODUCTION

This report, issued in July 1998, contains the results of our performance audit* of Oil and Natural Gas* Production Reporting.

AUDIT PURPOSE

This performance audit was conducted as part of the constitutional responsibility of the Office of the Auditor General. Performance audits are conducted on a priority basis related to the potential for improving effectiveness* and efficiency*.

BACKGROUND

Oil and natural gas producers report information on production in Michigan to four State agencies: the Real Estate Division, Department of Natural Resources (DNR); the Motor Fuel, Tobacco, and Miscellaneous Taxes Division, Department of Treasury; the Geological Survey Division, Department of Environmental Quality (DEQ); and the Public Service Commission, Department of Consumer and Industry Services (DCIS).

DNR uses production information to verify the amount of royalties* paid to the State for production from State-owned mineral rights. The Department of Treasury uses production information in connection with its administration of the Michigan Severance Tax Act. DEQ uses oil and natural gas production information to monitor production from prorated oil wells*. DEQ also uses the information for geological and environmental purposes. DCIS uses gas production information to monitor production from all gas wells* and casinghead gas* fields.

AUDIT OBJECTIVES, CONCLUSIONS, AND NOTEWORTHY ACCOMPLISHMENTS

Audit Objective: To determine the effectiveness of controls over State oil and natural gas mineral rights leasing, royalty payments due the State for oil and natural gas production, and severance tax and surveillance fee payments for oil and natural gas produced in Michigan.

Conclusion: We concluded that the controls over State oil and mineral rights leasing, royalty payments due the State for oil and natural gas production, and severance tax and surveillance fee payments for oil and natural gas produced in Michigan were not effective. We noted reportable conditions* relating to coordination of roles, royalty production reporting, monitoring of royalty remittances, revenue verification, DNR audits, the Real Estate Information System, and monitoring of severance tax collection (Findings 1 through 7).

Noteworthy Accomplishments: In 1996, DNR began conducting audits of post-production costs* claimed by the operators* of Antrim natural gas* wells in which the State had a royalty interest. At the time of our audit, audits of five operators had been completed. As a result of these audits, DNR had recovered $480,926 of improper post-production costs. Three additional audits were in process. DNR's plan is to audit all operators of Antrim natural gas wells in which the State has a royalty interest.

Audit Objective: To assess the completeness and accuracy of reported oil and natural gas production data.

Conclusion: We concluded that the oil and natural gas production data reported to each of the departments was reasonably complete and accurate. We noted reportable conditions relating to royalty production reporting (Finding 2) and monitoring of royalty remittances (Finding 3). These findings are reported under the effectiveness of controls objective of this report.

Audit Objective: To determine the efficiency of the State system for receiving oil and natural gas production data.

Conclusion: We concluded that the State system for receiving oil and natural gas production data was not efficient. We noted one material condition* :

- Oil and natural gas producers reported production data separately to each of the four departments involved in oil and natural gas matters in a hard copy (paper) format. As a result, some data was reported to each department and other information that could have been used by several agencies was reported to only one. In addition, each department maintained its own data base and little comparison or sharing of reported data between departments occurred (Finding 8).

  All four departments agreed with this recommendation.

AUDIT SCOPE AND METHODOLOGY

Our audit scope was to examine the program and other records of the Real Estate Division, Department of Natural

Resources; the Motor Fuel, Tobacco, and Miscellaneous Taxes Division, Department of Treasury; the Geological Survey Division, Department of Environmental Quality; and the Public Service Commission, Department of Consumer and Industry Services, relating to oil and natural gas production. Our audit was conducted in accordance with *Government Auditing Standards* issued by the Comptroller General of the United States and, accordingly, included such tests of the records and such other auditing procedures as we considered necessary in the circumstances.

Our audit procedures included examinations of program records and activities for the period October 1, 1994 through June 30, 1997.

We reviewed and evaluated internal controls related to royalty payments, severance tax payments, and surveillance fee payments. We reviewed the DNR lease* to determine if the lease provisions adequately protect the State's interests. We tested records for selected production units to determine that production was reported consistently to each department and that royalties, severance taxes, and surveillance fees were paid based on reported quantities.

AGENCY RESPONSES

Our audit report contains 8 findings and 10 related recommendations. DNR agreed with the 9 recommendations which applied to it. The Department of Treasury agreed with the 4 recommendations which applied to it. DEQ agreed with the 3 recommendations which applied to it. DCIS agreed with the 3 recommendations which applied to it.