

NM STATE LAND OFFICE

Royalty Management Division



Industry Training 2023

Disclaimer

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Royalty Management Division

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NM STATE LAND OFFICE

Audit Bureau

Industry Training 2023



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AUDITOR	
Nutritional Facts	
Serving Size: 1 Amazing Person	
% Daily Value	
Hard Working	100%
Passion	100%
Determination	100%
Caring	100%
Respect	100%
Caffeine	100%
Regret	0%
*These facts are 100% correct	

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Agenda

- Goals of the Audit
- Scope Selection
- Types of Audits
- What to Expect During an Audit
- Audit Challenges
- Deductions
- Completion of an Audit



Goals of the Audit

- To ensure the Trust Beneficiaries get their fair share of royalties
 - 22 Beneficiaries comprised of the following:
 - Common Schools, Hospitals, Universities & Community Institutions
- Working together with industry to ensure that the royalties have been correctly remitted and allocated to the respective leases.
 - Each lease is linked to a specific beneficiary
- Compliance with Contract Terms (Lease/Cooperative Agreement)
- Customer Education/Support



Audit Selection

The Audit Bureau's goal is to audit 80% of royalties in 4 to 5 year cycles

- Company Selection
 - Random Selection
 - Major focus is on the larger and midsize companies
 - Some selection of smaller companies
 - Business Relationships
 - Close Out
 - Mergers/Name Changes
 - Affiliations/Joint Ventures
 - Other Field Audits & Referrals
 - When auditing an entity where there is shared interest property(s) and variances are identified
 - Interagency referrals, including required compliance review prior to refunds

Types of Audits

- Desk Audit
 - Smaller companies OR select properties identified through a prior audit of another company OR referral
 - Scope **not** large enough to warrant travel to the company
- Field Audit
 - Scope large enough to warrant travel to the company
 - Auditors on site for one or two weeks
- Trespass Royalties
 - Identified production without an active Unit/Comm agreement or Lease Contract
 - Royalties due on these schedules is 100% of value
 - Look out for Termination Notices on PUN(s) or Contracts
 - Upon filing a return a PUN error may result and remitted royalties will go into suspense

Pre-Audit

Both Field and Desk Audits begin with the following pre-audit procedures:

- Volume Review- Review volumes reported on the C-115 and Severance Tax returns to volumes reported on the OGR2, factoring in the State's Net Interest (SNI)
- Value Review- Review of gross/net proceeds as well as per volume values reported to the NMSLO in comparison to the values reported to Taxation and Revenue
- Wellhead Price Review- A per volume value comparison to other remitters and other properties in same field or area
- Deduction Review- % of Gross Proceeds, comparison to other remitters and other properties in same field or area

Volume Comparison

- Volume Comparison Report



SALE YEAR	SALE MONTH	PROP PUN	PROP NAME	POOL IDN	C115 DISPOSITION	SNI	SNI VOLUME	ROYALTY VOLUME	ROYALTY DIFF	TAX VOLUME	TAX DIFF
2023	01	1234567	TRAINING	4567	1,000	100	1,000	500	500	1,000	0
					OCD		NMSLO		AUDIT		

SALE YEAR	SALE MONTH	PROP PUN	PROP NAME	POOL IDN	C115 DISPOSITION	SNI	SNI VOLUME	ROYALTY VOLUME	ROYALTY DIFF	TAX VOLUME	TAX DIFF
2023	01	1234567	TRAINING	4567	1,000	50	500	500	0	1,000	0
					OCD	↑	NMSLO				

Value Review

Example 1

Volume Review

PUN	PROP NAME	MTHYR	SNI VOLUME	ROYALTY VOLUME	ROYALTY DIFF	TAX VOLUME	TAX DIFF
1234567	TRAINING	Feb-21	1,000	675	325	1,000	-

Value Review

PUN	PROP NAME	MTHYR	VOLUME	GRS VALUE	ROYALTY GRS PRICE	TAX GRS VALUE	TAX GRS PRICE
1234567	TRAINING	Feb-21	675	\$ 2,000	\$ 2.96	\$ 2,000	\$ 2.00

- Volumetric discrepancy
- Price/MCF differs but gross proceeds match
 - No monetary audit finding
 - Underreported volumes
 - -0- MCF reported on product code 7
 - Amended reporting necessary

Example 2

Volume Review

PUN	PROP NAME	MTHYR	SNI VOLUME	ROYALTY VOLUME	ROYALTY DIFF	TAX VOLUME	TAX DIFF
1234567	TRAINING	Feb-21	1,000	675	325	1,000	-

Value Review

PUN	PROP NAME	MTHYR	VOLUME	GRS VALUE	ROYALTY GRS PRICE	TAX GRS VALUE	TAX GRS PRICE
1234567	TRAINING	Feb-21	675	\$ 1,350	\$ 2.00	\$ 2,000	\$ 2.00

- Volume discrepancy
- Price/MCF matches but gross proceeds differs
- Audit needed

Variances Review

- Common Causes:

- 1) Underreported volumes due to -0- MCF reported on product code 7 line
- 2) No reporting on Negative Gross Revenue
- 3) No reporting on Negative Net Revenue
- 4) No reporting on newly acquired properties
- 5) Reporting on incorrect basis – Takes/Entitlements
- 6) Reporting to incorrect:
 - a) SNI
 - b) PUN
 - c) Product Code
 - d) Allocation
 - e) Pressure Base



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What to Expect



Desk Audit - Overview

- The Auditor will:
 - 1) Inform the Company that they have been selected for a desk audit
 - 2) Provide draft schedules to the company for review
 - 3) Response is required on the draft schedules within 30 days
 - a) Company agreement – Move on to “Next Steps”
 - b) Company disagreement – Provide supporting documentation
 - 4) Final schedules will be provided
- Next Steps:
 - 1) The Company will file return(s) & remit payment
 - 2) Interest Assessment(s) will be generated
 - 3) Interest will be remitted

Typical Timeline of Field Audits

Audit Activity	Week 1	Week 2	Week 3	Week 4	Week 5	Week 6	Week 7	Week 8	Week 9	Week 10
Pre-Audit										
Field Work										
Post Audit										

- Pre-Audit – Scope Selection
 - One to three weeks
- Field Work
 - One to two weeks
 - Dates will be coordinated
- Post Audit
 - Two to six weeks

Of course this is dependent upon the size of the scope, complexity of the properties, and other factors.

Field Audit - Initial Contact

- The Auditor will inform the Company that they have been selected for audit and develop a schedule of tentative field audit dates
- Engagement Letter
 - Objective of the audit
 - Number of auditors
 - Request for sample package
 - Confirmation of field audit dates
 - Company questionnaire
 - A list of necessary documents

Document Preparation

- Files uploaded to an FTP site or hardcopies
 - Each property should have a separate folder
 - Relevant documents should be placed in that respective property's folder

At a **minimum** the following documents must be provided:

- ✓ Settlement Statements for all scoped properties and periods
- ✓ Allocation Schedules (if necessary)
- ✓ DOIs
- ✓ Contract Terms
- ✓ Cross-reference of wells and settlement statements (multiple statements and wells)
- ✓ Transportation and processing invoice statements
- ✓ Net back pricing and calculation methods



All documents used in your calculation of state royalties

Field Work

Discussion

- Opening conference
- Explanation of tests the auditors will perform
- Business practice questions
- Sample packet questions
- DOI walkthrough by the subject matter experts
- Company's system walkthrough



Testing

- Volume, proceeds, deductions



Closing Conference

- Explanation of the tests the auditors performed
- Explanation of findings
- Questions/concerns



Post Audit

- Issue letter
 - Indicating the completion of the field work
 - Deadline for response (30 days)
 - Instruction on amendments
- Detailed Narrative Report
 - Company information
 - System Summary
 - Audit procedures performed
 - Conclusion
- Findings
 - Summary of Exceptions
 - Detailed audit schedules



Deductions

- Allowable
 - Post production costs to make the product merchantable
- Non-Allowable
 - New Mexico Gas Processors Tax (NMGPT)
 - Low Volume Fees, Throughput Fees or Low Margin Fees
 - Penalties
 - Marketing fees
 - Any other costs incurred not related to make the product merchantable

Completion of the Audit

- The audit is completed when all state royalties and interest due are paid
 - Remember when amending returns, previously booked lines must be backed out as they were originally filed, **including the original transaction code**
 - Audit filings need to be booked with a **transaction code of 55**
- The NMSLO **does not** close audits
 - Therefore, no closing letter will be sent at the end of the audit
 - Properties can be re-audited if changes are made to them

Audit Challenges

- Operator Changes/Acquisitions
 - Effective dates of royalty burdens
- Takes vs. Entitlements
 - Takes - Uniform Land Owner, Beneficiary & Royalty Rate
 - Entitlements – Everything else - Methodology is similar to federal royalty
- Reporting to Incorrect PUN – Production Unit Number
 - Volume comparison imbalances
 - Over/under payment of royalties
 - Affect distribution to Trust Beneficiaries



Audit Challenges



Reporting to the incorrect PUN(s)

SALES YEAR	SALES MONTH	PUN	PROPERTY NAME	POOL	C115 DISPOSITION	SNI	SNI VOLUME	REMITTED VOLUME	DIFFERENCE
2020	2	1234567	TRAINING STATE	96830	94	100%	94	348	-254
2020	2	7654321	TRAINING STATE COM	51300	254	100%	254	0	254

- Total volumes between the two properties is 348 BBLs
- All 348 BBLs are remitted to PUN 1234567
- No reporting to PUN 7654321
 - Will be an audit finding resulting in a lot of work for both agencies
 - May result in an underpayment of royalties if lease rates are different
 - May result in beneficiaries being under paid if lease royalty rates are different

Audit Challenges



Reporting:

Value & No Volume, Incorrect Pressure Base or Wrong Product Code

- Volume comparison imbalances
- NM standard pressure base on gas = 15.025
- Double check product codes
 - Common product codes

Product Code	Type
1	Oil
2	Oil Condensate
4	Unprocessed Gas
3	Processed (Residue) Gas
7	Gas Plant Products
17	Carbon Dioxide Gas (CO2)

Audit Challenges

Production Date: November 2018
Statement Date: December 21, 2018

Accounting Date: December 2018
Run ID: 100066

A

301160.00

Settlement Summary

System	LOW	Component Value	Residue Value	Fees & Adjustments	Gross Value	Exempt Value						Net Value
Rate per MCF:	3.04579											
Rate per MMBTU:	2.38362	\$4,671.53	\$1,717.50	\$506.84	\$5,882.19	0.00	0.00	0.00	0.00	0.00	0.00	\$5,882.19

Wellhead Information

Component Settlement

	MCF	MMBTU		Theoretical Gallons	Fixed Recoveries	Allocated Gallons	Shrink MMBTU	Contract %	Settlement Gallons	Price	Component Value
Gross WH :	1,931.25	2,467.75									
Allocation Decimal:	1.000000	1.000000									
Paystation:	1,931.25	2,467.75	ETHANE	7,320.75	0.7500	5,490.56	364.24	87.50	4,804.24	0.1868140	\$897.50
			PROPANE	3,581.64	0.9000	3,223.48	295.15	87.50	2,820.55	0.6051890	\$1,706.96
Contractual Field Deducts:	-125.53	-160.40	ISO-BUTANE	550.02	0.9700	533.52	53.15	87.50	466.83	0.7641260	\$356.72
Net Delivered:	1,805.72	2,307.35	NORMAL BUTANE	1,135.43	0.9700	1,101.37	114.26	87.50	963.70	0.7017200	\$676.25
			PENTANES PLUS	1,234.57	0.9800	1,209.88	137.89	87.50	1,058.64	0.9768140	\$1,034.10
Wellhead BTU (14.730D):		1.2778									
Gas Factor:	0.0000										
				13,822.42		11,558.81	964.69		10,113.96		\$4,671.53

Residue Settlement

Net Delivered MMBTU	Shrink	Contractual Fuel/Flare	Theoretical Residue	Allocated Residue	Net Residue MCF	Net Residue MMBTU	Settlement %	Settlement Residue	Price	Residue Value
2,307.35	964.69	138.44	1,204.22	1,204.22	1,293.22	1,204.21	87.50	1,053.68	1.6300000	\$1,717.50

Statement volumes & values are referenced on the next slide

Color coding: Wellhead Residue Liquids

Audit Challenges

- Product Code 7 reporting = Wellhead MCF – Residue MCF

Line	PUN	Lease Number	Product Code	TXN Code	ARMS Length	Volume BBL/MCF	NGL Gallons	BTU Content of GAS	GROSS PROCEEDS	Transportation Deduction	Gas Marketing Prep/Other	Gas Processing Deductions	STATE ROYALTY
1	1234567	V0-123	3	51	Y	1268		1277	1718	0	0	0	286
2	1234567	V0-123	7	51	Y	625	10114		4672	0	0	0	779

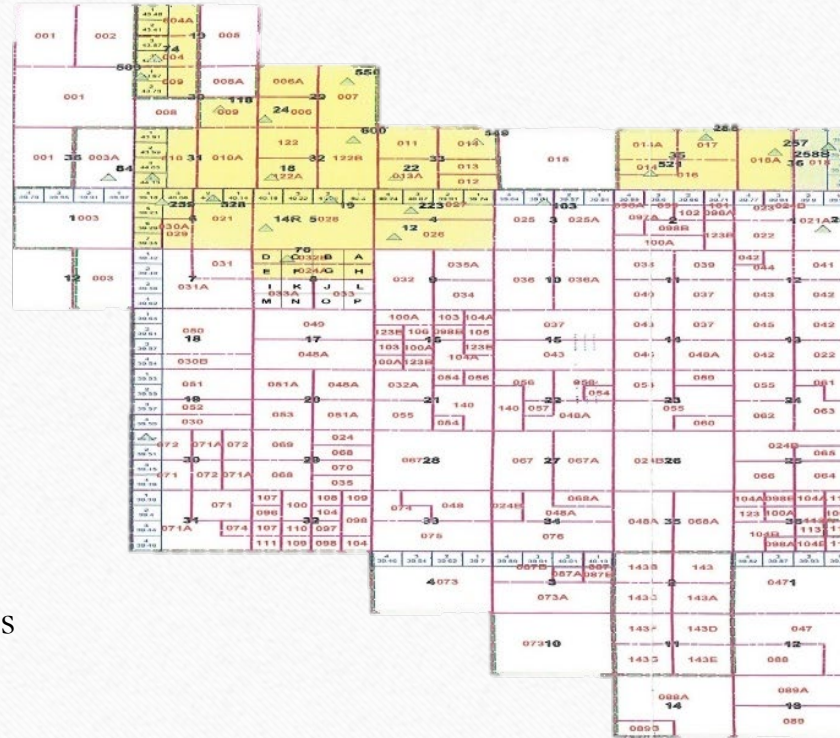
- Wellhead MCF was 1,893 (1,931.25*(14.73/15.025))
- Residue was 1,268 (1,293.22*(14.73/15.025))
- Product Code 7 MCF Reporting 1,893 – 1,268 = 625

Volume & values above are referenced from the previous slide

Color coding: Wellhead Residue Liquids

Audit Challenges

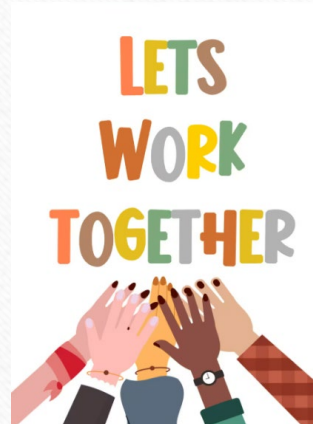
- Unit Accounting
 - P/A Wells or N/P Wells
 - Phases
 - Unit/Com Wells aka Overlap Wells
 - Consent/Non-consent Wells
 - DOI Information
- CDPs
 - Settlement Statements
 - Incorrect Allocations
- Netback Pricing
 - Supply pools
 - Weighted Average Sales Price (WASP) calculations
- Affiliated Sales
 - Tracing – First Arm's length Sale



Contact Us

In an effort to improve our process we invite you to contact us with suggestions you would like to make regarding our filing process or applications.

We look forward to hearing from you!



New Mexico State Land Office

QUESTIONS???



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Thank you for your time and participation!

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Closing

