

DEPARTMENT OF NATURAL RESOURCES  
PROCESS OF AUDITING MINERAL ROYALTIES



PERFORMANCE AUDIT  
ISSUED JULY 28, 2010

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LOUISIANA LEGISLATIVE AUDITOR  
DARYL G. PURPERA, CPA, CFE

July 28, 2010

The Honorable Joel T. Chaisson, II,  
President of the Senate  
The Honorable Jim Tucker,  
Speaker of the House of Representatives

Dear Senator Chaisson and Representative Tucker:

This report provides the results of our performance audit on the Department of Natural Resources' process of auditing mineral royalties. The audit was conducted under the provisions of Title 24 of the Louisiana Revised Statutes of 1950, as amended.

The report contains our findings, conclusions, and recommendations. Appendix A contains the response of the Department of Natural Resources. I hope this report will benefit you in your legislative decision-making process.

We would like to express our appreciation to the management and staff of the Department of Natural Resources for their assistance during this audit.

Sincerely,

Daryl G. Purpera, CPA, CFE  
Legislative Auditor

DGP/dl

DNR 2010



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# Office of Legislative Auditor

Daryl G. Purpera, CPA, CFE, Legislative Auditor



## Department of Natural Resources Process of Auditing Mineral Royalties

July 2010

Audit Control # 40090002

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### Executive Summary

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We conducted a performance audit on the Office of Mineral Resources (OMR) within the Department of Natural Resources (DNR). We focused our audit efforts on its process to ensure that the state is collecting accurate royalty payments for all minerals produced from state lands. Our objective and the overall results of our audit are summarized below.

**Objective:** Has DNR developed a comprehensive auditing process to ensure that the state is receiving accurate mineral royalties?

We identified weaknesses with OMR's audit coverage and its current process for auditing royalties. Those weaknesses are as follows:

- **OMR has audited approximately 21% of royalties and has recovered over \$75 million during the last five fiscal years. However, according to OMR data, OMR has not audited 168 of 522 (32%) of companies who have paid approximately \$43 million in royalties over the last 10 fiscal years.** OMR stated that it would like to audit a larger percentage of royalties and periodically audit smaller companies as these audits may bring in additional revenue to the state. According to their data, OMR auditors have generated approximately \$1.2 million per auditor per year over the last 10 fiscal years.
- **OMR has not conducted a desk audit of volume since 2000.** Desk audits compare the volume of oil and gas sold to the volume of oil and gas produced and help OMR ensure that royalty payments submitted by companies are reasonable. These audits also help ensure that all production wells on state lands are submitting royalty payments. In a July 2009 audit report on the Minerals Management Service (MMS),<sup>1</sup> the Governmental Accounting Office (GAO) conducted work similar to a volume audit for a sample of companies in the Gulf of Mexico and found approximately \$117 million in royalties that may not have been collected by the federal government. By not conducting these volume audits, DNR could be missing opportunities to identify extra royalty payments that are owed to the state.

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<sup>1</sup> The Minerals Management Service is a federal agency within the Department of the Interior and is responsible for reviewing royalty payments for wells on federally owned lands and water bottoms.

- **DNR has not coordinated audit activities that could affect the accuracy of royalty payments.** Both the Office of Conservation (OOC) within DNR and the Louisiana Department of Revenue (LDR) conduct audits that could help OMR verify the accuracy of royalty payments. However, OMR does not coordinate with OOC to obtain errors that OOC finds in its production audits or to obtain information on problems that OOC inspectors find at well sites. In addition, OMR does not coordinate with LDR to obtain the results of LDR severance tax audits. Because severance taxes are deducted when calculating royalty payments, incorrect severance taxes may result in incorrect royalty payments. If DNR improved coordination and communication with other departments and agencies, OMR would be better equipped to verify royalty payments and possibly identify additional dollars owed to the state.

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### Audit Initiation, Scope and Methodology

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We conducted this performance audit under the provisions of Title 24 of the Louisiana Revised Statutes of 1950, as amended. In accordance with state law, the legislative auditor scheduled a performance audit of DNR. This audit focused on determining whether DNR has established an audit process to ensure that royalty payments are accurate. We primarily focused on oil and gas royalty payments since these make up the majority of royalties. Our audit scope generally covered FY 2008 and FY 2009. To answer our objective, we performed the following steps:

- Researched state law, the administrative code, executive budget documents, and other internal reports to understand the department's legal authority, responsibilities, mission, goals, and objectives
- Interviewed various staff and key personnel related to oil and gas regulation, royalty reporting, and audit
- Interviewed LDR personnel concerning severance tax auditing
- Accompanied DNR personnel on a well/lease inspection
- Obtained and reviewed relevant internal audit procedures and plans from DNR
- Obtained fiscal data from DNR such as royalty payments collected, audits conducted, and monetary returns from audits
- Interviewed officials in the Texas General Land Office to obtain information on certain procedures in Texas
- Reviewed information from the Bureau of Land Management and the MMS within the U.S. Department of the Interior to obtain information on their procedures
- Reviewed relevant audit reports from the GAO

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 objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objective.

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**Background**

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**Overview of DNR**

The overall mission of DNR is to manage, protect, and preserve the state’s nonrecurring natural resources which include oil, gas, lignite and other minerals, groundwater and coastal wetlands, and renewable energy. DNR plans to accomplish its mission through conservation, regulation, and scientifically sound management. DNR is composed of four offices. These offices and their FY 2009 expenditures and staffing are summarized in Exhibit 1.

<b>Exhibit 1 DNR Offices, Expenditures, and Staffing FY 2009</b>		
<b>Office</b>	<b>FY 2009 Expenditures</b>	<b>FY 2009 Staffing</b>
Office of the Secretary	\$32,258,078	89
Office of Conservation	16,764,485	187
Office of Mineral Resources	12,351,992	75
Office of Coastal Restoration and Management	109,245,619	159
<b>Total</b>	<b>\$170,620,174</b>	<b>510</b>
<b>Source:</b> Prepared by legislative auditor's staff using actual expenditures reported in the FY 2010 executive budget.		

Our audit focused on whether DNR has a comprehensive process to ensure that royalties submitted to the state are accurate. Ensuring that the state receives optimal revenues from royalty payments is the primary responsibility of OMR. However, the OOC also has regulatory authority over oil and gas wells so its duties also affect the accuracy of royalty payments. The definition of royalties, as well as specific details about the role of DNR in auditing royalties, is outlined in the sections that follow.

**Definition of Royalties**

Louisiana produces minerals such as crude oil, natural gas, sulfur, salt, gravel, and lignite. If these minerals are produced from state-owned land or water bottoms, the state takes in revenue called royalties. DNR is responsible for collecting and auditing these royalty payments to ensure that the state receives the accurate amount of royalties it is owed.

Royalty amounts are derived by multiplying a percentage up to 25% (also called the "state decimal") on the net value of oil, gas, and other mineral productions. According to DNR, there are approximately 2,000 active state leases on over one million acres of state lands. Exhibit 2 outlines the formula for calculating the amount of royalties.

**Exhibit 2**  
**Royalty Calculation**

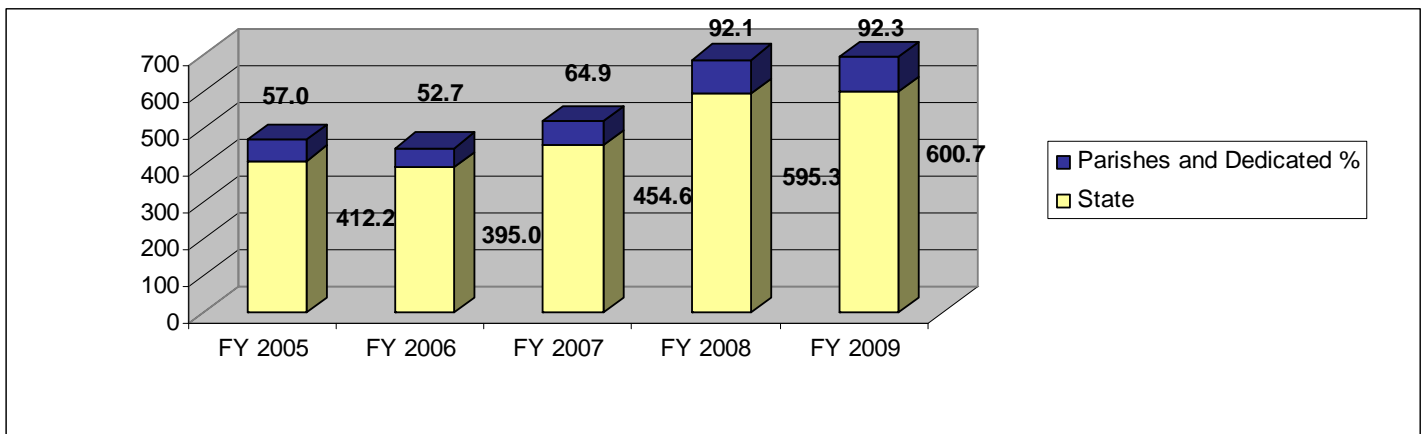
**(Price x Volume) - Severance Tax - Allowable Expenses = Net Value**

**Net Value x State Decimal (up to 25%) = Royalty Payment**

**Source:** Developed by legislative auditor's staff using information from DNR.

The accuracy of royalty payments is important to the state because royalties provide revenue to the state. As shown in Exhibit 3, the total amount of royalties received was \$693 million in FY 2009. One-tenth of royalty revenue each month is distributed to the parishes where the production occurs. A certain percentage is also statutorily dedicated to certain entities, such as the Department of Wildlife and Fisheries. However, most royalties go to the State General Fund in accordance with Article VII, Section 9 of the Louisiana Constitution. Exhibit 3 summarizes the total amount of royalty revenues from FY 2005 to FY 2009.

**Exhibit 3**  
**Total Amount of Revenue in Millions From Royalties**  
**FY 2005-2009**



**Source:** Prepared by legislative auditor's staff using data from OMR. Total royalties collected differ from Exhibit 4 because of the timing of data collection.



## **DNR's Role in Auditing Royalty Payments (OMR)**

According to Louisiana Revised Statute (R.S.) 30:129, the State Mineral Board is required to determine whether the companies complied with all lease terms. To fulfill this requirement, DNR's OMR conducts (or has conducted) a variety of audits to help ensure that companies are submitting accurate royalty payments. These audits are summarized below.

**Desk Audits of State Royalty Reports.** Desk audits of state royalty reports consist of reviewing exception reports generated by the Strategic Online Natural Resources Information System (SONRIS). Companies are required to submit monthly royalty reports that document their sale of oil, gas, and other mineral products and the amount of royalty due to the state. Five staff in the Royalty Reporting Section within OMR review each report for obvious errors and recalculate totals. Once obvious errors are corrected, the reports are entered in SONRIS and the system performs a series of validations on each report. For example, SONRIS validates that the price and severance tax is reasonable and validates that the state's percentage share of royalty is correct. Once all reports have been entered, SONRIS generates exceptions. Some exceptions are rejected and must be sent back to the companies for correction. Companies may be billed for additional royalties that they did not initially submit.

**Desk Audits of Volume (or Compliance Reviews).** As stated above, companies submit monthly royalty reports to OMR. To conduct desk audits of volume, OMR staff in the Royalty Reporting Section compare the state royalty reports to the production reports and transporter reports submitted to OOC. Staff then send letters to the companies requesting an explanation for any variances between these reports. Depending on their response, OMR may bill the companies for additional royalties. However, these audits have not been conducted in over 10 years. See page 10 for more information on this issue.

**Field/Desk Audits of Royalty Payments.** Twelve auditors in the regional offices conduct field audits on a certain percentage of royalty dollars each year. Field audits are generally conducted on companies with royalties totaling \$100 million or greater. The auditors conduct onsite audits at company offices and review documentation such as meter statements, check details, and wire transfers to verify the volume and price of oil and gas sold. Also, desk audits are generally conducted on companies with royalties totaling \$1 million or less. These audits are similar to field audits except they are conducted in the regional offices of DNR. Both types of audits detect problems that often result in DNR billing companies for additional royalties. For example, in FY 2009, auditors collected from companies approximately \$6.4 million in additional royalties.

## **Other Audits That Affect Accuracy of Royalty Payments (OOC and LDR)**

In addition to OMR's role in auditing royalty payments described previously, both DNR's OOC and LDR conduct audits which impact the accuracy of royalty payments. These duties are summarized below.

**DNR's OOC.** R.S. 30:4 gives the commissioner of OOC the jurisdiction and authority over all persons and property necessary to effectively enforce laws relating to oil and gas. As such, this office has the authority to inspect and examine properties and leases and to test and gauge all oil and gas wells, tanks, refineries and modes of transportation for compliance with regulations. OOC also issues permits for companies to drill wells on both public and private lands and determines the allowable amount (volume) that each well can produce. A total of 22 staff in the Production Audit Section within the OOC are responsible for inputting data from production and transporter reports into SONRIS. SONRIS reviews and reconciles reports and generates error reports that production auditors review and correct. Some errors may require that companies submit corrected data. The purpose of these audits is to ensure that companies are submitting required reports and complying with production regulations.

**LDR.** LDR has four auditors that are responsible for conducting audits to ensure that companies are paying the correct amount of severance taxes on all required wells. Severance taxes are calculated based on the total volume of oil and gas produced. Severance taxes also affect the accuracy of royalty payments because companies are allowed to deduct severance taxes when calculating royalty payments.

**Objective: Has DNR developed a comprehensive auditing process to ensure that the state is receiving accurate oil and gas royalties?**

While DNR conducts field audits that have generated over \$75 million in additional royalty payments over the last five fiscal years to the state, OMR's audit process could be more comprehensive by periodically auditing smaller companies. OMR has never audited approximately 32% of companies who have submitted approximately \$43 in royalties over the last 10 fiscal years. Although these companies have not paid a large amount of royalties overall, there is no assurance that what these companies have been paying over the years is accurate.

In addition, DNR has not conducted a desk audit of volume (see page 5) in over 10 years. These audits are used extensively in other states as a cost-effective way of identifying errors in royalty payments. Finally, DNR is not currently using all available sources of data to help ensure that royalty payments are accurate. These issues are discussed in more detail below.

**OMR field auditors have audited 21% of royalties and have recovered over \$75 million in additional royalties over the last five fiscal years**

As mentioned in the background section, OMR conducts field audits of royalty payments to ensure that companies pay the state the correct amount of royalties. According to OMR data, OMR has conducted field audits on over \$469 million in royalties over the last five fiscal years. These audits have resulted in over \$75 million of additional royalties for the state.

According to DNR, the number of audits OMR conducts each year is dictated by its objective in the executive budget and its staffing levels. The current FY 2010 objective requires that OMR increase the percentage of royalties audited to total royalties paid by 1% per year up to a maximum of 25%. Exhibit 4 on the following page summarizes total royalty dollars submitted to OMR, the percentage of royalty dollars audited by OMR, the amount recovered by OMR, and the requirements specified in OMR's objective in the executive budget for the last five fiscal years.

**Exhibit 4**  
**Total and Percentage of Royalties Collected and Audited,**  
**Percentage of Additional Royalties Collected From Audits,**  
**and Audit Requirements in Executive Budget**  
**FY 2005 to FY 2009**

<b>Fiscal Year</b>	<b>Total Royalties Collected in Audited Year*</b>	<b>Total Amount Audited</b>	<b>% Audited</b>	<b>Amount of Additional Royalties Collected From Audits</b>	<b>Requirement per Objective in Executive Budget for Fiscal Year</b>
2009	\$519,528,580	\$96,657,718	19%	\$6,389,061	To increase the percentage of royalties audited to royalties paid by 1% each year
2008	447,669,081	102,375,023	23%	2,805,081	To increase the percentage of royalties audited to royalties paid by 1% each year
2007	469,216,638	105,783,589	23%	3,490,560	To increase the percentage of royalties audited to royalties paid by 1% each year
2006	431,821,285	74,985,155	17%	7,097,735	To increase the percentage of royalties audited to royalties paid by 1% each year
2005	374,217,632	89,813,476	24%	55,469,241**	Maintain the percentage of royalties audited to royalties paid at 25%
<b>Total</b>	<b>\$2,242,453,215</b>	<b>\$469,614,961</b>	<b>21%</b>	<b>\$75,251,678</b>	

\*The total royalty dollars collected differ from the numbers in Exhibit 3 because audits are based on royalty dollars collected two years back. For example, the audits conducted in FY 2008 are for royalties from FY 2006.

\*\*FY 2005 audit collections were higher than normal because of two settlements the state received resulting from audits.

**Source:** Prepared by legislative auditor's staff using data from OMR.

As the exhibit shows, OMR has audited from 17% to 24% of royalty dollars each year over the last five fiscal years. However, DNR stated that because the objective specifies a target percentage to audit, it limits the number and variety of companies who are audited each year. To meet its objective, OMR generally uses the amount of royalties as the primary criteria<sup>2</sup> in selecting companies to audit. As a result, it is possible that many of the same companies have been reviewed year after year and some companies have never been audited at all. According to OMR data, approximately 168 of 522 (32%) of companies have never been audited. These companies have submitted approximately \$43 million in royalties over the last 10 fiscal years. Although these companies paid a relatively small amount of royalties, there is no assurance that what these companies have been submitting in royalties during that time frame is accurate. Because more comprehensive audit coverage may mean increased revenue to the state, OMR should plan to include smaller companies in its audit schedule as well.

<sup>2</sup> OMR also uses additional risk factors, such as leads from other divisions and previous audit findings, to select some companies but larger companies are first priority to meet the objective.

Other states, such as Texas and Alaska, are not required to audit a certain percentage of royalties each year. These states use a variety of risk-based criteria to select companies to audit and then try to audit as many as their resources allow. At the federal level, a similar performance goal at MMS that specified a required percentage to audit was criticized in an Inspector General's report for reducing the number of companies subjected to compliance work.

According to OMR, the reason that it has not increased the percentage of royalties it audits to include these smaller companies is due to a lack of audit staff. OMR has evaluated the cost-effectiveness of hiring more auditors and found that over the last 10 years, each auditor has generated an average of \$1.2 million in increased revenue each year. Hiring additional auditors to increase audit coverage may result in a cost-effective way to increase revenue to the state. According to OMR, it requested 10 additional auditors in the FY 2010 budget request; however, the request was not approved.

To better show its performance and potentially justify more positions, OMR should consider revising its current performance information to show the outcomes from its audit efforts. As discussed above, OMR auditors recover a large amount as a result of their audits. However, OMR's current objective does not include performance indicators that show these outcomes resulting from audits. Texas uses several indicators to show the outcomes of its audits, including the percent of oil and gas revenue resulting from audits and the average revenue generated per auditor. Outcome measures such as these would allow the legislature and other decision makers to better evaluate the cost-effectiveness and success of audit efforts. For example, the average amount recovered per audit or auditor would be a useful indicator to show the effectiveness of OMR audits.

**Recommendation:** DNR should consider adjusting its selection criteria for audits to provide the most comprehensive audit coverage as possible, which includes periodically auditing smaller companies.

**Summary of Management's Response:** DNR disagrees with this recommendation and stated that their current selection criteria are sufficiently comprehensive and provide the greatest return on investment.

**Recommendation:** DNR should assess its agency resources as a whole and determine if it would be cost effective to transfer existing resources within DNR to audit a larger percentage of royalties.

**Summary of Management's Response:** DNR agrees with this recommendation and stated that they will evaluate their resources to determine if some resources can be transferred to the auditing function.

**Recommendation:** DNR should consider working with the Office of Planning and Budget to revise its overall objective and associated performance indicators to ensure appropriate audit coverage while better reflecting the actual outcomes.

**Summary of Management's Response:** DNR partially agrees with this recommendation and stated that if they were granted the staff resources, they would revise their current performance indicator to audit 33% of royalties per year. DNR stated that auditing all payors on a three-year rotating cycle is the most effective methodology.

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### **OMR has not conducted desk audits of volume since 2000**

OMR's Royalty Reporting Section previously conducted desk audits of volume (also called compliance reviews) which helped ensure that royalty payments were reasonable and complete. This review compared the sales volume of oil and gas reported to OMR with the production volume of oil and gas reported to OOC in production reports and transporter reports. However, OMR has not conducted these desk audits since 2000. Although OMR did not have any data on the amount of revenue generated from these past audits, OMR staff said that these audits were lucrative for the state because they found additional royalties owed to the state from companies. In addition, these audits require fewer staff and less time so they can be more cost-effective than field audits.

Other states, such as Texas and Oklahoma, and the federal government (MMS) all use these types of audits to help ensure that royalties reported by companies are reasonable. In FY 2009, Texas generated an additional \$3.1 million in additional revenue for the state from these types of audits.

Not only are these audits important for ensuring that royalty payments are reasonable, they are also important for ensuring that royalties have been collected from all wells that are reporting production on state lands. For example, in a July 2009 audit report on MMS, GAO compared a sample of federal leases in the Gulf of Mexico producing gas to royalty reports for the same time frame and found that 5.5% of royalty reports were missing. These reports represented approximately \$117 million in royalties that may not have been collected.

According to OMR, it has not performed these audits because of a lack of staff. OMR currently has five audit staff in this section and there are approximately 250 companies who send in royalty reports to review on a monthly basis. However, OMR is in the process of converting to an online system that will accept royalty reports electronically and will automate some of the preliminary audit steps. According to OMR, this system should allow auditors more time to focus on conducting volume audits.

Another alternative is to automate the actual desk audits of volume. Since both OOC and OMR enter data on volume into the SONRIS, DNR should investigate whether a query or program could be developed to compare these reports and generate exceptions when differences exist between OOC and OMR reports. Texas is currently pursuing automating this review as well.

**Recommendation:** DNR should require companies to use electronic reporting for both production reports and royalty reports. Requiring companies to enter these reports directly into SONRIS would allow auditors more time to conduct desk audits of volume.

**Summary of Management's Response:** DNR agrees with this recommendation and stated they are currently working toward this goal.

**Recommendation:** DNR should resume conducting desk audits of volume. The results of these audits should be documented and additional collections resulting from these audits should be tracked.

**Summary of Management's Response:** DNR agrees with this recommendation and stated they have a written plan for resuming volume audits.

**Recommendation:** Once all companies are reporting electronically and DNR resumes conducting desk audits of volume, DNR should consider developing a program within SONRIS that automates volume audits. This program should also include exception reports that are generated when volume numbers do not match between OOC and OMR.

**Summary of Management's Response:** DNR agrees with this recommendation and stated they will work with their information technology staff to automate the process.

**Recommendation:** Once DNR resumes its desk audits of volume, it should use the results of these audits as part of its selection criteria for scheduling companies for field audits.

**Summary of Management's Response:** DNR agrees with this recommendation and stated that volume audit results will be included in the audit selection criteria when they are resumed.

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### **DNR has not coordinated audit activities that could affect the accuracy of royalty payments**

DNR has not ensured that all audit activities that could affect the accuracy of royalties are coordinated with other departments and agencies. Although both OOC and LDR conduct audits related to the accuracy of oil and gas volume, neither entity reports the results of their audits to OMR nor does OMR try to obtain such results. Since the volume of oil and gas is a key input into the royalty calculation, having this information would help OMR verify the accuracy of royalty payments.

As mentioned on page 6, a total of 22 OOC production auditors input data into SONRIS from production and transportation reports showing the volume of oil and gas produced and transported from all wells in the state. SONRIS reconciles the reports and generates an error report if it finds a discrepancy between what is reported. Production auditors review the error reports and companies may be asked to submit corrected data. However, OMR does not coordinate with OOC to obtain the results of OOC's production audits.

In addition, OOC field agents conduct a variety of inspections of wells. In FY 2009, they conducted approximately 27,000 field inspections. These inspections are designed to ensure that wells are operating in accordance with rules and regulations. However, OOC does not report problems that its inspectors found to OMR. Some of these problems could affect royalties. We asked OOC to provide us with inspection findings that could affect the accuracy of royalties, but OOC said that production inspections are generally handwritten as narrative inspections and the results could not easily be quantifiable.

LDR also has useful information that could help OMR better verify the accuracy of royalty payments. LDR auditors review a sample of severance tax reports and conduct field audits to ensure that severance taxes were calculated correctly. Severance taxes, like royalties, are based on the volume of oil and gas produced. Ensuring that severance tax is calculated correctly is important because companies are allowed to deduct severance taxes when calculating royalty payments. Therefore, if severance taxes are incorrect, it is likely that royalties will also be incorrect. Although OMR verifies severance tax information when it conducts royalty field audits, it does not coordinate with LDR to obtain the results of its severance tax audits. Routinely obtaining the results of LDR audits would help OMR verify the accuracy of severance taxes on a more frequent basis.

LDR audits have consistently found problems related to companies who both under pay and over pay their severance taxes. For example, from FY 2007 to FY 2009, LDR data shows that some companies have overpaid approximately \$22 million in severance taxes and others have underpaid approximately \$32 million in severance taxes resulting in a net underpayment of taxes of approximately \$10 million. Exhibit 5 summarizes this information.

<b>Exhibit 5</b>				
<b>Total Amount of Severance Tax Overpayments and Underpayments</b>				
<b>FY 2007 to FY 2009</b>				
	<b>FY 2007</b>	<b>FY 2008</b>	<b>FY 2009</b>	<b>TOTAL</b>
Overpayments	\$5,275,443	\$6,121,742	\$10,775,007	\$22,172,192
Underpayments	14,079,007	7,386,479	11,097,711	32,563,197
			<b>Net Underpayment</b>	\$10,391,005
<b>Source:</b> Prepared by legislative auditor's staff using data from LDR.				

As the exhibit shows, LDR audits find substantial errors related to the correct calculation of severance taxes. DNR is currently pursuing a cooperative endeavor agreement that transfers the severance tax auditing function from LDR to OMR. Transferring this function to DNR may resolve the problems discussed above.



**Recommendation:** DNR should develop a system or process whereby OOC would report any production discrepancies, errors, or violations it discovers in its compliance work to OMR. This process would help ensure that royalty payments are based on accurate data.

**Summary of Management's Response:** DNR agrees with this recommendation and stated that they are in the process of executing a Memorandum of Understanding between OMR and OOC to accomplish this goal.

**Recommendation:** DNR management should require OMR auditors to coordinate and communicate with LDR to verify the accuracy of severance tax data.

**Summary of Management's Response:** DNR agrees with this recommendation but states that this is a moot point since DNR will conduct LDR's severance tax field audits beginning July 1, 2010.

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**APPENDIX A: MANAGEMENT'S RESPONSE**



BOBBY JINDAL  
GOVERNOR



ROBERT D. HARPER  
SECRETARY

**State of Louisiana**  
DEPARTMENT OF NATURAL RESOURCES  
OFFICE OF MINERAL RESOURCES  
STATE MINERAL AND ENERGY BOARD

June 23, 2010

Mr. Daryl Purpera, CPA  
Louisiana Legislative Auditor  
Post Office Box 94397  
Baton Rouge, Louisiana 70804-9397

Dear Mr. Purpera:

The Department of Natural Resources has reviewed the revised draft of your office's performance audit report on the process of auditing mineral royalties. The Department, for the most part, concurs with the findings and recommendations contained in that report. As requested, we have included the enclosed completed checklist. Our comments regarding the weaknesses identified in the report are as follows.

**Finding #1: • OMR has audited approximately 21% of royalties and has recovered over \$75 million during the last five fiscal years. However, according to OMR data, they have not audited 168 of 522 (32%) of companies who have paid approximately \$43 million in royalties over the last ten fiscal years.**

**DNR's Response:** We concur that 168 of companies who have paid royalties in the past ten years have not been audited. We also concur that auditing more companies would generate additional revenue for the state.

**Finding #2: • OMR has not conducted a desk audit of volume since 2000.**

**DNR's Response:** We concur that OMR has not conducted a desk audit of volume since 2000. We also recognize the importance of this function and have been working to resume this program. We anticipate that we will be able to resume volume auditing by the end of fiscal year 2011.

**Finding #3: • DNR has not coordinated audit activities that could affect the accuracy of royalty payments.**

**DNR's Response:** We concur, in part, with the finding that OMR has not coordinated audit activities with the Office of Conservation (OOC) and the Department of Revenue (LDR). To date, there has been no system of communications with either entity. However, we do not concur that incorrect severance taxes may result in incorrect royalty payments because severance tax deductions are audited for accuracy during royalty field audits. As part of the Streamlining Commission's recommendations, OMR will take over LDR's severance tax field audit program and the two audits will be integrated beginning July 1, 2010. We concur that a

Daryl Purpera, CPA  
June 24, 2010  
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system of communications between OMR and OOC will be beneficial. Consequently, we have executed a Memorandum of Understanding to establish a system of communications in which OMR will be notified of production audit findings.

In closing, we greatly appreciate the professional efforts of your office in the preparation of this report. We are proud that our performance information is valid and relevant to the department's mission, goals, and objectives, and demonstrates the success of our audit program. We believe that the report's recommendations will be useful in our administration of our audit program.

Sincerely,



Louis E. Buatt  
Acting Assistant Secretary

Enclosure

cc: Robert D. Harper, Secretary