

## STATE and TRIBAL ROYALTY AUDIT COMMITTEE

---

State of Alaska • Blackfeet Nation • State of California • State of Colorado • Fort Peck Tribes  
Jicarilla Apache Tribe • State of Louisiana • State of Montana • Navajo Nation • State of New Mexico  
State of North Dakota • State of Oklahoma • Shoshone & Arapaho Tribes • Southern Ute Indian Tribe • State of Texas  
State of Utah • Ute Indian Tribe • Ute Mountain Ute Tribe • State of Wyoming

---

Lisa Dockter, *Chair* (970) 563-5559  
Dennis R. Roller, *1st Vice Chair* (701) 250-4682  
Brenda Petersen, *2nd Vice Chair* (303) 355-0400

*Former Chair, Ex Officio:*  
Joe Vintz

September 27, 2006

Ms. Lucy Querques Denett  
Associate Director  
Minerals Management Service  
U.S. Department of the Interior  
1849 C Street NW, MS 4230  
Washington, DC 20240

Dear Ms. Denett:

The purpose of this letter is to follow-up on several points that were discussed during the teleconference held on September 12, 2006, between the State and Tribal Royalty Audit Committee officers (including at large members Steve Dilsaver and Perry Shirley), yourself, as well as other Minerals Management Service (MMS) staff.

In retrospect, we feel a person to person meeting, as opposed to a teleconference, would have been more beneficial in terms of communicating and understanding specifically the points being made by the individuals participating in the discussion. As such, we wish to reiterate our request to meet with you in Denver in October 2006. We also request that MMS not proceed with any final decisions that may impact STRAC's ability to fulfill its obligations under its Cooperative Agreements with MMS, and more importantly, the royalty audit and investigation activities mandated by the Royalty Simplification and Fairness Act of 1996 and the Federal Oil and Gas Royalty Management Act of 1982. Specifically, those decisions concern the frequency and structure of STRAC meetings, the STRAC Peer Review Program, and STRAC's future participation in MMS policy development, and audit and investigation related matters.

STRAC wishes to clarify that we do not feel that there are any compelling reasons to change the current frequency of the STRAC meetings with MMS, which is now established three times annually with the MMS hosting a Denver meeting once each year. However, we concur that the structure of our meetings with MMS could be improved upon, in terms of agenda development, topics, and presentation of topics.

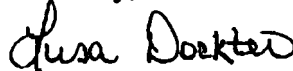
During the teleconference discussion, a new term referred to as a "National" meeting was mentioned. While this matter may simply be viewed as a terminology matter, we will regard our regularly scheduled meetings with MMS as STRAC meetings. We believe that a minimum of one STRAC meeting a year with the MMS will not suffice. As we are all aware, the environment in which we perform our audit and investigative activities is ever changing in terms of federal, state and Indian tribal rules and regulations, policies, laws, case law, industry, accounting systems, audit issues, etc. The STRAC and MMS meetings fulfill the communication, coordination, cooperation, and consultation that is absolutely necessary for meaningful partnerships and government-to-government working relationships to exist. Too often over the past years, royalty payors have complained about the lack of communication and coordination among the states, tribes and MMS regarding audit and investigation activities. Likewise, states and tribes have a legitimate stake in MMS' decisions concerning its Royalty Management Program and the STRAC meetings provide the means to discuss and make appropriate decisions when necessary.

We also fail to understand the rationale provided for resorting to "Regional" meetings, in lieu of STRAC meetings. A majority of audit issues are not regional. It is important that we have a central point of discussion for such matters where all states, tribes, and MMS audit staff can discuss these matters in a cohesive manner.

We look forward to continuing our discussion on matters related to STRAC meetings, including locations and frequency, during our meeting with you in October. Additionally, we also would like to discuss STRAC's Peer Review program and our future participation in MMS task groups wherein decisions are made on such matters relevant to system audit and investigation work and policy affecting royalty valuation.

If you have any questions regarding this matter, please call me at (970) 563-5559.

Sincerely,



Lisa Dockter

Chairperson

State and Tribal Royalty Audit Committee

xc: STRAC Membership

## STATE and TRIBAL ROYALTY AUDIT COMMITTEE

---

State of Alaska • Blackfeet Nation • State of California • State of Colorado • Fort Peck Tribes  
Jicarilla Apache Tribe • State of Louisiana • State of Montana • Navajo Nation • State of New Mexico  
State of North Dakota • State of Oklahoma • Shoshone & Arapaho Tribes • Southern Ute Indian Tribe • State of Texas  
State of Utah • Ute Indian Tribe • Ute Mountain Ute Tribe • State of Wyoming

---

Lisa Dockter, *Chair* (970) 563-5559  
Dennis R. Roller, *1st Vice Chair* (701) 250-4682

*Former Chair, Ex Officio:*  
Joe Vintze

Lucy Querques Denett  
Associate Director  
Minerals Management Service  
Washington, DC 20240

Dear Ms. Denett:

On behalf of the State and Tribal Royalty Audit Committee (STRAC), we are writing to request information on the Minerals Management Service's (MMS's) "compliance review" program.

At the recent STRAC/MMS meeting in Salt Lake City, STRAC was told that its individual jurisdictions would be "required to request" authority to conduct compliance reviews as part of their contracts with Interior. Currently, our jurisdictions' contracts delegate authority to conduct "audits" of leases within their respective borders; a compliance review is not an audit.

There is no statute or regulation under which our jurisdictions can request the authority to conduct compliance reviews, despite the fact the MMS's program has been in place since 2001. MMS officials and staff at the meeting were in hopeless disagreement regarding the authority for delegation of the compliance review function. Mr. Sykora disagreed with the Contracting Office and MMS managers. States and Tribes cannot be paid for work that cannot be delegated under the law, which was also acknowledged by MMS.

For well over two years, STRAC has asked MMS to provide it with statistics and other data regarding the quality and efficiency of compliance reviews to no avail. STRAC needs this information so that it can advise its jurisdictions on whether conducting compliance reviews is worthwhile. As you know, MMS used to publish statistics on the revenue collections attributable to its separate approaches, e.g., exceptions processing. MMS ceased these publications in 2001, the year the compliance review process was initiated. At the Salt Lake meeting, MMS did make a presentation involving a few anecdotal compliance reviews, approximately four, but these raised more questions than they answered.

Accordingly, we must renew our request for the information that we have repeatedly told MMS is necessary. This includes:

- The total dollars collected since 2001 *as a direct result* of the compliance review process, broken down in terms of offshore, 8(g), onshore, Tribal and Allottee leases. This should exclude collections since 2001 attributable to the previous audit program and, particularly, audits conducted by States and Tribes;
- The cost/benefit of conducting compliance reviews;  
  
The number of random audits conducted under the compliance review process, broken down in terms of offshore, 8(g), onshore, Tribal and Allottee leases;
- The number of audit referrals conducted under the compliance review process, broken down in terms of offshore, 8(g), onshore, Tribal and Allottee leases;
- The number of random or referral audits that revealed further underpayments of royalties, the type of violations involved and the effort made by MMS to compile the type of violations into its compliance review process;
- The number of orders issued by MMS *as a direct result* of the compliance review process, broken down in terms of offshore, 8(g), onshore, Tribal and Allottee leases. This should exclude orders issued since 2001 attributable to the previous audit program and, particularly, orders issued as a result of audits conducted by States and Tribes; and
- A breakdown of MMS's appropriated or offline dollars since 2001 allocated to compliance reviews, random or referral audits, Accenture, other private consultants or entities (such as Inovis); quality reviews, training, preparation of congressional reports and strategic plans, SES promotions, and bonuses.
- Average labor hours needed to perform a compliance review

As you know, many STRAC jurisdictions question the merit of compliance reviews. For example, some think that these reviews are little more than partial data entry verification efforts similar to exceptions processing. In fact, some delegations have found that without an effective exception verification process since the re-engineering efforts, there are many more reporting errors. Others think that the flaws in MMS's new automated compliance system, which you recently referred to as "over re-engineering", has lead to serious deficiencies in compliance reviews. Others think that compliance reviews are simply a means to squeeze States and Tribes out of the program. Similarly, some others

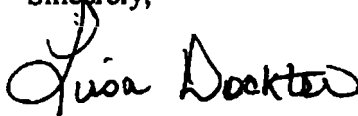
– with a substantial number of so-called “strategic” properties – fear that requiring them to conduct compliance reviews will risk their ability to create more dollars for their jurisdictions, which will threaten their program evaluations.

In MMS’s recent “Strategic Business Planning Initiative”, the agency pledged to improve its cooperation with States and Tribes. Yet, these jurisdictions remain without the data necessary to enhance cooperation between them and MMS. STRAC jurisdictions need the above information if MMS truly desires them to support the agency’s goals.

STRAC would appreciate receiving the information requested as soon as possible and no later than the next scheduled STRAC/MMS meeting in New Mexico.

Thank you, in advance, for your cooperation.

Sincerely,

A handwritten signature in black ink that reads "Lisa Dockter". The signature is written in a cursive, flowing style.

Lisa Dockter,  
STRAC Chair  
State and Tribal Royalty Audit Committee

## STATE and TRIBAL ROYALTY AUDIT COMMITTEE

---

State of Alaska • Blackfoot Nation • State of California • State of Colorado • Fort Peck Tribes  
Jicarilla Apache Tribe • State of Louisiana • State of Montana • Navajo Nation • State of New Mexico  
State of North Dakota • State of Oklahoma • Shoshone & Arapaho Tribes • Southern Ute Indian Tribe • State of Texas  
State of Utah • Ute Indian Tribe • Ute Mountain Ute Tribe • State of Wyoming

---

Lisa Dockter, *Chair* (970) 563-5559  
Dennis Roller, *1st Vice Chair* (701) 250-4682

*Former Chair, Ex Officio:*  
Joe Vintz

February 21, 2006

The Honorable Richard W. Pombo  
Chairman, Committee on Resources  
House of Representatives  
Washington, D.C. 20515

Dear Mr. Chairman

This letter is to clarify points addressed by Ms. Johnnie Burton, Director of the U.S. Department of Interior's Minerals Management Service (MMS), in her letter to you dated January 24, 2006. The Director's letter was an attempt to address issues raised in an article published in the *New York Times* on January 24, 2006, under the title As Profits Soar, Companies Pay U.S. Less for Gas Rights.

The State and Tribal Royalty Audit Committee (STRAC) is an organization comprised of eleven (11) states and nine (9) Indian tribes that, under agreements with the Secretary, audit leases within their respective jurisdictions to ensure proper payment of royalties from oil, gas and solid mineral companies. The agreements are authorized under Sections 202 and 205 of the Federal Oil and Gas Royalty Management Act (FOGRMA), as amended by the Federal Oil and Gas Royalty Simplification and Fairness Act of 1996 (FOGRSFA). STRAC has provided accountability for the money owed to their jurisdictions in a cost efficient manner. STRAC also has considerable knowledge regarding MMS's computer systems, its prior audit programs and its current "compliance review" initiative. For that reason, most STRAC members would like to provide you with the following information.

1. The article questioned the MMS's auditing practices. In order to cover a larger percentage of the royalties paid, MMS has geared its compliance efforts away from conducting audits in accordance with Government Auditing Standards (GAS) to completing compliance reviews. A compliance review is an analysis designed to determine the reasonableness of company-reported royalty and production data on properties. They do not involve independent verification of the accuracy of the reported information. In other words, compliance reviews do not involve getting underneath the

reported information to look at company books, records (e.g., invoices, run tickets) to confirm whether the company reported correctly on any of its reports.

2. A compliance review incorporates steps that, under normal circumstances, should be completed through automated verification. MMS' new computer system was to provide tools for automated verification for production volumes and royalty rate. The computer system originally delivered does not have automated verification capabilities. As a result, since November 2001 the compliance reviews have been performed manually, using data downloaded and manually input into Excel. We understand that the MMS is currently developing an online compliance module with the tools being made available to the delegations during the summer of 2007. Very little coordination has occurred between the States/Tribes and the MMS on this module and it is unclear how effective the tools will be based upon questionable MMS data and limitations of sharing data across land ownerships. We would recommend that the MMS initiate an Independent Validation and Verification (IVV) contract to ensure that the module will work.

3. As initially designed in the new computer system, with the input of States and Tribes, the "company profiles" – part of the "automated" compliance system – would have included data from SEC reports. SEC reports can be of value to a compliance process. Although there was other evidence of oil undervaluation, SEC reports helped expose that companies were actually receiving NYMEX prices for production and sometimes NYMEX plus bonuses. MMS in fact relied on this information in its evaluation of the flaws in the oil rules.

4. Several STRAC delegations have received in writing from the MMS that they are to do compliance reviews and reduce the number of audits because MMS has "shifted a large portion of its audit resources to compliance review work". In fact, in January 2006, MMS informed STRAC that its jurisdictions would be "*required to request*" the compliance review function in our future contracts. In the request format provided by MMS, the compliance review is referred to as automated verification. Jurisdictions were to request this additional function with no additional funding. If no additional funding is provided, part of the audit function will have to be sacrificed. This is on top of some STRAC organizations already losing some audit positions due to MMS reallocating funds.

5. In order for STRAC organizations to determine the efficiency and effectiveness of compliance reviews, STRAC on numerous occasions has requested that MMS provide statistics. MMS still has not provided STRAC with information regarding how much it has collected as a direct result of the compliance review program, hours per review, and the cost/benefit analysis (see attached). MMS used to publish separate statistics on the collections attributable to its various collection systems, e.g. audit, exceptions processing, financial compliance, etc. MMS stopped publishing these statistics in 2001, the year it obtained a new computer system and started compliance reviews.

Richard W. Pombo

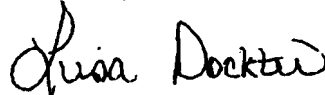
6. The 2005 "peer review", referred to in Ms. Burton's letter did not include an audit or opinion on the validity of the compliance review process. It did not review the economy or efficiency of the compliance review process. It only covered audits.

7. Although MMS made some improvements in the federal oil regulations by adopting NYMEX/WTI prices, the current Administration has not applied these changes to Indian leases, despite repeated public promises that this was a "priority" because of the Trust obligation. A new rule for Indian leases has been stalled for 5 years.

STRAC jurisdictions aggressively strive to fulfill their fiduciary responsibilities. If used properly, compliance reviews can be an effective supplement to our primary responsibility to complete GAS audits on properties selected by States and Tribes based on their independent audit judgment and experience. Given limited resources compliance reviews can be used as an efficient way to determine if "second tier" properties as determined by States and Tribes are in reasonable compliance or if they should be selected for a GAS audit. STRAC still needs to ensure their various jurisdictions they are receiving the highest value permitted by the regulations for natural resources. This cannot be accomplished by forsaking GAS audits for compliance reviews. STRAC needs additional funding in order to ensure their fiduciary responsibility to their various jurisdictions and the American people can be fulfilled. Your consideration of our request will be greatly appreciated.

If you have any questions, please contact us. STRAC's next meeting is currently scheduled for May 2-4, 2006 in Albuquerque, New Mexico. We welcome the attendance of you or your staff.

Sincerely,



Lisa Dockter  
Southern Ute Indian Tribe  
STRAC Chair