



TEXAS GENERAL LAND OFFICE  
GEORGE P. BUSH, COMMISSIONER

## REPORT ON THE AUDIT OF THE ROYALTY AUDIT PROCESSES

SEPTEMBER 2018

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### OVERALL CONCLUSION

Royalty Audit management and staff have developed a detailed audit program for staff to follow while conducting audits. The procedures are designed to provide a roadmap for each phase of the audit and for the team member assigned to conduct the technical review of the auditor's work. Royalty Audit should ensure that the audits are appropriately conducted and supported with adequate documentation in accordance with the programs' established procedures.

- Ensure that the technical review is conducted and documented in TeamMate® prior to issuing the preliminary audit billing.
- Ensure that all procedural steps in the audit program are completed and documented.

### MANAGEMENT'S SUMMARY RESPONSE

Management concurs with the recommendations. The "Detailed Results" section of this report contains management's response to each observation.

### ACKNOWLEDGEMENTS

We appreciate the assistance and cooperation provided to us by the management and staff of the Energy and Financial Management divisions during this audit. For questions about this report, please contact Jack Timmins at (512) 463-5350 or Tracey Hall at (512)463-6078.

*Tracey Hall*

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Tracey Hall, CPA, CISA  
Director of Internal Audit

Date September 25, 2018

## OBJECTIVES

The objectives of the audit were based on the results of a risk assessment performed during the planning phase of the audit. The objectives were:

1. To determine if royalty audits are appropriately conducted and supported with adequate documentation in accordance with the programs' established procedures.
2. To determine if settlements are appropriately approved and audits are closed-out according to established procedures.

## SCOPE & METHODOLOGY

The scope of the audit consisted of reviewing and evaluating information and documents involved in the Royalty Audit Processes performed in the Energy Division. The project will address activity performed during fiscal year 2016 and 2017.

The methodology included observing processes, interviewing employees, collecting information, performing tests, and analyzing and evaluating the information.

The audit was conducted in accordance with *Government Auditing Standards* and *International Standards for the Professional Practice of Internal Auditing*. 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 objectives.

## BACKGROUND INFORMATION

The Texas General Land Office (GLO) manages state oil and gas leases and the revenue generated from these leases is for the benefit of the Permanent School Fund (PSF). To ensure that the PSF is receiving the most revenue possible from state lands, the GLO makes it a priority to properly account for production revenue from state oil, gas and hard mineral leases. The importance of the Permanent School Fund places a special responsibility on the lessee/operator or agent to report revenues correctly, and on the GLO staff to ensure compliance with lease agreements.

The GLO performs royalty compliance audits, limited reviews, and lease reconciliations on the oil and gas royalty data received by the state. These procedures ensure the royalty paid to the state accounts for all oil and gas produced on state lands, or lands in which the state has an interest, is valued accurately in accordance with the lease agreements.

The Texas Natural Resources Code authorizes the GLO to conduct royalty audits, which include the right to inspect and examine books, accounts, reports, and other records relating to the payment of royalties, in-kind volume deliveries, and/or other consideration due to the state.

Texas Natural Resources Code section 52.135 Inspections and Examinations (b) states that "If, after inspection and examination of books, accounts, reports, or other records, the commissioner or his representative determines that additional royalties are due under a lease of state land or minerals, the

commissioner shall send to the lessee by certified mail, return receipt requested, an audit billing notice notifying the lessee of such additional royalties, and interest and penalty, due and of the reasons for such determination.”

The GLO Minerals Audit Oil and Gas Audit Program (Audit Program) establishes the procedural steps that audit staff are to follow when conducting the audit. The procedures are designed to provide a roadmap for staff to follow for each phase of the audit and for the team member assigned to conduct the technical review of the auditor’s work. Royalty Audit staff utilize TeamMate® Audit Management System for their electronic working papers. The policies of the program area require that all audit work papers are to be input into TeamMate® and signed off by the preparer and the technical reviewer after reviewing the work product.