COMMISSION ON MARGINALLY PRODUCING OIL AND GAS WELLS

**FOR THE PERIOD
JANUARY 1, 2008 THROUGH
DECEMBER 31, 2009**

OPERATIONAL AUDIT

OFFICE OF THE STATE AUDITOR AND INSPECTOR
OKLAHOMA

Oklahoma State Auditor
& Inspector

Audit Report of the
Commission on Marginally Producing
Oil and Gas Wells

For the Period
January 1, 2008 through December 31, 2009

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July 30, 2010

TO THE COMMISSION ON MARGINALLY PRODUCING OIL AND GAS WELLS

This is the audit report of the Commission on Marginally Producing Oil and Gas Wells for the period January 1, 2008 through December 31, 2009. The Office of the State Auditor and Inspector is committed to serving the public interest by providing independent oversight and by issuing reports that serve as a management tool to the State. Our goal is to ensure a government that is accountable to the people of the State of Oklahoma.

We wish to take this opportunity to express our appreciation to the Agency's staff for the assistance and cooperation extended to our office during the course of our engagement.

Sincerely,

STEVE BURRAGE, CPA
STATE AUDITOR & INSPECTOR

Background

The Commission on Marginally Producing Oil and Gas Wells (the Agency) was created by the legislature in 1992 to define, identify, and evaluate the economic and operational factors of marginal oil and gas wells and to work to encourage well operators and elected officials to make appropriate efforts to extend the wells' lives. The Agency is funded by a fee of $.0035 per barrel of crude oil and $.00015 per thousand cubic feet of natural gas produced in the state.

The Agency is overseen by a nine-member commission (the Commission) selected from the oil, natural gas and royalty owner associations, Osage County, and the four districts of the Corporation Commission.

Commission members are:

David Guest .... Chairman
Stan B. Noble .... Vice-Chairman
David Moore .... Secretary
A. Hearne Williford .... Member
Paul L. Bruce .... Member
Charles B. "Chuck" Davis .... Member
Thomas F. Dunlap .... Member
Bill Gifford .... Member
Ken Kerrihand .... Member

Table 1 summarizes the Agency's sources and uses of funds for state fiscal years 2008 and 2009 (July 1, 2007 through June 30, 2009).

Table 1 - Sources and Uses of Funds for SFY 2008 and SFY 2009

	2008	2009
Sources:		
Marginal Well Fee	$405,936	$578,603
Other Grants, Refunds, Reimbursements	180,999	188,439
Other Non-Revenue Receipts	1,289	0
Total Sources	$588,224	$767,042
Uses:		
Personnel Services	$306,415	$324,486
Professional Services	47,192	71,847
Miscellaneous Administrative	165,341	117,813
General Operating Expenses	11,544	52,697
Travel	16,867	45,457
Rent Expense	18,531	23,913
Office Furniture and Equipment	6,695	15,871
Other	4,064	1,604
Total Uses	$576,649	$653,688

Source: Oklahoma PeopleSoft Accounting System (unaudited, for informational purposes only)

Purpose, Scope, and Sample Methodology

This audit was conducted in response to 74 O.S. § 212, which requires the State Auditor and Inspector's Office to audit the books and accounts of state officers whose duty it is to collect, disburse or manage funds of the state.

The audit period covered was January 1, 2008 through December 31, 2009.

We selected our samples in such a way that whenever possible, the samples are representative of the populations and provide sufficient evidential matter. Sample methodologies can vary and are selected based on the audit objective and whether the total population of data was available. Random sampling is the preferred method; however, we may also use haphazard sampling (a methodology that produces a representative selection for non-statistical sampling), or judgmental selection when data limitation prevents the use of the other two methods. We identified specific attributes for testing each of the samples. When appropriate, we projected our results to that population.

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 objectives. This report is a public document pursuant to the Oklahoma Open Records Act (51 O.S. § 24A.1 et seq.), and shall be open to any person for inspection and copying.

Objective 1 – To determine whether the Agency's internal controls provide reasonable assurance that revenues and expenditures (including payroll) were accurately reported in the accounting records.

Conclusion

The Agency's internal controls do not provide reasonable assurance that revenues and non-payroll expenditures were accurately reported in the accounting records. The Agency's internal controls do provide reasonable assurance that payroll expenditures were accurately reported in the accounting records.

As explained throughout the report, we experienced a general lack of supporting documentation maintained by the Agency. 21 O.S. § 590.A requires that "every state governmental entity shall, for a period of two (2) years, maintain accurate and complete records... reflecting all financial and business transactions, which records shall include support documentation for each transaction. No such records shall be disposed of for three (3) years thereafter...." Failure to retain proper documentation can allow for unauthorized or inappropriate transactions to occur. The reader should keep this in mind when reading this report.

Methodology

<u>January 1, 2008 to January 31, 2008</u>

The previous audit report of the Agency, dated June 17, 2008, contained several audit findings related to the conflicting responsibilities of the former director of operations. Her duties included:

- Preparing the deposit slip, taking the deposit to the bank, and posting the deposit to PeopleSoft;
- Claims processing and general ledger functions;
- Initiating capital asset transactions, tagging the asset, and maintaining the inventory records; and
- Contracting with her husband's company, Kitchell Inc., to provide database entry services.

The former director of operations resigned her position in February 2008, and the Office of State Finance (OSF) began performing several of her duties February 1, 2008. We confirmed with the executive director that the former director of operations' responsibilities were the same as listed above from January 1, 2008 until OSF took over

February 1, 2008. The following procedures were performed for the month of January 2008 as a result of prior year findings:

- Comparing vendors present in January and February expenditure records with those present in March records;
- Reviewing the expenditure records for any reimbursements, travel payments, or other payments to the former director of operations;
- Reviewing the expenditure records for any payments to Kitchell Inc. during the audit period and reviewing the claims for anything unusual[1] or unreasonable; and
- Scanning the expenditures from the audit period, focusing on January and February in detail, for anything unusual[1].

Observation

As a result of these procedures we noted that two payments to Kitchell Inc. totaling $442.50 were made in February and March 2008. However, no unusual charges were included on the invoices, they were properly approved, and no further payments were made during the audit period. According to management, the contract with Kitchell Inc. was terminated.

Methodology

February 1, 2008 to December 31, 2009

To accomplish our objective, we performed the following:

- Documented internal controls related to the receipting and expenditure processes (excluding payroll), which included discussions with Agency personnel, observation, and review of documents;
- Tested controls, which included:
  - Discussing with personnel to determine whether the Agency's duties were properly segregated by ensuring the person who:
    - Reviewed the bank deposit was independent of the deposit preparation function;
    - Reviewed the bank deposit receipt was independent of delivering the deposit to the bank;
    - Reviewed the reconciliations was independent of the receipting process; and
    - Approved the expenditures prior to payment was independent of the claims posting process;
  - Reviewing a random sample of 40 deposits (totaling $124,289.10) from the period to determine whether:
    - The bank deposit was properly verified on a signed calculator tape by an employee other than the director of operations;
    - The bank deposit was mathematically accurate;
    - The bank deposit receipt agreed to the bank deposit slip;
    - The deposit was posted to PeopleSoft in a timely manner (within 3 business days); and
    - Any visible date stamps on checks reflected that funds received were deposited at the bank on a timely basis (within 24 hours or upon reaching $100);

[1] "Unusual" in this context was defined as vendors, purchased items, or account codes that were unfamiliar to the auditor or seemed inconsistent with the Agency's mission.

- Reviewing 25 randomly selected deposits of funds received through ok.gov (totaling $10,070) to ensure they agree to Agency records;
- Testing three randomly selected OSF Form 11 monthly clearing account reconciliations to ensure the reconciliation is accurate and approved by the executive director. This includes tracing amounts to supporting documentation and verification of mathematical accuracy;
- Reviewing three randomly selected reconciliations to ensure that the clearing account transfer was performed and reflected under "Section A: Vouchers Written" of the reconciliation form, and scanning the rest of the Agency transfer records to determine when additional clearing account transfers were conducted; and
- Reviewing 40 randomly selected claims (totaling $26,711.14) from the period of February 2008 through August 2009[2] to determine whether payments were properly and independently approved. This includes ensuring that the invoice supports the payment, is approved by the executive director, is mathematically accurate, that the expenditure appears reasonable given the Agency's mission, and that the invoice bears an original signature.

Methodology **<u>January 1, 2008 to December 31, 2009</u>**

Because the executive director was present beginning January 1, 2008 and was able to verify the payroll process in place, the following payroll procedures were performed for the entire audit period. Our reviews of significant laws listed here were also conducted for the full audit period.

- Documented internal controls related to the payroll process, which included discussions with Agency personnel, observation, and review of documents;
- Tested controls, which included:
    - Reviewing all employee timesheets and payroll documentation for six randomly selected months from the audit period to ensure:
        - All timesheets were approved by the executive director;
        - Payroll claim documents were approved by the executive director or director of operations; and
        - Hours listed on employee timesheets agreed to the corresponding payroll registers;
    - Reviewing form OPM-14 for all salary changes and terminations that took place during the audit period to ensure the forms were approved by the executive director, or in the case of changes pertaining to the executive director, approved by the Commission; and
    - Reviewing the payroll documentation from two months after each termination to ensure the separated employee was no longer on the payroll;
- Reviewed the PeopleSoft HR Actions report from the period to ensure the executive director's annual salary did not exceed the maximum limit set forth in 74 O.S. § 3601.2;

[2] This procedure was limited to exclude the final four months of the audit period due to a lack of segregation of duties during those months, as the director of operations was responsible for posting expenditure claims in PeopleSoft and for receiving the resulting warrants from the State Treasurer's Office. See finding entitled "Inadequate Segregation of Duties in the Expenditure Process" on page 9 of this report.

- Discussed with personnel to determine whether a process had been put in place to alert the Agency to any fees which are not paid or not properly paid, as required by 52 O.S. § 703.C. This statute requires that the Agency take "appropriate and necessary actions to collect any fee which is not paid or is not properly paid."

Observation **Lack of Controls over Funds Received at Trade Expos and Workshops**

An effective internal control system provides for accountability of funds.

Revenues received in cash and check form at the Agency's trade expositions and workshops are recorded on pre-numbered receipts at the time received. However, these receipts are not ultimately compared to the revenues received during preparation of the bank deposit.

Because management was not aware of the risks involved in not reconciling the cash and checks received to the appropriate receipt books, any employee with access to the funds after the receipts are written may have the opportunity to misappropriate those funds and it may not be detected.

Recommendation The employee responsible for reviewing the bank deposit should reconcile the funds received at Agency events to the receipt books used at the event, to be sure all funds are included in the deposit and all numbered receipts are accounted for.

Views of Responsible Officials The Agency will continue its dual control process in which two staff members and/or agency representatives (Commissioner or Advisory Council member) verify the amount collected at an event. In addition, they will ensure that receipt numbers are used in a proper numeric order and a grand total tape or document verified and signed by both parties is provided with fees collected and returned to the Agency. This tape or document will be signed by the dual control persons. Upon delivering items to the director of operations, a re-verification of the amounts will be done by the Director of Operations and Public Information Officer. A separate deposit of such fees will be prepared for deposit to the bank and clearing account. New procedures to be implemented effective 8/1/2010.

Observation **Inadequate Segregation of Duties Related to Bank Deposits**

An effective internal control system provides reasonable assurance that assets are adequately safeguarded by properly segregating duties of employees.

Due to the Agency's small staff size, the bank deposit slip completed by the director of operations is not being effectively verified by someone independent of the deposit preparation process.

- In six of the 40 deposits tested (totaling $17,848 of the total sample of $124,289.10), no verifying calculator tape was included;
- In one additional case (totaling $1,625), no supporting documentation was maintained; and
- In seven cases (totaling $11,162.84), the photocopied checks in the deposit documentation did not agree to the calculator tape because checks were not copied or were recorded at the wrong amount on the calculator tape.

This process could allow for funds to be received and not deposited without being detected in a timely manner.

Recommendation

An employee other than the director of operations should verify the deposit slip to the checks received. As the public information officer receives check copies related to her duties, she is the ideal employee to perform this comparison as she may notice if checks originally received are missing. However, if she is unavailable, another employee should verify the deposit slip to the checks. The signed and dated calculator tape should be retained with the deposit documentation as a record of this review.

Views of Responsible Officials

Considering we have actual bank receipts that verify amounts that were deposited with the bank, the Agency disagrees with the notion that the calculator tapes differed from the actual deposits made. However, the dual control process currently used and detailed below will be enforced to ensure compliance with current state laws or policies and procedures. This reinforcement will begin immediately.

The administrative assistant receives the checks and makes photocopies; the director of operations prepares the actual bank deposit slip and prepares a calculator tape which verifies the totals; the press information officer re-verifies the amount shown on the deposit slip by preparing another calculator tape and then takes the items to the bank for deposit. In the absence of the director of operations or press information officer, the public affairs officer or the executive director will fulfill these duties.

Observation

Lack of Supporting Documentation to Support Review of Revenues Received Online

An effective internal control system provides for accurate and reliable records and adequate review of supporting documentation.

Due to a lack of document retention or organization of financial records at the Agency, for seven of the 25 online revenue deposits tested, the Agency could not provide us with appropriate supporting documentation. This represents $2,465 of our total sample of $10,070. We were therefore unable to determine whether the amounts deposited were supported by ok.gov or Agency records.

Payments received through ok.gov may not be included in Agency records.

Recommendation

Revenues received online should be reconciled to Agency records and to the e-mails sent by ok.gov to ensure they are complete and accurate. This supporting documentation should then be retained with the appropriate deposit paperwork.

Views of Responsible Officials

A process to address this issue was in place prior to the audit but had been somewhat relaxed due to a change in personnel performing this duty. However, we have re-enforced this process by now having the administrative assistant attach shipping documentation to the ok.gov receipt daily. With doing this, any discrepancies in payment processing can be resolved immediately.

Observation

Deposits Not Posted to PeopleSoft in a Timely Manner

An effective internal control system provides for prompt recording of accounting transactions.

Thirty-five of the deposits in our sample of 40 (those deposited before September 2009) were the responsibility of OSF Shared Services, a division of the Office of State Finance that provides certain accounting services to state agencies for a fee. Of these 35 items, eight were not posted to PeopleSoft within three business days of deposit, and were posted an average of 7.75 business days after deposit. The documentation for these deposits did not include evidence of when the deposit records were forwarded to OSF

Shared Services, so we are unable to determine whether the delay in posting is the responsibility of the Agency or Shared Services.

The additional five items in our sample (those deposited during September through December 2009) were the responsibility of the Agency. Of these five items, three were not posted to PeopleSoft within three business days of deposit, and were posted an average of 9.3 business days after deposit. Due to the Agency's limited staff size, only one person has the ability to enter deposit information into PeopleSoft.

In the PeopleSoft system, cash is not available until the journal entry is made and added to the Agency's cash balance. Therefore, the available cash balance on PeopleSoft reports could be misstated.

Recommendation We recommend management exercise diligence and ensure their deposit entries are posted into PeopleSoft within three business days of deposit.

Views of Responsible Officials The director of operations will ensure that deposits are posted in the PeopleSoft system within three business days of the actual deposit being made at the bank. This re-enforcement of procedure will begin 7/19/10.

Observation **<u>Revenues Not Deposited at the Bank on a Timely Basis – Repeat Finding</u>**

An effective internal control system provides for adequate safeguarding of assets. In addition, 62 O.S. § 34.57.C requires that deposits of $100 or greater be taken to the bank on the same day as received, and receipts awaiting deposit be properly safeguarded.

Due to the Agency's small staff size, deposits are not always deposited at the bank on a timely basis. Of the 40 deposits tested, 22 included check copies with visible date stamps reflecting when payments were received by the Agency. Of the 22 deposits that included visible date stamps, two contained checks totaling $100 or more which had been date stamped more than 24 hours before deposit (in one case as far back as 8 business days before deposit, and in the other case 15 business days before deposit). These two deposits totaled $7,095 of the total sample of $124,289.10.

It should be noted that the Agency does secure funds properly in a locked desk drawer while awaiting deposit.

Improprieties could occur and not be detected in a timely manner.

Recommendation All funds should be deposited within one business day of being received or upon reaching $100, as required by 62 O.S. § 34.57.C.

Views of Responsible Officials The director of operations will ensure that deposits are made within one business day or when amounts accrue to $100.00. In the absence of the director of operations, this duty can be handled by the press information officer or executive director. The re-enforcement of this procedure will begin 7/19/10.

Observation **<u>Reconciliations Not Reviewed on a Timely Basis</u>**

An effective internal control system provides for an adequate reconciliation of accounting records with a sufficient and timely review.

In testing our sample of three reconciliations from the period of February 2008 through December 2009, we defined a timely review as being performed before the Form 11 reconciliation is due to the Office of State Finance on the 10th day of the following month. Of the three reconciliations tested, none was reviewed within that period. Two of these reconciliations were performed by OSF Shared Services. The reconciliation for June 2008 was not forwarded to the Agency for approval in a timely manner, as it was date-stamped received by the Agency on August 19, 2008 and approved by the executive director on August 28, 2008. The December 2008 reconciliation is not date-stamped received so it is uncertain whether OSF Shared Services or the Agency is responsible for the tardiness of review.

The reconciliation in our sample that was prepared by the Agency for October 2009 was also signed after the due date, on December 22, 2009. We reviewed the signature dates on the other three months' reconciliations prepared by the Agency and noted that two of them were approved at least three weeks after the close of the month being reconciled, for a total of three out of four months with untimely reviews. These untimely reviews are due to the fact that the executive director is often out of the office performing Agency business.

It should be noted that with respect to the items tested, the executive director's review appears to have been completed properly, as the reconciliations tie to supporting documentation and are mathematically accurate.

This process could allow errors in Agency or OST records to go unnoticed and uncorrected for extended periods of time, negating the purpose of the reconciliation. It could also result in an incorrect amount of funds being transferred from the agency clearing account to its revolving fund.

Recommendation

In order for the review of reconciliations to be an effective control, the review should be performed as soon as possible after preparation of the reconciliation, so that errors can be caught and corrected in a timely manner. Per OSF Procedures Manual Chapter 500, reconciliations are due to OSF by the 10th day of the following month, so we would expect to see review and approval, including any necessary corrections, completed during that timeframe.

Views of Responsible Officials

Due to errors posted in the PeopleSoft System with the October 2009 deposits, corrections were initiated by OSF prior to providing the executive director with valid documents to sign. However, beginning 8/1/10, the executive director will sign appropriate documentation and forward to OSF within 10 business days of the beginning of each month.

Observation

Clearing Account Transfers Not Completed Monthly – Repeat Finding

62 O.S. § 34.57.E.1 requires that "at least once each month each state agency shall transfer monies deposited in agency clearing accounts to the various funds or accounts, subdivisions of the state, or functions as may be provided by statute."

Funds were not transferred from the clearing account to the Agency's revolving fund during the following months: March, June, July, and September of 2008, and January, May, June, September, and November of 2009. Transfers were the responsibility of OSF Shared Services from February 2008 through August 2009, and the responsibility of the Agency from September through December 2009.

Funds are not available to be expended by the Agency until they have been transferred from the clearing account. Failure to properly transfer as required by 62 O.S. § 34.57.E.1 reduces the amount of cash available for the Agency to fulfill its obligations.

Recommendation

The Agency should implement necessary procedures to ensure funds are transferred from the clearing account at least once per month as required by state statute.

Views of Responsible Officials

The director of operations will ensure that clearing account transfers are done on a monthly basis. This will be re-enforced beginning 8/1/10.

Observation

<u>Inadequate Segregation of Duties in the Expenditure Process – Repeat Finding</u>

An effective internal control system provides reasonable assurance that assets are adequately safeguarded by properly segregating duties of employees.

Due to the Agency's small staff size, for the period of September through December 2009 the director of operations was responsible for posting expenditure claims to PeopleSoft and for receiving the resulting warrants issued by the State Treasurer's Office.

Improprieties could occur and not be detected in a timely manner.

Recommendation

The Agency should implement procedures separating the duties of posting expenditures and receiving warrants. If that is impossible due to the small size of the Agency, we recommend the executive director review the warrant registers corresponding to each batch of warrants received for reasonableness based upon his familiarity with expenses.

Views of Responsible Officials

Beginning 7/19/10, the director of operations will begin printing duplicate copies of voucher claim jacket forms and giving them to the administrative assistant as a verification tool to use as actual checks are delivered to agency. Initialed copies of these duplicate forms will be filed with accounting files kept by the director of operations.

Observation

<u>Non-compliance with 52 O.S. § 703.C – Repeat Finding</u>

52 O.S. § 703.C states, "The Commission on Marginally Producing Oil and Gas Wells shall be responsible for taking appropriate and necessary actions to collect any fee which is not paid or is not properly paid."

Per discussion with staff, the Agency currently has no process in place to ensure that all fees due are being properly paid and received by the Agency. While the Agency has been planning to put a process in place, management has not yet determined the appropriate course of action.

It is possible the Agency did not receive all fees due, which would limit their ability to carry out their mission.

Recommendation

The Agency should comply with 52 O.S. § 703.C, and develop a procedure to ensure they are being properly paid.

Views of Responsible Officials

The director of operations will network with other agencies receiving fees in an effort to initiate an appropriate process for ensuring proper payment from liable companies. This process will begin 9/1/10.

Other Items Noted

Although not considered significant to the audit objective, we feel the following issue(s) should be communicated to management.

Observation **No Statute Found Requiring State General Revenue Fund Transfer**

The Agency currently transfers 10% of its monthly revenues received to the State general revenue fund. We discussed with management to determine what statute had prompted the Agency to transfer these funds, and no Agency-specific statute could be located. We believe the Agency may have begun transferring funds in connection to state statute 62 O.S. § 211. This statute requires that "all self-sustaining boards created by statute to regulate and prescribe standards, practices, and procedures in any profession, occupation or vocation... shall pay into the General Revenue Fund of the State ten percent (10%) of the gross fees so charged, collected and received by such board." However, as the Marginal Wells Commission does not regulate or license a profession, this statute does not necessarily apply to the Agency.

It appears the Agency may have misinterpreted the above state statute at some point in time, and as a result may be transferring funds unnecessarily.

Recommendation Management should discuss this matter with their liaison at the Attorney General's office to determine whether or not they are truly required to transfer 10% of revenues to the State's general revenue fund. If they are not required to do so, they should cease transferring those funds immediately.

Views of Responsible Officials The executive director or director of operations will contact the Attorney General's office by 7/19/10 to verify whether the Agency is liable to transfer 10% of all revenues to the State's general fund. If no statute is in place for this transfer, the Agency will not transfer said funds from July 2010 revenue.

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