ATTESTATION REPORT
OF THE
NEBRASKA OIL AND GAS
CONSERVATION COMMISSION

JULY 1, 2003 THROUGH JUNE 30, 2004

Issued on April 15, 2005

NEBRASKA OIL AND GAS CONSERVATION COMMISSION

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BACKGROUND

The Nebraska Oil and Gas Conservation Commission (Commission) was created in 1959 to curb wasteful practices in oil and gas production. The Commission has three members appointed by the Governor to four-year terms with legislative approval. The Commission hires a Director, who is not a Commission member, and fixes his or her salary. The Director administers and enforces the Oil and Gas Conservation Law of 1959 and all rules, regulations, and orders promulgated by the Commission. The Director also acts as the Commission's Secretary and keeps its minutes and records. The Director must be a qualified petroleum engineer with at least three years of actual field experience in the drilling and operation of oil and gas wells.

The duties of the Commission are as follows:

- To encourage and promote the development, production and use of oil and gas in ways which prevent waste.
- To provide for the operation and development of oil and gas properties which permits recovery of the most oil and gas possible while protecting owners' rights.
- To encourage and authorize cycling, recycling, pressure maintenance, and secondary recovery operations to obtain maximum oil and gas economic recovery in the State.
- To conduct hearings to devise and adopt programs aimed at accomplishing the duties listed above.

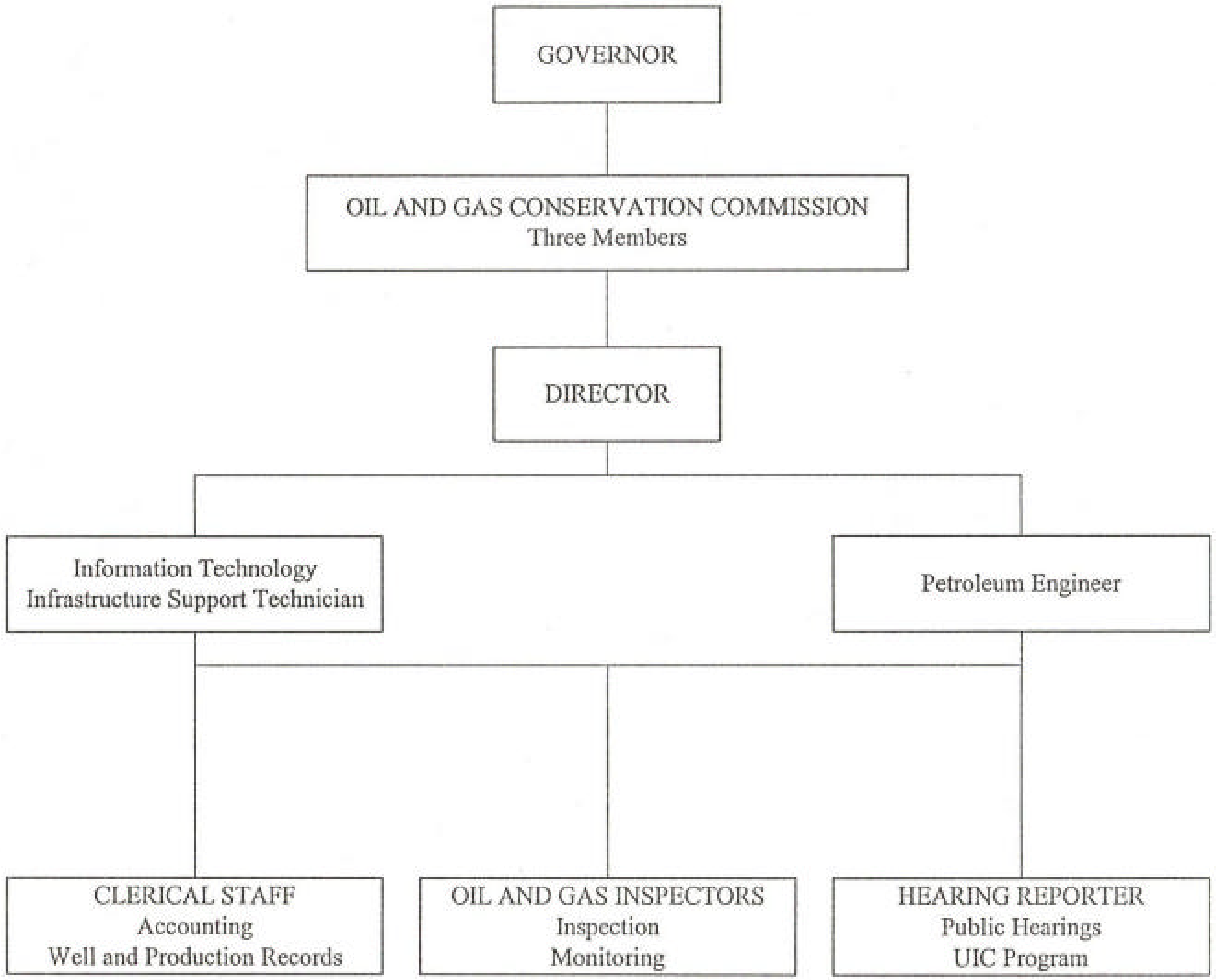
The Nebraska Oil and Gas Conservation Commission's operation cost is paid primarily by the conservation tax proceeds collected by the Nebraska Department of Revenue from a tax assessed on the value of all oil and gas produced in the State. The Commission performs its duties with seven full-time and one part-time staff members.

MISSION STATEMENT

The mission of the Nebraska Oil and Gas Conservation Commission is to foster, encourage and promote the development, production and utilization of natural resources of oil and gas in the State. The mission will be accomplished in such a manner as will prevent waste, protect correlative rights of all owners, and encourage and authorize secondary recovery, pressure maintenance, cycling, or recycling, in order that the greatest ultimate recovery of oil and gas may be obtained within the State while protecting the environment. To this end the landowners, producers, and the general public will realize and enjoy the greatest possible good from these vital, irreplaceable natural resources.

NEBRASKA OIL AND GAS CONSERVATION COMMISSION

ORGANIZATIONAL CHART



EXIT CONFERENCE

An exit conference was held March 18, 2005 with the Commission to discuss the results of our examination. Those in attendance for the Nebraska Oil and Gas Conservation Commission were:

NAME	TITLE
William H. Sydow	Director
Mary L. Pohl	Information Technology Infrastructure Support Technician

SUMMARY OF COMMENTS

During our examination of the Nebraska Oil and Gas Conservation Commission, we noted certain matters involving the internal control over financial reporting and other operational matters which are presented here.

1. ***Commuting Use of State Vehicles:*** Income adjustments were not made to report as taxable income the value of the daily use of two Commission-owned vehicles primarily for commuting purposes.

2. ***Fines/Penalties:*** Neb. Rev. Stat. Section 57-919 R.R.S. 2004 requires all money collected by the Tax Commissioner, the Commission, or as civil penalties under sections 57-901 to 57-921 be remitted to the State Treasurer for credit to the Oil and Gas Conservation Fund. However, this Statute appears to be in conflict with the Nebraska Constitution, Article VII, Section 5, which requires such monies be appropriated for the use and support of the common schools in the respective subdivision where the penalties were levied.

3. ***Labor Documentation:*** Commission employees did not maintain timesheets or other documentation to record at least 40 hours of labor was worked each week.

4. ***Capital Asset Transactions:*** The Commission did not establish as an asset within the capital assets system of the Nebraska Information System (NIS) the $1,737 purchase of an employee workstation.

5. ***Employment Eligibility Verifications:*** Employment Eligibility Verification (Form I-9) as required by the U.S. Department of Justice Immigration and Naturalization Service was not obtained for Commission employees hired after November 6, 1986.

6. ***Commission Rules and Regulations:*** The Commission has not updated its Rules and Regulations on file in the office of the Nebraska Secretary of State since May 1994 despite changes in statutory authority and fee increases.

7. ***Nebraska Information System and Accounting Procedures:*** Significant concerns or areas where improvement to the NIS is needed to ensure NIS integrity and operation efficiency were identified.

More detailed information on the above items is provided hereafter. It should be noted this report is critical in nature as it contains only our comments and recommendations on the areas noted for improvement.

SUMMARY OF COMMENTS
(Continued)

Draft copies of this report were furnished to the Commission to provide them an opportunity to review the report and to respond to the comments and recommendations included in this report. All formal responses received have been incorporated into this report. Responses have been objectively evaluated and recognized, as appropriate, in the report. Responses that indicate corrective action has been taken were not verified at this time but will be verified in the next examination.

We appreciate the cooperation and courtesy extended to our staff during the course of the examination.

COMMENTS AND RECOMMENDATIONS

1. Commuting Use of State Vehicles

Internal Revenue Service (IRS) Publication 15-B, Employer's Tax Guide to Fringe Benefits, requires the reporting of income of any employee's personal use of employer provided vehicles. Commuting, which is defined as the travel between an employee's home and regular work location, is deemed personal use. The law provides that a value of $1.50 per one-way commute ($3.00 round trip) be added to the employee's taxable income to account for this personal use of employer provided vehicles since this fringe benefit is to be subject to employment and income taxes. In addition, the Nebraska State Accounting Manual, in detailing travel expense policies, reiterates the IRS definition of commuting and states that each agency is responsible for correctly entering commuting income adjustments into the Nebraska Information System (NIS) during each calendar year payroll. Sound business practices also require that agency-owned vehicles incur reasonable daily and/or average mileage use in order to justify such ownership. For example, the Nebraska Department of Administrative Services (DAS) Transportation Services Bureau standards for permanently assigned vehicles include, in part, a monthly travel minimum of 1,000 miles and a monthly vehicle utilization of at least 17 working days.

The daily use of two Commission-owned vehicles was primarily related to commuting from employees' homes to the Commission office location at the beginning and end of each work day as well as similar round-trips during the employees' lunch breaks. However, no income adjustments were made to report the value of this personal use as taxable income to the respective employees. The vehicles in question are assigned to the Commission's Director and Petroleum Engineer and, during the fiscal year ended June 30, 2004, were used an average of 433 and 472 miles per month, respectively.

Failure to comply with State guidelines and, in particular, Federal regulations may result in civil and criminal sanctions against individuals in violation of tax law.

> We recommend the Commission review the IRS Code and all applicable related publications and, as appropriate, report the taxable commuting use of State vehicles as defined by the IRS. We also recommend the Commission review its vehicle utilization and the need for Commission-owned vehicles with primarily daily employee commuting.

Commission's Response: We will further investigate the referenced IRS publication. However, we disagree with the statement that the vehicles are used "primarily for commuting purposes" since 86% of these vehicles' mileage is for trips and inspections. We offer the following facts pertaining to the two vehicles in question.

A. Both vehicles are codified as Duty Stations in Nebraska Revised Statute 81-1011.

COMMENTS AND RECOMMENDATIONS
(Continued)

1. <u>Commuting Use of State Vehicles</u> (Continued)

Commission's Response, Concluded:

B. The drivers of the vehicles are the Director and Staff Petroleum Engineer, both of whom are on-call at all times of the day, every day of the week except when on approved leave.

C. The vehicles are driven to work with the full expectation that they may be used to travel to the field with no prior notice or scheduling.

D. The two employees live within one (1) mile of the office. During calendar years 2003 and 2004, in-town travel averaged 75 miles per month. This mileage represents only 14% of the total miles for these two vehicles over the two-year period. We take exception to the use of the mileage averages, of 433 and 472 miles per month shown in the comments, without explanation of the breakdowns of the mileages.

E. The Commission must use a public parking lot which is not secured during the evening. Vandalism to any vehicle left over-night is highly probable so these vehicles are parked at the employee's homes on nights and weekends.

F. The vehicles are primarily used for inspections, well testing, and travel to Lincoln or McCook, Nebraska, or Denver, Colorado. Sidney does not have aviation services so all airline travel must begin at Denver International Airport which is approximately 165 miles from Sidney. Lincoln is 360 miles from Sidney while McCook is 180 miles away. Travel to and from these cities is required.

G. There is no company in Sidney through which a vehicle could be rented when any need arose.

H. The vehicles must be kept in a condition that guarantees readiness at all times. Frequent use ensures their useful and dependable condition.

I. The vehicles contain personal protective gear and clothing which is used for inspections. Items that may be included are hardhats, steel-toed shoes/boots, coats, winter coveralls, and rain slickers. This equipment is necessary to be in the vehicles since it could be used literally at any time.

J. The vehicles include a 1996 Dodge 4WD pickup with 225,000 miles and a 1992 Dodge all-wheel drive minivan with 85,000 miles. We have maintained the vehicles and they serve us well since we have versatility between them in a number of areas.

COMMENTS AND RECOMMENDATIONS
(Continued)

1. Commuting Use of State Vehicles (Concluded)

APA's Response: While we concede the majority of the actual miles the vehicles traveled in a given month and/or calendar year appeared to be related to employees' work-related trips and/or inspections, such use for trips and/or inspections was very infrequent. Based on our examination of the Commission's vehicle logs, it is an accurate statement that the daily use of two Commission-owned vehicles was primarily related to commuting from employees' homes to the Commission's office location. *Government Auditing Standards* require, during the course of our examination, we report all apparent violations of State and Federal statutes, laws, and/or regulations. While Nebraska law may designate your vehicles as "duty stations" for the purpose of DAS Transportation Services Bureau regulations, the IRS relies upon its own tests to determine whether use of a motor vehicle constitutes a taxable fringe benefit. These tests are independent of Nebraska statute. We would encourage the Nebraska Oil and Gas Conservation Commission to consult with its legal counsel on requesting a private letter ruling from the IRS on whether its employees may exclude the value of this taxable fringe benefit from their income based on what the Commission feels are its particular unique facts and/or circumstances.

2. Fines/Penalties

The Nebraska Constitution Article VII, Section 5 (1) states, ". . . all fines, penalties, and license money arising under the general laws of the state . . . shall belong and be paid over to the counties respectively where the same may be levied or imposed . . . All such fines, penalties, and license money shall be appropriated exclusively to the use and support of the common schools in the respective subdivisions where the same may accrue . . . ."

Neb. Rev. Stat. Section 57-919 R.R.S. 2004 states, in part, ". . . all money collected by the Tax Commissioner or the Commission or as civil penalties under sections 57-901 to 57-921 shall be remitted to the State Treasurer for credit to a special fund to be known as the Oil and Gas Conservation Fund . . . ."

The State Statute appears to be in conflict with the Nebraska Constitution. However, the Tax Commissioner and the Commission followed the language provided in the Statute for the deposit of all monies collected.

When conflict exists between State Statute and the Constitution there is an increased risk of misinterpretation and/or dispute.

COMMENTS AND RECOMMENDATIONS
(Continued)

2. <u>Fines/Penalties</u> (Concluded)

> We recommend the Commission consult with the Attorney General to resolve the apparent conflict between the State Statute and the Nebraska Constitution.

Commission's Response: We will contact the Attorney General's office concerning this matter and possible disputes over the disbursement of monies collected by the Commission. Since the passage of the statutes authorizing our agency and its inception in 1959, we are not aware of any situation where a disagreement has ever occurred.

3. <u>Labor Documentation</u>

Neb. Rev. Stat. Section 84-1001(1) R.R.S. 1999 states, "All state officers and heads of departments and their deputies, assistants, and employees . . . shall render not less than forty hours of labor each week . . ." Good internal control requires the Commission obtain adequate documentation illustrating employee compliance with this statutory requirement. Additionally, good internal control requires labor documentation include the authorizing signatures of both the employee and the employee's immediate supervisor.

During the examination we noted the Commission's employees report only their leave usage and not the number of hours worked each week. In addition, neither the employee nor the employee's immediate supervisor signed the Commission's monthly leave usage forms.

Without adequate controls and documentation there is an increased risk of errors.

> We recommend documentation procedures be implemented that require employees either maintain timesheets or otherwise document that not less than 40 hours of labor were worked each week. In addition, we recommend the Commission's labor documentation include the authorizing signatures of both the employee and the employee's immediate supervisor.

Commission's Response: We have implemented the use of a revised leave document as recommended. The previous document showed the amount and type of monthly leave hours for each employee. Employees will now sign a statement attesting to the hours worked, or approved for vacation/illness, every week of a monthly pay period.

COMMENTS AND RECOMMENDATIONS
(Continued)

3. Labor Documentation (Concluded)

However, I don't believe that "good internal control" requires the signature of an employee. Good internal control in this area is based upon proper supervision and motivation of employees, if and when required.

APA's Response: The inclusion of authorizing signatures of both employees and their immediate supervisors on labor documentation would serve as a good internal control for the Commission. Such signatures are intended to serve as a knowledgeable declaration that the labor documentation being provided is a complete and accurate account of employee hours rendered.

4. Capital Asset Transactions

The Commission's capital asset policy requires all items originally purchased at a cost of at least $1,500 be inventoried. DAS capital asset guidelines require all assets being procured with a total cost of at least $1,500 be established as assets within the capital assets system of NIS and that these expenditures be primarily classified within the 58XXXX capital outlay object account codes (the coding of capital outlay purchases is a critical issue in the tracking and accounting for property identified as capital assets). Specifically related to the inventory of equipment and furniture, DAS guidelines additionally require capital outlay expenditures involving capital acquisitions or additions having useful lives of more than two years be inventoried within the capital assets system of NIS. Lastly, good internal control requires adequate procedures be in place to ensure compliance with all applicable capital asset policies.

The Commission's purchase of an $1,737 employee workstation was not established as an asset within the capital assets system of NIS. The Commission's rationalization for not adding the workstation as a capital asset was: 1) the vendor, while having quoted $1,737 for the workstation purchase, sent the Commission two separate invoices which, individually, did not exceed $1,500; and 2) the workstation components (drawers, shelves, etc.) were individually itemized on the vendor invoices and the individual item cost of each component did not exceed $1,500.

Without adequate controls there is an increased risk of errors.

> We recommend the Commission implement procedures to ensure all capital outlay purchases are capitalized strictly in accordance with the capitalization policies of DAS and the Commission. Generally, if expenditures are coded to capital outlay accounts, they should be capitalized accordingly and if not capitalized, such expenditures should be coded to operating expenditure object account codes.

COMMENTS AND RECOMMENDATIONS
(Continued)

4. Capital Asset Transactions (Concluded)

Commission's Response: The Commission has an Equipment Inventory Policy and adequate procedures have been in-place for a number of years. Assets are listed on at least one of two, up-to-date asset lists. The asset listings of individual items purchased for over $1,500 are also in the possession of the Materiel Division of the Department of Administrative Services through NIS. We believe that the sole issue of this comment is a matter of interpretation as to what "individual items purchased at a cost of $1,500.00" means. We respectfully disagree with the Auditor.

The comment stems from the purchase of a component workstation. The equipment that was purchased is currently incorporated to form one unit but consists of ten (10) individual pieces. Each piece was invoiced and shipped on an itemized basis, duly inventoried, and numbered with a property tag. It is possible that selected pieces of the current assemblage may be removed from the current set-up and placed at various other work areas in our office. Further, individual pieces could be subject to surplus in the future, not the entire unit. Therefore, the decision was made to place these ten pieces, as individual assets, on the Master Inventory only and not the second list of items with a value over $1,500.

The decision to inventory each piece was made solely by the agency Director and was consistent with the inventory of similar equipment currently being used by the Director and staff.

APA's Response: Based on the Commission's capital asset policy and DAS capital asset guidelines all items originally purchased at a cost of at least $1,500 are to be inventoried. Again, the employee workstation as purchased, while it may have been made up of numerous components such as drawers, shelves, etc., had a total purchase cost for the workstation as a whole in excess of the $1,500 established capitalization threshold. It is unacceptable to break down or separately itemize purchases to avoid proper capitalization.

5. Employment Eligibility Verifications

The U.S. Department of Justice Immigration and Naturalization Service requires all employees, citizens, and noncitizens hired after November 6, 1986 have an Employment Eligibility Verification (Form I-9) completed and retained to document employment eligibility. The completed I-9 Forms are to be retained by employers for three years after the date of hire or one year after the date employment ends, whichever is later.

COMMENTS AND RECOMMENDATIONS
(Continued)

5. Employment Eligibility Verifications (Concluded)

The Commission did not have employment procedures in place which required the completion of Form I-9 for all employees hired after November 6, 1986. As a result, at the time of payroll testing no Form I-9 was on file for the four Commission employees tested.

Employers are subject to civil or criminal penalties if they do not comply with the provisions of the Immigration and Control Reform Act of 1986, which is the authority for collecting Form I-9.

> We recommend the Commission obtain all required Employment Eligibility Verification forms.

Commission's Response: We were unaware of the federal requirement and have now verified that all of our employees, hired after November 6, 1986, are citizens of the United States. This includes our most recent employee who was hired effective April 1, 2005.

6. Commission Rules and Regulations

Neb. Rev. Stat. Section 84-902 R.R.S. 1999 requires each agency file in the office of the Nebraska Secretary of State a certified copy of the rules and regulations in force and effect in such agencies. In order to keep the rules and regulations on file with the Secretary of State updated and current, Neb. Rev. Stat. Section 84-907 R.R.S. 1999 outlines the adoption, amendment, repeal, hearing, and notice procedures for agency rules and regulations.

The Commission has not updated its rules and regulations on file in the office of the Secretary of State since May 1994 despite fee and statutory authority changes having occurred since then. For example, effective October 1, 1995 the Commission's hearing fee increased from $100 to $250, the Commission plugging fee increased from $25 to $100, and the drilling permit fee increased from $75 to $200 (these fees are currently set in Neb. Rev. Stat. Sections 57-911 and 57-906 R.R.S. 2004) and 1999 Neb. Laws LB 293, Section 1, created the Well Plugging and Abandonment Trust Fund and outlined its use and related fee structure. As of March 18, 2005 the Commission has not yet implemented provisions related to Neb. Rev. Stat. Section 57-923 R.R.S. 2004.

When rules and regulations are not kept current there is an increased risk of misinformation being distributed and the potential for dispute as a result of such.

> We recommend the Commission work to update and keep current its rules and regulations as made available to the public and filed in the office of the Nebraska Secretary of State.

COMMENTS AND RECOMMENDATIONS
(Continued)

6. Commission Rules and Regulations (Concluded)

Commission's Response: We have not updated our rules to account for several changes based upon amendments to the Nebraska statutes. Regarding the changes to fee structures, we notified all of our operators of this change to statute by memorandum and no one has ever complained about the fact that they are not current in the rules. We will be working toward rule-making in the future; however, due to the cost of rule-making and the lengthy time periods involved, we will seek to amend a number of rules, not just the ones pertaining to three fees. The idle well fee will require a grass-roots rule-making.

Rule-making and revision is a time-consuming task that will require a great effort by one individual. Due to our current work requirements and responsibilities, the updating of our rules has been a very low priority.

7. Nebraska Information System and Accounting Procedures

Good internal control requires a plan of organization, procedures, and records designed to safeguard assets and provide reliable financial records. Without adequate training, written procedures, and controls, there is a risk that employees may unintentionally corrupt critical data and that errors could occur and go undetected.

During the fiscal year ended June 30, 2003, the State of Nebraska implemented significant components of a new information system called the Nebraska Information System (NIS). Three major components were the Payroll, Fixed Asset, and Financial components, which went live during the fiscal year ended June 30, 2003. During the fiscal year ended June 30, 2004, the Procurement and Employee Self-Service components were partially implemented. NIS affects all Nebraska State agencies.

A consultant hired by the Auditor of Public Accounts (APA) with expertise in studying large computer systems performed a study of NIS processes and controls prior to June 30, 2003. The APA also performed a preliminary examination of internal controls as of June 30, 2003, at all State agencies in July and August of 2003. In addition, while performing examination procedures the APA obtained a further understanding of NIS.

From these studies and examinations, the APA has identified concerns and areas where improvement to NIS is needed. During the fiscal year ended June 30, 2004, the Department of Administrative Services (DAS) Accounting Division addressed some areas of concern previously reported. However, the following are the more significant concerns or areas where improvement is still needed to ensure NIS integrity and operational efficiency:

COMMENTS AND RECOMMENDATIONS
(Continued)

7. Nebraska Information System and Accounting Procedures (Continued)

a. The reconciliation between the State Treasurer's actual bank statements and records, the Nebraska Accounting System (NAS-the previous accounting system before NIS), NIS accounting records, and the related disposition of reconciling items was not completed for November 2002 through December 2003 in a timely manner. Subsequent to December 2003, the DAS Accounting Division performed some reconciliation procedures. As of July 2004, the June 30, 2003, reconciliation indicates an unknown variance between the bank records and the accounting records of $3,654,783, with the bank being short compared to the accounting records.

During the fiscal year ended June 30, 2004, DAS Accounting Division began performing a daily reconciliation of activity recorded on NIS compared to the activity recorded in the bank on a limited test basis. For those days tested, the activity recorded on NIS can be reconciled to the activity in the bank. The monthly reconciliations for the months of July 2003 through February 2004 for the fiscal year ended June 30, 2004 have been performed and indicate fluctuations in the variance amounts. The latest monthly reconciliation performed, February 2004, indicates an unknown variance between the bank records and the accounting records of $5,112,201, with the bank being short compared to the accounting records. This variance was provided to us by DAS Accounting Division and its accuracy has not been verified by the APA.

Although some reconciliation procedures have been performed (daily reconciliation of activity going through NIS to the activity recorded through the bank), the monthly reconciliation for the months March 2004 through June 2004 are still in the preliminary stages and are not complete as of July 2004. Complete and timely reconciliation procedures between bank records and accounting records provide control over cash and accurate financial information. The reconciliation procedures should be completed timely and on at least a monthly basis to ensure all financial information is correct in NIS.

b. During the early implementation months of NIS, DAS Accounting Division did not have a comprehensive written NIS policy and procedures manual available for users. During the fiscal year ended June 30, 2004, DAS Accounting Division made progress in this area and significant policies and procedures can be found by users on the DAS Accounting Division website. However, the APA, after reviewing the old accounting procedures manual, did note some procedures still being performed under those policies that have not been incorporated as NIS policies. We recommend DAS Accounting Division continue to update their NIS policies and procedures to include all policies and procedures in place to help ensure consistent and accurate accounting of the State's financial transactions.

COMMENTS AND RECOMMENDATIONS
(Continued)

7. <u>Nebraska Information System and Accounting Procedures</u> (Continued)

c. During the early implementation of NIS it was determined the NIS Payroll application was not allocating salaries and benefits appropriately to salaried employees who incur hours that are distributed across multiple business units. This would apply to many State agencies' funds, programs, and grants. During the fiscal year ended June 30, 2004, agencies developed "work around" solutions to this problem, however, there has been no system change to resolve this problem. The "work around" solutions can be very time consuming. We recommend DAS Accounting Division consider obtaining a system change to allocate salaries and benefits appropriately for salaried employees who incur hours that are distributed across multiple business units.

d. During the first year of NIS implementation an outside consultant noted a detailed analysis had not been performed to determine whether users received adequate training to enable them to appropriately perform their job functions. The APA is not aware of any detailed analysis of user training conducted by the DAS Accounting Division during the fiscal year ended June 30, 2004, but does acknowledge a significant training effort by the DAS Accounting Division during this period. We recommend the DAS Accounting Division continue their training efforts as well as identifying user training needs.

e. Since the implementation of NIS, DAS Accounting Division has not updated their records retention and disposition schedule with the Records Management Division of the Secretary of State. The records retention schedule on file with the Secretary of State covers the records under the old accounting system and was last updated in 1986.

   Neb. Rev. Stat. Section 84-1207 R.R.S. 1999 states the head of any State agency shall make and submit to the State Records Administrator schedules proposing the length of time each record series warrants retention for administrative, legal, historical or fiscal purposes, after it has been made in or received by the agency, and lists of records in the custody or under the control of the agency which are not needed in the transaction of current business, and do not possess sufficient administrative, legal, historical or fiscal value to warrant their further retention.

   Since many of the records (and their titles) are significantly different under NIS than they were under the old accounting system we do not believe the DAS Accounting Division is in compliance with the above statute with the current retention schedule on file with the Secretary of State. In addition, for legal purposes and for good business practices we believe a comprehensive DAS Accounting Division records retention schedule is imperative. We recommend the DAS Accounting Division work with the Secretary of State to develop a comprehensive records retention schedule for all records they maintain.

COMMENTS AND RECOMMENDATIONS
(Continued)

7. <u>Nebraska Information System and Accounting Procedures</u> (Continued)

f. The payroll component is not designed to promote an effective segregation of duties. We recommend the DAS Accounting Division consider implementing the compensating control as identified in the k. section of this comment.

g. During the first year of NIS implementation an outside consultant noted access to sensitive General Accounting functions had been provided to individuals who may not require such access as a part of their job responsibilities. Based on our inquiries, DAS Accounting Division management noted, "All critical function access rights have been secured down to the appropriate high level matrix codes." We could not verify the accuracy of this statement as requested information and documentation have not been provided to us.

h. During the first year of NIS implementation an outside consultant noted the State had not documented or formalized comprehensive information security procedures for NIS. Based on our inquiries, DAS Accounting Division management noted, "The NIS CNC's and the NIS Security team have developed a comprehensive security policy." We could not verify the accuracy of this statement as requested information and documentation have not been provided to us.

i. During the first year of NIS implementation an outside consultant noted the State had not implemented a formal, comprehensive business continuity or disaster recovery plan that comprehends both NIS and its supporting infrastructure. Based on our inquiries, DAS Accounting Division management noted, "We have now contracted with an outside vendor for business continuity planning." Documentation provided to us by DAS management indicates the State has a disaster recovery plan, however, it is not complete and the business continuity plan is in the draft stage but has not yet been tested. We recommend the State continue to implement formal, comprehensive business continuity and disaster recovery plans.

j. The APA reviewed certain data in the NIS address book in July 2004. We noted the following related vendor information:

1. Duplicate Name and Address – Our review noted a total of 4,435 duplicate records. However, all have different address book numbers.

2. Duplicate Bank Information – 4,118 vendors had duplicate bank information.

COMMENTS AND RECOMMENDATIONS
(Continued)

7. Nebraska Information System and Accounting Procedures (Continued)

3. Vendors with no Federal Tax Identification Number (FTIN) in NIS and Vendors with an FTIN of 000000000 – 3,789 vendors either had no FTIN or an FTIN with all zeros. The vendors with zeros as their FTIN were all PW (welfare) vendor types. Out of the 3,789 records 3,408 had no FTIN at all.

When duplicate records are in the NIS address book database there is a greater risk of duplicate payments being made and not being detected and queries of the database for vendor information may not be complete because the queries may not include all vendor information. In addition, when the database does not include FTIN numbers for all vendors there is a greater risk of payments to a fictitious vendor. DAS Accounting Division should correct the database for duplicate records and ensure all vendors included in the database have an FTIN.

k. DAS Accounting Division payroll procedures require each State agency to certify its payroll for each pay period to ensure payroll is processed accurately and completely. This certification is to be in writing, either through an email or letter to the DAS Accounting Administrator. In our review of the final payroll notification and certification procedures processed in July 2003 and May of 2004 and discussion with DAS Accounting Division personnel, the certification procedures were not always performed. Our review also noted that the DAS Accounting Division did not have a policy on the information that should be included in the written certification. We noted during our testing, when there was a certification, there was no consistency in the information provided by State agencies.

DAS Accounting Division should establish a policy on detailing the information to be included in the certification, should ensure all State agencies consistently follow this policy, and ensure all payroll expenditures are certified.

The issues identified above are the responsibility of the DAS Accounting Division and NIS Functional Team as they relate directly to NIS; however, they directly affect all Nebraska State agencies' financial information and must be disclosed in this report. The results of the consultant's study of NIS were communicated in a separate report to DAS, who is responsible for NIS. Letters to each State agency communicated the results of the APA's preliminary examination of internal controls at the State agency level. Additional concerns identified by the APA were communicated to the appropriate State officials.

Commission's Response: The design and implementation of this system was conducted without any consultation with our Commission. Since no one on our staff is a professional accountant, we can not offer any technical statements concerning the system. However, we will share several operational viewpoints.

COMMENTS AND RECOMMENDATIONS
(Continued)

7. <u>Nebraska Information System and Accounting Procedures</u> (Concluded)

Commission's Response, Concluded:

1. *The system is designed for GAAP accounting, not cash accounting. Our staff members who are required to use this system spend a considerable amount of time reconciling accounting at the end of each month. Since our Commission is a cash-funded agency and we vitally need to know balances and amounts at the end of every month, this system needs some improvement to serve our purposes. We do not know if GAAP accounting is applicable to cash-funded agencies.*

2. *The decisions to implement NIS and then effectively terminate the Accounting group within the Department of Administrative Services has caused great burden to our agency. One member of our staff used to spend approximately two hours per day performing the required accounting actions. With NIS and reduced accounting staff in Lincoln, we now estimate that approximately six hours per day is required to perform these same duties. We believe it is fair to say that these two decisions have negatively impacted every agency within state government. The decisions have absolutely had negative impacts within our agency since they have added to our administrative burdens.*

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NEBRASKA OIL AND GAS CONSERVATION COMMISSION

INDEPENDENT ACCOUNTANT'S REPORT

Nebraska Oil and Gas Conservation Commission
Sidney, Nebraska

We have examined the accompanying schedule of revenues, expenditures, and changes in fund balances of the Nebraska Oil and Gas Conservation Commission (Commission) for the fiscal year ended June 30, 2004. The Commission's management is responsible for the schedule of revenues, expenditures, and changes in fund balances. Our responsibility is to express an opinion based on our examination.

Our examination was conducted in accordance with attestation standards established by the American Institute of Certified Public Accountants, and the standards applicable to attestation engagements contained in *Government Auditing Standards* issued by the Comptroller General of the United States, and accordingly, included examining, on a test basis, evidence supporting the schedule of revenues, expenditures, and changes in fund balances and performing such other procedures as we considered necessary in the circumstances. We believe that our examination provides a reasonable basis for our opinion.

In our opinion, the schedule referred to above presents, in all material respects, the revenues, expenditures, and changes in fund balances of the Nebraska Oil and Gas Conservation Commission for the fiscal year ended June 30, 2004, based on the accounting system and procedures prescribed by the State of Nebraska Director of Administrative Services as described in Note 1.

In accordance with *Government Auditing Standards,* we have also issued our report dated March 18, 2005, on our consideration of the Nebraska Oil and Gas Conservation Commission's internal control over financial reporting and our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an attestation engagement performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our examination.

This report is intended solely for the information and use of the Commission and the appropriate Federal and regulatory agencies. However, this report is a matter of public record and its distribution is not limited.

March 18, 2005

Assistant Deputy Auditor

NEBRASKA OIL AND GAS CONSERVATION COMMISSION

SCHEDULE OF REVENUES, EXPENDITURES, AND CHANGES IN FUND BALANCES

For the Fiscal Year Ended June 30, 2004

	Oil & Gas Conservation Fund 25710	UIC Inventory Fund 45710	Oil & Gas Trust Fund 65710	**Total (Memorandum Only)**
REVENUES:				
Intergovernmental	$ -	$ 90,644	$ -	$ 90,644
Sales & Charges	22,088	-	-	22,088
Miscellaneous	23,141	-	6,485	29,626
TOTAL REVENUES	45,229	90,644	6,485	142,358
EXPENDITURES:				
Personal Services	333,044	78,372	-	411,416
Operating	70,521	11,597	433	82,551
Travel	4,710	2,185	-	6,895
Capital Outlay	7,458	1,701	-	9,159
TOTAL EXPENDITURES	415,733	93,855	433	510,021
Excess (Deficiency) of Revenues Over (Under) Expenditures	(370,504)	(3,211)	6,052	(367,663)
OTHER FINANCING SOURCES (USES):				
Business & Franchise Taxes (Note 6)	318,829	-	-	318,829
Deposits-Producer CD's In Lieu of Bonds Received (Note 5)	-	-	105,000	105,000
Deposits-Producer CD's In Lieu of Bonds Refunded (Note 5)	-	-	(55,000)	(55,000)
TOTAL OTHER FINANCING SOURCES (USES)	318,829	-	50,000	368,829
Net Change in Fund Balances	(51,675)	(3,211)	56,052	1,166
FUND BALANCES, JULY 1, 2003	587,790	6,826	642,425	1,237,041
FUND BALANCES, JUNE 30, 2004	$ 536,115	$ 3,615	$ 698,477	$ 1,238,207
FUND BALANCES CONSIST OF:				
General Cash	$ 536,056	$ 3,615	$ 38,477	$ 578,148
Deposits with Vendors	59	-	-	59
Deposits-Producer CD's In Lieu of Bonds	-	-	660,000	660,000
TOTAL FUND BALANCES	$ 536,115	$ 3,615	$ 698,477	$ 1,238,207

The accompanying notes are an integral part of the schedule.

NOTES TO THE SCHEDULE

For the Fiscal Year Ended June 30, 2004

1. Criteria

The accounting policies of the Nebraska Oil and Gas Conservation Commission are on the basis of accounting as prescribed by the State of Nebraska Department of Administrative Services (DAS).

Per Neb. Rev. Stat. Section 81-1107(2) R.S.Supp., 2004, the State of Nebraska Director of Administrative Services duties include "The keeping of general accounts and the adoption and promulgation of appropriate rules, regulations, and administrative orders designed to assure a uniform and effective system of accounts and accounting, the approval of all vouchers, and the preparation and issuance of warrants for all purposes."

The Nebraska Information System (NIS) is the official accounting system prescribed by DAS for the State of Nebraska. Policies and procedures are detailed in NIS manuals and Nebraska Accounting System Concepts published by DAS and available to the public. The financial information used to prepare the schedule of revenues, expenditures, and changes in fund balances for the Commission was obtained directly from the NIS. NIS records accounts receivable and accounts payable as transactions occur. As such certain revenues are recorded when earned and expenditures are recorded when a liability is incurred, regardless of the timing of related cash flows. The accounts payable liability recorded on NIS, and thus recorded as expenditures, as of June 30, 2004 includes only those payables posted to NIS before June 30, 2004 and not yet paid as of that date. The amount recorded as expenditures as of June 30, 2004 **does not** include amounts for goods and services received before June 30, 2004 which had not been posted to NIS as of June 30, 2004.

NIS also records other liabilities (primarily in the Distributive Fund Type) in accounts titled Tax Refund Payable, Deposits, Due to Fund and Due to Government. The assets in these funds are being held by the State as an agent and will be used to pay those liabilities to individuals, private organizations, other governments, and/or other funds. The recording of those liabilities reduces the fund balance/equity. For further information on the activity recorded to those accounts for the fiscal year ended June 30, 2004 see Note 5.

The Commission had no accounts receivable at June 30, 2004. The NIS system does not include liabilities for accrued payroll and compensated absences.

The fund types established by NIS that are used by the Commission are:

> **20000 – Cash Funds** – account for revenues generated by specific activities from sources outside of State government and the expenditures directly related to the generation of the revenues. Cash funds are established by State statutes and must be used in accordance with those statutes. For the Commission, this consists primarily of an oil and gas conservation tax that is collected by the Nebraska Department of Revenue.

NOTES TO THE SCHEDULE
(Continued)

1. Criteria (Continued)

40000 – Federal Funds – account for all federal grants and contracts received by the State. Expenditures must be made in accordance with applicable federal requirements. The Commission received a grant entitled "Underground Injection Control" (UIC) from the United States Environmental Protection Agency (EPA).

60000 – Trust Funds – account for assets held by the State in a trustee capacity. Expenditures are made in accordance with the terms of the trust. For the Commission, revenues and expenditures consist of operator bonds or certificates of deposit the Commission has cashed in because of well operator noncompliance with drilling requirements.

The major revenue object account codes established by NIS used by the Commission are:

Intergovernmental – Revenue from other governments in the form of grants, entitlements, shared revenues, payments in lieu of taxes, or reimbursements. For the Commission, this consists of a Federal grant from the EPA for the Underground Injection Control (UIC) Program.

Sales & Charges – Income derived from sales of merchandise and commodities, compensation for services rendered, and charges for various licenses, permits, and fees. For the Commission, this primarily consists of drilling and abandonment permit fees.

Miscellaneous – Revenue from sources not covered by other major categories, such as investment income and bonds or certificates of deposit which the Commission cashed in because of operator noncompliance with drilling requirements.

The major expenditure object account titles established by NIS used by the Commission are:

Personal Services – Salaries, wages, and related employee benefits provided for all persons employed by the Commission.

Operating – Expenditures directly related to a program's primary service activities.

Travel – All travel expenses for any state officer, employee, or member of any commission, council, committee, or board of the State.

Capital Outlay – Expenditures which result in the acquisition of or an addition to capital assets. Capital assets are resources of a long-term character, owned or held by the government.

NOTES TO THE SCHEDULE
(Continued)

1. Criteria (Concluded)

Other significant object account codes established by NIS and used by the Commission include:

Assets – Resources owned or held by a government that have monetary value. Assets include cash accounts and deposits with vendors. Cash accounts and deposits with vendors are also included in fund balance and are reported as recorded on NIS.

Liabilities – Legal obligations arising out of transactions in the past that must be liquidated, renewed, or refunded at some future date. Accounts payable transactions increase expenditures and decrease fund balance. Other liabilities recorded on NIS for the Commission's funds at June 30, 2004 included Deposits. The activity processed on NIS through these accounts is summarized in Note 5.

Other Financing Sources – Business and franchise taxes collected on behalf of the Commission by the Nebraska Department of Revenue and distributive activity related to operator deposits.

2. State Agency

The Nebraska Oil and Gas Conservation Commission (Commission) is a State agency established under and governed by the laws of the State of Nebraska. As such, the Commission is exempt from State and Federal income taxes. The schedule includes all funds of the Commission.

The Nebraska Oil and Gas Conservation Commission is part of the primary government for the State of Nebraska.

3. Totals

The Totals "Memorandum Only" column represents an aggregation of individual account balances. The column is presented for overview informational purposes and does not present consolidated financial information because interfund balances and transactions have not been eliminated.

4. Capital Assets

Under NIS, capital assets are not capitalized in the funds used to acquire or construct them. Instead, capital acquisitions are reflected as expenditures. Capital assets, which would include property, plant, equipment, and infrastructure assets (e.g., roads, bridges, sidewalks, and similar items) would be reported for the State of Nebraska in the Comprehensive Annual Financial Report (CAFR). The Commission's values all capital assets at cost where historical records are available and at estimated

NOTES TO THE SCHEDULE
(Continued)

4. Capital Assets (Concluded)

historical cost where no historical records exist. Donated capital assets are valued at their estimated fair market value on the date received. Generally, equipment that has a cost of $1,500 at the date of acquisition and has an expected useful life of two or more years is capitalized. Depreciation expenses would be reported in the CAFR in the funds used to acquire or construct them for the State of Nebraska. The cost of normal maintenance and repairs that does not add to the value of the asset or extend asset life is not capitalized.

Equipment is depreciated using the straight-line method with estimated useful lives of three to ten years.

Capital asset activity of the Commission for the fiscal year ended June 30, 2004 was as follows:

	Beginning Balance	Increases	Decreases	Ending Balance
Capital assets				
Equipment	$ 247,420	$ 7,238	$ 17,532	$ 237,126
Less accumulated depreciation for:				
Equipment				196,439
Total capital assets, net of depreciation				$ 40,687

5. Changes in Deposits

Operators are required to furnish either bonds or Certificates of Deposit (CD) to indemnify the State against loss should the operator not comply with drilling requirements. The CDs are held by the Commission and are accompanied by letters of agreement from the issuing banks recognizing that the CDs are payable or assignable by the Commission only. During the fiscal year ended June 30, 2004, $105,000 in new CDs were received by the Commission and $55,000 in CDs were released.

Fund	Balance July 1, 2003	In	Out	Balance June 30, 2004
Oil & Gas Trust Fund 65710	$ 610,000	$ 105,000	$ 55,000	$ 660,000

NOTES TO THE SCHEDULE
(Continued)

6. Conservation Tax

Neb. Rev. Stat. Section 57-919 R.R.S. 2004 levies a conservation tax, not to exceed 15 mills per dollar, based on the well value of all oil and gas produced, saved, and sold or transported from any premises in Nebraska. This Statute gives the Commission the authority to reduce or increase the mill levy amount and assigns responsibility for collection of the tax to the Tax Commissioner (Nebraska Department of Revenue). All money so collected by the Tax Commissioner is remitted to the State Treasurer for credit to the Oil and Gas Conservation Fund.

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NEBRASKA OIL AND GAS CONSERVATION COMMISSION

REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING AND ON COMPLIANCE AND OTHER MATTERS BASED ON AN EXAMINATION OF THE SCHEDULE OF REVENUES, EXPENDITURES, AND CHANGES IN FUND BALANCES PERFORMED IN ACCORDANCE WITH *GOVERNMENT AUDITING STANDARDS*

Nebraska Oil and Gas Conservation Commission
Sidney, Nebraska

We have examined the accompanying schedule of revenues, expenditures, and changes in fund balances of the Nebraska Oil and Gas Conservation Commission for the fiscal year ended June 30, 2004, and have issued our report thereon dated March 18, 2005. We conducted our examination in accordance with attestation standards established by the American Institute of Certified Public Accountants and the standards applicable to attestation engagements contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

Internal Control Over Financial Reporting

In planning and performing our examination, we considered the Nebraska Oil and Gas Conservation Commission's internal control over financial reporting in order to determine our procedures for the purpose of expressing our opinion on the schedule of revenues, expenditures, and changes in fund balances, and not to provide an opinion on the internal control over financial reporting. However, we noted a certain matter involving the internal control over financial reporting and its operation that we consider to be a reportable condition. Reportable conditions involve matters coming to our attention relating to significant deficiencies in the design or operation of the internal control over financial reporting that, in our judgment, could adversely affect the Nebraska Oil and Gas Conservation Commission's ability to record, process, summarize, and report financial data consistent with the assertions of management in the financial schedule. A reportable condition is described in the Comments Section of the report as Comment Number 7 (Nebraska Information System and Accounting Procedures).

A material weakness is a reportable condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements caused by error or fraud in amounts that would be material in relation to the financial schedule being examined may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. Our consideration of the internal control over financial reporting would not necessarily disclose all matters in the internal control that might be reportable conditions and, accordingly, would not necessarily disclose all reportable conditions that are also considered to be material weaknesses. However, we believe the reportable condition described above is not a material weakness.

<u>Compliance and Other Matters</u>
As part of obtaining reasonable assurance about whether the Nebraska Oil and Gas Conservation Commission's schedule of revenues, expenditures, and changes in fund balances, is free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial schedule amounts. However, providing an opinion on compliance with those provisions was not an objective of our examination, and, accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*.

We noted certain additional items that we reported to management of the Nebraska Oil and Gas Conservation Commission in the Comments Section of this report as Comment Number 1 (Commuting Use of State Vehicles), Comment Number 2 (Fines/Penalties), Comment Number 3 (Labor Documentation), Comment Number 4 (Capital Asset Transactions), Comment Number 5 (Employment Eligibility Verifications), and Comment Number 6 (Commission Rules and Regulations).

This report is intended solely for the information and use of the Commission and the appropriate Federal and regulatory agencies. However, this report is a matter of public record and its distribution is not limited.

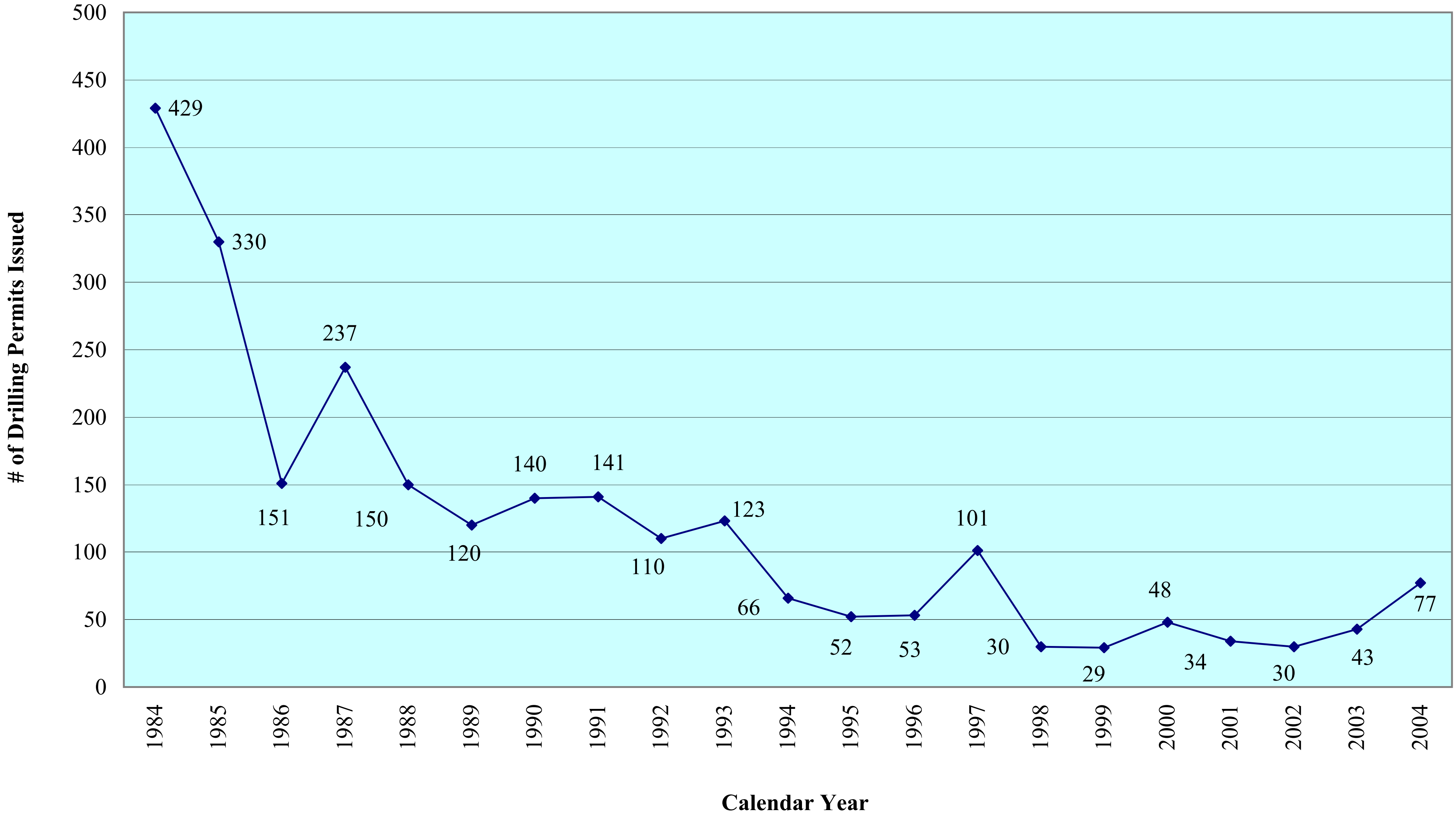
Timothy J. Channer CPA

March 18, 2005 Assistant Deputy Auditor

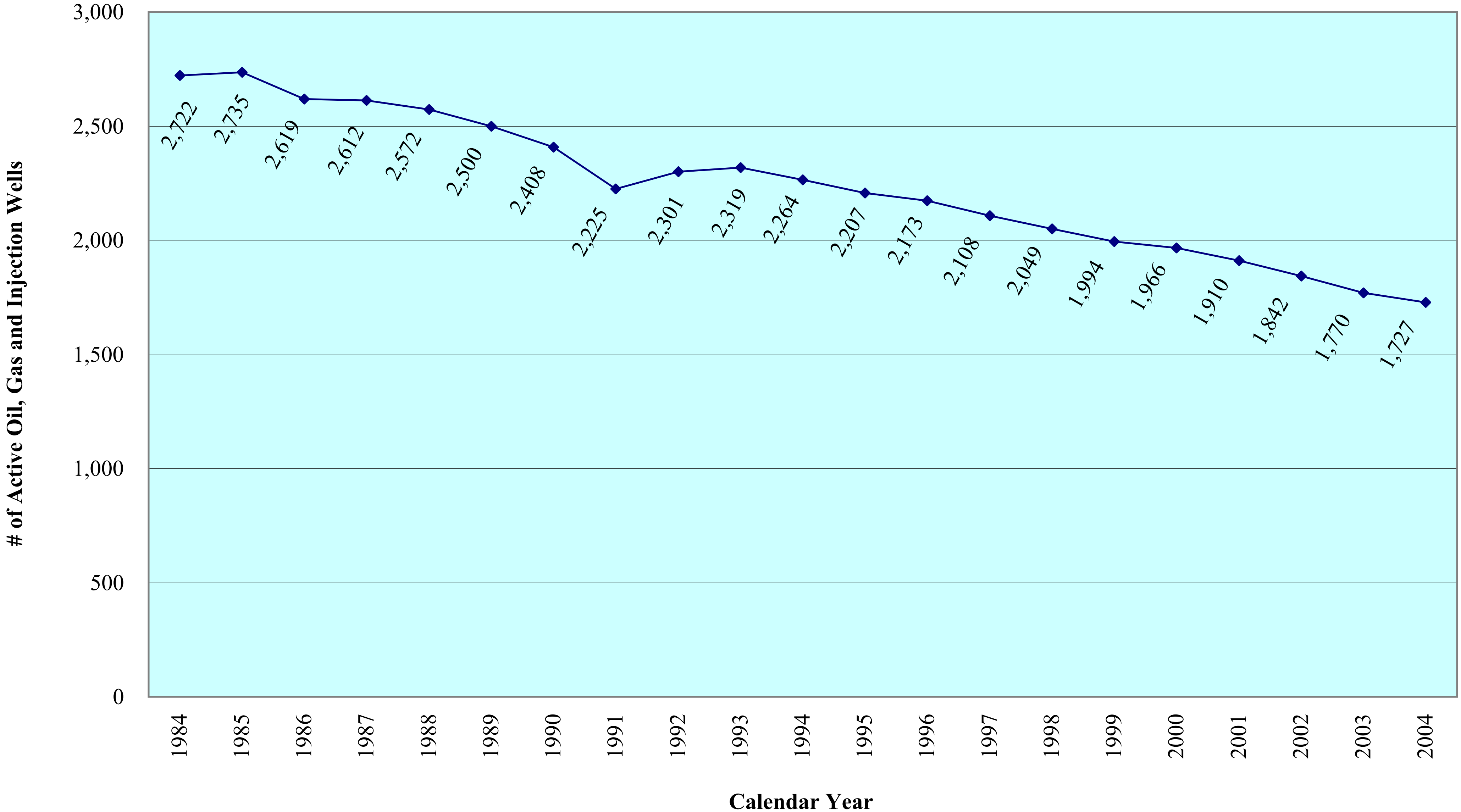
STATISTICAL SECTION

Our examination was conducted for the purpose of forming an opinion on the schedule of revenues, expenditures, and changes in fund balances. Statistical Section information is presented for purposes of additional analysis. Such information has not been subjected to the procedures applied in the examination of the schedule of revenues, expenditures, and changes in fund balances, and, accordingly, we express no opinion on it.

NEBRASKA OIL AND GAS CONSERVATION COMMISSION
DRILLING PERMITS ISSUED



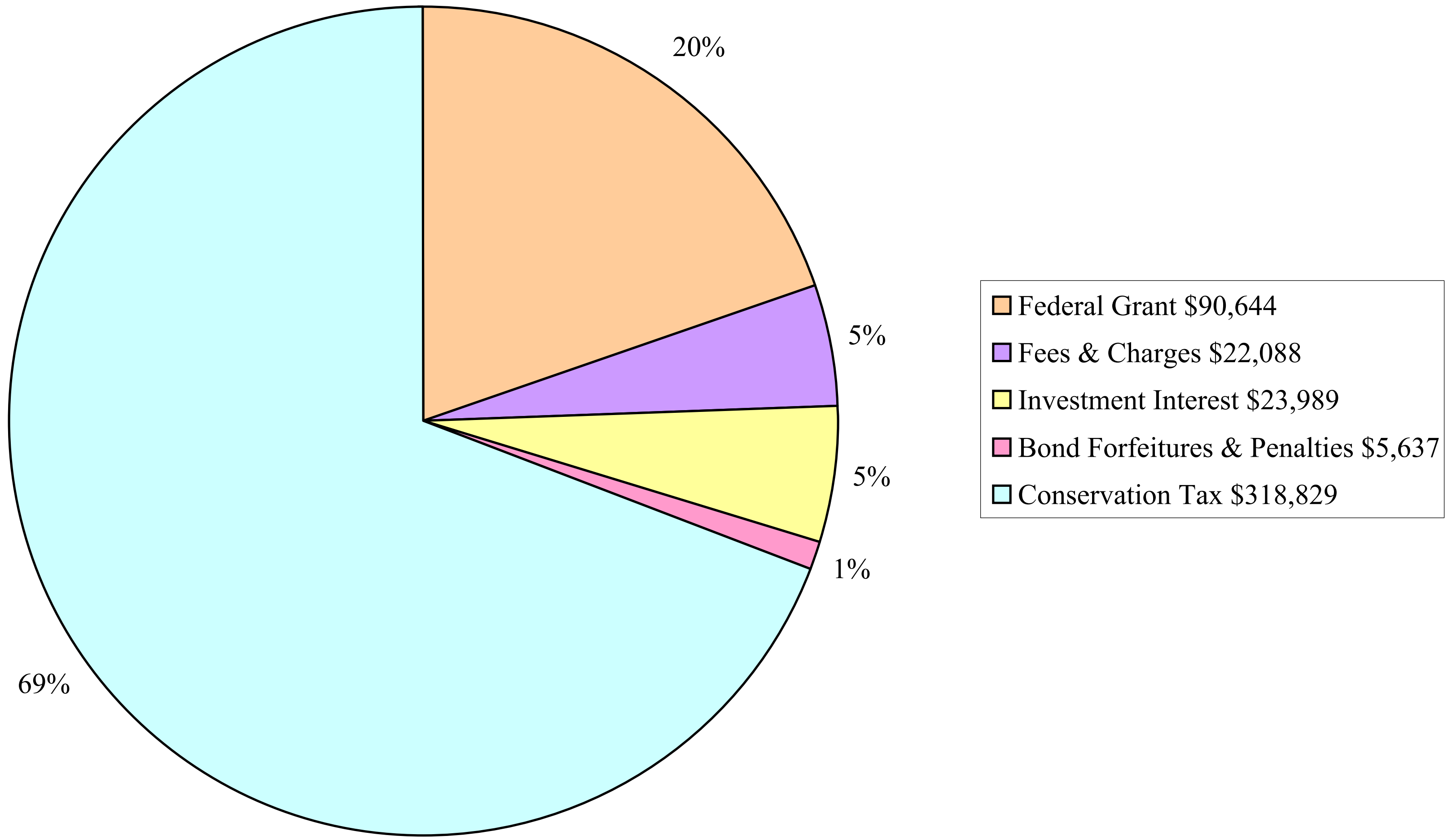
NEBRASKA OIL AND GAS CONSERVATION COMMISSION
ACTIVE OIL, GAS, AND INJECTION WELLS



NEBRASKA OIL AND GAS CONSERVATION COMMISSION

REVENUES (All Sources)

For the Fiscal Year Ended June 30, 2004



NEBRASKA OIL AND GAS CONSERVATION COMMISSION
EXPENDITURES (All Funds)
For the Fiscal Year Ended June 30, 2004