ATTESTATION REPORT
OF THE
NEBRASKA OIL AND GAS
CONSERVATION COMMISSION

JULY 1, 2005 THROUGH JUNE 30, 2007

Issued on September 14, 2007

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.

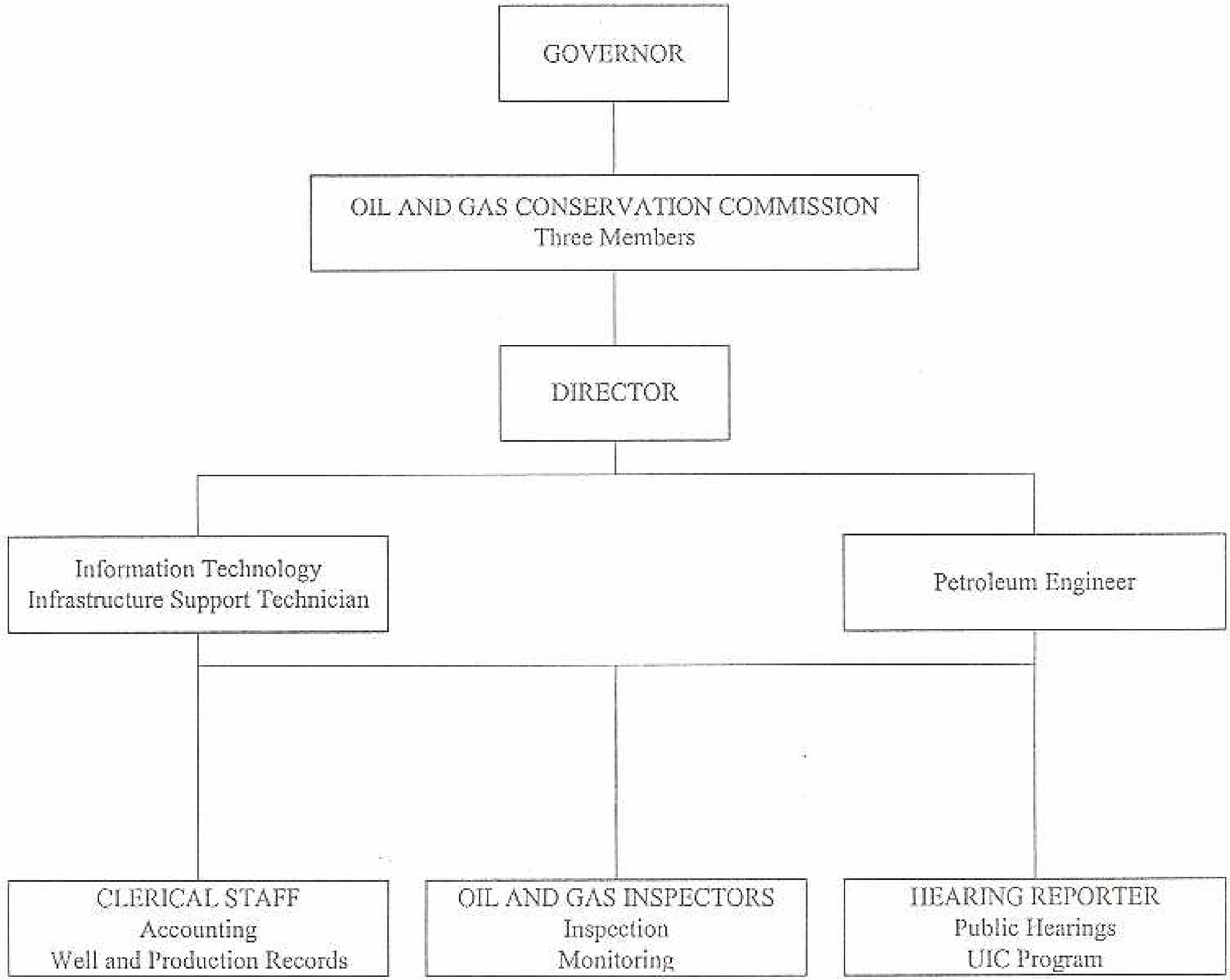
The Nebraska Oil and Gas Conservation Commission's operation cost is paid primarily by the conservation tax proceeds collected by the Nebraska Department of Revenue from a tax assessed on the value of all oil and gas produced in the State. The Commission performs its duties with seven full-time and one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

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 August 7, 2007, 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

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 that are presented here.

1. ***Untaxed 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 used for daily commuting purposes.

2. ***Personal Use of Commission Vehicles and Equipment:*** Several instances were noted in which use of Commission-owned vehicles and equipment included personal interests. Neb. Rev. Stat. Section 81-1024 R.R.S. 1999 strictly prohibits any State of Nebraska officer or employee from using any motor vehicle owned by the State for any personal use whatsoever. Commission equipment use policies require Commission-owned equipment be used for State business purposes only and only by Commission employees.

3. ***Unrecorded Employee Leave:*** In July 2005 an employee was absent from his position for four days due to medical reasons. The Director had instructed the employee to not record any leave usage despite the employee having had available accumulated leave hours.

4. ***Travel Expenditures:*** Numerous exceptions were noted in the area of employee travel expense reimbursements including, round dollar meal amounts claimed, meals claimed and reimbursed in excess of GSA meal expense guidelines, two instances in which the Director claimed expenses related to meals for himself and other individuals who were not employees of the Commission and/or the State of Nebraska, one instance in which the Director claimed personal vehicle mileage which exceeded the approximate State cost of a Commission-owned vehicle by $100 when he opted to take his personal vehicle so his family could accompany him on a business-related trip, one instance in which an expense reimbursement document of the Director did not have approval by any other Commission employee, and observation that the Commission's employee expense reimbursement documents continue to contain employee social security numbers.

5. ***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.

6. ***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.

SUMMARY OF COMMENTS
(Continued)

7. ***Contracts:*** Commission did not consistently obtain formal, written contracts with providers of various Information Technology (IT) services and, as such, also did not enter any contract information into the state accounting system's database of service contracts regarding its use of these providers.

8. ***Excessive Sick Leave Documentation:*** During our examination, we noted two instances in which an employee had taken sick leave for 6 consecutive workdays. No substantiating evidence was on file.

9. ***Conservation Tax Reconciliation Procedures:*** To further ensure the completeness and accuracy of the Commission's conservation tax revenues, the Commission should implement spot checks of its reconciled Form 61 copies (Nebraska Severance and Conservation Tax Return) to the quarterly tax recap statements received from the Nebraska Department of Revenue.

10. ***NIS Access Termination:*** Nebraska Information System (NIS) access for the Commission's former NIS Authorized Agent, who resigned effective October 31, 2006, was not terminated in a timely manner.

11. ***Expenditure Recognition:*** A $19,372 contract payment was not properly coded as a prior year obligation ("P9" transaction on NIS) when paid in July 2006.

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.

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. Untaxed 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 (TSB) 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. Lastly, sound business practices would also require that agency-owned vehicle use not be an assumed right of an employee but rather incidental to one's employment for the conducting of official business of the State.

During our examination the following was noted:

- While the majority of the actual miles Commission vehicles travel appeared to be related to employees' work-related trips and/or inspections, such use was infrequent. Based on our examination of the Commission's vehicle logs, 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.

- In a July 5, 2006, letter to the Auditor of Public Accounts Commissioner Thomas Sonntag stated, "our Commission has determined that it is proper for the employees of the Commission to commute to and from their residences using Commission vehicles…."

- **No** income adjustments have ever been made to report the value of this commuting fringe benefit as taxable income to the respective employees.

- The vehicles in question are assigned to the Commission's Director and Petroleum Engineer.

- The Commission's Director referred to any on-call, after-hours use of the vehicles as "pretty rare," which would leave the primary purpose of the vehicles as providing for daily commuting and work-related trips.

COMMENTS AND RECOMMENDATIONS
(Continued)

1. Untaxed Commuting Use of State Vehicles (Continued)

- In Fiscal Year (FY) 06 the vehicle assigned to the Director logged 8,276 miles; however, 162 days, or 62% of the work year the vehicle was used solely for daily commuting.
- In FY 07 the vehicle assigned to the Director logged 5,804 miles; however, 165 days, or 63% of the work year the vehicle was used solely for daily commuting.
- In FY 06 the vehicle assigned to the Petroleum Engineer logged 4,383 miles; however, 177, or 68% of the work year the vehicle was used solely for daily commuting.
- In FY 07 the vehicle assigned to the Petroleum Engineer logged 3,793 miles; however, 192 days, or 74% of the work year the vehicle was used solely for daily commuting.

A similar finding was noted in our previous report.

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. While Nebraska law may designate the Commission's vehicles as "duty stations" for the purpose of DAS Transportation Services Bureau regulations, the Internal Revenue Service relies upon its own tests to determine whether use of a motor vehicle constitutes a taxable fringe benefit. Those tests are independent of Nebraska statute.

> We strongly recommend the Commission review IRS Code and all applicable publications and, as appropriate, annually report the taxable commuting use of State vehicles as defined by the IRS. If the Commission feels it is correct to exclude the value of this otherwise taxable fringe benefit from employee income based on any particular unique facts and/or circumstances, we would encourage the Commission to consult with its legal counsel to request a private letter ruling from the IRS. Lastly, we also recommend the Commission periodically review its overall vehicle utilization and reassess the need for Commission-owned vehicles when used primarily for daily employee commuting to and from their personal residences.

Commission's Response: In so far as the Commission does not have access to a fenced, secure facility in which to keep its vehicles and in accordance with the philosophy that certain employees be available to respond in an efficient and timely manner to both field emergencies and regularly scheduled duties, it has always been the policy of the Commission to have the aforementioned employees keep these vehicles near them at all times. This includes, but is not

COMMENTS AND RECOMMENDATIONS
(Continued)

1. Untaxed Commuting Use of State Vehicles (Continued)

Commission's Response, Continued:
limited to, housing the vehicles at the residence during non-office hours. The use of these vehicles is not considered to be an employment benefit, and taxable as such, since it is for the benefit of the Commission.

- *Four individuals employed by our Commission are on-call 24 hours per day, seven days per week, unless on scheduled vacation. At the present time, these individuals include the Director; staff Petroleum Engineer, the Denver-Julesburg Basin Field Inspector and the Cambridge Arch Field Inspector.*

- *Each of these employees is assigned a Commission owned vehicle for the purpose of conducting their official duties and executing the responsibilities of the Commission. These four vehicles, owned by the Commission, are all classified as duty stations in accordance with the Rules and Regulations of the Nebraska Oil and Gas Conservation Commission and Chapter 57, Revised Statutes of the State of Nebraska. Additionally, cellular telephones for emergency communications are provided for the execution of their duties.*

- *The Nebraska Oil and Gas Conservation Commission can not own its own office and/or other associated facilities. There is no State of Nebraska operated motor pool in either Sidney or McCook. Therefore, the Commission has no secure facility for storage of its vehicles during non-daylight hours.*

- *Of the miles logged by the Director over the past two fiscal years, eighty-two percent (82%) of the total miles were for either out-of-town travel or inspections in the field. Of the miles logged by our staff engineer, seventy-eight percent (78%) were out-of-town or field related. Since the two individuals are on-call virtually all of the time, it is incumbent that the vehicles they drive be immediately available should the need arise.*

- *It has been suggested that these two vehicles are unnecessary for our operations and that personal vehicles should be used for travel. The Director drove approximately 11,546 out-of-town miles over the two fiscal years. Using the current IRS operating expenses of 48.5 cents/mile and the auditor's calculated operating expense of 13.125 cents/mile, the additional cost to the Commission would be approximately $4,000 per year to reimburse the employee versus operating the current 2002 Ford pickup that has 115,000 miles on it.*

  Our staff engineer drove approximately 6,377 out-of-town miles during the past two fiscal years. Using the same expenses, the Commission would have to pay an additional $2,232 to reimburse the employee versus operating the current 2001 Ford pickup that has 150,000 miles on it.

COMMENTS AND RECOMMENDATIONS
(Continued)

1. Untaxed Commuting Use of State Vehicles (Concluded)

Commission's Response, Concluded:

Based upon this analysis, it is also cost-effective to utilize Commission owned vehicles for travel and the Commission may save approximately $6,200/year.

When the vehicles are driven on a daily basis, they generally log from four to six miles per day. Using the operating expense of 13.125¢/Mile as calculated by the auditors, the operating cost of these vehicles ranges from 53 to 79 cents per day each. Using the numbers of days in the report for FY06 for these vehicles at 4 miles per day, the operating expense was $178.00. For FY07, the two vehicles logged 357 days for an operating expense of approximately $187.50.

- *Both the Director and the Petroleum Engineer fully expect and are prepared to receive a telephone call during the work-day to respond to any emergency or condition that would require their immediate leave.*

Our Commission will seek wise counsel in this matter.

Auditor's Response: *Government Auditing Standards* require we report all apparent violations of State and Federal statutes, laws, and/or regulations. Based on our examination of the Commission's vehicle logs, the daily commuting use of the vehicles in question appear to constitute a taxable fringe benefit according to the Internal Revenue Service's definition of such. As the Commission may be in longstanding violation of IRS regulations regarding this untaxed benefit, we strongly encourage the Commission to obtain a private letter ruling from the IRS based on what the Commission feels are its particular circumstances.

2. Personal Use of Commission Vehicles and Equipment

Neb. Rev. Stat. Section 81-1024 R.R.S. 1999 states, "No officer or employee of the State of Nebraska shall use any motor vehicle owned by the State of Nebraska for any personal use **whatsoever**. Any officer or employee who violates any of the provisions of this section shall be deemed guilty of a Class V misdemeanor. Upon conviction thereof the court shall have the power to add to the judgment that any officer or employee so convicted shall be removed from office or employment …." In addition, Commission Information Technology equipment usage policies state that Commission owned equipment is to be used for State business purposes only and is only to be used by Commission employees.

COMMENTS AND RECOMMENDATIONS
(Continued)

2. <u>Personal Use of Commission Vehicles and Equipment</u> (Continued)

During our examination the following was noted:

- One instance in which the Director's son accompanied him, traveling in a vehicle owned by the State of Nebraska, on a business trip to Iowa City, Iowa and Wichita, Kansas. The son's travel was personal in nature and related to him visiting medical schools in the area. In this instance the Director should have used his personal vehicle, as opposed to the Commission vehicle, in order to avoid any personal use whatsoever. Had the Director used his personal vehicle, any mileage reimbursement could not have exceeded the approximate $247 State cost had a Commission-owned vehicle been utilized by the Director alone.

- One instance in which the Director admitted that a guest user Internet account was set up on a Commission-owned laptop for his son's use when traveling with him on a business trip. The Director indicated the account was never used because of what he felt were excessive hotel connection fees. Regardless, the setup of the account was done for personal reasons.

- One instance in which the Director admitted to having used a Commission-owned vehicle to haul sod from his personal residence to the local landfill. The Director stated this was not done as a separate trip; but rather as part of his daily commute to/from work.

- Director admitted to having used a Commission-owned vehicle to haul both personal and Commission recyclables to local recycling drop-off locations. The Director stated these were combined, not separate, trips.

- Director admitted to having occasionally used a Commission-owned vehicle to attend personal functions/activities at a local church while on his lunch break.

- Director admitted to permitting employees to run personal errands, as needed, during the workday, including those with Commission-owned vehicles.

Without procedures to ensure State vehicles are used properly, there is an increased risk of misuse. Violation of Neb. Rev. Stat. Section 81-1024 R.R.S. 1999 constitutes a Class V misdemeanor and official misconduct in office which may result in removal from office or loss of employment.

> We recommend the Commission implement procedures to ensure all vehicles owned by the State of Nebraska are **<u>only</u>** utilized for official State business. Personal use of any vehicle owned by the

COMMENTS AND RECOMMENDATIONS
(Continued)

2. Personal Use of Commission Vehicles and Equipment (Continued)

State of Nebraska must be absolutely prohibited both in fact and appearance. We further recommend all equipment, including vehicles, computer hardware, computer software, etc., be used for official business purposes only, by employees only.

Commission's Response: Each of the bulleted items is addressed individually. In each of the cited items, there was never any intention of defrauding the Commission or misusing State property.

- *My son did accompany me on the trip to Iowa City where I met with Dr. Raymond Anderson, Senior Research Geologist with the Iowa Geological Survey, in his office at the University of Iowa. Dr. Anderson is the world's foremost expert on the Mid-Continent Rift which has oil and gas potential in Nebraska. My son's activities were also on the same campus and no extra mileage was involved. Upon leaving Iowa City, I drove to Wichita to meet with the presidents of two oil and gas exploration companies who were contemplating an exploration program in Nebraska. Directly enroute from the hotel to my scheduled appointment, I dropped my son off at the campus of Wichita State University and then proceeded to meet with the two gentlemen. After the meeting ended at 5:30 p.m., I drove back to my son's location, picked him up, and returned to the hotel. The following day, we drove the 550 miles from Wichita back to Sidney. His attendance in the Commission vehicle helped me to safely drive the nearly 1,500 mile trip and did not cost our Commission any extra funds.*

  To my knowledge, there is no statute restricting non-employees from traveling in a state-owned vehicle.

- *My son was able to travel with me to Washington, DC, where I attended a meeting of the Interstate Oil and Gas Compact Commission. He also attended a portion of that meeting with me. A laptop computer, which is nearly exclusively used by our Petroleum Engineer, was set up with an account that would have allowed us to check emails with the password of "ED". This pass-worded user ID was required to log-in to the computer in keeping with our access control policy. I was, and remain, unfamiliar with laptops and wireless access but my son was not. He would have been an aid to me in order to check my emails but we did not connect because of excessive fees in the hotel.*

  In our offices, we provide a secure, public access terminal for the convenience and use of Commission guests. Additionally, public use accounts are included on Commission-owned laptop computers for use by guests and students at conferences. These accounts are provided so that these individuals may access our public data and records.

COMMENTS AND RECOMMENDATIONS
(Continued)

2. <u>Personal Use of Commission Vehicles and Equipment</u> (Concluded)

Commission's Response, Concluded:

Lastly, nearly all of our employees use our home computers to perform work for the Commission, while at home, and we use personally-owned items and equipment to perform our duties in the office.

- *As a part of my daily travel, I did take sod to the public recycle facility operated by the City of Sidney. My intention was never to specifically use the vehicle for this purpose.*

- *As a community, Sidney recycles materials but the city does not provide a pickup service. Personal recyclable materials were combined with the office recyclables. A Commission vehicle was used to transport these recyclables to the City Park collection location, approximately nine blocks from our office.*

- *I have had the opportunity to eat lunch with other men at my church on Thursdays at noon and now serve on a search committee that meets at noon every Thursday. Our staff knows of my location and availability on these days should I need to be reached and return to the office or otherwise be in communication. We remain on-call during our lunch times.*

- *On occasion, nearly everyone must leave the office to attend to an errand. We encourage them to make use of their personal break times. In down-town Sidney, you don't have to go very far and it doesn't require any lengthy time periods.*

Auditor's Response: We strongly reiterate that State statute does not permit personal use of any vehicle owned by the State of Nebraska <u>whatsoever</u>. This prohibition is strict and absolute and, as such, the Commission should similarly prohibit, both in fact and appearance, any personal use by its employees.

3. <u>Unrecorded Employee Leave</u>

NAPE/AFSCME labor contract item 14.24 Advancement of Vacation and Sick Leave states, "Agency heads may advance vacation and sick leave to employees in an amount not to exceed a total of 80 hours (pro-rated for part-time employees). Employees shall reimburse the State for all used unearned vacation and sick leave upon separation or transfer." Neb. Rev. Stat. Section 81-1320, R.R.S. 1999, outlines the permanent State employee sick leave schedule and authorizes permanent State employees to earn 96 hours (8 hours per month) during their first year of continuous employment. Lastly, administrative leave requires the approval of the Governor or his designee and may not be authorized by others.

COMMENTS AND RECOMMENDATIONS
(Continued)

3. <u>Unrecorded Employee Leave</u> (Concluded)

During our examination one instance was noted in which an Oil and Gas Inspector was absent from his job for a total of 4 workdays (32 hours) in July 2005; however, no leave usage was reported. When questioned about this unrecorded leave the Commission Director stated he personally had told the Inspector to take the time off without recording any leave. The Director further asserted, in writing, that the Inspector had no accumulated sick leave; however, a review of NIS determined the Inspector had 24 hours of accumulated sick leave at June 30, 2005, and 32 hours at July 31, 2005.

A lack of accountability for leave used increases the risk for loss or fraudulent use of funds.

> We recommend the Commission process a sick leave adjustment to amend the Oil and Gas Inspector's accumulated sick leave balance for the 32 hours of leave which should have been recorded in July 2005. We further recommend all employee absences be completely and accurately recorded.

Commission's Response: When we hired this employee in April 2005, he had made arrangements in January 2005 to have surgery in July 2005. It was agreed that he would not reschedule his surgery and we did not know how many days were going to be involved for his recovery. Our employee traveled to consult with the surgeon on one of the days. The Director assumed that it would certainly be more than three days to have the surgery and recover. We were not clear as to whether or not there would be any accrued leave to use for the surgery and recovery time. Apparently, as the auditor pointed out, the employee, who is a field inspector and is on call, had earned the necessary 32 hours of sick leave by the end of July 2005 which was the month of the surgery. The Director considered the fact that our employees who are on-call and/or travel on Saturdays and Sundays never receive compensation or compensatory time off for their services in excess of 40 hours. It was believed that it would be un-necessary to be concerned about the days missed because they would certainly be worked later on during Saturdays, Sundays, or during the night.

This particular case was a one-time occurrence and did not "increase the risk for the loss or fraudulent use of funds" as stated by the auditors. We have now processed his time off as "Sick Leave" prior to the writing of this response.

Auditor's Response: While the Commission may feel such unrecorded employee leave will be "made up" by employees at a later time, complete and accurate recording of actual hours worked and leave used is fundamental to ensuring compliance with Labor contracts and State statutes.

COMMENTS AND RECOMMENDATIONS
(Continued)

4. Travel Expenditures

The Nebraska State Accounting Manual, AM-005, Travel Expense Policies states, "Pursuant to Section 81-1174, employees traveling on State business shall claim only actual amounts paid for meals …" The Federal General Service Administration (GSA) per diem rates provide guidance for reasonable lodging and meal expenses in travel status. Good internal control requires procedures to ensure all reimbursements are reasonable and necessary expenses and that adequate supporting documentation is maintained. Good internal control further requires procedures to be in place to ensure compliance with State statute and the Nebraska State Accounting Manual policies.

A total of 10 employee expense reimbursement documents were tested during our examination; we noted the following:

- Numerous instances were noted in which employee meal logs reported round dollar meal amounts which raise concern as to whether or not employees are reporting actual costs.

- Numerous instances in which meals were claimed and reimbursed in excess of GSA meal expense guidelines. Amounts claimed ranged from $1 to $21 over the GSA guidelines.

- Two instances, totaling $41, in which the Director claimed expenses related to meals for himself and other individuals who were not employees of the Commission and/or the State of Nebraska. One of the individuals had hosted the Director overnight at no cost prior to a course start and in return the Director took the individual to breakfast. The second individual was the instructor of the course being attended by the Director and the Director took the instructor to lunch. While the Director's expense was appropriately business-related, his share of the total meal costs was undeterminable.

- One instance in which the Director claimed $142 in personal vehicle mileage when he took his personal vehicle in order that his family could accompany him on a business-related trip. This reimbursement exceeded the approximate $42 State cost that would have been incurred had a Commission-owned vehicle been utilized by the Director alone. In this instance, the Director should have only claimed costs up to $42 in order to not exceed State costs had the Commission-owned vehicle been used.

- One instance in which an expense reimbursement document of the Director did not have approval by any other Commission employee.

- The Commission's employee expense reimbursement documents continue to contain employee social security numbers.

COMMENTS AND RECOMMENDATIONS
(Continued)

4. **Travel Expenditures** (Continued)

Without adequate review and documentation of expenses, there is an increased risk for loss or errors to occur.

> We recommend the Commission implement procedures to ensure travel expenses are reasonable, adequately documented, and in compliance with State guidelines.

Commission's Response: We believe that we currently have adequate control and approval processes that address all of these areas. We do not believe that there is any abuse in any area. A short response to each of the bulleted comments is as follows:

- *The two employees, in this instance, attended meetings and training sessions sponsored by the Ground Water Protection Council. The Risk Based Data Management (RBDMS) technical team, of which they are/were members, is a very close-knit group and eats many meals together. Meal costs are generally split among the group and appropriate tips are included. Each individual then contributes their share which is nearly always an integer value without cents.*

- *We report actual expenses and use the federal Per Diem as a guideline. Our guideline looks for the total cost of daily meals not any one individual meal during the day. We assume that none of the Per Diem amounts examined over the period exceeded the federal levels on a total daily basis.*

- *The Director's share of these two meals was 50% at each meal cost. The meals were both at the **Delectable Egg** and in fact the ordered meals were exactly the same in both instances. The Director returned home at 2045 Hours and did not eat an evening meal. In both instances, our Commission received benefit from each of these meals.*

- *The round trip to Denver International Airport is approximately 320 miles. The auditor has calculated that the cost of operating our Commission vehicle would have been $42, or 13.125¢/Mile. The reimbursed cost of $142 was at the IRS-determined rate. We were unaware of any differences outlined by statute, rule, or regulation concerning this matter in the use of personal vehicle for convenience versus a Commission-owned vehicle.*

  In the past thirteen years, families have occasionally accompanied our employees on out-of-town business trips. To our knowledge, the Commission has always reimbursed vehicle expenses. For all of the years prior to the implementation of NIS, this reimbursement was always approved by the State Accounting Division of the Department of Administrative

COMMENTS AND RECOMMENDATIONS
(Continued)

4. <u>Travel Expenditures</u> (Concluded)

Commission's Response, Concluded:

Services in Lincoln. This issue never arose at any time in the past. The occasion very seldom arises where family members could accompany one of our employees on any business trip. The likely situation is that our employees are required to travel and be away from their family for the entire weekend.

- *We can not explain why the document lacked an approval signature. The expense document that lacked the signature was submitted by the Director. With our policy and approval process, the document was reviewed/coded by two other employees. We have a policy in-place that stipulates the approval process for our expense reimbursements. We believe that this process was followed and that the expenses were accurately coded, approved within NIS, and ultimately reimbursed.*

- *We have used the same expense document for many years and they are kept in a file for the required time period. We understand that there is risk of theft of personal information and will cease to "fill in that blank." We could alter the archived documents in certain areas by cutting off or marking out sensitive information if the Auditor's office feels this alteration is not illegal. Please advise our Commission as to the legality of altering an existing document.*

As to your recommendation, we generally concur but also believe that our current manner of approval and scrutiny is adequate.

Auditor's Response: If, as the Commission asserts, it uses Federal per diems as a guideline it should already be aware that IRS guidelines break down into breakfast, lunch, dinner, and incidentals, the maximum daily reimbursement rates while on travel. Additionally, the Commission should consult the Nebraska Department of Administrative Services Accounting Division with any questions regarding the expense reimbursement form.

5. <u>Rules and Regulations</u>

Neb. Rev. Stat. Section 84-902 R.S.Supp., 2006 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.S.Supp., 2006 outlines the adoption, amendment, repeal, hearing, and notice procedures for agency rules and regulations.

COMMENTS AND RECOMMENDATIONS
(Continued)

5. <u>Rules and Regulations</u> (Concluded)

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 August 6, 2007, the Commission has not yet implemented provisions related to Neb. Rev. Stat. Section 57-923 R.R.S. 2004.

A similar finding was noted in our previous report.

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 continue to 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.

Commission's Response: We concur with your recommendation. As we discussed with the auditors, our Commission has operated effectively without having one additional professional position filled since late 1993. The Commission lost the FTE for this position during the 1994 legislative session and an executive order has frozen agency FTE's since that time. The Director has become responsible for technical job duties in a number of areas that were previously performed by the vacated position. However, without this staff position, our functionality is impaired in the area of rule-making since this position had always been responsible for the stewardship of new or revised rules.

Rule-making is not easy or inexpensive, requires much time and effort, and the procedure can become confused. At this time, the Director is the only person who could accept the task of revising our rules. We hereby ask the office of the Auditor of Public Accounts to provide our agency with a step-by-step outline for the rule-making process that would incorporate compliance with state statutes and executive orders as well as federal requirements that might be applicable. This outline will then be used to make the necessary changes to our rules.

Auditor's Response: The Commission should consult with its own legal counsel, as well as the Nebraska Secretary of State, for comprehensive guidance in navigating the rule-making process.

COMMENTS AND RECOMMENDATIONS
(Continued)

6. 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. In June 2005, the Commission requested guidance and/or clarification on this issue from the State of Nebraska Office of the Attorney General. In a letter dated January 5, 2006, the Office of the Attorney General suggested the Commission consider proposing amendatory legislation to the Nebraska Legislature which would allow civil penalties levied by the Commission to be used for the common schools. The Commission has taken no action on the suggestion of the Office of the Attorney General regarding this issue.

In the fiscal years ended June 30, 2007, and 2006 the Commission received $1,000 and $6,250, respectively, in fines/penalties.

A similar finding was noted in our previous report.

When conflict exists between State statute and the Constitution there is an increased risk of misinterpretation and/or dispute. Furthermore, if fines are deposited into the Oil and Gas Conservation Fund as provided by statute and Commission procedures, the monies are not being distributed as required by the Nebraska Constitution.

> We recommend the Commission work with the Legislature to resolve the apparent conflict between State statutes and the Nebraska Constitution.

Commission's Response: We remain aware of this previous finding and communicated with our attorney at the Attorney General's office during 2005 and in to 2006. We would not have any problem complying with the Constitutional portion of this conflict but then we would be breaking the state law under the Commission's statutes.

It's easier said than done to find a Senator who is willing to introduce a bill, tougher to get a bill out of committee let alone see the bill passed. Our Commission has worked with several former legislators, Senators Matzke and Baker, to introduce and attempt passage of four bills over the

COMMENTS AND RECOMMENDATIONS
(Continued)

6. Fines/Penalties (Concluded)

Commission's Response, Concluded:
past eight years. Three of the bills were not voted out of the Natural Resources Committee and one died on the floor. We find it rather discouraging to work hard to attempt legislation that would be of benefit the Commission and encourage the development of oil and gas in Nebraska only to have bills die in Committee.

It is possible that the constitutional office of the Auditor of Public Accounts might have more success in amending this oil and gas related law than the Commission.

7. Contracts

Neb. Rev. Stat. Section 73-502 R.R.S. 2003 defines contract for services as "any contract that directly engages the time or effort of an independent contractor whose purpose is to perform an identifiable task, study, or report rather than to furnish an end item of supply, goods, equipment, or material …." In addition, Neb. Rev. Stat. Section 73-505 R.R.S. 2003 states "State agency directors shall be responsible for maintaining accurate documentation of the process used for selection of all contracts for services . . ." Good internal control requires Agencies to consistently obtain written, legally exercised contract documents whenever engaging services. Lastly, Neb. Rev. Stat. Section 73-503 R.R.S. 2003 states "All state agencies shall process and document all contracts for services through the state accounting system."

During our examination, we noted the following:

- Commission obtained sole source deviation approval from the Department of Administrative Services (DAS) for $36,500 in Information Technology (IT) services from an independent contractor related to implementation of an online data mining application. The Commission did not obtain a formal, written contract with this contractor and, as such, did not enter any contract information into the state accounting system's database of service contracts.

- Two additional purchases of IT services from independent contractors, one for $4,500 and one for $3,300, were similarly not documented via formal, written contracts with the contractors and; therefore, did not have any information entered into the state accounting system's database of service contracts.

Inadequate controls and noncompliance with State requirements increases the risk for misuse of Commission funds.

> We recommend the Commission follow State statutes and DAS Rules and Regulations.

COMMENTS AND RECOMMENDATIONS
(Continued)

7. Contracts (Concluded)

Commission's Response: We do not disagree with the recommendation and will seek the aid of DAS Materiel Division in the future. However, we want to make it known that the three cited expenditures were specifically for consulting to aid our employees in the development "data mining" from our web-site and we remain in doubt as to whether the use of consultants on an hourly basis is a "contract". To our knowledge, we complied with every aspect of approval prior to using any of these companies and consulting, as in these cases, generally is never subject to a written contract.

The Director of DAS approved the largest project and the necessity of a written contract was never brought up nor was there any discussion as to entering the project into any system. Our staff members personally knew the personnel who were going to be working with us on the project through our association with the Ground Water Protection Council and other software development projects. The same firm had previously written the initial programming for the Alaska Oil and Gas Conservation Commission and was the only company that could have aided us in this project.

We question the assertion that a written contract was necessary in the last two minor expenditures. They are within the Director's spending authority. We will seek further clarification with both our Attorney General and the Department of Administrative Services.

Auditor's Response: We would simply reiterate to the Commission the Statutory definition of a contract for services. This definition does not exclude consultants nor set a dollar threshold below which the definition would not apply.

8. Excessive Sick Leave Documentation

NAPE/AFSCME and State of Nebraska Labor Contract, Sections 14.12 and 14.13, Request for Sick Leave states "Substantiating evidence may be required if the sick leave absence exceeds three consecutive workdays. Sick leave may be denied when the employee fails to substantiate the legitimate use of sick leave." In addition, the sick leave policy of the Nebraska Oil & Gas Conservation Commission, as documented in its personnel handbook, requires substantiating evidence of sick leave use if the sick leave absence exceeds 5 consecutive workdays. Substantiating evidence shall be a signed doctor's note.

During our examination we noted two instances in which an employee had taken sick leave for 6 consecutive workdays. No substantiating evidence was on file.

A similar finding was noted in our previous report.

Noncompliance with the NAPE/AFSCME Labor Contract and Commission policies result in an increased risk of abuse of sick leave.

COMMENTS AND RECOMMENDATIONS
(Continued)

8. Excessive Sick Leave Documentation (Concluded)

> We recommend the Commission implement procedures to ensure substantiating evidence is maintained for excessive sick leave usage.

Commission's Response: Our Commission does have a policy in-place so that we require a note from the doctor if the legitimacy of the sick leave was in question. In the case specifically cited in your comment, our employee was required to be in attendance during her husband's hospitalization in Denver, CO, and then spend several days at home during the initial phase of his out-patient recovery. Her time away was previously approved by the Director, known to every one in our office, and marked on our office calendar. The legitimacy of the leave was never questioned. She documented the leave on her time sheet which was approved by the Director. No doctor's note was required due to the known circumstances. We are also concerned with the potential violation of the federal HIPAA laws in matters concerning sick leave verification.

Our agency has never had any abuse of sick leave taken and has, for years, ranked in the lower range when compared to all of state government. Our Commission ranked 61st out of 69 agencies for "Average Sick Days Used by Agency" as shown in the most recently published Personnel Almanac, July 2007.

Auditor's Response: We remind the Commission of the need to completely and accurately record all employee leave usage (as previously discussed in Comment Number 3), as well as comply with Labor contracts and the Commission's own personnel policies. A doctor's note that does not detail circumstances of an employees' illness does not violate HIPAA laws and should be consistently obtained.

9. Conservation Tax Reconciliation Procedures

Neb. Rev. Stat. Section 57-919, R.R.S. 2004, regarding the Oil and Gas Conservation Fund, permits a tax, not to exceed fifteen mills (.015) on the dollar, to be levied and assessed on the value, at the well, of all oil and gas produced, saved, and sold or transported from the premises in Nebraska where produced. This statute further assigns the duty to make collection of such assessments to the Tax Commissioner with all money collected being remitted to the State Treasurer for credit to the Oil and Gas Conservation Fund.

COMMENTS AND RECOMMENDATIONS
(Continued)

9. <u>Conservation Tax Reconciliation Procedures</u> (Continued)

During our examination, we noted the following:

- While the Commission has some procedures in place to ensure purchasers are completely and accurately reporting production/sales information, the Commission's "reconciliation" procedures could be improved by implementing, at a minimum, spot checks of the Form 61's (Nebraska Severance and Conservation Tax Return) received by the Commission to the quarterly tax recap spreadsheets received by the Commission from the Nebraska Department of Revenue to ensure the completeness and accuracy of actual tax collections since collections are not performed by another agency.

- While the Commission has some monthly "reconciliation" procedures in place, as is noted in the third bullet, small barrel variances too large to be attributable to shrinkage, are not adequately investigated and resolved by the Commission.

- One of twenty oil sales selected from the Commission's monthly "reconciliations" noted a 25 barrel variance in the number of production barrels reported by the producer (215) and the number of barrels purchased as reported independently by the purchaser (190); an amount too large to be attributable to shrinkage. When questioned by auditor the Commission contacted producer and determined producer had, in error, over-reported production. The purchaser had correctly paid conservation tax based on 190 barrels; therefore, the impact of this error is to the completeness and accuracy of the Commission's production records.

When production and purchase data reported to the Commission by producers and purchasers is not, at a minimum, spot checked to actual collections, there is an increased risk of loss, theft, or misuse of Commission funds.

> We recommend the Commission implement, at a minimum, spot checks of its reconciled Form 61's to the quarterly tax recap statements received from the Nebraska Department of Revenue to further ensure the completeness and accuracy of the Commission's conservation tax revenues. While the Commission's reconciliation procedures include identification of any variances between production and purchase barrel data reported to the Commission, the Commission's procedures should also include timely resolution of any variance too large to be attributable to shrinkage or other reasonable explanation.

COMMENTS AND RECOMMENDATIONS
(Continued)

9. <u>Conservation Tax Reconciliation Procedures</u> (Concluded)

Commission's Response: Our Commission does have several procedures in-place to verify whether or not sales volumes reported by the producer correspond with those volumes reported on the Form 61. Based upon our reporting requirements, all volumes reported on Commission Form 7A must balance or the volumes can not be input into our electronic system. If there is a variance, we would assume that the problem lies with the first purchaser.

In this particular instance, we believed that the first purchaser was incorrect since all reported volumes during the month balanced. Our sales volumes generally total 195,000 barrels per month, so the volume of 25 barrels is not significant and were "long" to the volume on the Form 7A.

We will begin to spot check the spreadsheet we receive from the Department of Revenue to determine if the first purchaser actually did remit the amount. However, the Revenue group should be doing this at the present time and our interest thereby protected.

10. <u>NIS Access Termination</u>

The Nebraska State Accounting Manual, General Policies, Section 32, Terminated Employee NIS ID's requires when an employee terminates from an agency, the Authorized Agent shall notify NIS Security to terminate the User's NIS ID within 5 work days from the employee's date of termination. In addition, good internal control requires each agency to develop procedures to immediately disable User ID's of terminated employees.

During our examination we noted NIS access for an employee who resigned effective October 31, 2006, was not terminated in the NIS system until November 30, 2006, at which time the NIS Security team terminated the User ID on its own and notified the Commission of such termination. It should be noted that in this instance the former employee had previously been the Commission's Authorized Agent and had functional user access to the majority of NIS system modules.

When system access is not promptly disabled for terminated employees there is an increased risk of loss, theft, or misuse of Commission assets.

> We recommend the Commission implement procedures to ensure User IDs of terminated employees are promptly disabled.

Commission's Response: We agree with the recommendation and hereby ask the office of the Auditor of Public Accounts to furnish our agency with their internal checklist for employee terminations within the Nebraska Information System (NIS).

COMMENTS AND RECOMMENDATIONS
(Continued)

10. NIS Access Termination (Concluded)

Commission's Response, Concluded:
In this particular case, we believed that everything had been addressed within NIS and that all security access had been cancelled. The checklist will certainly aid us in this area.

Auditor's Response: The Commission should consult its own legal counsel, as well as the Nebraska Department of Administrative Services Personnel Division, for guidance in developing and/or implementing a termination checklist.

11. Expenditure Recognition

Standard practice in accrual-basis accounting, which is compliant with Generally Accepted Accounting Principles, is to record and recognize expenditures in the period in which they incur and to match them with related appropriations. In the case of prior year obligations paid in subsequent years, even though cash is not exchanged the transactions would be recorded as prior year obligations, particularly if they are significant to cash flow.

During our examination we noted one instance in which a $19,372 contract payment was not properly coded as a prior year obligation ("P9" transaction on NIS) when paid in July 2006 despite the contract when signed in May 2006 clearly stated the "… $19,372 is due now …."

When expenditures are not completely and accurately reported, there is an increased risk of misstatement in NIS, and, as a result, in the State of Nebraska's annual financial reporting.

> We recommend the Commission implement procedures to ensure complete and accurate accounting for all expenditures.

Commission's Response: The invoiced expenditure of $19,372 was for the purchase of the hard data for our LANDSAT-based photogeologic/geomorphic study. This study required a deficit spending request and approval by the Legislature at the recommendation of the Appropriation Committee. There was no "emergency" clause with this appropriation so that portion of the legislative bill did not become effective until some time after the passage of the bill. Once the appropriation was approved by the legislature the contract was signed. The contract was signed by the Director in May. However, we did not receive approval from the Materiel Division of the Department of Administrative Services for the deviation request until mid-July and the check request was submitted immediately after that. In any event, the study could not have been commenced until Mr. Koger received the check, purchased the raw data, and then received the data. Mr. Koger did not have any significant time invested on this project from May until late July.

We will continue to make every effort to code our expenditures into the proper fiscal year.

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NEBRASKA OIL AND GAS CONSERVATION COMMISSION

INDEPENDENT ACCOUNTANT'S REPORT

Nebraska Oil and Gas Conservation Commission
Lincoln, Nebraska

We have examined the accompanying schedules of revenues, expenditures, and changes in fund balances of the Nebraska Oil and Gas Conservation Commission (Commission) for the fiscal years ended June 30, 2007, and June 30, 2006. The Commission's management is responsible for the schedules 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 schedules 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 schedules referred to above present, in all material respects, the revenues, expenditures, and changes in fund balances of the Nebraska Oil and Gas Conservation Commission for the fiscal years ended June 30, 2007, and June 30, 2006, 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 September 10, 2007, 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 management, the Commissioners, others within the Commission, and the appropriate Federal and regulatory agencies. However, this report is a matter of public record and its distribution is not limited.

Pat Reding, CPA

September 10, 2007 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, 2007

	Oil & Gas Conservation Fund 25710	UIC Inventory Fund 45710	Oil & Gas Trust Fund 65710	**Totals (Memorandum Only)**
REVENUES:				
Intergovernmental	$ -	$ 63,900	$ -	$ 63,900
Sales & Charges	37,576	-	-	37,576
Miscellaneous	33,312	-	1,208	34,520
TOTAL REVENUES	70,888	63,900	1,208	135,996
EXPENDITURES:				
Personal Services	372,413	82,551	-	454,964
Operating	123,231	12,080	-	135,311
Travel	9,861	561	-	10,422
Capital Outlay	15	2,114	-	2,129
TOTAL EXPENDITURES	505,520	97,306	-	602,826
Excess (Deficiency) of Revenues Over (Under) Expenditures	(434,632)	(33,406)	1,208	(466,830)
OTHER FINANCING SOURCES (USES):				
Sales of Assets	893	-	-	893
Deposits from Common Fund	379,574	-	-	379,574
TOTAL OTHER FINANCING SOURCES (USES)	380,467	-	-	380,467
Net Change in Fund Balances	(54,165)	(33,406)	1,208	(86,363)
FUND BALANCES, JULY 1, 2006	680,396	765	830,696	1,511,857
FUND BALANCES, JUNE 30, 2007	$ 626,231	$ (32,641)	$ 831,904	$ 1,425,494
FUND BALANCES CONSIST OF:				
General Cash	$ 593,172	$ 359	$ 26,904	$ 620,435
Deposits with Vendors	59	-	-	59
Due To Other Funds	-	(33,000)	-	(33,000)
Due From Other Funds	33,000	-	-	33,000
Deposits-Producer CD's in Lieu of Bonds	-	-	805,000	805,000
TOTAL FUND BALANCES	$ 626,231	$ (32,641)	$ 831,904	$ 1,425,494

The accompanying notes are an integral part of the schedule.

NEBRASKA OIL AND GAS CONSERVATION COMMISSION

SCHEDULE OF REVENUES, EXPENDITURES, AND CHANGES IN FUND BALANCES

For the Fiscal Year Ended June 30, 2006

	Oil & Gas Conservation Fund 25710	UIC Inventory Fund 45710	Oil & Gas Trust Fund 65710	**Totals (Memorandum Only)**
REVENUES:				
Intergovernmental	$ -	$ 82,200	$ -	$ 82,200
Sales & Charges	31,120	-	-	31,120
Miscellaneous	31,671	-	1,179	32,850
TOTAL REVENUES	62,791	82,200	1,179	146,170
EXPENDITURES:				
Personal Services	359,670	75,286	-	434,956
Operating	114,268	7,190	15,342	136,800
Travel	10,684	1,653	-	12,337
Capital Outlay	27,698	-	-	27,698
TOTAL EXPENDITURES	512,320	84,129	15,342	611,791
Excess (Deficiency) of Revenues Over (Under) Expenditures	(449,529)	(1,929)	(14,163)	(465,621)
OTHER FINANCING SOURCES (USES):				
Sales of Assets	3,008	-	-	3,008
Deposits from Common Fund	554,787	-	-	554,787
Adjustments to Fund Balance	-	-	70,000	70,000
TOTAL OTHER FINANCING SOURCES (USES)	557,795	-	70,000	627,795
Net Change in Fund Balances	108,266	(1,929)	55,837	162,174
FUND BALANCES, JULY 1, 2005	572,130	2,694	774,859	1,349,683
FUND BALANCES, JUNE 30, 2006	$ 680,396	$ 765	$ 830,696	$ 1,511,857
FUND BALANCES CONSIST OF:				
General Cash	$ 680,337	$ 765	$ 25,696	$ 706,798
Deposits with Vendors	59	-	-	59
Deposits-Producer CD's In Lieu of Bonds	-	-	805,000	805,000
TOTAL FUND BALANCES	$ 680,396	$ 765	$ 830,696	$ 1,511,857

The accompanying notes are an integral part of the schedule.

NOTES TO THE SCHEDULES

For the Fiscal Years Ended June 30, 2007, and June 30, 2006

1. Criteria

The accounting policies of the Nebraska Oil and Gas Conservation Commission (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., 2006, 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 the Nebraska State Accounting Manual published by DAS – Accounting Division 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 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, 2007, and June 30, 2006, include only those payables posted to NIS before June 30, 2007, and June 30, 2006, and not yet paid as of that date. The amount recorded as expenditures as of June 30, 2007, and June 30, 2006, **do not** include amounts for goods and services received before June 30, 2007, and June 30, 2006, which had not been posted to NIS as of June 30, 2007, and June 30, 2006.

NIS also records other liabilities in accounts titled Deposits and Due to/from Fund for the Commission. 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 of the activity recorded to those accounts for the fiscal years ended June 30, 2007, and June 30, 2006, see Notes 6 and 7.

The Commission had no accounts receivable at June 30, 2007, and June 30, 2006. NIS 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 SCHEDULES
(Continued)

1. <u>Criteria</u> (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 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 SCHEDULES
(Continued)

1. <u>Criteria</u> (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, 2007, and June 30, 2006, included Deposits and Due to/from Fund. The activity processed on NIS through these accounts is summarized in Notes 6 and 7.

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. <u>State Agency</u>

The Nebraska Oil and Gas Conservation 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 schedules include all funds of the Commission.

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

3. <u>Totals</u>

The Totals "Memorandum Only" columns represent an aggregation of individual account balances. The columns are presented for overview informational purposes and do not present consolidated financial information because interfund balances and transactions have not been eliminated.

4. <u>General Cash</u>

General cash accounts are under the control of the State Treasurer or other administrative bodies as determined by law. All cash deposited with the State Treasurer is initially maintained in a pooled cash account. On a daily basis, the State Treasurer invests cash not needed for current operations with the State's Investment Council that maintains an operating investment pool for such investments. Interest earned on those investments is allocated to funds based on their percentage of the investment pool.

NOTES TO THE SCHEDULES
(Continued)

5. 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 values all capital assets at cost where historical records are available and at estimated 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 the asset's 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, 2007, was as follows:

	Beginning Balance	Increases	Decreases	Ending Balance
Capital Assets				
Equipment	$ 226,533	$ 2,114	$ 17,786	$ 210,861
Less accumulated depreciation for:				
Equipment				172,555
Total capital assets, net of depreciation				$ 38,306

Capital asset activity of the Commission for the fiscal year ended June 30, 2006, was as follows:

	Beginning Balance	Increases	Decreases	Ending Balance
Capital Assets				
Equipment	$ 228,820	$ 27,693	$ 29,980	$ 226,533
Less accumulated depreciation for:				
Equipment				167,467
Total capital assets, net of depreciation				$ 59,066

NOTES TO THE SCHEDULES
(Continued)

6. 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 letter of agreement from the issuing banks recognizing that the CDs are payable or assignable by the Commission only.

Deposit activity of the Commission for the fiscal year ended June 30, 2007, was as follows:

Fund	Balance July 1, 2006	In	Out	Balance June 30, 2007
Oil and Gas Trust Fund 65710	$ 805,000	$ 65,000	$ 65,000	$ 805,000

Deposit activity of the Commission for the fiscal year ended June 30, 2006, was as follows:

Fund	Balance July 1, 2005	In	Out	Balance June 30, 2006
Oil and Gas Trust Fund 65710	$ 735,000	$ 85,000	$ 15,000	$ 805,000

7. Changes in Due to/from Fund

Early in each Federal fiscal year the Commission “loans” funds from the Oil & Gas Conservation Fund, 25710, to the Federal UIC Inventory Fund, 45710, while it waits for final award documents and release of funding from the U.S. EPA for its UIC grant. As of the date of this examination the Commission had intentionally not signed the 2007 UIC grant award due to what it considered unreasonable and unanticipated new administrative grant conditions requiring the Commission to agree to use the National Environmental Information Exchange Network, to support electronic data reporting, sharing, and integration of both regulatory and non-regulatory environmental data. As of June 30, 2007, the Commission had not drawn down any funds from the EPA for the period of March through June 2007. The Commission is working to resolve this dispute with the EPA.

	Balance July 1, 2006	In	Out	Balance June 30, 2007
Oil & Gas Conservation Fund 25710	$ -	$ -	$ 33,000	$ 33,000
UIC Inventory Fund 45710	$ -	$ 33,000	$ -	$ 33,000

NOTES TO THE SCHEDULES
(Continued)

8. Deposits from Common Fund

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 assign 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.

9. Adjustments to Fund Balance

Adjustments to Fund Balance transactions are those recorded directly to a fund's asset account or equity account rather than through a revenue or expenditure account. Adjustments to Fund Balance include Producer CD's in Lieu of Bonds received and/or refunded. See Note 6.

10. Reconciliation of Bank Records to the Nebraska Information System

Through their bank reconciliation procedures, DAS State Accounting Division (State Accounting) has identified a large unknown statewide variance between the State Treasurer's bank statements and the State's balances in the general ledger. This unknown variance indicates the bank records are short as compared to the accounting records. Some adjustments to the accounting records may be needed and may affect the fund balances of the Commission. At this time, it has not been determined how or when adjustments to the accounting records might be made. State Accounting is unable to determine the affect of such adjustment, if any, on the Commission's balances; however, State Accounting believes it will not have a material impact on the Commission's operations.

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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 SCHEDULES 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 schedules of revenues, expenditures, and changes in fund balances of the Nebraska Oil and Gas Conservation Commission as of and for the years ended June 30, 2007, and June 30, 2006, and have issued our report thereon dated September 10, 2007. 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 as a basis for designing our procedures for the purpose of expressing our opinion on the schedules of revenues, expenditures, and changes in fund balances, but not for the purpose of expressing an opinion on the effectiveness of the Nebraska Oil and Gas Conservation Commission's internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of the Nebraska Oil and Gas Conservation Commission's internal control over financial reporting.

A control deficiency exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect misstatements on a timely basis. A significant deficiency is a control deficiency, or combination of control deficiencies, that adversely affects the entity's ability to initiate, authorize, record, process, or report financial data reliably in accordance with the accounting system and procedures prescribed by the State of Nebraska Director of Administrative Services such that there is more than a remote likelihood that a misstatement of the entity's financial schedule that is more than inconsequential will not be prevented or detected by the entity's internal control.

A material weakness is a significant deficiency, or combination of significant deficiencies, that results in more than a remote likelihood that a material misstatement of the financial schedules will not be prevented or detected by the Nebraska Oil and Gas Conservation Commission's internal control.

Our consideration of internal control over financial reporting was for the limited purpose described in the first paragraph of this section and would not necessarily identify all deficiencies in internal control that might be significant deficiencies or material weaknesses. We did not identify any deficiencies in internal control over financial reporting that we consider to be material weaknesses, as defined above.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the Nebraska Oil and Gas Conservation Commission's financial schedules are 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 schedules amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit, 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 (Untaxed Commuting Use of State Vehicles), Comment Number 2 (Personal Use of Commission Vehicles and Equipment), Comment Number 3 (Unrecorded Employee Leave), Comment Number 4 (Travel Expenditures), Comment Number 5 (Rules and Regulations), Comment Number 6 (Fines/Penalties), Comment Number 7 (Contracts), Comment Number 8 (Excessive Sick Leave Documentation), Comment Number 9 (Conservation Tax Reconciliation Procedures), Comment Number 10 (NIS Access Termination), and Comment Number 11 (Expenditure Recognition).

Nebraska Oil and Gas Conservation Commission's written response to the findings identified in our audit are described in the Comments Section of the report. We did not examine Nebraska Oil and Gas Conservation Commission's response and accordingly, we express no opinion on it. Where no response is indicated, the Commission declined to respond.

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

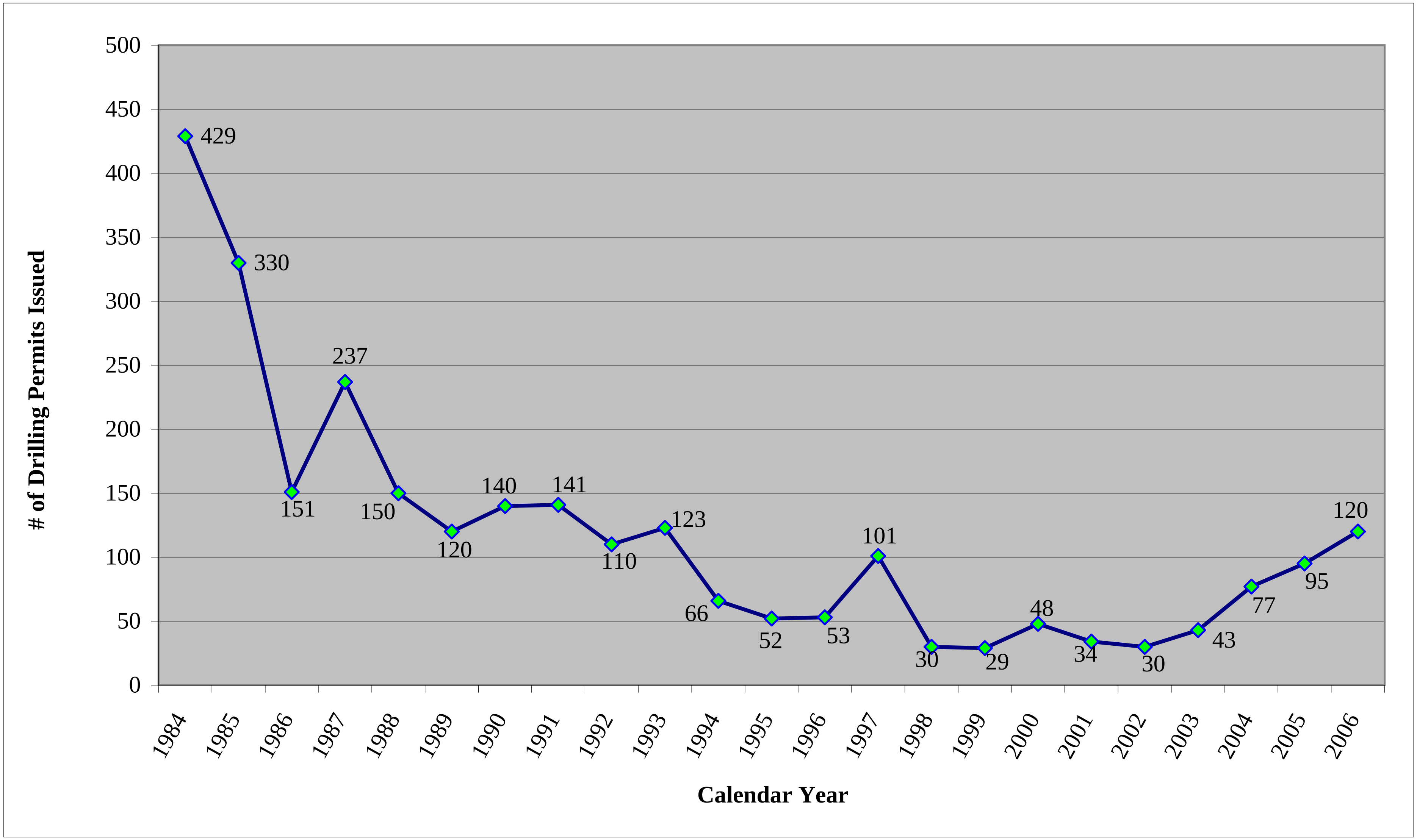
Pat Reding, CPA

September 10, 2007 Assistant Deputy Auditor

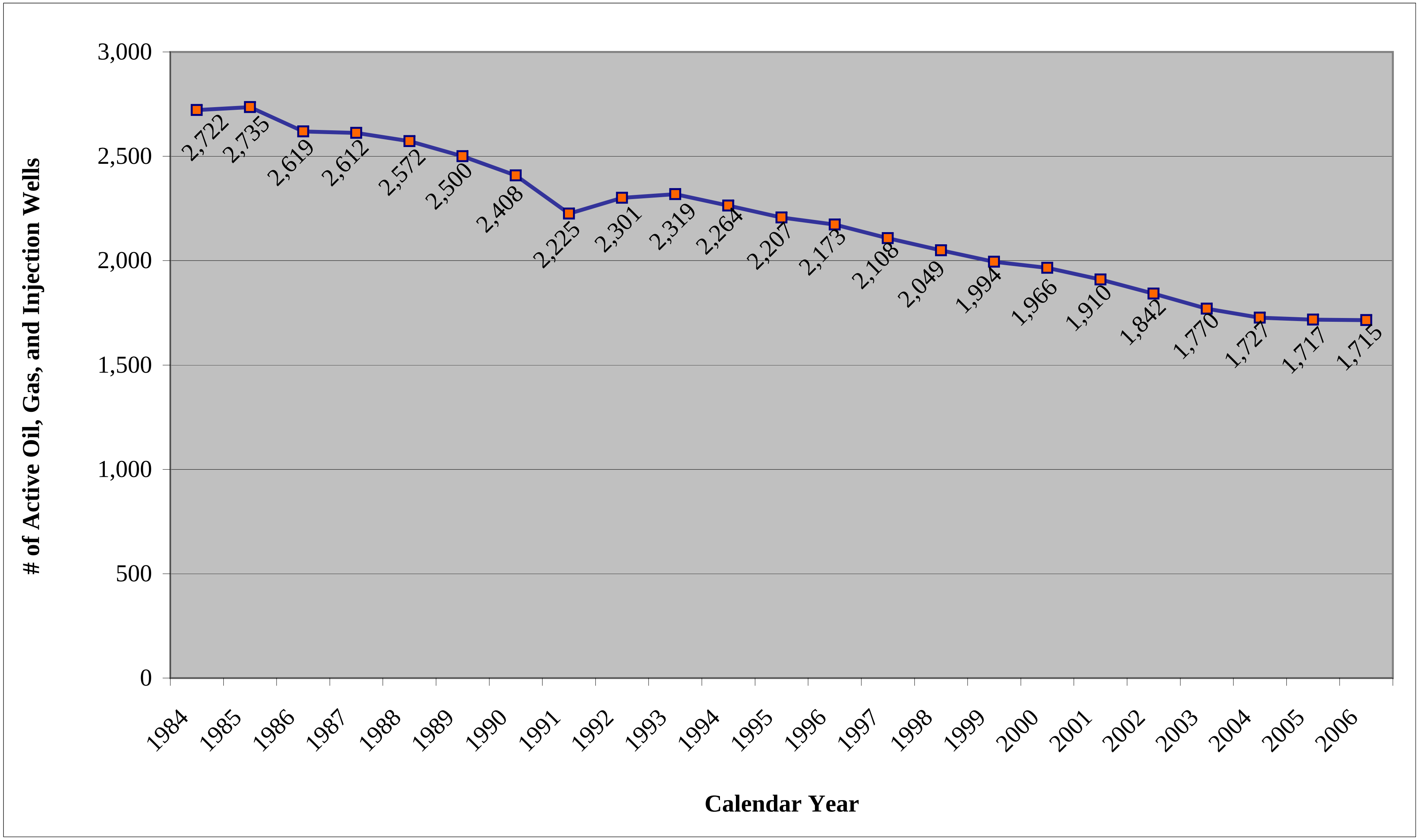
STATISTICAL SECTION

Our examination was conducted for the purpose of forming an opinion on the schedules 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 schedules of revenues, expenditures, and changes in fund balances, and, accordingly, we express no opinion on it.

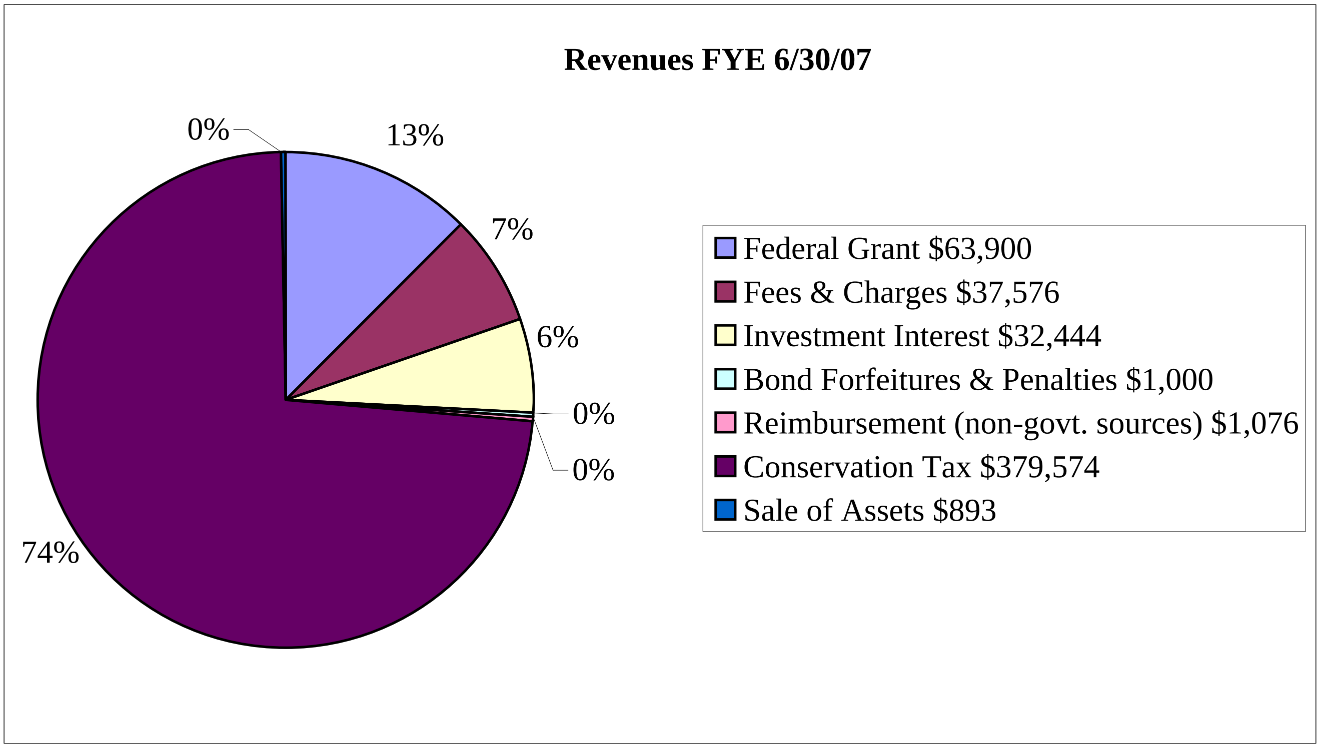
NEBRASKA OIL AND GAS CONSERVATION COMMISSION
DRILLING PERMITS ISSUED

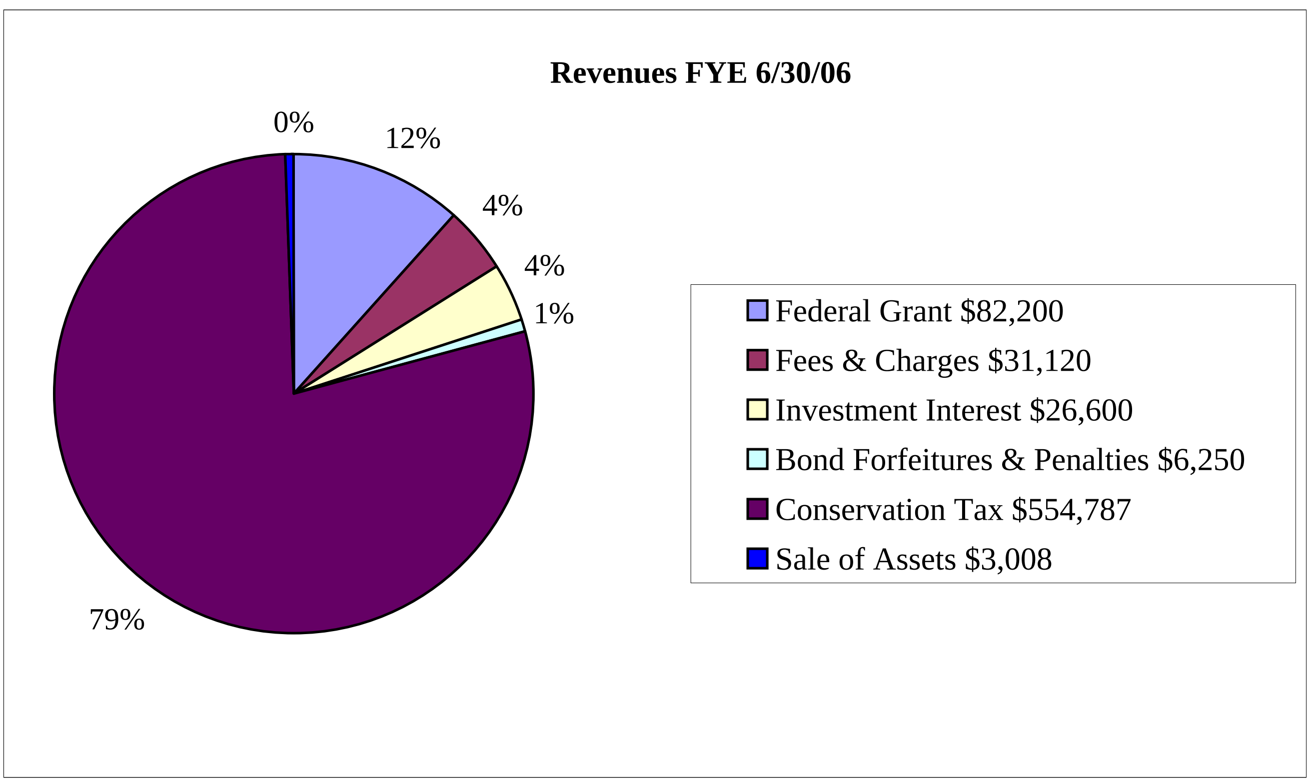


NEBRASKA OIL AND GAS CONSERVATION COMMISSION
ACTIVE OIL, GAS, AND INJECTION WELLS



NEBRASKA OIL AND GAS CONSERVATION COMMISSION
REVENUES (ALL SOURCES)
For the Fiscal Years Ended June 30, 2007, and 2006





NEBRASKA OIL AND GAS CONSERVATION COMMISSION

EXPENDITURES (ALL FUNDS)

For the Fiscal Years Ended June 30, 2007, and 2006