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**JPMorgan Chase Gas Revenue Bank
Account Audit**

July 11, 2014



**City of Fort Worth
Department of Internal Audit**

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Fort Worth, Texas 76102

Audit Staff

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The JPMorgan Chase Gas Revenue Bank Account Audit was conducted as part of the Department of Internal Audit's Fiscal Year 2014 Annual Audit Plan.

Audit Objectives

The objectives of this audit were to determine whether:

- gas revenue sent to JPMorgan Chase Bank (by oil and gas companies on behalf of the City of Fort Worth) was posted appropriately to the City's individual gas revenue bank sub-accounts; and,
- gas revenue received by JPMorgan Chase Bank (on behalf of the City of Fort Worth) was properly transferred to the City's consolidated bank account.

Audit Scope

Our audit scope covered gas revenue sent by oil and gas companies to JPMorgan Chase Bank (on behalf of the City of Fort Worth) and subsequently transferred to the City of Fort Worth from FY2009 through FY2013.

Opportunity for Improvement

Routine and timely gas revenue account reconciliations

Executive Summary

The Department of Internal Audit performed an audit of City of Fort Worth (CFW) gas revenue bank accounts held at JPMorgan Chase Bank. Our audit covered the period of October 1, 2008 through September 30, 2013.

Based on the work performed, we concluded that the accountability for gas revenue was established, in that gas revenue was posted appropriately to the City's bank sub-accounts and subsequently to the City's consolidated bank account. However, as discovered by management, gas revenue was not always transferred from the City's bank sub-accounts to the City's consolidated bank account in a timely manner. Management subsequently requested this audit due to this discovery and the scheduled closing of the JPMorgan Chase gas revenue bank account.

Our audit results indicated that the non-detection of untimely bank account transfers was due to the Gas Lease Division not reconciling gas revenue (reported by oil and gas companies) to deposits into/transfers between CFW gas revenue bank accounts. Gas Lease Division management indicated that they did not receive sufficient information from JPMorgan Chase or the oil and gas companies to perform the reconciliation. This internal control weakness is discussed further within the [Detailed Audit Finding](#) section of this report.

Internal controls related to the City's cash flow are important and help detect any errors and/or irregularities. Management recognizes and agrees that this internal control weakness existed, and has responded as to action they have already taken to mitigate the risk.

We feel that management's response adequately addresses the audit recommendation and will help prevent the reoccurrence of untimely transfers between CFW gas revenue bank accounts.



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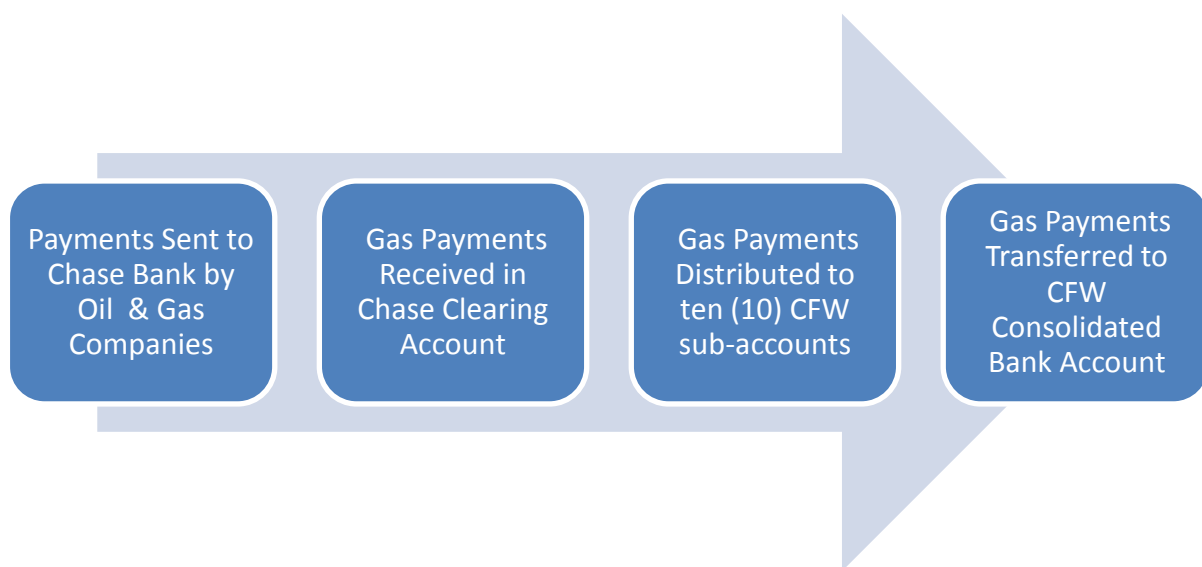
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Background

The CFW is located on one of the most active shale formations in the United States – the Barnett Shale. The Barnett Shale contains an estimated 40 trillion cubic feet of natural gas. Recent improvements in horizontal drilling and hydraulic fracturing technology have made gas exploration from the Shale more profitable, which attracted many natural gas producers to the area. The CFW has entered into numerous agreements with oil and gas producers interested in drilling under the City’s land. Under these agreements, the CFW is entitled to bonuses and royalties associated with the oil and gas production. However, the City has only received revenue and bonuses related to gas production from the current leases.

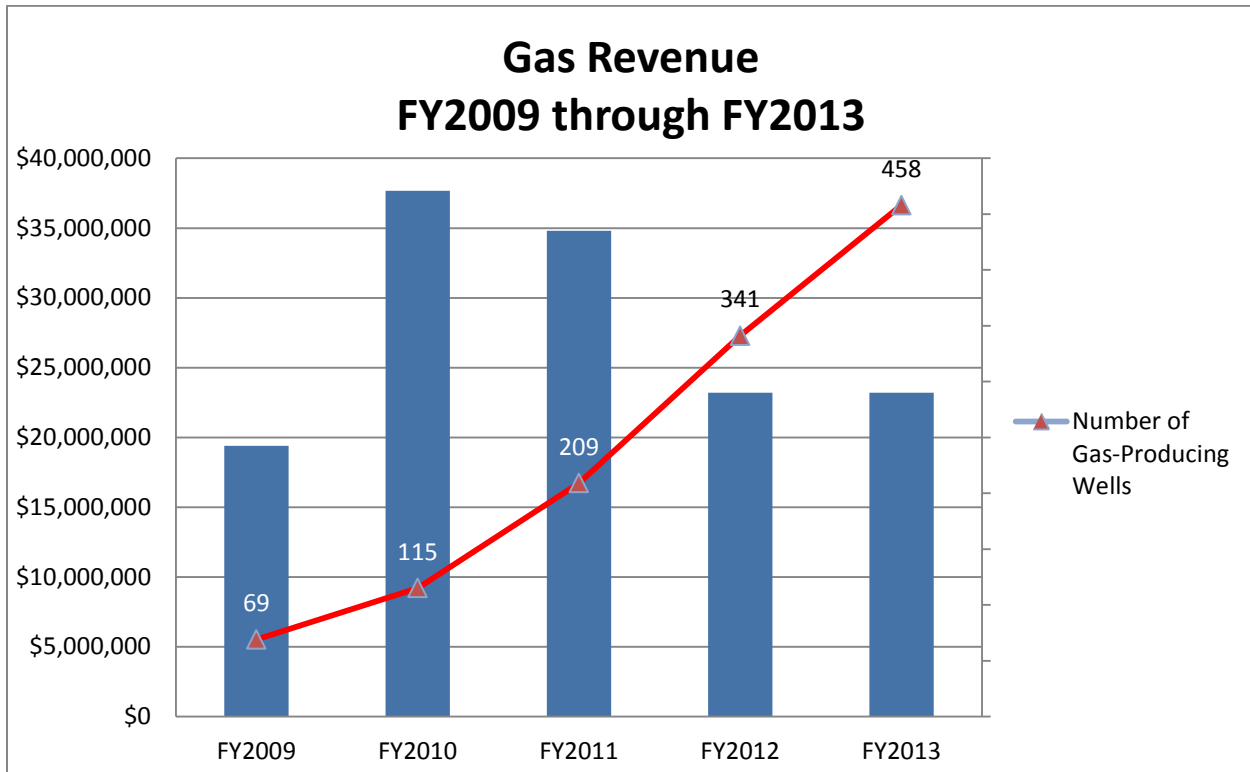
Due to high gas production activity and revenue, the City sought outside assistance to help manage its gas revenue. In March 2004, the CFW entered into an agreement authorizing Bank One to open an alternative assets agency account on behalf of the CFW. After Bank One’s merger with JPMorgan Chase Bank, the City entered into an agreement with JPMorgan Chase Bank. As a part of this agreement, JPMorgan Chase Bank was to transfer gas income received from third parties’ bonus and royalty payments to the CFW; process gas revenues by well property and producer; maintain existing gas property account(s) and establish bank sub-accounts for accounting and distribution purposes.

According to the CFW’s Gas Revenue Distribution Policy (which is a part of the city’s Financial Management Policy Statements), gas revenue is to be distributed to different CFW departments depending on the location of gas leases. For example, gas revenue associated with a well located on airport property would only be available for use by the Aviation Department. JPMorgan Chase, therefore, established bank sub-accounts to record revenue for each department. Each month, gas revenue recorded in the bank sub-accounts is to be transferred to the CFW’s consolidated bank account, as illustrated below.





From the inception of the Barnett Shale development during the first decade of 2000, the CFW has received over \$200 million from oil and gas companies for lease bonuses and gas sales - \$138 million of which was received from FY2009 through FY 2013 as depicted in the following chart.



Source: Consolidated Annual Financial Report and the CFW's Gas Lease Division

On September 27, 2013, an approximate \$1.3 million transfer was made from the CFW's bank sub-accounts to the City's consolidated bank account. It was at that time, that City management became aware that the approximate \$1.3 million had accumulated within the City's bank sub-accounts throughout the contractual period. Management promptly requested that the Department of Internal Audit ensure that gas revenue (due to the City) was properly reflected in the City's bank account.

Since JPMorgan Chase did not bid on the new gas banking contract, the Gas Lease Division was required to close the JPMorgan Chase Bank account used for gas royalties. The Gas Lease Division, therefore, required a full accounting of bank account activity prior to the bank accounts being formally closed.

Effective April 14, 2013, the CFW contracted its gas banking services to Wells Fargo Bank.

Objectives

The objectives of this audit were to determine whether:

- gas revenue sent to JPMorgan Chase Bank (by oil and gas companies on behalf of the CFW) was posted appropriately to the individual CFW gas revenue bank sub-accounts; and,
- gas revenue received by JPMorgan Chase Bank (on behalf of the CFW) was properly transferred to the City's consolidated bank account.

Scope

Our audit scope covered gas revenue sent by oil and gas companies (on behalf of the CFW) to JPMorgan Chase Bank and subsequently transferred to the CFW from FY2009 through FY2013.

Methodology

To achieve the audit objectives, the Department of Internal Audit performed the following steps.

- Interviewed CFW Gas Lease Division personnel to gain an understanding of their processes and system of internal controls
- Requested and obtained listings of gas revenue payments from oil and gas companies
- Obtained Gas Revenue Monthly Distribution Reports, CFW gas revenue bank sub-account statements and CFW consolidated bank account statements from JPMorgan Chase
- Reconciled payments included in listings provided by oil and gas companies to JPMorgan Chase's bank statements, to ensure that all revenue was properly accounted for by the bank
- Reconciled gas revenue bank sub-account statements to the CFW's consolidated bank account statements, to ensure that all revenue was correctly transferred to the consolidated bank account
- Researched and resolved discrepancies

We conducted this audit in accordance with generally accepted government auditing standards, except for peer review. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.



Audit Results

We concluded that all funds sent from oil and gas companies to JPMorgan Chase Bank, on behalf of the CFW, were properly recorded in CFW gas revenue bank sub-accounts at JPMorgan Chase Bank and were transferred directly to the CFW's consolidated bank account.

While the Department of Internal Audit concluded that gas revenue received from oil and gas companies had been properly transferred to the CFW, we did identify internal control weaknesses which, if not corrected, could result in the non-posting and/or delay in posting of revenue to the CFW's consolidated bank account.

- The CFW was not provided a listing or summary of payments made by oil and gas companies that could be independently compared to deposits recorded by JPMorgan Chase Bank.
- The CFW did not perform reconciliations of gas revenue received from oil and gas companies that were deposited into the CFW's bank sub-accounts and then subsequently transferred to the consolidated bank account.

When a summary of payments from oil and gas companies and routine reconciliations are not required, the CFW may not detect whether gas revenue has been properly transferred to the consolidated bank account. The \$1.3 million that is discussed in the [Background](#) section of this report is an example of what can result when such processes are not required.

Overall Evaluation

High	Medium	Low
Reconciliation of gas revenue: 1) received and deposited into the CFW's bank sub-accounts, then 2) transferred from the CFW's bank sub-accounts to the CFW's consolidated bank account	N/A	N/A



Detailed Audit Finding

Oil and gas revenue, deposited into the CFW's bank sub-accounts and consolidated bank account, is not reconciled to revenue reports prepared by oil and gas companies.

Timely account reconciliation is an important internal control practice that should be a part of any business' process. Reconciliations are performed to compare two sets of records so that any differences between the record sets can be identified, researched and resolved in a timely manner.

The CFW receives a substantial amount of gas revenue. However, amounts received from oil and gas companies were not reconciled to amounts deposited into the City's bank sub-accounts or to the amounts that were subsequently transferred to the CFW consolidated bank account.

If reconciliations are not performed, errors and/or irregularities could occur without timely detection. Consequently gas funds that are not transferred into the CFW's consolidated bank account are not available for capital expenditures or depositing to the Trust.

According to CFW Financial Management Policy Statements, internal control structure should be established to provide reasonable assurance that City assets are safeguarded and that the possibilities for material errors in the City's financial records are minimized. The Gas Lease Division indicated that reconciliations were not performed due to lack of resources, formalized procedures and insufficient information from JPMorgan Chases and the oil and gas companies.

Recommendation:

The Planning and Development Director should require that CFW Gas Lease Division personnel implement a formal reconciliation process that consists of following steps:

- require and obtain listings of gas revenue payments directly from oil and gas companies;
- reconcile amounts included in the oil and gas company listings to amounts deposited into the CFW's gas revenue bank sub-accounts;
- reconcile gas revenue from bank sub-accounts to amounts deposited into the CFW's consolidated bank account; and,
- research and resolve any discrepancies in a timely manner.

Auditee's Response:

Concur. The Gas Lease Division has since re-engineered the gas revenue bank configuration and procedures, specifically:

- the number of gas revenue bank accounts was reduced by six (6) with the change to Wells Fargo Bank;



- the amounts sent by the oil and gas companies are now tracked and reconciled monthly to the amounts received by Wells Fargo Bank;
- a formal monitoring/reconciliation process is now in place to ensure all gas revenue receipts are transferred into the CFW consolidated bank account and Trust Funds on a timely basis or otherwise are accounted for;
- staff in the Gas Lease Division and Treasury can view all gas lease revenue accounts online at the current bank (Wells Fargo) for verification of receipts and disbursements; and,
- additional staff have been added to the Gas Lease Division.

Target Implementation Date: Completed

Responsibility: N/A



Acknowledgements

The Department of Internal Audit would like to thank staff within the City's Gas Lease Division, JPMorgan Chase Bank and local oil and gas companies for their cooperation and assistance during this audit.