



MEMORANDUM

Date: January 27, 2017

To: Honorable Mayor and Members of the City Council

From: Patrice Randle, City Auditor

Subject: XTO Gas Royalty Audit (Audit Project #2014.003)

The Department of Internal Audit conducted a review of gas revenue at Fort Worth's Meacham Airport.

BACKGROUND

A 2013 internal audit of gas leases with Chesapeake Energy Corporation identified significant underpayment of royalties due to the City. These underpayments resulted primarily from Chesapeake's deduction of costs not permitted by the lease contract. Based on the issues identified during the Chesapeake audit, an audit of the XTO Meacham Airport leases was initiated to verify compliance with lease/contract terms. The Department of Internal Audit contracted with oil and gas consulting firm WA Waterman & Company (an expert in oil and gas industry auditing) to lead the audit process.

AUDIT OBJECTIVE

The objective of this audit was to determine whether XTO royalty payments complied with the lease agreement in respect to production volumes, pricing, and deduction of costs.

AUDIT SCOPE

Our audit included a review of XTO gas royalty payments, related to 26 wells in the Meacham Airport Unit lease, for production months August 2010 through February 2014.

AUDIT METHODOLOGY

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

- followed guidance provided by WA Waterman & Company to:
 - interpret contract terms;
 - identify the technical methodology to use for specific audit steps; and,
 - identify contractual issues.

- reviewed production and pricing documents provided by XTO;
- reviewed Texas Railroad Commission reports;
- reviewed Texas Comptroller of Public Accounts gas reports; and,
- interviewed XTO personnel regarding production and pricing of the Meacham well gas.

We conducted this audit in accordance with generally accepted government auditing standards, except for peer review¹. 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.

CONCLUSION

Primary issues from the referenced 2013 audit were not identified during our audit of XTO Energy. Based on our audit results, XTO Energy did not deduct post-production costs that were prohibited under the lease contract.

c: Steve Cooke, Property Management Department Director
Sarah Fullenwider, City Attorney
David Cooke, City Manager
Jay Chapa, Assistant City Manager

¹ Government auditing standards require audit organizations to undergo an external peer review every three years. A peer review is planned in 2017 for the three-year period ending December 31, 2016.