STATE OF MICHIGAN
DEPARTMENT OF NATURAL RESOURCES
LANSING

RICK SNYDER
GOVERNOR

DR. WILLIAM E. MORITZ
DIRECTOR

June 13, 2016

To: Dr. William E. Moritz, Director

Information: Natural Resources Commission

Transaction: Mineral Audit Program Fees – For Information Only

Authority: Part 5, of the Natural Resources and Environmental Protection Act, 1994 PA 451, authorizes the Director of the Department of Natural Resources (DNR) to enter into contracts for mineral extraction.

Discussion: The State of Michigan (State) owns 4.1 million acres of combined surface and mineral rights, and an additional 2.3 million acres of mineral rights only. Under the provisions of 1994 PA 451, the DNR is responsible for managing these lands and mineral resources to ensure protection and enhancement of the public trust.

In 1997, the DNR established an audit program to examine lessee royalty payments and post-production cost deductions to assess whether the State was receiving its proper economic share under the terms of the lease. A fee was established to cover the cost of the audit program, including the hiring of independent contractors who would review the lessees' records and report their findings to the DNR.

The fee was established by increasing the minimum bonus bid of $10 to $13 per acre, with the first $3 (Audit Fee) over $10 going to the audit fund.

On August 9, 2012, after staff completed an assessment of the audit program, the Director approved staff's recommendation to temporarily suspend the Audit Fee for implementation at the anticipated auctions to be held October 2012, May 2013, October 2013 and May 2014. This temporary suspension was the result of sufficient fund balances to support related expenditures of the program. The Director further called for staff to reevaluate the audit program every two years and bring a recommendation forward regarding the scope of the program and the proposed Audit Fee for subsequent four anticipated auctions.

In April 2016, staff completed an analysis of the audit expenditures for the program over the past two years finding that:

> The program only incurred costs of $114,696. The amount of revenues collected in excess of costs incurred at this time is $1,098,461.

The cost of the program has decreased from its inception for various reasons, including:

1. Competitive bidding for audit contracts.
2. More knowledgeable contractors.
3. Settlements being reached without the need for litigation.
4. A series of vacancies and "acting" roles occurred during FY 2015 and FY 2016.
5. The pre-qualified auditor contract has expired. A request for proposal for a new pre-qualified auditor contract is in process. A new contract is expected to be complete by the end of FY 2016. No audit contracts associated with this program are anticipated to be issued for FY 2016. One audit contract was issued in FY 2014 and two audit contracts were issued in FY 2015.
6. A new auditor position was created in FY 2016 and an auditor has been hired. The auditor started in February 2016. Work has been primarily on existing audits while becoming familiar with the program.
7. The auditing specialist position has been vacant for FY 2016.

The DNR anticipates contracting for audits by the first quarter of FY 2017 and expenditures to increase to pre-FY 2013 levels beginning in FY 2017. Therefore, after completion of the program analysis, staff recognized there is sufficient balance in the audit fee revenues to enable a recommendation that the temporary suspension of the Audit Fee be extended.

The audit program and proposed temporary suspension of the Audit Fee was reviewed with representatives of the Michigan United Conservation Clubs, and Michigan Oil and Gas Association. Mutual agreement was reached on recommendations that the Director could:

Extend the temporary suspension of the Audit Fee to $0 per acre for the anticipated auctions to be held October 2016, May 2017, October 2017, and May 2018.

Direct staff to evaluate the audit program every two years with the reevaluation to include the scope of the program, analysis of the audit fee revenue balance and expenditures, and presentation of recommendations to the Director regarding:

1. Any changes to the audit program objectives.
2. What the proposed Audit Fee amount would be, based upon anticipated costs and existing fee revenue balance, for the subsequent four anticipated auctions.

3. In early 2018, staff will provide specific recommendations for the anticipated October 2018, May 2019, October 2019, and May 2020 auctions.

Notice: This item will appear on the July 5, 2016 DNR Business Calendar for information only. It will be published again on the August 2, 2016, DNR Business Calendar for action and will be eligible for approval August 11, 2016.

Recommendation: Proceed with submitting the Audit Fee proposal to the Director for action at the August 11, 2016 NRC meeting. Upon approval of the Director, the Audit Fee temporary suspension to $0 per acre in additional bonus will be extended, effective September 1, 2016, for the four anticipated auctions to be held October 2016 through May 2018. Thereafter, every two years staff will reevaluate the audit program, bringing additional recommendations to the Director regarding the scope of the program and the proposed Audit Fee for the subsequent four anticipated auctions.

Debbie Begalle, Acting Chief
Forest Resources Division

Russ Mason, Ph.D., Chief
Wildlife Division

James L. Dexter, Chief
Fisheries Division

Mark Sweatman, Director
Office of Minerals Management

William O'Neill
Natural Resources Deputy

I approve the staff recommendation.

Dr. William E. Moritz
Director

Approval Date