

Financial Viewpoint

Information That Could Save You \$\$\$

The Importance of a Healthy Lease

Accurate and timely royalty reporting and payment will keep your "Lease in Good Standing"

- **Lease-level obligations:**

Lease-level obligations are rents, advance royalties, minimum royalties, minimum royalties payable in advance, and bonuses. The amounts due, and due dates, are outlined in your lease instrument. If you do not pay on time, MMS will assess interest.

In general, report your lease-level obligations on the Production and Royalty Report, Form MMS-4430 (P&R). However, there are exceptions when you must use the Report of Sales and Royalty Remittance, Form MMS-2014 (2014) to report lease-level obligations.

- **Royalty payments:**

Royalties are the payments you make based on sales of your production. Your lease instrument states whether you pay at an ad valorem or cents per ton rate. Federal payments are due the last day of the month following the month of your sale. For example if you sold in 12/2003, your royalties are due 1/31/2004. Indian payments can be due on the 25th of the month following the month of your sale. However, Indian leases vary, so check your lease instrument on the due date of your royalty payment. Again, MMS will assess interest if you pay your royalties late.

- Connecting the accounting dots will save you money!

A lease in good standing will speed the Bureau of Land Management's (BLM) review and issuances of these actions:

- **Royalty Rate Reductions:**

A company can request in writing that BLM lower the royalty rate stipulated in a lease. There are many reasons by which a request would be made, and among them are adverse geologic conditions or economic hardship. Before the BLM approves the lower rate (usually approved retroactively), BLM requests MMS to review the lease account.

- **Lease Assignment:**

A lease assignment involves the lessee transferring ownership of the lease to a different entity. The lessee may transfer part of the lease or the entire lease. The assignment terms are stated in the

lease instrument. However, before the lease can be assigned, BLM requests MMS to review the lease account.

- **Lease Relinquishment:**
A lease relinquishment involves the lessee surrendering or abandoning all rights to the lease. Relinquishment terms are also stated in the lease instrument. The lessee, lessor, or BLM can request for a lease to be surrendered. However, before the relinquishment can occur, MMS must review the lease account.
- **Bankruptcies'**

If you have not reported and paid your obligations according to your lease terms, your request for royalty rate reductions, lease assignments and lease relinquishments will be delayed.

Form MMS-2014 vs. Production & Royalty Report

Regulations beginning at 30 CFR § 210.200 require lessees (sometimes termed payors and/or customers) to report on the P&R. The P&R report consolidates production, lease-level obligation and sales royalty reporting, and is done through the internet. Before the P&R, customers reported production on the Solid Minerals Operations Reports A&B (SMOR) and Solid Minerals Facility Reports A&B (SMFR). Further, customers reported lease-level obligations and sales royalties on the 2014. Although the P&R is the primary reporting tool for solid minerals customers, there are instances when the customer must use the 2014. Those instances include:

- a) Reporting missed pre-populated lease-level obligations
- b) Reporting adjustments

If a customer must use the Form MMS-2014, it can be found on the web at:

<http://www.mrm.mms.gov/ReportingServices/Forms/Forms.htm>

Under 'Reporting Forms', find the heading 'Current Solid Minerals Forms'. Click on 'Royalty Reporting Forms'. Then click on 'MMS-2014'.

As mentioned, there are instances when you must use the 2014. Two instances are to:

- **Report lease-level obligations not reported on your P&R:**
Rent, Deferred Bonus, and Minimum Royalty Payable in Advance (MRPIA) are listed on the 'Other Obligations' tab the month before their due date (what MMS terms as 'pre-population'). Occasionally, a customer fails to submit the P&R containing the pre-populated obligations. If this happens, you must use the 2014 to report the missed submission. There is an exception to this rule, however. If you fail to submit a pre-populated deferred bonus obligation, you must contact MMS immediately. Deferred bonuses cannot be reported on the 2014; therefore, MMS must create an internal receivable to report it.
- **Report adjustments to sales month/years not originally reported on the P&R:**
For example, if you reported 'original' royalties for any sales month/year on the P&R via the 'P&R Original' tab, then you should make adjustments on the P&R via the 'Adjustments' tab. If you did not report 'original' royalties on the P&R, but instead reported on the 2014, then you must make any adjustment via the 2014.

Rent, Deferred Bonus, and MRPIA are the only obligations which pre-populate the 'Other Obligations' tab of the P&R. Again, these obligations will pre populate the month before their due date. Once these obligations pre-populate (and you do not login and submit the P&R which contain them), they will not pre-populate again; this means you've missed reporting them through the P&R. (Note: since these obligations pre-populate, they will not be available in the drop down menu under 'Payment Types' displaying all other obligations in the 'Other Obligations' tab.)

Again, when you fail to open and submit a P&R with pre-populated lease-level obligations, you miss reporting those obligations on the P&R and must report those obligations on the 2014. For example, if Rent is due 1/2004, it will pre populate in December 2003. If you do not log in to the P&R in December 2003 and submit the P&R which contains the rent, it will NOT be reported. Consequently, you must fill out a 2014 to report the rent (remember, the exception to this rule is the Deferred Bonus obligation; if you miss reporting it, contact MMS immediately).

2014 Reporting Tips

- If you are making adjustments, you must 'back' out the original line and enter the new line on your new report. Remember, you cannot make 'net' adjustments (as you can on the P&R) on the 2014.
- Remember the paper 2014 is manual (non-electronic) and requires 2-3 weeks process time, so submit early.

Areas of 2014 that DO NOT apply to Solid Minerals:

1. Box 8 API Well No
2. Box 9 MMS Agreement No
3. Box 16 Gas MMBtu

Areas of 2014 that you want to point out for Lease-level Obligations:

1. Payor Name
2. Payor Code
3. Federal/Indian Report Indicator
4. Payor Assigned Document Number: You must assign a unique eight character Customer Document ID in this space. If you have a specific question on this document, refer to the Customer Document ID Number you've assigned.
5. MMS Lease Number
6. Sales mm/year
7. Transaction code
8. RVL A
9. Payment Method Code
10. Page Total
11. Report Total
12. Payment Information box – TALK about Credits: the customer is allowed to include any documents which contain credits. For solid customers, please consult with a solids accountant before you fill out this area.
13. Signature Block

Listed below are some of the transaction codes and payment method codes solids customers will use on the new 2014.

Transaction Codes are:

- TC 02 = MRPIA
- TC 04 = Non-recoupable Rent
- TC 05 = Recoupable Rent
- TC 32 = Advance Royalty

TC 25 = Recouping Rent
TC 33 = Recoup Advance Royalty
TC 52 = Recoup MRPIA

Payment Method Codes are:

01 = Check
03 = Electronic Funds Transfer (EFT)
02 = Indian reports

Note: Unless otherwise directed by MMS, if you submit a report containing Indian leases, you must use payment method code 02

You cannot submit the 2014 electronically; thus, you must fill out a paper copy to submit to MMS.

For a complete list, please go to:

<http://www.mrm.mms.gov/ReportingServices/PDFDocs/2014CT.pdf>

If you do not submit a P&R or a 2014 to report pre-populated obligations, MMS will mail you a FIN type invoice or bill. FIN type invoices are generated for lease-level obligations that have not been reported. Other types of invoices are:

- INT = generated for interest due on late payments
- OIR = generated for over recoupment of Indian balances
- OTH = generated for audit or compliance findings (replaces FBILs)

Failure to report, mis-reporting, and non-payment of lease-level obligations are the leading causes of a lease to be "Not in Good Standing".

Adjustments:

As previously discussed, pre-populated items that you missed reporting on the P&R requires you to submit a 2014. In addition, adjustments also require you to submit 2014s. These are the types of adjustments that you must report on a 2014:

- Value adjustments not reported on your P&R
- Retroactive Royalty Rate Reductions not reported on your P&R
- Establishing a credit for a sales month not reported on your P&R

Value Adjustments:

Generally, you report sales royalties via the 'P&R Original' tab. Thus, any adjustments you make will be through the 'Value Adjustments' tab of the P&R. (Note: value adjustments can also be made through the Volume/Value Adjustment Report; however, if you are only making value adjustments and no volume changes, please use the 'Value Adjustments' tab, as the Volume/Value Adjustment Report is more complicated to complete.) However, if you did not submit original sales royalties via the P&R, then any adjustments you make will be through the 2014 (see additional explanation on next page). You must use the new version of the 2014.

Retroactive Royalty Reductions:

Again, as long as you report your sales royalties via the 'P&R Original' tab, then any adjustment you make to reflect your approved royalty rate reduction will be through the P&R. Otherwise, you must use the 2014.

Royalty Rate Reduction (RRR) Tips:

While you are awaiting approval from BLM on your royalty rate reduction request, please continue to report and pay lease-level obligations and royalties at the original (higher) rate. Reporting and paying your obligations and royalties at the original royalty rate will expedite establishing your credit once your lower rate is approved by BLM.

You establish your credit for your royalty rate reduction in one of two ways for each sales month:

- 1) If your original royalties for a specific sales month were established using the 2014, then your credit for that sales month will be established via the 2014 also. You will 'back out' the originally reported line with the original royalty rate and thus showing the higher royalty amount and re-report another line with the reduced royalty rate and therefore, lower royalty amount.
- 2) On the other hand, if your original royalties for a specific sales month were established via the P&R, your credit will be established on the P&R via the Volume/Value Adjustment Report.

Credits:

If you establish the obligation by reporting on the P&R, then you recoup by also using the 'Other Obligations' tab of the P&R. However, if you established the obligation by reporting it on the 2014, then you must recoup by also using the 2014.

If you did not previously submit an original P&R, you still have the option of making your adjustment via the P&R (instead of using the 2014 as stated above). Before you can make an adjustment on the P&R, you MUST submit a P&R Original for the sales month(s) for which you want to make your adjustment. Please call MMS for help.

Use the P&R to report various types of credits for a lease account:

- Recouping Rent
- Recoup Advance Royalty
- Recoup Minimum Royalty Payable In Advance

However, if you established the obligation on the 2014, then you must recoup using the 2014. For example, if you reported recoupable rent due 01/2001 on the 2014, then you must recoup that rent on the 2014 also.

Credits must be established in MMS' system prior to using as payment on submitted P&R or MMS-2014 receivables.

P&R Reporting Tips

On the Main Payment Page tab of the P&R:

- Do not change the Customer Document ID on the P&R.
- Make sure you use the same Payment Method Type on the P&R as your Payment. If you submit an incorrect payment method on the Main Payment page of the P&R, you can correct your submission, but first call MMS for help.

The exception is for pre-populated obligations on the P&R. If you submit a P&R with pre-populated obligations with the incorrect payment method, you cannot correct it using the P&R because the pre-populated obligations are not available to be chosen from the 'Payment Type' dropdown menu. You must use a 2014 to correct your mistake.

Critical Electronic Wire Payment and check information includes:

- Customer Name
- Customer ID (MA___)
- Customer Document ID used on the P&R, or Payor-Assigned Document Number on the 2014. If your wire or check pays for multiple documents, list each document on your payment instrument

Interest Invoices

The Solid Minerals Accounting and Reference Team began issuing interest invoices related to the P&R (MMS-4430) in late FY07 through FY08. All interest invoices undergo a rigorous review process that requires substantial documentation to support the validity of an invoice.

Per 30 CFR 218.202, Late payment charges will be assessed on any late payment or underpayment from the date that the payment was due until the date that payment was received at the MMS.

Late payment interest invoices are appealable. If you believe that interest was assessed and should not have been, you have the right to appeal. Appeal documentation must be received 30 days from the date you received the invoice.

Ready for Treasury

As a payor, you do not want to receive a ready for treasury notification.

The implications for your company are: (1) corporate credit will be affected; and (2) an additional 28% penalty will be assessed by the Department of Treasury.

Steps to avoid a Ready for Treasury referral:

- (1) Submit payment documentation timely
- (2) Submit appeal documentation timely
- (3) Contact a member of the Accounting and Reference Team upon receipt of a Demand to Payor – this will begin the review process; however, ensure that the all appropriate appeal documentation is filed if you are in disagreement with the invoice received.

Time is money. Payments should be received timely by the MMS.

Do it right the first time and it won't come back to haunt you. All required reports and payments should be submitted when due. If you have a problem reporting, please call a member of the Accounting and Reference Team.

If you need help – call. We are here to help whether it relates to payments or reporting.

Contact Information

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