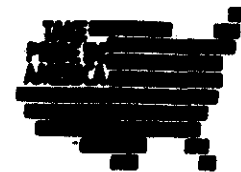




United States Department of the Interior



MINERALS MANAGEMENT SERVICE
ROYALTY MANAGEMENT PROGRAM
P.O. BOX 25165
DENVER, COLORADO 80225

IN REPLY
REFER TO:

MAR 14 1988

FAD-LCB-L-GK
Mail Stop 652

Dear Payor:

As you may be aware, in November 1986 the Minerals Management Service (MMS), Royalty Management Program (RMP) initiated a project for the purpose of identifying and implementing needed systems improvements. One initiative identified by RMP's Systems Improvement Team and endorsed by the Royalty Management Advisory Committee was to correct the royalty rate and unit value calculations on the Explanation of Payments (EOP) Reports. The EOP Report prepared by MMS must include for each lease a description of the type of payment being made, the period covered by the payment, the source of the payment, sales amounts upon which the Payment is based, the royalty rate, and the unit value. The EOP Report is sent with all payments to the States, Bureau of Indian Affairs offices, and Indian tribes as required by 30 CFR, Chapter II, Part 219 (1986). Royalty rate and unit price variances on the EOP Reports cause the States and Indians concern about apparent royalty underpayments.

A royalty rate project was recently initiated by MMS to identify problems causing royalty rate variances on the EOP Reports. The results of this limited review indicate a significant number of royalty rate differences are caused by payors not properly reporting their interest for each lease. The predominant payor reporting error is that Sales Quantity and Sales Value are overstated thus causing the calculated royalty rate and unit price to be understated creating the appearance of potential underpayment. This letter provides clarification on how to properly report Sales Quantity and Sales Value for royalties due (Transaction Code 01) entries on the monthly Report of Sales and Royalty Remittance, Form MMS-2014. Critical to the proper calculation of royalty rates and unit price is an understanding of the following definitions:

Sales Quantity is the portion of the monthly product volume for which you have responsibility for paying and reporting royalties to MMS; i.e., do not report 100 percent of the sales volume for the lease unless you are responsible for paying and reporting the royalties due on that volume.

Sales Value is the corresponding dollar value of the Sales Quantity.

Royalty Quantity is the result of the Sales Quantity times the royalty rate specified in the lease document.

Royalty Value is the result of the Sales Value times the royalty rate.

The relationship between Sales Quantity, Sales Value, Royalty Quantity, and Royalty Value is represented as follows:

$$\frac{\text{Royalty Value}}{\text{Royalty Quantity}} = \frac{\text{Sales Value}}{\text{Sales Quantity}} = \text{Price per unit of measure}$$

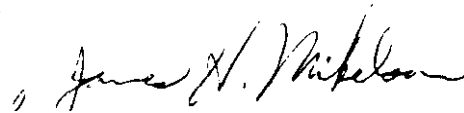
AND

$$\frac{\text{Royalty Value}}{\text{Sales Value}} = \frac{\text{Royalty Quantity}}{\text{Sales Quantity}} = \text{Royalty rate for lease}$$

We request your cooperation and support to ensure that all future reports adhere to these guidelines to reduce the number of questions regarding alleged royalty underpayment. Please be advised that continued problems with royalty rate and unit price calculations being caused by payor misreporting may result in the royalty rate edit being upgraded to a fatal error. Erroneous reporting assessments could therefore be issued to payors for failure to properly report Sales Quantity and Sales Value information on the Form MMS-2014.

If you have any questions, please contact your Lessee Contact Branch representative.

Sincerely,



James R. Detlefs, Chief
Fiscal Accounting Division