



# OFFICE OF THE STATE AUDITOR



August 25, 2020

DIANNE E. RAY, CPA  
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STATE AUDITOR

## SEVERANCE TAXES – STATUS REPORT

Members of the Legislative Audit Committee:

Attached are the status reports from the Department of Natural Resources (Natural Resources) and Department of Revenue (Revenue) on the implementation of recommendations contained in the Office of the State Auditor's (OSA) *Severance Taxes Performance Audit*, issued January 2020.

### OSA REVIEW OF DOCUMENTATION

As part of the status report process, we requested and received supporting documentation for each recommendation that Natural Resources and Revenue reported as having been implemented. Specifically, we reviewed the following documentation:

- A sample of the Notice of Alleged Violations (NOAV) that were sent out by the Colorado Oil and Gas Conservation Commission (COGCC) for missing oil and gas production reports.
- COGCC inspector guidance for ensuring oil and gas meter calibration during inspections.
- The Division of Reclamation, Mining, and Safety's (DRMS) notice of reporting requirements to mining operations.
- DRMS's annual report of production, which has been posted to its website.
- Revenue's draft rules requiring that all withholding statements be submitted by taxpayers.

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303.869.2800

- The report identifying all delinquent oil and gas production reports sent by COGCC to Revenue for use in its field audit function.

Based on our review, the supporting documentation substantiates Natural Resources' and Revenue's reported implementation statuses.



# COLORADO

## Department of Natural Resources

Executive Director's Office  
1313 Sherman Street, Room 718  
Denver, CO 80203

June 11, 2020

Dianne E. Ray, CPA  
State Auditor  
Colorado Office of the State Auditor  
1525 Sherman St., 7<sup>th</sup> Floor  
Denver, Colorado 80203

In response to your request, we have prepared the attached status report on the implementation status of audit recommendations contained in the Severance Taxes Performance Audit. The report provides an explanation of the actions taken by the Department of Natural Resources to implement each recommendation.

If you have any questions about this status report or the Department's efforts to implement the audit recommendations, please contact our Chief of Operations Lynne Steketee at 719-481-1857 or [lynne.steketee@state.co.us](mailto:lynne.steketee@state.co.us).

Sincerely,

*Dan Gibbs*

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Dan Gibbs  
Executive Director, Department of Natural Resources



## AUDIT RECOMMENDATION STATUS REPORT

AUDIT NAME	Severance Taxes
AUDIT NUMBER	1928P
AGENCY	Department of Natural Resources
DATE OF STATUS REPORT	July 31, 2020

### SECTION I: SUMMARY

REC. NUMBER	AGENCY'S RESPONSE	ORIGINAL IMPLEMENTATION DATE	CURRENT IMPLEMENTATION STATUS	CURRENT IMPLEMENTATION DATE
1a	Agree	January 2020	Implemented	January 2020
1b	Agree	January 2020	Implemented	January 2020
2	Agree	August 2020	Implemented	June 2020
3a	Agree	January 2021	Implemented	June 2020
3b	Agree	June 2021	Implemented	June 2020
5	Agree	February 2020	Implemented	February 2020

## SECTION II: NARRATIVE DETAIL

### RECOMMENDATION 1A

The Colorado Oil and Gas Conservation Commission (Commission) should ensure that all oil and gas operators submit required monthly production reports and that all reports are complete by:

A. Using delinquent report information from its database to routinely identify operators that appear to be in violation of reporting requirements, notifying operators when a reporting violation appears to have occurred, and requiring operators to submit the information or an explanation of why the information does not need to be submitted. The Commission should commence enforcement action, taking into account statutory deadlines, by assessing penalties against those operators who fail to come into compliance after being notified of the missing reports.

CURRENT IMPLEMENTATION STATUS	Implemented	CURRENT IMPLEMENTATION DATE	January 2020
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### AGENCY UPDATE

*COGCC changed the frequency for determining compliance with the requirement for operators to submit production reports from annually to monthly. In addition, it developed and implemented a tool that sends the operator an email notice the day after a report is due if the report is missing. If the report has not been received within 30 days of the due date, a second, warning email is sent. If the report has not been received within 60 days of the due date, the enforcement process is initiated by issuing the operator a Notice of Alleged Violation (NOAV). Since the implementation of this recommendation in January 2020, 154 NOAVs have been issued for missing production reports. The practice of automatically generating emails to notify operators of a missing report has resulted in approximately half the missing reports being submitted without having to issue an NOAV. Because of the time it takes to prosecute an NOAV, no penalties have been collected as of July 31, 2020.*

**RECOMMENDATION 1B**

The Colorado Oil and Gas Conservation Commission (Commission) should ensure that all oil and gas operators submit required monthly production reports and that all reports are complete by:

- B. Implementing a process for identifying monthly well production reports that are missing required data fields, such as a report review process, notifying operators when a violation appears to have occurred, and requiring operators to submit the missing information or an explanation of why the information is missing. The Commission should commence enforcement action, taking into account statutory deadlines, by assessing penalties against those operators who fail to come into compliance after being notified of the missing information.

CURRENT IMPLEMENTATION STATUS	Implemented	CURRENT IMPLEMENTATION DATE	January 2020
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*Same response as 1A, above.*

**RECOMMENDATION 2**

The Colorado Oil and Gas Conservation Commission should fulfill its statutory charge to ensure accurate reporting of oil and gas production by implementing processes for reviewing calibration reports to verify the accuracy of measurement equipment for oil and gas wells. This could include requiring operators to provide calibration reports annually, routinely requesting and reviewing calibration reports on a sample basis, and/or reviewing calibration reports as part of routine well inspections.

CURRENT IMPLEMENTATION STATUS	Implemented	CURRENT IMPLEMENTATION DATE	June 2020
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**AGENCY UPDATE**

*Field inspectors added a review of the meter calibration dates to their existing “Gas Meter Run” standard operating inspection procedure. Information on last certification date is documented with a comment, photo of the certification tag, or both.*

**RECOMMENDATION 3A**

The Department of Natural Resources should ensure that the Division of Reclamation, Mining, and Safety (Division) complies with statute and that the State has complete data on the amount of mined minerals produced and sold in Colorado by:

- A. Requiring mine operators to report annually the information required by statute on their mining activity for the preceding year.

CURRENT IMPLEMENTATION STATUS	Implemented	CURRENT IMPLEMENTATION DATE	June 2020
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**AGENCY UPDATE**

*The Division has fully implemented the requirement to have mine operators report annually, and will amend the C.R.S 34-24-101 report as necessary.*

**RECOMMENDATION 3B**

The Department of Natural Resources should ensure that the Division of Reclamation, Mining, and Safety (Division) complies with statute and that the State has complete data on the amount of mined minerals produced and sold in Colorado by:

- B. Producing and issuing an annual report on the mining industry in Colorado that includes statutorily-required information, including specific production and processing data for individual mines and posting the annual report to the Division’s website.

CURRENT IMPLEMENTATION STATUS	Implemented	CURRENT IMPLEMENTATION DATE	June 2020
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**AGENCY UPDATE**

*The Division received reports from all mining operations, fulfilling the requirements of C.R.S 34-21-101 and 34-24-101. C.R.S 34-21-101 requires the Division of Reclamation, Mining, and Safety to produce an annual report on the mining industry in the State of Colorado. C.R.S 34-24-101 requires operators to report location, production, and safety data to the State of Colorado every year. The annual report contains the site name, permitted operator, address, city, county, production capacity, resources mined, total production for the quarter and year, reporting year, mining method, mine status, total employees, days and hours worked, injuries and fatalities, facility location, and percentage of materials retained in state or shipped out of state. Mines that were not producing in 2019 because they were idled, in temporary cessation, or reclaiming are not included in this report.*

**RECOMMENDATION 5**

The Department of Revenue (Department) should work with the Colorado Oil and Gas Conservation Commission (Commission) to obtain Commission data on missing or incomplete well production reports to help ensure that the Department has complete production information, or knowledge of missing production reports, when conducting audits to verify that the production amounts reported to the Commission are consistent with the income reported on severance tax returns. If production information is missing, the Department should follow up with taxpayers to obtain the missing information during an audit.

<b>CURRENT IMPLEMENTATION STATUS</b>	Implemented	<b>CURRENT IMPLEMENTATION DATE</b>	February 2020
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**AGENCY UPDATE**

*A cooperative process was developed with the Department of Revenue and was ready for use as part of the original audit response. The process was actually used in February 2020 when DOR requested missing production reports for the years 2017 and 2018.*



**COLORADO**  
Department of Revenue  
Taxation Division

June 12, 2020

Dianne E. Ray, CPA  
State Auditor  
Colorado Office of the State Auditor  
1525 Sherman St., 7<sup>th</sup> Floor  
Denver, CO 80203

Dear Auditor Ray:

In response to your request, we have prepared the attached status report on the implementation status of audit recommendations contained in the Severance Taxes Performance Audit. The report provides a brief explanation of the actions taken by the Department of Revenue to implement each recommendation.

We would like to convey our appreciation to you and your staff for the support throughout the audit process and the collaborative approach.

If you have any questions about this status report and the Department's efforts to implement the audit recommendations, please contact Brendon Reese at 303-519-2868 or [Brendon.Reese@state.co.us](mailto:Brendon.Reese@state.co.us).

Sincerely,

*Brendon C. Reese*

Brendon C. Reese,  
Acting Senior Director, Taxation

## AUDIT RECOMMENDATION STATUS REPORT

AUDIT NAME	Severance Taxes
AUDIT NUMBER	1928P
AGENCY	Department of Revenue
DATE OF STATUS REPORT	June 12, 2020

### SECTION I: SUMMARY

REC. NUMBER	AGENCY'S RESPONSE	ORIGINAL IMPLEMENTATION DATE	CURRENT IMPLEMENTATION STATUS	CURRENT IMPLEMENTATION DATE
4	Agree	December 2020	Partially Implemented	December 1, 2020
5	Agree	February 2020	Implemented	March 16, 2020

## SECTION II: NARRATIVE DETAIL

### RECOMMENDATION 4

The Department of Revenue (Department) should improve its processes for ensuring that the amount of severance taxes assessed and collected is accurate by requesting an Attorney General’s opinion on the Department’s authority to require Oil and Gas Withholding Statements and assess penalties against taxpayers for failure to comply. If the Attorney General determines that the Department has this authority, the Department should require the statements and assess penalties, as necessary, against taxpayers who fail to comply. If the Attorney General determines that the Department does not have the authority, the Department should work with the General Assembly to pursue statutory changes to give the Department this authority. The Department should then use the information in the statements to help verify that all interest owners who are required to file severance tax returns and pay their severance tax liability have done so.

CURRENT IMPLEMENTATION STATUS	Partially Implemented	CURRENT IMPLEMENTATION DATE	December 1, 2020
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### AGENCY UPDATE

The Department has developed rules to clarify the requirement to file oil and gas withholding statements, including the due date for such filings, as well as the penalties imposed. Stakeholder responses are due by June 30, 2020. We plan to issue a notice of proposed rulemaking on or before July 30, 2020. We have tentatively scheduled the hearing for September 8, which will allow us to have the rules adopted and effective by December.

### RECOMMENDATION 5

The Department of Revenue (Department) should work with the Colorado Oil and Gas Conservation Commission (Commission) to obtain Commission data on missing or incomplete well production reports to help ensure that the Department has complete production information, or knowledge of missing production reports, when conducting audits to verify that the production amounts reported to the Commission are consistent with the income reported on severance tax returns. If production information is missing, the Department should follow up with taxpayers to obtain the missing information during an audit.

CURRENT IMPLEMENTATION STATUS	Implemented	CURRENT IMPLEMENTATION DATE	March 16, 2020
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### AGENCY UPDATE

The Department requested from the COGCC a report of the missing production reports for all of 2017 and 2018 and received the file on March 16, 2020. We have worked with COGCC to be able to receive this report in the future and will request more current periods as those periods fall within the scope of our audits. This information will be reviewed during audits of taxpayers. If production information is missing, the Department will follow up with the audited taxpayers to obtain the missing information as part of an audit.