

24
1-1-99
85



Department of Energy
Washington, DC 20585

December 1, 1998

RECEIVED
JAN 07 1999
OSTI

**MEMORANDUM FOR THE DEPUTY ASSISTANT SECRETARY, NAVAL
PETROLEUM AND OIL SHALE RESERVES**

FROM: *Arlene M. Ackerly*
Lawrence R. Ackerly, Regional Manager
Western Regional Audit Office

Office of Inspector General

SUBJECT: **INFORMATION:** Report on "Agreed-Upon Procedures Between
the Department of Energy and Occidental Petroleum Corporation for
the Sale of Naval Petroleum Reserve Number 1" (WR-FC-99-02)

BACKGROUND

As required by the Fiscal Year 1996 National Defense Authorization Act, the Department of Energy (DOE) offered Naval Petroleum Reserve Number 1 (NPR-1) for sale. On October 6, 1997, DOE announced it had agreed to sell all of the Government's interest in NPR-1 to Occidental Petroleum Corporation (Occidental) for \$3.65 billion. Although the effective date of the sale was October 1, 1997, the closing date of the sale was February 5, 1998. A Preliminary Settlement Statement for the sale was presented to Occidental as of February 5, 1998. Occidental was to receive the net economic benefit of NPR-1 operations between the effective date and the closing date of the sale.

This report presents the results of the independent certified public accountants' agreed-upon procedures work on the Preliminary Settlement Statement of the Purchase and Sale Agreement between DOE and Occidental. Your office requested this work. To fulfill our responsibilities, we contracted with the independent public accounting firm of KPMG Peat Marwick LLP to conduct the work for us, subject to our review. The work was done in accordance with the Statements on Standards for Attestation Engagements issued by the American Institute of Certified Public Accountants. As such, the independent certified public accountants performed only work that was agreed upon by DOE and Occidental. This report is intended solely for the use of DOE and Occidental and should not be used by those who have not agreed to the procedures and taken responsibility for the sufficiency of the procedures for their purposes. However, this report is a matter of public record, and its distribution is not limited.

MASTER

DISTRIBUTION OF THIS DOCUMENT IS UNLIMITED

DISCLAIMER

**Portions of this document may be illegible
in electronic image products. Images are
produced from the best available original
document.**

KPMG

RECEIVED
JAN 07 1999
GSTI

U.S. Department of Energy

NAVAL PETROLEUM RESERVE NO. 1

**Independent Accountant's Report
on Applying Agreed-Upon Procedures**

60 East South Temple
Suite 900
Salt Lake City, UT 84111

Independent Accountant's Report on Applying Agreed-Upon Procedures

To the Management of the Naval Petroleum Reserve in California
and Occidental Petroleum Corporation:

We have performed the procedures enumerated below, which were agreed to by the management of the U.S. Department of Energy (DOE) Naval Petroleum Reserve in California (NPRC) and Occidental Petroleum Corporation (Occidental), solely to assist you in connection with the evaluation of the Preliminary Settlement Statement of the Purchase and Sale Agreement (PSA) between DOE and Occidental. The procedures enumerated below were applied to the Preliminary Settlement Statement and NPRC's supporting accounting records. This engagement to apply agreed-upon procedures was performed in accordance with standards established by the American Institute of Certified Public Accountants. The sufficiency of these procedures is solely the responsibility of the management of NPRC and Occidental. Consequently, we make no representation regarding the sufficiency of the procedures described below either for the purpose for which this report has been requested or for any other purpose. The attached Exhibit A summarizes the financial impact of the findings listed below.

Cash Balances

1. We obtained the bank reconciliations for February 1998 and agreed them to the general ledger balances. We tested the arithmetical accuracy of the schedules. We found no exceptions as a result of these procedures.
2. We requested a list of all cash accounts from Bechtel Petroleum Operations, Inc. (Bechtel), and compared the accounts to our Naval Petroleum Reserve No. 1 (NPR-1) September 30, 1997, financial statement audit work papers (hereafter referred to as the fiscal 1997 audit work papers). We identified the following bank accounts: General Fund Account, Payroll Account, and Funding Account. We found no exceptions as a result of these procedures.
3. We obtained confirmation of the accounts identified in item 2 with the financial institution as of February 28, 1998. We inquired of the financial institution and Bechtel management regarding other arrangements or transactions. No other arrangements or transactions were noted by the financial institution or by management as part of these procedures. We found no exceptions as a result of these procedures.



4. We compared the balances confirmed by the financial institution in item 3 to the bank reconciliations. No restrictions were noted by the financial institution as part of the confirmation procedures. We found no exceptions as a result of these procedures.
5. We traced all deposits in transit greater than \$50,000 on the February 1998 bank reconciliation to the March 1998 bank statements. We verified that all checks greater than \$50,000 shown in Bechtel's records as written during February 1998 cleared the bank in February 1998 or were included on the outstanding check listing of the February 1998 bank reconciliation. We determined that paid checks and the debit or credit memorandums greater than \$50,000 representing transfers between bank accounts were included on the tabulation of transfers between bank accounts. We also verified that all outstanding checks as of February 1998 cleared the bank in March 1998. We found no exceptions as a result of these procedures.
6. We reviewed the current bank account signature authorization letter. The following Bechtel employees were listed as current bank signers:

D. G. Trybul
J. E. Winkler
J. P. Watson
P. S. Bealessio
R. A. Ridenour

Inventories

1. We compared the documentation of the physical inventory calculations performed as of October 1, 1997 to the calculations as of February 5, 1998. The inventory calculations were conducted using the same methods and were conducted with the assistance of an independent third party. We noted an exception in calculation methods between the inventory observation and the PSA as reported in item 7 below. We found no other exceptions as a result of these procedures.
2. For supplies inventory, we obtained the reconciliation of the final inventory listing as of September 30, 1997, and traced the general ledger balance to the reconciliation. All reconciling items were less than \$10,000 and, therefore, no reconciling items were tested. We found no exceptions as a result of these procedures.
3. For supplies inventory, we judgementally selected ten receiving reports completed prior to October 1, 1997, and ten receiving reports completed subsequent to September 30, 1997. We traced the reports to the corresponding period's accounts payable reports. We judgementally selected ten warehouse issues completed prior to October 1, 1997, and ten warehouse issues completed subsequent to September 30, 1997. We traced the transactions to the Warehouse Activity Report for the corresponding period. We found no exceptions as a result of these procedures.

4. For supplies inventory, we obtained the final inventory listing as of February 5, 1998, and tested the arithmetical accuracy of 25 judgementally selected line items. We traced the report total to the general ledger balance reconciliation. All reconciling items were less than \$10,000; therefore, in accordance with the agreed-upon procedures no reconciling items were tested. We found no exceptions as a result of these procedures.
5. We inquired of the treatment of inventory write-downs and reviewed the treatment in the general ledger. We verified that the transactions were not included as costs in the settlement statement. We found no exceptions as a result of these procedures.
6. For product inventory, the ending balances as of February 5, 1998, were not pertinent to the settlement statement except to the extent that they were part of the reconciliation of the production statements. Procedures related to the production statements are documented in the trade receivables, sales, production, credit notes and collections section of this report. For purposes of revenue cut-off, we agreed the ending product inventory as of February 5, 1998, to the production accounting statements, Statements 1, 1-A, and 1-B. We found no exceptions as a result of these procedures.
7. For product inventory as of October 1, 1997, we compared the October 1997 average product sales prices to the inventory balances per the production accounting statements. We also compared the inventory balances to the fiscal 1997 audit workpapers. The inventory balances on the preliminary settlement statement agreed to the production accounting statements and the fiscal 1997 audit workpapers.

While performing our procedures, we noted that the PSA required that final inventory balances be calculated in accordance with Exhibit D of the PSA. NRPC performed an inventory count, which was observed by an independent third party, as of October 1, 1997. We compared the counts and methods to Exhibit D of the PSA and noted certain differences (such as shrinkage factors, pressure assumptions, and pipeline measurement methods) in the calculation methods. Calculation of the effects of the differences between Exhibit D and the methods used by NRPC were beyond the scope of these procedures. For purposes of this report, we recalculated the inventory values for the settlement statement based on the inventory quantities as calculated by NRPC as of October 1, 1997.

The inventory quantities that NRPC calculated on October 1, 1997, included crude oil, natural gas, propane, mixed butane, iso-butane, natural gasoline, mixed natural gas liquids (Mixed NGL), and butane gas mix (BG Mix). NRPC's counts included inventories in areas not included on the production accounting statements including pipelines, tanks, and other storage vessels. The production accounting statements did not include any inventory of natural gas, Mixed NGL, and BG Mix.

NRPC classified all inventory in excess of the quantities on the production accounting statements as unit inventory. NRPC treated all inventory of liquids on the production accounting statements as unit inventory (inventory of liquids was not allocated between partners until it was sold). NRPC tracked crude oil inventory on the production accounting statements after Chevron had received their equity; therefore, all crude oil inventory balances on the production accounting statements were treated as DOE inventory. Any crude oil inventory balances on the production accounting statements in excess of the inventory counts by zone were treated as unit inventory owed to DOE.

NPRC determined the value of the inventory on the preliminary settlement statement using September 1997 average product sales prices rather than October 1997 averages; however, for the final adjustment noted below NPPC used October 1997 averages. NPPC estimated the finished liquid products contained within the Mixed NGL and BG Mix in order to determine their value. NPPC allocated the Mixed NGL quantities between mixed butane, iso-butane, propane, and natural gasoline based on the relative quantities of these products produced in September 1997. NPPC allocated BG Mix between mixed butane, iso-butane, and natural gasoline based on chemical analyses performed by Chevron and NPPC. NPPC valued the BG Mix and Mixed NGL based on the values of the final products to which they were allocated. NPPC has not reduced the estimated values of any of the hydrocarbons for the cost of any additional processing required prior to their sale. NPPC considers the additional processing costs to be negligible.

NPPC allocated unit inventory between DOE and Chevron as follows:

- Crude oil was allocated based on the zone identified in NPPC's inventory counts.
- Natural gas was allocated based on the zone that NPPC identified as the source of the product or based on an average of amounts processed in September 1997.
- Mixed butane, iso-butane, propane, and natural gasoline (collectively referred to as Finished Liquids) were assigned to zones at the ratio of each zone's production to total production in September 1997. The Finished Liquids were then allocated between DOE and Chevron based on each zone's cost sharing percentages.
- Mixed NGL was divided into Finished Liquids and then allocated using the same methodology used to allocate Finished Liquids.
- BG Mix was allocated based on the Steven's zone cost sharing percentages.

We agreed the inventory quantities of each hydrocarbon used in the final inventory in calculation to the inventory counts performed by NPPC on October 1, 1997. We recalculated the total inventory value of \$3,302,092 using the calculations noted above. Considering the allocation methods noted above, DOE's share of the inventory was \$3,082,516 and Chevron's share of the inventory was \$219,576. The inventory adjustment on the preliminary settlement statement increased the purchase price adjustment by \$2,234,441. DOE's share of inventory over the amount included in the preliminary settlement statement increased the purchase price adjustment by \$848,075.

While performing our procedures, we noted that the McKittrick 17Z Gas Plant had shipped to NPPC 121,809 gallons of BG Mix in excess of NPPC's allotment as of 7:00 am on October 1, 1997. The over shipment was netted against shipments subsequent to October 1, 1997. We recalculated the value of the BG Mix using the same assumptions used by NPPC as noted above for BG Mix. The excess shipments decreased the purchase price adjustment by \$47,641.

We found no other exceptions as a result of these procedures.

8. We agreed the over or under product balances as of October 1, 1997 to the production accounting statements and the fiscal 1997 audit work papers. No adjustments were noted in excess of \$10,000.

We compared prices used to calculate the over or under product balances to the October 1997 average product sales prices. We determined that the prices used in calculating the over or under balances were the average September 1997 prices rather than the average sales prices from October 1997. The over or under product balance adjustment included in the preliminary settlement statement increased the purchase price adjustment by \$8,997. The recalculated over or under product balance adjustment using the October 1997 average product sales prices should have been a decrease of \$738, resulting in a net decrease to the purchase price adjustment of \$9,735. We found no other exceptions as a result of these procedures.

9. We agreed the schedule of gas imbalances with Southern California Gas to the general ledger and supporting documentation. We found no exceptions as a result of these procedures.

Prepaid Expense

1. We obtained the supporting schedules for the prepaid expenses as of September 30, 1997, and agreed them to the general ledger. We tested the arithmetical accuracy of the schedules. We found no exceptions as a result of these procedures.
2. Prepaid costs as of September 30, 1997, that will benefit the operation of the reserves will increase the purchase price. Other prepaids and prepaid insurance were to be excluded from the purchase price adjustment. We obtained the supporting cash vouchers for prepaid expenses. No prepaid insurance was recorded as of September 30, 1997. Two prepaid amounts were for costs incurred prior to September 30, 1997. The net decrease to the purchase price adjustment for the overstated prepaids was \$796.

Property, Plant, and Equipment, and Oil & Gas Properties

1. We obtained the documentation of internal control test work performed in the fiscal 1997 financial statement audit related to property, plant, and equipment and oil & gas properties. We inquired of appropriate accounting personnel regarding modifications to the accounting procedures occurring during the period from October 1, 1997 through February 5, 1998 (hereafter referred to us the settlement statement period). We noted no significant modifications to the accounting procedures occurring during the settlement statement period.
2. We obtained the summary schedules of the book basis for property, plant, and equipment, and agreed the balances to the general ledger. We arithmetically checked the accuracy of the schedules. We found no exceptions as a result of these procedures.
3. We agreed the beginning balances of the schedules obtained in item 2 to the fiscal 1997 audit work papers. We found no exceptions as a result of these procedures.
4. We agreed the fixed asset subsidiary ledger to the general ledger. We agreed the work-in-process detail to the general ledger. We found no exceptions as a result of these procedures.

5. We judgementally selected a sample of 50 transactions from the fixed asset additions. For each item selected, we agreed the addition to the appropriate cash voucher; examined the cash voucher for proper authorization; examined the invoice to determine that the cost, type of asset, and use of asset were properly recorded; examined the Authorization for Expenditure (AFE) and supplemental AFE for proper approval; and examined the Completion Notice for appropriate documentation and signatures.

The PSA Section 3.3(a) excludes "capital expenditures for any single project or equipment or facility acquisition in an amount exceeding \$300,000." Capital expenditures on AFE 60064 during the settlement statement period were \$310,241. The excess expenditures of \$10,241 were excluded costs. The net decrease to the purchase price adjustment after consideration of Chevron's 29.9881 percent share of the cost amounted to \$7,170.

We found no other exceptions as a result of these procedures.

6. We obtained the detail listings of transfers and disposals. We tested the arithmetical accuracy of the listings. We traced the listing totals to the roll forward of fixed assets and determined that the assets were removed from the fixed asset detail. We found no exceptions as a result of these procedures.
7. We traced transfers in total from wells in progress to capitalized costs. We found no exceptions as a result of these procedures.
8. We obtained the general ledger detail for asset revaluations. The general ledger showed no asset revaluations during the settlement statement period. We found no exceptions as a result of these procedures.
9. We compared the schedule of capitalized internal overhead costs added to oil and gas properties to fixed asset reconciliations. We determined that the methodology was consistent with prior periods. We found no exceptions as a result of these procedures.

Trade Receivables, Sales, Production, Credit Notes, and Collections

1. We obtained the documentation of the internal control test work performed in the fiscal 1997 financial statement audit related to trade receivables, sales, production, credit notes, and collections. We inquired of appropriate accounting personnel regarding modifications to the accounting procedures occurring during the settlement statement period. We noted no significant modifications to accounting procedures during the settlement statement period.
2. We obtained the Summary of Income Report for each month during the period October 1997 through February 1998, and agreed the balances to the settlement statements. We recalculated the average monthly price per the Summary of Income Report. We compared the production per the Statements 1, 1-A, and 1-B to the Summary of Income report for each month and agreed reconciling items to supporting documentation. We confirmed the revenues received by the U.S. Treasury and agreed the amount to a reconciliation of the revenues per the settlement statement.

The Summary Income Reports for October 1997 included sales for butane, iso-butane, propane, and natural gas beginning 12:00 midnight, September 30. The ownership change according to the PSA is 7:00 am, October 1, 1997. Accordingly, the seven hours of sales from midnight to 7:00 am should have been excluded from the settlement statement. The excluded sales increased the purchase price adjustment by \$130,399. Crude oil and natural gasoline cut-off on the Summary Income Reports was recorded as of 7:00 am, October 1, 1997.

The preliminary settlement statement contained actual revenues for October 1997 through December 1997. Subsequent revenues were estimated on the preliminary settlement statement. The preliminary settlement statement estimated revenues subsequent to December 31, 1997 to be \$44,962,899. Actual revenues recorded subsequent to December 31, 1997 as of the accounting period closed June 30, 1998 were \$37,323,830. The difference between estimated revenues and actual revenues increased the purchase price adjustment by \$7,639,069. This amount excluded the effect of Pacific Gas & Electric (PG&E) payments for electricity sold subsequent to the closing date. PG&E payments are addressed in item 5 below.

While performing our procedures, we noted that NRPC did not use the correct equity allocation percentages for the Dry Gas Zone. NRPC used 77.0492 percent for DOE's ownership for Dry Gas Zone production. The correct allocation based on the new equity redetermination effective October 1, 1997, was 83.8726 percent. The percentage used by NRPC resulted in excessive allocations to Chevron, but did not affect the settlement statement adjustment. The settlement statement adjustment was based on actual sales which were not affected by the change in equities. The allocation resulted in a misstatement of the over or under balance between Occidental and Chevron and should be corrected on future divisions of natural gas.

We found no additional exceptions as a result of these procedures.

3. We judgementally selected a sample of 25 "run/meter tickets" from October 1997 through February 1998. We performed the listed procedures for the following categories:

Crude Oil

- Agreed the crude oil meter readings from the run ticket selected to the previous meter reading to verify that the beginning reading on the run ticket selected matched the ending reading of the previous run ticket.
- Recalculated the net barrels based on temperature; base, sediment and water; and meter factor.
- Recalculated the price based on bulletins in effect for that period, specific gravity used, and temperature.
- Using the observed gravity and temperature, we recalculated the corrected gravity used to adjust the price to the correct rate.
- Verified that the meter ticket was signed by the producer and that the observed gravity and temperature were recorded.
- For each ticket, we selected one customer and recalculated the billing amounts and traced the amounts to the invoices.
- Recalculated the price per barrel based on the particular contract for the customer.
- Traced the cash receipt to the U.S. Treasury report of cash receipts and to the accounts receivable ledger.

Liquids

- Selected the bill of lading which showed the weight of the truck when empty, and the weight of the truck when loaded.
- Recalculated the pounds and the conversion from pounds to gallons.
- Recalculated the price, which was the contract price plus or minus the price adjustment factor.
- Traced the cash receipt of the sale to the U.S. Treasury report of cash receipts and to the accounts receivable ledger.

Natural Gas

- Obtained the daily meter reading report of natural gas.
- Recalculated the amount of natural gas sold.
- Recalculated the price based on the contract and traced the amount to the invoice.
- Traced the cash receipt for the sale to the U.S. Treasury report of cash receipts and to the accounts receivable ledger.

We found no exceptions as a result of these procedures.

4. We agreed the total receipts for the month of January 1998 to the corresponding journal entry and related DOE oil and gas revenues report. We found no exceptions as a result of these procedures.
5. We obtained the PG&E statement for each month during the period October 1997 through February 1998 and agreed the kilowatt hours to the supporting NRPC calculations. We tested the arithmetical accuracy of the schedules.

While performing these procedures, we became aware that NRPC continued to collect the PG&E electricity payments after the closing date. The purchase price adjustment, after consideration of the revenue adjustment in 2 above, included payments through February 4, 1998. Through the accounting period ended June 30, 1998, NRPC collected additional revenues of \$891,555 through and including the May payment. The decrease to the purchase price adjustment for PG&E revenues collected by NRPC was \$891,555.

We found no other exceptions as a result of these procedures.

6. We verified that the policy of segregating the duties of authorization, recording, and custody of cash receipts were not modified from prior years. We agreed the total cash receipts of one month, January 1998, to the corresponding journal entry and cash deposits. We found no exceptions as a result of these procedures.
7. We obtained an aged listing of trade receivables as of February 28, 1998 (the end of the account cycle for the last period of operations). We agreed the reconciliation to the general ledger. We arithmetically checked the accuracy of the schedules. We found no exceptions as a result of these procedures.
8. We agreed subsequent receipt of all trade receivables outstanding as of February 28, 1998 in excess of \$50,000 to U.S. Treasury reports. Our test comprised 94 percent of the outstanding balance as of February 28, 1998. We found no exceptions as a result of performing these procedures.

9. We selected the last ten meter tickets as of the sale closing date and verified that the meter ticket recorded deliveries prior to February 5, 1998, 7:00 am. We traced the meter tickets to the accounts receivable subsidiary ledger. We found no exceptions as a result of these procedures.
10. According to the agreed-upon procedures, we reviewed the accounting sales records to select 25 credit memos in October and November and 10 credit memos subsequent to the sale closing date. NRPC issued no credit memos in October and November 1997. We selected 10 credit memos issued subsequent to February 5, 1998. We verified that the credits were properly authorized and traced the credit adjustments to the revenue balances which are adjusted in item 2 above. We found no exceptions as a result of these procedures.
11. We inquired as to any recoveries of written-off receivables. We found no recoveries.

Expenditures, Accounts Payable, Purchases, and Payments

1. We obtained the documentation of internal control test work performed in the fiscal 1997 financial statement audit related to expenditures, accounts payable, purchases, and payments. We inquired of appropriate accounting personnel regarding modifications to the accounting procedures occurring during the settlement statement period. We noted no significant modifications to accounting procedures during the settlement statement period.

We inquired of NRPC management and Bechtel management and reviewed the PSA to identify unallowable costs. We identified the following unallowable costs that should have been excluded from the purchase price adjustment:

Other Miscellaneous Exclusions

The preliminary settlement statement reduced unit costs for Other Miscellaneous Exclusions of \$361,832. Other Miscellaneous Exclusions consisted of various unallowable costs excluded by the PSA. Included in the unallowable costs were over accruals and under accruals that Bechtel had preliminarily allocated between Chevron and NRPC based on a general allocation percentage. Bechtel has subsequently updated the allocations of each cost based on specific cost codes.

Bechtel also updated the Other Miscellaneous Exclusions for costs recorded through the period ended June 30, 1998. The updated Other Miscellaneous Exclusions increased by \$8,527,859 of employee severance-related costs, \$7,104,330 of Bechtel pension plan termination costs, and other smaller items totaling \$85,352. The increased exclusions decrease the purchase price. The unallowable costs updated through June 30, 1998 decreased the purchase price adjustment by \$15,717,541.

Pension and Other Post Retirement Benefit Costs

The preliminary settlement statement did not include costs incurred for pension and other post retirement benefit costs. As noted above, DOE incurred costs related to the termination of the pension plan. Those costs have been excluded as they were not a part of the normal operations of the reserve. Under management's direction, we estimated the pension and other post retirement benefit costs that would apply to the normal operations of the reserve. These estimates were calculated in accordance with generally accepted accounting principles.

We estimated the pension cost for fiscal 1998 to be \$1,736,000 or \$580,000 for the four month settlement statement period. We estimated the pension cost from the 1997 actuarial report and included service costs, interest cost, return on assets, and amortization of the transition obligation, prior service cost and gain or loss. Service cost was adjusted to reflect the passage of one year and for general decreases in discount rates.

We estimated the post retirement benefit cost for fiscal 1998 to be \$520,000 or \$170,000 for the four month settlement statement period. The post retirement benefit plan was terminated with no benefits accruing to nonvested employees; therefore, no service cost component was included in the calculation. The fiscal 1998 cost was based on the accumulated post retirement benefit obligation for only the vested employees. The estimated costs included interest cost and gain/loss amortization.

The pension and other post retirement benefit cost estimates of \$750,000 were reduced to \$592,028 after allowing for Chevron's 21.063 percent share of the cost. The additional costs of pension and other post retirement benefits were an increase to the purchase price adjustment.

NPR-2 Management and Operation

The PSA allowed costs incurred for the operation of NPR-1. Costs associated with NPR-2 management and operation were not allowable costs. We obtained a detailed listing of costs associated with the cost sharing program NPR-2 and agreed them to the general ledger. The excluded costs decreased the purchase price adjustment by \$75,643.

Sale of NPR-1

The PSA allowed costs incurred for the operation of NPR-1. Costs associated with the sale of NPR-1 were not allowable costs. We obtained a detail listing of costs associated with the sale of NPR-1 and agreed them to the general ledger. The excluded costs decreased the purchase price adjustment by \$29,702.

Actual Fringe for Severance Payments

Costs associated with the severance payments to terminated employees of Bechtel were included in the adjustment of estimated expenditures to actual expenditures noted in item 2 below. The severance costs were then excluded as part of the unallowable cost adjustment noted above. The cost exclusion of severance payments used an estimated fringe rate. We obtained a summary of actual severance and related fringe costs and agreed them to the corresponding payroll reports. Gross severance payments were \$8,965,522, and costs of the employer's portion of FICA, federal unemployment, state unemployment, 401(k) contributions, and 401(a) contributions were \$884,839 or 9.8694 percent of the gross severance payments. The total unallowable severance payments were \$9,850,362, which was \$195,123 less than the original exclusion estimate of \$10,045,485. The \$195,123 adjustment of the severance exclusion was reduced to \$154,024 after allowing for Chevron's 21.063 percent share of the cost. Using the actual fringe costs for the severance exclusion increased the purchase price adjustment by \$154,024.

2. We compared the period expenses on an annualized basis to expense incurred in fiscal 1997. We inquired of Bechtel management regarding fluctuations in excess of \$250,000 and 10 percent on an annualized basis.

The preliminary settlement statement contained actual expenditures from October 1997 through December 1997. Subsequent expenditures were estimated on the preliminary settlement statement. The preliminary settlement statement estimated expenditures subsequent to December 31, 1997 to be \$7,541,756. Actual expenditures recorded subsequent to December 31, 1997 as of the accounting period closed June 30, 1998 were \$26,681,660. The difference between estimates and actual increased the purchase price adjustment by \$19,139,904.

We found no other exceptions as a result of these procedures.

3. We selected a sample of cash vouchers as noted below. For each cash voucher selected, we performed the following procedures as applicable for the nature of the expenditure:

- Compared the invoice with the purchase order as to vendor, quantity, price, and evidence of approval for payment;
- Agreed the expenditure requisition to the purchase order;
- Compared the invoice with evidence of receipt of goods or services to determine the proper period of accrual;
- Verified evidence of review of mathematical accuracy;
- Traced the account distribution to the supporting documentation;
- Determined whether the invoice had been properly canceled;
- Reviewed the invoice for proper approval;
- Agreed freight bills charged to related invoices;
- Verified approval, proper supporting documentation, arithmetical accuracy, and authorization of the nature of the travel for travel expenditures; and
- Determined the expenditure was allowable under the Appendix A of Bechtel's operating contract.

We obtained a listing of all cash vouchers for October 1997. We selected all cash vouchers greater than \$2,000 (570 cash vouchers) as well as judgementally selected 323 additional cash vouchers less than \$2,000. Based on the results of that test work, NRPC and Occidental management requested that we select approximately 100 cash vouchers per month from November 1997 through March 1998, as well as all cash vouchers in November 1997 for vendors for which exceptions were found in October 1997. Management also requested that we review an additional 70 cash vouchers paid to employees of Bechtel in October 1997.

We tested 963 cash vouchers from October 1997, 359 cash vouchers from November 1997, and approximately 100 per month from December 1997 through March 1998. We identified 38 cash vouchers which were not properly accrued in fiscal 1997, or otherwise identified by NRPC as requiring accrual (31 of these were from October 1997). Proper accrual of the 38 cash vouchers decreased the purchase price adjustment by \$348,414.

4. We examined the operating committee minutes for each active operating program, noting that the minutes were signed by the appropriate NRPC and Chevron operating committee members. We agreed the cost sharing percentages per the minutes to the percentages in the computer system.

Effective October 1, 1997, the Dry Gas zone equity percentages for DOE changed from 77.0492 percent to 83.8726 percent. As part of the adjustment of the allocation percentage for expenditures for the Dry Gas zone to the new equity, NRPC underbilled Chevron by \$222,060 in December 1997. We recalculated the adjustment and agreed the amount to the general ledger and the corrected joint owner billing. The correction decreased the purchase price adjustment by \$222,060.

We found no other exceptions as a result of these procedures.

5. We obtained schedules of accounts payable, accrued and other liabilities as of September 30, 1997, and income and expense for the fiscal period not covered by other sections of the agreed-upon procedures. We tested the arithmetical accuracy of the schedules and agreed the amounts to supporting documentation. The following adjustments affecting the settlement statement were noted:

Contract Retention

The contract retention payable account was over accrued as of September 30, 1997. The excess accruals were credited to expense in October 1997; therefore, the preliminary settlement statement understated expenditures by \$27,883. The \$27,883 was reduced for Chevron's share of the cost of \$5,717. Elimination of the excessive accruals increased the purchase price adjustment by \$22,166.

Payroll Accruals

The payroll accrual as of September 30, 1997 did not include accruals for the employer portion of FICA and certain fringe benefit amounts. The FICA accrual was adjusted as part of the cash vouchers test work in item 3 above. The remaining unaccrued fringe benefit amount was \$42,216. We recalculated the fringe benefit accrual as follows: the year-end payroll accrual amount multiplied by the fiscal 1997 estimated fringe additive rates. This adjustment, after being reduced by 21.063 percent for Chevron's share of the cost, decreased the purchase price adjustment by \$33,324.

Vacation Accrual

We agreed the vacation accrual as of September 30, 1997, of \$1,944,953 plus an estimated fringe accrual of \$447,339 to the general ledger. The fringe accrual rate of 23 percent of wages included fringe benefits that would not be applicable when the vacation is paid to terminated employees or in a lump sum. We recalculated the revised fringe accrual of \$191,955 using the same fringe rates as for severance costs of 9.8694 percent. The over accrual of \$255,384 was reduced for Chevron's share of the cost of \$55,118. Elimination of the over accrual increased the purchase price adjustment by \$200,266.

DOE Administrative and Marketing Costs

DOE administrative and marketing costs included on the settlement statement represented the gross pay for all DOE employees at NRPC. We agreed the costs to the DOE payroll registers. We agreed all employees listed on the payroll registers to a listing of DOE employees as of September 30, 1997. We identified an unallowable early retirement payment of \$25,000 that should be excluded from the purchase price adjustment. We also calculated actual payroll costs from January 1, 1998 through February 4, 1998 and compared the actual costs to the estimated costs recorded on the preliminary settlement statement resulting in an adjustment \$23,256. The excluded costs and the adjustment of estimated to actual costs decreased the purchase price adjustment by \$48,256.

Cut-off Period Production Adjustment

The cut-off for the accounting period ended September 30, 1997 was midnight. The PSA cut-off was October 1, 1997 at 7:00 am. Under management's direction, we estimated the costs for the seven hours of operations as follows: operation costs per barrel of oil equivalent (BOE) of \$2.87 from fiscal 1997, multiplied by seven hours of average DOE production of 29,699 BOE based on October 1997 production. The estimated costs for the seven hours of operations decreased the purchase price adjustment by \$85,236.

Miscellaneous Credits

NRPC received miscellaneous deposits for items such as van pool reimbursements, insurance payment reimbursements, tax refunds, etc. We obtained a detail listing of the credits and reviewed amounts in excess of \$1000. We reviewed supporting documentation to determine whether the credits had been accrued in the proper period. We identified 16 credits for \$122,417 which had not been accrued in fiscal 1997. The \$122,417 was reduced by \$25,480 for Chevron's share of the credits. Proper accrual of the credits increased purchase price adjustment by \$96,937.

We found no other exceptions as a result of these procedures.

6. We recalculated the remediation costs for fiscal 1997 as \$310,150 or \$850 per day. Therefore, the maximum allowable fiscal 1998 costs were \$107,950 (\$850 multiplied by 127 days). Actual costs incurred in fiscal 1998 were \$815,900, resulting in an unallowable amount of \$707,950. This adjustment is reduced by 21.648 percent for Chevron's share of the costs. The allocated amount of \$554,693 was a decrease to the purchase price adjustment.

Payroll costs

1. We obtained the documentation of internal control test work performed in the fiscal 1997 financial statement audit related to payroll costs. We inquired of appropriate accounting personnel regarding modifications to the accounting procedures occurring during the settlement statement period. We noted no significant modifications to accounting procedures during the settlement statement period.
2. We obtained a reconciliation of payroll reports to the general ledger. We agreed reconciling items in excess of \$50,000 and 10 percent of the report amount to supporting documentation. We found no exceptions as a result of these procedures.

3. We judgementally selected a sample of 50 payroll checks from the payroll ledgers for the period from October 1, 1997 to February 5, 1998. For each payroll check selected, we obtained canceled checks or direct deposit reports, time cards, and personnel files. We performed the following procedures:
 - Calculated the number of vacation weeks the employee was eligible for in accordance with company policy as set forth in Appendix A of Bechtel's contract;
 - Traced used vacation time to the individual employees vacation record to verify that vacation time used after October 1, 1997 was earned and accrued prior to October 1, 1997 or that it was earned after October 1, 1997 and charged to the period subsequent to September 30, 1997;
 - Agreed hours worked to authorized time cards or labor distribution cards;
 - Verified that time cards and labor distribution cards were approved;
 - Agreed pay rates to authorized pay rates approved by NRPC for the specific level and type for applicable period;
 - Agreed the labor allocation to the supporting documents;
 - Ascertained that payment for overtime was in accordance with Appendix A;
 - Obtained canceled checks and agreed the payee name, check number, amount, and date to the payroll register;
 - Examined the signature and endorsement;
 - For direct deposit payroll, examined signed authorization for the deposit;
 - Recomputed the gross pay based on hours worked, authorized pay rates, and recomputed the FICA amount; and
 - Determined compliance with Appendix A of Bechtel's contract for payments for layoffs, disability, shift differential, vacations, leave of absence, death allowance, safety and patent awards, travel reimbursement, relocation, temporary duty, as applicable and agreed amount to supporting documents.

For vacation test work, Bechtel could not provide the vacation accrual worksheet for one individual. Of the 49 individuals tested, 10 individuals took vacation during the final pay period of the fiscal year for which the vacation was not deducted until subsequent to the fiscal year end. Bechtel reviewed all employee vacation taken during the final pay period of the year and recalculated \$38,265, including a fringe rate of 9.8694 percent, that should have been deducted from the vacation accrual as of September 30, 1997. We compared the 49 individuals tested to Bechtel's calculation and noted no inconsistencies between our test work and Bechtel's calculation. The \$38,265 was reduced by \$8,207 for Chevron's share of the cost. Elimination of the excessive vacation accrual amount increased the purchase price adjustment by \$30,058.

Vacation accrued for the 49 individuals was for the pay period ended October 4, 1997. Bechtel recalculated the four day over accrual of vacation for all employees to be \$20,804, including a fringe rate of 9.8694 percent. We compared Bechtel's calculation to our test work and noted no inconsistencies. The \$20,804 was reduced by \$4,462 for Chevron's share of the cost. Elimination of the over accrued vacation increased the purchase price adjustment by \$16,342.

We found no other exceptions as a result of these procedures.

4. We obtained a listing of annualized salaries greater than \$90,000 and verified compliance with approval requirements as set forth in Appendix A of Bechtel's contract. We found no exceptions as a result of these procedures.

5. We judgementally selected a sample of 25 terminations during the settlement statement period and performed the following procedures:

- Recomputed the employee's last gross pay and agreed the rate of pay to the employee's wage form at the termination date;
- Agreed to the termination documentation;
- Traced the severance pay to the payroll distribution reports;
- Agreed the accrued vacation hours paid per the registers to the appropriate termination form and verified that hours were charged to the proper period;
- Examined the canceled check or direct deposit authorization for accrued vacation payment, termination allowance check, or final pay for propriety;
- Compared the signatures to the signed W-4; and
- Inspected the next payroll register subsequent to the termination period to verify that the employee was removed.

We found no exceptions as a result of these procedures.

* * * * *

We were not engaged to, and did not, perform an audit, the objective of which would be the expression of an opinion on the specified elements, accounts, or items. Accordingly, we do not express such an opinion. Had we performed additional procedures, other matters might have come to our attention that would have been reported to you.

This report is intended solely for the use of the management of NRPC and Occidental and should not be used by those who have not agreed to the procedures and taken responsibility for the sufficiency of the procedures for their purposes. However, this report is a matter of public record and its distribution is not limited.

KPMG Peat Marwick LLP

October 25, 1998

Exhibit A

The following exhibit summarizes the findings noted in the attached agreed-upon procedures report and is included for summary purposes only. The following should be read in connection with the detail explanations provided in the attached report in the corresponding section and procedure number.

<u>Section/ Procedure Number</u>	<u>Description</u>	<u>Amount</u>
<u>Inventories</u>		
7.	Inventory balance adjustment using average October 1997 sales price and October 1, 1997 inventory count	\$ 848,075
7.	Excess shipments of BG Mix from 17Z gas plants	(47,641)
7.	Inventory balance calculations are not consistent with Exhibit D of the Purchase and Sale Agreement. Calculation of differences is outside the scope of the agreed-upon procedures	Undetermined
8.	Over or under allocation adjustment using average October sales price	(9,735)
<u>Prepaid Expenses</u>		
2.	Prepaid expenses incurred prior to October 1, 1997	(796)
<u>Property, Plant, and Equipment, and Oil & Gas Properties</u>		
5.	Capital expenditures in excess of \$300,000	(7,170)
<u>Trade Receivables, Sales, Production, Credit Notes, and Collections</u>		
2.	Sales for seven hours from September 30, 1997 midnight to October 1, 1997, 7:00 a.m.	130,399
2.	Adjust revenue estimate to actual for period subsequent to December 31, 1997	7,639,069
2.	Dry Gas zone equity allocations were not correct. Excess allocations to Chevron should be corrected on future divisions of natural gas.	
5.	Pacific Gas and Electric electricity payments subsequent to the closing date	(891,555)

Exhibit A (continued)

<u>Section/ Procedure Number</u>	<u>Description</u>	<u>Amount</u>
<u>Payroll costs</u>		
3.	Vacation used in September 1997	30,058
3.	Over accrued vacation for four days of October 4, 1997, pay period	16,342

CUSTOMER RESPONSE FORM

The Office of Inspector General has a continuing interest in improving the usefulness of its products. We wish to make our reports as responsive as possible to our customers' requirements, and, therefore, ask that you consider sharing your thoughts with us. On the back of this form, you may suggest improvements to enhance the effectiveness of future reports. Please include answers to the following questions if they are applicable to you:

1. What additional background information about the selection, scheduling, scope, or procedures of the audit would have been helpful to the reader in understanding this report?
2. What additional information related to findings and recommendations could have been included in this report to assist management in implementing corrective actions?
3. What format, stylistic, or organizational changes might have made this report's overall message more clear to the reader?
4. What additional actions could the Office of Inspector General have taken on the issues discussed in this report which would have been helpful?

Please include your name and telephone number so that we may contact you should we have any questions about your comments.

Name _____ Date _____

Telephone _____ Organization _____

When you have completed this form, you may telefax it to the Office of Inspector General at (202) 586-0948 or you may mail it to:

Office of Inspector General (IG-1)
U.S. Department of Energy
Washington, D.C. 20585
ATTN.: Customer Relations

If you wish to discuss this report or your comments with a staff member of the Office of Inspector General, please contact Wilma Slaughter at (202) 586-1924.