WEXPRO COMPANY
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LEGAL DEPARTMENT

February 27, 1986

Mr. Bob Lake
Price Waterhouse
50 West Broadway
Salt Lake City, Utah 84101

Dear Bob:

Re: Accounting for Production Taxes

Attached is a proposed method of accounting for production taxes between Mountain Fuel Supply Company and Wexpro Company. Both companies believe this is a prudent cost saving measure.

We respectfully request Accounting Monitor approval of this action.

Very truly yours,

Ruland J. Gill, Jr.

Ruland J. Gill, Jr.
Managing Attorney

pw

Attachment

APPROVED THIS 12th DAY OF May, 1986.

UTAH DIVISION OF PUBLIC UTILITIES

PRICE WATERHOUSE

Price Waterhouse

DISCUSSION OF THE PROPER ACCOUNTING METHODOLOGY FOR PRODUCTION TAXES ON MFS OWNED PROPERTIES

Mountain Fuel Supply Co. is currently paying production taxes on properties owned by Mountain Fuel Supply and operated by Wexpro. These production taxes are expensed in Mountain Fuel's account 408. This is an involved process that has become quite cumbersome from an accounting standpoint. Since Wexpro is the legal operator, they are required by law to pay production taxes for all working interest owners. Wexpro must in turn bill all working interest owners for their share of the production taxes. In the case of Mountain Fuel, Wexpro pays the production taxes and bills Mountain Fuel. This transaction clears the entry on Wexpro's books. Mountain Fuel in turn reimburses Wexpro and records the expense in account 408. Wexpro has the necessary accounting system in place to properly record and audit production taxes due to its oil and gas operations. Once the production tax bill is passed to Mountain Fuel, there must be a system that properly records and audits these expenses at Mountain Fuel. There would be greater efficiency by having only one company perform these functions.

Beginning 1/1/86, it is proposed that Mountain Fuel will no longer accrue production taxes on a monthly basis. As Wexpro receives the bills for the production taxes, they will add them to the operator service fee for the month that they are due. Wexpro will in turn make the payment to the proper taxing authority. The result is that the accounting process would become much more efficient by having only one company keep track of the production tax activity. This efficiency was recognized by Ernst & Whinney in its May 9, 1985 audit of Mountain Fuel Supply's books and records. A copy of that audit report is attached.

The production taxes on properties owned by Mountain Fuel and operated by an entity other than Wexpro (an "outside operator") are paid by the "outside operator." The "outside operator" in turn sends Wexpro a bill for Mountain Fuel's share of production taxes. Mountain Fuel's share is determined by its working interest.

These taxes on "outside operated" properties have been properly reflected in the service fee calculations from the beginning and there is no proposal to make changes in the billing of production taxes on properties operated by "outside operators."

Through researching the "Wexpro Stipulation and Agreement," it becomes very clear production taxes were meant to be included in the calculation of the operator service fee. Under Article III-5(b) of the Wexpro Agreement, Wexpro bills Mountain Fuel for the operation of all productive gas reservoirs. Exhibit E of the agreement sets out the guidelines for charges allowed under Article III-5(b) and states, "The monthly operator service fee to be charged to Mountain Fuel Supply Company by Wexpro for the production of hydrocarbons.....will included the costs detailed below." Those detailed costs include taxes; Article I-36 defines taxes as "all exactions resulting from levies by government, including....taxes on.....production...." Paragraph 7.1.2 of the Wexpro Stipulation clearly points out that costs associated with the service fees paid to Wexpro as required by the stipulation and agreement are to be reflected using 191 account procedures.

Currently, Mountain Fuel has on file with the Utah Public Service Commission an application to adjust base rates for natural gas service in Utah due to periodic changes in the cost of gas charged by suppliers. This application has incorporated in it the necessary adjustments to Mountain Fuel's rates to effect the proposal discussed here.

Historically, Mountain Fuel included the production taxes in question as part of its distribution non-gas cost component of rates.

Mountain Fuel sets commodity rates to customers on the basis of annual costs. Therefore, Mountain Fuel will be receiving revenues to cover the expected production tax billing prior to the actual paying of these taxes. This will cause an over-collection of costs in the first part of the year. This over-collection will become part of the 191 Account. To the extent that these costs are over-collected, the customer will be made whole by the interest calculation that is applied to the monthly balance of the 191 account. This is similar to the current practice of reducing the production tax accrual from rate base when calculating distribution non-gas rates.

In order to comply with the terms of the Wexpro Agreement, it is clear Mountain Fuel's distribution non-gas component of rates should be adjusted to remove the effects of the production properties. Mountain Fuel's current application before the Utah Public Service Commission has adjusted both the distribution non-gas component of rates, and the commodity component of rates, to reflect the proper accounting of the production taxes.

It is common industry practice to include production taxes in pass-through proceedings. This is logical and appropriate because the taxes are considered a cost of producing gas, and the level of production taxes is directly correlated with production volumes.

Mountain Fuel has filed its pass-on application in the state of Wyoming, which includes the adjustments described here. The Wyoming commission approved that pass-on application on December 30, 1985.

Re: Accounting for Production Taxes

APPROVED this ______ day of _______________, 1985.

BALL ASSOCIATES, LTD.

By ______________________________
Date ______________________________

PRICE WATERHOUSE

By ______________________________
Date ______________________________

UTAH DIVISION OF PUBLIC UTILITIES

By ______________________________
Date ______________________________

STAFF OF WYOMING PUBLIC SERVICE COMMISSION

By ______________________________
Date ______________________________