

HANLEY PETROLEUM INC.

AUDIT OF

KACHINA 8 FED #2

OPERATED BY

SANTA FE ENERGY RESOURCES, INC.

BUFILE EXAMINER CATANACH	
OIL COLLECTION DIVISION	
HANLEY	EXHIBIT NO. 5
CASE NO.	10513

Hanley Petroleum Inc.

Audit of
Kachina 8 Fed #2

Operated by
Santa Fe Energy Resources, Inc. (SFER)

We have completed our examination of expenditures applicable to the Kachina 8 Fed #2 for the period from inception through June 30, 1992. The audit was performed to determine that expenditures were reported in accordance with the provisions of the State of New Mexico, Energy, Minerals and Natural Resources Department, Oil Conservation Division, Orders Numbered R-9480, R-9480-A, and R-9480-B.

GENERAL INFORMATION

The Kachina 8 Fed #2 Lease is located in Lea County New Mexico. The well was spudded on September 12, 1991.

Gross expenditures from inception through the May 31, 1992 joint interest billing equaled \$924,494.90. These expenditures consisted of \$18,977.42 for lease operations and \$905,517.48 for drilling and completion.

AUDIT SCOPE

The auditors examined, in detail, selected charges to the joint account as deemed necessary. The examination included, but was not limited to, specific reviews in the following areas:

1. Reconciliation of tubular materials used/charged.
2. Accountability for wellhead equipment charged.
3. Validity of drilling contractor charges.
4. Validity of other third-party charges.
5. Propriety of operator's direct & overhead charges.
6. Verification of current market prices charged for the operator's material and equipment.

The operator provided the auditors access to original supporting documentation for all charges as requested. The operator also provided copies of tour reports, State Completion Reports and the drilling contract.

AUDIT OPINION

Based on the examination completed, it is the opinion of the auditors that the accounting for the operations conforms to the provisions of the State of New Mexico, Energy, Minerals and Natural Resources Department, Oil Conservation Division, Orders Numbered R-9480, R-9480-A, and R-9480-B except as noted in Attachments A and B of this report.

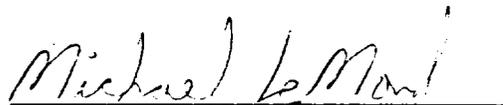
Gross exceptions total \$106,557.09.

The operator should credit the joint account in accordance with these exceptions or explain why a request is denied. Further, all adjustments resulting from the audit should be identified on the joint interest billing as "AUDIT EXCEPTION ADJUSTMENT".

We appreciate the courtesy and cooperation extended to the auditors by the operator's personnel during the audit.

Very truly yours,

Hanley Petroleum Inc.


Michael LeMond, Controller

ATTACHMENT A
SUMMARY OF AUDIT EXCEPTIONS

Audit Exception	Description	Amount
1	Expense report	\$ 271.75
2	Invoices Coding	490.89
3	Discounts	69.51
4	Legal expenses	6,000.45
5	Expense reports	2,278.99
6	Drilling Mud	4,428.60
7	2 7/8" tubing	1,346.80
8	Parted 8 5/8" casing	91,670.10
	TOTAL EXCEPTIONS	----- \$106,557.09 =====
	TOTAL NET CREDITS DUE NON-OPERATOR (1)	\$ 91,670.10
	TOTAL CREDITS DUE JOINT ACCOUNT (2)	14,886.99
	TOTAL EXCEPTIONS	----- \$106,557.09 =====

- (1): Audit Exception 8.
(2): Audit Exceptions 1 through 7.

ATTACHMENT B
SUMMARY COMMENT BY AUDIT EXCEPTION

AUDIT EXCEPTION NO. 1

Expense report

An expense report from Michael W. White for the period from 5-1-92 to 5-31-92 has \$271.75 charged to the Kachina 8 Fed #2. The charge according, to the "Business Purpose of Expense and Location" part of the report, indicates the amount was for "SFP Mining 1-29".

Credit Due the Joint Account	\$271.75
------------------------------	----------

AUDIT EXCEPTION NO. 2

Invoices Coding

Invoices totaling \$490.89 were charged to the Kachina 8 Fed #2, however vendor invoices indicated that the charges were for other SFER properties.

Credit Due the Joint Account	\$490.89
------------------------------	----------

AUDIT EXCEPTION NO. 3

Discounts

Discounts were miscalculated on Vantage Tubular invoices. The calculations did not reflect reduced sales tax.

Credit due the Joint Account	\$69.51
------------------------------	---------

AUDIT EXCEPTION NO. 4

Legal Expenses

Legal expenses totaling \$6,000.45 were charged to the Joint Account. These expenses were incurred during the SFER/Hanley Petroleum Inc. Conservation Hearing and should not be charged to the Joint Account.

Credit due the Joint Account \$6,000.45

AUDIT EXCEPTION NO. 5

Expense reports

Expense reports of \$2,278.99 were charged to the Joint Account. These expenses were incurred during the SFER/HPI Conservation Hearing and should not be charged to the Joint Account.

Credit due the Joint Account \$2,278.99

AUDIT EXCEPTION NO. 6

Drilling mud

The tour reports indicate that 14 sacks of "Drispac" were used. The vendor invoice includes billings for 36 sacks of "Drispac". At a rate of \$201.30 per sack, the joint account was over billed \$4,428.60.

Credit due the Joint Account \$4,428.60

AUDIT EXCEPTION NO. 7

2 7/8" Tubing

The joint account was charged for 11,462.4' of 2 7/8" N-80 tubing. Per the New Mexico Conservation Report C-104 dated 2/7/92, 11027' was run in the hole. Allowing a .0059 thread make up loss, gross tubing in the hole is 11,092.4'. The joint account needs to be credited for 370' of unused tubing, at an average price of \$3.64/ft, totaling \$1,346.80.

Credit due the joint account \$1,346.80

AUDIT EXCEPTION NO. 8

Parted 8 5/8" Casing

Santa Fe Energy proposed in its AFE that 8 5/8" 24# casing be run. Hanley Petroleum insisted that due to the depth and pressure involved a heavier weight casing was required. Santa Fe disregarded this warning. The lighter weight casing was run and subsequently failed. The work required to remedy the situation resulted in charges to the Joint Account in the amount of \$91,670.10. The operator should bear the cost of the repair, as they disregarded the competent warnings of Hanley Petroleum Inc. The joint account should be credited \$91,670.10.

Credit due the joint account \$91,670.10

KACHINA 8 FED #2
PARTED CASING EXPENDITURES
MAY 31, 1992

<u>VENDOR NAME</u>	<u>INVOICE #</u>	<u>WORK DATE</u>	<u>DESCRIPTION</u>	<u>AMOUNT</u>
CACTUS DRILLING	15456	09/29 - 10/06/91	159.5 HOURS OF DAYWORK @ \$185.417/HR TAX INCLUDED	\$31,200.58
PETCO	101-37025	09/29/91	FISHING TOOL RENTAL	13,529.44
THE DIA-LOG COMPANY	411-89299	09/29/91	LOG 8 5/8" CASING	1,453.32
OTIS ENGINEERING	810798	09/30/91	VIDEO SERVICE	5,435.36
HALLIBURTON SERVICES	178849	10/01/91	CEMENT SQUEEZE	4,861.90
HALLIBURTON SERVICES	153640	10/02/91	CASING ALIGNMENT TOOL	15,399.33
SCHLUMBERGER	760700	10/04/91	LOG WELL TO 8982'	19,790.17
				<u>\$91,670.10</u>

KACHINA 8 FED #2
TUBULAR RECONCILIATION
MAY 31, 1992

MATERIAL -----	SOURCE -----	ACTUAL FEET BILLED -----	FOOTAGE PER NMCC REPORTS -----	THREAD LOSS -----	DIFFERENCE -----
13 3/8" 48# H-40	MT-AMI31607 (9/91)	<u>430.87'</u>	422'	3.08'	5.79'
8 5/8" 24# J&K-55	CENTRAL PIPE & SUPPLY	332.9'			
	MT-AMI31608 (10/91)	2879'			
	MT-AMI31609 (11/91)	<u>(124')</u>			
		3087.9'	3080'	21.61'	(13.71')
5 1/2" 17# N-80	BOVAIRD SUPPLY	2671.48'			
5 1/2" 17# N-80	VANTAGE TUBULARS	3498.00'			
5 1/2" 17# L-80	MT-AMI31609 (11/91)	(295')			
5 1/2" 17# K-55	MT-AMI10812 (10/91)	1252'			
	MT-AMI10812 (10/91)	364'			
	MT-AMI10812 (10/91)	121'			
	MT-AMI10813 (11/91)	164'			
	MT-AMI10813 (11/91)	245'			
	MT-AMI10813 (11/91)	573'			
5 1/2" 17# J-55	MT-AMI10812 (10/91)	122'			
5 1/2" 15.5# K-55	VANTAGE TUBULARS	<u>2819.2'</u>			
		11534.68'	11480'	83.80'	(29.12')
2 7/8" 6.5# N-80	VANTAGE TUBULARS	9898.4'			
	MT-AMI10978 (11/91)	1947'			
	MT-AMI32112 (2/92)	<u>(383')</u>			
		11462.4'	11027'	65.40'	370.00'