

PERMIAN BASIN ROYALTY TRUST

Form 10-Q

November 07, 2006

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**UNITED STATES SECURITIES AND EXCHANGE COMMISSION**  
**Washington, D.C. 20549**  
**FORM 10-Q**

☒ **Quarterly Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934**  
**For the Quarterly Period ended September 30, 2006**

☐ **Transition Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934**  
**For the transition period from \_\_\_\_\_ to \_\_\_\_\_**

**Commission file number 1-8033**

**PERMIAN BASIN ROYALTY TRUST**

**(Exact Name of Registrant as Specified in the Permian Basin Royalty Trust Indenture)**

Texas  
(State or Other Jurisdiction of  
Incorporation or Organization)

75-6280532  
(I.R.S. Employer Identification No.)

Bank of America, N.A.  
Trust Department  
901 Main Street  
Dallas, Texas 75202  
(Address of Principal Executive  
Offices; Zip Code)  
(214) 209-2400

(Registrant's Telephone Number, Including Area Code)

Indicate by check mark whether the registrant: (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports) and (2) has been subject to such filing requirements for the past 90 days. Yes ☒ No ☐

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of accelerated filer and large accelerated filer in Rule 12b-2 of the Exchange Act.

Large accelerated filer ☐ Accelerated filer ☒ Non-accelerated filer ☐

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).  
Yes ☐ No ☒

Number of Units of beneficial interest of the Trust outstanding at November 1, 2006: 46,608,796.

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Certification of Ron E. Hooper

Certificate by Bank of America

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**PERMIAN BASIN ROYALTY TRUST**  
**PART I FINANCIAL INFORMATION**

**Item 1. Financial Statements**

The condensed financial statements included herein have been prepared by Bank of America, N.A. as Trustee for the Permian Basin Royalty Trust, without audit, pursuant to the rules and regulations of the Securities and Exchange Commission. Certain information and footnote disclosures normally included in annual financial statements have been condensed or omitted pursuant to such rules and regulations, although the Trustee believes that the disclosures are adequate to make the information presented not misleading. It is suggested that these condensed financial statements be read in conjunction with the financial statements and the notes thereto included in the Trust's latest annual report on Form 10-K. In the opinion of the Trustee, all adjustments, consisting only of normal recurring adjustments, necessary to present fairly the assets, liabilities and trust corpus of the Permian Basin Royalty Trust at September 30, 2006, and the distributable income and changes in trust corpus for the three-month and nine-month periods ended September 30, 2006 and 2005 have been included. The distributable income for such interim periods is not necessarily indicative of the distributable income for the full year.

Deloitte & Touche LLP, an independent registered public accounting firm, has made a limited review of the condensed financial statements as of September 30, 2006 and for the three-month and nine-month periods ended September 30, 2006 and 2005 included herein.

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**REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM**

Unit Holders of Permian Basin Royalty Trust and  
Bank of America, N.A., Trustee

We have reviewed the accompanying condensed statement of assets, liabilities and trust corpus of Permian Basin Royalty Trust as of September 30, 2006, and the related condensed statements of distributable income for the three-month and nine-month periods ended September 30, 2006 and 2005 and changes in trust corpus for the three-month and nine-month periods ended September 30, 2006 and 2005. These condensed financial statements are the responsibility of the Trustee.

We conducted our reviews in accordance with the standards of the Public Company Accounting Oversight Board (United States). A review of interim financial information consists principally of applying analytical procedures and making inquiries of persons responsible for financial and accounting matters. It is substantially less in scope than an audit conducted in accordance with the standards of the Public Company Accounting Oversight Board (United States), the objective of which is the expression of an opinion regarding the financial statements taken as a whole.

Accordingly, we do not express such an opinion.

As described in Note 1 to the condensed financial statements, these condensed financial statements have been prepared on a modified cash basis of accounting, which is a comprehensive basis of accounting other than accounting principles generally accepted in the United States of America.

Based on our reviews, we are not aware of any material modifications that should be made to such condensed financial statements for them to be in conformity with the basis of accounting described in Note 1.

We have previously audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the statement of assets, liabilities and trust corpus of Permian Basin Royalty Trust as of December 31, 2005, and the related statements of distributable income and changes in trust corpus for the year then ended (not presented herein); and in our report dated March 14, 2006, we expressed an unqualified opinion on those financial statements. In our opinion, the information set forth in the accompanying condensed statement of assets, liabilities and trust corpus as of December 31, 2005, is fairly stated, in all material respects, in relation to the statement of assets, liabilities and trust corpus from which it has been derived.

/s/ Deloitte & Touche LLP

Dallas, Texas

November 7, 2006

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**PERMIAN BASIN ROYALTY TRUST  
CONDENSED STATEMENTS OF ASSETS, LIABILITIES AND TRUST CORPUS**

	September 30, 2006 (Unaudited)	December 31, 2005 (Unaudited)
<b>ASSETS</b>		
Cash and short-term investments	\$ 6,637,774	\$ 7,264,048
Net overriding royalty interests in producing oil and gas properties (net of accumulated amortization of \$9,494,537 and \$9,364,586 at September 30, 2006 and December 31, 2005, respectively)	1,480,679	1,610,630
<b>TOTAL ASSETS</b>	<b>\$ 8,118,453</b>	<b>\$ 8,874,678</b>
<b>LIABILITIES AND TRUST CORPUS</b>		
Distribution payable to Unit holders	\$ 6,637,774	\$ 7,264,048
Commitments and contingencies		
Trust corpus 46,608,796 Units of beneficial interest authorized and outstanding	1,480,679	1,610,630
<b>TOTAL LIABILITIES AND TRUST CORPUS</b>	<b>\$ 8,118,453</b>	<b>\$ 8,874,678</b>

The accompanying notes to condensed financial statements are an integral part of these statements.

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**PERMIAN BASIN ROYALTY TRUST  
CONDENSED STATEMENTS OF DISTRIBUTABLE INCOME (UNAUDITED)**

	THREE MONTHS ENDED		NINE MONTHS ENDED	
	September 30		September 30	
	2006	2005	2006	2005
Royalty income	\$ 18,697,269	\$ 15,989,323	\$ 51,655,740	\$ 42,266,409
Interest income	31,635	13,777	95,350	36,821
	18,728,903	16,003,100	51,751,090	42,303,230
General and administrative expenditures	(152,561)	(112,337)	(677,389)	(648,236)
Distributable income	\$ 18,576,342	\$ 15,890,763	\$ 51,073,701	\$ 41,654,994
Distributable income per Unit (46,608,796 Units)	\$ .398559	\$ .340939	\$ 1.095795	\$ .893715

The accompanying notes to condensed financial statements are an integral part of these statements.

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CONDENSED STATEMENTS OF CHANGES IN TRUST CORPUS (UNAUDITED)**

	THREE MONTHS ENDED September 30		NINE MONTHS ENDED September 30	
	2006	2005	2006	2005
Trust corpus, beginning of Period	\$ 1,527,299	\$ 1,705,706	\$ 1,610,630	\$ 1,795,267
Amortization of net overriding royalty interests	(46,620)	(45,820)	(129,951)	(135,381)
Distributable income	18,576,342	15,890,763	51,073,701	41,654,994
Distributions declared	(18,576,342)	(15,890,763)	(51,073,701)	(41,654,994)
Total Trust Corpus, end of period	\$ 1,480,679	\$ 1,659,886	\$ 1,480,679	\$ 1,659,886
Distributions per unit	\$ .398559	\$ .340939	\$ 1.095795	\$ .893715

The accompanying notes to condensed financial statements are an integral part of these statements.



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**PERMIAN BASIN ROYALTY TRUST**

**NOTES TO CONDENSED FINANCIAL STATEMENTS (UNAUDITED)**

**1. BASIS OF ACCOUNTING**

The Permian Basin Royalty Trust ( Trust ) was established as of November 1, 1980. The net overriding royalties conveyed to the Trust include: (1) a 75% net overriding royalty carved out of Southland Royalty Company's fee mineral interests in the Waddell ranch in Crane County, Texas (the Waddell Ranch properties ); and (2) a 95% net overriding royalty carved out of Southland Royalty Company's major producing royalty interests in Texas (the Texas Royalty properties ). The net overriding royalty for the Texas Royalty properties is subject to the provisions of the lease agreements under which such royalties were created. The financial statements of the Trust are prepared on the following basis:

Royalty income recorded for a month is the amount computed and paid to Bank of America, N.A. ( Trustee ) as Trustee for the Trust by the interest owners: Burlington Resources Oil & Gas Company LP ( BROG ), a subsidiary of ConocoPhillips for the Waddell Ranch properties and Riverhill Energy Corporation ( Riverhill Energy ), formerly a wholly owned subsidiary of Riverhill Capital Corporation ( Riverhill Capital ) and formerly an affiliate of Coastal Management Corporation ( CMC ), for the Texas Royalty properties. Schlumberger Technology Corporation ( STC ) currently conducts all field, technical and accounting operations on behalf of BROG with regard to the Waddell Ranch properties. Riverhill Energy currently conducts the accounting operations for the Texas Royalty properties. Royalty income consists of the amounts received by the owners of the interests burdened by the net overriding royalty interests ( Royalties ) from the sale of production less accrued production costs, development and drilling costs, applicable taxes, operating charges, and other costs and deductions multiplied by 75% in the case of the Waddell Ranch properties and 95% in the case of the Texas Royalty properties.

As was previously reported, in February 1997, BROG sold its interest in the Texas Royalty properties to Riverhill Energy.

The Trustee has been advised that in the first quarter of 1998, STC acquired all of the shares of stock of Riverhill Capital. Prior to such acquisition by STC, CMC and Riverhill Energy were wholly-owned subsidiaries of Riverhill Capital. The Trustee has further been advised that in connection with STC's acquisition of Riverhill Capital, the shareholders of Riverhill Capital acquired ownership of all of the shares of stock of Riverhill Energy. Thus, the ownership in the Texas Royalty properties referenced above remained in Riverhill Energy, the stock ownership of which was acquired by the former shareholders of Riverhill Capital.

Trust expenses recorded are based on liabilities paid and cash reserves established out of cash received or borrowed funds for liabilities and contingencies.

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Distributions to Unit holders are recorded when declared by the Trustee.

Royalty income is computed separately for each of the conveyances under which the Royalties were conveyed to the Trust. If monthly costs exceed revenues for any conveyance ( excess costs ), such excess cannot reduce royalty income from other conveyances, but is carried forward with accrued interest to be recovered from future net proceeds of that conveyance.

The financial statements of the Trust differ from financial statements prepared in accordance with accounting principles generally accepted in the United States of America ( GAAP ) because revenues are not accrued in the month of production and certain cash reserves may be established for contingencies which would not be accrued in financial statements. Amortization of the Royalties calculated on a unit-of-production basis is charged directly to trust corpus. This comprehensive basis of accounting other than GAAP corresponds to the accounting permitted for royalty trusts by the U.S. Securities and Exchange Commission as specified by Staff Accounting Bulletin Topic 12:E, Financial Statements of Royalty Trusts.

**New Accounting Pronouncements**

In February 2006, the FASB issued SFAS No. 155, Accounting for Certain Hybrid Financial Instruments an amendment of FASB Statements No. 133 Accounting for Derivative Instruments and No. 140 Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities. This statement resolves issues addressed in Statement 133 Implementation Issue No. D1, Application of Statement 133 to Beneficial interests in Securitized Financial Assets. This statement is effective for all financial instruments acquired or issued after the beginning of an entity s first fiscal year that begins after September 15, 2006. The Trust has no financial instruments and accordingly, this new Standard will not impact the financial statements of the Trust.

In March 2006, the FASB issued SFAS No. 156, Accounting for Servicing of Financial Assets an amendment of FASB Statements No. 140 Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities. This statement requires an entity to recognize a servicing asset or servicing liability each time it undertakes an obligation to service a financial asset by entering into a servicing contract in certain situations. This statement is effective as of the beginning of an entity s first fiscal year that begins after September 15, 2006. The Trustee does not believe the adoption of this statement will have a material effect on the Trust s financial statements.

In July 2006, the FASB issued FASB Interpretation No. 48 ( FIN 48 ), Accounting for Uncertainty in Income Taxes, which clarifies the accounting for uncertainty in income taxes recognized in the financial statements in accordance with SFAS No. 109, Accounting for Income Taxes. FIN 48 is effective for fiscal years beginning after December 15, 2006. The Trustee does not believe that the adoption of this statement will have a material effect on the Trust s financial statements.

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In September 2006, the FASB issued SFAS No. 158, *Employers' Accounting for Defined Benefit Pension and Other Postretirement Plans – an amendment of FASB Statements No. 87, 88, 106 and 132(R)*. This statement improves financial reporting by requiring an employer to recognize the over funded or underfunded status of a defined benefit postretirement plan (other than a multiemployer plan) as an asset or liability in its statement of financial position and to recognize changes in that funded status in the year in which the changes occur through comprehensive income of a business entity or changes in unrestricted net assets of a not-for-profit organization. This statement is effective as of the end of the fiscal year ending after December 15, 2006. The Trustee does not believe that the adoption of this statement will have a material effect on the Trust's financial statements.

In September 2006, the FASB issued SFAS No. 157, *Fair Value Measurements*. This statement defines fair value, establishes a framework for measuring fair value in generally accepted accounting principles (GAAP), and expands disclosures about fair value measurements. This statement is effective for financial statements issued for fiscal years beginning after November 15, 2007. The Trustee does not believe that the adoption of this statement will have a material effect on the Trust's financial statements.

## **2. FEDERAL INCOME TAXES**

For Federal income tax purposes, the Trust constitutes a fixed investment trust which is taxed as a grantor trust. A grantor trust is not subject to tax at the trust level. The Unit holders are considered to own the Trust's income and principal as though no trust were in existence. The income of the Trust is deemed to have been received or accrued by each Unit holder at the time such income is received or accrued by the Trust and not when distributed by the Trust.

The Royalties constitute economic interests in oil and gas properties for Federal income tax purposes. Unit holders must report their share of the revenues from the Royalties as ordinary income from oil and gas royalties and are entitled to claim depletion with respect to such income.

The Trust has on file technical advice memoranda confirming the tax treatment described above.

The classification of the Trust's income for purposes of the passive loss rules may be important to a Unit holder. Royalty income generally is treated as portfolio income and does not offset passive losses.

Unit holders should consult their tax advisors for further information.

## **3. SUBSEQUENT EVENTS**

Subsequent to September 30, 2006, the Trust declared a distribution on October 21, 2006 of \$.110204 per unit payable on November 15, 2006, to Unit holders of record on October 31, 2006.

## **4. STATE TAX CONSIDERATIONS**

All revenues from the Trust are from sources within Texas, which has no individual income tax. However, the franchise tax currently imposed by the state of Texas on corporations (the definition of which generally includes limited liability companies) is partly based on federal taxable income, which will include income from the Trust.

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The Texas legislature recently passed H.B. 3, 79th Leg., 3d C.S. (2006), which was signed into law on May 18, 2006. H.B. 3 significantly reforms the Texas franchise tax system and replaces it with a new Texas margin tax system. The margin tax expands the type of entities subject to tax to generally include all active business entities, including corporations and limited liability companies currently subject to the franchise tax. The new margin tax also will apply to the following common entity types that are not currently subject to tax: general and limited partnerships (unless otherwise exempt), limited liability partnerships, trusts (unless otherwise exempt), business trusts, business associations, professional associations, joint stock companies, holding companies, and joint ventures. The effective date of the margin tax is January 1, 2008, but the tax generally will be imposed on gross revenues generated in 2007 and thereafter.

Trusts and partnerships that meet statutory requirements and receive at least 90% of their gross income from designated sources, including royalties from mineral properties, and do not receive more than 10% of their income from operating an active trade or business, are generally exempt from the margin tax as passive entities. Virtually all of the income of the Trust consists of income from net overriding royalty interests (or net profits interests) that are treated as royalty income for federal income tax purposes, but, there is no legislative history making it clear that the Trust will be treated as a passive entity for margin tax purposes. Clarification by additional legislative action or the issuance of applicable administrative rules promulgated by the Texas Comptroller, may be forthcoming prior to the effective date of that Act.

If the Trust is exempt from the margin tax at the trust level as a passive entity, each Unit holder that is a business entity subject to the margin tax would generally include its share of the Trust's revenues in its margin tax computation. If, however, the margin tax is imposed on the Trust at the trust level, each such Unit holder would generally exclude its share of the Trust's revenues from its margin tax calculation. Each Unit holder that is a business entity is urged to consult his own tax advisor regarding the requirements for filing state income, franchise and margin tax returns.

## **Item 2. Trustee's Discussion And Analysis**

### **Forward Looking Information**

Certain information included in this report contains, and other materials filed or to be filed by the Trust with the Securities and Exchange Commission (as well as information included in oral statements or other written statements made or to be made by the Trust) may contain or include, forward looking statements within the meaning of Section 21E of the Securities Exchange Act of 1934, as amended, and Section 27A of the Securities Act of 1933, as amended. Such forward looking statements may be or may concern, among other things, capital expenditures, drilling activity, development activities, production efforts and volumes, hydrocarbon prices and the results thereof, and regulatory matters. Although the Trustee believes that the expectations reflected in such forward-looking statements are reasonable, such expectations are subject to

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numerous risks and uncertainties and the Trustee can give no assurance that they will prove correct. There are many factors, none of which is within the Trustee's control, that may cause such expectations not to be realized, including, among other things, factors such as actual oil and gas prices and the recoverability of reserves, capital expenditures, general economic conditions, actions and policies of petroleum-producing nations and other changes in the domestic and international energy markets. Such forward looking statements generally are accompanied by words such as estimate, expect, predict, anticipate, goal, should, assume, believe, or other words that convey the uncertainty of events or outcomes.

**Three Months Ended September 30, 2006 Compared to Three Months Ended September 30, 2005**

For the quarter ended September 30, 2006 royalty income received by the Trust amounted to \$18,697,269 compared to royalty income of \$15,989,323 during the third quarter of 2005. The increase in royalty income is primarily attributable to significant increases in both oil and gas prices.

Interest income for the quarter ended September 30, 2006, was \$31,635 compared to \$13,777 during the third quarter of 2005. The increase in interest income is primarily attributable to higher interest rates and more funds available for investment. General and administrative expenses during the third quarter of 2006 amounted to \$152,561 compared to \$112,337 during the third quarter of 2005. The increase in general and administrative expenses can be primarily attributed to increased legal and audit expenses.

These transactions resulted in distributable income for the quarter ended September 30, 2006 of \$18,576,342 or \$.398559 per Unit of beneficial interest. Distributions of \$.129940, \$.126203 and \$.142414 per Unit were made to Unit holders of record as of July 31, 2006, August 31, 2006 and September 29, 2006, respectively. For the third quarter of 2005, distributable income was \$15,890,763, or \$.340939 per Unit of beneficial interest.

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Royalty income for the Trust for the third quarter of the calendar year is associated with actual oil and gas production for the period of May, June and July 2006 from the properties from which the Trust's net overriding royalty interests (Royalties) were carved. Oil and gas sales attributable to the Royalties and the properties from which the Royalties were carved are as follows:

	<b>Third Quarter</b>	
	<b>2006</b>	<b>2005</b>
<b>Royalties:</b>		
Oil sales (Bbls)	198,283	215,618
Gas sales (Mcf)	869,934	957,711
<b>Properties From Which The Royalties Were Carved:</b>		
<b>Oil:</b>		
Total oil sales (Bbls)	308,150	327,081
Average per day (Bbls)	3,349	3,555
Average price per Bbl	\$ 65.95	\$ 49.38
<b>Gas:</b>		
Total gas sales (Mcf)	1,539,034	1,612,808
Average per day (Mcf)	16,729	17,531
Average price per Mcf	\$ 7.42	\$ 6.34

The posted price of oil increased to an average price per barrel of \$65.95 per Bbl in the third quarter of 2006, compared to \$49.38 per Bbl in the third quarter of 2005. The Trustee has been advised by ConocoPhillips that for the period of August 1, 1993, through September 30, 2006, the oil from the Waddell Ranch properties was being sold under a competitive bid to a third party. The average price of gas increased from \$6.34 per Mcf in the third quarter of 2005 to \$7.42 per Mcf in the third quarter of 2006 due to change in overall market variables.

Since the oil and gas sales attributable to the Royalties are based on an allocation formula that is dependent on such factors as price and cost (including capital expenditures), the production amounts in the Royalties section of the above table do not provide a meaningful comparison. Oil and gas sales volumes from the Underlying Properties (as defined in the Trust's Annual Report on Form 10-K for the year ended December 31, 2005) decreased for the applicable period in 2006 compared to 2005.

Capital expenditures for drilling, remedial and maintenance activities on the Waddell Ranch properties during the third quarter of 2006 totaled \$3,332,426 as compared to \$1,789,545 for the third quarter of 2005. ConocoPhillips has informed the Trustee that the 2006 capital expenditures budget has been revised to \$36.5 million for the Waddell Ranch properties. The total amount of capital expenditures for 2005 was \$14.7 million.

The Trustee has been advised that there were 7 wells completed and 6 wells in progress, and 6 workover wells completed and 19 workover wells in progress, during the three months ended September 30, 2006 as compared to 2 wells completed, no wells in progress, and 13 workover wells in progress for the three months ended September 30, 2005 on the Waddell Ranch properties. There were 2 facility projects completed and 3 projects in progress for the third quarter of 2006.

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Lease operating expense and property taxes totaled \$3.4 million for the third quarter of 2006, compared to \$3.1 million in the third quarter of 2005 on the Waddell Ranch properties. This increase is primarily attributable to increased electrical costs and increased ad valorem taxes paid for the third quarter in 2006.

**Nine Months Ended September 30, 2006 and 2005**

For the nine months ended September 30, 2006, royalty income received by the Trust amounted to \$51,655,740 compared to royalty income of \$42,266,409 for the nine months ended September 30, 2005. The increase in royalty income is primarily due to an increase in oil and gas prices in the first nine months of 2006 compared to the first nine months in 2005. Interest income for the nine months ended September 30, 2006 was \$95,350 compared to \$36,821 for the nine months ended September 30, 2005. The increase in interest income is attributable primarily to an increase in interest rates and more funds available for investment. General and administrative expenses for the nine months ended September 30, 2006 were \$677,389. During the nine months ended September 30, 2005, general and administrative expenses were \$648,236. The increase in general and administrative expenses is primarily due to increased legal and audit expenses.

These transactions resulted in distributable income for the nine months ended September 30, 2006 of \$51,073,701, or \$1.095795 per Unit. For the nine months ended September 30, 2005, distributable income was \$41,654,994, or \$.893715 per Unit.

Royalty income for the Trust for the period ended September 30, 2006 is associated with actual oil and gas production for the period November 2005 through July 2006 from the properties from which the Royalties were carved. Oil and gas production attributable to the Royalties and the properties from which the Royalties were carved are as follows:

	<b>First Nine Months</b>	
	<b>2006</b>	<b>2005</b>
<b>Royalties:</b>		
Oil sales (Bbls)	574,593	605,204
Gas sales (Mcf)	2,420,037	2,617,686
<b>Properties From Which The Royalties Were Carved:</b>		
Oil:		
Total oil sales (Bbls)	912,712	948,727
Average per day (Bbls)	3,343	3,475
Average price per Bbl	\$ 59.43	\$ 45.47
Gas:		
Total gas sales (Mcf)	4,394,940	4,632,853
Average per day (Mcf)	16,099	16,970
Average price per Mcf	\$ 8.05	\$ 6.38

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The average price of oil increased during the nine months ended September 30, 2006 to \$59.43 per barrel compared to \$45.47 per barrel for the same period in 2005. The increase in the average price of oil is primarily due to increased demand in 2006, caused by a worldwide market demand. The increase in the average price of gas from \$6.38 per Mcf for the nine months ended September 30, 2005 to \$8.05 per Mcf for the nine months ended September 30, 2006 is primarily the result of an increase in the spot prices of natural gas.

Since the oil and gas sales volumes attributable to the Royalties are based on an allocation formula that is dependent on such factors as price and cost (including capital expenditures), the production amounts in the Royalties section of the above table do not provide a meaningful comparison. The oil and gas sales volumes from the properties from which the Royalties are carved have remained relatively constant for the applicable period of 2006 compared to 2005. Capital expenditures for the Waddell Ranch properties for the nine months ended September 30, 2006 totaled \$9.6 million compared to \$7 million for the same period in 2005. ConocoPhillips has previously advised the Trust that the 2006 capital expenditures budget for the Waddell Ranch properties is \$36.5 million.

The Trust has been advised that 15 wells were drilled and completed and 6 wells to be completed on the Waddell Ranch properties during the nine months ended September 30, 2006, as compared to 6 wells drilled and completed on the Waddell Ranch Properties during the nine months ended September 30, 2005. Approximately 29 workover wells were completed and approximately 19 workover wells were in progress as of September 30, 2006. Approximately 2 facilities projects were completed and 3 facilities projects were in progress.

Lease operating expense and property taxes totaled \$10.4 million in 2006 compared to \$8.7 million for the same period in 2005. The increase in lease operating expense is primarily attributable to higher electrical costs than in 2005 and increased property taxes.

**Calculation of Royalty Income**

The Trust's royalty income is computed as a percentage of the net profit from the operation of the properties in which the Trust owns net overriding royalty interests. These percentages of net profits are 75% and 95% in the case of the Waddell Ranch properties and the Texas Royalty properties, respectively. Royalty income received by the Trust for the three months ended September 30, 2006 and 2005, respectively, were computed as shown in the table below:



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	THREE MONTHS ENDED SEPTEMBER 30,			
	2006		2005	
	WADDELL RANCH PROPERTIES	TEXAS ROYALTY PROPERTIES	WADDELL RANCH PROPERTIES	TEXAS ROYALTY PROPERTIES
Gross proceeds of sales from the Underlying Properties				
Oil proceeds	\$ 14,384,090	\$ 5,937,295	\$ 11,783,550	\$ 4,369,141
Gas proceeds	10,074,892	1,340,989	9,047,274	1,180,180
Total	24,458,982	7,278,284	20,830,824	5,549,321
Less:				
Severance tax:				
Oil	626,555	202,914	483,590	168,686
Gas	677,834	90,410	571,626	76,621
Lease operating expense and property tax:				
Oil and gas	3,379,091	285,000	3,100,383	225,000
Capital expenditures	3,332,426		1,789,545	0
Total	8,015,906	578,324	5,945,144	470,307
Net profits	16,443,076	6,699,960	14,885,680	5,079,014
Net overriding royalty interests	75%	95%	75%	95%
Royalty income	\$ 12,332,307	\$ 6,364,962	\$ 11,164,260	\$ 4,825,063

**Critical Accounting Policies and Estimates**

The Trust's financial statements reflect the selection and application of accounting policies that require the Trust to make significant estimates and assumptions. The following are some of the more critical judgment areas in the application of accounting policies that currently affect the Trust's financial condition and results of operations.

**Basis of Accounting**

The financial statements of the Trust are prepared on a modified cash basis and are not intended to present financial positions and results of operations in conformity with accounting principles generally accepted in the United States of America (GAAP). Preparation of the Trust's financial statements on such basis includes the following:

Royalty income and interest income are recorded in the period in which amounts are received by the Trust rather than in the period of production and accrual, respectively.

General and administrative expenses recorded are based on liabilities paid and cash reserves established out of cash received.

Amortization of the royalty interests is calculated on a unit-of-production basis and charged directly to trust corpus when revenues are received.

Distributions to Unit holders are recorded when declared by the Trustee (see Note 1 to the Financial Statements).

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The financial statements of the Trust differ from financial statements prepared in accordance with accounting principles generally accepted in the United States of America because royalty income is not accrued in the period of production, general and administrative expenses recorded are based on liabilities paid and cash reserves established rather than on accrual basis, and amortization of the royalty interests is not charged against operating results. This comprehensive basis of accounting other than GAAP corresponds to the accounting permitted for royalty trusts by the U.S. Securities and Exchange Commission as specified by Staff Accounting Bulletin Topic 12:E, Financial Statements of Royalty Trusts.

## **New Accounting Pronouncements**

In February 2006, the FASB issued SFAS No. 155, *Accounting for Certain Hybrid Financial Instruments* an amendment of FASB Statements No. 133 *Accounting for Derivative Instruments* and No. 140 *Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities*. This statement resolves issues addressed in Statement 133 Implementation Issue No. D1, *Application of Statement 133 to Beneficial interests in Securitized Financial Assets*. This statement is effective for all financial instruments acquired or issued after the beginning of an entity's first fiscal year that begins after September 15, 2006. The Trust has no financial instruments and accordingly, this new Standard will not impact the financial statements of the Trust.

In March 2006, the FASB issued SFAS No. 156, *Accounting for Servicing of Financial Assets* an amendment of FASB Statements No. 140 *Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities*. This statement requires an entity to recognize a servicing asset or servicing liability each time it undertakes an obligation to service a financial asset by entering into a servicing contract in certain situations. This statement is effective as of the beginning of an entity's first fiscal year that begins after September 15, 2006. The Trustee does not believe the adoption of this statement will have a material effect on the Trust's financial statements.

In July 2006, the FASB issued FASB Interpretation No. 48 (FIN 48), *Accounting for Uncertainty in Income Taxes*, which clarifies the accounting for uncertainty in income taxes recognized in the financial statements in accordance with SFAS No. 109, *Accounting for Income Taxes*. FIN 48 is effective for fiscal years beginning after December 15, 2006. The Trustee does not believe that the adoption of this statement will have a material effect on the Trust's financial statements.

In September 2006, the FASB issued SFAS No. 158, *Employers' Accounting for Defined Benefit Pension and Other Postretirement Plans* an amendment of FASB Statements No. 87, 88, 106 and 132(R). This statement improves financial reporting by requiring an employer to recognize the over funded or underfunded status of a defined benefit postretirement plan (other than a multiemployer plan) as an asset or liability in its statement of financial position and to recognize changes in that funded status in the year in which the changes occur through comprehensive income of a business entity or changes in unrestricted net assets of a not-for-profit organization. This statement is effective as of the end of the fiscal year ending after December 15, 2006. The Trustee does not believe that the adoption of this statement will have a material effect on the Trust's financial statements.

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In September 2006, the FASB issued SFAS No. 157, *Fair Value Measurements*. This statement defines fair value, establishes a framework for measuring fair value in generally accepted accounting principles (GAAP), and expands disclosures about fair value measurements. This statement is effective for financial statements issued for fiscal years beginning after November 15, 2007. The Trustee does not believe that the adoption of this statement will have a material effect on the Trust's financial statements.

**Revenue Recognition**

Revenues from the royalty interests are recognized in the period in which amounts are received by the Trust. Royalty income received by the Trust in a given calendar year will generally reflect the proceeds, on an entitlement basis, from natural gas produced and sold for the twelve-month period ended October 31st in that calendar year. Royalty income received by the Trust in the third quarter of 2006 generally reflects the proceeds associated with actual oil and gas production for the period of May, June and July 2006.

**Reserve Disclosure**

As of January 1, 2006, independent petroleum engineers estimated the net proved reserves attributable to the royalty interests. In accordance with Statement of Financial Standards No. 69, *Disclosures About Oil and Gas Producing Activities*, estimates of future net revenues from proved reserves have been prepared using year-end contractual gas prices and related costs. Numerous uncertainties are inherent in estimating volumes and the value of proved reserves and in projecting future production rates and the timing of development of non-producing reserves. Such reserve estimates are subject to change as additional information becomes available. The reserves actually recovered and the timing of production may be substantially different from the reserves estimates.

**Contingencies**

Contingencies related to the Underlying Properties that are unfavorably resolved would generally be reflected by the Trust as reductions to future royalty income payments to the Trust with corresponding reductions to cash distributions to Unit holders. The Trustee is aware of no such items as of September 30, 2006.

**Use of Estimates**

The preparation of financial statements in conformity with the basis of accounting described above requires management to make estimates and assumptions that affect the reported amounts of certain assets, liabilities, revenues and expenses as of and for the reporting period. Actual results may differ from such estimates.

**Item 3. Qualitative and Quantitative Disclosures About Market Risk**

There have been no material changes in the Trust's market risk, as disclosed in the Trust's Annual Report on Form 10-K for the fiscal year ended December 31, 2005.

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**Item 4. Controls and Procedures**

As of the end of the period covered by this report, the Trustee carried out an evaluation of the effectiveness of the design and operation of the Trust's disclosure controls and procedures pursuant to Exchange Act Rules 13a-15 and 15d-15. Based upon that evaluation, the Trustee concluded that the Trust's disclosure control and procedures are effective in timely alerting the Trustee to material information relating to the Trust required to be included in the Trust's periodic filings with the Securities and Exchange Commission. In its evaluation of disclosure controls and procedures, the Trustee has relied, to the extent considered reasonable, on information provided by Burlington Resources Oil & Gas Company LP, the owner of the Waddell Ranch properties, and Riverhill Energy Corporation, the owner of the Texas Royalty properties. There has not been any change in the Trust's internal control over financial reporting during the period covered by this report that has materially affected, or is reasonably likely to materially affect, the Trust's internal control over financial reporting.

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**PART II OTHER INFORMATION**

**Items 1 through 5.**

Not applicable.

**Item 6. Exhibits and Reports on Form 8-K**

- 4.1 Permian Basin Royalty Trust Indenture dated November 3, 1980, between Southland Royalty Company (now Burlington Resources Oil & Gas Company LP) and The First National Bank of Fort Worth (now Bank of America, N.A.), as Trustee, heretofore filed as Exhibit (4)(a) to the Trust's Annual Report on Form 10-K to the Securities and Exchange Commission for the fiscal year ended December 31, 1980 is incorporated herein by reference.
- 4.2 Net Overriding Royalty Conveyance (Permian Basin Royalty Trust) from Southland Royalty Company (now Burlington Resources Oil & Gas Company LP) to The First National Bank of Fort Worth (now Bank of America, N.A.), as Trustee, dated November 3, 1980 (without Schedules), heretofore filed as Exhibit (4)(b) to the Trust's Annual Report on Form 10-K to the Securities and Exchange Commission for the fiscal year ended December 31, 1980 is incorporated herein by reference.
- 4.3 Net Overriding Royalty Conveyance (Permian Basin Royalty Trust - Waddell Ranch) from Southland Royalty Company (now Burlington Resources Oil & Gas Company LP) to The First National Bank of Fort Worth (now Bank of America, N.A.), as Trustee, dated November 3, 1980 (without Schedules), heretofore filed as Exhibit (4)(c) to the Trust's Annual Report on Form 10-K to the Securities and Exchange Commission for the fiscal year ended December 31, 1980 is incorporated herein by reference.
- 10.1 Registration Rights Agreement dated as of July 21, 2004 by and between Burlington Resources, Inc. and Bank of America, N.A., as trustee of Permian Basin Royalty Trust, heretofore filed as Exhibit 10.1 to the Trust's Quarterly Report on Form 10-Q to the Securities and Exchange Commission for the quarterly period ended June 30, 2004 is incorporated herein by reference.
- 10.2 Underwriting Agreement dated December 15, 2005 among the Permian Basin Royalty Trust, Burlington Resources, Inc., Burlington Resources Oil & Gas L.P. and Lehman Brothers Inc. and Wachovia Capital Markets, LLC as representatives of the several underwriters heretofore filed as Exhibit 10.1 to the Trust's current report filed on Form 8-K to the Securities and Exchange Commission filed on December 19, 2005 is incorporated herein by reference.

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- 10.3 Underwriting Agreement dated August 2, 2005 among the Permian Basin Royalty Trust, Burlington Resources, Inc., Burlington Resources Oil & Gas L.P. and Goldman Sachs & Co. and Lehman Brothers Inc. as representatives of the several underwriters, heretofore filed as Exhibit 10.1 to the Trust's current report filed on Form 8-K to the Securities and Exchange Commission filed on August 8, 2005, is incorporated herein by reference.
- 31.1 Certification by Ron E. Hooper, Senior Vice President and Trust Administrator of Bank of America, Trustee of Permian Basin Royalty Trust, dated November 7, 2006 and submitted pursuant to Rule 13a-14(a)/15d-14(a).
- 32.1 Certificate by Bank of America, Trustee of Permian Basin Royalty Trust, dated November 7, 2006 and submitted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

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**SIGNATURES**

Pursuant to the requirements of the Securities Exchange Act of 1934, the Registrant has duly caused this Report to be signed on its behalf by the undersigned thereunto duly authorized.

BANK OF AMERICA, N.A.,  
TRUSTEE FOR THE  
PERMIAN BASIN ROYALTY TRUST

By: /s/ RON E. HOOPER  
Ron E. Hooper,  
Senior Vice President and Trust  
Administrator Bank of America, N.A.

Date: November 7, 2006

(The Trust has no directors or executive officers.)



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**INDEX TO EXHIBITS**

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32.1	Certificate by Bank of America, Trustee of Permian Basin Royalty Trust, dated November 7, 2006 and submitted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

\* A copy of this  
Exhibit is

available to any  
Unit holder, at  
the actual cost  
of reproduction,  
upon written  
request to the  
Trustee, Bank of  
America, N.A.,  
901 Main Street,  
Dallas, Texas  
75202.