Energy and Mines

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Main points

In this chapter, we report the results of our audit of the Department and the Oil and Gas Environmental Fund for the year ended March 31, 2002. We found the Fund's financial statements are reliable and the Department had adequate rules and procedures to safeguard and control its assets and the assets of the Fund except for the processes to ensure the accuracy of royalties and taxes due to the Department.

The Department relies on its audits of producers' returns to ensure it assesses and collects all royalties and taxes. In this chapter, we make three recommendations to improve the Department's audit processes. The Department needs to plan its audits better, ensure its auditors are appropriately trained, and improve its practices to supervise its auditors' work.

We also report that the Department complied with authorities except for the payment to NewGrade Energy Inc. that continues to need proper authority.

Introduction

The Department of Energy and Mines (now part of the Department of Industry and Resources) is responsible for managing Saskatchewan's energy and mineral resources.

The Department faces many challenges in managing Saskatchewan's energy and mineral revenues. These challenges include:

- promoting exploration to optimize the discovery and development of energy and mineral resources in Saskatchewan;
- ensuring responsible energy and mineral development while optimizing government revenues to pay for programs and services;
- ensuring the completeness and accuracy of all royalties and taxes due to the Department; and
- ensuring that industry activities are conducted in a safe and environmentally responsible manner.

In 2001-02, the Department incurred expenses totalling $30 million and earned revenue of $911 million. Information about the Department's revenue and expenses appears in its annual report and in *Public Accounts 2001-02: Volume 2: Details of Revenue and Expenditure* (to view a copy of this report see http://www.gov.sk.ca/finance/paccts).

Each year the Department collects about $900 million of royalties and taxes from a variety of sources. The Department's royalty and tax revenues are one of the largest sources of revenue for the Government.

One of the challenges that the Department faces is to ensure the completeness and accuracy of all royalties and taxes due to the Department. Producers of resources self assess the amount of royalties and taxes that they owe and submit the completed returns to the Department along with payments of the amounts assessed. The Department verifies the information on the returns to ensure it is accurately assessing all royalties and taxes owed to it.

The Department is also responsible for the Oil and Gas Environment Fund (Fund). The purpose of the Fund is to provide a mechanism to clean up abandoned wells and respond to environmental problems associated with the exploration, development, production, and transportation of oil and gas. In 2001-2002, the Fund earned revenue of $87,950 and did not incur any expenses. The Fund held assets of $2.6 million as at March 31, 2002. The Fund's financial statements are included in its annual report.

Effective April 1, 2002, the Department of Energy and Mines became part of the Department of Industry and Resources.

Our audit conclusions and findings

In our opinion, for the year ended March 31, 2002:

- **the financial statements of the Oil and Gas Environmental Fund are reliable;**

- **the Department had adequate rules and procedures to safeguard and control its assets and the assets of the Fund except for its rules and procedures for ensuring the accuracy and completeness of royalties and taxes due to the Department; and**

- **the Department complied with the authorities governing its activities and the activities of the Fund regarding financial reporting, safeguarding assets, revenue raising, spending, borrowing, and investing, except the Department may not have accurately assessed and collected all the royalty and tax revenues required by the law and its payments to Newgrade Energy Inc. continue to need authority.**

Producers' royalty and tax returns not adequately verified

The Department's procedures for verifying producers' royalty and tax returns are not adequate. As a result, the Department may not have accurately assessed and collected all the royalties and taxes due to the Department.

To ensure that the royalties and taxes assessed are complete and accurate, the Department does two types of audits on the returns: desk audits and field audits. Desk audits are the procedures that the

Department does to check returns for reasonability and obvious errors. Desk audits are done at the Department. Field audits are the procedures that the Department does to check the producers' completed returns against the producers' source documents. Field audits are done at the producers' premises. To ensure that these audits provide the Department reasonable assurance that the royalties and taxes assessed by producers are complete and accurate, the Department must have adequate rules and procedures to plan the audits, do the audits on the returns, and to follow up on its audit findings.

We used the following criteria to evaluate the Department's procedures for verifying producers' royalties and taxes owed to the Department. The Department should have:

- an approved overall audit plan that ensures adequate audit coverage for all royalties and taxes due to the Department;
- audit staff with adequate knowledge, skills, and abilities to plan and do the audits; and
- proper supervision practices to ensure audits are approved and carried out as planned.

The Department's management agreed that these criteria are reasonable and attainable.

Detailed findings

The Department should have an approved overall audit plan that ensures adequate audit coverage for all royalties and taxes due to the Department

We expected the Department to have processes to ensure that it: 1. aligns the overall audit plan with the strategic plan; 2. approves a detailed yearly audit plan; and 3. has adequate resources to carry out the audit plan.

In addition to aligning the overall audit plan to the strategic plan, an overall audit plan would document the Department's risk assessment for each tax and royalty and its audit strategies to manage those risks. Such a risk assessment would also document the Department's plans to reduce the risks to an acceptable level for those royalties and taxes that are not subjected to audits.

The Department does not prepare or communicate to all appropriate staff an overall (master) audit plan. Instead, the Department issues several planning memoranda to communicate its priorities to staff.

The absence of a master audit plan increases the risk that the Department may not accurately assess and collect all taxes and royalties from producers. For example, the Department told us it does not audit producers' returns for all oil and gas royalties. Management told us the Department does not do field audits of these returns because it has other ways to ensure the assessment and collection of oil and gas royalties. One of those ways is to agree the production and sales information received from the oil producers to the information received from the oil purchasers and the transporters. However, the Department did not agree the information received from the producers to the information received from the purchasers in a timely manner. Also, for the year ended March 31, 2002, the Department has not yet agreed the information received from oil producers to the information received from oil transporters. As at March 31, 2003, the Department has not completed this task.

Because the Department does not prepare a master audit plan to ensure adequate audit coverage for all royalties and taxes, the Department does not know that it has accurately assessed all the taxes and royalties due to the Department. In addition, because the Department does not prepare a master audit plan, it is unable to determine the resources it needs to provide the needed audit coverage.

Because the Department does not know that it has accurately assessed all the taxes and royalties owed to the Department, we are unable to determine if the Department has assessed and collected all taxes and royalties as required by the law.

1. **We recommend that the Department prepare an overall audit plan that ensures the accurate assessment and collection of all royalties and taxes due to the Department.**

Management told us that the Department is preparing a comprehensive audit plan addressing the Department's risks and strategies to address those risks.

The Department should have audit staff with adequate knowledge, skills, and abilities to plan and do the audits

We expected the Department to have processes to ensure that for its audit staff the Department:

1. has a minimum standard for education and experience for hiring and promoting; and
2. has an adequate training/learning plan.

The Department has adequate processes to ensure that audit staff have appropriate education and experience for hiring. However, the Department does not have a documented training/learning plan for its auditors.

The Department assesses and collects royalties and taxes from a complex industry that uses fast changing technologies to explore, produce, transport, and account for resources. Accordingly, the Department's audit staff require training to maintain and enhance the competencies needed to do their job well.

2. We recommend that the Department develop and implement a formal training/learning plan for its auditors.

Management told us that its auditors are long-term employees and that, due to the specialty nature of the royalty and tax programs, they learn on the job. Management also told us that the Department is currently preparing training plans for its staff.

The Department should have proper supervision practices to ensure audits are approved and carried out as planned

We expected the Department to have processes to ensure that it:

1. told auditors what to audit and how to do it (e.g. policies and procedures manual); and
2. monitored the work of the auditors to ensure it was done according to the Department's instructions.

The Department did not have adequate processes to tell staff what to audit and how to audit it. When auditors do not have adequate direction, there is a risk that they may not audit the most important revenue streams or may not carry out audits properly.

We found that auditors did not always document specific audit objectives, leave evidence for what they did, and why, complete the audits as planned or document reasons for changes to the audit plans.

In addition, we did not always find evidence of management's review and approval of the audit plan and the audit findings. Such a review and approval would ensure that audit results are well supported and would be useful in case of challenges by producers.

3. We recommend that the Department improve its supervisory practices to ensure that audits are approved and carried out as planned.

Payments to NewGrade Energy Inc. continue to need authority

NewGrade Energy Inc. (NewGrade) is owned by Crown Investment Corporation of Saskatchewan (CIC) and Consumers' Co-operative Refineries Ltd. (CCRL). Both CIC and CCRL have a 50% interest in NewGrade.

Producers of gas on Crown land remit royalties to the Department under *The Crown Oil and Gas Royalty Regulations*. NewGrade buys some of this gas from producers to use in its heavy oil upgrader in Regina.

In 2001-02, the Department paid $8.5 million to NewGrade. The Department called this payment "NewGrade Royalty Rebate." The Department used Order in Council 7/89, issued under Section 24 of *The Financial Administration Act, 1993,* as its authority for the payment. Section 24 of the Act allows the Lieutenant Governor in Council to remit royalties, but not the powers to make grants.

We have reported for many years that the payment to NewGrade is a grant and not a remission of royalties. We take this view because the producers are still required to pay the royalties.

We continue to recommend that the Department record this payment as grant and not reduction of royalty revenue. (See our 2001 Fall Report – Volume 2 for details.)

On September 28, 2001 and October 22, 2002, the Standing Committee on Public Accounts considered this matter and did not concur with our recommendation.

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