



# **Aboriginal Affairs and Northern Development Canada**

## **Internal Audit Report**

### **Audit of AANDC Management of Northern Oil and Gas**

**Prepared by:**

**Audit and Assurance Services Branch**

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## ACRONYMS

AANDC	Aboriginal Affairs and Northern Development Canada
ADM	Assistant Deputy Minister
CAPP	Canadian Association of Petroleum Producers
COGOA	Canada Oil and Gas Operations Act
CPRA	Canada Petroleum Resources Act
DRAP	Deficit Reduction Action Plan
EL	Exploration Licence
FLRR	Frontier Lands Registration Regulations
FLPRR	Frontier Lands Petroleum Royalty Regulations
GNWT	Government of the Northwest Territories
LAS	Land Administration System
NAO	Northern Affairs Organization
NEB	National Energy Board
PL	Production Licence
RMS	Royalty Management System
SDL	Significant Discovery Licence

# EXECUTIVE SUMMARY

## ***Background***

An *Audit of AANDC Management of Northern Oil and Gas* was included in the 2014-2015 to 2016-2017 Risk-Based Audit Plan approved by Aboriginal Affairs and Northern Development Canada's (AANDC) Deputy Minister on February 6, 2014. The audit was identified as a priority area as the management of northern oil and gas is complex and important to the economic development of the Canada's North.

The responsible management of Canada's northern petroleum resources supports the Government of Canada's Northern Strategy to ensure the North achieves its true promise as a healthy, prosperous region within a strong and sovereign Canada. An estimated one quarter of the country's discovered conventional oil and one third of the country's natural gas are in the North. Developing these natural resources in a responsible and environmentally sound manner is a priority for Canada.

The administration of oil and gas rights in Nunavut and the Arctic Offshore are under federal authority, and are the responsibility of the Minister of AANDC. These responsibilities are managed by the Petroleum and Mineral Resources Management Directorate within AANDC's Northern Affairs Organization (NAO).

On April 1, 2014, the Government of the Northwest Territories (GNWT) assumed responsibility for land and resources management in the territory with the Northwest Territories Lands and Resources Devolution Agreement coming into effect. This includes responsibilities for management of onshore oil and gas reserves. The territorial government has become responsible for the management of onshore lands, the issuance of rights and interests with respect to onshore minerals, oil and gas, and the collection of royalties. Responsibilities for management of onshore oil and gas reserves in the Yukon were devolved to the territory in 2003. Arctic offshore and Nunavut onshore oil and gas reserves remain the responsibility of the Minister of AANDC.

Petroleum resource management on Crown lands is exercised under federal legislation. The *Canada Petroleum Resources Act* (CPRA) and its regulations govern the granting and administration of Crown exploration and production rights and set the royalty regime. The *Canada Oil and Gas Operations Act* (COGOA) governs the regulation of petroleum operations and associated benefits requirements. Land, royalty and benefits matters are managed by the Department on behalf of the Minister of AANDC, while the National Energy Board's (NEB) responsibilities include the regulation of oil and gas exploration, development and production, enhancing worker safety, and protecting the environment on frontier lands.

Issuance of exploration licences by the Minister of AANDC initiates the cycle of exploration. Typically, exploration activities include seismic analysis required to identify favourable well locations, followed by drilling which can lead to discoveries and eventual development.

On Crown lands north of latitude 60° in the Northwest Territories, Nunavut and the offshore Arctic waters during the 2013 calendar year, total oil production was approximately 4.1 million barrels and total natural gas production was approximately 4.7 billion cubic feet. Royalties received from oil and gas production on northern frontier lands in the 2013 calendar year was \$10.05 M. In the 2013-2014 fiscal year, it was \$8.8M. This amount was reduced to \$8.3M after issuance of two refunds arising from reassessment of royalties.

During the same period, three fields produced oil and/or gas in the Northwest Territories: the Norman Wells field in the Central Mackenzie Valley, the Ikhil gas field on the Mackenzie Delta, and the Cameron Hills field southwest of Hay River in the southern Northwest Territories. There are no producing fields in Nunavut or in offshore Arctic waters. Post-devolution, the GNWT will be responsible for royalty collection for onshore production sites in the Northwest Territories (other than Norman Wells and Ikhil).

Since devolution to the GNWT, the Petroleum and Mineral Resources Management Directorate of AANDC's NAO sector remains responsible for: the issuance and management of Exploration Licences, Significant Discovery Licences, and Production Licences in Nunavut and the northern offshore, pursuant to the CPRA; the collection of royalties for the Norman Wells and Ikhil production sites; and, the maintenance of a public registry of the oil and gas rights.

### ***Audit Objective and Scope***

The objective of the audit was to determine whether AANDC is fulfilling its obligations with respect to the regulation and administration of northern oil and gas resources in an efficient, effective and controlled manner.

The audit scope included an assessment of the adequacy and effectiveness of the internal controls in place to support the effective and efficient execution of AANDC's responsibilities in managing oil and gas resources north of latitude 60°.

The scope of the audit included AANDC program activities during the period from April 1, 2013 through to May 30, 2014. For file testing, the scope was extended to include the time period from April 1, 2009 to March 31, 2014 in order to increase the number of sample files tested.

In developing observations, the audit took into consideration that many program activities and responsibilities were devolved to the GNWT on April 1, 2014.

In support of the Department's compliance with the Treasury Board Policy on Internal Control, the Chief Financial Officer Sector recently conducted operational effectiveness testing of the key financial controls for the Revenue Management and Guarantee Deposits process associated with northern oil and gas. Based on this work, these functions were scoped out of the audit.

### ***Statement of Conformance***

This audit conforms to the Internal Auditing Standards for the Government of Canada, as supported by the results of the quality assurance and improvement program.

## **Observed Strengths**

Throughout the audit fieldwork, the audit team observed examples of how controls are properly designed and are being applied effectively by AANDC. This has resulted in positive findings, which are listed below:

- Stakeholders interviewed from the National Energy Board (NEB) and Canadian Association of Petroleum Producers (CAPP) noted that AANDC northern oil and gas personnel have significant experience and are very knowledgeable in rights and royalties management.
- There was an appropriate consideration for risks to AANDC throughout the transition of files and transfer of issuance of rights to the GNWT (e.g. through protocols, working groups, committees).

## **Conclusion**

Generally, the audit found that management controls are in place, and are functioning effectively and efficiently, to ensure that AANDC is fulfilling its obligations with respect to the regulation and administration of northern oil and gas resources. Some areas for improvement were noted to strengthen management practices in the following areas: practices and internal control procedures used to ensure compliance to Acts and Regulations; system access and functionality; documentation of roles and responsibilities; and, periodic review of program design.

## **Recommendations**

The audit team identified areas where management control practices and processes could be improved, resulting in the following four recommendations:

1. The Assistant Deputy Minister of the Northern Affairs Organization should ensure control practices are clearly understood and consistently followed to ensure compliance to the *Canada Petroleum Resources Act (CPRA)*, *Canada Oil and Gas Operations Act (COGOA)*, and *Frontier Lands Registration Regulations (FLRR)*.
2. The Assistant Deputy Minister of the Northern Affairs Organization, in collaboration with the Chief Information Officer, should:
  - perform a review of user access to the Land Administration System (LAS) and the Royalty Management System (RMS) and formalize a process for ongoing review and removal of access to the systems;
  - assess the feasibility of improving RMS functionality to reduce the need for external spreadsheets; and,
  - review data entry validation controls in RMS in order to reduce the risk of data integrity errors.

3. The Assistant Deputy Minister of the Northern Affairs Organization, in collaboration with the Director General, Human Resources and Workplace Services Branch should, as part of the process to finalize and formalize the post-devolution organizational structure and roles and responsibilities related to northern oil and gas management, ensure that the revised structure and alignment of responsibilities are clearly articulated and communicated to industry and other stakeholders.
4. The Assistant Deputy Minister of the Northern Affairs Organization should, upon completion of devolution, develop a practice to perform a periodic review of program design and identify options for recommendation which could help improve the design of the program.

### ***Management Response***

Management is in agreement with the findings, has accepted the recommendations included in the report, and has developed a management action plan to address them. The management action plan has been integrated into this report.

# 1. INTRODUCTION AND CONTEXT

An *Audit of AANDC Management of Northern Oil and Gas* was included in the 2014-2015 to 2016-2017 Risk-Based Audit Plan approved by Aboriginal Affairs and Northern Development Canada's (AANDC) Deputy Minister on February 6, 2014. The audit was identified as a priority area as the management of northern oil and gas is complex and important to the economic development of the Canada's North.

The responsible management of Canada's northern petroleum resources supports the Government of Canada's Northern Strategy to ensure the North achieves its true promise as a healthy, prosperous region within a strong and sovereign Canada. An estimated one quarter of the country's discovered conventional oil and one third of the country's natural gas are in the North. Developing these natural resources in a responsible and environmentally sound manner is a priority for Canada. Industry and government collaborate with northern partners to advance knowledge to support responsible resource development in the North.

The administration of oil and gas rights in Nunavut and the Arctic Offshore are under federal authority, and are the responsibility of the Minister of AANDC. These responsibilities are managed by the Petroleum and Mineral Resources Management Directorate within AANDC's Northern Affairs Organization (NAO). Oil and gas rights in the Northwest Territories are administered by the territorial government, under the responsibility of the Minister of Industry, Tourism and Investment. The administration of onshore oil and gas resources in the Yukon were devolved to the territory in 2003.

Petroleum resource management on Crown lands is exercised under federal legislation. The *Canada Petroleum Resources Act* and its regulations govern the granting and administration of Crown exploration and production rights and set the royalty regime. The *Canada Oil and Gas Operations Act* governs the regulation of petroleum operations and associated benefits requirements. Land, royalty and benefits matters are managed by the Department on behalf of the Minister of AANDC, while the National Energy Board's (NEB) responsibilities include the regulation of oil and gas exploration, development and production, enhancing worker safety, and protecting the environment on frontier lands.

## **Canada Petroleum Resources Act**

The *Canada Petroleum Resources Act* (CPRA) governs the lease of federally-owned oil and gas rights on frontier lands to oil and gas companies that wish to find and produce oil and gas. It is the statute under which the federal government must first give permission for oil and gas exploration to occur on frontier lands, which is done through a public Call for Bids. CPRA provides opportunity for the federal government to protect the environment by attaching exploration restrictions when leasing rights, or by stopping work if there is an environmental issue.

The CPRA also states that a public register of all interests and instruments registered is established and maintained in accordance with the regulations of the CPRA by a Registrar. The Registrar is an AANDC employee designated by the Minister of AANDC, who is responsible for



maintaining the Register and the System of Registration established under the CPRA. Furthermore, the Registrar is responsible for registering approved instruments in accordance with the CPRA and the regulations.

The CPRA describes the role of the Registrar, the process for Calls for Nominations and Calls for Bids, which is administered by AANDC, and the need for operators to provide Benefits Plans to the Department for monitoring. In addition, the role and responsibilities of the Registrar are further described in the *Frontier Lands Registration Regulations* (FLRR).

### **Canada Oil and Gas Operations Act**

The *Canada Oil and Gas Operations Act* (COGOA) governs the exploration, production, processing, and transportation of oil and gas in marine areas controlled by the federal government, but does not include areas controlled by provincial governments. The purpose of the COGOA is to promote safety, protection of the environment, the conservation of oil and gas resources, and joint production agreements. Regulation of the industrial activities with respect to resource conservation, environmental protection and safety of workers is administered by the NEB.

Both CPRA and COGOA establish the requirement for a Benefits Plan and its approval by the Minister of AANDC. A Benefits Plan represents a documented commitment by an operator that is engaged in the exploration and drilling for and the production and transport of oil and gas in northern frontier lands to provide employment to Canadians and full and fair opportunity to Canadian businesses.

Issuance of exploration licences by the Minister of AANDC initiates the cycle of exploration. Typically, exploration activities include seismic analysis required to identify favourable well locations, followed by drilling which can lead to discoveries and eventual development.

A Ministerial delegation of authority is in place designating the Assistant Deputy Minister of the Northern Affairs Organization as the person who may exercise certain powers under the Acts.

### **Call Cycle Process**

Opening lands to issuance is the first step in encouraging economic development from exploration activity. Currently, only certain regions of the Northwest Territories and Nunavut with high petroleum potential are regularly opened for industry to nominate and acquire exploration rights. To sustain investment, an annual opportunity for industry to bid and win new exploration licences is a critical requirement. Each new cycle of calls for nominations and bids ensures that new companies can acquire lands on a fair, competitive basis to test new methods and explore new exploration targets.

Once an exploration licence is awarded, the successful company can pursue exploration activities subject to meeting the regulatory requirements governing operations, including comprehensive safety planning and financial assurance. Operational authorizations are issued by the NEB, subject to environmental screening and assessment as may be required for the specific project.

The *Canada Petroleum Resources Act* (CPRA) provides three forms of tenure instruments: Exploration Licence (EL), Significant Discovery Licence (SDL), and Production Licence (PL); all of which can be obtained through a call cycle process. The key stages in the life cycle of an oil and gas agreement on Federal lands north of latitude 60° and AANDC's responsibilities are summarized below.

1. Community Engagement - In accordance with the provisions of land claims settlement agreements, the Department seeks the views and support of Aboriginal communities and organizations prior to initiating a call cycle. Relevant land claims settlements agreements define how such engagement should proceed.
2. Call for Nominations - The Call for Nominations provides industry with an opportunity to identify parcels of land within a defined area where the subsurface may be of exploratory interest. Companies that are interested in acquiring exploration rights submit their land nominations on which they are prepared to bid. The Call for Nominations usually remains open for approximately 6 weeks.
3. Call for Bids - A Call for Bids is required by legislation before frontier lands may be disposed for oil and gas interests. The Call for Bids invites companies to bid on specific parcels. All bids are assessed against a single bidding criterion as required by legislation. Currently, for Exploration Licences (EL), this criterion is the dollar value of the work commitment (representing the amount of money the company will spend exploring the lands within Period 1 of the Exploration Licence which is up to nine years) – and the highest bid wins.
4. Issuance of Licence - This phase of the cycle has two steps: the announcement of the winning bid(s) and the issuance of the licence(s).
  - a. Announcement of the Winning Bid(s) - Results are communicated to the Minister of AANDC, seeking decision to accept the bid(s), to announce the result(s) and to award the licence(s).
  - b. Issuance of the Licence(s) – In order to confer and manage the rights to explore, develop and produce petroleum products over frontier lands, the CPRA provides three forms of tenure instruments:
    - i. Exploration Licence (EL): Exploration licenses have a term up to 9 years, and by policy are currently split into two periods with drilling required in the first period.
    - ii. Significant Discovery Licence (SDL): Significant discovery licences have an indefinite tenure over lands held by the applicant and declared a discovery by the National Energy Board; and,
    - iii. Production Licence (PL): Production licences have a term of 25 years plus extensions. A PL provides exclusive right to produce petroleum from the applicable frontier lands.

## **Oil and Gas Resources**

On Crown lands north of latitude 60° in the Northwest Territories, Nunavut and the offshore Arctic waters during the 2013 calendar year, total oil production was approximately 4.1 million barrels and total natural gas production was approximately 4.7 billion cubic feet. Royalties received in the 2013-2014 calendar year from oil and gas production on northern frontier lands amounted to approximately \$8.8M.

During the same period, three fields produced oil and/or gas in the Northwest Territories: the Norman Wells field in the Central Mackenzie Valley, the Ikhil gas field on the Mackenzie Delta, and the Cameron Hills field southwest of Hay River in the southern Northwest Territories. There are no producing fields in Nunavut or in offshore Arctic waters.

### **Supporting Systems**

AANDC's responsibilities in managing oil and gas resources on reserves north of latitude 60° are supported primarily by two systems: the Land Administration System (LAS); and, the Royalty Management System (RMS).

- LAS is a Microsoft Access database application used to assist with the management of rights on lands under the CPRA and the COGOA. Information kept in the system includes Frontier lands data, including nominations, licence information, NEB declarations, wells, as well as the guarantee deposit information such as the company name, deposit type (i.e. cheque, letter of credit), financial institution and reference number.
- RMS is an online electronic application and integrated computer system developed by an external contractor for the program to computerize the submission of monthly royalty returns with required production and sales data by interest holders who own share interests in a Production Licence of the project.

### **Devolution**

On April 1, 2014, the Government of the Northwest Territories (GNWT) assumed responsibility for land and resources management in the territory with the Northwest Territories Lands and Resources Devolution Agreement coming into effect. This includes responsibilities for management of onshore oil and gas reserves. Offshore oil and gas reserves remain under federal authority. The territorial government has become responsible for the management of onshore lands, the issuance of rights and interests with respect to onshore minerals and oil and gas. In addition the GNWT will be responsible for the collection of royalties from onshore production sites in the Northwest Territories (other than the Norman Wells and Ikhil sites).

The Petroleum and Mineral Resources Management Directorate of AANDC's NAO sector remains responsible for: the issuance and management of Exploration Licences, Significant Discovery Licences, and Production Licences in Nunavut and the northern offshore, pursuant to the CPRA. As a result of the devolution of onshore responsibilities to the GNWT, AANDC's scope of responsibility and volume of activity has decreased. AANDC remains responsible for the collection of royalties for the Norman Wells and Ikhil production sites and maintaining a public registry of the oil and gas rights.

As previously noted, the management and regulation of Yukon onshore oil and gas was a federal responsibility until its devolution to the territory in 2003.

## 2. AUDIT OBJECTIVES AND SCOPE

### 2.1 Audit Objective

The objective of the audit was to determine whether AANDC is fulfilling its obligations with respect to the regulation and administration of northern oil and gas resources in an efficient, effective and controlled manner.

### 2.2 Audit Scope

The audit scope included an assessment of the adequacy and effectiveness of the internal controls in place to support the effective and efficient execution of AANDC's responsibilities in managing oil and gas resources north of latitude 60°.

The scope of the audit included AANDC program activities during the period from April 1, 2013 through to May 30, 2014. For sample testing purposes, the scope of the audit was extended from April 1, 2009 to March 31, 2014 in order to increase the number of samples (i.e. calls, licenses, Benefits Plans) available for testing.

In developing observations, the audit took into consideration that many northern oil and gas program activities and responsibilities were devolved to the GNWT on April 1, 2014.

The Chief Financial Officer Sector recently conducted operational effectiveness testing of the key financial controls for the Revenue Management and Guarantee Deposits process associated with northern oil and gas. Based on the audit team's review of the testing methodology, approach, and results it was determined that these areas would not be included in the audit scope so that this work is not duplicated.

## 3. APPROACH AND METHODOLOGY

The audit was conducted in accordance with the requirements of the Treasury Board *Policy on Internal Audit* and followed the Treasury Board *Internal Auditing Standards for the Government of Canada*. The audit examined sufficient, relevant evidence to provide a reasonable level of assurance in support of the audit conclusion.

The principal audit techniques used included:

- Interviews with management from the AANDC Petroleum and Mineral Resources Management Directorate;
- Interviews with external stakeholders, including the National Energy Board and the Canadian Association of Petroleum Producers;
- Review of relevant documentation such as:
  - CPRA – *Canada Petroleum Resources Act*;
  - COGOA – *Canada Oil and Gas Operations Act*;
  - FLPRR – *Frontier Lands Petroleum Royalty Regulations*;
  - FLRR – *Frontier Lands Registration Regulations*;

- Program procedures and presentations which described control practices and processes;
- Sample testing of eight Exploration Licensees, one Significant Discovery License, one approved Benefits Plan, and one waived Benefits Plan to examine and review program records management and control practices used to ensure compliance to the Acts and Regulations.

The audit criteria developed for this audit are included in Appendix A.

## **4. CONCLUSION**

Generally, the audit found that management controls are in place, and are functioning effectively and efficiently, to ensure that AANDC is fulfilling its obligations with respect to the regulation and administration of northern oil and gas resources. Some areas for improvement were noted to strengthen management practices in the following areas: practices and internal control procedures used to ensure compliance to Acts and Regulations; system access and functionality; documentation of roles and responsibilities; and, periodic review of program design.

## **5. FINDINGS AND RECOMMENDATIONS**

Based on a combination of the evidence gathered through interviews, the examination of documentation and systems and analysis, each audit criterion was assessed by the audit team and a conclusion for each audit criterion was determined. Where a significant difference between the audit criterion and the observed practice was found, the risk of the gap was evaluated and used to develop a conclusion and to document recommendations for improvement.

The observations that follow include both management practices considered to be strong, those considered adequate, as well as those requiring improvement. Recommendations for corrective actions accompany areas identified for improvement.

### **5.1 Stewardship**

#### **5.1.1 License Issuance and Administration**

The Minister of AANDC provides industry with an annual opportunity to obtain exploration rights. The exploration rights are issued pursuant to the CPRA which provides for an open, competitive bidding process. A Call for Nominations normally precedes each Call for Bids cycle, allowing industry to specify lands of interest. Calls for Bids are open for the statutory minimum of 120 days, and are published in Part I of the Canada Gazette. The rights issuance process is based on a single, quantifiable bidding criterion with rights going to the highest bid. Following a Call for Bids cycle for exploration licences, successful bidders are required to post 25% of the work proposal bids as security against the performance of work in a timely manner. This deposit is referred to as the work deposit. The deposit is refundable as expenditures are incurred.

The CPRA and COGOA also require that a Benefits Plan be approved by the Minister of AANDC before authorization of any oil and gas work or activity. A Benefits Plan represents a documented commitment by a company to provide employment to Canadians and full and fair opportunity to Canadian businesses.

It is essential that established processes and controls are used to by the program to ensure that compliance, fairness and confidentiality are respected in the rights issuance process.

To examine and review program records management and control practices, the audit selected a sample of Exploration Licences, Significant Discovery Licenses, and Benefits Plans and found that control practices are used to ensure compliance with the Acts, fairness, and confidentiality in the call cycle. Some of the key controls observed include the following:

- A Briefing Note that details the results of calls and decisions is sent to the Assistant Deputy Minister (ADM) of NAO to evidence their approval;
- An Information Note is sent to the Minister at key points in the call cycle process;
- Winning bids are selected on the basis of the criterion specified in the call and those involved in the review of sealed bids all sign a declaration form to evidence their confidentiality and agreement with the outcome of the bid analysis;
- An Internet Content Request and Authorization form is used to evidence quality assurance review of call information that is posted publicly on the internet;
- The call for bids and summary of terms and conditions are published online and in the Canada Gazette for at least 120 days before the closing date for the submission as specified in the call; and,
- Date stamping is used on correspondence to evidence adherence to deadlines outlined in Acts, regulations, and policies (e.g. bidding company is required to submit work deposit within 15 days of notice of a successful bid).

It was also noted through testing of sample files that there are a few areas where consistency in the implementation of program control practices could be improved.

- The successful bidder is expected to post a 25% work deposit and the issuance fee of \$250 per grid prior to being awarded the Exploration Licence. When the work deposit is received, the Registrar is expected to receive and stamp the work deposit letter. In the sample licenses examined by the audit team, the audit found that the work deposit was not always stamped correctly, and in one instance, the work deposit received was short \$15 but was still stamped (although \$15 remaining balance was received shortly after). The audit also noted that the email which is used by the program to confirm receipt of a work deposit did not always clearly confirm the deposit amount and in one sample tested, the email confirmed an incorrect amount. Without effective or consistent use of controls which clearly demonstrate that work deposits are received in a timely manner and for correct amounts, there is increased risk of being non-compliant to the Acts and Regulations.
- Program management is responsible for providing recommendations to the Minister or ADM, NAO (where delegated) on the outcome of Calls, recommendations on the

approval of Calls and Licenses, and recommendations related to Benefits Plans. The Minister or ADM, NAO is expected to review such Briefing Notes and demonstrate approval and concurrence by signing the Briefing Note. The audit found, however, that not all samples tested included clear evidence that the Minister or ADM, NAO had approved the Briefing Notes for signed Licenses or for approvals or waiving of Benefits Plans. Although the audit found appropriately signed licenses and signed letters which were sent to companies indicating approval or waiving of Benefits Plans, demonstrating internal approvals is an important control practice. Program management noted that some approvals may have been obtained verbally or demonstrated using other control practices in place at the time (e.g. departmental routing slips). Without consistent or clear demonstration of Minister or ADM, NAO approval, there is increased risk of non-compliance to the Acts.

- Lastly, the audit noted that some internal program control procedures were not always consistently followed. Specifically, the Internet Content Request and Authorization Form was not always used to demonstrate that program management had reviewed the Call information which is posted externally. Program management noted that, historically, Call information published externally may have been approved through other control practices. Without clear and consistent demonstration that management has reviewed and approved Call content published externally, there is increased risk of errors inadvertently being published in Call information.

Given that the scope of the audit period included activities as far back as 2009-2010, the audit recognizes that some of the testing exceptions were from 2009-2010 when control practices may have differed. The audit found that internal controls related to compliance, fairness and confidentiality regarding the rights issuance process improved in the more recent sample files examined. While the audit noted the recent process improvements, there is still an opportunity for management to make additional progress in ensuring control practices are consistently executed.

***Recommendation:***

1. The Assistant Deputy Minister of the Northern Affairs Organization should ensure control practices are clearly understood and consistently followed to ensure compliance to the *Canada Petroleum Resources Act (CPRA)*, *Canada Oil and Gas Operations Act (COGOA)* and *Frontier Lands Registration Regulations (FLRR)*.

### **5.1.2 System Access and Functionality**

The Land Administration System (LAS) supports the granting and managing of licenses. LAS is a Microsoft Access database application used to assist with the management of rights on lands under the CPRA and the COGOA. LAS is effectively used by the program to capture titles/licenses (EL's, SDL's, PL's) information, discovery areas, and company contact information. LAS is also used by the program to track dates (such as expiration), land summary and patterns.

The Royalty Management System (RMS) is the online, in-house developed application used by interest holders, and oil and gas companies owning a share in a Production Licence, to submit required production and sales figures. RMS is used by the program to help manage royalty collection and through Citrix, an application that enables secure remote access to RMS, provides for electronic submission of required royalty information. In addition to the RMS system, the program also conducts monthly review of royalty returns, validation of the computed royalty payable for the month, financial reviews of abnormal transactions which significantly reduce the royalty payable for the month and trend analysis of data submitted through RMS. Data submitted by the interest holder to AANDC is compared to the general ledger and the companies' financial documentation (e.g. producer statement and expense vouchers). Submitted reports are also compared with the fair market value of petroleum products, average gas prices, and/or data provided by the NEB.

For these systems, it is critical that processes and procedures are in place to support data integrity and provide appropriate user access. In reviewing the access to LAS and RMS, the audit expected to find that appropriate controls were used to grant, review, and revoke system access.

With respect to system access controls, the audit noted the following areas for improvement:

- A limited number of users have been granted access to LAS; however, the audit found that there is no formal or periodic review of LAS user access. The audit also found that there is no formal or periodic review of access to RMS that is performed by the program to ensure ongoing appropriateness, and there is no formal process to revoke user access to RMS.
- Testing also found one instance (out of five user accounts sampled) where a Technical Advisor created a RMS user account for themselves in order to provide IT-related support, which could present a risk to the program if they chose to enter false information.

The lack of a formal process for granting and removing user access to key systems increases the risk that user access is inconsistent with management's expectations thereby putting the integrity of information at risk.

While there are a limited number of industry holders currently under AANDC responsibility who are using RMS after devolution, two areas for improvement were also noted with regards to RMS functionality:

- Data entry validation controls in RMS could be improved. During walkthroughs conducted by the audit team to test system functionality, the audit noted that some fields can be left at "0" (zero) when interest holders submit data to RMS, despite the field requiring a value based on the other submitted data. This may result in an incomplete Monthly Royalty Return. The program is therefore relying on other mitigating controls to detect possible data entry errors (e.g. trend analysis, royalty audits). In addition, the audit noted that industry companies can submit a Monthly Royalty Return with blank fields and/or fields with erroneous characters. Deficiencies in data entry validation controls increases the risk of errors being inadvertently input and require additional due



diligence by program management to identify anomalies and take corrective action, or would otherwise go undetected.

- RMS does not accurately calculate balance owing for each royalty account due to the system configuration. Any adjustments to the Royalty Returns and royalty accounts can only be carried forward but cannot be retroactively applied to prior production months.. The audit noted that the existing financial transactions summary page in RMS does not meet user needs for ongoing monitoring of royalty payment and reconciliation because the system does not provide for accurate calculation of monthly balances of royalty accounts after amendments to royalty returns,, which causes Royalty Officers to create an additional tracking system. As a secondary tool, a Microsoft Excel spreadsheet is currently used by to track monthly royalty payables and to reconcile the payments collected from interest holders. Limitations in RMS functionality such that users' needs are not being met create an unnecessary requirement for the use of an external system of record (i.e. Microsoft Excel spreadsheets) and increase the risk of data integrity not being adequately preserved or protected.

Without regular review of system access rights, system functionality, and data entry validation controls, and with the possibility that oil and gas production in the North increases in the foreseeable future and there are more users of RMS, there is increased risk of inappropriate system access, which could impact data integrity or result in inefficiencies.

***Recommendation:***

2. The Assistant Deputy Minister of the Northern Affairs Organization, in collaboration with the Chief Information Officer, should:
  - perform a review of user access to the Land Administration System (LAS) and the Royalty Management System (RMS) and formalize a process for ongoing review and removal of access to the systems;
  - assess the feasibility of improving RMS functionality to reduce the need for external spreadsheets; and,
  - review data entry validation controls in RMS in order to reduce the risk of data integrity errors.

## **5.2 People**

### **5.2.1 Documentation of Roles and Responsibilities**

As of April 1, 2014, in accordance with the Northwest Territories Lands and Resources Devolution Agreement and the Northwest Territories Devolution Act, the Government of Canada transferred the administration and control of public lands, resources and rights in respect of waters in the Northwest Territories to the Commissioner of the Northwest Territories.

As a result of the devolution of northern oil and gas activities to the GNWT, the organizational structure within NAO and the Petroleum and Mineral Resources Management Directorate has been impacted. Management is taking the opportunity to review and revise the current

organizational structure, including reporting relationships, roles and responsibilities, and job descriptions.

With the devolution of onshore oil and gas reserves in the Northwest Territories, the GNWT took over royalty collection responsibility from AANDC for active project files. AANDC's Petroleum and Mineral Resources Management Directorate offered support to the GNWT and provided support for a seamless transition. The audit found that there was an appropriate consideration for risks to AANDC, along with supporting processes, throughout the transition of files and transfer of issuance of rights to the GNWT (e.g. through protocols, working groups, committees).

After this transition it is critical that operational practices are appropriately designed and effective to ensure a clear organizational structure, roles and responsibilities. This also includes communicating these changes clearly to external industry and stakeholders who rely on the program.

The audit found that while roles and responsibilities post-devolution were generally clear for those interviewed, reporting relationships and organizational structures had not been approved and job descriptions had not been finalized at the time of the audit. These tools will be important in clarifying any roles or responsibilities which were transferred or transitioned as a result of devolution or other organizational activities implemented by the Directorate. It is also important that new roles within the Directorate are made clear to industry, who rely on the program staff, information on the AANDC web site, and communication from the program to inform their business decisions and strategies for exploration in the North.

Without clear articulation, communication, and documentation of roles and responsibilities, both internally and externally, there is increased risk of confusion or concern in how activities will be performed post-devolution and in how the Department and program responsibilities under the Acts will continue to be fulfilled.

***Recommendation:***

3. The Assistant Deputy Minister of the Northern Affairs Organization, in collaboration with the Director General, Human Resources and Workplace Services Branch should, as part of the process to finalize and formalize the post-devolution organizational structure and roles and responsibilities related to northern oil and gas management, ensure that the revised structure and alignment of responsibilities are clearly articulated and communicated to industry and other stakeholders.

## **5.3 Policy and Programs**

### **5.3.1 Periodic Review of Program Design**

The responsible management of Canada's northern petroleum resources supports the Government of Canada's Northern Strategy to ensure the North achieves its true promise as a healthy, prosperous region within a strong and sovereign Canada. As previously noted, an estimated one quarter of the country's discovered conventional oil and one third of the country's natural gas are in the North, and developing these resources in a responsible and

environmentally sound manner is a priority for Canada. To achieve this, it is essential for Industry and government to collaborate with northern partners to advance knowledge to support responsible resource development in the North.

It is important that the monitoring of policy and program design occurs on a regular basis to help identify areas for improvement and increase the likelihood that the program remains relevant to industry stakeholders.

The audit found that there is no formal or cyclical review undertaken to assess whether improvements could be made to improve the policy or legislative framework. Program management noted that changes to policies and the legislative framework are largely driven by the public, external stakeholders, and industry proponents.

The external stakeholders interviewed (e.g. NEB and CAPP) noted that AANDC northern oil and gas personnel have significant experience and are very knowledgeable in rights and royalties management, and that communication with departmental officials was regular and effective. The stakeholders reported a general satisfaction with the current program as currently designed, although, in their view, the program and Department are at risk of lagging other countries if there is no regular review of policy and program design that includes a benchmarking exercise with other countries.

The Deficit Reduction Action Plan (DRAP) and devolution has led to significant organizational and program changes within the Directorate over the last few years. Once these changes have been fully implemented, there is an opportunity to review and reassess program design.

Without a formal and periodic process to monitor external environments and review policy and program design, there is increased risk that the program will not continue to effectively and efficiently support the Government of Canada's Northern Strategy.

***Recommendation:***

4. The Assistant Deputy Minister of the Northern Affairs Organization should, upon completion of devolution, develop a practice to perform a periodic review of program design and identify options for recommendation which could help improve the design of the program.

## 6. MANAGEMENT ACTION PLAN

Recommendations	Management Response / Actions	Responsible Manager (Title)	Planned Implementation Date
<p>1. The Assistant Deputy Minister of the Northern Affairs Organization should ensure control practices are clearly understood and consistently followed to ensure compliance to the <i>Canada Petroleum Resources Act (CPRA)</i>, <i>Canada Oil and Gas Operations Act (COGOA)</i>, and <i>Frontier Lands Registration Regulations (FLRR)</i>.</p>	<ul style="list-style-type: none"> <li>• Directorate will organize yearly training sessions for all officers engaged in CPRA, COGOA and FLRR matters to ensure consequential administrative practices are followed, in particular, all decision points are verified against legislative requirements.</li> </ul>	<p>Assistant Deputy Minister, Northern Affairs Organization</p>	<p>October 1, 2014</p>
<p>2. The Assistant Deputy Minister of the Northern Affairs Organization, in collaboration with the Chief Information Officer, should:</p> <ul style="list-style-type: none"> <li>• perform a review of user access to the Land Administration System (LAS) and the Royalty Management System (RMS) and formalize a process for ongoing review and removal of access to the systems;</li> <li>• assess the feasibility of improving RMS functionality to reduce the need for external spreadsheets; and,</li> <li>• review data entry validation controls in RMS in order to reduce the risk of data integrity errors.</li> </ul>	<ul style="list-style-type: none"> <li>• IMB is currently reviewing the list of users with the client, and will request that they do a quarterly review based on lists we will provide them on a regular basis.</li> <li>• Formal process will be implemented requiring Director, NPMRMD or Manager, Land Tenure or Royalty Management approval for new user accounts for LAS and RMS.</li> <li>• A change in functionality request will be submitted to IMB to deal with the need for external spreadsheets.</li> <li>• Royalty management manager will oversee the review of all fields to ensure validation rules are implemented where appropriate.</li> </ul>	<p>Assistant Deputy Minister, Northern Affairs Organization</p> <p>Chief Information Officer</p>	<p>October 1, 2014</p>

<p>3. The Assistant Deputy Minister of the Northern Affairs Organization, in collaboration with the Director General, Human Resources and Workplace Services Branch, should, as part of the process to finalize and formalize the post-devolution organizational structure and roles and responsibilities related to northern oil and gas management, ensure that the revised structure and alignment of responsibilities are clearly articulated and communicated to industry and other stakeholders.</p>	<ul style="list-style-type: none"> <li>• New structure and responsibilities will be conveyed to industry and stakeholders during planned meetings in Fall/Winter 2014 and as further opportunities present.</li> </ul>	<p>Assistant Deputy Minister, Northern Affairs Organization</p> <p>Director General, Human Resources and Workplace Services Branch</p>	<p>December 31, 2014</p>
<p>4. The Assistant Deputy Minister of the Northern Affairs Organization should, upon completion of devolution, develop a practice to perform a periodic review of program design and identify options for recommendation which could help improve the design of the program.</p>	<ul style="list-style-type: none"> <li>• As part of continuous improvement, program design will be reviewed prior to the launch of each Call for Bids (usually on annual basis).</li> <li>• A yearly assessment will examine current policy and legislative framework for offshore exploration and the associated considerations. This may identify issues that could warrant changes to program design. In addition, the program will look to build on existing multi-lateral collaboration through the Arctic Council for further opportunities to share best practices with organizations with similar mandates.</li> </ul>	<p>Assistant Deputy Minister, Northern Affairs Organization</p>	<p>Ongoing, annually</p> <p>October 1, 2014</p>

## Appendix A – Audit Criteria

To ensure an appropriate level of assurance to meet the audit objective, the following criteria were developed to address the objective. Audit criteria were developed in alignment with Treasury Board's *Audit Criteria related to the Management Accountability Framework: A Tool for Internal Auditors*.

<b>Stewardship</b>	
1.1	Established processes are in place to ensure compliance, fairness and confidentiality are respected in the rights issuance process.
1.2	Compliance and monitoring activities are in place to ensure compliance with the terms of rights issuances and the CPRA, COGOA and FLRR.
1.3	Processes and procedures exist to support data integrity and appropriate access to the systems.
<b>People</b>	
2.1	Operational practices are appropriately designed and effective to ensure a clear organizational structure, roles and responsibilities.
<b>Policy and Programs</b>	
3.1	Monitoring of policy and program design options occurs in a regular and timely manner.

## **Appendix B – Relevant Acts and Regulations**

The following authoritative sources were examined and used as a basis for this audit:

- *Canada Oil and Gas Operations Act*
- *Canada Petroleum Resources Act*
- *National Energy Board Act*
- *Frontier Lands Registration Regulations*
- *Frontier Lands Petroleum Royalty Regulations*