

# North Dakota State Auditor's Office

## Industrial Commission Audit Report For the Year Ended June 30, 2018

Client Code 405



Department of Mineral Resources  
Lignite Research Program  
Oil and Gas Research Program  
Renewable Energy Program  
Pipeline Authority  
Transmission Authority  
Outdoor Heritage Fund

**Joshua C. Gallion**  
North Dakota State Auditor

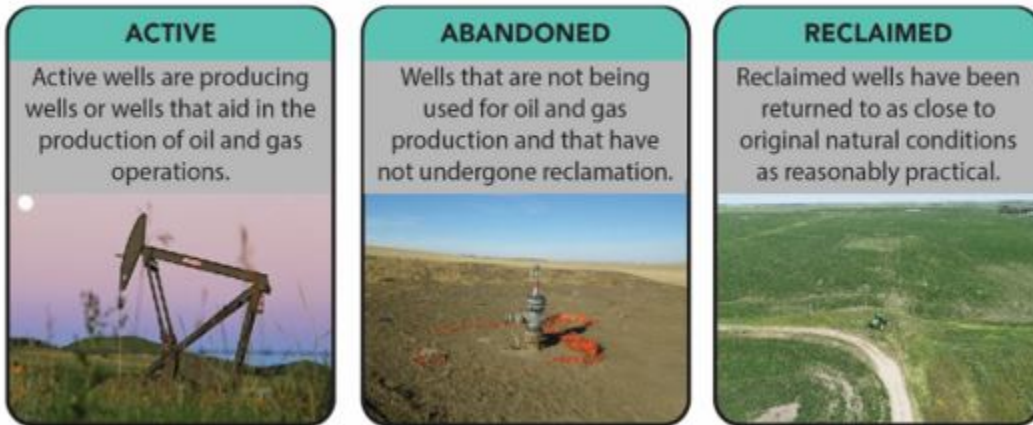


### Abandoned Wells

This audit questioned, "Is the Industrial Commission adequately monitoring abandoned wells in North Dakota?"

We found the Industrial Commission was adequately reviewing well files and ensuring operators follow through with the requirements to either bring abandoned wells back into production, properly temporarily plug the well, or permanently plug the well and reclaim the land.

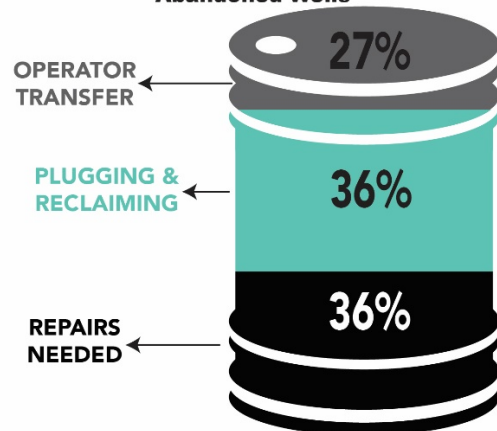
#### Lifecycle of Oil and Gas Wells Overseen by the Industrial Commission



As of May 2019, there were 590 abandoned wells in the state.

We found the three main reasons for a well to fall into abandoned status was due to the well needing repairs, the process of plugging and reclaiming the land, and operator transfers.

#### Top 3 Reasons for Tested Abandoned Wells



Source: Risk Based Data Management System

### Laws and Appropriations

We concluded the Industrial Commission followed law and appropriation requirements.

## **KEY PERSONNEL**

### **State Auditor's Office Staff**

Allison Bader, MBA, Audit Manager  
Kevin Scherbenske, CPA, Audit Supervisor  
Elizabeth Rogers, Auditor  
Jackie Ressler, Auditor  
Krista Lambrecht, CPA, Auditor

### **Client Staff Contacts**

Karlene Fine, Executive Director  
Lynn Helms, Director, Mineral Resources  
Robyn Loumer, Accounting Manager

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STATE OF NORTH DAKOTA  
**OFFICE OF THE STATE AUDITOR**  
STATE CAPITOL  
600 E. BOULEVARD AVENUE – DEPT 117  
BISMARCK, NORTH DAKOTA 58505

## *Transmittal Letter*

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June 27, 2019

Members of the North Dakota Industrial Commission

Ms. Karlene Fine, Executive Director, Industrial Commission

We are pleased to submit this audit of the Industrial Commission for the year ended June 30, 2018. This audit resulted from the statutory responsibility of the State Auditor to audit or review each state agency once every two years. The same statute gives the State Auditor the responsibility to determine the contents of these audits.

The primary consideration in determining the contents of these audits is to produce informative audits to improve government. Statutory audit requirements are an important part of these audits and are addressed by our standard audit objective. Additionally, whenever possible additional audit objectives are included to increase responsiveness and effectiveness of state government.

Allison Bader was the audit manager. Inquiries or comments relating to this audit may be directed to the audit manager by calling (701) 328-2241. We wish to express our appreciation to Ms. Karlene Fine, Mr. Lynn Helms, and their staff for the courtesy, cooperation, and assistance they provided to us during this audit.

Respectfully submitted,

/S/

Joshua C. Gallion  
State Auditor

cc: Legislative Audit and Fiscal Review Committee  
Chris Kadrmas, Legislative Council Fiscal Analyst

# Audit Results

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## Abandoned Wells

The audit of abandoned wells was designed and conducted to meet the following objective:

Is the Industrial Commission adequately monitoring abandoned wells?

### Conclusions

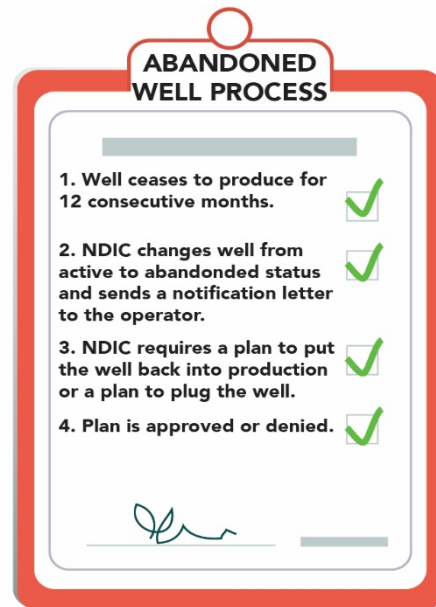
We found that the Risk Based Data Management System was properly identifying wells that were no longer producing oil and had fallen into abandoned status. We also determined the Industrial Commission adequately reviews well files and monitors operators to either bring the well back into production or properly plug and reclaim the well in a timely manner.

### Background Information and Results

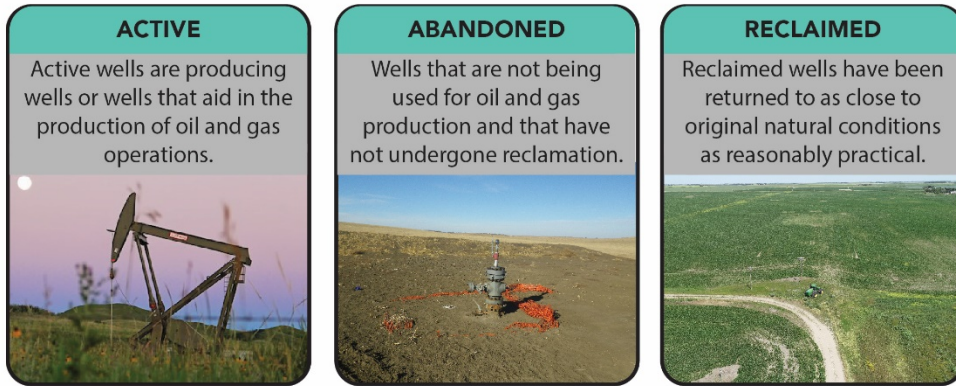
According to the Industrial Commission and our audit, the following procedures surround the status of abandoned wells.

Well abandonment is often a misused term. The most common reason for a well to fall into abandoned status is due to uneconomic production. It is not uncommon for a well to be out of production for a year or more, therefore putting them into abandoned status. During this time, the operator must submit an action plan, also known as a sundry notice, each year to the Industrial Commission, updating them on the status of the well.

Each well within the state is tracked in a Risk Based Data Management System (RBDMS). Operators are required to submit monthly production reports on each well that they own. These production reports are submitted directly to the RBDMS. When there has been a cessation of production for twelve consecutive months, the RBDMS consequently changes the status of the well from active to abandoned. The system will then generate a letter to the operator informing them of the status change and requiring them to submit an action plan for that well. Under North Dakota Administrative Code (NDAC) the operator has the option to submit plans to bring the well back into production in paying quantities, achieve temporary abandonment status, or permanently plug the well and reclaim the land.



## Lifecycle of Oil and Gas Wells Overseen by the Industrial Commission



Temporary abandonment status is an option available when the operator intends to use the well in the future. To achieve temporary abandonment status, the operator must submit plans to the Industrial Commission showing the future intended use and how they intend to temporarily plug the well. If the Commission approves the temporary abandonment status, the well must be plugged according to the plans that were approved. An inspector from the Commission must be present to witness and document all plugs set, witness a casing pressure test and submit a well integrity report. The operator is then required to file a sundry notice reporting the work is completed.



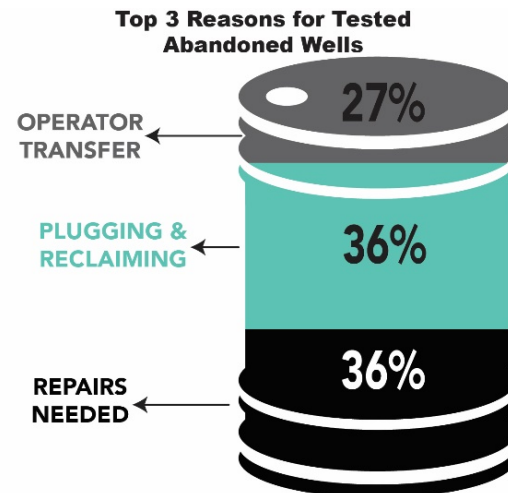
Source: Industrial Commission

When a well has reached its economic limit and serves no purpose, it must be permanently plugged, and the surface reclaimed. Before a well can be plugged, the operator must file plans for plugging the well for the Commission to review. Once the Commission is satisfied with the procedures, the operator may proceed with plugging. A field inspector from the Commission must be present for the plugging of the well. Once the well has been plugged, the well site must be reclaimed. Reclamation is returning a site, access road, and other associated facilities constructed, as close as practicable to original condition. Reclamation is not considered complete until the state releases the site from the company's bond. This may take several years, as reclamation is not complete until the regrowth of ground cover is satisfactory. During this time, the well site is inspected each year. The cost of reclaiming the site is typically covered by the well operator or the company's bond under that well. The Abandoned Well Plugging Site Restoration Fund will pay for plugging and reclamation costs if the operator or surety fails to satisfy the bond's conditions, the operator fails to produce a single well bond or has gone bankrupt, or for wells left in inadequate reclamation status before 1983 for which there is no longer any continuing reclamation responsibility under state law. In fiscal year 2018 the Industrial Commission reported there were two sites they did reclamation work on for a total cost of \$862,338.

If the operator does not respond to the abandoned well notification letter and submit an action plan for one of the three options, the well and bond are subject to forfeiture by the Commission. The Commission can also file a complaint, schedule a legal hearing and subject the operator to fines which help cover the costs of plugging and reclaiming the well site.

The Industrial Commission relies heavily on the RBDMS to track and monitor the wells, update status changes, and hold all documentation surrounding the activity of the well. Therefore, we reviewed the system controls responsible for changing the status to ensure wells in abandoned status were being accurately identified. We also inspected well files for evidence that notification was given to the operator informing them of the status change, actions plans were submitted and either approved or denied by the Commission, and that the Commission monitored the well to make sure the action plans were properly followed through.

We found that the RBDMS was properly identifying wells that were no longer producing oil and had fallen into abandoned status. We also determined the Industrial Commission adequately reviews well files and monitors operators to either bring the well back into production or properly plug and abandon the well in a timely manner. During testing, we found the three main reasons for a well to fall into abandoned status is due to the well needing repairs, the process of plugging and reclaiming the land, and operator transfers.



Source: Risk Based Data Management System

### **Internal Control**

We gained an understanding of internal control and concluded as to the adequacy of their design. We also tested the operating effectiveness of those controls we considered necessary based on our assessment of audit risk.

Auditors are required to report deficiencies in internal control that are significant within the context of the objectives of the audit. A deficiency in internal control exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect: misstatements in financial or performance information, violations of laws and regulations or impairments of effectiveness or efficiency of operations, on a timely basis. Considering both qualitative and quantitative factors, we did not identify any deficiencies in internal control that were significant within the context of our audit objectives and based upon the audit work performed.

### **Scope**

The scope of this audit of abandoned wells included operations of the Oil and Gas Division within the North Dakota Industrial Commission. The audit was for the year ended June 30, 2018, however well data was obtained through May 17, 2019, as the system used for data is an active web-based system and does not have the capability to pull historic data. The audit did not include the well inspection process or the evaluation of sufficiency of funding in the Abandoned Well Plugging Site Restoration Fund.



## ***Methodology***

To meet this objective, we:

- Interviewed management and personnel in the Oil and Gas Division.
- Obtained access to the Risk Based Data Management System and analyzed system controls.
- Identified state law (North Dakota Century Code and North Dakota Administrative Code) and internal guidance for abandoned wells.
- Inspected well files for evidence status notification letters and action plans to bring abandoned wells into compliance.

In aggregate, there were no significant limitations or uncertainties related to our overall assessment of the sufficiency and appropriateness of audit evidence.

## **Statutory Audit Requirements**

The objective related to our statutory audit requirements is:

Are there any exceptions to report relating to statutorily required audit testing?

Statutorily required audit testing includes: performing the post audit of financial transactions, detecting and reporting any defaults, determining that expenditures have been made in accordance with law, appropriation acts, and emergency commission action, and evaluating blanket bond coverage. Defaults are defined as failures to do something required by duty or law. Bonding coverage provides insurance to state agencies for any default or wrongful act on the part of any public employee or public official.

### **Conclusion**

No exceptions to our statutorily required audit testing were identified.

Audit procedures included testing compliance with appropriation laws, evaluating the adequacy of blanket bond coverage, performing tests of expenditures and procurement, and analysis of legally restricted funds.

### **Internal Control**

We gained an understanding of internal control and concluded as to the adequacy of their design. We also tested the operating effectiveness of those controls we considered necessary based on our assessment of audit risk.

Auditors are required to report deficiencies in internal control that are significant within the context of the objectives of the audit. A deficiency in internal control exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect: misstatements in financial or performance information, violations of laws and regulations or impairments of effectiveness or efficiency of operations, on a timely basis. Considering both qualitative and quantitative factors, we did not identify any deficiencies in internal control that were significant within the context of our audit objectives and based upon the audit work performed.

### **Scope**

This audit of the Industrial Commission is for the year ended June 30, 2018.

The Industrial Commission has operations in the following locations. Each location was included in the audit scope:

- Administrative office in the State Capitol.
- Department of Mineral Resources office, Bismarck
- Core and Sample Library, Grand Forks
- Regional offices in Dickinson, Minot, and Williston

## **Methodology**

To meet this objective, we:

- Performed detailed analytical procedures including computer-assisted auditing techniques. These procedures were used to identify high-risk transactions and potential problem areas for additional testing.
- Interviewed appropriate agency personnel.
- Queried the ConnectND (PeopleSoft) system for data analysis. Significant evidence was obtained from ConnectND.
- Observed the Industrial Commission's processes and procedures.
- Inspected documentary evidence.
- Tested compliance with appropriation laws and regulations including related transfers and emergency commission action. Where necessary, internal control was tested which included selecting representative samples to determine if controls were operating effectively and if laws were being followed consistently.
- Reviewed adequacy of blanket bond coverage by comparing coverage to state bonding guidelines.
- Performed an analysis and selected a sample of high-risk transactions, including procurement, for further testing.
- Inspected meeting minutes as a follow up due to a recommendation from the prior audit.

In aggregate, there were no significant limitations or uncertainties related to our overall assessment of the sufficiency and appropriateness of audit evidence.

## **Authority and Standards**

This one-year performance audit of the Industrial Commission has been conducted by the Office of the State Auditor pursuant to authority within North Dakota Century Code Chapter 54-10.

We conducted this performance audit in accordance with *Generally Accepted Government Auditing Standards* issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

The criteria used to evaluate internal control is published in the publication *Standards for Internal Control in the Federal Government* issued by the Comptroller General of the United States (Green Book, GAO-14-704G). Agency management must establish and maintain effective internal control in accordance with policy of the Office of Management and Budget (OMB Policy 216).

# Financial Statements

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## Statement of Revenues and Expenditures

	<u>June 30, 2018</u>
<b><u>Revenues and Other Sources:</u></b>	
Fines	\$ 1,561,976
Permits, Fees, and Commission	556,386
Charges for Sales and Services	299,541
Refunds	178,878
WAWS Authority Contracts	150,000
Federal Revenue	105,784
Interest and Investment Earnings	56,681
Miscellaneous Revenue	8,664
Transfers In	37,680,412
<b>Total Revenues and Other Sources</b>	<b><u>\$ 40,598,322</u></b>
<b><u>Expenditures and Other Uses:</u></b>	
Grants	\$ 13,325,317
Salaries and Benefits	10,624,617
Contract Services	5,470,710
Professional Fees and Services	1,447,382
Rentals/Leases - Buildings	920,315
Travel	805,345
Operating Fees and Services	262,737
IT Communications and Data Processing	215,400
Professional Development	67,304
IT Equipment and Software	61,571
Transfers Out	965,366
<b>Total Expenditures and Other Uses</b>	<b><u>\$ 34,166,064</u></b>

Source: ConnectND Financials

\* The above financial statement does not include expenditures of the Building Authority as they were not included in the scope of the audit.

**Statement of Appropriations**

**For the Year Ended June 30, 2018**

<b>Expenditures by Line Item:</b>	<b>2017-19 Biennium Appropriation</b>	<b>Expenditures</b>	<b>Unexpended Appropriation</b>
Salaries and Wages	\$ 22,014,084	\$ 10,830,300	\$ 11,183,784
Operating Expenses	12,254,627	7,208,909	5,045,718
Grants-Bond Payments	15,569,162	9,077,974	6,491,188
Contingencies	<u>221,737</u>	<u>0</u>	<u>221,737</u>
<b>Total</b>	<b><u>\$ 50,059,610</u></b>	<b><u>\$ 27,117,183</u></b>	<b><u>\$ 22,942,427</u></b>
<b>Expenditures by Source:</b>			
General	\$ 27,767,665	\$ 14,479,610	\$ 13,288,055
Other	<u>22,291,945</u>	<u>12,637,573</u>	<u>9,654,372</u>
<b>Total</b>	<b><u>\$ 50,059,610</u></b>	<b><u>\$ 27,117,183</u></b>	<b><u>\$ 22,942,427</u></b>

Source: ConnectND Financials

\* The Industrial Commission appropriation includes Building Authority. The above appropriation statement reflects expenditures from the Building Authority which was not included in the scope of the audit.

\* Industrial Commission appropriation includes Public Finance Authority. Expenditures for Public Finance Authority were obtained from the Statement of Appropriations in the Authority's audited financial statements for the eighteen months ended December 31, 2018. Public Finance Authority was not included in the scope of the audit.

## *Status of Prior Recommendations*

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### **Untimely Approval and No Records Retention of Meeting Minutes (Finding 17-1)**

**Recommendation:**

We recommend the Industrial Commission:

- Ensure meeting minutes are prepared timely and approve the minutes at the Industrial Commission's next meeting;
- Complete a records retention schedule for Industrial Commission meeting minutes for archival purposes.

**Status:**

Implemented.

You may obtain audit reports on the internet at:

[www.nd.gov/auditor](http://www.nd.gov/auditor)

or by contacting the Office of the State Auditor at:

**Email:** [ndsao@nd.gov](mailto:ndsao@nd.gov)

**Phone:** (701) 328-2241

**Office of the State Auditor**

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