



**Department of Interior
Office of Natural Resources Revenue**

**Independent Peer Review of
North Dakota State Auditor's Office
Royalty Audit Section**

For the Period January 1, 2016 through December 31, 2018

June 10, 2019

INDEPENDENT PEER REVIEW OF THE NORTH DAKOTA STATE AUDITOR'S
OFFICE ROYALTY AUDIT SECTION FOR THE PERIOD JANUARY 1, 2016
THROUGH DECEMBER 31, 2018

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INDEPENDENT PEER REVIEW OF NORTH DAKOTA STATE
AUDITOR'S OFFICE
ROYALTY AUDIT SECTION

Dennis Roller
Audit Manager
North Dakota
State Auditor's Office
Royalty Audit Section

We have reviewed the system of quality control for the audit organization of the North Dakota State Auditor's Office Royalty Audit Section (Royalty Audit Section) in effect for the selected audit work performed by the Royalty Audit Section during the period January 1, 2016, through December 31, 2018. A system of quality control encompasses the Royalty Audit Section's organizational structure and the policies adopted and procedures established to provide it with reasonable assurance of conforming to *Government Auditing Standards*. The elements of quality control are described in the *Government Auditing Standards*. The Royalty Audit Section is responsible for designing a system of quality control and complying with it to provide reasonable assurance of performing and reporting in conformity with applicable professional standards in all material respects. Our responsibility is to express an opinion on the design of the system of quality control and the Royalty Audit Section's compliance therewith based on our review.

Our review was conducted in accordance with *Government Auditing Standards* and Council of Inspectors General on Integrity and Efficiency (CIGIE) standards and guidelines. During our review, we obtained an understanding of the nature of the audit organization, and the design of the system of quality control sufficient to assess the risks implicit in its audit function. Based on our assessments, we selected engagements and administrative files to test for conformity with professional standards and compliance with the Royalty Audit Section system of quality control. The engagements selected represented a reasonable cross section of open and closed royalty audits for the Royalty Audit Section. The contract for the peer review only allows information to be given to a contractor to conduct a peer review of oil and gas leases. No corresponding statutory authority exists now for the Office of Natural Resources Revenue (ONRR) to give any type of confidential information to a contractor to conduct peer reviews of coal, solids, section 8(g), and geothermal resources. Therefore, these audits were not included in the population of engagements to be selected for review. Prior to concluding the review, we reassessed the

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adequacy of the scope of the peer review procedures and met with management to discuss the results of our review. We believe that the procedures we performed provide a reasonable basis for our opinion.

In performing our review, we obtained an understanding of the system of quality control for the Royalty Audit Section. In addition, we tested compliance with the quality control policies and procedures of the Royalty Audit Section to the extent we considered appropriate. These tests covered the application of the policies and procedures on selected engagements. Our review was based on selected tests; therefore, it would not necessarily detect all weaknesses in the system of quality control or all instances of noncompliance with it.

There are inherent limitations in the effectiveness of any system of quality control, and therefore noncompliance with the system of quality control may occur and not be detected. Projection of any evaluation of a system of quality control to future periods is subject to the risk that the system of quality control may become inadequate because of changes in conditions, or because the degree of compliance with the policies or procedures may deteriorate. Section B to this report identifies the engagements that we reviewed.

In our opinion, the system of quality control for the audit organization of the Royalty Audit Section in effect for the selected audit work performed during the period January 1, 2016, through December 31, 2018, has been suitably designed and complied with to provide the Royalty Audit Section with reasonable assurance of performing and reporting in conformity with applicable professional standards in all material respects. State and Tribal organizations can receive a rating of *pass*; *pass with deficiencies*, or *fail*. The North Dakota State Auditor's Office Royalty Audit Section has received a peer review rating of *pass*.

Acuity Consulting Inc.

June 10, 2019

SECTION A – SUMMARY OF RESULTS

1. Background

ONRR was created by Secretarial Order in 2010. ONRR was created to replace the Minerals Management Service (MMS), Minerals Revenue Management (MRM), which was created by Secretarial Order in 1982 to consolidate the management of the public's mineral resources under one agency. MMS had two operational program areas: 1) the Offshore Energy and Minerals Management program, which managed the Nation's natural gas, oil, and other mineral resources on the Outer Continental Shelf and 2) MRM, which collects, accounts for, and audits, revenues from offshore Federal mineral leases and from onshore mineral leases on Federal and Indian lands. ONRR (and formerly MRM) has collected and distributed over \$200 billion since 1982. The revenues ONRR accounts for are distributed to special-purpose accounts administered by other Federal agencies, the U.S. Department of the Treasury, States, and the American Indian Community. ONRR reviews, analyzes, and audits companies' royalty payments to ensure they are in compliance with applicable laws, rules, and regulations. Royalty audits are conducted in accordance with GAGAS, the ONRR Audit Manual (AM), and applicable policies and procedures. The audit compliance function is headquartered in Lakewood, Colorado, with field offices located in Houston and Dallas; Texas, Oklahoma City and Tulsa; Oklahoma, and Farmington, New Mexico. ONRR also performs attestation engagements in accordance with GAGAS on its State and Tribal partners to determine compliance with the delegated agreement/cooperative agreement contract terms.

State and Tribal Audits

The States and Tribes perform royalty audits under delegated and cooperative agreements with ONRR in accordance with GAGAS and the ONRR AM. These States and Tribes must have an external peer review performed by reviewers independent of ONRR every 3 years. The Federal Oil and Gas Royalty Management Act (FOGRMA) authorized the Department of Interior (DOI) to enter into cooperative agreements with Indian tribes under section 202 and to delegate audit authority to states under section 205. Under a cooperative agreement, an Indian tribe or state is permitted to conduct inspections, audits, and investigations of activities on their respective Indian or Federal lands. ONRR has cooperative agreements to conduct royalty audits of Federal and Tribal leases as follows: 9 States - FOGRMA Section 205 Delegated Audit Agreements; and 6 Tribes - FOGRMA Section 202 Cooperative Audit Agreements.

Royalty Audit Section

In accordance with §202 of the Federal Oil and Gas Royalty Management Act of 1982 (P.L. 97-451) as amended, the Secretary of the Interior has authorized ONRR to enter into a Delegation of Authority Agreement No. D16AC00015 with the North Dakota State Auditor's Office to conduct audits and investigations related to royalty payments made for oil and gas produced and sold from Federal leases located within the borders of the State.

The North Dakota State Auditor's Office signed a six (6) year (October 1, 2016 through September 30, 2022) Grant and Cooperative Agreement with ONRR. The North Dakota State Auditor's Office has had a contract with ONRR to perform oil & gas royalty auditing on the Federal oil and gas leases located within the borders of the State.

The North Dakota State Auditor's Office Oil & Gas Royalty Audit Section conducts royalty audits on leases producing and selling oil and gas within the boundaries of the State of North Dakota. The North Dakota State Auditor's Office conducts the audits in accordance with the ONRR Audit Manual (AM) and the *Government Auditing Standards* (2011 Revision), also known as the Yellow Book. The standards require that each organization should have quality control standards implemented and they should also undergo an external quality control review every three years.

2. Objective

The objective of this engagement was to conduct an Independent Peer Review of the royalty audit operations of the Royalty Audit Section in accordance with GAGAS 2011 Revision, and the Council of the Inspectors General on Integrity & Efficiency (CIGIE) standards and guidelines under the Inspector General Reform Act 2008. The peer review considered selected audit work performed by the Royalty Audit Section during the period January 1, 2016, through December 31, 2018.

3. Scope

The scope was to perform a peer review of selected audits conducted by the Royalty Audit Section during the period January 1, 2016, through December 31, 2018. Our review was sufficient in scope to provide us a reasonable basis in determining whether, for the period under review, the reviewed audit organization's system of quality control was suitably designed and whether the audit organization was complying with its' quality control system to provide the audit organization with reasonable assurance of conforming to applicable professional standards.

The contract for the peer reviews only allows information to be given to a contractor to conduct a peer review of oil and gas leases. No corresponding statutory authority exists now for ONRR to give any type of confidential information to a contractor to conduct peer reviews of coal, solids, section 8(g), and geothermal resources. Therefore, audits of these resources were excluded from the scope of audits subject to our review.

4. Methodology

Acuity reviewed the system of quality control for the audit function of the Royalty Audit Section in effect for reports selected from the period January 1, 2016, to December 31, 2018. We selected our sample of engagements from the population of audits performed during the period January 1, 2016, through December 31, 2018. If any audits were selected for which information could not be provided as indicated in the scope section above, the audit was replaced. Acuity conducted the peer review of five selected engagements in conformity with standards and guidelines established by CIGIE and GAGAS. We tested compliance with ONRR's system of quality control to the extent we considered appropriate.

Finally, Acuity Consulting Inc., (Acuity) provided a written report to the Contracting Officer's Representative (COR), the applicable ONRR management, and the Royalty Audit Section.

5. Peer Review Results

Based on our peer review procedures, the system of quality control for the audit function of the Royalty Audit Section in effect during the period covered, was suitably designed to meet the requirements of the quality control standards established by CIGIE and complied with DOI ONRR standards to provide reasonable assurance of performing and reporting in accordance with applicable professional auditing standards in all material respects. Agencies can receive a rating of *pass*; *pass with deficiency* (deficiencies) or *fail*. The Royalty Audit Section has received a peer review rating of *pass*.

SECTION B – PEER REVIEW DETAILS

1. Peer Review Scope and Methodology

Acuity conducted the review from May 20, 2019 through May 22, 2019, of the selected reports for the period January 1, 2016, to December 31, 2018. We performed the peer review in accordance with GAGAS, CIGIE standards and guidelines, and the AM. We tested compliance with ONRR’s system of quality control to the extent we considered appropriate. We selected four (4) audits performed during the period as well as one (1) surprise audit on site. We reviewed and examined supporting working papers to ensure that they were in compliance with CIGIE, GAGAS, and AICPA audit criteria applicable to ONRR policies and procedures.

We also tested the Royalty Audit Section’s compliance with continuing professional education (CPEs) for staff. Auditors performing work under GAGAS, including planning, directing, performing fieldwork, or reporting on an audit or attestation engagement under GAGAS, need to maintain their professional competence through CPE. Therefore, each auditor performing work under GAGAS, should complete every two years at least 80 hours of CPE that directly enhance the auditor’s professional proficiency to perform an audit. At least 24 hours of the 80 hours of CPE at a minimum should be in subjects directly related to government auditing, the government environment, or where the audited entity operates. CPE hours are acquired through class attendance, self-study and on-site training.

In analyzing the Royalty Audit Section’s quality control system, we evaluated audit policies and procedures and the following elements for the selected reports inspected. Those elements are: Independence; Professional Judgment; Competence; Audit Planning; Supervision; Evidence and Audit Documentation; Reports on Performance Audits; Non-audit Services; and, the Quality Control Process.

2. Royalty Audit Section Reports Reviewed

We visited the North Dakota State Auditor’s Office Royalty Audit Section in Bismarck, ND and reviewed the following reports:

Number	Type of Report	Report Date	Name
14-00621-002	Closed	December 21, 2017	*Kodiak Oil and Gas
14-00054-004	Closed	November 1, 2018	Hess
14-00053-001	Closed	September 18, 2017	Newfield Exploration Company
18-00201-001	Closed	August 30, 2018	NP Resources LLC
14-00055-001	Closed	February 21, 2018	Oasis Petroleum Inc.,

(*) – Surprise Pick

We wish to acknowledge the exceptional assistance and extensive cooperation provided by the Royalty Audit Section office in our performance of the peer review. The work could not have been completed without their full participation and support.

STATE AUDITOR
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STATE OF NORTH DAKOTA
OFFICE OF THE STATE AUDITOR
DIVISION OF ROYALTY AUDIT
425 NORTH 5TH STREET
BISMARCK, NORTH DAKOTA 58501

June 9, 2019

Ms. TaVonna Serious, CGFM, CICA, CFE
Audit Manager, Acuity Consulting, Inc.
6910 Richmond Highway
Alexandria, VA 22306

Ms. TaVonna Serious:

Thank you for your peer review of our compliance with the applicable professional audit standards for the audits performed under our 205 delegation contract with the Department of the Interior, Office of Natural Resources Revenue.

Your review provides assurance to the citizen of the United States that when performing audits of the oil and gas removed from Federal leases with the boundaries of the State of North Dakota that we are in compliance with the applicable professional auditing standards.

Once again, I want to thank you for the peer review and the professionalism with which it was performed.

Sincerely,

A handwritten signature in cursive script that reads "Dennis Roller".

Dennis Roller, Royalty Audit Manager
North Dakota State Auditor's Office