



Aboriginal Affairs and  
Northern Development Canada

Affaires autochtones et  
Développement du Nord Canada

# **Aboriginal Affairs and Northern Development Canada**

## **Internal Audit Report**

### **Audit of Southern Oil and Gas**

**Prepared by:**

**Audit and Assurance Services Branch**

**Project#: 13-45**

**September 2013**

# TABLE OF CONTENTS

- ACRONYMS ..... ii
- EXECUTIVE SUMMARY ..... 1
- 1. INTRODUCTION AND CONTEXT .....5
- 2. AUDIT OBJECTIVE AND SCOPE .....6
- 3. APPROACH AND METHODOLOGY .....7
- 4. CONCLUSION.....8
- 5. FINDINGS AND RECOMMENDATIONS.....8
  - 5.1. Lease and Royalty Administration and Regulatory Compliance.....9
  - 5.2. Information Management.....14
  - 5.3. People .....16
- 6. MANAGEMENT ACTION PLAN .....18
- Appendix A: Oil & Gas Lifecycle .....21
- Appendix B: Audit Criteria.....23
- Appendix C: Applicable Legislation, Regulations, and Policies .....24

## ACRONYMS

AANDC	Aboriginal Affairs and Northern Development Canada
ADM	Assistant Deputy Minister
AES	Audit and Evaluation Sector
CSA	Control Self-Assessment
IOGC	Indian Oil and Gas Canada
IRC	Indian Resource Council
LED	Lands and Economic Development
MOU	Memorandum of Understanding
RIMS	Resource Information Management System
RUGS	RIMS User Groups
SOA	Special Operating Agency

# EXECUTIVE SUMMARY

## ***Background***

An Audit of Southern Oil and Gas was included in the 2013-2014 to 2015-2016 Risk-based Audit Plan approved by the Aboriginal Affairs and Northern Development Canada (AANDC) Deputy Minister on February 27, 2013. The project was included in the plan on the basis that First Nations' oil and gas management is extremely complex, and Indian Oil and Gas Canada (IOGC) had not been audited directly in over ten years.

Aboriginal Affairs and Northern Development Canada, through Indian Oil and Gas Canada, assists in managing production, prices and collection of royalties for oil and gas production on First Nation reserves. IOGC is a Special Operating Agency (SOA) within AANDC and is managed by an Executive Director who reports to the Assistant Deputy Minister (ADM) of Lands and Economic Development. IOGC is responsible for carrying out the legal obligations of the federal government related to the management of oil and gas resources on First Nation lands and to support First Nation initiatives in managing and controlling their oil and gas resources. IOGC works in partnership with more than 50 First Nations with oil and gas agreements in the provinces of British Columbia, Alberta, Saskatchewan and Manitoba. In the last five years IOGC has collected over \$1 billion from oil and gas activities on behalf of First Nations.

IOGC currently operates under the authority of the *Indian Oil and Gas Act, 1985* and the *Indian Oil and Gas Regulations, 1995*. Revisions have been made to the Act which will come into force with a set of core regulatory changes in 2014. IOGC is responsible for oil and gas on First Nation reserve lands across Canada, with all of IOGC's work located south of the 60th parallel, most of that in the Western Canada Sedimentary Basin.

IOGC's general responsibilities are to:

- identify and evaluate oil and gas resource potential on Indian reserve lands;
- encourage companies to explore for, drill and produce these resources through leasing activity;
- ensure equitable production, fair prices and proper collection of royalties on behalf of First Nations; and,
- secure compliance with and administer the regulatory framework in a fair manner.

At the end of fiscal year 2012-13, IOGC was administering approximately 700 sub-surface agreements and 4,800 surface agreements. During the fiscal year 2012-13, approximately 140 wells were drilled on First Nation reserve lands and IOGC collected approximately \$180 million on behalf of First Nations. IOGC has a staff complement of 88, and has an operating budget of approximately \$12 Million.

## **Modernization of the Indian Oil and Gas Act**

Modernization of the *Indian Oil and Gas Act* (“The Act”) and associated regulations is a key priority for IOGC. This process is expected to take several years and involve extensive consultations. Amendments to the Act received royal assent in May 2009. A joint process is currently underway with IOGC, oil and gas producing First Nations, the Joint Technical Committee, and the Indian Resource Council to develop the new regulations.

The IOGC Modern Act, Regulations and Systems (MARS) project scope includes significant effort and activity in developing new regulations, revising business processes (“future state”), and making enhancements to information systems. Due to the volume of the regulatory amendments expected, the work has been divided into multiple modules and phases. In preparation for new regulations IOGC modified its organizational structure, effective April 2013, to better support anticipated operational requirements.

Modernizing the *Indian Oil and Gas Act* and its associated regulations is intended to address the existing regulatory gap and level the playing field between off-reserve and on-reserve oil and gas activities. Amendments to the Act will also reduce barriers to economic development and will allow the federal government to better fulfill its obligation to manage oil and gas resources on First Nations lands.

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

The objective of the audit was to determine whether AANDC and Indian Oil and Gas Canada are fulfilling their obligations with respect to the regulation and administration of oil and gas resources on reserve in an efficient, effective, and controlled manner.

The audit scope included an assessment of the adequacy and effectiveness of the governance, risk management, and internal controls in place to support the effective and efficient execution of AANDC’s and the IOGC’s responsibilities in managing oil and gas resources on First Nation reserves.

The audit scope included processes and controls in place used by AANDC and IOGC to:

- manage the negotiation, issuance and administration of agreements with oil and gas companies and First Nations;
- monitor oil and gas production and prices;
- verify/assess and collect moneys such as bonuses, royalties and rents; and,
- ensure environmental requirements are met.

In addition, given IOGC is a separate employer from AANDC with a compensation plan in which all employees are eligible for performance pay, the audit scope also included IOGC’s processes and controls in place with regards to the management of the staff performance appraisal process.

The scope of the audit covered the period April 1, 2011 through to March 31, 2013.

## **Statement of Conformance**

This audit conforms with 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 and IOGC. This has resulted in the several positive findings listed below:

- There are experienced and knowledgeable staff in key positions;
- There are well documented procedural documentation and process maps for several key processes. IOGC staff perform procedures in accordance with these procedural documents and process maps;
- Checklists and control documentation are used to ensure quality and standardization throughout the lifecycle of agreements and to ensure IOGC and AANDC obligations and responsibilities are met;
- The staff performance appraisal process is conducted appropriately and well documented; and,
- The Resource Information Management System (RIMS) captures a significant amount of information and provides a good base level of operational support for IOGC.

## **Conclusion**

Generally, the audit found that AANDC and Indian Oil and Gas Canada control practices are adequate and effective. Some opportunities for improvement were noted to strengthen management practices in the following areas: policy and procedures documentation and maintenance of supporting control documentation, monitoring activities, agreement processing approach and performance measurement, and information management.

## **Recommendations**

The audit team identified areas where control practices and processes could be improved, resulting in six recommendations, as follows:

1. The Executive Director of Indian Oil and Gas Canada should ensure IOGC policy and procedures are sufficiently documented for key processes which clearly describe roles and responsibilities.
2. The Executive Director of Indian Oil and Gas Canada should ensure that supporting evidence to demonstrate due diligence, review, and approval is properly maintained for accountability and audit trail purposes.

3. The Executive Director of Indian Oil and Gas Canada should document the approach and selection rationale used to select companies for monitoring reviews, and for production reviews, implement a contracting vehicle, update the risk matrix used, and ensure company action plans are adequately reviewed and approved by the independent reviewer prior to final approval by IOGC.
4. The Executive Director of Indian Oil and Gas Canada should review control requirements and implement a risk-based approach to process different types of agreement transactions in order to improve processing timeliness. It is further recommended that performance indicators be developed and monitored to reflect the time to process agreement transactions and highlight delays and/or bottlenecks pertaining to certain types of transactions.
5. The Executive Director of Indian Oil and Gas Canada should ensure the Steering Committee provides governance and oversight of RIMS in order to ensure change requests are prioritized and high risk issues are addressed in a timely manner. It is further recommended that primary RIMS enhancements are identified and the revised RIMS2 business case be presented to Headquarters.
6. The Executive Director of Indian Oil and Gas Canada should ensure regulations and procedures posted on the IOGC website remain up-to-date, in particular as new regulations come into effect.

### ***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 in this report.

# 1. INTRODUCTION AND CONTEXT

An Audit of Southern Oil and Gas was included in the 2013-2014 to 2015-2016 Risk-based Audit Plan approved by the Aboriginal Affairs and Northern Development Canada (AANDC) Deputy Minister on February 27, 2013. The project was included in the plan on the basis that First Nations' oil and gas management is extremely complex, and Indian Oil and Gas Canada (IOGC) had not been audited directly in over ten years.

## 1.1. *Indian Oil and Gas Canada*

As part of its legislative obligations, AANDC provides land management services to over 600 First Nations with more than 2,800 reserves covering over 3 million hectares of reserve land across Canada. Land management generally includes activities related to the ownership, use, and development of land and resources for personal, community and economic purposes. This includes the management of oil and gas resources on First Nation land. The vast majority of these on-reserve resources are located south of the 60<sup>th</sup> parallel and centralized in the western Canadian provinces.

AANDC, through Indian Oil and Gas Canada, assists in managing production, prices, and collection of royalties for oil and gas production on First Nation reserves. IOGC is a Special Operating Agency within AANDC and is managed by an Executive Director who reports to the Assistant Deputy Minister of Lands and Economic Development. IOGC is responsible for carrying out the legal obligations of the federal government related to the management of oil and gas resources on First Nation lands and to support First Nation initiatives for management and controlling their oil and gas resources. IOGC works in partnership with more than 50 First Nations with oil and gas agreements in the provinces of British Columbia, Alberta, Saskatchewan and Manitoba. In the last five years IOGC has collected over \$1 billion from oil and gas activities on behalf of First Nations.

IOGC currently operates under the authority of the *Indian Oil and Gas Act, 1985* and the *Indian Oil and Gas Regulations, 1995*. Revisions have been made to the Act which will come into force with a set of core regulatory changes in 2014. IOGC is responsible for oil and gas on First Nation reserve lands across Canada, but only a handful of reserves exist north of the 60th parallel, none of which are currently producing oil and gas; therefore, all of IOGC's work is south of the 60th parallel, with most of that in the Western Canada Sedimentary Basin.

IOGC's general responsibilities are to:

- identify and evaluate oil and gas resource potential on Indian reserve lands;
- encourage companies to explore for, drill and produce these resources through leasing activity;
- ensure equitable production, fair prices and proper collection of royalties on behalf of First Nations; and,
- secure compliance with and administer the regulatory framework in a fair manner.

IOGC operates under the direction of a Chief Executive Officer/Executive Director who participates as a member of the nine-member Co-management Board. The Board was established in 1996 by the signing of a Memorandum of Understanding (MOU) between the Minister of Aboriginal Affairs and Northern Development and the Indian Resource Council (IRC). The MOU established a Board to co-manage IOGC operations, focusing on areas of collective interests, such as IOGC issues, policies, plans, priorities and resources. Six of the nine Board members are selected by the IRC and three by the Crown. Two Board members serve as co-chairs, the Chairman of the IRC and the ADM, Lands and Economic Development, AANDC.

At the end of fiscal year 2012-13, IOGC was administering approximately 700 sub-surface agreements and 4,800 surface agreements. During the fiscal year 2012-13, approximately 140 wells were drilled on First Nation reserve lands and IOGC collected approximately \$180 million on behalf of First Nations. IOGC has a staff complement of 88, and has an operating budget of approximately \$12 Million.

Please refer to Appendix A of this report for a description of the lifecycle phases for oil and gas exploitation on reserves.

### **Modernization of the Indian Oil and Gas Act**

Modernization of the *Indian Oil and Gas Act* ("The Act") and associated regulations is a key priority for IOGC. This process is expected to take several years and involve extensive consultations. Amendments to the Act received royal assent in May 2009. A joint process is currently underway with IOGC, oil and gas producing First Nations, the Joint Technical Committee, and the IRC to develop the new regulations.

The Modern Act, Regulations and Systems (MARS) project scope includes significant effort and activity in developing new regulations, revising business processes ('future state'), and making enhancements to information systems. Due to the volume of the regulatory amendments expected, the work has been divided into multiple modules and phases. In preparation for new regulations, in April 2013, IOGC modified its organizational structure to better support anticipated operational requirements.

Modernizing the Indian Oil and Gas Act and its associated regulations is intended to address the existing regulatory gap and level the playing field between off-reserve and on-reserve oil and gas activities. Amendments to the Act will also reduce barriers to economic development and will allow the federal government to better fulfill its obligation to manage oil and gas resources on First Nations lands.

## **2. AUDIT OBJECTIVE AND SCOPE**

### **2.1. Audit Objective**

The objective of the audit was to determine whether AANDC and Indian Oil and Gas Canada are fulfilling their obligations with respect to the regulation and administration of oil and gas resources on reserve in an efficient, effective, and controlled manner.

## **2.2. Audit Scope**

The audit scope included an assessment of the adequacy and effectiveness of the governance, risk management, and internal controls in place to support the effective and efficient execution of AANDC's and IOGC's responsibilities in managing oil and gas resources on First Nation reserves.

The audit scope included processes and controls in place used by AANDC and IOGC to:

- manage the negotiation, issuance, and administration of agreements with oil and gas companies and First Nations;
- monitor oil and gas production and prices;
- verify/assess and collect moneys such as bonuses, royalties, and rents; and,
- ensure environmental requirements are met.

In addition, given IOGC is a separate employer from AANDC with a compensation plan in which all employees are eligible for performance pay, the audit scope also included IOGC's processes and controls in place with regards to the management of the staff performance appraisal process.

The scope of the audit covered the period April 1, 2011 through to March 31, 2013.

In order to assist with the scoping of the audit, the Audit and Evaluation Sector (AES) facilitated a control self-assessment (CSA) Workshop with IOGC on June 26, 2013. This workshop provided management with the opportunity to assess 23 control areas. The CSA workshop is a venue through which internal audit gathers participants' opinions on the importance, efficiency, and effectiveness of key management practices. Specifically, views were gathered on how well each of their key management practices is functioning to support achievement of the organization's objectives. The CSA workshop was facilitated by an AES facilitation team and was designed to allow for maximum discussion, with anonymous voting technology used to encourage open and objective feedback.

As a result of the workshop discussions, preliminary interviews and process walkthroughs, the review of extensive IOGC documentation, and the review of previous engagement findings (such as the Audit of Trust Accounts), AES identified the above noted scope areas, based on potential risk, that required further analysis during audit examination phase.

## **3. APPROACH AND METHODOLOGY**

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

The probability of significant errors, fraud, non-compliance, and other exposures were assessed and documented during the planning phase according to Audit and Assurance Services Branch protocols.

The audit approach included, but was not limited to:

- Interviews with key management personnel and selected staff;
- Review of relevant documentation such as:
  - Process documentation for areas selected for the audit, including: issue and administer sub-surface agreement, issue and administer surface agreements, royalty administration, monitoring and compliance and surrenders and terminations of agreements;
  - Procedural guides, control checklists, templates and compliance plans;
  - Employee performance appraisal frameworks, policy, and assessment criteria;
- Review of a sample (90) of different types of sub-surface and surface agreement working files (e.g. new, amendments, assignment, expiry/surrender) and employee performance agreements (5) to test adequacy and effectiveness of controls; and,
- Walkthroughs of systems used (i.e. RIMS) to assess design effectiveness in supporting processes;

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

## **4. CONCLUSION**

Generally, the audit found that AANDC and Indian Oil and Gas Canada control practices are adequate and effective. Some opportunities for improvement were noted to strengthen management practices in the following areas: policy and procedures documentation and maintenance of supporting control documentation, monitoring activities, agreement processing approach and performance measurement, and information management.

## **5. FINDINGS AND RECOMMENDATIONS**

Based on a combination of the evidence gathered through the examination of documentation and systems, analysis, and interviews, 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.

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

- There are experienced and knowledgeable staff in key positions;
- There are well documented procedural documentation and process maps for several key processes. IOGC staff perform procedures in accordance with these procedural documents and process maps;
- Checklists and control documentation are used to ensure quality and standardization throughout the lifecycle of agreements;
- The staff performance appraisal process is conducted appropriately and well documented; and,
- The Resource Information Management System (RIMS) captures a significant amount of information and provides a good base level of operational support for IOGC.

Observations below include both management practices considered to be adequate as well as those requiring improvement. Recommendations for corrective actions accompany areas identified for improvement.

### ***5.1. Lease and Royalty Administration and Regulatory Compliance***

IOGC is responsible for fulfilling the Crown's fiduciary and statutory obligations related to the regulation and administration of oil and gas resources on First Nation lands. These responsibilities include the negotiation, issuance, and administration of agreements with oil and gas companies and First Nations.

Through documentation review, interviews and sample testing of oil and gas agreements, the audit found that IOGC has established key controls to ensure accuracy, completeness, and competitive and fair return is included in agreements and that agreements issued are accurate, complete, valid, and administered in a timely manner. Examples of IOGC practices observed include synopsis and rationalization memos, verification checklists prepared by staff/administrators, reviewed by supervisors and/or managers, and validation checklists which are used to verify data entry in RIMS. The audit also observed experienced and knowledgeable staff in key positions, and those responsible for helping to establish royalty rates, terms and conditions of the sub-surface agreements have significant negotiation experience (more than 5 years experience). Service standards are used to track performance.

In addition, IOGC has established compliance and monitoring activities to ensure compliance with the terms of agreements and all applicable Acts and regulations, including ensuring environmental requirements are met. Examples of compliance monitoring practices observed during the course of the audit include monthly commitment status reports, periodic rent reviews, continuance reviews, as well as, royalty audits, production, and price verification reviews.

With regards to environmental obligations, IOGC Environmental Analysts were found to be integrated into key processes, perform periodic environmental site visits, conduct scheduled environmental compliance reviews, and confirm and approve reclamation and surrender of exploration sites.

### 5.1.1. Policy and Procedures Documentation

In order for IOGC to fulfill the Crown's fiduciary and statutory obligations related to the management of oil and gas resources on First Nation lands, it is important that IOGC establish policies and procedures which detail key responsibilities, activities, and process steps. Documented policies and procedures help to ensure IOGC oil and gas agreements are administered accurately and consistently, clarify roles and responsibilities, and provide guidance to support IOGC employees.

The audit found IOGC has developed several policies, procedure documents, and process maps which detail key process steps and control points. As noted above, IOGC management has also developed control checklists and routing slips to ensure quality and standardization throughout the lifecycle of agreements and ensure processes are performed in accordance with IOGC policies. Audit testing found that IOGC staff generally perform control procedures in accordance with these procedural documents and process maps.

While most key IOGC processes are adequately documented, the audit found a couple exceptions in documentation of policy and procedures, including:

- IOGC assists First Nations to dispose of their oil and gas rights through the granting of sub-surface agreements, including helping to negotiate these agreements with companies and ensuring fair returns for First Nations. Among the items negotiated are bonus terms (permit and lease) which are paid to First Nations. In order to determine the terms of the bonus, IOGC Sub-surface Negotiators reference bonus terms that have been established for lands that are located in close proximity to the new oil or gas site (i.e. within a one-mile radius). If there are no operating wells within close proximity, the Sub-surface Negotiator takes into consideration the bonus terms that have been established for lands that are located within a two-mile radius, then three-mile radius, and so on. The audit, however, noted that this process of determining bonus terms is not formally documented; and,
- A key monitoring responsibility of the IOGC environmental group is to perform field inspections of oil and gas facilities to monitor industry compliance with the environmental terms of oil and gas agreements and to ensure the adequacy of site reclamations prior to the surrender of agreements. Performance of these site inspections often requires IOGC Environmental Analysts to work alone in remote locations, with limited communications connectivity. The audit noted that there is no IOGC “work alone” policy established to define roles and responsibilities and related “work alone” safety procedures are not formally documented.

Without adequately documented procedures for all key practices, there is an increased risk that roles and responsibilities are not clearly understood, processes are inconsistently applied by staff, or rationale for key decisions are not adequately documented.

#### ***Recommendation:***

1. The Executive Director of Indian Oil and Gas Canada should ensure IOGC policy and procedures are sufficiently documented for key processes which clearly describe roles and responsibilities.

### 5.1.2. Maintaining Supporting Control Documentation

AANDC and IOGC operates pursuant to the *Indian Oil and Gas Act* and the *Indian Oil and Gas Regulations* and there is a requirement that all necessary supporting documentation for oil and gas sub-surface and surface agreements be properly maintained, and key technical IOGC personnel and delegated authorities perform adequate review and approval at key stages of the process.

As noted above, to ensure accuracy, completeness, and validity in the administration of oil and gas agreements, IOGC has implemented controls including procedural documentation, process maps, control checklists and routing slips.

The audit examined a sample of 90 oil and gas agreement (e.g. new surface agreements, sub-surface, amendments, assignments, surrenders, etc.). In all samples reviewed, the audit expected to find that controls were followed consistently and as per IOGC procedural documentation. While almost all 90 agreements reviewed included appropriate authorizations and approvals, a few minor exceptions were noted such as missing an acreage confirmation or a letter informing the First Nation of an assignment. A few minor instances were also noted where control checklists for processes such as issuance of surface agreements and surface amendments were completed; however, there was no evidence on the completed checklist of approval from the responsible manager.

When key documentation is not properly maintained or controls are not followed as intended there is increased risk of not being able to sufficiently demonstrate evidence of management due diligence, review and approval.

#### **Recommendation:**

2. The Executive Director of Indian Oil and Gas Canada should ensure that supporting evidence to demonstrate due diligence, review, and approval is properly maintained for accountability and audit trail purposes.

### 5.1.3. Monitoring Activities

IOGC is responsible for collecting oil and gas royalties on behalf of First Nations for all oil and gas produced from First Nation reserve lands; therefore, it is important that IOGC have practices in place to monitor oil and gas production and prices and verify, assess, and collect moneys such as bonuses, royalties, and rents. It is also important that IOGC make sure submitted royalty data is validated and verified and moneys collected are managed appropriately.

The audit found that IOGC has implemented a monitoring and assurance framework to validate and verify information reported to IOGC and manage the collection of monies. Procedure manuals and business rules are in place to guide IOGC practices for the collection of funds and management of suspense accounts. The audit found that IOGC has established practices to regularly monitor the status of agreements, conduct periodic rent reviews, and provide companies with monthly statements of account.

Royalty payers are required to submit royalty information (i.e. production volumes and pricing) through IOGC's electronic submission system. As production and price information is self-reported by companies to IOGC, IOGC has implemented assurance programs and monitoring activities to verify that company production volumes are reported accurately for well and production entities to ensure proper reporting and payment of revenues for all parties involved. As part of this assurance program, prices reported are verified and well production and royalty payments are subject to periodic audits which ensure proper reporting and payment of revenues for all parties involved.

While many of the IOGC monitoring framework activities were found to be well controlled, the audit found a few areas for improvement, as noted below.

The audit found that parts of the price, production, and royalty review processes are not fully documented. Specifically, although risk factors are considered in selecting companies for price, production, and royalty reviews, the audit noted that the approach and selection rationale is not formally documented.

The reporting of oil and gas production to provincial agencies is mandatory, in accordance with their respective regulatory requirements. To confirm that production information is being reported accurately and on a timely basis by production entities, IOGC subjects operators to periodic production reporting reviews. As per the IOGC Production Reporting Handbook, selecting which property or facility to review is determined based on selection criteria determined by IOGC (e.g. volumes, value of production, audit history, other factors such as complaints, etc.). An independent third party reviewer performs the review, assesses the information reported (e.g. schematics, reports, factors, procedures, formulas, tests, etc.), and determines any deficiencies or discrepancies in the production reporting.

When a review is completed, any deficiencies or discrepancies found during the review are expected to be communicated to the operator and the operator is required to provide a detailed response outlining what steps were taken to address the deficiency and what steps will be taken to prevent future occurrences of the non-compliance. Upon receipt of an operator's response letter, each item in the deficiency letter is expected to be checked by the reviewer to ensure a proper response has been received. When the operator has satisfactorily addressed the concerns noted in the deficiency letter, a closure letter is expected to be submitted to the operator stating that the items raised have been satisfactorily addressed. Final approval of the operator response is then provided by IOGC.

It was noted during the audit that no production reporting reviews to facilitate IOGC's production volume validation process were completed in 2012-2013. This was due to the fact that the contracting vehicle in place for an independent reviewer expired and no new contracting vehicle was put in place as the priority focus was on regulations modernization. In addition, it was noted that the risk matrix (i.e. selection criteria) used to select which property or facility for production reporting review has not recently been updated, and is considered by IOGC to be out of date.

Lastly, while IOGC reported that independent reviewers do review operator responses to verify that operator actions will adequately address identified discrepancies and deficiencies, the audit found that the review and commentary by the independent reviewer is not adequately and consistently documented as per the IOGC Production Reporting Handbook.

When the rationale used to select companies, property, or facility for review is not up to date or not documented, there is an increased risk that monitoring activities performed may not address the most significant priorities or risks. Without adequate verification of operator production reporting information, there is a risk that production report information is not accurately reported. Lastly, without proper evidence of review of operator action plans, there is increased risk that operator responses do not fully address the identified discrepancies or deficiencies.

***Recommendation:***

3. The Executive Director of Indian Oil and Gas Canada should document the approach and selection rationale used to select companies for monitoring reviews, and for production reviews, implement a contracting vehicle, update the risk matrix used, and ensure company action plans are adequately reviewed and approved by the independent reviewer prior to final approval by IOGC.

#### **5.1.4. Agreement Processing Approach and Performance Measurement**

In order to balance control requirements with available support and resources, it is important that IOGC follow a risk-based approach to processing oil and gas agreements. In addition, it is important that performance measurement strategies accurately reflect the desired outcomes and management monitor performance against planned results.

IOGC is responsible for processing a variety of transactions related to oil and gas agreements, including issuing and terminating surface and sub-surface leases, as well as assigning lease interests. While some transactions are simple and can be processed quickly, others are more complex and require negotiation with the company and the First Nation involved in order to process. IOGC has developed detailed procedures to process each type of transaction, which include completing checklists that are reviewed and approved by the Supervisor and Manager. As the workload is sometimes greater than the resources available, lease issuance agreements take precedence in processing. These types of transactions are considered higher risk, and their status is followed up on routinely by the companies and First Nations involved.

An assignment of a company's interest in an oil and gas contract occurs when a company sells or transfers an interest in the contract to another company or companies. When a company assigns its interest in a control, such as a permit or oil and gas lease, the company must obtain approval from IOGC, who reviews the assignment to determine whether it is in accordance with the regulations. IOGC can refuse an assignment for a variety of reasons, including if a royalty payment is outstanding, a party to the assignment is in default, the assignment is not properly executed, or the assignee cannot demonstrate sufficient financial ability to fulfill its obligations. Management noted IOGC is currently experiencing a backlog in processing assignments of

agreements. Audit file testing of 20 assignments found they averaged approximately 1 year from receipt of assignment notification until completion.

While control checklists are used to ensure consistency and completeness, the audit found that a risk-based approach is not used to process surface agreement activities, despite some transactions being considered higher risk than others. In addition, performance indicators used by IOGC were found to measure only some aspects of the process (i.e. service standards for acknowledging receipt of an application) rather than the entire processing time, and therefore do not highlight the fact that completion of transactions can sometimes be delayed significantly.

IOGC has begun an activity to develop process maps of desired future state processes to support the new Act and regulations. During 2013-14, design state and future state process mapping will continue with a focus on royalties, royalty-related work areas. As part of this initiative, there is opportunity for IOGC to review control requirements and performance measures in support of the new regulations.

Without an approach which balances control requirements with risk and available resources, there is increased risk that resources are not optimized, resulting in slower processing overall and potential client dissatisfaction or liabilities. In addition, by not having performance measures that measure a complete transaction, there is risk that that management will not be able to identify potential process bottlenecks or sufficiently communicate actual processing times to clients.

***Recommendation:***

4. The Executive Director of Indian Oil and Gas Canada should review control requirements and implement a risk-based approach to process different types of agreement transactions, in order to improve processing timeliness. It is further recommended that performance indicators be developed and monitored to reflect the time to process the agreement transactions and highlight delays and/or bottlenecks pertaining to certain types of transactions.

## **5.2. Information Management**

### **5.2.1. Resource Information Management System (RIMS)**

It is critical to have information management systems which capture, process, and disseminate accurate and timely data and information to support IOGC in the efficient and effective processing and administration of agreements. It is also important that these systems keep pace with changes in the business environment, and with provincial and industry advances in administration of and gas agreements. An important aspect of information management systems is to ensure there is effective governance and a structured and orderly approach to manage changes to information systems, introduce new systems, and manage the eventual decommission of legacy information management systems.

With regards to IOGC, the 'Resource Information Management System' (RIMS) is used to capture information related to oil and gas agreements. RIMS was developed with the objective of facilitating the accurate and timely processing of information, as required by IOGC. The audit found that RIMS captures a significant amount of information and provides a good base level of operational support for IOGC. As an information management tool for capturing and tracking information, RIMS was found to be integral to many of IOGC's business processes and mandated responsibilities.

Upgrades to RIMS have been proposed as part of the Modernized Act, Regulations and System (MARS) project, as many developments have occurred in the oil and gas business environment over the past few years and RIMS is a crucial part of IOGC activities within this environment.

The initial proposed solution for upgrading RIMS to better support new Indian Oil and Gas Act regulations, which included significant system upgrades and enhancements, was deemed too cost-prohibitive to pursue (i.e. full replacement of RIMS). As such, IOGC is now reviewing business requirements and examining options for modernizing RIMS within a reduced budget. A reduced-scope, focused, and modular solution to enhance the current RIMS platform is being considered. A revised business case and action plan is being developed and priority is being given to areas of greater need (e.g. royalty management).

Given the change in direction, a backlog of RIMS change requests now require review and prioritization by IOGC management to determine which enhancements can be managed incrementally within RIMS, or require inclusion in the revised business case for RIMS2. At the time of the audit, an IOGC Steering Committee and working group had recently been established to review and prioritize requested changes to RIMS; however, given the Steering Committee was newly created, the audit was unable to conclude on its effectiveness.

A formal and effective governance mechanism or change management practice is essential for the RIMS initiative. Without one, there is an increased risk that change requests will be inappropriately prioritized so that "must have" changes to RIMS are not identified and implemented in a timely manner.

### ***Recommendation***

5. The Executive Director of Indian Oil and Gas Canada should ensure the Steering Committee provides governance and oversight of RIMS in order to ensure change requests are prioritized and high risk issues are addressed in a timely manner. It is further recommended that primary RIMS enhancements be identified and the revised RIMS2 business case be presented to Headquarters.

### **5.2.2. Information available on IOGC Website**

As the regulations and requirements for on-reserve oil and gas activity are unique, it is important that accurate and timely information is available to stakeholders (companies and First Nations) in order for them to understand what is required of them. On-reserve oil and gas activity accounts for only a very small portion of oil and gas activity in Alberta and Saskatchewan, and

so these unique regulations are often not familiar to industry, as companies are more familiar with provincial regulations.

It was noted during the audit that while there is a significant amount of information available on the IOGC website, information on regulations and processes for on-reserve oil and gas activity is not always up-to-date. Specific examples include information related to environmental procedures, and royalty and production requirements.

Without providing accurate and timely information that is required to inform industry stakeholders on IOGC's practices, there is an increased risk that industry will not initiate or maximize its on-reserve oil and gas activity, therefore impeding on First Nation's ability to realize economic development.

***Recommendation:***

6. The Executive Director of Indian Oil and Gas Canada should ensure regulations and procedures posted on the IOGC website remain up-to-date, in particular as the new legislation and regulations comes into effect.

### **5.3. People**

A key element of a performance management program is to reward staff for strong performance. This includes conducting periodic assessments of staff performance. It is important that these performance appraisals be conducted in a consistent manner across the organization and be aligned to IOGC objectives.

As a SOA under AANDC, IOGC was established with separate employer status to enable IOGC to have qualified staff to properly manage oil and gas rights and to compete with compensation provided by industry for limited professional and technical expertise. While IOGC staff continue to be public servants under the Public Service Employment Act, IOGC was established with a pay plan that includes a performance pay system that is applicable to all employees and provides for in-range salary movement based on performance.

To meet these commitments, IOGC has implemented a Performance Management Policy to set out IOGC's policy and responsibilities related to performance management. Performance management plan guidelines also outline the performance management cycle which includes performance planning, regular progress reviews, year-end review, Executive Committee level review, post-review discussion, and recourse process. Periodic (quarterly) reviews of employee performance are completed throughout the year to monitor progress, identify problem areas, if any, and provide coaching, training and/or assistance if applicable. At year-end, an evaluation process begins whereby all employees are assessed by their supervisor/manager on the achievement of their objectives. A set of performance ratings have been established to consistently assess performance. Once all assessments are complete, the Executive Committee, composed of IOGC Directors, review the individual evaluations and collectively agree on an overall performance rating. Management also analyses the results to validate and calibrate performance ratings.

The audit found that the staff performance appraisal process is well designed and documented. The audit also reviewed a sample of performance agreements and noted that performance assessments are conducted in a consistent basis across the organization and aligned with IOGC objectives.

***Recommendation:***

No recommendations were identified in this area.

## 6. MANAGEMENT ACTION PLAN

Recommendations	Management Response / Actions	Responsible Manager (Title)	Planned Implementation Date
<p>1. The Executive Director of Indian Oil and Gas Canada should ensure IOGC policy and procedures are sufficiently documented for key processes which clearly describe roles and responsibilities.</p>	<p>Indian Oil and Gas Canada will ensure policy and procedures are sufficiently documented for key processes and that they clearly describe roles and responsibilities. A policy/procedure on the process of determining bonus will be documented and in place by March 31, 2014 and a work alone policy and related safety procedures will be developed and approved by June 30, 2014.</p>	<p>Executive Director, Indian Oil and Gas Canada</p>	<p>June 30, 2014</p>
<p>2. The Executive Director of Indian Oil and Gas Canada should ensure that supporting evidence to demonstrate due diligence, review, and approval is properly maintained for accountability and audit trail purposes.</p>	<p>Indian Oil and Gas Canada will ensure supporting evidence to demonstrate due diligence, review and approval is properly maintained for accountability and audit trail purposes. By June 30, 2014, IOGC will review and revise its checklists to note key documents required and ensure the appropriate sign-off and other due diligence requirements for each transaction type are noted and present.</p>	<p>Executive Director, Indian Oil and Gas Canada</p>	<p>June 30, 2014</p>

<p>3. The Executive Director of Indian Oil and Gas Canada should document the approach and selection rationale used to select companies for monitoring reviews, and for production reviews, implement a contracting vehicle, update the risk matrix used, and ensure company action plans are adequately reviewed and approved by the independent reviewer prior to final approval by IOGC.</p>	<p>Indian Oil and Gas Canada will document the approach and selection rationale used to select companies for price, production volume and royalty reviews by June 30, 2014. New contract vehicles for price, production and royalty reviews will be in place by December 30, 2013. The risk matrix used to select which property or facility for production reporting review will be updated by March 31, 2014. Requirements to document the review and commentary by independent reviewers prior to final approval by IOGC will be implemented by March 31, 2014.</p>	<p>Executive Director, Indian Oil and Gas Canada</p>	<p>June 30, 2014</p>
<p>4. The Executive Director of Indian Oil and Gas Canada should review control requirements and implement a risk-based approach to process different types of agreement transactions in order to improve processing timeliness. It is further recommended that performance indicators be developed and monitored to reflect the time to process agreement transactions and highlight delays and/or bottlenecks pertaining to certain types of transactions.</p>	<p>Indian Oil and Gas Canada will complete a review of its control requirements and will implement a risk based approach to process different types of agreement transactions by June 30, 2014. Existing performance indicators will be reviewed/ revised and new performance indicators will be developed, as necessary, by March 31, 2014, which will reflect the time to process agreement transactions and which will highlight delays or bottlenecks for certain transaction-types.</p>	<p>Executive Director, Indian Oil and Gas Canada</p>	<p>June 30, 2014</p>

<p>5. The Executive Director of Indian Oil and Gas Canada should ensure the Steering Committee provides governance and oversight of RIMS in order to ensure change requests are prioritized and high risk issues are addressed in a timely manner. It is further recommended that primary RIMS enhancements are identified and the revised RIMS2 business case be presented to Headquarters.</p>	<p>Indian Oil and Gas Canada will ensure the Steering Committee provides governance and oversight of RIMS during monthly meetings which provide: oversight of RIMS and of the work of the RIMS user group, which meets weekly to address operational issues; prioritization of change requests for resolving system fixes; to ensure high risk issues are addressed in a timely manner; and the identification and consideration of required RIMS enhancements to determine whether investment for new desired functionality should be made within the existing RIMS, or the RIMS2 system under development. The revised RIMS2 business case will be presented to headquarters as part of the IMB gating process by March 31, 2014.</p>	<p>Executive Director, Indian Oil and Gas Canada</p>	<p>March 31, 2014</p>
<p>6. The Executive Director of Indian Oil and Gas Canada should ensure regulations and procedures posted on the IOGC website remain up-to-date, in particular as new regulations come into effect.</p>	<p>Indian Oil and Gas Canada will complete a review and update its website documentation by March 31, 2014 and will add a last reviewed date to ensure quarterly updates at a minimum, with changes to specified areas more frequently, if required.</p>	<p>Executive Director, Indian Oil and Gas Canada</p>	<p>March 31, 2014</p>

## Appendix A: Oil & Gas Lifecycle

The key stages in the lifecycle of an oil and gas agreement on First Nation reserve land and IOGC's responsibilities are summarized below:

- 1) **Land for Leasing:** Prior to leasing, IOGC confirms reserve title to the land and verifies that the lands are designated, which allows IOGC to manage the First Nation's oil and gas resources.
- 2) **Sub-surface Agreements:** Sub-surface agreements provide companies with rights to drill and to produce oil and gas. IOGC assists the First Nation to negotiate agreements with companies and also ensures fair returns before IOGC and the First Nation approve the agreement. IOGC drafts, issues and administers the agreements and collects bonuses, royalties and rents from companies on behalf of the First Nation.
- 3) **Seismic Programs:** Exploratory licenses provide companies with surface access to conduct seismic activity. A company must submit an environmental assessment, as part of the exploratory license application, to IOGC and the First Nation. IOGC collects compensation for the exploratory work from companies on behalf of First Nations.
- 4) **Surface Agreements:** Surface agreements provide companies with the right to construct surface facilities such as well sites and access roads or to install pipelines. A company must submit an environmental assessment, to IOGC and the First Nation, with their surface lease or right-of-way application. IOGC ensures that environmental protection standards are met before IOGC and the First Nation approve the agreement. Additionally, companies must conduct ongoing environmental monitoring during construction and operation phases. IOGC administers the agreements and collects initial considerations and annual rents from companies on behalf of the First Nation.
- 5) **Drilling Wells:** A company must have a surface lease, must obtain a provincial well license and submit it to the First Nation and IOGC prior to drilling. IOGC collects drilling information from companies for statistics and other purposes, such as helping with IOGC's interpretation of the geology under the reserve.
- 6) **Production:** IOGC monitors and evaluates all aspects of oil and gas production from drilling to abandonment, such as monitoring offset drilling and ensuring proper measurement and production reporting. IOGC ensures that production occurs in a sound environmental manner and that royalties are calculated accurately, including auditing prices and deductions. IOGC collects royalties on behalf of the First Nation.
- 7) **Well Abandonment:** A company requires written permission from IOGC in consultation with the First Nation to abandon a well. IOGC checks the well for additional production possibilities.
- 8) **Surrenders of Sub-Surface Agreements:** IOGC reviews all surrender requests in consultation with the First Nation. IOGC will process and execute the surrender, provided

that the company is not in default of any part of the Regulations or the lease on First Nation reserve lands.

- 9) **Surrenders of Surface Agreements (Remediation and Reclamation):** Before IOGC will consider a surface surrender, companies must abandon any wells, remove any facilities, conduct remediation if necessary and reclaim the area. The surrenders of surface agreements are approved by IOGC following confirmation, by inspection with the First Nation, that reclamation is satisfactory.

## Appendix B: Audit Criteria

The audit objective was linked to audit criteria developed in alignment with Treasury Board of Canada Secretariat's *Audit Criteria related to the Management Accountability Framework: A Tool for Internal Auditors (March 2011)*. Additional audit criteria were developed to address specific risks identified in the planning phase.

<b>Audit Criteria</b>	
<b>Lease and Royalty Administration and Regulatory Compliance</b>	
1.1	Established processes are in place to ensure accuracy, completeness, and competitive and fair return is included in sub-surface agreements
1.2	Surface agreements issued are accurate, complete, valid, and administered in a timely manner
1.3	Submitted royalty data is validated and verified and moneys collected are managed appropriately
1.4	Compliance and monitoring activities are in place to ensure compliance with the terms of agreements and all applicable Acts and Regulations
<b>Information Management</b>	
2.1	Processes and procedures exist to support the continuity of information and systems
<b>People</b>	
3.1	Performance appraisals are conducted in a consistent basis across the organization and aligned with IOGC objectives

## Appendix C: Applicable Legislation, Regulations, and Policies

- *Indian Act, 1985*
- *Indian Oil and Gas Act, 1985*
- *Indian Oil and Gas Regulations, 1995*
- *Canadian Environmental Assessment Act, 2012*
- *Canadian Environmental Protection Act, 1999*
- *Fisheries Act, 1985*
- *Navigable Waters Protection Act, 1985*
- *Saskatchewan Treaty Land Entitlement Act, 1993*
- *Claim Settlements (Alberta and Saskatchewan) Implementation Act, 2002*
- *Federal Real Property and Federal Immovables Act, 1991*
- *Species At Risk Act, 2002*
- *Migratory Birds Convention Act, 1994*
- *Financial Administration Act, 1985*
- *Assignment of Contract Rights and Approval Policy, 2004*
- *Disposition of Oil and Gas Rights Policy, 2001*
- *Operational Volumetric Policy, 2007*
- *Manual for the Administration of Band Moneys*