Energy

SUMMARY

DEPARTMENT

Matters from the current audit

The Department of Energy should improve its financial reporting processes—see below

Matters from prior audits

The department has implemented an enterprise risk management system—see page 126

The department implemented a process to ensure bioenergy grant recipients comply with the terms of their grant agreements—see page 126

FINDINGS AND RECOMMENDATIONS

Matters from the current audit

Improve financial reporting processes

Background

The Department of Energy has a difficult financial reporting task. The provincial royalty system is predicated on self-reporting where the petroleum and natural gas industry is expected to understand the relevant energy legislation and comply with it. This can have an impact on the completeness of revenue when the petroleum and natural gas industry does not fully meet the legislative requirements and, for example, report inaccurate or incomplete data. Natural gas revenue is calculated based on allowable costs incurred by the royalty payers and production volumes that are reported to the department by royalty payers. The costs and volumes could vary significantly from that initially reported.

The department estimates what the costs, volumes and royalty rates for the fiscal year should be, based on statistical analysis of industry data. For projects from which bitumen royalty is paid and the project has reached payout, the royalty rate starts at 25% of net profits and increases to 40% of net profits depending on the average price of oil. Payout is defined at the first date at which the cumulative revenue of a project firsts equals the cumulative cost of the project. The department does not know the actual amount it will receive in royalties until months after the government's fiscal year end. But it must report an estimated amount for royalties when it reports on the government's finances for the fiscal year. Estimating these amounts requires using complex models. In addition, the department has introduced many incentive programs for which royalty adjustments are necessary.

RECOMMENDATION 15: IMPROVE FINANCIAL REPORTING PROCESSES

We recommend that the Department of Energy improve its processes to prepare department and ministry financial statements and supporting working papers.

Criteria: the standards for our audit

The department should have effective quality control processes to produce timely and accurate year-end financial statements and supporting working papers.

This requires:
- standard procedures to assist program areas in developing estimates for financial reporting
- thorough review of accruals and known amounts
- effective processes to review financial statements and supporting working papers before they are presented for audit
- Our audit findings

Our audit findings

KEY FINDINGS

The department's finance group:
- has not provided standard procedures to assist program areas in developing estimates for financial reporting
- is not doing a thorough review of accruals and known amounts
- is adjusting the financial statements for errors but not flowing the adjustments through to the supporting notes and schedules
- made multiple financial statements errors and provided us with many sets of draft financial statements to audit

During the audit, we identified many errors and inconsistencies in the financial statements. The program areas had an insufficient understanding of how to develop financial reporting estimates. The finance group did not effectively review the estimates it received from the program areas. We identified errors that overstated royalty revenue by $32 million and net income by $42 million, and understated liabilities by $23 million. The notes to the financial statements understated royalty credits by $40 million and overstated contractual obligations by $36 million. These errors did not have an impact on the amount of royalty collected and were subsequently corrected by management.

Implications and risks if recommendation not implemented

Without effective processes to estimate and review amounts reported in the financial statements, the department cannot promptly and accurately report its financial results.

Matters from prior audits

Implement an enterprise risk management system—implemented

In 2013[1] we recommended that the department design and implement an effective enterprise risk management system (ERM) to ensure it identified, tracked and appropriately mitigated relevant risks.

The department implemented our recommendation by initiating a formal risk management process, which includes a variety of processes to continuously identify and manage significant issues and risks as they arise.

[1] *Report of the Auditor General of Alberta—October 2013*, no. 6, page 87.

Ensuring compliance with terms of bioenergy grant agreements—implemented

In 2012[2] we recommended that the department ensure that recipients under the Bioenergy Producer Credit Grant program comply with their grant agreements.

The department implemented our recommendation by obtaining outstanding annual reports from prior-year grant recipients and ensuring that all grant recipients are submitting the required reports as outlined in the grant agreements. We noted that the department has developed a process to follow up with grant recipients who fail to submit the required reports. Additionally, we did not identify any instance of non-compliance during our testing of bioenergy grants.

OUTSTANDING RECOMMENDATIONS

DEPARTMENT

Management has identified this recommendation as implemented—to be confirmed with a follow-up audit:

Improving processes to recognize royalty revenue estimates in the financial statements —October 2012, no. 15, p. 97
(Originally November 2011, no. 13, p. 89)

We again recommend that the Department of Energy improve its controls to ensure consistent application of methodology used to calculate bitumen royalty estimates.

[2] *Report of the Auditor General of Alberta – October 2012, No. 14*, page 96.