



Department of the Interior Office of Inspector General

Audit of Oversight Performed by the Minerals Management Service of Non-Federal Auditors

No. 2003-I-0061

August 2003

August 22, 2003

Memorandum

To: Assistant Secretary for Land and Minerals Management

From: Anne L. Richards
Regional Audit Manager

Subject: Final Report, Audit of Oversight Performed by the Minerals Management Service of Non-Federal Auditors (Report No. 2003-I-0061)

The attached report presents the results of our review of the Minerals Management Service's (MMS) oversight of non-federal auditors. Our objective was to determine whether MMS' oversight of royalty audits conducted by non-federal auditors is effective to ensure compliance with the Government Auditing Standards (Standards). We concluded that MMS' oversight was reasonably effective to ensure states and tribes complied with the Standards.

We did, however, find weaknesses that MMS needs to correct. We noted that (1) some cooperative agreements contained outdated provisions, (2) audits of Jicarilla tribal leases were not covered by internal quality control reviews, and (3) neither the MMS' internal quality control reviews nor the state peer review processes had a formal follow-up process.

In the May 12, 2003 response to the draft report, the Assistant Secretary and the MMS Director agreed with the findings and recommendations in the report. However, the response did not provide sufficient information for us to consider all the recommendations resolved and implemented. Accordingly, we are requesting that MMS provide us with the information indicated in Appendix 4. We would appreciate your written response to this report by October 1, 2003.

The legislation, as amended, creating the Office of Inspector General requires that we report to Congress semiannually on all audit reports issued, actions taken to implement our audit recommendations, and recommendations that have not been implemented. Therefore, this report will be added to the next semiannual report.

We appreciate the cooperation provided by the MMS staff during our audit. If you have any questions regarding this report, please call me at (303) 236-9243.

Attachment

CONTENTS

	<u>Page</u>
Background.....	1
Objective.....	2
Scope and Methodology	3
Results of Audit	5
1. Cooperative Agreement Provisions Were Outdated	7
2. Audits of Jicarilla Leases Are Not Reviewed.....	8
3. Followup Process Is Not Formalized	9
4. Suggestions for Improvement	10
Other Matters	11
Appendices	
1. Cooperative Audit Agreements With State and Indian Tribal Governments.....	12
2. MMS Response and OIG Reply	13
3. MMS Response to Draft Audit Report.....	14
4. Status of Recommendations	20



BACKGROUND

- Companies pay a percentage (called a “royalty”) of the value of minerals produced from Federal and Indian lands. The Federal and state governments share the royalties from Federal leases while the Indian tribes and individual Indians retain all royalties from leases on their land.
- MMS conducts audits of and contracts with state and tribal audit organizations to conduct audits of companies to verify that royalties have been correctly paid. MMS has executed cooperative agreements with 10 state and 8 tribal audit organizations (Appendix 1) to perform royalty audits of Federal and Indian leases located within their state or tribal boundaries.
- MMS has oversight responsibility to ensure that states and tribes perform quality audits and satisfy the terms of the cooperative agreements.



OBJECTIVE

- Determine whether MMS' oversight of royalty audits conducted by non-federal auditors is effective to ensure compliance with the Government Auditing Standards.



SCOPE AND METHODOLOGY

- Our audit addressed MMS' oversight of royalty audits performed by state and tribal auditors under authority of the Federal Oil and Gas Royalty Management Act of 1982, sections 202 and 205 as amended, for audits conducted in 1999 through 2002.
- MMS did not accumulate data on the total number of audits conducted by the states and tribes during this period, so we could not determine the total universe of audits under review.
- To accomplish our objectives, we:
 - Gained an understanding of MMS' oversight process.
 - Obtained an understanding of the peer reviews conducted by the states and tribes of each other. A peer review is a review by an independent, external auditor to determine whether an audit organization has complied with required audit standards.
 - Obtained an understanding of the internal quality control systems of states and tribes and the quality control reviews conducted by MMS of the states and tribes.



SCOPE AND METHODOLOGY (Continued)

- Interviewed MMS officials and contacted three state and two tribal audit organizations to learn how their peer reviews, internal quality control systems, and quality control reviews are designed and function.
- Reviewed relevant documentation regarding planning and performance of peer reviews and quality control reviews. However, we did not review working papers from individual audits because we were evaluating MMS' overall process and not conducting a quality review of audit work conducted by the states and tribes.
- We conducted our work from July through September 2002 in accordance with the Government Auditing Standards.



RESULTS OF AUDIT

- MMS' oversight was reasonably effective to ensure that states and tribes complied with the Government Auditing Standards. Specifically, MMS:
 - Determined that states and tribes on a regular and effective basis complied with audit contracts and monitored states' and tribes' audit performance, including reviews of annual work plans and budgets.
 - Consistently conducted internal reviews of states and tribes.
 - Performed reasonably complete internal reviews of states and tribes.
- MMS is correcting some of the internal quality control system weaknesses, in response to our recent audit of its audit offices, that affect its oversight of states and tribes.
 - The quality review checklist is being revised to include assessments of:
 - Due professional care¹
 - Audit planning and reporting
 - Supervisory review

¹ According to the Government Auditing Standards (3.28), exercising due professional care “means using sound judgment in establishing the scope, selecting the methodology, and choosing tests and procedures for the audit.”



RESULTS OF AUDIT (Continued)

- A formal follow-up process is being established to verify that identified weaknesses receive appropriate and timely corrective action.
- MMS needs to correct the following weaknesses.
 - Outdated provisions in some cooperative agreements.
 - Lack of internal quality control reviews in audits of Jicarilla tribal leases.
 - Lack of a formal follow-up process for the MMS' internal quality control reviews and for the state peer reviews.
- MMS should consider the other opportunities for improvement identified by our audit.



1. COOPERATIVE AGREEMENT PROVISIONS WERE OUTDATED

- The agreements with states and tribes were not always updated for current auditing standards and policies.
 - Four out of eight agreements were not modified to include compliance with a Departmental directive to permanently retain Indian trust data.
 - Two agreements referenced outdated versions of the Government Auditing Standards.

Recommendation

MMS should ensure that the agreements reflect current auditing standards and policies.



2. AUDITS OF JICARILLA LEASES ARE NOT REVIEWED

- The MMS audit team assigned to the Jicarilla cooperative agreement did not undergo regular internal quality control reviews.
 - Unlike the other agreements, which require the state or tribe to conduct the audits, the Jicarilla cooperative agreement stipulates that a tribal official will only monitor and assist an MMS audit team.
 - MMS has not included audits of Jicarilla leases in its routine schedule of internal reviews that it conducts of its own auditors.
 - Government Auditing Standards (Section 3.31 to 3.32) require an appropriate internal quality control system to be in place. The system should be designed to ensure that all MMS audit teams follow adequate audit policies and procedures (President's Council on Integrity and Efficiency Guide, Appendix I, Internal Quality Control System).

Recommendation

MMS should include audit work conducted by its Jicarilla audit team in its internal quality control process.



3. FOLLOW-UP PROCESS IS NOT FORMALIZED

- States and tribes properly scheduled and performed peer reviews, but there was no formal follow-up process established.
- Similarly, MMS' internal reviews of states and tribes did not have a formal and timely follow-up process to ensure that identified weaknesses were corrected.
 - MMS stated that it has initiated an interim follow-up process. However, the new process has not been documented and does not provide for the reviewed state or tribal audit group to prepare a written action plan to address reported deficiencies.

Recommendations

- ❖ MMS should ensure that the reviewed office, in response to each peer review and internal review containing findings, prepare a formal action plan (written, with reasonable deadlines and responsible officials identified).
- ❖ MMS should schedule internal reviews to evaluate implementation of the action plans, when appropriate.



SUGGESTIONS FOR IMPROVEMENT

- Based on our observations during the audit, we also believe that MMS can strengthen its oversight of states and tribes by:
 - Using MMS auditors to assist the smaller state/tribal audit organizations in performing independent referencing (verification of facts and conclusions in each audit report to supporting work papers) of report products.
 - Ensuring that state/tribal auditors are properly qualified and independent. Each state/tribal audit group should annually certify that all auditors are current with their continuing education and are independent of their auditees.
 - Requiring that state and tribal audit reports clearly identify that the state or tribe is responsible for the audit work.
 - Requiring that peer reviews cover all relevant steps contained in guidelines published by the President's Council on Integrity and Efficiency (PCIE).
 - Adopting the PCIE recommendation of providing no advance notice of audit files selected for review.



OTHER MATTERS

- During the course of our audit, several state and tribal organizations expressed concern over the overlap between MMS' oversight, as conducted through its internal review process of state and tribal audit groups, and the states' and tribes' own internal quality control systems and the external peer reviews to which all audit groups are subjected.

We concluded that since these separate processes are all required by Government Auditing Standards one cannot be substituted for another. As a result there is some overlap among the processes that cannot be avoided.

COOPERATIVE AUDIT AGREEMENTS WITH STATE AND INDIAN TRIBAL GOVERNMENTS

State Governments

California

Colorado

Louisiana

Montana

New Mexico

North Dakota

Oklahoma

Texas

Utah

Wyoming

Tribal Governments

Blackfeet Nation

Crow Indian Tribe

Jicarilla Apache Indian
Tribe

Navajo Nation

Shoshone & Arapaho
Tribes

Southern Ute Indian Tribe

Ute Indian Tribe

Ute Mountain Ute Indian
Tribe

MMS RESPONSE AND OIG REPLY

In the May 12, 2003 response (Appendix 3) to the draft report, the Assistant Secretary for Land and Minerals Management, and the Director, MMS, agreed with three of the four recommendations and with all five of the suggested improvements.

Regarding recommendation 1 to ensure that agreements with states and tribes are updated timely, MMS stated that all 18 audit agreements were modified to require that auditors comply with the 1994 version of the Government Auditing Standards as amended in 1999. This satisfied the recommendation, and we consider the recommendation resolved and implemented. However, the General Accounting Office issued revised Government Auditing Standards in June 2003 , and we suggest that MMS update the audit agreements to reflect the new Standards.

Regarding recommendation 2 to include audit work conducted by MMS' Jicarilla audit team in its internal quality control process, MMS did not provide its concurrence or non-concurrence. MMS stated that the audit team for Jicarilla tribal leases has been covered by the internal quality control review process. We found, however, that the Jicarilla team was not, in fact, subjected to regular internal reviews. Although the MMS response indicates concurrence with our recommendation, we request that MMS reaffirm that the Jicarilla team will be included in future internal reviews.



United States Department of the Interior

MINERALS MANAGEMENT SERVICE
Washington, DC 20240



MAY 12 2003

Memorandum

To: Assistant Inspector General for Audits

Through: Rebecca W. Watson *Rebecca W. Watson*
Assistant Secretary – Land and Minerals Management MAY 21 2003

From: R. M. "Johnnie" Burton
Director *Johnnie Burton*

Subject: Draft Audit Report on the Minerals Management Service's Oversight of
Non-Federal Auditors (Assignment No. C-IN-MMS-0118-2002)

Thank you for the opportunity to respond to the Draft Audit Report on the Minerals Management Service's Oversight of its non-Federal auditors. We are providing you our general comments on the recommendations and suggestions. We agree with most of the recommendations and will continue coordination efforts with our State and Tribal constituents to develop workable solutions that will improve MMS's oversight to our non-Federal auditors.

Please contact Denise Johnson at (202) 208-3976 if you have further questions.

Attachment

The MMS Response to Office of the Inspector General Draft Audit Report "Oversight of
Non-Federal Auditors" Dated March 28, 2003

The MMS is committed to excellence in its audit programs and welcomes the Office of Inspector General's (OIG) constructive criticism and suggestions for further improvement. As pointed out in the review, the MMS has worked diligently to implement the internal quality control recommendations identified in the past review of our audit offices. The OIG suspended its audit during the survey phase because they found the MMS to be in reasonable compliance with the standards. We will continue efforts to work with our State and Tribal constituents to develop workable solutions to additional recommendations of the State and Tribal Royalty Audit Committee (STRAC) Peer Reviews in order to improve the oversight to our non-Federal auditors. The MMS appreciates the OIG opinion that our oversight activity of the State and Tribal audit organizations is in compliance with generally accepted Government Auditing Standards (GAS).

The MMS agrees that with minor improvements the overall internal review process will be greatly strengthened. Overall the MMS and the STRAC believe that the STRAC Peer Review program is an external quality control review process that meets the GAS independence requirements. The reviews are conducted in accordance with the GAS standards and are performed by independent external reviewers. The STRAC Peer Review Standards Committee has set strict composition and qualification standards for the team leader and team members who must meet independence, professionalism and experience requirements to be selected as peer reviewers. The MMS has recently requested the General Accounting Office (GAO) provide us with written approval to continue performing and relying on these reviews to ensure compliance with the GAO's GAS.

The following sections of this response provide the MMS's comments on the recommendations and suggestions presented by the OIG draft report and describe the specific actions underway or planned by the MMS to satisfy the response. The MMS corrective actions for many of the recommendations are well underway or implemented.

The Deputy Associate Director for Minerals Revenue Management will be the MMS official responsible for monitoring the audit oversight group to ensure full implementation of the improvement actions described in this response.

1. COOPERATIVE AGREEMENT PROVISIONS WERE OUTDATED

OIG Recommendation:

The MMS should ensure that the agreements are updated in a timely manner to reflect current auditing standards and policies.

The MMS Response:

Concur. All 18 State contracts have been amended to reference the most current version of the Government Auditing Standards. All read as follows: "All audit activities performed by the State shall be performed in accordance with the MMS audit standards as documented in the MMS Audit Manual and the "Government Auditing Standards", 1994 version as amended in 1999, by the Comptroller General of the United States".

Additionally, the four agreements with Indian tribes that do not include language regarding the departmental directive to permanently retain Indian trust data will be amended to include the revised language requiring the tribes to maintain Indian records indefinitely.

2. AUDITS OF JICARILLA LEASES ARE NOT REVIEWED

OIG Recommendation:

The MMS should include audit work conducted by its Jicarilla audit team in its Internal Quality Control Review (IQCR) process.

The MMS Response:

The OIG's assessment of this issue needs further clarification. Unlike other State and Tribal contracts, the Jicarilla audits continue to be performed by the MMS employees and not non-Federal auditors. The MMS employees are under the supervision of the MMS managers and supervisors who have been covered by the IQCR process. The non-Federal Tribal representative paid for under this contract does not prepare work papers or any other audit products and therefore, is not covered by the IQCR process. The non-Federal Tribal representative's responsibilities are to suggest audit targets, review issue letters and orders, and to advise and assist with any settlement agreements with companies on orders for additional payments on Jicarilla leases.

3. FOLLOW-UP PROCESS IS NOT FORMALIZED

OIG Recommendation:

The MMS should ensure that a formal action plan (written, with reasonable deadlines and responsible officials identified) is prepared by the reviewed office in response to each peer review and internal review containing findings.

The MMS Response:

Concur. Follow-up procedures for all MMS IQCR's now require written action plans approved by MRM senior managers to ensure timeliness of corrective actions. In fact, we have implemented follow-up processes including approved action plans with this year's internal compliance reviews. The IQCR team and the State and Tribal Contract

Administrators are coordinating with the State and Tribal Audit Programs to develop workable solutions for State and Tribal reviews.

OIG Recommendation:

The MMS should schedule internal reviews to evaluate implementation of the action plans when appropriate.

The MMS Response:

Concur. As stated above, we have implemented follow-up processes including approved action plans with this year's internal compliance reviews. The MMS has drafted procedures for State and Tribal follow-up for discussion with STRAC. The procedures require the Contracting Officer for Technical Review (COTR) to contact the 202/205 supervisor, discuss the report, and request a response within 30 days including a written action plan. The 202/205 supervisor's response and action plan are also sent to the IQCR coordinator. If the IQCR coordinator does not receive the response within the 30-day period, the COTR and the MMS audit manager are notified of the failure to respond. Within 90 days from the date of the report, the IQCR coordinator will follow-up with the auditee to verify implementation of corrective actions and gather supporting documentation. When all corrective actions are fully implemented, the IQCR coordinator sends a final report to the COTR and the MMS audit manager. This notification constitutes reasonable assurance and is the basis for closing an action for follow-up purposes.

In 2002, the MMS implemented a database to track status and closure of all IQCR recommendations. The current follow-up procedures require the IQCR coordinator to follow-up on the action plan within 90 days to verify implementation of corrective actions. The IQCR coordinator notifies management and the COTR when actions are completed. This notification constitutes reasonable assurance and is the basis for closing an action for follow-up purposes. The MMS will also explore the practicality of adding a special project review to its Alternative Management Control Review (AMCR) process beginning with fiscal year 2004. The AMCR team can verify whether agreed upon IQCR corrective actions were fully and properly implemented.

4. SUGGESTIONS FOR IMPROVEMENTS

OIG Observation:

Based on our observations during the audit, we believe the MMS can strengthen its oversight of States and Tribes by:

- a. Using the MMS auditors to assist the smaller State/Tribal audit organizations in performing independent referencing of report products.

The MMS Response:

Concur. The MMS supports this suggestion and has auditors assigned to each of the 202/205 cooperative agreements we administer. Currently, most of our assistance is focused on the smaller 202/205 audit staffs that may not have a full staff or those with audit managers who also perform audits and need assistance meeting GAS requirements for independence. We also provide non-auditors to these groups to assist in answering questions that arise during the development of audit issues. Currently, the MMS is assisting the Crow Tribe, with an audit staff of one, with initiating this year's audit plan and establishing proper management controls. We will continue to make State and Tribal audit organizations aware of our assistance programs.

OIG Observation:

b. Ensuring State/Tribal auditors are properly qualified and independent. Each State/Tribal audit group should annually certify that all auditors are current with their continuing education and are independent of their auditees.

The MMS Response:

Concur. To enter into a 202/205 cooperative agreement with the MMS, the State or Tribe must meet specific educational requirements for its auditors. As a component of each agreement, the MMS also budgets for training and provides GAS and other related training courses to meet the continuing education requirements. The MMS frequently announces training opportunities to State and Tribal representatives at scheduled STRAC meetings. The STRAC will address these suggestions in the next update of its peer review program. This effort will coincide with the publication of the revised GAS.

OIG Observation:

c. Requiring that State and Tribal audit report products clearly identify that the State or Tribe is responsible for the audit work.

The MMS Response:

Concur. The MMS will continue coordination efforts with STRAC to clearly delineate State and Tribal responsibility in audit products.

OIG Observation:

d. Requiring that peer reviews cover all relevant steps contained in guidelines published by the President's Council on Integrity and Efficiency (PCIE).

The MMS Response:

Concur: The STRAC fully intends to incorporate the PCIE recommendations with the next major update of the peer review audit program. This effort will coincide with publication of the revised GAS. An exposure draft of the GAS is out for comment.

OIG Observation:

e. Adopting the PCIE recommendations of providing no advance notice of audit files selected for review.

The MMS Response:

Concur. The MMS agrees with the PCIE recommendations of providing no, or a very limited notice of audit files selected for review. The auditee should not be involved in the selection process or influence it in any way. We have taken steps to limit the auditee's involvement. Extensive efforts to make the Compliance Tracking System (CTS) current and up-to-date will continue to help facilitate the selection process and promote independence of audit files for review.

The IQCR team provides the auditee and the individuals assisting in the review with a 30-day notice prior to the scheduled IQCR visit. This 30-day notice facilitates workload management issues and assures resource availability for necessary assistance. However, we do limit notice of cases. The engagement letter, asking for specific cases, is sent to the auditee one-week prior to the commencement of the review. When the IQCR team arrives they have the option of requesting additional cases. This option has been exercised when conducting this year's IQCR's. The MMS is discussing PCIE recommendations with STRAC for peer reviews of States and Tribes.

STATUS OF RECOMMENDATIONS

Finding/ Recommendation Reference	Status	Action Requested
1	Resolved and implemented.	No further action is needed.
2	Unresolved; additional information requested.	Please state concurrence or non-concurrence with the recommendation. If concurrence is indicated, confirm that the Jicarilla tribal audit team will be included in future internal quality control reviews. If non-concurrence is indicated, provide reasons for the non-concurrence.
3a and 3b	Resolved and implemented.	No further action is needed.

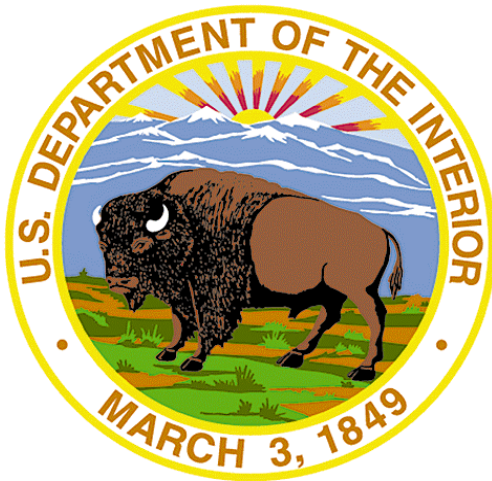
How to Report Fraud, Waste, Abuse and Mismanagement

Fraud, waste, and abuse in government are the concern of everyone — Office of Inspector General staff, Departmental employees, and the general public. We actively solicit allegations of any inefficient and wasteful practices, fraud, and abuse related to Departmental or Insular Area programs and operations. You can report allegations to us by:

Mail: U.S. Department of the Interior
Office of Inspector General
Mail Stop 5341-MIB
1849 C Street, NW
Washington, DC 20240

Phone: 24-Hour Toll Free 800-424-5081
Washington Metro Area 202-208-5300
Hearing Impaired (TTY) 202-208-2420
Fax 202-208-6081
Caribbean Region 340-774-8300

Internet: www.oig.doi.gov/hotline_form.html



U.S. Department of the Interior
Office of Inspector General
1849 C Street, NW
Washington, DC 20240

www.doi.gov
www.oig.doi.gov