

7 OIL AND GAS EXPLORATION AND PRODUCTION

BACKGROUND

- 7.1 In 2001, the Government of Nova Scotia released *Seizing The Opportunity*, a document presenting the government's new energy strategy. One of the recommendations of the strategy was the formation of a new department to monitor all of the Province's energy needs and opportunities. The Department of Energy was established in June 2002 when the former Nova Scotia Petroleum Directorate and the former Energy Utilization Section of the Department of Natural Resources were combined to create the new organization. The new Department handles all matters of Provincial responsibility relating to energy resources. This includes offshore and onshore oil and gas matters, policy relating to electricity generation and use, and renewable energy regulation. Exhibit 7.2 on page 120 provides a list of the legislation and regulations the Department administers.
- 7.2 As part of its mandate, the Department of Energy promotes economic activities and benefits related to offshore petroleum development. This involves pursuing new employment and business development opportunities, promoting existing local industries and capabilities, and securing fair market advantage for Nova Scotia businesses. The Department endeavors to educate and advise Nova Scotians on energy issues and represents the interests of the Province during regulatory approval processes. As well, the Department is responsible for issuing and managing rights for exploration, production and storage of onshore petroleum resources.
- 7.3 The Department of Energy is organized into three major areas of operation - Energy Transportation and Utilization, Resource Assessment and Royalties, and Benefits and Training. The Department has budgeted expenditures of \$7.6 million and revenues of \$27.2 million for 2003-04, and a full-time staff of 41. All but \$0.2 million of the Department's revenues are from offshore petroleum royalties.
- 7.4 Nova Scotia has benefited from two offshore petroleum projects. The Cohasset-Panuke project was a small oilfield development project that produced approximately 45 million barrels of oil over a seven-year period beginning in 1992. The Sable Offshore Energy Project (SOEP) started to produce natural gas and natural gas liquids in 1999, approximately when Cohasset-Panuke oil production ceased. The Department of Energy estimates that SOEP fields have yielded approximately 600 billion cubic feet of gas to date.
- 7.5 The Federal and Provincial governments have taken different positions concerning the ownership of offshore petroleum resources. This issue was put aside with the signing of the Canada-Nova Scotia Offshore Petroleum Resources Accord in 1986. In 1990, identical Federal and Provincial legislation called the Canada-Nova Scotia Offshore Petroleum Resources Accord Implementation Act became law. The

Accord and Accord Implementation Acts guide offshore petroleum exploration, development and production in Nova Scotia.

- 7.6** The Accord and Accord Implementation Acts recognize the equality of the Federal and Provincial governments in the management of offshore petroleum resources. In 1990, the Canada-Nova Scotia Offshore Petroleum Board was created. Under the Accord Implementation Acts, all responsibilities related to offshore oil and gas activities have been delegated by the two levels of government to the Board. The Board is governed by a five-member Board of Directors. The Federal and Provincial governments each appoint two members to the Board, jointly appoint a Board Chair, and approve annual budgets. They also have the right to jointly issue written directives to the Board and review its operations. As well, certain decisions made by the Board are defined as fundamental decisions, and these must be jointly approved by the Federal and Provincial Energy Ministers before they are implemented.
- 7.7** According to the Accord and Accord Implementation Acts, the Canada-Nova Scotia Offshore Petroleum Board is responsible for:
- issuing rights and managing offshore oil and gas resources;
 - monitoring and promoting the health and safety of offshore workers;
 - ensuring offshore activities do not result in undue environmental impacts;
 - reviewing, approving and monitoring industrial and employment benefits plans; and
 - collecting, monitoring and distributing technical, financial and statistical data.
- 7.8** The Accord Implementation Acts give the Provincial government the right to tax offshore oil and gas resources as if they were onshore resources. The Province has developed a royalty regime which specifies the royalty payments that offshore project operators must pay on the sale of oil and gas produced from offshore reserves. Specific royalty regimes were developed for the Cohasset-Panuke and SOEP projects. A generic royalty regime was developed to apply to all future offshore oil and gas developments. Exhibit 7.3 on page 121 provides information on total royalties collected by the Province to date and forecasted to 2005.
- 7.9** There are also several Federal government departments and agencies with legislative responsibilities that affect certain aspects of offshore oil and gas development. These include the National Energy Board, Canadian Environmental Assessment Agency, Environment Canada, Fisheries and Oceans Canada, and Natural Resources Canada. The Provincial government's responsibility for regulating natural gas distribution, including offshore and onshore pipelines and licensing of marketing franchises, is administered by the Nova Scotia Utility and Review Board.

RESULTS IN BRIEF

7.10 The following are our principal observations from this audit.

- Planning is performed within the Department at appropriate times and levels of detail. The Department prepares its annual business plan in accordance with government guidelines.
- The Department has appropriate performance management processes, including the development of work-plans, regular progress meetings and annual performance appraisals. Departmental performance measures require further development and reporting on performance could be improved.
- The regulation of offshore petroleum activities is shared between the Federal and Provincial governments and is the responsibility of a separate organization called the Canada-Nova Scotia Offshore Petroleum Board. We found that the Department's responsibilities relating to the petroleum sector are clearly defined in legislation and regulations and we did not observe any unmet legislative or regulatory requirements.
- We observed efforts by the Department to participate in Federal-Provincial initiatives to make the regulation of offshore activities more efficient.
- The Department administers royalty regulations and agreements on behalf of the Province. There are a number of safeguards built into regulations and agreements to ensure only shareable revenues and expenses are used in the calculation of royalties. The Department is currently auditing revenues and costs of the Sable Offshore Energy Project. We are somewhat concerned about the length of time it is taking to complete audits.
- Approval and monitoring of oil and gas company benefit plans are responsibilities of the Canada-Nova Scotia Offshore Petroleum Board. The Department receives copies of benefit plans and contracts submitted by oil and gas companies from the Board, and uses the information to develop programs that will help Nova Scotian industries and educational institutions develop local capabilities in performing work on offshore projects.
- Legislative and regulatory responsibilities for onshore oil and gas activities are well defined and we saw no instances of unmet requirements. However, we noted a need for improvements in file documentation. We also believe there is a need to formally consider ways of addressing uncertainty and delays in administering onshore rights resulting from two government departments being involved in the process.

AUDIT SCOPE

- 7.11** In October 2003 we completed a broad scope audit of the Department of Energy. The audit was conducted in accordance with Section 8 of the Auditor General Act and auditing standards established by the Canadian Institute of Chartered Accountants, and included all tests and other procedures we considered necessary in the circumstances.
- 7.12** The objectives of this assignment were to assess the Department's:
- planning and performance management processes; and
 - systems for the administration and enforcement of Provincial legislation, regulations, policies and agreements related to offshore and onshore petroleum responsibilities.
- 7.13** As described earlier in this Chapter, a number of responsibilities for offshore oil and gas fall to other organizations – Federal, Provincial and partnerships of the two. Our audit addressed only the systems and practices of the Department of Energy, and with the exception of one matter relating to the Department of Natural Resources, did not include any other organization.
- 7.14** Audit criteria were developed to assist in the planning and performance of the audit (Exhibit 7.1). The criteria were discussed with and accepted as appropriate by senior management of the Department.

PRINCIPAL FINDINGS

Planning and Performance Management

- 7.15** **Planning** - In December 2001 the Provincial Government released its energy strategy. The strategy was developed through a wide-ranging public and stakeholder consultation process with leadership and coordination by the Nova Scotia Petroleum Directorate and Department of Natural Resources. The strategy called for the establishment of a Department of Energy and set out the strategic direction and focus for the new department.
- 7.16** We found that the Department of Energy prepares its annual business plan in accordance with government guidelines. Senior management guides the planning process, and there is appropriate input from all levels of staff. The Department's 2003-04 business plan adopts the energy strategy's three primary goals as strategic goals of the Department. The business plan also ties into the core business areas set out in the 2003-04 Government Business Plan. However, we noted that the link between the Department's strategic goals and core business areas and priorities could be more clearly presented.

- 7.17** We believe planning is being performed within the Department at appropriate times and levels of detail. Based on discussions with Department management, we believe the goals, objectives and priorities outlined in the energy strategy and the Department's business plan are realistic, challenging and attainable. Some of the objectives are quantified and progress is measurable. However, more work needs to be done in this area, as discussed further in paragraph 7.21.
- 7.18** We observed that the Department's business plan is used to prepare division and individual work plans. The priorities of the Department are set out in documents called operational plan initiatives, and each outlines actions required to achieve the Department's objectives. Each initiative is assigned to a staff member who is required to coordinate tasks, allocate responsibilities, report on progress and generally ensure the initiative is carried out. Workplans for individual staff members are developed from these documents.
- 7.19** We observed that the Department's plans are clearly presented and well communicated. Key documents such as the energy strategy and business plan are available on the Department's website. Staff are informed of Department priorities and plans through meetings and discussion with management, and development of the operational plan initiatives and individual workplans.
- 7.20** **Performance management** - Performance management can be viewed as a cycle comprising planning, implementation, assessment, improvement and accountability. Our observations with respect to Department planning are discussed in the section above. We observed that the Department addresses other elements of performance management through regular meetings of senior management, divisional meetings and discussions with staff. Yearly performance appraisals are performed for all staff.
- 7.21** In order to determine whether intended results are being achieved, an organization needs to have credible information on the performance of its programs and services. The Department of Energy has identified four expected outcomes in its business plan, along with performance measures to track results in each area. The Department is working towards establishing baseline data for comparative purposes for two of these measures, but management acknowledged that the other two measures require further development. We encouraged the Department to continue developing its existing performance measures and to consider formulating additional measures to improve its ability to determine whether the Department's activities are achieving expected results.
- 7.22** Organizational accountability is enhanced through regular public reporting of results against desired outcomes. Good public performance reporting should focus on critical aspects of performance, state goals and performance expectations and relate the results achieved to the stated goals.
- 7.23** At the time of our audit, the Department had prepared a draft of its 2002-03 Accountability Report. This is the first such report since the creation of the Department in 2002. The final version is due for submission to the House of

Assembly by December 31, 2003. We looked at the draft document and found that it was prepared in accordance with government guidelines. The Department will not be reporting performance measures in this report, as required, because the Department is relatively new and specific measures have not been identified for the year being reported upon. We made suggestions relating to the need for more clearly stated goals and objectives and more information on reported accomplishments.

- 7.24** In February 2003, the Department released a progress report on the implementation of the energy strategy. Such reporting was requested by participants in the energy strategy development process. The 2003 report provides general information on actions taken to date, with some information on specific accomplishments. It describes actions to be taken in the near future and expected results. However, we believe it falls short of being a performance reporting document because it does not clearly set out targets to be achieved and actions needed to achieve them, or provide explanations for cases where targets were not met.

Recommendation 7.1

We recommend that performance reports prepared by the Department state more clearly the objectives being sought and relate the results of the Department's activities to those objectives, along with explanations if targets are not achieved.

Compliance

- 7.25** **Legislation and regulations** - The Department of Energy administers Nova Scotia legislation and regulations pertaining to the Province's responsibilities for offshore and onshore petroleum resources (Exhibit 7.2). The Department has a number of legislative powers to ensure oil and gas companies adhere to the various requirements of legislation and regulations. We noted that legislation administered by other departments, such as the Occupational Health and Safety Act and the Environment Act, also pertain to onshore petroleum activities and contain extensive enforcement provisions.
- 7.26** We found that responsibilities are clearly defined in legislation and regulations, and we did not find any unmet requirements pertaining to the legislation administered by the Department. We noted that all energy legislation except that related to offshore oil and gas activity is being consolidated into a new Energy Act. At the time of our audit, work was underway on most sections of the proposed legislation. The draft legislation will be released to stakeholders and the public for review and comment before being presented to the House of Assembly.
- 7.27** **Offshore oil and gas activities** - As discussed in paragraph 7.6, responsibility for administering offshore petroleum rights in Nova Scotia has been delegated to the Canada-Nova Scotia Offshore Petroleum Board. The responsibilities and operation of this Board are clearly defined in legislation.

- 7.28** The Canada-Nova Scotia Offshore Petroleum Resources Accord states that the objectives of the Accord are to be reviewed every five years. Although no formal review has been conducted, in May 2002 the Government of Canada agreed to the Province's request to review the objectives of the Accord, including revenue-sharing and regulatory efficiency. Discussions are currently underway between both levels of government on fulfilling the intent of the Accord.
- 7.29** Regulatory approval is required from several Federal departments and agencies before offshore oil and gas projects can proceed. In November 2002, Federal, Provincial and industry representatives met at the Atlantic Energy Roundtable to discuss ways to make the regulatory approval process more efficient and effective. A steering committee was established to review and make recommendations to improve the offshore regulatory regime. A benchmarking study commissioned by the committee found that the regulatory approval process for offshore oil and gas projects in Atlantic Canada takes approximately two years to complete, compared to one year for other offshore areas such as Norway, the United Kingdom and Gulf of Mexico. A second meeting of the Atlantic Energy Roundtable will be held in the fall of 2003 to discuss the report and recommendations prepared by the committee.
- 7.30** The Regulatory Advisory Committee, which reports to the Federal Minister of Environment, has been asked to make recommendations to improve the efficiency and effectiveness of the assessment process under the Canadian Environmental Assessment Act as it pertains to offshore exploration and development proposals. The Committee is composed of representatives from the Federal and Provincial governments, industry, environmental organizations and aboriginal groups. The Committee is to report to the Federal Minister of Environment by December 2003.
- 7.31** Ensuring offshore petroleum activities are conducted in a safe manner is the responsibility of the Canada-Nova Scotia Offshore Petroleum Board. The Board regulates offshore health and safety in accordance with the Accord Implementation Acts and Regulations, as well as its own health and safety requirements. Identical draft offshore occupational health and safety legislation has been prepared for Canada, Nova Scotia and Newfoundland to address Canada's east coast offshore area. It has been distributed to interested parties for feedback. It is intended that the legislation will be presented to the Nova Scotia and Newfoundland legislatures and the House of Commons in the fall of 2003.
- 7.32** **Offshore petroleum royalties** - The Province is entitled to all royalties from offshore oil and gas production, as stipulated by the Offshore Petroleum Royalty Act and regulations and as established by the Canada-Nova Scotia Offshore Petroleum Resources Accord.
- 7.33** The Province is currently receiving royalties under the Sable Offshore Energy Project Royalty Agreement (Exhibit 7.3). The royalty agreement establishes lower royalty rates in the early years of the project to allow the SOEP partners to recoup exploration and construction costs faster. Royalties are set at 1% of gross revenues for three years after the start of commercial production of gas. In March 2003,

according to the agreement, SOEP royalties increased to 2% of gross revenues. At future dates, royalties will increase to 5% of gross revenue, and then to various percentages of net revenues (with set minimums based on gross revenues). The Regulations, as well as agreements signed with the project partners, define how these royalties are to be calculated.

- 7.34** The SOEP partners provide the Department of Energy with an estimate of the amount of royalties to be paid for the upcoming calendar year. In accordance with the Canada-Nova Scotia Offshore Petroleum Resources Accord, all royalty payments are made to the Federal government, which forwards them on to Nova Scotia. The Department receives monthly royalty payments based upon estimated annual royalties. The SOEP partners submit annual royalty returns which have been examined by their external auditors. Any differences between estimated and actual royalties due are settled at that time. If a SOEP partner fails to make a payment by the date specified, interest is charged on the outstanding amount.
- 7.35** We found there are a number of safeguards built into royalty regulations and agreements to ensure only shareable revenues and expenses are used in the calculation of royalties. The agreements specify which costs are shareable. The basis of accounting for such transactions is clearly defined and the treatment of non-arm's length transactions is spelled out. There is a process for settling disputes in this area. One major safeguard is the Department's legislative authority to audit the accounting records of the SOEP partners for royalty purposes.
- 7.36** We examined the Department's royalty auditing practices. We found that royalty audits are based upon an assessment of risk so that areas of higher risk receive greater attention. At the time of our audit, Department staff were auditing construction and pre-production costs incurred by the SOEP partners during the 1995 to 1999 calendar years. Most of the testing was complete. Discussions are being held with the SOEP partners in an attempt to reach agreement on an interpretation of definitions contained in the royalty agreements and whether certain costs not defined in the royalty agreements are claimable in the calculation of royalty payments. The outcome of these discussions will lay the foundation for subsequent audits. The Department is planning to issue an assessment of allowable SOEP partner costs for the 1995 to 1999 period by December 31, 2004.
- 7.37** We found that substantial audit work has been performed on project royalties received during the 2000 and 2001 calendar years, but there is still considerable work to do on construction and operating costs. The royalty meters, which measure the amount of gas coming ashore, have not been fully audited. However, some work has been performed with respect to the meters and the Department derives some assurance about meter accuracy by comparing reported production volumes with volumes received by gas customers. In addition, the Department is considering the contracting of a specialist in measurement procedures to assist in the audit of petroleum volumes used to calculate royalties.
- 7.38** We are somewhat concerned by the amount of time it is taking to bring audits up-to-date. We understand that much of the delay is a result of the on-going

discussions mentioned in paragraph 7.36. Nevertheless, the Department's audit function is comprised of only two individuals, one of whom has responsibilities in addition to audit.

Recommendation 7.2

We recommend the Department review its plans for royalty audits to determine if sufficient resources are allocated to ensure audits are completed on a timely basis and address all necessary areas.

- 7.39** **Onshore oil and gas activities** - The Department of Energy is responsible for granting onshore petroleum rights under the Petroleum Resources Act. At the time of our audit, there were thirteen exploration agreements and one production agreement in effect.
- 7.40** We found that, although the granting of onshore rights is the responsibility of the Department of Energy, some of the administration for onshore rights is performed by the Department of Natural Resources. Before the Department of Energy was created, Natural Resources managed onshore petroleum and mineral rights with one integrated system. After the Department of Energy was created and it became responsible for onshore petroleum rights, Natural Resources retained some responsibility for administering the rights because it already had an established and integrated system. However, we were informed that there are some uncertainties and delays in the onshore petroleum rights process because of the involvement of two government departments. As well, it is not clear whether or not efficiency is being achieved by this arrangement. We understand that this issue is being reviewed by the Department of Energy as part of the drafting of the new Energy Act, discussed in paragraph 7.26.
- 7.41** Onshore seismic and drilling activities must be conducted in accordance with requirements specified in certain Acts and Regulations administered by the Departments of Energy, Environment and Labour, Natural Resources, and Transportation and Public Works. To help oil and gas companies propose and undertake onshore petroleum activities, a "One Window Committee" composed of representatives from each Department has been established to coordinate all activities related to onshore oil and gas exploration. Companies make presentations on their seismic and drilling proposals at Committee meetings. Requirements of legislation administered by the Departments are explained at those meetings. Company officials then work with staff of the individual Departments to obtain necessary approvals. To ensure Committee members are fully aware of each Department's oil and gas activities, various documents are shared among Committee members.
- 7.42** Department of Energy staff review the daily or weekly activity reports submitted by companies conducting seismic and drilling activities. Staff also monitor activities through site visits and direct communication with company officials.

Drilling sites and drilling rigs are examined by a third party inspector hired by the Department. The Department is given copies of the inspection reports and notified when deficiencies described in the reports have been corrected. At the end of each seismic and drilling program, companies submit reports to the Department on geological and geophysical data obtained and their interpretation of that data.

- 7.43** We examined documentation maintained by the Departments of Energy and Natural Resources for a number of exploration activities undertaken by oil and gas companies. We found that some documentation required from the companies was not in the files and we could not determine if the documents had been prepared or received. Management assured us that most required documents are received, but there are sometimes significant delays in receiving them due to technical reasons and these delays are generally not noted in the files. Also, documents are not always filed in a consistent manner and some of the items may be in other files.

Recommendation 7.3

We recommend that the Departments of Energy and Natural Resources develop monitoring procedures to ensure all documentation required has been received and is in the appropriate files.

- 7.44** Companies are required to clean up their work sites at the end of seismic and drilling projects and obtain releases from all property owners. The Department of Energy will request the Department of Natural Resources to release security deposits to the companies after these activities have been completed. Whereas other departments may perform a final inspection of the site and inform the Department of Energy if there is any outstanding work to be completed, Department of Energy staff generally do not visit a site before a security deposit is released. We agree with management that this is something that could be done on a sample basis to improve controls over release of deposits.

- 7.45** **Benefits** - One of the objectives of the Canada-Nova Scotia Offshore Petroleum Resources Accord and its associated legislation is to ensure Nova Scotia is the principal beneficiary of offshore oil and gas resources. Benefits to the people and economy of Nova Scotia include:
- the payment of royalties, Provincial corporate income taxes, municipal property taxes and other taxes by oil and gas companies;
 - increased career and employment opportunities for Nova Scotians;
 - increased skill levels of Nova Scotians and the ability to use these skills in other employment opportunities;
 - increased university and other research and development; and

- the potential to develop a petrochemical industry and other energy intensive industries.

7.46 Nova Scotia's royalty system is designed to encourage oil and gas development by setting a lower royalty rate in the early years of a project. The Province's share increases as the project's capital investment is recovered and a reasonable rate of return is achieved. In a report entitled *Atlantic Petroleum Royalties: Fair Deal or Raw Deal?* prepared for the Atlantic Institute for Market Studies, the author concluded:

"The royalty regimes in both Nova Scotia and Newfoundland are competitive when compared with relevant international practice. Thus the regimes are not vulnerable to criticism that the governments are not getting fair value for the resources on behalf of their citizens. By the same token, the fact that industry has endorsed the regimes and is making investments under them suggests there is no compelling need for reductions. Governments are not trying to grab too much and producers are not enjoying a free ride." (G.C. Watkins, June 2001, page vii)

7.47 Under the Accord, the Federal government may be required to make a 'crown share adjustment' payment to the Province based upon oil and gas company profits from offshore projects. No payment has yet been calculated or paid in accordance with this clause. Federal regulations defining how this payment is calculated are necessary before any amounts owing can be determined. Since May 2002, the Office of Intergovernmental Affairs has been coordinating discussions on behalf of the Province with Natural Resources Canada on this and other issues related to the offshore.

7.48 In 1999, the Sable Offshore Energy Project partners signed seven agreements with the Province to address a number of issues. Under the Scotia Benefits Fund Agreement, the Province established a Scotia Benefits Fund to which SOEP partners would contribute a total of \$14,126,000 over seven years. Amounts received under this agreement are deposited to this Fund. However, the Funds are transferred to the general revenues of the Province at a later date because the stated purpose of the Fund is for "benefiting the economy, people or government of Nova Scotia."

7.49 Under the Nova Scotia Market Development Agreement, the SOEP partners are providing the Province with \$20 million over the initial ten years of the project to promote the use of natural gas. The Province announced that \$14 million would be directed towards helping individual Nova Scotians, small businesses and institutions use natural gas. The remaining \$6 million will go toward customers already using natural gas in the Province and expanding the pipeline system beyond the approved franchise area.

7.50 Under the Nova Scotia Training, Research and Development Agreement, the SOEP partners were required to transfer an operations training simulator to a training or educational institution in Nova Scotia by January 2002. The transfer has not occurred, upon the request of the SOEP partners. The Department is negotiating with the partners to make alternate arrangements concerning the training simulator. As well, an Advisory Council on Training and Research

and Development was not established as required by the agreement. The SOEP partners have instead provided funding to the Petroleum Research Advisory Council for research and development purposes.

- 7.51** The Accord Implementation Acts require oil and gas companies to submit benefit plans to the Canada-Nova Scotia Offshore Petroleum Board for any proposed exploration and development projects. Companies must commit in their plans to the principles of providing “full and fair opportunity” and “first consideration” to Nova Scotians and Nova Scotia companies in procurement, employment, training, research and development. The Accord Implementation Acts do not specify targets for Nova Scotia or Canadian content and participation. Oil and gas companies are required to submit yearly benefit reports to the Board. A Federal-Provincial Benefits Review Committee has been established to review benefit plans and reports, discuss benefits-related issues and provide advice to the Board. The Department of Energy is provided with copies of all benefit plans and reports submitted to the Board, as well as reports on offshore contracts awarded by oil and gas companies. This information is recorded in a database maintained by the Department and used to develop programs that will help Nova Scotian industries and educational institutions develop local capabilities in performing work on offshore projects.
- 7.52** Development of Nova Scotia’s offshore is relatively new compared to other well-established areas, such as the Gulf of Mexico and the North Sea. Finding oil and gas in the offshore is very expensive and risky, and the amount of proven reserves off Nova Scotia is still relatively low. Uncertainty over the size of undiscovered resources means that some flexibility in Federal-Provincial policy making with respect to requirements placed on oil and gas companies is required if Nova Scotia is to compete with other parts of the world that offer similar or better potential. At the November 2002 Atlantic Energy Roundtable, discussed in paragraph 7.29, a task force was created to explore ways to improve industrial benefits and business opportunities from offshore activities. The task force is expected to report on its findings at a second meeting of the Roundtable, scheduled for the fall of 2003.
- 7.53** Onshore exploration agreements are awarded based upon the dollar value of the exploration programs. Companies are encouraged to employ Nova Scotians and use Nova Scotia goods and services. Starting in 2002, companies were required to submit annual benefit reports, with the first reports due to the Department in the fall of 2003.

CONCLUDING REMARKS

- 7.54** The Department of Energy has appropriate systems and processes for planning and performance management. We believe Departmental efforts to formulate and report against performance outcomes could be further developed and expanded, and performance reporting could provide more detailed information on Department performance with respect to its predetermined objectives.

- 7.55** Department systems and practices relating to compliance with legislation, regulations and agreements are appropriate. We believe more attention should be given to royalty auditing, and more care should be taken to ensure all required reporting for onshore oil and gas activities is received and properly filed.
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Audit Criteria

Audit criteria are reasonable and attainable standards of performance and control, against which the adequacy of systems and practices can be assessed. They relate to the audit objectives developed for an assignment and are used to design detailed audit tests and procedures.

The following criteria were used in our audit of the Department of Energy.

- Planning should be an integral element of the management of the Department and address all critical aspects of the Department's operations and responsibilities. Planning should be performed at appropriate stages and levels, based on sufficient, appropriate information. Planning should focus on goals and objectives and means of achieving them. Goals and objectives should be realistic, attainable, challenging, prioritized and preferably quantifiable and measurable. There should be clear responsibilities, resource requirements, timelines and monitoring procedures for the achievement of planned goals. Plans should comply with government format and content guidelines and be appropriately approved. Plans should be clearly presented and communicated to individuals and groups affected by them.
- Performance management should focus on all significant aspects of Departmental operations. Goals and targets, and means of achieving them, should be set for key areas of operation. There should be appropriate systems for gathering accurate and complete performance information. Performance should be measured and monitored on a regular and timely basis. Performance information should be reported on a comparative basis, significant variances should be investigated and explained, and plans should be developed for addressing inadequacies in performance.
- The Department should comply with applicable provisions of Provincial legislation, regulations and agreements. The Department's objectives, strategies and policies should be consistent with Provincial legislation and regulations. Authorities and responsibilities for the enforcement of Provincial legislation, regulations and agreements should be clear. There should be procedures to ensure Provincial legislation, regulations and agreements relating to responsibilities residing outside of the Department are appropriately enforced.

Legislation Administered by the Department of Energy

Canada-Nova Scotia Offshore Petroleum Resources Accord Implementation (Nova Scotia) Act

- Nova Scotia Offshore Area Certificate of Fitness Regulations
- Nova Scotia Offshore Area Oil and Gas Spills and Debris Liability Regulations
- Nova Scotia Offshore Area Petroleum Diving Regulations
- Nova Scotia Offshore Petroleum Drilling Regulations
- Nova Scotia Offshore Area Petroleum Geophysical Operations Regulations
- Nova Scotia Offshore Area Petroleum Installations Regulations
- Nova Scotia Offshore Area Petroleum Production and Conservation Regulations

Energy Resources Conservation Act

- Gas Plant Facility Regulations
- Onshore Petroleum Geophysical Exploration Regulations

Energy-efficient Appliances Act

- Energy-efficient Appliances Regulations

Gas Distribution Act

- Gas Distribution Regulations
- Board Gas Distribution Regulations (Nova Scotia)

Offshore Petroleum Royalty Act

- Offshore Petroleum Royalty Regulations

Petroleum Resources Act

- Petroleum Resources Regulations
- Onshore Petroleum Geophysical Exploration Regulations
- Onshore Petroleum Drilling Regulations

Petroleum Resources Removal Permit Act

- Petroleum Resources Removal Permit Exemption Regulations

Pipeline Act

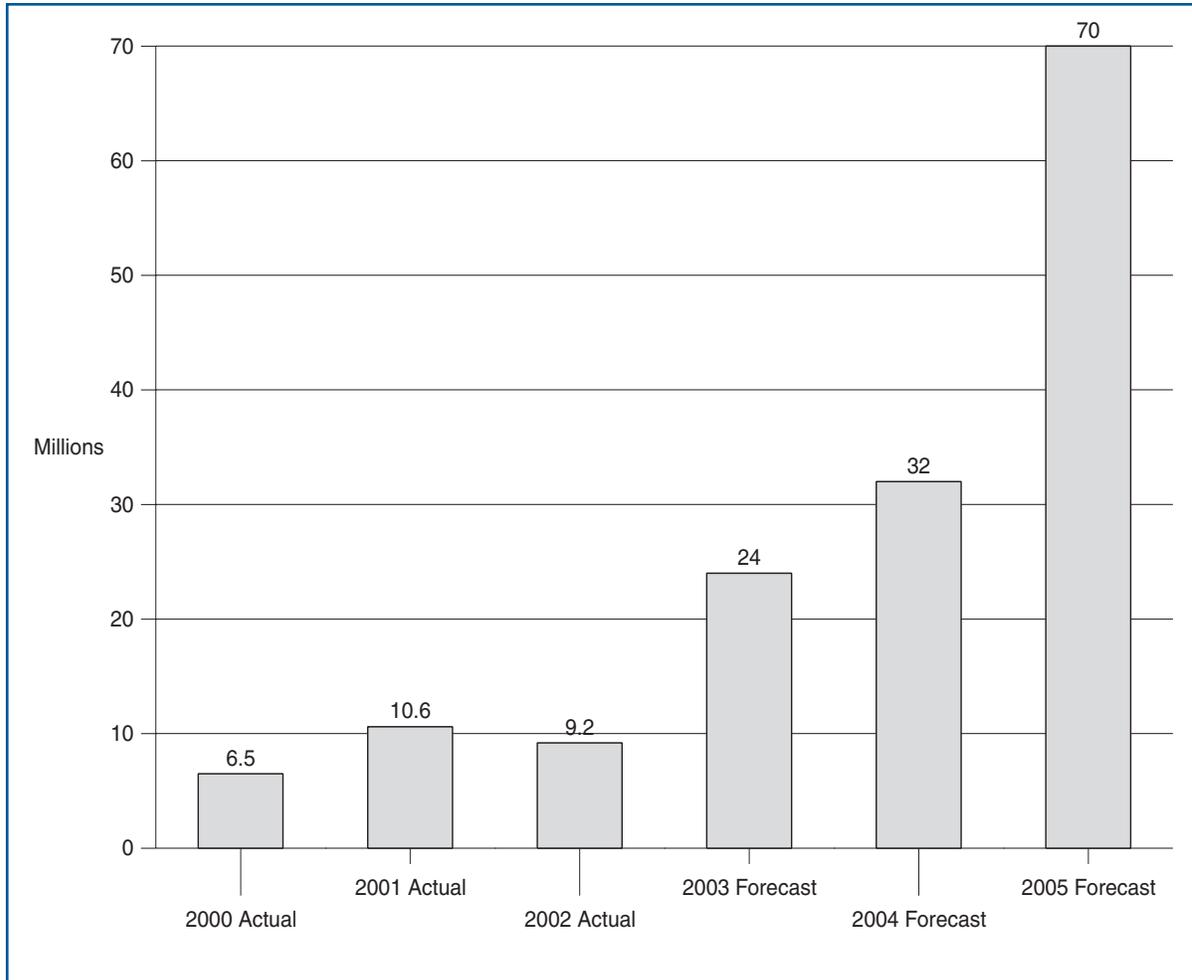
- Land Acquisition Regulations
- Pipeline Benefits Plan Regulations
- Pipeline Regulations (Nova Scotia)
- Gas Plant Facilities Regulations

Underground Hydrocarbons Storage Act

- Underground Hydrocarbons Storage Regulations

Nova Scotia Oil and Gas Royalty Revenues

Exhibit 7.3



Notes:

- All royalty revenues in the above chart are from the Sable Offshore Energy Project (SOEP) and are on a calendar year basis.
- Actual figures for years 2000, 2001 and 2002 are subject to audit by the Department of Energy.
- Forecasted figures for 2003, 2004 and 2005 represent April 2003 estimates of the Department of Energy based on information from the SOEP partners and the Canada–Nova Scotia Offshore Petroleum Board. Royalty forecasts are subject to volatile and unpredictable fluctuations in gas prices, as well as to changing estimates of recoverable hydrocarbon reserves. Accordingly, forecasts are updated as new information arises.
- The Department estimates that \$1.6 to \$2.3 billion of royalty revenues will be received from SOEP by its forecasted completion in 2020.

DEPARTMENT OF ENERGY'S RESPONSE

The Department of Energy has reviewed the report and findings of the Auditor General and is in agreement with the results and recommendations of the audit. The following comments pertain to the three recommendations contained in the report.

We recommend that performance reports prepared by the Department state more clearly the objectives being sought and relate the results of the Department's activities to those objectives, along with explanations if targets are not achieved. The Department of Energy will have a complete set of performance measures, with baseline data and targets, in its 2004/05 business plan. Once the initial set of performance measures have been established, the Department will consider the creation of additional measures for subsequent business plans. The Department also intends to update its Energy Strategy Progress Report early in calendar 2004, and will clearly report on progress made against specific Energy Strategy Targets with explanations where those targets have not been met.

We recommend the Department review its plans for royalty audits to determine if sufficient resources are allocated to ensure audits are completed on a timely basis and address all necessary areas. The Department agrees that the existing resources that are currently dedicated to administrating the royalty agreements need augmentation. In this regard, it is planned to contract

specific audit assistance in the January/February 2004 time frame. In addition, the Department continually monitors new developments and will add additional audit and administration staff, as required, to ensure timely and effective completion of audits.

We recommend that the Departments of Energy and Natural Resources develop monitoring procedures to ensure all documentation required has been received and is in the appropriate files. The Department of Energy has recently discussed this issue with Natural Resources as it was agreed that in the short term the Registrar of Mineral and Petroleum Titles (Natural Resources), and the Senior Geologist and Rights Administrator (Energy) will keep each other more regularly notified of obligations of agreement holders, as well as documents received in accordance with existing agreements. In the medium term, the Energy Act will specify both the new responsibilities of the Department of Energy with respect to duties currently performed by the Registrar of Mineral and Petroleum Titles and the interaction between Energy and Natural Resources in this regard.

Finally, the Department wishes to express its appreciation to the Auditor General for its review and valuable contribution to the administration of energy issues in Nova Scotia.