



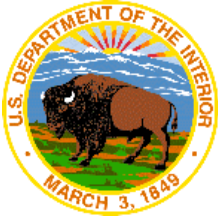
## **U.S. Department of the Interior Office of Inspector General**

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### ***Audit of the Minerals Management Service Audit Offices***



*MMS Photo*



# United States Department of the Interior

## Office of Inspector General

134 Union Boulevard, Suite 510  
Lakewood, CO 80228

March 31, 2003  
7430

### Memorandum

To: Assistant Secretary for Land and Minerals Management

From: Anne Richards *Anne Richards*  
Regional Audit Manager, Central Region

Subject: Final Report, Audit of the Minerals Management Service Audit Offices  
(No. 2003-I-0023)

The attached report presents the results of our audit of the Minerals Management Service (MMS) audit offices. Our objective was to determine whether MMS' internal quality control system provides reasonable assurance that MMS audits are performed in accordance with established policies, procedures, and the Government Auditing Standards (Standards). We concluded that the system was not sufficient and that some of MMS' audits did not meet the Standards.

In the December 19, 2002 response to the draft report, the Director of MMS expressed general agreement with the report's findings and concurrence with all of our recommendations. However, the response did not provide sufficient information for us to consider all of the recommendations resolved. Accordingly, we are requesting that MMS provide us with the information requested in Appendix 7. Please respond to this report by May 9, 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.

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

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# EXECUTIVE SUMMARY

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## RESULTS IN BRIEF

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### **MMS audit work did not always meet Government Auditing Standards.**

We audited the Minerals Management Service's (MMS) audit offices and discovered an organization challenged by both management and control issues.

MMS auditors are responsible for monitoring the annual collection of \$6 billion in royalties and fees for minerals produced from federal and Indian lands. The objective of this audit was to determine if MMS had effective internal quality controls sufficient to ensure that its audits follow Government Auditing Standards (Standards). We concluded MMS' systems and safeguards are insufficient, and that some of its audit work did not meet the Standards. As a result of our audit, we discovered:

- MMS' internal audit process was ineffective because it lacked accountability, did not cover all audit work, and was incomplete.
- An instance of MMS auditors recreating working papers that they could not find. Rather than informing us that the papers were lost, they recreated and backdated the files to when they believed the work had been performed. One of the employees who created the false documents was given a monetary award for "creativity." We also identified other files that could not be found.
- Not all MMS auditors met their continuing education requirements. Specifically, 12 percent of MMS auditors were deficient in their training and therefore should not have been conducting audits until they received the required training.

We have made several recommendations regarding these issues; all are presented throughout the report and in Appendix 1.

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## **MMS ACTIONS**

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As a result of our audit, MMS is taking some actions to correct and strengthen its internal quality control review process. MMS is creating a database to follow up on its recommendations from its internal quality control reviews, updating the internal review checklist, and providing results of individual quality reviews to appropriate management officials.

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# CONTENTS

	Page
INTRODUCTION .....	1
BACKGROUND .....	1
RESULTS OF AUDIT .....	2
INTERNAL QUALITY CONTROL SYSTEM .....	2
DUE PROFESSIONAL CARE .....	6
PROFESSIONALISM .....	8
SAFEGUARDING AUDIT FILES .....	8
CONTINUING PROFESSIONAL EDUCATION .....	10
ADHERENCE TO THE GOVERNMENT AUDITING STANDARDS .....	12
ADDITIONAL ISSUES .....	13
APPENDICES	
1. RECOMMENDATIONS .....	15
2. MINERALS MANAGEMENT SERVICE ORGANIZATION, RESPONSIBILITIES, AND RESOURCES .....	17
3. RESULTS OF REVIEW OF 14 AUDIT SUBCASES .....	18
4. SCOPE AND METHODOLOGY .....	26
5. PRIOR AUDIT COVERAGE .....	28
6. MMS RESPONSE .....	29
7. STATUS OF RECOMMENDATIONS.....	37

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## INTRODUCTION

This report presents the results of our audit of the Minerals Management Service (MMS) audit offices. We performed this audit using the guidance published by the President's Council on Integrity and Efficiency for external quality control reviews.

The objective of our audit was to determine whether MMS' internal quality control system provides reasonable assurance that MMS audits are performed in accordance with established policies, procedures, and the Government Auditing Standards.

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## BACKGROUND

MMS manages the Nation's oil, gas, and other mineral resources on the Outer Continental Shelf. It also collects, accounts for, and disburses revenues from minerals produced on federal and Indian lands. MMS collects about \$6 billion annually in rents, royalties, and other payments. To help ensure that the correct amounts of royalties are reported and received, MMS – which includes in its workforce about 165 auditors – conducts audits as well as other compliance activities. In addition, MMS contracts through cooperative agreements and delegations with state and Tribal auditors; we did not include the audit work conducted under these contracts in our audit.

During the period of our audit, MMS was designing and implementing a re-engineered compliance process. This new process will shift the focus from auditing on a company basis (auditing all of a company's leases at the same time) to a property basis (auditing leases grouped in one producing geographic location).

To estimate expected royalty payments the auditors will team with geologists, economists, petroleum engineers, and other related disciplines forming a multifunctional team. MMS states this will result in fewer audits and improve the timeliness of compliance activities. Some of MMS' auditors have already been assigned to the re-engineering activity rather than traditional audit work. Additional information about the MMS organization, responsibilities, and resources is presented in Appendix 2.

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## RESULTS OF AUDIT

MMS policy requires that the Government Auditing Standards (Standards), issued by the Comptroller General of the United States, be used when conducting royalty audits. Following these Standards – including independence, professional judgment, and a trained audit staff – ensures information in audit reports is credible.

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### INTERNAL QUALITY CONTROL SYSTEM

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**MMS' internal quality control system is ineffective.**

MMS' internal quality control system does not provide assurance that its audits are performed in accordance with established policies, procedures, and the Government Auditing Standards. Both the Standards and the MMS Audit Manual require an effective internal quality control system to be in place. MMS' system relies on an internal quality control review process (internal review). The internal reviews are to be conducted by MMS' Center for Excellence. MMS has established a cycle to ensure that each of its field offices is reviewed at least once every two to three years.

However, design flaws render the internal review process ineffective. Specifically, the internal review process does not ensure accountability for taking corrective action, the method for selecting audits for review is insufficient, and reviewers do not check for compliance with all auditing standards.

#### Accountability

There was insufficient accountability for corrective actions in MMS' internal review process.

- The process was placed several layers below the management level that is responsible for audits. It is located in the Planning and Accountability Team (Team). The Team is one of four in the Center for Excellence, which reports to the Deputy Associate Director of Minerals Revenue Management (MRM). The Associate Director of MRM is the management official responsible for audits. The Team reports to an official two layers below the level responsible for overall audit quality.

- A General Schedule grade 12 auditor who is several grades below the rank of those whom he is reviewing conducts the internal reviews.
- There was no formal process to communicate findings to upper management. The results of the internal reviews are only provided to the auditors that conducted the original audit.
- MMS did not have a formal process to follow up on previously identified problems.

In our opinion, a well-designed internal quality review process should occupy a prominent place in the organization. The principal reviewer should be at a grade level commensurate with the individuals that he or she reviews. The results of the reviews should be formally communicated to management above the individual audit supervisors or offices, and the offices should be required to provide a written corrective action plan in response to any deficiencies noted. The office responsible for the internal reviews should conduct follow-up reviews when significant deficiencies are found.

### **Audit Selection**

Only a portion of MMS' audit work is subject to an internal review, and the auditors under review can influence the selection process. When selecting audits for an internal review, the MMS Compliance Tracking System is queried for audits having a closed status. This status is then confirmed with the office or supervisor responsible for the audit work. In addition the team verifies that the audit selected required the lessee to pay additional royalties (commonly called an "order to pay"). The review team then eliminates from its internal review selection any audit identified as not having an "order to pay." Therefore, if an audit did not result in an "order to pay," it would never undergo an internal review.

By limiting the internal reviews to only those audits that resulted in an "order to pay," the internal review process is ignoring a significant portion of MMS audit work. It was impossible for us to determine the number of audits that would have been excluded from the internal quality reviews. All audit work must be conducted in accordance with the Standards and MMS' internal guidance, including



the work that does not result in an audit finding (“order to pay.”) All audit work subject to the Standards should be covered by an effective internal quality control system.

Also, by checking with the auditee before selecting an audit to review, the review team allows the auditee to potentially exclude an audit with known problems or deficiencies from the internal review process. While we did not identify any specific instances of an auditee removing an audit from consideration by the review team because of known deficiencies, the potential exists.

### **Review Checklist**

MMS has been using an incomplete checklist when conducting its internal reviews. The checklist, or questions to be answered by the review, was based on the Standards but was incomplete in regard to due professional care (sound judgment), audit planning, and reporting. For example, the checklist did not include questions designed to evaluate:

- Whether the audit work, in total, met the standard of due professional care.
- The completeness of the documentation in the areas of audit planning, management controls, and prior audit coverage.
- Whether supervisory review notes, comments, and questions were properly answered in the working papers.

In our detailed evaluation of individual working paper files for 14 selected audits, we found problems with some of the areas omitted from MMS’ internal review checklist.

The internal review process needs to be designed to allow the reviewers to reach an opinion on whether the audit work reviewed meets the Standards. In order for the checklist to be an adequate tool for the review teams, MMS needs to expand its checklist to include all the applicable Standards and to call for conclusions on the overall quality of the audit work under review.

As a result of the deficiencies identified, MMS’ internal quality control process did not provide reasonable

assurance that audits are being conducted in accordance with the Standards and the MMS Audit Manual, thus MMS was not in compliance with the Standards.

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## **MMS ACTIONS**

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### **MMS is taking action to correct and strengthen its internal review process.**

MMS is taking some actions to correct and strengthen its internal review process to address some of the deficiencies we identified. Specifically, MMS is taking steps to:

- Provide the results of the individual reviews to the appropriate management officials.
- Create a database and process to follow up with organizations within six months of an internal review to ensure that recommendations have been addressed.
- Provide additional training to its auditors on the requirements of the Standards.
- Identify a methodology that will allow the review teams to independently identify audits for review.
- Include audit work that did not result in an order to pay in the review process.
- Update the internal review checklist to include additional areas noted in the Standards and in the peer review guidelines published by the President's Council on Integrity and Efficiency.

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## **RECOMMENDATIONS**

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We recommend that the Director, MMS, correct and strengthen the design and function of the internal quality control review process. Specific improvements should include the following:

- Place the internal review function directly under the Associate Director of Minerals Revenue Management.
- Require that internal review reports be transmitted to the Associate Director of Minerals Revenue Management.
- Ensure the individuals conducting the internal reviews are at an appropriate grade level.

- Ensure all audit work is subject to review and that the internal review team independently selects the audits to be reviewed.
- Require that auditors performing internal reviews check for compliance with all Standards as well as the MMS Audit Manual.

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## **DUE PROFESSIONAL CARE**

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### **MMS auditors' work did not always comply with the Standards.**

MMS auditors did not always meet the Standards for conducting their audits with due professional care. We believe these deficiencies occurred because MMS had not made a consistent commitment to conduct audits in accordance with the required Standards and the MMS Audit Manual.

MMS' Audit Manual states that royalty audits are to be conducted in accordance with the Standards. The Standards make it clear that the work must be fully supported by evidence and documented in the audit working papers. The Standards state:

Working papers should contain sufficient information to enable an experienced auditor having no previous connection with the audit to ascertain from them the evidence that supports the auditors' significant conclusions and judgments.

We evaluated individual audit working paper files for 14 audit subcases<sup>1</sup> (audits) to determine if we could ascertain from the documentation the evidence that supported the auditors' significant judgments and conclusions. We did not re-evaluate the individual audit conclusions and accordingly express no opinion on them.

We found numerous problems or missing documentation for audit planning, supervision, fieldwork, and/or reporting in 10 of 14 audits. Standards were not met because sufficient audit work was not performed or the work performed was not sufficiently documented. Specifically, we found the following deficiencies:

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<sup>1</sup> We originally selected a sample of 15 audit subcases to review, but the working paper files were missing for one subcase. MMS officials improperly recreated working papers for this audit. This issue is discussed in detail in the Professionalism section of this report.

- No written audit plan was prepared for four audits.
- The audit plan was not updated to include a major change in the audit scope and methodology for one audit.
- There was no timely supervisory review of working papers for four audits.
- Supervisory reviews were inadequate for two audits.
- The sampling criteria used to conduct the audit were not documented in the working papers for seven audits.
- The results of significant audit steps and conclusions (for example, tests of management controls) were not documented for seven audits.
- The audit objective was not explained in the report for one audit.
- The audit issue letter or close-out summary was not cross-indexed to supporting working papers for two audits.
- The audit reports did not disclose what Standards were followed for two audits.

We identified other weaknesses with the 14 audits. We have provided MMS with a detailed list, by audit number, of the problems we identified. These weaknesses, while needing management attention, did not merit detailed mention in this report. Appendix 3 links the deficiencies we identified with the specific Standards and the pertinent sections of the MMS Audit Manual.

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## RECOMMENDATIONS

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We recommend that the Director, MMS:

- Ensure all audit activities are conducted with due professional care and auditors maintain the highest level of integrity in all of their professional activities by instituting a strengthened internal quality control system.

- Ensure an external quality control review is conducted of MMS' audit activities after the corrective actions outlined in this report have been implemented.
- Disclose in future audit products that MMS has not undergone a recent external quality control review and does not have a current opinion on its internal quality control system until a subsequent external quality control review is conducted.

We recommend that the Assistant Secretary:

- Require periodic updates on the status of the corrective actions until the MMS audit offices receive an unqualified opinion on an external quality control review.

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## **PROFESSIONALISM**

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### **MMS auditors recreated audit working papers.**

We found that in one instance MMS officials did not adhere to high levels of integrity and professionalism required by the Standards. We selected for review an audit involving Navajo Indian leases. When MMS officials could not locate this audit file, instead of informing us of that fact, they recreated and backdated the working papers. The recreated papers were dated to when MMS believed the work had been done rather than when the replacement working papers were actually created.

MMS then granted a cash award, citing “creativity,” to the auditor who reconstructed the working papers.

MMS delivered the newly created working papers to us without any mention of the reconstruction. MMS only admitted that they had reconstructed the working papers after we confronted them with questions about the quality of the recreated working papers.

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## **SAFEGUARDING AUDIT FILES**

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### **MMS could not locate some of its audit working paper files.**

Because a working paper file that we selected for our detailed review was missing and was improperly recreated, we extended our audit to include steps to determine if working paper files generally existed and were complete for MMS audits. We selected a statistical sample of 191 audits completed between May 1997 and October 2001 (see Appendix 4). We then visited the MMS audit offices

and examined the audit files and evaluated the filing procedures. The working papers for 27 audits in the sample were not found, but MMS researched each case and we accepted its explanations that the files for 21 audits had not been created or needed. MMS was unable to provide adequate explanations as to why the six remaining audit files were missing. Of the six missing files, two pertained to Indian leases.

Using a 95 percent confidence rate, we statistically projected the results of our sample. At that level of confidence, the working papers for at least 14 – and possibly as many as 62 audits – are missing from a total universe of 987 audits.

In addition, we judgmentally selected an additional 58 audits. These audits were performed by the same individuals who recreated the Navajo Indian lease working papers. We added this step to determine if working papers existed and contained proper documentation. We were able to account for all these files although some of these files were incomplete.

We requested audit files for a total of 249 audits in both the statistical and judgmental samples and actually reviewed 192 sets of files. Of the 192 sets reviewed, 30 (16 percent) were incomplete. For example, working papers were missing or the master index was missing.

Based on our analysis of the two samples of working papers, we identified internal control weaknesses for safeguarding audit documentation at four of the six audit field offices. The two other field offices and the nine residency offices, however, had good controls over their working paper files.

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## RECOMMENDATIONS

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We recommend that the Director, MMS:

- Ensure all audit field offices have adequate controls over audit working papers, including an up-to-date log annotated with storage locations and secured containers for storage.
- Ensure all stored working paper files are complete.

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## **CONTINUING PROFESSIONAL EDUCATION**

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**A significant number of auditors did not meet the continuing professional education requirements.**

MMS did not ensure that the individual auditors had sufficient Continuing Professional Education (CPE) hours to meet Standards. The Standards require that every auditor responsible for planning, directing, conducting, or reporting on audits under these Standards have a minimum of 80 hours of CPEs every two years, with no less than 20 hours in any one year. The Standards impose this requirement jointly on the individual auditors and the audit organization but hold the organization responsible for documenting training records and establishing and implementing a program to ensure auditors meet these qualifications.

### **Insufficient Continuing Professional Education Hours**

Based on a review of MMS' training information, a significant number of MMS auditors (12 percent) did not obtain the minimum required CPE hours for the time period reviewed. We reviewed MMS auditors' training for 1999-2000 timeframe. We limited our review of the training records to those employees who worked on audits during the two-year period. We excluded part-time auditors, recent hires, and those auditors assigned to the MMS re-engineering project.

MMS' training records showed that 18 (12 percent) of MMS auditors did not comply with the CPE requirements of the Standards. Auditors who do not have sufficient CPEs are not qualified to perform audits in accordance with the Standards.

MMS lacked a competent tracking system, demonstrated by MMS' difficulty in providing lists of training hours for its auditors. We had to submit repeated requests, sometimes contacting various offices within MMS, to get training information for employees or to identify employees who should be excluded (part-time, recent hires and auditors assigned to the re-engineering project) from the evaluation of training records. At the time of our review, MMS required individual supervisors to track the training hours for their employees rather than using a centralized database or tracking system. Some individual supervisors did not fulfill their responsibility to keep track of the training provided for their staff. Further, because of the ongoing re-engineering effort, some auditors were reassigned to different supervisors and duty locations during the time period under review. This increased the

difficulty of tracking and recording training hours for these auditors. Consequently, supervisors did not always have the necessary information to evaluate whether the auditors were properly trained.

#### **Documentation to Support Reported Training**

MMS was not able to provide support that its auditors actually received all the CPE hours listed for 1999 and 2000. We selected 20 auditors based on location and grade and reviewed MMS' supporting documentation. MMS could not provide documentation to support the minimum required training for 13 of 20 auditors for the two-year period. For example:

- The number of hours listed for a course exceeded the hours shown on the supporting documentation.
- The auditor did not actually attend all the courses listed.
- Courses were sometimes counted twice using different course titles in the list of training hours.

In addition to these problems, MMS could not provide any documentation for a total of 113 hours of training out of 1,724 hours reviewed (or six percent) for these 20 auditors.

MMS also needs to improve the type of documentation it maintains to support its training record-keeping system. We addressed this issue in a separate management letter to MMS.

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#### **MMS ACTIONS**

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**MMS is taking some actions to better track auditors' continuing professional education hours.**

MMS is taking some actions to better track auditors' CPE hours. Specifically, one of the audit groups is consolidating the databases maintained by the individual supervisors and adding a critical element to managers' performance plans to ensure subordinates meet training requirements. MMS has stated that it has taken steps to ensure all auditors are on track to meet the training requirements in 2002.

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#### **RECOMMENDATIONS**

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We recommend that the Director, MMS:

- Ensure all auditors receive sufficient CPEs as required by the Government Auditing Standards.



- Develop a centralized system that tracks and monitors the training provided to each auditor.
- Maintain appropriate and complete supporting documentation.

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## ADHERENCE TO THE GOVERNMENT AUDITING STANDARDS

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We believe that MMS failed to fully adhere to the Standards and its own Audit Manual. This has resulted in unreliable audit quality and documentation and precludes established controls from functioning effectively.

Efforts in recent years to expedite audit decisions and re-engineer the royalty compliance process may have inadvertently contributed to the deficiencies in audit working papers.

For example, a decision in 1999 to expedite the closure of current audits so that a new audit strategy could begin may have resulted in some auditors disregarding working paper quality standards. An e-mail instruction was sent to auditors requesting an immediate review of their ongoing work to identify and expeditiously close audit work that the auditor did not believe would result in significant findings. The e-mail contained directions on how to properly close out the audit by documenting the decision and its basis and having a supervisor review and approve the decision. All audit organizations must make decisions about how to best use their limited resources, and we do not take exception to the process outlined in the e-mail instruction. However, we were provided copies of the e-mail to justify audit working papers that clearly did not meet quality standards. For example, a copy of the e-mail was included in a folder of loose paper that contained some audit information, but no working papers or conclusions. Also, MMS officials provided a copy of the e-mail to justify why working papers were not available for one audit subcase that we had asked to review. They stated that the audit was closed without working papers.

MMS was also in the process of re-engineering its operations during the time period under review. This was a major effort that required the close attention of managers and senior level officials. The re-engineered process will shift the focus from auditing on a company basis to evaluating expected royalty values on a property basis. The re-engineered process will use multifunctional teams,

including auditors, to conduct the expected royalty analyses. MMS plans to conduct significantly fewer audits under this process. We believe this may have contributed to MMS auditors being less stringent about adhering to audit standards that they believed would not matter in the future. In fact, at one of our meetings, an Audit Manager clearly stated that he believed MMS would no longer be conducting audits and did not need to be concerned about having an adequate internal quality control system as required by the Standards.

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## **ADDITIONAL ISSUES**

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During the course of our audit, some additional issues came to our attention that we believe should be communicated to the management of MMS for corrective action. We prepared a management letter to MMS communicating these issues. However, we believe one issue merits inclusion in this summary report.

### **Written Reports for Audits with No Findings**

MMS does not prepare written report products for all of its audit work. In general, MMS prepares a report only when an audit concludes that a royalty payor owes additional money. When an audit does not result in an underpayment determination (order to pay), MMS usually does not issue a report. In our sample of 14 audits, eight audits had no royalty findings and only a summary of results was prepared. In our opinion, applicable audit standards require that MMS notify the company of the results with a written report for all audits, regardless of the conclusions. MMS told us that when the audit work is terminated without an order to pay, the results of the work do not need to be formally communicated in writing to the subject of the audit (auditee). We disagree with this policy.

The 1994 version of the Government Auditing Standards, as amended, Section 7.2, states, “Auditors should prepare written audit reports communicating the results of each audit.” We believe that this reporting requirement applies to all MMS audits conducted under the Standards because even when an audit concludes that royalties were not underpaid, this conclusion represents the results of that completed audit. In our opinion, the auditee (the royalty payor) has a direct interest in the audit results and therefore is entitled to receive a report.

In its Exposure Draft of proposed changes to the Government Auditing Standards, dated January 2002, the General Accounting Office continues to include this requirement.

Therefore, we strongly suggest that MMS prepare audit reports in accordance with the Standards for all audits, including those that do not result in findings.

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**MMS RESPONSE AND  
OIG REPLY**

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In the December 19, 2002 response (Appendix 6) to the draft report, the Director, MMS, generally agreed with the findings and concurred with all of the report's recommendations.

In its response, MMS requested that we revise our overall conclusion that it had not complied with the Standards. Specifically, MMS agreed that in some cases its audits did not comply with all the Standards, but believes that this condition did not reflect on the overall quality of the audit program. Based on the response, we revised the executive summary of the report to clarify that not all of the MMS audits reviewed were in noncompliance with the Standards.

Based on the MMS response, we consider Recommendations 1b, 2, 4, 9, and 10 resolved and implemented and Recommendation 3 resolved but not implemented. Finally, MMS concurred with Recommendations 1a, 1c, 1d, 1e, 5, 6, 7, and 8, but we request that MMS provide the target dates for implementation of the corrective actions. The status of all recommendations is shown in Appendix 7.

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## RECOMMENDATIONS

We recommend that the Director, MMS:

1. Correct and strengthen the design and function of the internal quality control review process. Specific improvements should include the following:
  - a. Place the internal review function directly under the Associate Director of Minerals Revenue Management.
  - b. Require that internal review reports be transmitted to the Associate Director of Minerals Revenue Management.
  - c. Ensure individuals conducting the internal reviews are at an appropriate grade level.
  - d. Ensure all audit work is subject to review and that the internal review team independently selects the audits to be reviewed.
  - e. Require auditors performing internal reviews to check for compliance with all generally accepted government auditing standards as well as the MMS Audit Manual.
2. Ensure all audit activities are conducted with due professional care and auditors maintain the highest level of integrity in all of their professional activities by instituting a strengthened internal quality control system.
3. Ensure an external quality control review is conducted of MMS' audit activities after the corrective actions outlined in this report have been implemented.
4. Disclose in future audit products that MMS has not undergone a recent external quality control review and does not have a current opinion on its internal quality control system until a subsequent external quality control review is conducted.
5. Ensure all audit field offices have adequate controls over audit working papers, including an up-to-date log annotated with storage locations and secured containers for storage.
6. Ensure all stored working paper files are complete.
7. Ensure all auditors receive sufficient CPE as required by the Standards.
8. Develop a centralized system that tracks and monitors the training provided to each auditor.

9. Maintain appropriate and complete supporting documentation of CPE received by the auditors.

We believe that the seriousness of the deficiencies that we found in this audit warrant an additional recommendation.

We recommend that the Assistant Secretary:

10. Require periodic updates on the status of the corrective actions until the MMS audit offices receive an unqualified opinion on an external quality control review.

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## **MINERALS MANAGEMENT SERVICE**

### **ORGANIZATION, RESPONSIBILITIES, AND RESOURCES**

The Minerals Management Service (MMS) was created by Secretarial Order in 1982 to consolidate the management of the public's mineral resources under one agency. MMS has two operational program areas: The Offshore Minerals Management program manages the Nation's natural gas, oil, and other mineral resources on the Outer Continental Shelf, and the Minerals Revenue Management program collects, accounts for, and disburses revenues from offshore mineral leases and from onshore mineral leases on Federal and most Indian lands.

The audit offices are part of the Minerals Revenue Management program. The auditors verify the accuracy of payments made by companies for minerals extracted from approximately 26,000 producing leases. Following a structured approach contained in the MMS Audit Manual, an audit determines whether royalties were valued and paid in accordance with MMS' regulations contained in the Code of Federal Regulations (30 CFR).

Before October 2000, the MMS audit offices were known as compliance divisions and were organizationally independent. Then in October 2000, as part of a comprehensive reorganization, the former Royalty Management Program was renamed the Minerals Revenue Management and the audit offices were combined with other mineral analytical functions into a comprehensive compliance and asset management process. The compliance and asset management process is divided into offshore and onshore components. Once fully implemented, the reorganization is intended to improve the timeliness and accuracy of royalty verification at less cost.

The overall fiscal year 2002 operating budget for MMS was \$269.6 million and provided for 1,776 full-time equivalent positions. The Minerals Revenue Management program was funded at \$83.3 million and about 573 positions. MMS employs approximately 165 auditors who work in Lakewood, Colorado; Farmington, New Mexico; Oklahoma City and Tulsa, Oklahoma; and Dallas and Houston, Texas. Some of these auditors are stationed at 13 of the largest royalty payor companies. While MMS is solely responsible for auditing offshore leases, the onshore compliance effort is supplemented by 10 state and eight Tribal audit organizations under delegated agreements with MMS. The state and Tribal organizations provide about 119 additional auditors, who coordinate their individual audits with those performed by MMS.

## Results of Review of 14 Audit Subcases

Deficiencies Noted	Government Auditing Standards Requirement (1994 Revision as Amended)	MMS Audit Manual Requirement
<b>Planning</b>  1. No audit engagement letter was sent to the auditee. <u>1 of 14 audits</u>	Government Auditing Standards (GAS) 6.2 states “Work is to be adequately planned.” In our opinion, an engagement letter should be sent to the auditee as part of maintaining the professional standards of the audit.	Audit Manual section 2.2.1 states “At or near the beginning of a new fiscal year, general notification letters are sent to entities selected for comprehensive audits. When you initiate an audit, you issue a more detailed engagement letter to the auditee—the entity to be audited including any affiliates and subsidiaries.”
2. The auditor did not prepare a written audit plan and/or program. <u>4 of 14 audits</u>	GAS 6.2 states “Work is to be adequately planned.”  GAS 6.3 states “In planning, auditors should define... methodology.... The methodology comprises the work in data gathering and in analytical methods....”  GAS 6.19 states “A written audit plan should be prepared for each audit.... The plan should include an audit program...about the audit objectives, scope and methodology....”  GAS 6.20 states “Documenting the audit plan is an opportunity for the auditors to review the work done in planning....”	Audit Manual section 2.2.4 states, “During audit plan development, you establish the scope of the work to be performed, select the leases and period to be reviewed, and develop detailed audit steps.” Audit Manual section 6 contains more information on developing an audit plan including “Background and Lease Inventory,” “Management Controls Reviews,” and “Audit Plan Development.”



<p>3. Work of the company's internal auditors was not considered. <u>14 of 14 audits</u></p>	<p>GAS 6.5 h. states "Consider whether the work of other auditors and experts may be used to satisfy some of the auditors' objectives."</p> <p>GAS 6.14 states that auditors should consider the work of other audit organizations.</p> <p>GAS 6.44 states, "When an assessment of management controls is called for, the work of the internal auditors can be used...."</p>	<p>Audit Manual section 6.1 Step 5 states "Review copies of audit reports performed by the auditee, joint venture partners, or other Federal agencies for your audit period."</p>
<p>4. Prior audit coverage was not reviewed. <u>3 of 14 audits</u></p>	<p>GAS 6.12 states "Auditors should follow up on significant findings and recommendations from previous audits that could affect the audit objectives."</p>	<p>Audit Manual section 6.1 Step 2 states "Review prior audits performed by MMS or others. Items to look for include previous findings and unresolved issues."</p>
<p>5. The audit methodology was not sufficient to answer the audit objective. <u>1 of 14 audits</u></p>	<p>GAS 6.4 states "Auditors should design the methodology to provide sufficient, competent, and relevant evidence to achieve the objectives of the audit."</p>	<p>The Audit Manual does not specifically address procedures to be used when GAS is not followed. However, Audit Manual section 4 states "MMS policy requires that Yellow Book standards be used when conducting royalty audits." By reference to the Yellow Book standards, GAS is required by the Audit Manual.</p>
<p>6. The auditor did not assess the risk that illegal acts or other noncompliance that is significant to the audit objective could occur. <u>14 of 14 audits</u></p>	<p>GAS 6.28 "requires determining if laws and regulations are significant to the audit objectives and, if they are, assessing the risk that significant illegal acts could occur."</p> <p>GAS 6.31 states "In planning tests of compliance with significant laws and regulations, auditors assess the risk that illegal acts could occur."</p>	<p>Audit Manual section 29 states, "Design the audit to provide reasonable assurance of detecting material misstatements resulting from direct and material illegal acts.... Be aware that indirect illegal acts may have occurred.... Be aware of the characteristics and types of potentially material irregularities that could be associated with the area audited. This awareness is necessary to plan the audit and reasonably ensure detecting material irregularities.... Understand the laws and regulations that have a direct and material effect on reporting and determining royalties...."</p>



7. Management controls were not considered or tested. <u>3 of 14 audits</u>	GAS 6.39 states "Auditors should obtain an understanding of management controls that are relevant to the audit. When management controls are significant to audit objectives, auditors should obtain sufficient evidence to support their judgments about those controls."	Audit Manual section 6.2 states, "Determining how much time and effort to expend on a management controls review requires considerable professional judgment...limit your systems control review to relevant operations.... The following steps provide general guidance.... Review and document the auditee's production and revenue accounting procedures and controls.... Evaluate and test the auditee's systems and controls.... Review and document the auditee's policy and practice for paying royalties.... Review the auditee's chart of accounts...document any systemic problems that might cause incorrect royalty payments. Factor the results into your audit scope."
<b>Supervision</b>		
8. The MMS' supervisory review noted deficiencies to be corrected (no audit plan), but the auditor did not make the corrections. <u>1 of 14 audits</u>	GAS 6.23 states "Supervision involves directing the efforts of auditors...keeping informed of significant problems encountered...."  GAS 3.32 states "The internal quality control system established by the audit organization should provide reasonable assurance that it...has established, and is following, adequate audit policies and procedures."	Audit Manual section 5.6 states "Supervisors are required to critique the work papers and obtain corrections if they are not satisfactory. After the auditor corrects the work papers, the supervisor signs and dates the page and assumes the same responsibility for the work papers as the auditor."

9. The audit issue letter of summary was not cross-indexed to the working papers. <u>4 of 14 audits</u>	<p>GAS 6.23 states "Supervision involves directing the efforts of auditors...keeping informed of significant problems encountered...."</p> <p>GAS 3.32 states "The internal quality control system established by the organization should provide reasonable assurance that it...has established, and is following, adequate audit policies and procedures."</p>	Audit Manual section 5.5.1 states, "Identify the sources of summary information."
10. Supervisor did not review audit files in a timely manner. <u>4 of 14 audits</u>	<p>GAS 6.23 states "Supervision involves directing the efforts of auditors...keeping informed of significant problems encountered...."</p> <p>GAS 6.25 states "...review of audit work may vary depending on the significance of the work or the experience of the staff...."</p>	Audit Manual section 5.6 states "Active and timely supervisory involvement with the audit is required."
11. No indication of supervisory review of audit plan or program. <u>3 of 14 audits</u>	<p>GAS 6.23 states "Supervision involves directing the efforts of auditors...reviewing the work performed...."</p> <p>GAS 6.25 states "...review of audit work may vary depending on the significance of the work or the experience of the staff...."</p>	Audit Manual section 5.6 states "Active and timely supervisory involvement with the audit is required."
12. Supervisory review was not sufficient to catch an error. <u>1 of 14 audits</u>	GAS 6.23 states "Supervision involves directing the efforts of auditors ... reviewing the work performed ...."	Audit Manual section 5.6 states "Active and timely supervisory involvement with the audit is required."

13. A lack of written audit planning activities is evidence that supervision was not sufficient. <u>5 of 14 audits</u> <b>Evidence</b>	GAS 6.23 states "Supervision involves directing the efforts of auditors...."  GAS 6.24 states "Supervisors should satisfy themselves that staff members clearly understand what work they are to do...."	Audit Manual section 5.6 states "Active and timely supervisory involvement with the audit is required.... Supervisors are required to critique the work papers and obtain corrections if they are not satisfactory."
14. The working papers did not include any sampling criteria used. <u>7 of 14 audits</u>	GAS 6.64 states, "Working papers should contain the objectives, scope, and methodology, including any sampling criteria used."	Section 5.3 of the Audit Manual states that work papers should be specific in documenting the sampling method (i.e., a universe; if downloaded, documents describing the download process; sample size; and type of sampling method).
15. The auditors intended to test management controls. Results of such tests, if conducted, were not documented. <u>4 of 14 audits</u>	GAS 6.39 states "Auditors should obtain an understanding of management controls that are relevant to the audit. When management controls are significant to audit objectives, auditors should obtain sufficient evidence to support their judgments about those controls."  GAS 6.64 states "Working papers should contain ...documentation of the work performed to support significant conclusions and judgments...."	Audit Manual section 6.2 states, "Determining how much time and effort to expend on a management controls review requires considerable professional judgment....limit your systems control review to relevant operations.... The following steps provide general guidance.... Review and document the auditee's production and revenue accounting procedures and controls.... Evaluate and test the auditee's systems and controls.... Review and document the auditee's policy and practice for paying royalties.... Review the auditee's chart of accounts...document any systemic problems that might cause incorrect royalty payments. Factor the results into your audit scope."  The Audit Manual contains the same language as GAS 6.64. In addition, Audit Manual section 5.1 states, "Audit working papers document evidence obtained or developed, methods and procedures followed, and

		conclusions reached during an audit.”  Audit Manual section 5.2 states “Working papers must be complete and accurate in order to provide support for findings and conclusions.” Audit Manual section 5.3 states, “Conclusions should also be fully supported by the information in the working papers....”
16. The working paper files did not contain the audit objective, scope, and/or methodology. 3 of 14 audits	GAS 6.3 states “In planning, auditors should define the audit’s objectives and the scope and methodology to achieve those objectives.”  GAS 6.64 states, “Working papers should contain the objectives, scope, and methodology, including any sampling criteria used.”	Audit Manual section 5 states “The Yellow Book, discussed in chapter 4, requires all Government auditors to prepare work papers that contain: 1. The objectives, scope, and methodology of the work performed, including any sampling criteria used.”
Quality Controls		
17. The audit report product was not independently referenced. 1 of 6 audits	GAS 3.32 states “The internal quality control system established by the organization should provide reasonable assurance that it ...has established, and is following, adequate audit policies and procedures.”  In our opinion, the referencing process is an important part of quality control.	Audit Manual section 25 states, “Referencing is the final review of a draft document to verify the accuracy of reported facts and to ensure that findings, conclusions, and recommendations are properly supported.  Referencing must be conducted on audit products to maintain professional auditing and reporting standards....  All orders to pay, orders to perform, and field reports are referenced .... Referencing is performed by an experienced auditor who did not directly participate in the audit....”
Reporting		
18. The audit objective was not clearly explained in the report. 1 of 6 audits	GAS 7.10 states “Auditors should report the audit objectives and the audit scope and methodology.”	The Audit Manual section 4.4 states “Auditors should report: The audit objectives, scope, and methodology.”  The Audit Manual section 24.3.3 states “Enforcement documents contain some or all of the following parts....



		objective and scope.”
19. The report did not explain the relationship between the universe and what was actually audited. 2 of 6 audits	GAS 7.14 states, “...auditors should describe the depth and coverage of work conducted...[and] explain the relationship between the universe and what was audited....”	The Audit Manual section 4.4 states “Auditors should report: The audit objectives, scope and methodology.”
20. The report did not include the “cause” element of the finding. 2 of 6 audits	GAS 7.18 states “In reporting the findings, auditors should include sufficient, competent, and relevant information to promote adequate understanding of the matters reported....” GAS 7.19 states “Audit findings often have been regarded as containing the elements of criteria, condition, and effect, plus cause when problems are found.”	The Audit Manual section 24.3.3 states “Enforcement documents contain some or all of the following parts.... Cause. Cause is the underlying action, lack of action, weakness, deficiency, or inadequacy that resulted in the problem.”
21. The audit report did not include a statement that the audit was conducted in accordance with GAGAS. 2 of 6 audits	GAS 7.24 states “Auditors should report that the audit was made in accordance with generally accepted government auditing standards.”	The Audit Manual Section 24.1 states, “the issue letter includes... a statement that the audit was conducted using generally accepted government auditing standards (GAGAS).” The Audit Manual section 24.2 states, “An order to pay or perform contains all the elements of an issue letter...as well as a statement that the audit was conducted in accordance with GAGAS.”
22. The audit report did not include a statement of the work done on management	GAS 7.34 states “Auditors should report the scope of their work on management controls and any significant weaknesses found during the audit.”	The Audit Manual section 4.4 states “Auditors should report.... The scope of their work on management controls and any significant weakness found during the audit.”

controls. 2 of 6 audits		
Due Professional Care		
23. By not complying with the standards shown above MMS auditors did not follow due professional care. 10 of 14 audits	GAS 3.27 states "This standard requires auditors to work with due professional care. Due care imposes a responsibility upon each auditor within the organization to observe generally accepted government auditing standards."	The Audit Manual section 4.2 states the same language as the GAS citation.

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## SCOPE AND METHODOLOGY

We conducted our audit work in accordance with the *Guide for Conducting External Quality Control Reviews of the Audit Operations of Offices of Inspector General*, issued in April 1997 by the President's Council on Integrity and Efficiency. We used the 1994 version of the generally accepted government auditing standards as amended, promulgated by the Comptroller General of the United States, and the January 1998 MMS Audit Manual as our criteria to evaluate MMS' internal quality control system, CPE, and selected audit working paper files. We initially began our review as an external quality control review. Based on subsequent discussions with the General Accounting Office and our legal counsel, we determined that it was inappropriate for the OIG to conduct an external review of a segment of the Department of the Interior and we completed our work as a traditional performance audit.

To accomplish our review, we visited the MMS audit field offices located in Lakewood, Colorado; Dallas and Houston, Texas; Oklahoma City and Tulsa, Oklahoma; and Farmington, New Mexico. We also visited nine oil and gas companies where MMS has established permanent residency offices. Our scope included audits conducted only by MMS auditors and, therefore, did not include audits conducted by the state and Tribal audit organizations.

Our audit steps included the following:

- We evaluated the effectiveness of MMS' internal quality control system by examining the process of selecting audits to review, comparing the review checklist to guidance from the President's Council on Integrity and Efficiency, the Standards and the MMS Audit Manual, and gaining an understanding of the procedures used to conduct the reviews and report the results of the reviews.
- We assessed MMS' compliance with the CPE requirements of the Government Auditing Standards by reviewing MMS' list of training for all auditors. We also reviewed the documentation supporting the list of training for 20 auditors.
- We examined a judgmental sample of 15 audits taken from MMS' universe of closed audits from May 1997 through October 2001. We checked the working paper files for compliance with the Government Auditing Standards and the MMS Audit Manual.
- We reviewed a scientific sample of 191 audit files to test the controls to safeguard working paper files. We also tested these files for authenticity and completeness of the working paper files and some selected aspects of the Standards, including supervisory review, planning, and documentation.

- For this audit step, we statistically sampled MMS' closed or appealed audit subcases for the period of May 1997 through October 2001. The sample consisted of 191 randomly selected subcases (audits) out of a sampling universe of 987 subcases, exclusive of state and tribal audits. The following parameters were used to select the sample size:
  - confidence level of 95 percent,
  - expected deviation (error) rate of one,
  - tolerable deviation rate of three.
- We reviewed 58 audit working paper files for the three MMS employees that were implicated in the recreation of the working papers for one audit. We also tested these files for authenticity and completeness of the working paper files and some selected aspects of the Standards, including supervisory review, planning, and documentation.

We conducted our audit in accordance with the Government Auditing Standards issued by the Comptroller General of the United States. Accordingly, we included such tests of records and other auditing procedures as we considered necessary under the circumstances.



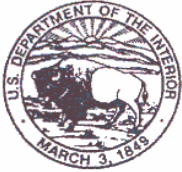
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## PRIOR AUDIT COVERAGE

The previous external quality control review of the MMS audit offices was conducted by the OIG. The report (No. 98-I-398) concluded that MMS was generally in compliance with the Government Auditing Standards and its audit manual. The review further found that MMS conducted audits in a professional manner, audit conclusions were adequately supported by the working papers, and most auditors were current with their CPE requirements. However, the review also disclosed the following weaknesses:

- Auditors did not prepare a risk assessment for compliance with laws and regulations.
- The internal quality control process did not check for compliance with all the elements of the Government Auditing Standards.
- Math computations were not independently verified.
- Some reports were not issued in a timely manner.
- Supervisory review of the working papers was not always in a timely manner.
- Some reports were issued without evidence of supervisory review of the working papers.
- Minor deficiencies were found in the quality of working papers.

The review stated that these weaknesses did not adversely affect the validity of the audit findings and conclusions.



## United States Department of the Interior

MINERALS MANAGEMENT SERVICE  
Washington, DC 20240



DEC 19 2002

### Memorandum

To: Assistant Inspector General for Audits

Through: Rebecca W. Watson *Rebecca W. Watson*  
Assistant Secretary - Land and Minerals Management

From: *for* R. M. "Johnnie" Burton *Walter D. Canine*  
Director

Subject: Office of Inspector General Draft Audit Report, "Peer Review of MMS Audit Offices" [C-IN-MMS-015-2001-A]

Thank you for the opportunity to respond to the draft audit report on our audit offices. We are providing to you our general comments on the audit findings and specific ones on the recommendations. We agree with the recommendations contained within the report, and have already begun implementing a number of them.

Please contact Bettine Montgomery at (202) 208-3976 if you have any further questions.

Attachment



**MMS Response to Office of the Inspector General  
Draft Report "Peer Review of MMS Audit Offices"  
dated November 4, 2002**

**Summary Statement:**

The Minerals Management Service (MMS) is committed to royalty audits of the highest quality and integrity. The MMS audit program has existed for more than 20 years. In that time, MMS auditors have performed thousands of audits of royalty payors and have effectively detected and collected over \$2.5 billion in additional royalty revenues for the benefit of state governments, American Indians, and the public trust.

The MMS is committed to excellence in its audit program and welcomes the OIG's constructive criticism and suggestions for further improvement. The MMS will therefore implement the OIG recommendations in order to improve audit quality and generate a higher level of confidence in our audit processes.

The MMS has completed a detailed review of the Office of the Inspector General (OIG) draft report, including changes made by the OIG on December 17, 2002. In the draft report, the OIG recommends that MMS improve the internal quality control review system used by the audit offices, provide better safeguards for audit files, and improve the system for tracking the continuing professional education for audit personnel. The MMS agrees with the OIG that improvements must be made in these areas.

In the Executive Summary of the draft report, the OIG concludes that some MMS audit work did not meet the Standards. The Executive Summary states the OIG's belief that, overall, MMS failed to fully comply with the Standards. While we agree that some of the cases did not comply with all of the Standards, we believe this was limited and does not reflect on the overall quality of the audit program. Accordingly, MMS respectfully requests that the OIG consider deleting this broad conclusion from any final report.

The following sections of this response provide MMS's comments on the findings and conclusions presented in the OIG draft report and describe the specific actions taken or planned by MMS in response to each OIG improvement recommendation. The Associate Director for Minerals Revenue Management will be the MMS official responsible for monitoring the progress of the audit offices to ensure full implementation of the improvement actions described in this response.

## **Internal Quality Control System**

The MMS agrees that the internal quality control review process used by the audit offices can and must be improved.

**OIG Recommendation:** Place the internal review function directly under the Associate Director, Minerals Revenue Management.

**MMS Response:** Concur. A new internal Quality Control Team is being established within the Office of the Deputy Associate Director who reports to the Associate Director.

**OIG Recommendation:** Require that internal review reports be transmitted to the MRM Associate Director.

**MMS Response:** Concur. We have recently implemented a process of forwarding final review reports to the Associate Director after review and appropriate corrections by the Quality Control Team and the Deputy Associate Director.

**OIG Recommendation:** Ensure individuals conducting the internal reviews are at the appropriate grade level.

**MMS Response:** Concur. A grade 14 manager will oversee the Quality Control Team. One or more grade 13 supervisors will also be assigned to the team.

**OIG Recommendation:** Ensure that all audit work is subject to review and that the internal review team independently selects the audits to be reviewed.

**MMS Response:** Concur. Future internal control reviews will include all audit categories, including audits closed with no findings or corrective actions. Review candidates will be independently selected by the Quality Control Team. Affected audit offices will not participate in the selection process. The Deputy Associate Director, through the Quality Control Team, will develop follow-up procedures and a tracking process to ensure that corrective actions are fully implemented by audit offices and personnel. The MMS will also provide training to auditors on requirements of the standards.

**OIG Recommendation:** Require that auditors performing internal reviews check for compliance with all Standards as well as the MMS Audit Manual.

**MMS Response:** Concur. The MMS is developing a new and updated internal review checklist to include additional areas noted in the Standards and in the peer review guidelines published by the President's Council on Integrity and Efficiency. The new internal quality control review checklist will emphasize due professional care, audit planning and reporting, and supervisory reviews. The checklist will enable conclusions on whether work meets the standards and will identify actions required to fully comply with the Standards and the MMS Audit Procedures Manual.

### **Due Professional Care**

Based on a sample of audit cases, the OIG concludes that some historical audit work did not fully comply with the Standards. Specifically, the OIG evaluated the files for 14 audit cases, concluding that sufficient audit work was not performed or that the work performed was not sufficiently documented.

For the past 3 years, MMS audit managers and assigned personnel have been heavily engaged in a reengineering of the MMS compliance processes and support systems. Many personnel have been in transition from traditional audit work to a new compliance and asset management process. The MMS acknowledges that the pressures and priorities of this transition, in some instances, may have contributed to the noted discrepancies with the Standards and incomplete audit documentation.

In spite of the stumbling of a few of its employees, MMS has great pride and confidence in the professionalism and quality of its audit personnel. When building a new national audit program 20 years ago, MMS recruited and hired many of the best and most experienced audit personnel in the Federal Government from the General Accounting Office, Department of Energy, Department of Defense, Internal Revenue Service, and from other Department of the Interior bureaus and offices, including the OIG.

The OIG acknowledges in its draft report that work was not performed to re-evaluate the audit conclusions for sampled cases. The detection and collection, over a 20 year period, of \$2.5 billion in underpaid royalties by the MMS audit program is testimonial to the commitment and effectiveness of its audit personnel. Over the 20-year history of the MMS audit program, the findings and conclusions of the individual audits have proven to be highly defensible and have fully and effectively supported massive litigation and other compliance and enforcement strategies of national scale. The MMS agrees that improvements can be made and, as described below, will implement the OIG improvement recommendations.

**OIG Recommendation:** Ensure that all audit activities are conducted with due professional care and auditors maintain the highest level of integrity in all their professional activities by instituting a strengthened internal quality control system.

**MMS Response:** Concur. The MMS believes the corrective actions outlined in the previous section of this response effectively and fully respond to this recommendation.

**OIG Recommendation:** Ensure an external quality control review is conducted of MMS audit activities after the corrective actions outlined in this report have been implemented.

**MMS Response:** Concur. The MMS has begun work that will lead to the competitive award of a contract for conducting the recommended external quality control review. The contractor will perform an independent review of the quality controls in use by the MMS audit offices. This external review will be initiated and completed in Fiscal Year 2003.

**OIG Recommendation:** Disclose in future audit products that MMS has not undergone a recent external quality control review and does not have a current opinion on its internal quality control system until a subsequent external quality control review is conducted.

**MMS Response:** Concur. Until such time as MMS obtains the desired external opinion, the following statement will be included in all future MMS audit reports. "MMS does not have a current opinion on its system of quality control. The MMS audit program will undergo an external quality control review in Fiscal Year 2003."

**OIG Recommendation:** That the Assistant Secretary for Land and Minerals Management require periodic updates on the status of the corrective actions until the MMS audit offices receive an unqualified opinion on an external quality control review.

**MMS Response:** Concur. The MMS will provide periodic status reports to the Assistant Secretary until an unqualified opinion is rendered on the audit program's quality control system.

## **Professionalism**

The OIG found one case where MMS auditors reconstructed a working paper file, when they could not locate the original audit file and backdated their work. The MMS agrees this was an egregious act. However, MMS believes that, based on the facts surrounding this situation, there was no intent on the part of the auditor and audit supervisor involved to mislead the OIG. The auditor and audit supervisor explicitly told audit managers and the MMS coordinator to the OIG's office that the files requested by the OIG could not be found and that they would need to be reconstructed from other records. Unfortunately, the MMS OIG contact failed to notify the OIG that the files turned over to them for this audit were not the original files. The OIG later learned of the reconstruction from MMS auditors who believed that the OIG staff had already been informed of this fact.

## **Safeguarding Audit Files**

In this section of the draft report, the OIG states that the MMS could not locate audit working paper files for six audit cases. The draft report does not specify which cases; however, MMS believes they are referring to six sub-cases (segments of audits) applicable to five audits. One of these five cases is the aforementioned audit of a single lease for which MMS auditors reconstructed the working papers.

The MMS agrees with the OIG that all working papers prepared by audit personnel should be secured, that audit files should be complete, and that the location of files should be known. The MMS further agrees that the process and procedures for filing and safeguarding audit files at some field office locations can and should be improved.

**OIG Recommendation:** Ensure that all audit offices have adequate controls over audit working papers, including an up-to-date log annotated with storage location and secured containers for storage.

**MMS Response:** Concur. The MMS audit field offices have taken steps to secure all audit files. Audit files for closed cases will be retained in locked storage containers or file rooms. Each office will have a designated person responsible for maintaining a log of all closed audits and the location of the respective files. Access and use of secured files will be effectively controlled through use of sign-out procedures.

**OIG Recommendation:** Ensure all stored working paper files are complete.

**MMS Response:** Concur. The MMS audit offices have started a comprehensive review of audit case files closed after January 1, 2001, to ensure that working paper files are complete. This effort will be the responsibility of the senior audit manager in charge of each MMS field audit office. This improvement initiative is expected to take approximately one year to complete.

### **Continuing Professional Education**

The Standards require that auditors engaged in the performance of audits acquire 80 hours of continuing professional education (CPE) every 2 years, with no less than 20 hours in 1 year. The OIG asserts that a "significant" number of MMS auditors (18 personnel, or 12 percent) did not meet the CPE requirements for the 1999–2000 timeframe. Only 6 of the 18 auditors failed to meet the 2 year, 80 hour CPE requirement. Twelve of the 18 auditors did meet the 2 year, 80 hour requirement, but acquired less than 20 CPE hours in one of the 2 years. We believe these incidences of less than 20 hours represent minor infractions of the Standards.

The MMS agrees improvements are needed in this area and, as described below, has already taken actions in response to the OIG recommendations.

**OIG Recommendation:** Ensure all auditors receive sufficient continuing professional education (CPE) as required by the Standards.

**MMS Response:** Concur. The MMS has taken steps to ensure that all audit personnel engaged in the conduct of audits did in fact acquire the CPE hours needed to fully comply with the Standards for 2001 and 2002.

**OIG Recommendation:** Develop a centralized system that tracks and monitors the training provided to each auditor.

**MMS Response:** Concur. The MMS has determined that it can best meet the intent of this recommendation by tracking and monitoring training within each of the two MMS compliance organizations (Offshore and Onshore Compliance and Asset Management). Each organization will implement a system for providing and monitoring the training needed to ensure that all assigned audit personnel engaged in audits are in current compliance with the CPE requirements.

**OIG Recommendation:** Maintain appropriate and complete supporting documentation of CPE received by the auditors.



**MMS Response:** Concur. The Offshore and Onshore Compliance and Asset Management organizations will maintain complete training documentation and CPE hours for all respective audit personnel that conduct audits.

### **Adherence to the Government Auditing Standards**

The OIG asserts in its draft report that MMS failed to fully adhere to the Standards and its own Audit Manual. The OIG concludes that this resulted in unreliable audit quality and documentation and precluded established controls from functioning effectively. The OIG makes no specific improvement recommendations in this section of the draft report.

The OIG correctly points out that the MMS audit program has been in transition due to reengineering changes and notes that audit management took steps to expedite closure of audits of historical periods. The MMS auditors have been challenged in the reengineering transition. Many audit supervisors and personnel have been required to manage an existing audit workload while leading efforts to test and implement new streamlined compliance processes for the future. We agree that some audit work has been expedited and that, for some audits, the quality and quantity of documentation has not fully met all Standards, however, we do not believe it's a reflection on the overall quality of the MMS audit program. MMS is confident that the corrective actions outlined in this response will achieve the process improvements sought by the OIG and endorsed by MMS management.

The unreliability of quality control and shortcomings in audit documentation cited in the OIG draft report are procedural in nature. These shortcomings will be corrected. The MMS has a strong commitment to quality and we renew this commitment in this document.

Recently, MMS audit managers and personnel have pioneered reengineering improvements in process and systems all designed to make future MMS royalty compliance and audit operations dramatically more efficient and effective. In the future, traditional audits across the royalty universe will give way to strategic, comprehensive property-based compliance reviews. In addition, we will expedite the overall MMS compliance process, and reduce the audit/compliance cycle with industry from 6 to 3 years or less.

The dramatic reengineering changes that are underway at the MMS will require close and continuing dialog and assistance from the General Accounting Office and the Office of the Inspector General to ensure that proper standards are in place and an effective internal quality control process is designed and implemented.

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## STATUS OF RECOMMENDATIONS

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Finding/Recommendation Reference	Status	Action Requested
1a, 1c, 1d, 1e, 5, 7, and 8	Management concurs; additional information requested.	Please provide the target dates for implementation.
1b, 2, 4, 9, and 10	Resolved and Implemented.	No further action is needed.
3	Resolved; scheduled for implementation in FY 2003.	Please keep us informed of the progress and results of the external quality control review.
6	Resolved; implementation in progress.	Please provide a specific date for completion of implementation and furnish the results of the comprehensive review of audit case files.

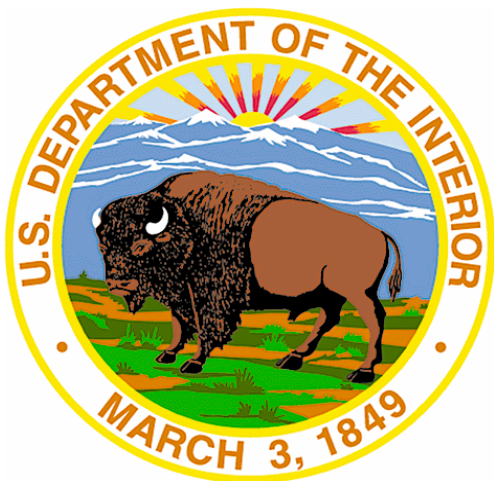
## How to Report Fraud, Waste, Abuse and Mismanagement

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  
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