Ministry of Energy and Resources

Saskatchewan Oil and Gas Orphan Fund Annual Report for 2021-22

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Letters of Transmittal

The Honourable Jim Reiter
Minister of Energy and Resources

Office of the Lieutenant Governor of Saskatchewan

I respectfully submit the Annual Report for the Ministry of Energy and Resources for the fiscal year ending March 31, 2022.

The Honourable Jim Reiter
Minister of Energy and Resources

Susanna Laaksonen-Craig
Deputy Minister of Energy and Resources

The Honourable Jim Reiter
Minister of Energy and Resources

Dear Minister:

I have the honour of submitting the Annual Report of the Ministry of Energy and Resources for the fiscal year ending March 31, 2022.

Susanna Laaksonen-Craig
Deputy Minister of Energy and Resources

Manager’s Responsibility for Financial Statements

The accompanying financial statements included in the annual report of the Oil and Gas Orphan Fund for the year ended March 31, 2022, are the responsibility of the management of the Ministry of Energy and Resources. Management has prepared the financial statements in accordance with Canadian public sector accounting standards. The financial information presented elsewhere in the annual report is consistent with that in the financial statements.

To ensure the integrity and objectivity of the financial data, management maintains a comprehensive system of internal controls including written policies and procedures, and an organizational structure that segregates duties. These measures provide reasonable assurance that transactions are recorded and executed in compliance with legislation and required authority, that assets are properly safeguarded and that reliable financial records are maintained.

The financial statements have been audited by the Office of the Provincial Auditor. Its report to the Members of the Legislative Assembly stating the scope of its examination and opinion on the financial statements appears on page 10.

Susanna Laaksonen-Craig
Deputy Minister of Energy and Resources

Introduction

The Saskatchewan Oil and Gas Orphan Fund was established in legislation in June 2007 following extensive consultation with oil and gas industry associations and other stakeholders. The consultative process led to the development of a comprehensive and robust set of regulations and a program that is fully funded and supported by the oil and gas industry.

The Oil and Gas Orphan Fund provides funding to address the costs of abandoning and decommissioning orphan wells and facilities and reclaiming the sites, as well as the costs of containing environmental emergencies arising from oil and gas operations. The fund receives revenue primarily through an annual levy that is paid by the oil and gas industry, thereby protecting taxpayers from exposure to these industry liabilities.

The legislative authority and specific provisions of the fund are found in *The Oil and Gas Conservation Act* and the regulations thereunder.

The fund is administered by the Saskatchewan Ministry of Energy and Resources (the Ministry).

Program Purpose

An orphan oil well is one where the licencee or owner of the well has ceased to exist due to insolvency or bankruptcy. The Saskatchewan Oil and Gas Orphan Fund was established as a means to pay for the costs associated with the abandonment and reclamation of orphan wells and facilities. The fund is capitalized through an annual levy paid by oil and gas companies. The program ensures that costs of abandoning and reclaiming orphan sites is not passed on to Saskatchewan taxpayers.

Program Activities for 2021-22

During the 2021-22 fiscal year, the Ministry invoiced the oil and gas industry $7.7 million in its annual orphan fund levy. The Ministry also carried out approximately $5.3 million in abandonment and reclamation work tied to orphan sites. This included:

- abandonment of 43 wells;
- 233 environmental site assessments;
- 135 reclamation projects; and,
- 45 applications for Acknowledgement of Reclamation (AOR) as part of final site closure.

For the 2022-23 fiscal year, the Ministry is forecasting to complete approximately 130 orphan well abandonments and approximately 400 site assessment and reclamation projects.

Risk Analysis

In order to reduce the risk and potential cost to the orphan fund, the Ministry administers the Licensee Liability Rating (LLR) program in parallel with the orphan program. The purpose of the LLR program is to backstop the orphan fund through the collection of security deposits from companies that may pose a higher risk to the fund in the event of insolvency. The security deposits are used to offset the cost to the fund of abandoning and reclaiming well and facility sites should the owner become insolvent.

Under the LLR program, each oil and gas company operating in Saskatchewan is rated numerically using the LLR system. The LLR is the ratio of a company's assets to liabilities. The asset value used in the formula is the production value from the company's operations. The liabilities are a company's total future cost to decommission all infrastructure and reclaim their sites. Companies whose rating is greater than 1.0 are considered to have assets greater than its liabilities and therefore pose a lower risk to the fund in the event of an insolvency. In contrast, those with a rating of less than 1.0 have assets less than its liabilities and are considered a higher risk to the fund in the event of an insolvency. Under the LLR program, operators with a rating of less than 1.0 are required to submit a security deposit to offset the risk posed to the fund.

As noted, the security deposits collected under the LLR program are intended to mitigate the potential risks to the fund posed by companies with an LLR less than 1.0. In Figure 1 below (current to March 31, 2022), it is evident that over the last number of years, the number of companies in this category has been relatively stable. As a result of the oil price crash in 2020, there was a slight increase in the number of companies with an LLR below 1.0. The number of companies in this rating has returned to pre-pandemic levels. The number of companies in this category collectively represent about 5 per cent of total provincial oil and gas liabilities and about 0.9 per cent of total provincial production value.

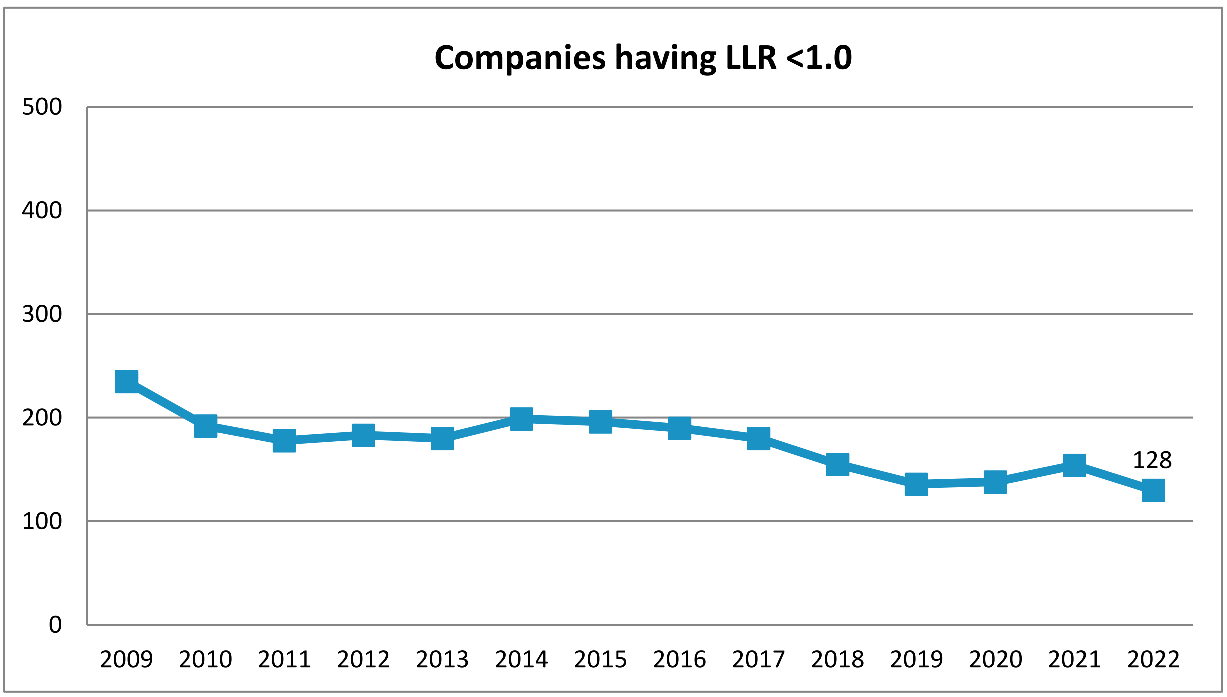

Figure 1 Number of companies with LLR below 1.0

The number of companies with an LLR greater than or equal to 1.0 increased from 99 in fiscal year 2020-21 to 115 in fiscal year 2021-22. This is attributed to the recovery of oil and gas prices from the low levels caused by the COVID-19 pandemic in 2020-21. The price recovery led to increased production, improving companies' LLR ratings through the 2021-22 fiscal year. Companies with an LLR greater than or equal to 1.0 represent approximately 95 per cent of total provincial oil and gas liabilities and about 99 per cent of total provincial production value. Figure 2 shows that the average provincial LLR has steadily declined since the inception of the program. This indicates that total industry liability is increasing more rapidly than total industry asset value. Over time, this could result in higher security deposit payments resulting in a decline in the ratio of assets to labilities. If security deposit payments, together with residual asset values, are insufficient to cover the abandonment and reclamation costs for orphaned wells and facilities, orphan levies may also increase over time. The increase in liability to asset value ratio can be attributed to several factors including lower oil and gas prices and a decrease in production during those lower price years. Since the LLR programs inception in 2009 the total provincial oil and gas production or asset value has remained relatively stable. To maintain production at current levels, industry has increased the drilling of new wells and the construction of new facilities, which leads to an increase in liabilities. With production remaining fairly constant, and the increase in liabilities from the factors previously mentioned, this has contributed to the decreasing of provincial LLR since 2009.

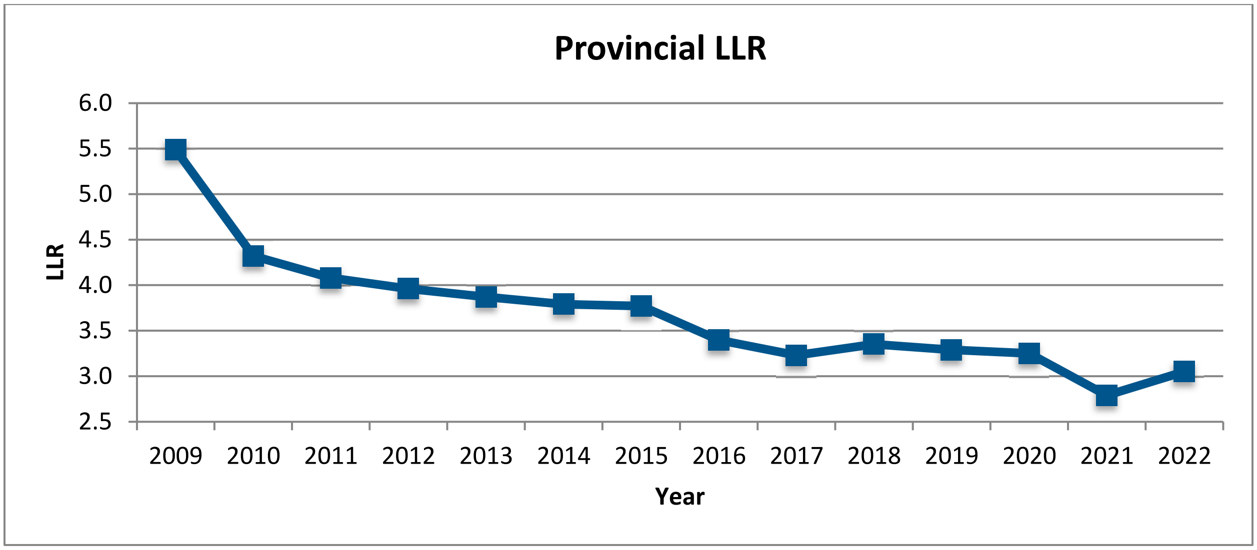

Figure 2 Average Provincial LLR

As of March 2022 the Ministry was holding $139.52 million in security under the LLR program. The total liability associated with licencees having an LLR less than 1.0 was $101 million. On balance, the security deposits held by the Ministry, together with the assets of these companies, are expected to be sufficient at the aggregate level to address risks to the fund stemming from any future insolvencies. However, there remains a risk that, for any particular insolvency, these amounts may not be enough to cover the actual cost of abandoning and reclaiming orphan sites. Any shortfall related to these costs is offset by the orphan fund capitalized through the annual orphan levy.

In addition to the LLR program, the Ministry has taken several actions to mitigate risks to the orphan fund associated with increased industry liabilities. This includes the development of the *Financial Security and Site Closure Regulations* (FSSCR). Once implemented, the FSSCR will include:

- Inactive Liability Reduction Program: a new results-based program for reducing liabilities held by oil and gas companies that will gradually bring down the percentage of inactive wells and facilities in the system through prescribed annual reduction targets;
- Enhanced LLR Program: adjusting the existing LLR formula to better reflect a licencee's actual assets and liabilities, facilitating more accurate security deposit calculations; and,
- Proportional Risk Assessments for Transfers: codification in regulations of a highly effective methodology for determining the additional security required for transfers between licensees that involve a high percentage of inactive wells and facilities.

The Ministry's work in managing risks to the orphan fund has also been supported by the January 2019 decision of the Supreme Court of Canada in the *Redwater* case. This decision affirmed that industry liabilities are given priority in the sale of any assets stemming from receiverships and bankruptcies.

Oil and Gas Orphan Fund Financial Statements

OIL AND GAS ORPHAN FUND

FINANCIAL STATEMENTS

For The Year Ended March 31, 2022

INDEPENDENT AUDITOR'S REPORT

To: The Members of the Legislative Assembly of Saskatchewan

Opinion

We have audited the financial statements of the Oil and Gas Orphan Fund, which comprise the statement of financial position as at March 31, 2022, and the statement of operations and accumulated surplus, and statement of cash flows for the year then ended, and notes to the financial statements, including a summary of significant accounting policies.

In our opinion, the accompanying financial statements present fairly, in all material respects, the financial position of the Oil and Gas Orphan Fund as at March 31, 2022, and the results of its operations, and its cash flows for the year then ended in accordance with Canadian public sector accounting standards.

Basis for Opinion

We conducted our audit in accordance with Canadian generally accepted auditing standards. Our responsibilities under those standards are further described in the *Auditor's Responsibilities for the Audit of the Financial Statements* section of our report. We are independent of the Oil and Gas Orphan Fund in accordance with the ethical requirements that are relevant to our audit of the financial statements in Canada, and we have fulfilled our other ethical responsibilities in accordance with these requirements. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

Responsibilities of Management and Those Charged with Governance for the Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements in accordance with Canadian public sector accounting standards for Treasury Board's approval, and for such internal control as management determines is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

In preparing the financial statements, management is responsible for assessing the Oil and Gas Orphan Fund's ability to continue as a going concern, disclosing, as applicable, matters related to going concern and using the going concern basis of accounting unless management either intends to liquidate the Oil and Gas Orphan Fund or to cease operations, or has no realistic alternative but to do so.

Those charged with governance are responsible for overseeing the Oil and Gas Orphan Fund's financial reporting process.

Auditor's Responsibilities for the Audit of the Financial Statements

Our objectives are to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes our opinion. Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with Canadian generally accepted auditing standards will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of these financial statements.

As part of an audit in accordance with Canadian generally accepted auditing standards, we exercise professional judgment and maintain professional skepticism throughout the audit. We also:

- Identify and assess the risks of material misstatement of the financial statements, whether due to fraud or error, design and perform audit procedures responsive to those risks, and obtain audit evidence that is sufficient and appropriate to provide a basis for our opinion. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control.

- Obtain an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Oil and Gas Orphan Fund's internal control.

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- Evaluate the appropriateness of accounting policies used and the reasonableness of accounting estimates and related disclosures made by management.

- Conclude on the appropriateness of management's use of the going concern basis of accounting and based on the audit evidence obtained, whether a material uncertainty exists related to events or conditions that may cast significant doubt on the Oil and Gas Orphan Fund's ability to continue as a going concern. If we conclude that a material uncertainty exists, we are required to draw attention in our auditor's report to the related disclosures in the financial statements or, if such disclosures are inadequate, to modify our opinion. Our conclusions are based on the audit evidence obtained up to the date of our auditor's report. However, future events or conditions may cause the Oil and Gas Orphan Fund to cease to continue as a going concern.

- Evaluate the overall presentation, structure and content of the financial statements, including the disclosures, and whether the financial statements represent the underlying transactions and events in a manner that achieves fair presentation.

We communicate with those charged with governance regarding, among other matters, the planned scope and timing of the audit and significant audit findings, including any significant deficiencies in internal control identified during the audit.

T. Clemett

Regina, Saskatchewan
July 22, 2022

Tara Clemett, CPA, CA, CISA
Provincial Auditor
Office of the Provincial Auditor

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Statement 1

OIL AND GAS ORPHAN FUND
STATEMENT OF FINANCIAL POSITION
Year Ended March 31

	2022	2021
FINANCIAL ASSETS		
Due from General Revenue Fund (Note 5)	$ 6,519,510	$ 4,195,481
Accounts Receivable	15,502	193,952
Interest Receivable	39,335	5,859
Total Financial Assets	6,574,347	4,395,292
LIABILITIES		
Accounts Payable	464,047	681,295
NET FINANCIAL ASSETS AND ACCUMULATED SURPLUS (Statement 2) (Note 3)	$ 6,110,300	$ 3,713,997

(See accompanying notes to the financial statements)

Statement 2

OIL AND GAS ORPHAN FUND
STATEMENT OF OPERATIONS AND ACCUMULATED SURPLUS
Year Ended March 31

	Budget	Actual	
	2022 (Note 7)	2022	2021
REVENUES:			
Levies (Note 6)	$9,000,000	$ 7,700,076	$ 1,999,431
License Application Fees (Note 6)	100,000	190,000	100,000
Forfeited Security Deposits (Note 6)	---	220,102	---
Abandonment and Reclamation proceeds	---	117,393	2,017
Interest (Note 5 & 6)	100,000	93,037	51,841
Other Revenue	---	302	25
Total Revenues	9,200,000	8,320,910	2,153,314
EXPENSES:			
Abandonment and Reclamation	8,945,000	5,428,182	6,784,174
Other Costs (Note 5)	55,000	496,425	62,592
Total Expenses	9,000,000	5,924,607	6,846,766
ANNUAL SURPLUS (DEFICIT)	$ 200,000	2,396,303	(4,693,452)
ACCUMULATED SURPLUS, BEGINNING OF YEAR		3,713,997	8,407,449
ACCUMULATED SURPLUS, END OF YEAR to Statement 1		$ 6,110,300	$ 3,713,997

(See accompanying notes to the financial statements)

Statement 3

OIL AND GAS ORPHAN FUND
STATEMENT OF CASH FLOWS
Year Ended March 31

	2022	2021
OPERATING TRANSACTIONS		
Cash Received From:		
Levies	$ 7,547,990	$ 1,989,970
License Application Fees	190,000	100,000
Forfeited Security Deposits	220,102	---
Abandonment and Reclamation proceeds	117,393	2,293
Interest	59,561	168,784
Other Revenue	302	25
Total Cash Received	8,135,348	2,261,072
Cash Paid For:		
Abandonment and Reclamation	5,645,315	6,269,836
Refunds	419	2,261
Other Expenses	165,585	---
Total Cash Paid	5,811,319	6,272,097
INCREASE (DECREASE) IN CASH	2,324,029	(4,011,025)
CASH, BEGINNING OF YEAR	4,195,481	8,206,506
DUE FROM GENERAL REVENUE FUND	$ 6,519,510	$ 4,195,481

OIL AND GAS ORPHAN FUND
NOTES TO THE FINANCIAL STATEMENTS
March 31, 2022

1. Authority

The Oil and Gas Environmental Fund was established on May 17, 1989, pursuant to Section 18.2 of *The Oil and Gas Conservation Regulations, 1985* (Regulations). The Oil and Gas Environmental Fund originated through a one-time assessment of $100 per well to a maximum of $20,000 per operator.

In June 2007, an amendment was made to the Oil and Gas Conservation Act (Act) that provided for the continuance of the existing Oil and Gas Environmental Fund as the Oil and Gas Orphan Fund (fund) (Order in Council #442/2007). The purpose of the fund is to address the issue of abandonment of wells, decommissioning of facilities, and clean-up of those wells and facilities where the obligations of the person responsible for carrying out those activities are not being met.

2. Significant Accounting Policies

Pursuant to Canadian Public Sector Accounting Standards, the fund is classified as a government component. These financial statements are prepared in accordance with public sector accounting standards. These financial statements do not present a statement of changes in net financial assets as the fund does not hold any non-financial assets. The fund did not have any re-measurement gains and losses; therefore, a statement of re-measurement gains and losses has not been provided.

a) The fund recognizes orphan fund license application fees as revenue when received with the accompanying first-time license application.

b) The fund recognizes orphan fund levies as revenue when the levies are assessed.

c) The fund recognizes forfeited security deposits as revenue when the Minister declares them forfeited to the Crown in the right of Saskatchewan (see Note 6).

d) Interest is earned monthly and received quarterly.

These standards require management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenue and expenses during the period. Actual results could differ from those estimates. Differences are reflected in current operations when identified.

3. Net Financial Assets

Under section 118 of the Regulations the net financial assets, together with any future recoveries of well site restoration costs, are available to provide for expenditures for the purposes of:

a) abandonment of wells, flowlines and facilities and restoration of those sites, as a result of disappearance or insolvency of the well owner or operator.

b) containment or clean-up of major environmental problems arising from oil and gas exploration, development, production or transportation operations.

c) to pay for technical, administrative, legal or other costs incurred in pursuing reimbursement for the costs mentioned in a) and b) from the person responsible for paying them.

d) to pay for a defunct working interest participant's share of abandonment and reclamations costs if those costs were incurred by a working interest participant of the defunct party.

4. Financial Instruments

The fund's financial instruments include Due from General Revenue Fund, accounts receivable, interest receivable and accounts payable. These are recorded at fair value. The carrying amount of these financial instruments approximate fair value due to their immediate or short-term maturity. The Fund is exposed to credit risk from the potential non-payment of accounts receivable. These instruments have no interest rate risk, liquidity risk or market risk. The valuation allowance for doubtful accounts at the end of March 31, 2022 was $368,455 (2021- $66,209).

5. Related Party Transactions

Included in these financial statements are transactions with ministries and agencies related to the fund by virtue of common control by the Government of Saskatchewan. A related party exists when one party has the ability to exercise control or shared control over the other. Two or more parties are related when they are subject to common control or shared control. Related parties also include key management personnel, their close family members and entities controlled by, or under shared control of, any of these individuals.

The fund's revenue and cash security deposits (Note 6) are deposited to the General Revenue Fund (GRF). These funds are included in the Consolidated Offset Balance Concentration (COBC) account held by the GRF and the fund receives interest quarterly. Participation in the COBC arrangement means that the interest on the bank account comes from the GRF rather than from a financial institution. The interest is based on the government's 30-day borrowing rate, which is calculated and paid by the Ministry of Finance. The fund received $93,037 in interest in 2021-22 (2021 - $51,841). The Government’s average 30- day borrowing rate for 2021-22 is 0.19%. (2021 0.19%).

The fund has not been charged with administrative costs and no provision for such costs is reflected in these statements. These costs are borne by the Ministry of Energy and Resources.

6. Fees, Levies and Security Deposits

Section 16 of the Regulations requires all first-time applicants for a well or upstream facility licensee to pay a one-time fee of $10,000 which is deposited into the fund.

To pay the costs to abandon and reclaim orphaned liabilities, the Saskatchewan Orphan Fund Levy was established. Each licensee in the province is levied, in accordance with the Regulations, on an annual basis to pay a percentage of a budget to carry out an annual orphan abandonment and reclamation program. Section 119 of the Regulations provides the details of how the levy is calculated for each licensee.

In addition, under the Licensee Liability Rating Program, the Minister in accordance with the Act and Regulations may require security deposits from holders of oil and gas licenses for the purpose of ensuring that they can meet their obligations with respect to suspension, abandonment, restoration, remediation, or reclamation of wells and upstream facilities and sites.

The cash security deposits and irrevocable letters of credit are held on behalf of holders of oil and gas licenses and are not included in the financial statements of the fund. On March 31, 2022, the fund held irrevocable letters of credits from the holders of oil and gas licenses consisting of $123,112,977 (2021 - $89,616,279) and security deposits held in the Province's GRF of $44,445,846 (2021 - $21,314,137). As of March 31, 2022 an additional $19,035,585 in security deposit amounts are to be provided by companies in either cash or irrevocable letters of credit.

As a licensee's liability rating improves, the cash may be refunded to the licensee. The licensees were notified in writing that interest will not be calculated or paid on security deposits.

If the criteria of the Acts and Regulations are not met, the security deposits may be forfeited fully or partially, and deposited into the fund.

7. Budget

The budget for the fund is included with the Ministry of Energy and Resources budget submission to Treasury Board. Treasury Board approves the fund's budget annually.