

John Kelly
Director, Internal Audit
Continental Resources, Inc.

Testimony before the Energy and Natural Resources Committee
In Support of HB 1080

Friday, March 12, 2021
10:30 A.M.
Peace Garden Room
600 E. Boulevard Ave.
Bismarck, North Dakota

Mr. Chairman and members of the Committee, for the record, my name is John Kelly and I am the Director, Internal Audit at Continental Resources, Inc. (“Continental”) and I am appearing today to speak in support of HB 1080 on behalf of Continental. Thank you for this opportunity to appear and testify at this hearing.

I will be speaking today about the audit process as it relates to the oil and gas industry and the proposed amendments to Section 15-05-10 of the North Dakota Century Code as set forth in HB 1080.

I. Education and Work Experience

As previously mentioned, I am the Director of Internal Audit at Continental and have held this position for [18] years. I have a Bachelor of Science in Accounting from Oklahoma State University. In addition to my accounting degree, I am a Certified Public

Accountant and a Certified Internal Auditor and maintain greater than forty hours of continuing professional education annually. Prior to joining Continental in 2003, I worked at Kerr-McGee and Amerada Hess in audit roles and later as a Controller of several entities including a public utility and midstream marketing company. My duties and responsibilities at Continental include Sarbanes Oxley compliance, operational and financial audits of CLR and contract compliance for joint venture audits and vendor audits. In connection with my professional training and work as an accountant in the oil and gas industry, I became a member of The Council of Petroleum Accountants Society or "COPAS" in 1985 and have been a member of COPAS for most of my career. COPAS is a non-profit professional organization that provides guidance and education on accounting issues in the oil and gas industry. Its mission is to provide expertise for the oil and gas industry through the development of Model Form Accounting Procedures, publications, and education. As a member of COPAS, I have attended both local and national meetings, participated in drafting teams, and opined on documents created by other COPAS members and teams.

II. The Oil and Gas Auditing Process

Generally speaking, there are two main components to the audit process in the context of oil and gas, the audit of expenditures and the audit of revenues. I will give a brief explanation of each, however, the audit of revenues is more relevant for the purposes of your consideration of HB 1080.

A. Audit of Expenditures

Joint Venture, also known as “JV” is an arrangement/agreement amongst the owners to develop the acreage. The agreement is typically a Joint Operating Agreement (JOA). One company is designated as the Operator and drills, completes and operates the well and performs the accounting. The non-operator(s) who hold interests in that spacing unit have the opportunity; yet, not the obligation to audit those records for propriety. We audit the records of myriad Operators on a two-year basis using a risk-based approach.

The Model Form Joint Operating Agreement (JOA) governs the relationship amongst operators and non-operators of oil and gas interests and provides for certain audit and accounting procedures relating to expenses incurred in connection with the production of oil and gas Per Section 5 of

Subsection D of Article V of the JOA, “Any audit of Operator’s records relating to amounts expended and the appropriateness of such expenditures shall be conducted in accordance with the audit protocol specified in Exhibit “C”.

Exhibit “C” of the JOA sets forth accounting procedures recommended by COPAS and provides that a non-operator “shall have the right to audit the Operator’s accounts and records relating to the Joint Account for any calendar year within the twenty-four (24) month period following the end of such calendar year.”

B. Audit of Revenues

[Audit of revenues, is conducted in a similar manner. As with JV audits, it is critical to the success of the auditor to conduct the audit timely as the records and personnel knowledgeable about those records likely exist if audited within a two year time span. [The audit of Revenue Audits (AG-21, I – FORWARD, A – General Comments), “If the contract is silent regarding the adjustment period, **then applicable state statutes would apply**. However, it is recommended that Revenue Audits should be performed within a reasonable period of time (e. g.,

24-36 months after statements are rendered)” if the contract is silent in regards to the adjustment period.]

HB 1080 amends Section 15-05-10 of the North Dakota Century Code to provide that the Board of University and School Lands (“Board”), as a royalty owner, may institute an action against a lessee for the failure to comply with the Board’s demands to pay royalties, interest, or penalties under Chapter 15-05, but that any such action must be commenced within six (6) years of the date oil or gas was produced under the State lease. In the context of a revenue audit concerning the payment of royalties, the six-year limitation proposed in HB 1080 is reasonable in the oil and gas industry. As discussed above, the JOA imposes a two (2) year deadline on operators to conduct expense audits. Furthermore, the six (6) year statute of limitations proposed in HB 1080 is analogous to the seven (7) year deadline required by the federal government for the auditing of the proper payment of royalties due and owing to the United States under federal oil and gas leases. See 30 U.S.C. § 1724.

In summary, the six (6) year statute of limitations allows for a reasonable period of time for the Board to audit its royalty payments and to make claims related thereto. The oil and gas industry should not be subject to extended look-back periods with respect to revenue audits when the rules governing its own audits are much shorter in length.

Thank you for your time today and I hope my testimony proves to be helpful to the Committee in its consideration of HB 1080.

72373234.1