Risks of material misstatement: Oil and gas

Note: This practice aid is intended to help auditors identify risks of material misstatement (RMM) in accordance with AU-C section 315, *Understanding the Entity and Its Environment and Assessing the Risks of Material Misstatement*. This publication is an *other auditing publication* as defined in AU-C section 200, *Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance With Generally Accepted Auditing Standards* (AICPA, Professional Standards). Other auditing publications have no authoritative status; however, they may help you, as an auditor, understand and apply certain auditing standards.

In applying the auditing guidance included in an *other auditing publication*, the auditor should, exercising professional judgment, assess the relevance and appropriateness of such guidance to the circumstances of the audit. This document has not been approved, disapproved, or otherwise acted on by any senior technical committee of the AICPA.

Instructions

AU-C section 315, *Understanding the Entity and Its Environment and Assessing the Risks of Material Misstatement*, requires that the auditor identify and assess the risks of material misstatement (RMM) at the financial statement level and relevant assertion level for classes of transactions, individual account balances, and disclosures to provide a basis for performing further audit procedures. RMM includes both inherent risk and control risk.

To aid auditors in meeting this requirement, this document includes examples of RMM in the oil and gas industry. **These examples do not include all RMM that could apply or be relevant.**

Refer to the AICPA's *Entities with Oil and Gas Producing Activities: Audit and Accounting Guide* for further information on auditing clients in the oil and gas industry.

Inherent risk

In audits of the financial statements of most entities with oil and gas producing activities, the primary focus is most often on the oil and gas properties. More often than not, the inherent risk for assertions about the accumulation and recovery of costs associated with the oil and gas properties is significant. Therefore, evaluating the accumulation and recovery of costs associated with the properties is important to the audit and to concluding from a reasonable assurance perspective whether the financial statements are presented in conformity with U.S. generally accepted accounting principles (GAAP).

RMM at the relevant assertion level

Higher risks of material misstatement may be present in certain financial statement assertions of entities with oil and gas producing activities related to classes of transactions, account balances, and disclosures including the following:

- Occurrence, completeness, accuracy, and cut off for recorded oil and natural gas sales amounts and operating expense amounts including period-end estimates
- Existence, rights and obligations, completeness, and valuation and allocation of proved and unproved oil and natural gas properties

- Existence, rights and obligations, completeness, and valuation of derivative instruments utilized for risk management or trading purposes
- Existence, rights and obligations, completeness, and valuation of current and deferred state, federal, and foreign income tax assets and liabilities, including liabilities for uncertain tax positions
- Existence, rights, completeness, and valuation of amounts due from other working interest owners for costs incurred in joint operations
- Existence, obligations, and completeness of amounts due to other working interest owners and royalty and other interest owners for collected proceeds for oil and natural gas sales

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