

DEPARTMENT OF MINES, MINERALS, AND ENERGY

**REPORT ON AUDIT
FOR THE TWO-YEAR PERIOD ENDED
JUNE 30, 2008**

APA

**Auditor of
Public Accounts**

COMMONWEALTH OF VIRGINIA

AUDIT SUMMARY

Our audit of the Department of Mines, Minerals, and Energy for the two-year period ended June 30, 2008, found:

- proper recording and reporting of all transactions, in all material respects, in the Commonwealth Accounting and Reporting System and the internal accounting system of the Department;
- matters involving internal control and its operations necessary to bring to management's attention; and
- no instances of noncompliance with applicable laws and regulations or other matters that are required to be reported.

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AUDIT FINDINGS AND RECOMMENDATIONS

Strengthen Controls over Access to the Commonwealth Accounting and Reporting System

The Department of Mines, Minerals, and Energy (Department) currently has two employees with access to both create and approve batched transactions in the Commonwealth Accounting and Reporting System (CARS). During the period under review, three employees had this level of access. For the two-year period ended June 30, 2008, we determined that the three individuals created and approved a total of 255 batches. Having individuals with the ability to create and approve transactions in CARS increases the risk of fraudulent entries and weakens internal controls.

Although our review found no indication of improper transactions, failure to separate the batch entry and batch approval duties provides an opportunity for individuals to make improper payments. We recommend that the Department separate the duties of batch entry and approval when dealing with the same batch of transactions. We also recommend that the Department review the current users that have access to CARS and change levels as appropriate to eliminate the ability of an individual to enter and approve a transaction.

Reconcile the Department's Internal Accounting System to the Commonwealth's Accounting System

The Department does not have a current process for reconciliation of their internal accounting system to CARS, and has therefore not performed a timely reconciliation between the two systems. By not reconciling the two systems the Department cannot ensure that CARS, the Commonwealth official financial system, accurately has all of the Department's transactions. As a result, CARS may not properly state the accurate revenue and expenses for the agency.

We recommend that the Department update and implement formal policies and procedures for reconciling their internal accounting system to CARS in a timely manner. These procedures should follow the policies outlined in the Commonwealth's Accounting Policies and Procedures Manual and include a formal review process by management.

AGENCY HIGHLIGHTS

The Department of Mines, Minerals, and Energy (Department) enforces federal and state laws and regulations governing the extraction of coal, oil, gas, and other minerals. The Department's mission is to enhance the development and conservation of energy and mineral resources in a safe and environmentally sound manner in order to support a more productive economy in the Commonwealth. The following six operational divisions assist the Department in achieving their mission:

Division of Energy

The Division of Energy focuses on advancing sustainable energy practices and behaviors. To accomplish this, the Division works to increase the use of proven energy conservation practices, foster growth of emerging and sustainable energy industries, identify applications of new and innovative energy technologies, and provide energy education and outreach to Virginians to increase their ability to make informed energy choices.

Division of Gas and Oil

The Division of Gas and Oil is responsible for regulating the effects of gas and oil operations both on and below the surface. The Division also issues permits, provides client assistance programs, inspects well sites and gathering pipelines, reclaims abandoned well sites, protects correlative rights, and promotes resource conservation practices.

Division of Mined Land Reclamation

The Division of Mine Land Reclamation is responsible for ensuring the reclamation of land affected by surface and underground coal mining activity. Major functions include regulating surface effects of coal mining, reclaiming abandoned mine lands, issuing permits, performing inspections, assisting small operators, and responding to citizen concerns.

Division of Mineral Mining

The Division of Mineral Mining provides for the safe and environmentally sound production of non-fuel minerals, and there are approximately 460 non-fuel mines which the Division permits and regulates. These include quarries, sand and gravel pits, and other surface and underground mining operations. The Division regulates the surface effects of mineral mining operations, reclaims abandoned mine sites, enforces health and safety standards in the mines, issues mining permits and licenses, provides industry training, and performs regular inspections of mineral mine operations.

Division of Mines

The Division of Mines protects the lives and health of all people employed at surface and underground coal mining operations and insures mine operator compliance with safety requirements. The Division performs regular mine inspections, investigates accidents and fatalities, conducts training and certification of miners, and provides technical assistance to mine operators.

Division of Geology and Mineral Resources

The Division of Geology and Mineral Resources supports the safe and intelligent use of resources by providing geologic and mineral resource information. The Division serves as the primary resource for accurate, timely, and objective information on Virginia's geology, mineral resources, and geological hazards. The Division conducts geological studies in support of economic development and to preserve the health and safety of the citizens.

FINANCIAL INFORMATION

The Department's primary funding sources are General Fund appropriations and federal grants. Federal grants assist in the reclamation of abandoned mine sites and in the regulation of coal mining. The Department also receives revenues from the issuance of licenses and permits, which it records in its special revenue funds.

The schedule below summarizes the Department's budgeted expenses compared with actual results for fiscal years 2008 and 2007. The Department received total resources of approximately \$34.2 million in fiscal year 2008 and \$34.1 million in fiscal year 2007. The increase from original to final budget for 2008 relates to a carry forward of unexpended fiscal year 2007 funds and additional federal funding received for energy conservation projects.

Analysis of Budgeted and Actual Expenses

Fiscal Years Ended June 30, 2008 and June 30, 2007

	<u>Original Budget</u>	<u>Final Budget</u>	<u>Actual Expenses</u>
Fiscal year:			
2008	\$30,389,065	\$34,176,411	\$26,245,051
2007	31,519,017	34,083,558	26,136,948

The following schedule summarizes the Department's expenses by major type of expense for fiscal years 2008 and 2007. The schedule does not include capital outlay expense of \$51,664 in 2007. Personnel expenses account for \$17.9 million, or 68 percent, of fiscal year 2008 expenses. The majority of the remaining expenses are contractual services and transfer payments. Contractual services mainly consist of reclamation, computer and telecommunications, and skilled services. The transfer payments include federal grants the Department distributes to localities and other state agencies for various water and energy projects.

Analysis of Actual Expenses by Major Object

Fiscal Years Ended June 30, 2008 and June 30, 2007

	<u>Fiscal Year 2008</u>	<u>Fiscal Year 2007</u>
Personal services	\$17,934,595	\$16,730,527
Contractual services	3,033,003	3,643,788
Supplies and materials	580,244	450,912
Transfer payments	3,438,662	4,403,329
Continuous charges	423,684	435,013
Equipment	785,598	473,379
Plant and improvements	<u>49,265</u>	<u>-</u>
Total	<u>\$26,245,051</u>	<u>\$26,136,948</u>

Performance Bonds

In order to conduct mining operations, mine and well operators must apply for a permit through the Department. After a mining permit application has been approved, but before the permit is issued, the applicant must file a performance bond made payable to the Department. These bonds represent a guarantee of funds to return lands to their original condition and state of use.

The applicant has five options to satisfy their bonding requirement; Cash Bonds, Surety Bonds, Letters of Credit, Certificates of Deposit, and Self Bonds. Cash Bonds represent money that the applicant deposits with the Treasurer of Virginia held in Trust Fund. The State Treasurer releases the money to the applicant upon completion of the mining project and the Department determines the applicant has returned the land to its original condition and state of use. Surety Bonds, Letters of Credit, and Certificates of Deposit represent a third party guarantee of funds payable to the Department in the event the applicant does not fully restore the land at the completion of the mining project. Beginning in 2004, applicants were able to apply for Self Bonding. Self-Bonding requires the company to meet the minimum net worth requirements established by the Department and provide the Department with evidence substantiating their financial solvency certified by an independent certified public accountant. The following table summarizes performance bond information from the Commonwealth's Accounting and Reporting System and the Department's performance bond tracking system.

Fiscal Years Ended June 30, 2008 and June 30, 2007

	<u>2008</u>	<u>2007</u>
Cash bonds deposited with the Treasurer of Virginia	\$ 4,257,518	\$ 3,708,650
Surety bonds	236,983,145	237,384,535
Letters of credit	6,033,225	4,998,925
Certificates of deposit	3,510,049	4,736,208
Self bonds	<u>13,832,075</u>	<u>17,850,475</u>
Total	<u>\$264,616,012</u>	<u>\$268,678,793</u>

Surety Bonds have continued to become less popular for mining applicants due to the strict requirements and increased costs from the surety companies. In the past, two individuals representing multiple companies held most of the Self Bonds. However, due to the strict requirements for Self Bonding, one individual switched to another bonding method resulting in an overall decline for Self Bonds. As a result, Letters of Credit and Cash Bonds are the more prevalent means of security. Cash Bonds are the simplest way for an applicant to satisfy their bonding requirement, and Letters of Credit require a minimal amount of funding by the applicant.



Commonwealth of Virginia

Walter J. Kucharski, Auditor

**Auditor of Public Accounts
P.O. Box 1295
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March 19, 2009

The Honorable Timothy M. Kaine
Governor of Virginia
State Capital
Richmond, Virginia

The Honorable M. Kirkland Cox
Chairman, Joint Legislative Audit
and Review Commission
General Assembly Building
Richmond, Virginia

We have audited the financial records and operations of the **Department of Mines, Minerals, and Energy** for the two-year period ended June 30, 2008. We conducted this performance audit in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

Audit Objectives

Our audit's primary objectives were to evaluate the accuracy of recorded financial transactions in the Commonwealth Accounting and Reporting System (CARS) and in the Department's internal accounting system, review the adequacy of the Department's internal controls, test compliance with applicable laws and regulations.

Audit Scope and Methodology

The Department's management has responsibility for establishing and maintaining internal control and complying with applicable laws and regulations. Internal control is a process designed to provide reasonable, but not absolute, assurance regarding the reliability of financial reporting, effectiveness and efficiency of operations, and compliance with applicable laws and regulations.

We gained an understanding of the overall internal controls, both automated and manual, sufficient to plan the audit. We considered materiality and control risk in determining the nature and extent of our audit procedures. Our review encompassed controls over the following significant cycles, classes of transactions, and account balances.

- Contractual services expenditures
- Transfer payments
- Payroll expenditures
- Appropriations
- Cash receipting
- Capital assets
- Performance bonding

Our audit did not include the management of agency owned vehicles or network security, which we audited previously and reported out in the Statewide Review of Fleet Management and Statewide Review of Information Security in the Commonwealth of Virginia reports.

We performed audit tests to determine whether the Department's controls were adequate, had been placed in operation, and were being followed. Our audit also included tests of compliance with provisions of applicable laws and regulations. Our audit procedures included inquiries of appropriate personnel, inspection of documents, records, and contracts, and observation of the Department's operations. We tested transactions and performed analytical procedures, including budgetary and trend analyses.

Conclusions

We found that the Department of Mines, Minerals, and Energy properly stated, in all material respects, the amounts recorded and reported in the Commonwealth Accounting and Reporting System and in the Department's internal accounting system. The Department records its financial transactions on the cash basis of accounting, which is a comprehensive basis of accounting other than accounting principles generally accepted in the United States of America. The financial information presented in this report came directly from the Commonwealth Accounting and Reporting System and the Department's internal accounting system.

We noted certain matters involving internal control and its operation that require management's attention and corrective action. These matters are described in the section entitled "Audit Findings and Recommendations."

Exit Conference and Report Distribution

We discussed this report with management on March 25, 2009. Management's response has been included at the end of this report.

This report is intended for the information and use of the Governor and General Assembly, management, and the citizens of the Commonwealth of Virginia and is a public record.

AUDITOR OF PUBLIC ACCOUNTS

SLJ/clj



COMMONWEALTH OF VIRGINIA

Department of Mines, Minerals and Energy

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March 25, 2009

Agency Response to APA Audit Recommendations

The Department of Mines, Minerals and Energy submit the following as our response to the two recommendations cited in the APA audit for FY 2007 and 2008 just concluded.

During FY 2007 and FY 2008, the Office of Financial Services (OFS) incurred a substantial turnover of staff due to retirements and transfers to other positions and departments. This turnover occurred between April 2007 and December 2008. Prior to this, the OFS staff was comprised of seven employees, two of which were stationed in Richmond and the other five being stationed in Big Stone Gap. Once the turnover of staff started, the decision was made to consolidate all OFS staff to Big Stone Gap. During this transition, we had one employee remaining in Richmond for approximately eight months. This was the position in question that had Type 8 access and also was responsible for reconciliation of our internal system to CARS.

This situation contributed to the recommendations cited in this report. Concerning the Type 8 access (create and approve batch transactions), this has been corrected since the transition of functions to Big Stone Gap. All Type 8 accesses are being changed to Type 7 (approval only) for the identified employees. Concerning reconciliation of our internal system to CARS, current policies and procedures are being updated and newly hired staff has been trained. Reconciliations are now current and being reviewed by the Accounting Manager.

Stephen A. Walz
Director

A handwritten signature in blue ink that reads "Stephen A. Walz".

AGENCY OFFICIALS

DEPARTMENT OF MINES, MINERALS, AND ENERGY
As of June 30, 2008

Benny R. Wampler, Acting Director

M. Frank Hampton, Jr., Fiscal manager
Division of Administration

Barbara T. Simcoe, Acting Director
Division of Energy

Bob R. Wilson, Director
Division of Gas and Oil

Bradley C. Lambert, Director
Division of Mined Land Reclamation

Conrad T. Spangler, Director
Division of Mineral Mining

Frank A. Linkous, Director
Division of Mines

Edward E. Erb, Director
Division of Mineral Resources