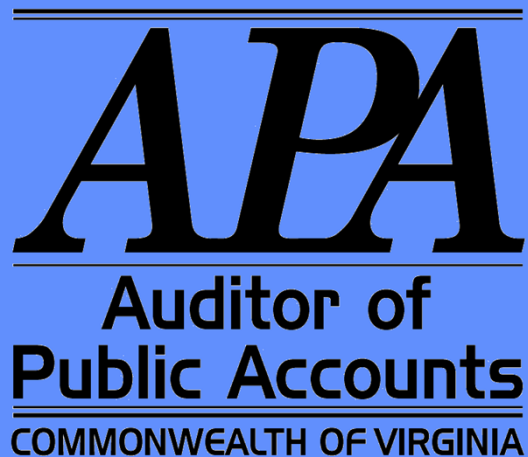


DEPARTMENT OF MINES, MINERALS, AND ENERGY

**REPORT ON AUDIT
FOR THE PERIOD
JULY 1, 2008 THROUGH JUNE 30, 2011**



AUDIT SUMMARY

Our audit of the Department of Mines, Minerals, and Energy, for the period July 1, 2008, through June 30, 2011, found:

- proper recording and reporting of all transactions, in all material respects, in the Commonwealth Accounting and Reporting System;
- no 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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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.

The Division of Energy manages the State Energy Program (SEP) grant program that receives funding from the U.S. Department of Energy, which is a cost-shared formula grant program. The U.S. Department of Energy distributes funding based on a distribution formula that considers population, energy portfolio criteria and other components.

Traditionally, the federal government had \$40 to \$50 million in annual appropriations for nationwide SEP disbursement. In fiscal 2009 as part of American Recovery and Reinvestment Act (ARRA), the Commonwealth received \$70,001,000.

Division of Gas and Oil

The Division of Gas and Oil regulates 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.

The Virginia Gas and Oil Board is associated with this Division. The Virginia Gas and Oil Board begins with Chapter 347 of the 1982 Act and amendments in 1990 put the Board in its current form. The Act gave authority to the Board to establish gas field rules to prevent waste and protect correlative rights, designate gas unit operators, approve forced pooling orders and escrowing, and approve disbursements from escrow. The Board has seven members appointed by the Governor for six years. The Board has authority to establish an escrow account for gas or oil owners who are unknown or unlocatable.

Division of Mined Land Reclamation

The Division of Mine Land Reclamation ensures 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 ensures 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 and compares them with actual results for fiscal years 2011, 2010, and 2009. The Department received total resources of approximately \$113.8 million in fiscal year 2011, \$101.3 million in fiscal year 2010, and \$33.6 million in fiscal year 2009. The increase from original to final budget for 2011 relates to funds the Department received from the Federal government for ARRA for fiscal years 2010 and 2011.

Analysis of Budgeted and Actual Expenses

Fiscal Years Ended June 30, 2011, 2010, and 2009

<u>Fiscal Year</u>	<u>Original Budget</u>	<u>Final Budget</u>	<u>Actual Expenses</u>
2011	\$32,758,697	\$113,849,390	\$56,575,694
2010	\$33,468,849	\$101,383,429	\$38,858,522
2009	\$33,756,897	\$ 33,557,831	\$26,281,747

The following schedule summarizes the Department's expenses by major type of expense for fiscal years 2011, 2010, and 2009. 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, 2011, 2010, and 2009

	<u>2011</u>	<u>2010</u>	<u>2009</u>
Personal services	\$17,701,744	\$16,791,618	\$17,846,625
Contractual services	6,278,337	3,914,504	2,890,371
Supplies and materials	442,472	393,988	421,034
Transfer payments	31,336,781	16,816,484	4,175,353
Continuous charges	376,067	446,140	431,127
Equipment	440,295	486,295	514,357
Plant and Improvements	<u>-</u>	<u>9493</u>	<u>2880</u>
Total	<u>\$56,575,694</u>	<u>\$38,858,522</u>	<u>\$26,281,747</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, 2011, 2010, and 2009

	<u>2011</u>	<u>2010</u>	<u>2009</u>
Cash bonds deposited with the Treasurer of Virginia	\$ 4,966,155	\$ 4,834,926	\$ 4,404,555
Surety bonds	233,082,010	238,659,695	247,060,425
Letters of credit	2,362,025	4,485,625	6,279,625
Certificates of deposit	3,981,389	4,498,989	3,750,089
Self bonds	<u>24,964,425</u>	<u>13,726,125</u>	<u>12,565,525</u>
Total	<u>\$269,356,004</u>	<u>\$266,205,360</u>	<u>\$274,060,218</u>

Surety Bonds have continued to become less popular for mining applicants due to the strict requirements and increased costs from the surety companies. The use of Self Bonds has also been on the decline due to stricter requirements and the higher up front capital costs requirements. 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 the Department only holding Self Bonds for one individual, which has resulted in an overall decline in the number of Self Bonds although the dollar value increased. As a result, Letters of Credit and Cash Bonds are becoming 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

Auditor of Public Accounts

Walter J. Kucharski
Auditor of Public Accounts

P.O. Box 1295
Richmond, Virginia 23218

November 3, 2011

The Honorable Robert F. McDonnell
Governor of Virginia

The Honorable Charles J. Colgan
Chairman, Joint Legislative Audit
and Review Commission

We have audited the financial records and operations of the **Department of Mines, Minerals, and Energy** (Department) for the period of July 1, 2008 through June 30, 2011, and we audited their compliance with federal regulations in managing the State Energy Program for the fiscal year ending June 30, 2011. 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 and DynaTerm (the Department's internal financial system), review the adequacy of the Department's internal controls, test compliance with applicable laws and regulations, including a review of compliance with federal regulations over the State Energy Program, and review corrective actions of audit findings from prior year reports.

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 significance and 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.

Federal grant revenues and expenses
Contractual services expenses
Bond Funds
Fixed Assets
Payroll expenses

Small purchase charge card
Revenues and Deposits
Fleet Management
Information Security

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, including a review of compliance with federal regulations over the State Energy Program. 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 properly stated, in all material respects, the amounts recorded and reported in the Commonwealth Accounting and Reporting System or DynaTerm. 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 or DynaTerm.

We noted no matters involving internal control and its operation that we consider necessary to be reported to management. The results of our tests of compliance with applicable laws and regulations, including those governing the State Energy Program, disclosed no instances of noncompliance or other matters that are required to be reported under Government Auditing Standards.

The Department has taken adequate corrective action with respect to audit findings reported in the prior years that are not repeated in this letter.

Exit Conference and Report Distribution

We discussed this report with management on November 16, 2011.

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

WJK/alh

AGENCY OFFICIALS

DEPARTMENT OF MINES, MINERALS, AND ENERGY
As of November 3, 2011

Conrad Spangler III, Director

Bradley C. Lambert, Deputy Director

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

Al Christopher, Director
Division of Energy

Gavin Bledsoe, Interim Director
Division of Mined Land Reclamation

Rick Cooper, Interim Director
Division of Gas and Oil

David Benner, Director
Division of Mineral Mining

Marshall Moore, Chief
Division of Mines

David Spears, Director
Division of Geology and Mineral Resources