



DEPARTMENT OF MINES, MINERALS, AND ENERGY

REPORT ON AUDIT FOR THE PERIOD JULY 1, 2011 THROUGH JUNE 30, 2017

Auditor of Public Accounts
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AUDIT SUMMARY

We have performed an audit of the following cycles at the Department of Mines, Minerals, and Energy, for the period July 1, 2011, through June 30, 2013:

| | |
|---------------------------------|-----------------------|
| Capital assets | Performance bonding |
| Contractual services expenses | Revenues and deposits |
| Financial system reconciliation | System access |
| Payroll expenses | |

For the period July 1, 2013, through June 30, 2017, we performed an audit of federal grant agreements and performance bonding.

Our audit found:

- proper recording and reporting of all transactions, in all material respects, in the Commonwealth's accounting and reporting system;
- no matters involving internal control and its operation 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. Six operational divisions assist the Department in achieving their mission: Energy, Gas and Oil, Geology and Mineral Resources, Mined Land Reclamation, Mineral Mining, and Mines.

Boards and Authorities

The Division of Energy provides support services to three energy authorities established by the Code of Virginia: the Virginia Offshore Wind Development Authority, the Virginia Nuclear Energy Consortium, and the Virginia Solar Energy Development and Energy Storage Authority. As of June 30, 2017, there has been no financial activity related to these authorities.

The Division of Gas and Oil provides support to the Virginia Gas and Oil Board. The purpose of the Board is to foster, encourage, and promote the safe and efficient exploration for and development, production, and utilization of gas and oil resources. The Board has specific authority to establish gas field rules to prevent waste of oil and gas, protect correlative rights, designate gas unit operators, approve forced pooling orders, and approve disbursements from escrow. In 2015 the General Assembly amended the Virginia Gas and Oil Act (Section 45.1-361 of the Code of Virginia) to address the release of funds held in escrow or suspense because of conflicting claims to coalbed methane gas.

FINANCIAL HIGHLIGHTS

The Department's primary funding sources are General Fund appropriations and federal grants. The federal funds 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.

Table 1 below summarizes the Department's budgeted expenses and compares them with actual expenses for fiscal years 2012 through 2017. The increase from original to final budget for 2012 relates to funds the Department received from the American Recovery and Reinvestment Act (ARRA).

Analysis of Budgeted and Actual Expenses

Table 1

| Fiscal Year | Original Appropriation | Final Appropriation | Actual Expenses |
|-------------|---------------------------|------------------------|-----------------|
| 2012 | \$32,680,284 | \$84,678,061 | \$59,819,542 |
| 2013 | 34,107,762 | 49,911,509 | 34,455,739 |
| 2014 | 34,449,933 | 44,189,360 | 36,661,807 |
| 2015 | 35,863,933 | 42,987,619 | 35,243,107 |
| 2016 | 34,355,541 | 40,415,011 | 32,221,537 |
| 2017 | 36,055,421 | 42,861,296 | 33,101,293 |

Source: Commonwealth's accounting and financial reporting system

Table 2 summarizes the Department's expenses by type of expense. Contractual services mainly consist of reclamation, computer and telecommunications, and skilled services. Transfer payments include federal grants the Department distributes to nongovernment entities, localities, and other state agencies for various land, water and energy projects. The decrease in transfer payments from fiscal year 2015 to 2016 is due to two projects ending in fiscal year 2015.

Analysis of Actual Expenses

Table 2

| Type of Expense | 2012 | 2013 | 2014 | 2015 | 2016 | 2017 |
|------------------------|---------------------|---------------------|---------------------|---------------------|---------------------|---------------------|
| Continuous Charges | \$ 380,039 | \$ 556,918 | \$ 582,382 | \$ 582,775 | \$ 585,337 | \$ 619,265 |
| Contractual Services | 5,021,814 | 5,375,906 | 7,722,040 | 4,938,718 | 5,272,917 | 6,707,575 |
| Equipment | 341,720 | 222,763 | 233,291 | 377,491 | 405,121 | 881,452 |
| Personal Services | 16,642,443 | 17,466,422 | 17,653,482 | 17,865,776 | 18,190,114 | 18,105,217 |
| Supplies and Materials | 454,502 | 429,556 | 432,374 | 388,966 | 397,279 | 384,279 |
| Transfer Payments | 36,979,024 | 10,404,174 | 10,038,238 | 11,089,381 | 7,370,769 | 6,403,505 |
| Total | \$59,819,542 | \$34,455,739 | \$36,661,807 | \$35,243,107 | \$32,221,537 | \$33,101,293 |

Source: Commonwealth's accounting and financial reporting system

Performance Bonds

In order to conduct mining operations, mine and well operators must apply for a permit. 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 six options to satisfy their bonding requirement: cash bonds, surety bonds, letters of credit, certificates of deposit, pooled bonds, and self-bonds. Cash bonds represent money that the applicant deposits with the Commonwealth, which the Department holds in trust. Once the mining project is complete, and the Department determines the applicant has returned the land to its original condition and state of use, the funds are released. Surety bonds, letters of credit, certificates of deposit, and pooled bonds 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 applicant 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. Table 3 summarizes performance bond information from the Commonwealth's accounting and financial reporting system and the Department's performance bond tracking system.

Performance Bonds

Table 3

| | 2012 | 2013 | 2014 | 2015 | 2016 | 2017 |
|-------------------------|----------------------|----------------------|----------------------|----------------------|----------------------|----------------------|
| Cash bonds | \$ 498,638 | \$ 604,333 | \$ 711,100 | \$ 577,900 | \$ 773,100 | \$ 940,600 |
| Surety bonds | 258,693,175 | 256,197,275 | 251,868,375 | 246,308,675 | 253,143,575 | 240,036,275 |
| Letters of credit | 923,100 | 1,503,100 | 849,300 | 1,820,999 | 2,161,599 | 1,591,299 |
| Certificates of deposit | 3,764,039 | 2,795,239 | 2,946,439 | 2,141,029 | 2,059,129 | 1,640,929 |
| Pooled bonds | 12,150,055 | 12,707,065 | 12,880,006 | 13,370,754 | 13,907,560 | 14,841,444 |
| Self-bonds | 24,964,425 | 24,964,425 | 24,964,425 | 24,964,425 | 24,964,425 | 24,964,425 |
| Total | \$300,993,432 | \$298,771,437 | \$294,219,645 | \$289,183,782 | \$297,009,388 | \$284,014,972 |

Source: Department's performance bond tracking system

Surety bonds continue to be the most popular option for mining applicants. Although cash bonding is the easiest method to satisfy the bonding requirement, it is the least utilized method due to the high cost to the applicant. Self-bonding has the strictest requirements and currently only one individual, representing multiple companies, is self-bonded. The Department issued a notice in May 2016 stating that the Department would no longer be accepting self-bonds; however, the self-bonds that were in place prior to this date will remain. Variances from year-to-year can be attributed to bond releases, permit issuances, bond issuances, and bond adjustments approved by the Department.



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Commonwealth of Virginia

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April 13, 2018

The Honorable Ralph S. Northam
Governor of Virginia

The Honorable Thomas K. Norment, Jr.
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, 2011, through June 30, 2017, as detailed in the audit scope and objectives section below. 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 Scope and Objectives

For the period July 1, 2011, through June 30, 2013, our audit's primary objectives were to evaluate the accuracy of transactions recorded in the Commonwealth's accounting and financial reporting system and the Department's internal financial system, review the adequacy of the Department's internal controls, and test compliance with applicable laws, regulations, contracts, and grant agreements. Our review encompassed controls over the following significant cycles, classes of transactions, and account balances.

| | |
|---------------------------------|-----------------------|
| Capital assets | Performance bonding |
| Contractual services expenses | Revenues and deposits |
| Financial system reconciliation | System access |
| Payroll expenses | |

For the period July 1, 2013, through June 30, 2017, our audit's primary objectives were to test internal controls and compliance with federal grant agreements, and review the adequacy of the Department's internal controls and compliance related to performance bonding with an emphasis on self-bonding.

Audit Methodology

The Department's management has responsibility for establishing and maintaining internal control and complying with applicable laws, regulations, contracts and grant agreements. 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, regulations, contracts, and grant agreements.

We gained an understanding of the overall internal controls, both automated and manual, as they related to the audit objectives, sufficient to plan the audit. We considered significance and risk in determining the nature and extent of our audit procedures. 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, regulations, contracts, and grant agreements as they pertain to our audit objectives.

Our audit procedures included inquiries of appropriate personnel, inspection of documents, records, and contracts, and observation of the Department's operations. We also tested details of transactions to achieve our objectives.

A nonstatistical sampling approach was used. Our samples were designed to support conclusions about our audit objectives. An appropriate sampling methodology was used to ensure the samples selected were representative of the population and provided sufficient, appropriate evidence. We identified specific attributes for testing each of the samples and when appropriate, we projected our results to the population.

Conclusions

We found that the Department properly stated, in all material respects, transactions recorded and reported in the Commonwealth's accounting and financial reporting system and the Department's internal accounting system, relating to the audit objectives.

With regards to the cycles listed above in the audit scope and objectives section, 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, regulations, contracts, and grant agreements disclosed no instances of noncompliance or other matters that are required to be reported under Government Auditing Standards.

Exit Conference and Report Distribution

We discussed this report with management on June 27, 2018. 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

JMR/clj

DEPARTMENT OF MINES, MINERALS, AND ENERGY

As of June 30, 2017

John Warren, Director

Bradley C. Lambert, Deputy Director

William L. Clear, Finance and General Services Manager
Division of Administration

Al Christopher, Director
Division of Energy

Rick Cooper, Director
Division of Gas and Oil

Randy Casey, Director
Division of Mined Land Reclamation

James Skorupa, Director
Division of Mineral Mining
Division of Geology and Mineral Resources

M. Randy Moore, Chief
Division of Mines