

DEPARTMENT OF MINES, MINERALS, AND ENERGY

**REPORT ON AUDIT
FOR THE TWO-YEAR PERIOD ENDED
JUNE 30, 2006**



AUDIT SUMMARY

Our audit of the Department of Mines, Minerals, and Energy for the two-year period ended June 30, 2006, 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;
- 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 of Virginia (Commonwealth). The following six operational divisions assist the Department in achieving their mission:

Division of Energy

The Division of Energy focuses on increasing energy efficiency in state government operations, promoting cost effective renewable energy resources for state applications, improving the energy efficiency of primary and secondary schools, and promoting the economic development of the Commonwealth's indigenous energy resources.

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 Virginia's non-fuel minerals. 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 Mineral Resources

The Division of Mineral Resources services 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 of the Commonwealth.

FINANCIAL INFORMATION

The Department's primary funding sources are General Fund appropriations and federal grants revenue. Federal revenue received is primarily to 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 2006 and 2005. The Department received total resources of approximately \$31.8 million in fiscal year 2006 and \$30 million in fiscal year 2005. The increase from original to final budget for 2006 relates to an extra pay period in June 2006, permit fee increases, and carry forwards from the oil overcharge funds.

Analysis of Budgeted and Actual Expenses

Fiscal Years Ended June 30, 2006 and June 30, 2005

	<u>Original Budget</u>	<u>Final Budget</u>	<u>Actual Expenses</u>
Fiscal year:			
2006	\$27,390,538	\$31,757,748	\$25,817,678
2005	27,390,519	30,054,574	24,573,780

The following schedule summarizes the Department's expenses by major object for fiscal years 2006 and 2005. The schedule does not include capital outlay expense of \$52,346 in 2006, and \$53,180 in 2005. Personnel expenses account for \$16.7 million, or 65 percent, of fiscal year 2006 expenses. The majority of the remaining expenses are for contractual services and transfer payments. The transfer payments include federal grants distributed to localities for various water projects and civil penalties.

Analysis of Actual Expenses by Major Object

Fiscal Years Ended June 30, 2006 and June 30, 2005

	<u>Fiscal Year 2006</u>	<u>Fiscal Year 2005</u>
Personal services	\$16,745,179	\$15,463,638
Contractual services	3,677,967	4,139,237
Supplies and materials	424,370	389,442
Transfer payments	3,994,422	3,683,315
Continuous charges	371,003	372,181
Property and improvements	-	90
Equipment	600,720	524,337
Plant and improvements	<u>4,017</u>	<u>1,540</u>
Total	<u>\$25,817,678</u>	<u>\$24,573,780</u>

Performance Bonds

In order to conduct mining operations in the Commonwealth, 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 can become Self Bonded. Self-Bonded 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, 2006 and June 30, 2005

	<u>2006</u>	<u>2005</u>
Cash bonds deposited with the Treasurer of Virginia	\$ 3,439,875	\$ 3,087,595
Surety bonds	241,532,686	249,839,505
Letters of credit	6,866,400	3,827,300
Certificates of deposit	3,539,489	3,020,588
Self bonds	<u>15,613,200</u>	<u>9,636,400</u>
Total	<u>\$270,991,650</u>	<u>\$269,411,388</u>

Surety Bonds have become less popular for mining applicants due to the strict requirements and increased costs from the surety companies. As a result, Letter of Credit and Self Bonding are the more prevalent means of security. These two methods require a minimal amount of funding by the applicant. Currently, only two individuals representing five different companies have Self Bonding approval.



Commonwealth of Virginia

Walter J. Kucharski, Auditor

**Auditor of Public Accounts
P.O. Box 1295
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April 18, 2007

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

The Honorable Thomas K. Norment, Jr.
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 2006. We conducted our audit in accordance with Government Auditing Standards, issued by the Comptroller General of the United States.

AUDIT OBJECTIVES

Our audit's primary objectives were to evaluate the accuracy of recorded financial transactions on the Commonwealth Accounting and Reporting System (CARS) and in the Department's internal accounting system, review the adequacy of the Department's internal controls, and 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
- Payroll expenditures
- Appropriations
- Cash receipting and collections of accounts receivable
- Fixed assets and department owned vehicles
- Network 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. 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 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 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 May 3, 2007.

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

AGENCY OFFICIALS

DEPARTMENT OF MINES, MINERALS, AND ENERGY

George P. Willis, Director

Benny R. Wampler, Deputy Director

Stephen A. Walz, Director
Division of Administration

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

John W. Warren, 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

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Division of Mineral Resources