

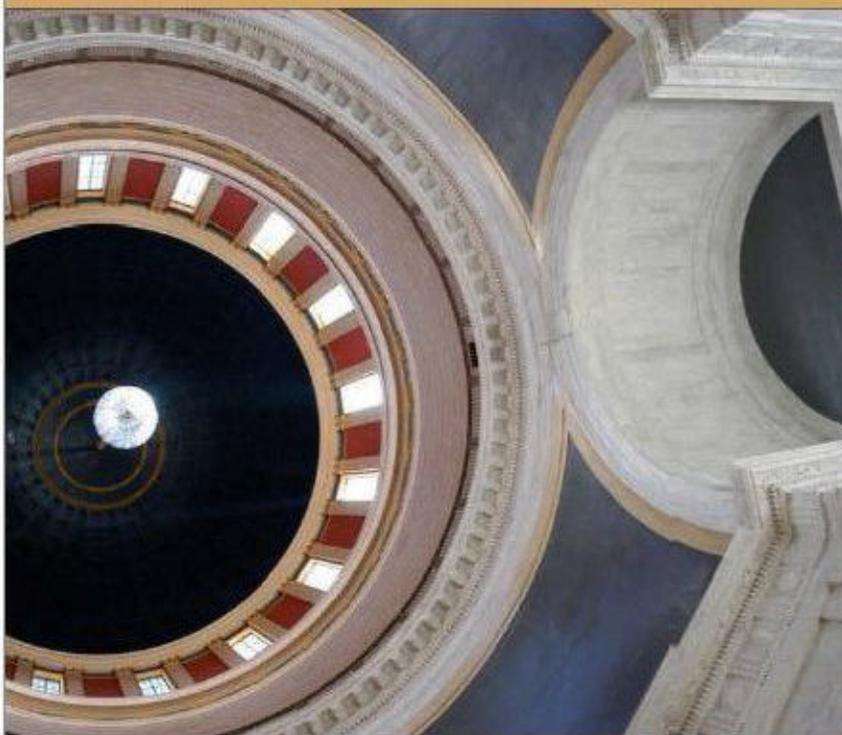
LEGISLATIVE AUDIT REPORT

West Virginia Department of Environmental Protection Special Reclamation Funds & Fund 8796

FOR THE PERIOD JULY 1, 2009 - JUNE 30, 2010

AUDIT SUMMARY

- We were unable to audit approximately \$25.7 million in revenues (Coal Tonnage Fees, Administrative Settlements, Court Settlements, Bond Forfeitures, and Fines and Penalties) in the Special Reclamation Funds 3312, 3317, and 3345 and the Acid Mine Drainage Abatement and Treatment Fund 8796
- A majority of the findings in this report resulted from limitations of the ERIS database and its inability to produce relevant, reliable reports and the lack of internal control over the database and the employees entering information into the database.



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WEST VIRGINIA LEGISLATURE
Joint Committee on Government and Finance

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The Joint Committee on Government and Finance:

In compliance with the provisions of the W.Va. Code, §4-2, as amended, we conducted a post audit of the West Virginia Department of Environmental Protection (DEP), Division of Land Restoration Special Reclamation Funds (Funds 3312, 3317, 3321, and 3345) and the Acid Mine Drainage Abatement and Treatment Fund (Fund 8796) for the period of July 1, 2009 through June 30, 2010. Any deviations from the audit period or the aforementioned funds are described in the Scope section. This concludes the audit of the Division of Land Restoration, which had a previous report issued January 2011. We have also previously issued five reports for the DEP Division of Water and Waste Management.

We have conducted our audit in accordance with Generally Accepted Government Auditing Standards except for the organizational independence impairment discussed in the Objectives and Methodologies section. Our audit disclosed certain findings, which are detailed in this report. Findings that were deemed inconsequential to the financial operations of the agency were discussed with management. DEP management responded to the audit findings; we have included the responses at the end of the report.

Respectfully submitted,

A handwritten signature in cursive script that reads "Stacy L. Sneed".

Stacy L. Sneed, CPA, CICA, Director
Legislative Post Audit Division

SLS/als

**WEST VIRGINIA DEPARTMENT OF ENVIRONMENTAL PROTECTION
SPECIAL RECLAMATION FUNDS & FUND 8796
JULY 1, 2009 – JUNE 30, 2010**

TABLE OF CONTENTS

EXECUTIVE SUMMARY	- 3 -
INTRODUCTION	- 24 -
POST AUDIT AUTHORITY.....	- 24 -
BACKGROUND.....	- 24 -
SPENDING UNIT CONTACTS	- 26 -
AUDIT SCOPE	- 27 -
OBJECTIVES AND METHODOLOGIES.....	- 27 -
CONCLUSIONS	- 29 -
EXIT CONFERENCE.....	- 30 -
FINDINGS AND RECOMMENDATIONS	- 31 -
INFORMATIONAL FINDING 1 - LACK OF COMMUNICATION WITH SRFAC.....	- 31 -
INFORMATIONAL FINDING 2 - NO AGGREGATE LIMIT FOR REC SITES LIABILITY INSURANCE .	- 34 -
INFORMATIONAL FINDING 3 - LACK OF DOC FOR OATHS AND REAPPT TO THE SRFAC	- 35 -
FINDING 1 - SCOPE LIMITATION OVER REVENUES RECEIVED	- 38 -
FINDING 2 - LACK OF DOC & UPDATING RECORDS OF INSOLVENT SURETY BONDS.....	- 44 -
FINDING 3 - LACK OF SAFEGUARDING OF CD'S & LOC'S	- 47 -
FINDING 4 - VAGUE AUTH TO COLLECT BOND FORFEITURES & WRITE-OFF UNCOLL.....	- 49 -
FINDING 5 - WEAKNESS OVER MAINTENANCE & MONITORING OF BONDS	- 52 -
FINDING 6 - UNABLE TO DETERMINE ADEQUACY OF BOND AMOUNTS	- 56 -
FINDING 7 - SIGNIFICANT WEAKNESSES OVER SELF-BONDING	- 58 -
FINDING 8 - INACCURATE ESTIMATED LIABILITIES.....	- 60 -
FINDING 9 - DISCREPANCIES OF BOND INVENTORY RECORDS	- 65 -
FINDING 10 - DIFFERENCES IN DEP & STO RECORDS	- 67 -
FINDING 11 - IMPROPER ACCOUNTING AND APPLICATION OF FORFEITED BONDS.....	- 69 -
FINDING 12 - NONCOMPLIANCE WITH W.VA. CODE 12-2-2.....	- 71 -
FINDING 13 - WEAKNESS OVER LIABILITY REPORTS.....	- 72 -

FINDING 14 - WEAKNESS OVER INSPECTIONS AND INSPECTION REPORTS.....	74 -
FINDING 15 - NONCOMPLIANCE WITH 180 RECLAMATION REQUIREMENT.....	77 -
FINDING 16 - NONCOMPLIANCE WITH REC PLANS & LACK OF DOC CHANGES.....	79 -
FINDING 17 - LACK OF OFFICIAL PROCEDURES	81 -
FINDING 18 - WEAKNESS OVER LEGISLATIVE RULE 38-2-20	83 -
FINDING 19 - NONCOMPLIANCE WITH ADMIN SETTLEMENT AGREEMENTS.....	85 -
FINDING 20 - NONCOMPLIANCE WITH COURT SETTLEMENT AGREEMENT	87 -
FINDING 21 - REVENUE AND EXPENDITURE MISSCLASSIFICATION	89 -
FINDING 22 - TRAVEL REIMBURSEMENTS NOT SUBMITTED WITHIN 15 DAYS	95 -
SUPPLEMENTAL INFORMATION FUND LISTING	96 -
APPENDIX A - DEP RESPONSE TO AUDIT FINDINGS.....	97 -
APPENDIX B - AUDITOR'S COMMENTS ON DEP'S RESPONSE TO AUDIT FINDINGS.....	126 -
CERTIFICATE OF DIRECTOR, LEGISLATIVE POST AUDIT DIVISION.....	134 -

WEST VIRGINIA DEPARTMENT OF ENVIRONMENTAL PROTECTION
SPECIAL RECLAMATION FUNDS & FUND 8796
JULY 1, 2009 – JUNE 30, 2010

EXECUTIVE SUMMARY

Informational

Finding 1 Lack of Communication with Special Reclamation Fund Advisory Council

- ◆ During our audit of the Special Reclamation Funds (hereafter referred to as the Funds) and the subsequent findings that are a result of our audit, it became apparent the Special Reclamation Fund Advisory Council (SRFAC) was not updated on key factors affecting the Funds.
- ◆ We also noted instances where the information had been edited before it was provided to the SRFAC. There were ten bond forfeited permits deleted from the variance reports because a DEP employee who has since retired was afraid they would be ‘misleading’ to the SRFAC. We were also unable to recreate the variance, which DEP provides to the SRFAC. The variance report provided in the Annual Report to the Legislature does not include the ten bond forfeited permits that were deleted.
- ◆ Based on our review of the actuary report, it does not appear DEP informed the actuaries of the weaknesses we found in the processes and in the data for the Funds. As of December 29, 2011, DEP has spent approximately \$110,504.00 on an actuarial study created from data from an unreliable database. The approved purchase order totaled \$230,100.00.
- ◆ Since the Annual Report prepared by the SRFAC is compiled using information provided by DEP and the actuarial report and we found issues with the database for the Funds as supported in the findings of this report, the SRFAC is making decisions and recommendations based on inaccurate information.
- ◆ According to DEP, DEP is fully transparent with the SRFAC. We inquired with the SRFAC as to DEP’s response and as to the items deleted from the records and the variance report calculations. Five members stated they felt DEP has been cooperative and responsive in updating them regularly and one member specifically stated, “I have no knowledge of the issue that you raised as Informational Finding #1 regarding the deletion of 10 permits from the variance report. The variance analysis between the recorded liability and the actual construction cost has been used as method to adjust the recorded liability for future expenditures. I have never double checked the math of the variance analysis.” The other five members did not specifically address the deletion of information from the records.

Auditor’s Recommendation

We recommend DEP notify the actuary of the weaknesses we have pointed out in our findings of this report and determine the effect on the Funds of providing unreliable data for the actuary report. We further recommend DEP improve their communications with the SRFAC and notify them of any and all information that has the potential to change the status of the Funds so the SRFAC can comply with W.Va. Code §22-1-17. Also, we recommend DEP comply with W.Va. Code §5A-8-9(b), as amended, and provide accurate data to the SRFAC by updating the estimated liability amounts and by

not removing any information from the documents provided. If information is removed based on a request from the SRFAC, DEP should document what was removed and the reason for removal.

Spending Unit's Response & Plan for Corrective Action

DEP Response has been included in Appendix A of this report.

Informational

Finding 2 No Aggregate Limit for Reclamation Sites Liability Insurance

- ◆ During our review of insurance coverage for reclamation sites, we noted DEP reclamation sites are covered by a blanket policy issued by the Board of Risk and Insurance Management (BRIM). The BRIM policy covering reclamation sites has a \$1,000,000.00 combined single limit per occurrence with an unlimited aggregate limit.

Auditor's Recommendation

We recommend the Legislature determine if a separate policy from BRIM for the reclamation sites is necessary. We further recommend the Legislature determine if an aggregate limit for the insurance coverage should be established to protect the interest of the State.

Spending Unit's Response & Plan for Corrective Action

DEP Response has been included in Appendix A of this report.

Informational

Finding 3 Lack of Documentation for Oaths and Reappointments to the Special Reclamation Fund Advisory Council

- ◆ During our review of the Special Reclamation Fund Advisory Council (SRFAC), we noted four of the five originally appointed members did not have oaths on file with the Secretary of State's Office;
- ◆ We noted expired terms for members representing the interests of Environmental Protection, the Coal Industry, Coal Miners, and the Actuary/Economist. We were unable to determine if these members were reappointed because no reappointment documentation was available for review and ;
- ◆ We noted three member positions were not fully represented in accordance with statute.

Auditor's Recommendation

We recommend oaths be taken, reappointments be made, and documentation of such events should be submitted to the SOS to be filed to maintain compliance with W.Va. Code §5A-8-9(b), as amended. Further, future reappointments must be made as term expirations occur as long as it is the intention for the appointee to remain on the SRFAC. If it is the intention to have someone else appointed to the position, we recommend it be done in a timely matter and proper documentation be kept for such actions. The same goes for when a member resigns from a position. In addition, we recommend DEP

comply with W.Va. Code §22-1-17, as amended, and work with the Governor to fill the General Public position immediately so all areas of interest are represented.

Spending Unit's Response & Plan for Corrective Action

DEP Response has been included in Appendix A of this report.

Finding 1 Scope Limitation over Revenues Received

- ◆ We were unable to determine whether revenues totaling \$25,656,970.25 were received timely and for the proper amounts because DEP does not have adequate internal controls in place to properly track and monitor monies due. \$25,656,970.25 was deposited into the State accounting system, WVFIMS, but we are unable to be certain DEP received all revenues due.

Auditor's Recommendation

We recommend DEP comply with W.Va. Code §5A-8-9(b), as amended, and maintain adequate revenue records. For Coal Tonnage Fees, we recommend DEP implement a reconciliation process to ensure amounts received by the Tax Department are equal to the amounts DEP should be receiving in coal tonnage fees before monies are allocated to funds 3321, 3324, and 3482. For Administrative Settlements and Court Settlements, we recommend DEP maintain a list of all settlement and forbearance agreements regardless of whether revenue is due. We further recommend DEP implement procedures to monitor and identify all uncollected payments that are a result of settlement or forbearance agreements.

For Bond Forfeitures, we recommend the agency adequately segregate the authorization, recording, custody, and reconciliation functions (the same employee cannot do the entire process). If adequate segregation of duties is not achievable due to staffing limitations, DEP must implement adequate internal controls to minimize the risk of fraud. Further, we recommend DEP implement a reconciliation process to reconcile amounts posted in ERIS to actual deposits in FIMS, revoke the signature authority to sign the Division Director's name; and stop keeping a 2nd set of accounting records.

For Fines and Penalties, we recommend DEP incorporate an overall numbering system for NOVs issued and perform a reconciliation between ERIS and WVFIMS. Further, we recommend DEP implement a way to properly track delinquent payments of fines and penalties and indicate blocked permits on the Assessment History Details Report. If adequate segregation of duties is not achievable due to staffing limitations, DEP must implement adequate internal controls to minimize the risk of fraud.

Spending Unit's Response & Plan for Corrective Action

DEP Response has been included in Appendix A of this report.

Auditor's Comments to Response

See Appendix B.

Finding 2 Lack of Documentation & Updating Records for Approx. \$17 Million of Insolvent Surety Bonds

- ◆ During our review of DEP’s bond listing¹, we noted DEP holds 2,451 surety bonds totaling \$691,207,509.83, of which, 42 surety bonds totaling \$18,888,728.00 posted by 21 different coal companies were issued by a surety company, which was later declared insolvent². Based on inquiry of DEP, it does not appear DEP was made aware by the surety company or the coal companies that United Pacific Insurance Company had been declared insolvent. Of the 42 securities:
 - 21 surety bonds, totaling \$16,892,088.00, are still held by DEP and up to December 29, 2011, there was no additional documentation provided showing an active surety company acquired those specific surety bonds making them appear worthless; On December 29th, DEP provided replacement bond documentation for 16 surety bonds totaling \$16,628,840.00, but five bonds totaling \$263,248.00 still lacked replacement documentation;
 - 12 surety bonds, totaling \$1,657,440.00, have surety bond riders or replacement bonds issued from another active surety company, but the bond rider/replacement bond information was not updated in DEP’s bond listing; and
 - Nine surety bonds, totaling \$339,200.00, were released³, but not updated in DEP’s bond listing.

Auditor’s Recommendation

We recommend DEP comply with Legislative Rule §38-2-11, as amended, and notify coal companies of financial institution insolvency and require the coal companies to replace the worthless bond instruments within 15 days, as required by the legislative rule. Also, we recommend DEP comply with W.Va. Code §5A-8-9(b), as amended, and make and maintain adequate and up to date records of all bond information. We further recommend DEP implement adequate internal controls to monitor the value of bonds and routinely compare the W.Va. Insurance Commissioner’s listing⁴ of active and inactive surety companies to the surety bonds held by DEP.

¹ Our audit scope was limited by the inability of DEP to produce relevant, reliable reports from the ERIS database. Our audit scope was further limited by DEP’s lack of internal controls over the database and the employees who enter the data. DEP provided us with information from this database to conduct our audit. Thus, we express no opinion on the reliability or validity of the ERIS database or any information provided from it. The findings in this report as well as findings in Legislative Post Audit’s previously issued audit reports for DEP prove the ERIS database to be unreliable.

² United Pacific Insurance Company, a subsidiary of Reliance Insurance Company, was declared insolvent by order of the Court on October 3, 2001.

³ W.Va. §22-3-23(c), as amended, states: If the secretary is satisfied that reclamation covered by bond or deposit or portion thereof has been accomplished as required by this article, he or she may release the bond or deposit, in whole or in part.

⁴ This active/inactive listing can be found on the W.Va. Insurance Commissioner’s webpage.

Spending Unit's Response & Plan for Corrective Action

DEP Response has been included in Appendix A of this report.

Auditor's Comments to Response

See Appendix B.

Finding 3 Lack of Safeguarding of CDs & LOCs

- ◆ During our review, we obtained information that made it clear the FDIC considers DEP to be a general creditor/lien holder, and does not acknowledge the waiver DEP has permit holders sign for rights to bonding securities upon permit revocation. The FDIC only insures the depositor not general creditor/lien holders.

Of the approximately \$906 million in DEP's bond listing¹, \$24,073,632.40 in bonds is in the form of Certificates of Deposit (CDs) and Letters of Credit (LOCs) that, according to the above, DEP will recover little, if anything if the company putting up the bond has their permit revoked and the institution issuing the security is declared insolvent or files bankruptcy. Of that amount, even if DEP was able to collect from the FDIC, \$5,012,594.98 is in excess of the \$250,000.00 FDIC insured amount and would be uncollectable.

Auditor's Recommendation

We recommend DEP ensure bonding instruments are safeguarded to the best of their ability. Also, we recommend DEP comply with W.Va. Code §5A-8-9(b), as amended, and make and maintain adequate records.

Spending Unit's Response & Plan for Corrective Action

DEP Response has been included in Appendix A of this report.

Auditor's Comments to Response

See Appendix B.

Finding 4 Vague Authority to Collect Bond Forfeitures and Write-off of Uncollectible Securities

- ◆ There is a vague authority for DEP to collect bond forfeiture revenues totaling \$2,755,030.77 during fiscal years 2009⁵ and 2010. W.Va. Code §22-3-17(b) specifically states the Attorney General will collect the forfeiture. However, DEP stated W.Va. Code §22-1-6(d)(8) gives the Secretary the authority to collect the forfeitures. It appears there are conflicting statements in the statute regarding who has the authority to collect bond forfeitures.

⁵ Fiscal year 2009 forfeiture revenues totaling \$2,531,686.82 were added to the scope of the audit because there was such a significant decrease in revenues received in fiscal year 2010. Fiscal year 2010 collections totaled \$223,343.95.

- ◆ We were unable to determine exactly how much had been written off as uncollectible because the DEP mining employee who initiated the collection process also will zero out the instrument in the records, and there is no oversight throughout the entire process. We contacted the Attorney General and were notified his office has not received any notices of forfeiture, or a list of any claims or debts to be dismissed or written off. We also contacted the Secretary of the Department of Administration in regards to claims or debts to be dismissed or written off and he was not aware of any such request by DEP.

Auditor's Recommendation

Due to the significant weaknesses mentioned above and the weaknesses noted in the forfeiture process in Finding 1, as well as DEP's vague authority, we recommend the Legislature clarify the Statute and require DEP to comply with W.Va. Code §22-3-17(b), as amended, and allow the Attorney General to collect bond forfeitures on behalf of DEP without delay. We further recommend DEP comply with W.Va. Code §14-1-18 and W.Va. Code §14-1-18a, as amended and cease writing off any uncollectible amounts without following the proper process involving the Attorney General and the Department of Administration and maintain all documentation relating to uncollectible and written-off amounts.

Spending Unit's Response & Plan for Corrective Action

DEP Response has been included in Appendix A of this report.

Auditor's Comments to Response

See Appendix B.

Finding 5 Weaknesses over Maintenance & Monitoring of Bonds totaling \$905,711,559.89

- ◆ During our inquiry of DEP's bond maintenance & monitoring procedures, we noted the following significant internal control weaknesses:
 - a) Lack of segregation of duties and no backup when employee handling bond instruments is on leave.
 - b) Bonding instruments, excluding cash, are kept in unsecured/unlocked filed cabinet(s) in the file room.
 - c) DEP is unable to determine if all coal companies have posted adequate bonds because no physical inventory of bonds is taken and no reconciliation of actual bonds to the bonds recorded in ERIS⁶ is performed.
 - d) Unable to determine the amount of pending bond instruments associated with mining permits waiting for approval because bonds are accepted at

⁶ Our audit scope was limited by the inability of DEP to produce relevant, reliable reports from the ERIS database. Our audit scope was further limited by DEP's lack of internal controls over the database and the employees who enter the data. DEP provided us with information from this database to conduct our audit. Thus, we express no opinion on the reliability or validity of the ERIS database or any information provided from it. The findings in this report as well as findings in Legislative Post Audit's previously issued audit reports for DEP prove the ERIS database to be unreliable.

field office locations and forwarded to the Charleston office to be filed and no pending list is maintained.

- e) Unable to determine if cash, official checks, etc. received were deposited within 24 hours due to DEP not maintaining a daily receipt log in accordance with statute.
- f) Premature cashing of bond instruments without DEP's knowledge.
- g) There is an overall lack of oversight and monitoring.

Auditor's Recommendation

We recommend DEP comply with W.Va. Code §12-2-2, as amended, and maintain a log of daily receipts, deposit money within 24 hours, and reconcile the log to the actual cash deposited. Also, we recommend DEP comply with W.Va. Code §5A-8-9(b), as amended, and maintain adequate bond records. Further, we recommend the agency implement the following:

- Maintain record of all bond materials received, including the pending bonds,
- Keep the cabinets locked in the file room and maintain a record of when the permit file is placed in or removed from the cabinet,
- Limit key access to supervisors/upper management (employees directly involved in the process should not have key access); if this is not possible, DEP must implement internal controls over the handling of bond instruments;
- Adequately segregate the authorization, recording, custody, and reconciliation functions (the same employee cannot obtain the bond, enter the bond in the system, maintain/edit the records, maintain custody of the bonds, release the bond, perform the reconciliation, etc.); if adequate segregation of duties is not achievable due to staffing limitations, DEP must implement adequate internal controls to minimize the risk of fraud;
- Perform a physical inventory of all bonds maintained every two years as well as a spot check once a year with approval by a supervisor as an indication of oversight;
- Add a "Location" field to be able to determine where the bond instruments relating to approved permits are located, and
- Add "Pending" in the Status field drop-down box in the ERIS bond list to be able to provide a report of pending permits awaiting approval.

Spending Unit's Response & Plan for Corrective Action

DEP Response has been included in Appendix A of this report.

Auditor's Comments to Response

See Appendix B.

Finding 6 Unable to Determine Adequacy of Bond Amounts

- ◆ During our review of reclamation bonds, we were provided an ERIS bond listing consisting of 2,380⁷ permits totaling approximately \$906 million. Of those 2,380 permits, 1,764⁸ totaling approximately \$887 million were mining permits. We attempted to analyze bonds for the 1,764 permits for compliance with W.Va. Code §22-3-11 and noted it appears that bond amounts were consistently improperly calculated, which would result in permits being under-bonded. However, based on the inability of DEP to produce relevant, reliable reports from the ERIS database and the lack of internal controls over the database, we were unable to determine whether bond amounts were calculated accurately in accordance with the statute.

Auditor's Recommendation

We recommend DEP comply with W.Va. Code §22-3-11, as amended, and compare the official records to the ERIS database and determine whether bond amounts have been appropriately calculated and determine whether sufficient bonds have been posted. If bonds are not sufficient, we recommend DEP notify the permit holders of their insufficient bonds and request immediate action to provide adequate bond amounts. If a permit holder fails to do so, DEP should notify said permit holder to cease operation and immediately begin reclamation. Furthermore, we recommend DEP comply with W.Va. Code §5A-8-9(b), as amended, and maintain adequate records. In addition, DEP should revise the current ERIS database or adopt a new system for entering, calculating, and monitoring bond instruments. Information should be updated as changes occur and the changes should be documented.

Spending Unit's Response & Plan for Corrective Action

DEP Response has been included in Appendix A of this report.

Auditor's Comments to Response

See Appendix B.

Finding 7 Significant Weaknesses over Self-Bonding

- ◆ During our review of reclamation bonds, we interviewed DEP personnel to obtain an understanding of how self-bonds are processed and maintained by the DEP Division of Mining and Reclamation (DMR). During this time, we noted the following significant weaknesses:
 - DEP does not have official or written procedures for processing self-bonds;
 - DEP does not have official or written procedures for how a self-bond would be processed in the event of forfeiture;
 - DEP stated the Attorney General does more than approve the Self-Bonding Application as to form;

⁷ All information is based off of the ERIS information provided by DEP. For our attempted analysis, we used the Current Bond Rate, Current Bond Acres, and Current Bond Amount columns in the ERIS bond listing.

⁸ 1,764 permits exclude Notices of Intent to Prospect and Quarry Permits.

- DEP allows guarantors to submit financial data that lumps owned and leased rights together and DEP does not require a breakdown of what the total consists of in order to determine if the amounts contain any intangible items; only tangible items can be used to determine if the guarantor meets the financial requirements for self-bonding;
- There is a lack of proper oversight over the financial evaluation process;
- Changes to self-bonds are made via email, telephone conversation, etc.;
- Upon the merger of two guarantors, DEP allowed the transfer of self-bond amounts from one company to the other without approving the application for the required new amount of self-bonding;
- DEP did not require the acquiring company to post adequate bonds until the self-bond could be approved;
- According to the DEP bond listing⁹, DEP currently holds \$174,643,488.67 in self-bonds from one single guarantor, but documentation shows the guarantor is only approved for \$125 million; and
- Based on information obtained during the audit, DEP would likely be considered a general creditor/lien holder in any court proceeding and probably would only be able to recover little, if any of the amount of self-bond in the event of forfeiture.

Auditor's Recommendation

We recommend the DEP comply with W.Va. Code §5A-8-9 as amended and maintain adequate records and protect the interests of the State. Further, based on the aforementioned significant weaknesses, we recommend the Legislature amend the statute to remove the allowance of self-bonding. If the statute cannot be amended, DEP must implement adequate internal controls and safeguards over self-bonding to protect the financial interests of the State.

Spending Unit's Response & Plan for Corrective Action

DEP Response has been included in Appendix A of this report.

Auditor's Comments to Response

See Appendix B.

⁹ Our audit scope was limited by the inability of DEP to produce relevant, reliable reports from the ERIS database. Our audit scope was further limited by DEP's lack of internal controls over the database and the employees who enter the data. DEP provided us with information from this database to conduct our audit. Thus, we express no opinion on the reliability or validity of the ERIS database or any information provided from it. The findings in this report as well as findings in Legislative Post Audit's previously issued audit reports for DEP prove the ERIS database to be unreliable.

Finding 8 Inaccurate Estimated Liabilities

- ◆ During our audit of reclamation of non-State owned property, we reviewed 22 randomly selected bond forfeited sites¹⁰ for fiscal year 2010, and noted liabilities were consistently underestimated due to various weaknesses including, but not limited to:
 - Pertinent reclamation activities were contracted out and not included in the purchase order or the estimated liability report;
 - Posted bond was insufficient to cover the estimated reclamation cost. (See Table 1 on Page 60)
 - Inaccurate tracking of specific site liabilities for cost recovery and accurate reporting;
 - Estimated liabilities stay on record at the initial estimated amount and are not re-estimated until the site is ready to be contracted out, which is usually years after the site is initially estimated;
 - Estimated liabilities for water reclamation have not been updated to reflect the loss of the NPDES lawsuit;
 - Some sites are on record as having \$0.00 liability or the place where the liability amount should be has been left blank; and
 - An unreliable special reclamation database is used to track costs. See Table 2 (Page61), which shows the differences in the special reclamation database and WVFIMS.

- ◆ According to DEP, as of October 24, 2011, there are 117 sites that have known current and/or future liabilities and 27 different sites, which may require additional liabilities to be incurred.

Auditor's Recommendation

We recommend DEP comply with W.Va. Code §5A-8-9, as amended, and make and maintain proper documentation relating to special reclamation estimated liabilities. Further, we recommend DEP do the following:

- Include estimated costs for services contracted out in estimated liabilities;
- Accurately track specific site liabilities for cost recovery and accurate reporting;
- Update estimated liabilities that have been on the books for an extended period of time to reflect a more accurate estimate;
- Update estimated liabilities for water reclamation sites to reflect the cost of obtaining the required NPDES permits;
- Utilize the Office of Surface Mining's (OSM) handbook for calculation of reclamation bond amounts and/or the estimation calculation sheets used by other states to estimate liabilities; and
- Make sure liability amounts for bond forfeited sites are not left blank and contain accurate estimated liabilities.

¹⁰ We are unable to determine the total number of bond forfeited sites that are currently being reclaimed or will require reclamation due to the state of DEP's records for reclamation sites.

Spending Unit's Response & Plan for Corrective Action

DEP Response has been included in Appendix A of this report.

Auditor's Comments to Response

See Appendix B.

Finding 9 Discrepancies of Bond Inventory Records

- ◆ During our review of documentation for 51 randomly selected bonds and 23 specifically selected¹¹ bonds in the bond listing¹² totaling \$49,017,979.17(5%) out of a population of approximately 4,005 bonds (based on bond ID) totaling \$905,711,559.89, we noted 53 bonds totaling \$20,146,006.81(41%) where supporting documentation was inconsistent with the bond listing. Based on an error rate of 71.6% and a population of 4,005 bonds, we are 95% confident the bond listing contains anywhere from 2,406 to 3,260 bond IDs with inconsistencies between the supporting documentation and bond listing.

Auditor's Recommendation

We recommend DEP comply with W.Va. Code §5A-8-9(b) and make and maintain adequate documentation to support and verify the ERIS bond listing with the official source documents. Also, we recommend DEP perform an inventory of all bonds in their possession and compare it to the bond listing in ERIS so all records can be updated to accurately reflect the bonds DEP holds. Further, we recommend DEP use a consistent form of entering information into the database, update changes as they occur, and document these changes in the comment column to list details such as 'Transfer', 'Amended', etc.

Spending Unit's Response & Plan for Corrective Action

DEP Response has been included in Appendix A of this report.

Auditor's Comments to Response

See Appendix B.

¹¹ These 23 bonds were selected because they had United Pacific Insurance Company listed as the surety company. This company was declared insolvent on October 3, 2001. See Finding 2 Lack of Documentation & Updating of Records for Approx. \$17 Million of Insolvent Surety Bonds

¹² Our audit scope was limited by the inability of DEP to produce relevant, reliable reports from the ERIS database. Our audit scope was further limited by DEP's lack of internal controls over the database and the employees who enter the data. DEP provided us with information from this database to conduct our audit. Thus, we express no opinion on the reliability or validity of the ERIS database or any information provided from it. The findings in this report as well as findings in Legislative Post Audit's previously issued audit reports for DEP prove the ERIS database to be unreliable.

Finding 10 Differences in DEP & STO Records

- ◆ During our comparison of the ERIS bond listing¹³ for Certificates of Deposit (CDs) and the West Virginia State Treasurer's Office (STO) Safekeeping Active Securities List of CDs, we noted the following:
 - The STO list had a total of \$16,228,678.83 and the ERIS list had an original amount total of \$16,177,452.99; a difference of \$51,225.84;
 - The Bond Issue Date did not match on 10 CDs totaling \$671,732.28;
 - The DEP list had nine CDs totaling \$180,233.22 that were not on the STO list:
 - One CD totaling \$10,220.00 appeared to be a duplicate in the DEP bond list;
 - One CD totaling \$118,000.00 was not on the STO list due to a glitch in the STO system, but the STO provided us with documentation from the vault;
 - Five CDs totaling \$41,432.81 were released, but not removed from the DEP bond list;
 - One CD totaling \$10,080.41, according to DEP, is currently with the DEP legal division; and
 - One CD totaling \$500.00 was actually a check, which was entered incorrectly on the DEP bond list.
 - The STO list had two CDs totaling \$63,500.00 that were not on the DEP list:
 - One CD totaling \$61,500.00 DEP has no record of this item ever being entered into the ERIS database and had no supporting documentation, yet documentation was provided by the STO;
 - One CD totaling \$2,000.00 was revoked and removed from the DEP bond list because it was deemed uncollectible, but DEP did not request the STO to remove it from the STO list.

Auditor's Recommendation

We recommend DEP comply with W.Va. Code §5A-8-9(b), as amended and make and maintain adequate documentation to support and verify the bond listings. Also, we recommend DEP perform an inventory of all bonds they hold and perform a reconciliation between ERIS and the STO listing regularly to identify and correct any differences in a timely manner. We further recommend DEP implement adequate internal controls and proper oversight.

¹³ Our audit scope was limited by the inability of DEP to produce relevant, reliable reports from the ERIS database. Our audit scope was further limited by DEP's lack of internal controls over the database and the employees who enter the data. DEP provided us with information from this database to conduct our audit. Thus, we express no opinion on the reliability or validity of the ERIS database or any information provided from it. The findings in this report as well as findings in Legislative Post Audit's previously issued audit reports for DEP prove the ERIS database to be unreliable.

Spending Unit's Response & Plan for Corrective Action

DEP Response has been included in Appendix A of this report.

Finding 11 Improper Accounting and Application of Forfeited Bonds

- ◆ During our inquiry with various DEP employees and a review of the documentation maintained by DEP, it became apparent that the Special Reclamation program does not properly account for forfeited bonds for reclamation sites. Also, the Special Reclamation program does not properly apply forfeited bonds to reclamation sites.

During fiscal years 2009 and 2010, the Special Reclamation program received approximately \$2,755,000.00 in forfeited bonds. We are unable to determine if bond amounts were specifically earmarked or 'committed' when received to prevent premature spending before reclamation is initiated at these sites. Forfeited bond amounts are reported in the Special Reclamation Funds and are used to make expenditures for reclamation sites other than those for which the bond was originally posted. In addition, DEP does not consider the amount of forfeited bond collection when assessing the specific reclamation site estimated liabilities.

Auditor's Recommendation

We recommend DEP comply with W.Va. Code §22-3-17, as amended, and commit and apply bonds to the site which originally posted the bond. Also, we recommend DEP consider bonds collected when factoring reclamation site estimated liabilities.

Spending Unit's Response & Plan for Corrective Action

DEP Response has been included in Appendix A of this report.

Finding 12 Noncompliance with W.Va. Code §12-2-2

- ◆ DEP did not maintain a daily itemized record of monies received totaling \$3,793,079.27 during fiscal year 2010 related to:

- Bond Forfeitures¹⁴ \$2,755,030.77
- Fines & Penalties..... \$688,062.00
- Court Settlement Revenues\$335,496.96
- Administrative Settlements and
Miscellaneous Revenues..... \$13,984.00
- Cash Disbursements – Reimbursement \$505.54

¹⁴ Our review of Bond Forfeitures included both FY 2009 and FY 2010 because there was such a significant decline in bond forfeiture revenue from FY 2009 to FY 2010. This is the only line item in the audit, which includes revenues from FY 2009.

Auditor's Recommendation

We recommend DEP comply with W.Va. Code §12-2-2, as amended, and maintain a record of daily receipts, deposit money within 24 hours, and reconcile the record to the actual cash deposited. Further, we recommend the deposit memo accompanying the checks to the Accounts Receivable Department include the following to enable a quick reference and an audit trail: (1) grantee/vendor name, (2) check number, and (3) check amount. Checks should be endorsed 'For Deposit Only' on the back of the check as soon as the check is received.

Spending Unit's Response & Plan for Corrective Action

DEP Response has been included in Appendix A of this report.

Finding 13 Weakness over Liability Reports

- ◆ During our audit of reclamation of non-State owned property for fiscal year 2010, we reviewed 22 randomly selected bond forfeiture sites¹⁵ and noted four (18%) of the sites did not have a Liability Report so we were unable to determine if the report was completed within the required time.
- ◆ Of the 18 bond forfeiture sites we were able to test, we noted the following weaknesses:
 - 14 (78%) of the Liability Reports were not completed in a timely matter;
 - Two (11%) of the Liability Reports did not have the required Environmental Resources Specialist's signature; and
 - One (6%) of the Liability Reports was prepared before the permit had been revoked.

Auditor's Recommendation

We recommend DEP comply with W.Va. Code §5A-8-9(b), as amended, as well as DEP internal policies and properly prepare Liability Reports for bond forfeited reclamation sites. Also, we recommend DEP ensure Liability Reports are filled out within the time period specified on the form. Further, we recommend the forms provide a space for the Environmental Resources Specialist and Environmental Resources Supervisor to print their name in addition to the space already provided for their signature.

Spending Unit's Response & Plan for Corrective Action

DEP Response has been included in Appendix A of this report.

Finding 14 Weakness over Inspections and Inspection Reports for Reclamation Sites

- ◆ During our audit of reclamation of non-State owned property for fiscal year 2010, we reviewed 391 inspection reports (214 Construction Inspection Reports, 174

¹⁵ We are unable to determine the total number of bond forfeited sites that are currently being reclaimed or will require reclamation due to the state of DEP's records for reclamation sites.

Water Inspection Reports, and three Land Inspection Reports) from ten randomly selected reclamation sites and noted the following:

- Ten (100%) bond forfeited sites did not have a complete inspection report completed at least once quarterly;
 - Seven (70%) bond forfeited sites did not have a partial inspection completed at least once a month;
 - Two (1%) inspection reports were not signed by the DEP Representative that completed the inspection;
 - 175 (82%) Construction Inspection Reports did not have the required Contract Representative Signature;
 - 87 (22%) forms were left incomplete in various sections; (General Information, Construction/ Maintenance, etc.)
 - 60 (15%) reports were not assigned an Inspection Report Number;
 - Three (1%) reports shared a Report Number with another Report;
 - At least 24 reports were missing according to Report Number;
 - 58 (15%) reports did not have an Inspection Date specified;
 - 20 (5%) reports had multiple dates listed for the Inspection Date;
 - Evidence of reclamation work in progress, but no evidence of inspections during that time;
 - Four different versions of the Construction Inspection Report and three versions of the Water Inspection Report all for the same time period;
 - Overall inconsistent use of an inspection numbering system to allow for adequate tracking and management review;
 - Lack of evidence of supervisory review;
 - Inspection names were not clearly signed; and
 - Evidence of expenditures for snow removal at two sites, but documentation stated inspectors were unable to get to the site due to weather conditions (snow).
- ◆ A comparison was made between Monthly Compilation Reports and reclamation inspection documentation for the ten reclamation sites¹⁶ reviewed and the following was noted:
- Monthly Compilation Reports did not match the inspection report documentation for any of the sites reviewed;
 - 852 total inspection reports were listed on the Monthly Compilation Reports, but only 391 inspection reports were documented in the files; and
 - Instances where inspection reports were completed, but not listed on the Monthly Compilation Reports.

¹⁶ We tested inspections for ten of the 22 selected bond forfeited sites. We are unable to determine the total number of bond forfeited sites that are currently being reclaimed or will require reclamation due to the state of DEP's records for reclamation sites.

Auditor's Recommendation

We recommend DEP comply with Legislative Rule §38-2-20 and W.Va. Code §22-3-15 and §5A-8-9, as amended, and properly prepare inspection report forms for reclamation site inspections and monthly compilation reports. Further, we recommend the following:

- All DEP Representatives use a uniform Construction Inspection Report Form, Water Inspection Report Form, Land Inspection Report Form, and Monthly Compilation Report Form;
- All Forms should specify whether or not a complete or partial inspection was completed upon the visit;
- Inspection Forms need to provide a space for the DEP Representative and Contract Representative to print their name in addition to the space for their signature;
- Establish an overall numbering system for inspection reports, and administer it consistently;
- Reconcile monthly compilation reports with actual reports for every inspector each month;
- Require supervisory approval on completed inspection forms and monthly compilation reports.

Spending Unit's Response & Plan for Corrective Action

DEP Response has been included in Appendix A of this report.

Finding 15 Noncompliance with 180 Day Reclamation Requirement

- ◆ During our audit of reclamation of non-State owned property, we tested 22 randomly selected bond forfeited sites¹⁷ and noted that none (100%) of the reclamation operations were initiated within 180 days as specified by Legislative Rule §38-2-20;
 - The longest time it took to initiate reclamation was approximately 8,476 days (23.5 calendar years) in excess of 180 days; and
 - The shortest time it took to initiate reclamation was approximately 151 days (0.4 calendar years) in excess of 180 days.

Auditor's Recommendation

We recommend DEP comply with Legislative Rule §38-2-20, as amended, and initiate reclamation operations to reclaim bond forfeited sites in accordance with the approved reclamation plan or an approved modification thereof within 180 days after the notice of forfeiture. If the 180 day requirement is too stringent, DEP should seek modification of the rule to a more reasonable time constraint that DEP will be able to meet.

¹⁷ We are unable to determine the total number of bond forfeited sites, which are currently being reclaimed or will require reclamation due to the state of DEP's records for reclamation sites.

Spending Unit's Response & Plan for Corrective Action

DEP Response has been included in Appendix A of this report.

Finding 16 Noncompliance with Reclamation Plans & Lack of Documenting Changes

- ◆ During our audit of reclamation of non-State owned property for fiscal year 2010, we reviewed ten of the 22 randomly selected bond forfeited sites¹⁷ for compliance with reclamation plans and noted the following:
 - The initial reclamation plan was not followed for any of the ten bond forfeited sites;
 - Modified reclamation plans consisted of a copy of the purchase order and additional items that were not included in the initial reclamation plan (excludes the trees that were in the initial reclamation plan). However, there was not an actual reclamation plan that was modified to reflect the changes made for any of the sites reviewed. For example, when DEP became responsible for a site, the initial reclamation plan should have been re-evaluated and modified to reflect any additional expenses and/or changes (heavy equipment rental, snow removal, using different grass and/or trees, laboratory water/soil analysis, etc.); and
 - The actual reclamation plans did not specify which revoked permit they were submitted with (only the filename indicated the permit number).

Auditor's Recommendation

We recommend DEP comply with W.Va. Code §22-3-10 and §5A-8-9, as amended, and properly maintain adequate documentation for initial reclamation plans. Further, we recommend DEP to do the following:

- Use a standardized form with the permit application to specify the initial reclamation plans;
- Keep and maintain any and all documentation pertaining to the reclamation plan;
- Follow the initial reclamation plan; and
- Document any and all changes or modifications to the initial plan and indicate the reason the changes or modifications occurred.

Spending Unit's Response & Plan for Corrective Action

DEP Response has been included in Appendix A of this report.

Auditor's Comments to Response

See Appendix B.

Finding 17 Lack of Official Procedures

- ◆ During our audit of reclamation of non-State owned property, we requested approved guidelines for inspections of reclamation sites and project prioritization. DEP informed

us there were procedures in draft form only. When we requested copies of the drafts, we were only provided the draft Reclamation Prioritization Procedures. We did not receive a copy of the draft of procedures for inspections of reclamation sites. However, since both of these procedures are still in draft form they cannot be considered as **official** procedures for purposes of our audit.

Auditor's Recommendation

We recommend DEP establish and distribute procedures to ensure adequate and complete inspections are consistently being implemented for each reclamation site. We also recommend DEP comply with W.Va. Code §22-3-11 (g), as amended, and finalize and distribute the draft for Reclamation Prioritization Procedures. We also recommend DEP finalize the Office of Special Reclamation (OSR) procedure handbook DEP mentioned in their cause to this finding. Further, we recommend DEP comply with W.Va. Code §5A-8-9, as amended, and make and maintain proper records of policies and procedures.

Spending Unit's Response & Plan for Corrective Action

DEP Response has been included in Appendix A of this report.

Finding 18 Weakness Over Legislative Rule §38-2-20

- ◆ Legislative Rule §38-2-20 is too vague in regards to inspection requirements for active and inactive permits and revoked permits under reclamation contract and not under reclamation contract. DEP has multiple different types of inspections, including Construction Inspections, Water Inspections, and Land Inspections. Each inspection has a different form and requires the inspector to look at different criteria. The Rule does not specify which type of inspection reports are required for each inspection or if all reports apply to all inspections.

Legislative Rule §38-2-20.1 uses the following definitions:

“1) Partial Inspection. For purposes of this section, a partial inspection is an on-site or aerial review of a person's compliance with **some** of the provisions of the Act, this rule, and the terms and conditions of the permit.

2) Complete Inspection. For purposes of this section, a complete inspection is an on-site review of a person's compliance with **all** the provisions of the Act, this rule, and the terms and conditions of the permit within the entire area disturbed or affected by the surface coal mining and reclamation operations.”

Auditor's Recommendation

We recommend DEP seek modification to the rule to overcome the weaknesses stated above. Specifically, to add a separate section for each type of inspection (construction inspections, water inspections, and land inspections), which specifies the requirements and steps necessary to complete each inspection. In lieu of the previous recommendation, DEP could create a new rule specifically for bond forfeited site reclamation and include a detailed section for inspections.

Spending Unit's Response & Plan for Corrective Action

DEP Response has been included in Appendix A of this report.

Finding 19 Noncompliance with Administrative Settlement Agreements

- ◆ During our review of Administrative Settlements¹⁸ totaling \$798,156.50, we noted DEP was in noncompliance with the settlement and forbearance agreement in regards to both timing and receipt of payments.
 - A written agreement between DEP and a coal company, dated February 10, 2003, stated the company would make payments to DEP to repay reclamation costs DEP incurred at one of the company's sites. This agreement set up a timeline for an initial payment and yearly payments after, but these payments were not received by DEP. As a result of not receiving any payments for this agreement, DEP lost approximately \$8 million in interest¹⁹.
 - On March 20, 2008, DEP and the company entered into another agreement to repay these reclamation costs and set up a new timeline for payments to be received. Payments were still not received according to the timeline in this agreement and DEP lost approximately \$9,820.00 to \$13,185.00 in interest¹⁹. On August 5, 2009, DEP and the company entered into one more agreement to repay these reclamation costs and set up a new timeline for receipt of payments. The payments are currently being made in accordance with the August 5, 2009 agreement.

Auditor's Recommendation

We recommend DEP comply with W.Va. Code §5A-8-9(b), as amended, and maintain adequate revenue records. In addition, we recommend DEP comply with all settlement and forbearance agreements. We further recommend DEP implement procedures to monitor and identify all uncollected payments, which are a result of settlement or forbearance agreements.

Spending Unit's Response & Plan for Corrective Action

DEP Response has been included in Appendix A of this report.

Finding 20 Noncompliance with Court Settlement Agreement

- ◆ During our review of the Court Settlement revenues totaling approximately \$335,497.00, we noted DEP was in noncompliance with the settlement agreement in regards to both timing and receipt of payments.

¹⁸ Revenues were misclassified. See Finding 21 Revenue and Expenditure Misclassification.

¹⁹ Interest was calculated based on historical interest rates of the W.Va. Money Markey Pool and the W.Va. Government Money Market Pool not factoring compounding or any additional provisions of the aforementioned agreements.

A settlement agreement entered into dated September 14, 2005 and a stipulation agreement dated September 22, 2008, stated an individual permit holder would make monthly payments of \$10,000.00 until January 1, 2009, at which time the monthly amount would increase to approximately \$40,000.00. However, DEP continued to receive \$10,000.00 monthly up through March 2010 and a final restitution payment totaling \$245,496.96 in April 2010. No extension agreement stating approval for continued monthly payments of \$10,000.00 was available for the payments received between January 2009 and April 2010. As a result of the payments being short each month, the State lost between approximately \$3,450.00 and \$5,268.00 in interest¹⁹ from January 2009 to April 2010.

Auditor's Recommendation

We recommend DEP comply with W.Va. Code §5A-8-9(b), as amended, and maintain adequate documentation to support verbal changes to settlement agreements or adhere to the documented agreed payment terms.

Spending Unit's Response & Plan for Corrective Action

DEP Response has been included in Appendix A of this report.

Finding 21 Revenue and Expenditure Misclassification

- ◆ During our various tests during fiscal year 2010, we noted eight revenue transactions totaling \$801,342.56, 16 expenditure transactions totaling \$8,833.22, and 3 reimbursement/refund transactions totaling \$827.26 were misclassified.

Auditor's Recommendation

We recommend DEP strengthen internal controls over classification of revenues and expenditures to ensure transactions comply with the West Virginia State Expenditure Schedule Instructions. We further recommend DEP's accounting section audit invoices before processing them and not rely on coding at the program level and also ensure that correct project IDs are used. Additionally, DEP needs to review the internal revenue codes, evaluate their effectiveness, and remove any codes that are not necessary. In regards to NPDES permits and Groundwater Protection fees, if DEP does not want to code these transactions to Object Code 130, they need to request a specific object code be added. Regardless, these types of transactions should not be coded to Object Code 051. We also recommend DEP stays consistent when choosing object codes for similar items.

Spending Unit's Response & Plan for Corrective Action

DEP Response has been included in Appendix A of this report.

Finding 22 Travel Reimbursements Not Submitted Within 15 Days

- ◆ During our audit of 30 travel and training expenditures totaling \$9,301.90, we noted ten instances totaling \$2,805.14 where DEP did not submit travel reimbursement requests to the Auditor's Office within 15 days. Of the ten

instances, six were submitted 16 to 21 days later and four were submitted approximately two and one-half years to four and one-half years later.

Auditor's Recommendation

We recommend DEP comply with section 2.5 of the West Virginia State Travel Policy and submit all travel reimbursement requests to the Auditor's Office within 15 days.

Spending Unit's Response & Plan for Corrective Action

DEP Response has been included in Appendix A of this report.

**WEST VIRGINIA DEPARTMENT OF ENVIRONMENTAL PROTECTION
SPECIAL RECLAMATION FUNDS & FUND 8796
JULY 1, 2009 – JUNE 30, 2010**

INTRODUCTION

POST AUDIT AUTHORITY

This is the report on the post audit of West Virginia Department of Environmental Protection (DEP), Division of Land Restoration (DLR) – Special Reclamation Funds (Funds 3312, 3317, 3321, & 3345) and the Acid Mine Drainage Abatement & Treatment Fund (Fund 8796) for the period of July 1, 2009 – June 30, 2010. Any deviations from the audit period can be found in the Audit Scope section. The audit was conducted pursuant to Chapter 4, Article 2, as amended, of the West Virginia Code, which requires the Legislative Auditor to “make post audits of the revenues and funds of the spending units of the state government, at least once every two years, if practicable, to report any misapplication of state funds or erroneous, extravagant or unlawful expenditures by any spending unit, to ascertain facts and to make recommendations to the Legislature concerning post audit findings, the revenues and expenditures of the State and of the organization and functions of the State and its spending units.”

BACKGROUND²⁰

Mission of the Department of Environmental Protection

Promoting a healthy environment.

Special Reclamation Funds & the Special Reclamation Fund Advisory Council

The office of Special Reclamation is part of the Division of Land Restoration. Special Reclamations is mandated by the State of West Virginia to protect public health, safety and property by reclaiming and treating water on all bond forfeited coal mining permits since August 1977 in an expeditious and cost effective manner. This may entail anything from minor to major land restoration and temporary to perpetual water treatment. Funding is from forfeited bond collections, civil penalties, investments, and the Special Reclamation Tax on mined coal.

Article 1, Chapter 22 of the Code of West Virginia was amended by the Legislature in 2001, creating an eight member Special Reclamation Fund Advisory Council with the responsibility of ensuring the effective, efficient and financially stable operation of the Special Reclamation Funds. The Funds were established for the reclamation and rehabilitation of lands subject to permitted surface mining operations and abandoned after 1977, where the bond posted is insufficient to cover the cost of reclamation. (W.Va. Code § 22-3-11). The Secretary of the Department of Environmental Protection is required to conduct formal actuarial studies every two years and conduct informal reviews annually on the Special Reclamation Fund and Special Reclamation Water Trust Fund.

²⁰ Background information obtained from the Annual Report to the Legislature, the DEP annual report, the DEP website, and the West Virginia Code.

The legislation establishing the Council also increased the tax on clean coal mined, from three to seven cents per ton (the “Continuing Tax”), and levied an additional seven cents per ton (the “Temporary Tax”), to be deposited into the Fund. The 2001 legislation provided for the Temporary Tax to be in effect for thirty-nine months. As a result of a 2005 actuarial report finding that the expiration of the Temporary Tax would result in nearly immediate insolvency of the fund, the Temporary Tax was extended by the Legislature in 2005, for an additional eighteen months. A 2007 actuarial study commissioned by the Council found that the failure to extend the Temporary Tax again would result in insolvency for the Fund. Accordingly, in 2008 the Legislature, through SB 751, enacted a temporary, twelve month tax of 7.4 cents to be allocated between the Fund and a Special Reclamation Water Trust Fund (the “SRWTF.”) An updated actuarial study in 2008 concluded that terminating the tax would result in insolvency within a few years. In response, in the 2009 legislative session, the Legislature amended W.Va. Code § 22-3-11 to remove the expiration date for the Temporary Tax and provided instead for biennial review of the Tax by the Legislature. (Acts of the Legislature 2009, chapter 216)

The Special Reclamation Fund is presently funded by a tax of 7.4 cents per ton of clean coal mined (the “Temporary Tax”), and by an additional tax of seven cents per ton of clean coal mined (the “Continuing Tax.”) From this revenue, funds based on a tax rate of 1.5 cents per ton are being paid into the Special Reclamation Water Trust Fund. In addition, coal tax revenues based on 12.9 cents per ton (7 cents plus 5.9 cents per SB 751) are being paid into the Special Reclamation Fund.

The Council is also required to make a report to the Legislature every year on the financial condition of the Fund. (W.Va. Code § 22-1-17).

Acid Mine Drainage Abatement & Treatment Fund (Fund 8796)

Fund 8796 falls under the Office of Abandoned Mine Lands & Reclamation, which was created in 1981 to manage the reclamation of lands and waters affected by mining prior to passage of the Surface Mining Control and Reclamation Act (SMCRA) in 1977. In response to the problems associated with inadequate reclamation of coal mining sites, Congress enacted the Surface Mining and Reclamation Act of 1977, which requires mining companies to reclaim land and waters affected by mining activities.

The West Virginia Department of Environmental Protection - Division of Land Restoration is currently located in Charleston, West Virginia, in Kanawha County. A listing of key DEP personnel is on the following page.

**WEST VIRGINIA DEPARTMENT OF ENVIRONMENTAL PROTECTION
SPECIAL RECLAMATION FUNDS & FUND 8796
JULY 1, 2009 – JUNE 30, 2010**

**SPENDING UNIT CONTACTS
FOR EXAMINATION PERIOD OF JULY 1, 2009 THROUGH JUNE 30, 2010**

West Virginia Department of Environmental Protection – Division of Land Restoration

Randy C. Huffman Cabinet Secretary (May 2008 – Present)

Lisa A. McClung Deputy Cabinet Secretary (May 2008 – Present)

June Casto Chief, Office of Administration (April 2008 – Present)

Jean J. Sheppard..... Controller (January 2010 – Present)

Ramona Dickson..... Controller (May 1998 - July 2009)

Ken Ellison..... Director, Division of Land
Restoration (March 2003 - Present)

WEST VIRGINIA DEPARTMENT OF ENVIRONMENTAL PROTECTION
SPECIAL RECLAMATION FUNDS & FUND 8796
JULY 1, 2009 – JUNE 30, 2010

AUDIT SCOPE

We have audited the West Virginia Department of Environmental Protection (DEP), Division of Land Restoration (DLR) – Special Reclamation Funds (Funds 3312, 3317, 3321, & 3345) and the Acid Mine Drainage Abatement & Treatment Fund (Fund 8796) for the period of July 1, 2009 – June 30, 2010. Our audit scope included a review of internal control and compliance with the West Virginia Code, Purchasing Division’s Policies and Procedures, Expenditure Schedule Instructions, applicable State rules, provisions of contract/grant agreements, and DEP internal policies applicable for fiscal year 2010. Areas of audit included the revenues for Bond Forfeitures, Administrative Settlements, Miscellaneous, Statutory Transfers, Prior Year Expiring Funds, Coal Tonnage Fees, Insurance Proceeds – Equipment Loss, Operating Funds Transfers, Fines and Penalties, and Court Settlements. Due to the significant decrease in bond forfeiture revenues from fiscal year 2009 to fiscal year 2010, the audit of bond forfeitures included fiscal years 2009 and 2010.

Additional areas of audit include the expenditures for Travel & Training, Hospitality, Contractual & Professional, Cash Disbursements (Object Codes 020, 021, 027, 031, 034, 035, 037, 053, 089, and 156), Miscellaneous, Reclamation of Non-State Owned Property, Reclamation of State-Owned Property, Repairs & Alterations, and Fund Transfers. Any additional revenue source codes/object codes not mentioned above were either tested during a previous audit of the Department of Environmental Protection or contained amounts that were considered inconsequential for audit purposes and were not included in the audit. The audit was conducted in accordance with Generally Accepted Government Auditing Standards, except for the organizational independence impairment described in the section below.

For bond forfeited sites, which had a bond issued by a surety company, the surety company can choose to either remit payment of the surety bond to the DEP or can choose to reclaim the land. Third party reclamation sites are inspected by the Division of Mining and Reclamation and were not part of the audit. Thus, we express no opinion for compliance at those sites.

Our audit scope was limited by the inability of DEP to produce relevant, reliable reports from the ERIS database. Our audit scope was further limited by DEP’s lack of internal controls over the database and the employees who enter the data. DEP provided us with information from this database to conduct our audit. Thus, we express no opinion on the reliability or validity of the ERIS database or any information provided from it. The findings in this report as well as findings in Legislative Post Audit’s previously issued audit reports for DEP prove the ERIS database to be unreliable.

OBJECTIVES AND METHODOLOGIES

The objectives of our post audit were to audit DEP’s revenues and expenditures; to report any misapplication of state funds or erroneous, extravagant or unlawful expenditures by DEP that we find; to ascertain facts, and to make recommendations to the Legislature concerning audit findings, the revenues and expenditures of the state and of the organization, and functions of the state and its

spending units. Additionally, we were to examine DEP's records and internal control over transactions and to evaluate its compliance with applicable laws, rules, regulations, DEP's internal policies, and provisions of contracts or grant agreements referred to in the Scope section.

In preparation for our testing, we studied legislation, applicable W.Va. Code sections, applicable rules and regulations, and policies of DEP. Provisions that we considered significant were documented and compliance with those requirements was verified by interview, observations of DEP's operations, and through inspections of documents and records. We also tested transactions and performed other auditing procedures that we considered necessary to achieve our objectives. Additionally, we reviewed the budget, studied financial trends, and interviewed DEP personnel to obtain an understanding of the programs and the internal controls respective to the scope of our audit. In planning and conducting our audit, we focused on the major financial-related areas of operations based on assessments of materiality and risk.

A variation of non-statistical and statistical sampling was used. Our samples of transactions were designed to provide conclusions about the validity of transactions, as well as internal control and compliance attributes. Some transactions for testing were selected randomly using RAT-STAT statistical software and other transactions were selected for testing using professional judgment.

Except for the organizational impairment described in the following paragraph, we conducted our post audit in accordance with the standards applicable to performance audits contained in 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 the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives. An audit includes examining, on a test basis, evidence about DEP's compliance with those requirements referred to above and performing such other procedures, as we considered necessary in the circumstances. Our audit does not provide a legal determination of DEP's compliance with those requirements.

In accordance with W.Va. Code §4-2, the Post Audit Division is required to conduct post audits of the revenues and expenditures of the spending units of the state government. The Post Audit Division is organized under the Legislative Branch of the State and our audits are reported to the Legislative Post Audit Subcommittee. Therefore, the Division has historically been organizationally independent when audits are performed on an agency, board, or program of the Executive Branch of the State. However, this organizational independence was impaired when the President of the Senate became acting Governor of the State on November 15, 2010, in accordance with W.Va. Code §3-10-2. Audits completed after this date, but before November 13, 2011, will not comply with Generally Accepted Governmental Auditing Standards sections 3.12 – 3.15. These sections of the auditing standards assert that the ability of an audit organization to perform work and report the results objectively can be affected by placement within the governmental organizational structure. Since the President of the Senate was acting Governor, the Executive Branch had the ability to influence the initiation, scope, timing, and completion of any audit. The Executive Branch could also obstruct audit reporting, including the findings and conclusions or the manner, means, or timing of the audit organization's reports.

DEP's written responses to the findings and recommendations identified in our audit have not been subject to the auditing procedures applied in the audit of DEP and, accordingly, we express no opinion.

DEP's management is responsible for establishing and maintaining effective internal control. Internal control is a process designed to provide reasonable assurance that objectives pertaining to the reliability of financial records, effectiveness and efficiency of operations including safeguarding of assets, and

compliance with applicable laws, rules, and regulations are achieved. Because of inherent limitations in internal control, errors or fraud may nevertheless occur and not be detected. Also, projections of any evaluation of internal control to future periods are subject to the risk that conditions may change or compliance with policies and procedures may deteriorate.

This communication is intended solely for the information and use of the Post Audit Subcommittee, the members of the W.Va. Legislature, and management of DEP. However, once released by the Post Audit Subcommittee, this report is a matter of public record and its distribution is not limited. Our reports are designed to assist the Post Audit Subcommittee in exercising its legislative oversight function and to provide constructive recommendations for improving State operations. As a result, our reports generally do not address activities we reviewed that are functioning properly.

CONCLUSIONS

DEP generally had adequate internal controls over its Statutory Transfers and Operating Funds Transfers. However, DEP had some significant internal control weaknesses and noncompliance in areas of high risk for errors.

For the items tested, DEP did not comply with parts of the following: West Virginia Code, Purchasing Division's Policies & Procedures, West Virginia Budget office 2010 Expenditure Schedule Instructions, applicable State of West Virginia rules, and internal DEP policies relevant for fiscal year 2010. Noncompliance with the aforementioned related to revenue receipts & deposits, reclamation bonding, inspections, reclamation expenditures, revenue classification, expenditure classification, and travel expenditures.

DEP failed to maintain an adequate system of internal controls over a majority of revenues received; therefore, we were unable to determine if all revenues due DEP were received. Information received from the ERIS database has been deemed unreliable, and DEP's Cabinet Secretary stated DEP is aware the information in the ERIS database is inaccurate, although it is provided to outside parties who may rely on the information to make decisions.

Most of the issues identified in this report result from inadequate recordkeeping, poor or nonexistent internal controls, and a lack of oversight on the part of DEP. Overall, DEP did not maintain adequate systems or have sufficient, reliable evidence to support certain material information. As such, this led to DEP's inability to (1) reasonably estimate or adequately support amounts reported for reclamation of Non-State owned property liabilities, (2) adequately account for and reconcile activities between the DEP records and the state accounting system, WVFIMS, (3) adequately account for reclamation bonds, (4) adequately safeguard interests of the State and its taxpayers, and (5) maintain reliable information to operate in an efficient and effective manner. The weaknesses noted in this report also affect DEP and the SRFAC's ability to measure the financial and nonfinancial performance of the Special Reclamation Program and activities.

DEP and the SRFAC have stated the Special Reclamation Funds are solvent, but based on the information provided during the audit, the findings of this report, and the additional millions in water liabilities resulting from the loss of the NPDES lawsuit, the 2011 annual report to the Legislature should report the funds as insolvent. If reclamation site liabilities are updated to reflect more accurate estimates as well as updated to include the new NPDES numbers, the fund already appears insolvent.

Based on the significant weaknesses over both the reclamation bonding process and the bond forfeiture process as indicated in the findings of this report, it is the opinion of the Legislative Auditor that a separate agency such as the Board of Treasury Investments (BTI) or the Investment Management Board (IMB) should take over all bond and bond-related activities. If the separate agency does not have adequate staffing to perform this type of work, the agency should create a specific section to handle bonds for DEP and possibly the entire state to adequately safeguard the interests of the State and its taxpayers.

Further, it is the opinion of the Legislative Auditor that DEP should interact with the Office of the Insurance Commissioner (OIC) to ensure timely notification of a financial institution's bankruptcy, insolvency, etc. is made.

It is also the opinion of the Legislative Auditor that the problems identified in the findings of this report will not be fixed in a consistent manner unless DEP hires and keeps an internal auditor.

EXIT CONFERENCE

We discussed this report with management of DEP on December 27, 2011. All findings and recommendations were reviewed and discussed. Management's response has been included at the end of the report in Appendix A. Auditor's comments to DEP management's response has been included at the end of the report in Appendix B.

WEST VIRGINIA DEPARTMENT OF ENVIRONMENTAL PROTECTION
SPECIAL RECLAMATION FUNDS & FUND 8796
JULY 1, 2009 – JUNE 30, 2010

FINDINGS AND RECOMMENDATIONS

**Informational
Finding 1**

Lack of Communication with Special Reclamation Fund Advisory Council

Condition:

During our audit of the Special Reclamation Funds (hereafter referred to as the Funds) and the subsequent findings that are a result of our audit, it became apparent the Special Reclamation Fund Advisory Council (SRFAC) was not updated on key factors affecting the Funds. During the December council meeting, one of the members stated DEP did not inform the Council about the NPDES lawsuit settlement and he had to find out about it in the newspaper. Until we met with the SRFAC after a December 2011 council meeting, the SRFAC was not even aware there was an ongoing audit of the Funds and DEP had not made them aware of any of the issues we had brought to their attention throughout the audit.

We also noted instances where the information had been edited before it was provided to the SRFAC. There were ten bond forfeited permits deleted from the variance reports because a DEP employee who has since retired was afraid they would be 'misleading' to the SRFAC. We were also unable to recreate the variance, which DEP provides to the SRFAC. Some of the bond forfeited permits excluded did not fall outside of two standard deviations of the mean and should not have been removed. Also, bond forfeited permits, which did fall outside of two standard deviations, were not removed. The bond forfeited permits, which were completely removed from the record as well as the bond forfeited permits DEP excludes from the variance calculation, are the same bond forfeited permits listed in each quarterly notebook; they remain stagnate. The variance report provided in the Annual Report to the Legislature does not include the ten bond forfeited permits that were deleted.

Based on our review of the actuary report, it does not appear DEP informed the actuaries of the weaknesses we found in the processes and in the data for the Funds. As of December 29, 2011, DEP has spent approximately \$110,504.00 on an actuarial study created from data from an unreliable database. The approved purchase order totaled \$230,100.00.

Since the Annual Report prepared by the SRFAC is compiled using information provided by DEP and the actuarial report and we found issues with the database for the Funds as supported in the findings of this report, the SRFAC is making decisions and recommendations based on inaccurate information.

According to DEP, DEP is fully transparent with the SRFAC. We inquired with the SRFAC as to DEP's response and as to the items deleted from the records and the variance report calculations. Five members stated they felt DEP has been

cooperative and responsive in updating them regularly and one member specifically stated, "I have no knowledge of the issue that you raised as Informational Finding #1 regarding the deletion of 10 permits from the variance report. The variance analysis between the recorded liability and the actual construction cost has been used as method to adjust the recorded liability for future expenditures. I have never double checked the math of the variance analysis." The other five members did not specifically address the deletion of information from the records.

Criteria: W.Va. Code §22-1-17, as amended, states in part:

"...(a) There is hereby created within the Department of Environmental Protection a Special Reclamation Fund Advisory Council. The council's purpose is to ensure the effective, efficient and financially stable operation of the special reclamation fund..."

W.Va. Code §5A-8-9(b), as amended, states in part:

"The head of each agency shall:

... (b) Make and maintain records containing adequate and proper documentation of the organization, functions, policies, decisions, procedures and essential transactions of the agency designed to furnish information to protect the legal and financial rights of the state and of persons directly affected by the agency's activities..."

Cause: According to DEP, DEP Directors also learned of the NPDES settlement by reading the newspaper. DEP stated the SRFAC had been briefed at various points during the lawsuit. DEP further stated they have clearly communicated with the SRFAC and if anything was removed from the records, it was at the advice of the SRFAC. **However, in regards to items removed from the records, communications regarding these items were not documented and the documents did not support DEP's statement.**

Effect: A lack of communication and documentation regarding discussions of the items listed above makes it difficult for the SRFAC to accurately report to the Legislature in the Annual Report of the Funds and makes it difficult for the SRFAC to fulfill their fiduciary responsibility to protect the Funds.

Recommendation: We recommend DEP notify the actuary of the weaknesses we have pointed out in our findings of this report and determine the effect on the Funds of providing unreliable data for the actuary report. We further recommend DEP improve their communications with the SRFAC and notify them of any and all information that has the potential to change the status of the Funds so the SRFAC can comply with W.Va. Code §22-1-17. Also, we recommend DEP comply with W.Va. Code §5A-8-9(b), as amended, and provide accurate data to the SRFAC by updating the estimated liability amounts and by not removing any information from the documents provided. If information is removed based on a request from the SRFAC, DEP should document what was removed and the reason for removal.

Spending Unit's
Response & Plan

For Corrective Action: *DEP Response has been included in Appendix A of this report.*

**Informational
Finding 2**

No Aggregate Limit for Reclamation Sites Liability Insurance

Condition: During our review of insurance coverage for reclamation sites, we noted DEP reclamation sites are covered by a blanket policy issued by the Board of Risk and Insurance Management (BRIM). The BRIM policy covering reclamation sites has a \$1,000,000.00 combined single limit per occurrence with an unlimited aggregate limit.

Cause: This finding resulted from a lack of oversight to minimize liability exposure risk and ensure the State's interests are protected.

Effect: By not establishing an aggregate limit on the insurance coverage, the State is open to an unlimited amount of liability with respect to reclamation sites.

Recommendation: We recommend the Legislature determine if a separate policy from BRIM for the reclamation sites is necessary. We further recommend the Legislature determine if an aggregate limit for the insurance coverage should be established to protect the interest of the State.

Spending Unit's
Response & Plan

For Corrective Action: *DEP Response has been included in Appendix A of this report.*

**Informational
Finding 3**

Lack of Documentation for Oaths and Reappointments to the Special Reclamation Fund Advisory Council

Condition:

During our review of the Special Reclamation Fund Advisory Council (SRFAC), we requested documentation from the Secretary of State (SOS) for oaths taken by the members appointed to the SRFAC and noted four of the five originally appointed members did not have oaths on file. Also, we noted expired terms for members representing the interests of Environmental Protection, the Coal Industry, Coal Miners, and the Actuary/Economist. We were unable to determine if these members were reappointed because no reappointment documentation was available for review. The following chart details these items.

<u>Interest Represented</u>	<u>Original Term Expired</u>	<u>Reappointment Date & New Term Expiration</u>	<u>Years Serving on Expired Terms</u>
Coal Industry	6/30/04	None	7.5
Environmental Protection	6/30/04	None	7.5
Actuary/Economist (original member)	6/30/06	None-Resigned 7/2/08	2.0
Coal Miners (original member)	6/30/06	None-Deceased 1/27/10	3.5

Also, we noted three member positions were not fully represented in accordance with statute. The following chart details these members and the period of no representation.

<u>Interest Not Fully Represented</u>	<u>Term Served</u>	<u>Years of No Representation</u>
Coal Miners (took original members position)	9/8/10-Current	0.5
General Public	9/19/02-8/29/05-Resigned	6.0
Actuary/Economist (took original members position)	6/10/11- Current	3.0

Criteria:

W.Va. Code §22-1-17, as amended, states in part:

“(a) There is hereby created within the Department of Environmental Protection a Special Reclamation Fund Advisory Council. The council’s purpose is to ensure the effective, efficient and financially stable operation of the special reclamation fund. The Special Reclamation Advisory Council shall consist of eight members, including the Secretary of the Department of Environmental Protection or his or her designee, the Treasurer of the State of West Virginia or his or her designee, the Director of the National Mine Land Reclamation Center at West Virginia University and five members to be appointed by the Governor with the advice and consent of the Senate.

(b) Each appointed member of the council shall be selected based on his or her ability to serve on the council and effectuate its purposes. The Governor shall appoint, from a list of three names submitted by the major trade association representing the coal industry..., a member to represent the interests of the industry. The Governor shall appoint, from a list of three names submitted by organizations advocating environmental protection, one member to represent the interest of environmental protection organizations. The Governor shall appoint, from a list of four names submitted by the coal mining industry and the organizations advocating environmental protection, one member who, by training and profession, is an **actuary or an economist**. The Governor shall appoint, from a list of three names submitted by the united mine workers of America, one member to represent the interests of coal miners. The Governor shall appoint a member to represent the **interests of the general public**.

(c) The terms of all members shall begin on the first day of July, two thousand two. The secretary shall be an ex officio, nonvoting member and serve as chairperson of the council. The terms of the Governors appointees shall be for six years. **Appointees may be reappointed to serve on the council.** The terms of the appointed members first taking office are to be expired as designated by the Governor at the time of the nomination, two at the end of the second year, two at the end of the fourth year and one at the end of the sixth year. As the original appointments expire, each subsequent appointment will be for a full six-year term. Any appointed member whose term has expired shall serve until a successor has been duly appointed and qualified. **Any person appointed to fill a vacancy is to serve only for the unexpired term...**

W.Va. Code §5A-8-9(b), as amended, states in part:

“The head of each agency shall:

... (b) **Make and maintain records containing adequate and proper documentation** of the organization, functions, policies, decisions, procedures and essential transactions of the agency designed to furnish information to protect the legal and financial rights of the state and of persons directly affected by the agency’s activities...”

Cause: There is no reasonable explanation as to why some members do not have oaths on file or were not reappointed. There is also no reasonable explanation as to why the Actuary/Economist position was not filled for three years or the General Public position for six years. During our review of the Economic Departments of area colleges, we noted 33 people had Ph.D.s. We also located at least five actuaries in the State. In addition, thousands of residents in the State are available to represent the General Public. Thus, people were available to be appointed, but appointments just were not made.

Effect: As a result of four members having no oath on file with the SOS, we were unable to determine if they solemnly swore to support the Constitution of the United States of America and the Constitution of the State of West Virginia to faithfully discharge the duties of the Special Reclamation Funds to the best of

their skill and judgment. Members who served or who are still serving on expired terms are in noncompliance with W.Va. Code §5A-8-9(b) and W.Va. Code §22-1-17. We understand there may be a time lag between term expiration and reappointment, but this lag should not exceed a reasonable time limit of a few months.

The Legislature created eight specific positions for the SRFAC to ensure the SRFAC was adequately balanced and contained representations from each of the different areas of interest. As a result of interests not being fully represented, the SRFAC was, and continues to be, unable to fulfill its duties as intended by the Legislature, and these areas of interest did not have the opportunity to vote on important decisions the SRFAC makes regarding the Special Reclamation Funds.

Recommendation: We recommend oaths be taken, reappointments made, and documentation of such events submitted to the SOS to be filed to maintain compliance with W.Va. Code §5A-8-9(b), as amended. Further, future reappointments must be made as term expirations occur as long as it is the intention for the appointee to remain on the SRFAC. If it is the intention to have someone else appointed to the position, we recommend it be done in a timely matter and proper documentation be kept for such actions. The same goes for when a member resigns from a position. In addition, we recommend DEP comply with W.Va. Code §22-1-17, as amended, and work with the Governor to fill the General Public position immediately so all areas of interest are represented.

Spending Unit's
Response & Plan

For Corrective Action: *DEP Response has been included in Appendix A of this report.*

Finding 1**Scope Limitation over Revenues Received**

Condition:

We were unable to determine whether revenues totaling \$25,656,970.25 were received timely and for the proper amounts because DEP does not have adequate internal controls in place to properly track and monitor monies due. \$25,656,970.25 was deposited into the State accounting system, but we are unable to be certain DEP received all revenues due. The revenue sources we were unable to audit are detailed below.

Coal Tonnage Fees - \$21,080,224.02²¹

The Tax Department sends DEP a report twelve times a year showing the amounts placed into fund 3345 from coal tonnage fees. DEP relies solely on these reports for coal tonnage amounts and DEP performs no additional reconciliation to ensure the amounts are correct before being allocated to funds 3321, 3324, and 3482 per statute.

Administrative Settlements²² – \$798,156.50

No list is maintained of all agreements regardless of whether revenue is due; therefore, we were unable to be certain that DEP received all revenues for settlement and forbearance agreements.

Court Settlements - \$335,496.96

No list is maintained of all agreements regardless of whether revenue is due; therefore, we were unable to determine if DEP should have received any additional revenues for settlement agreements.

Bond Forfeitures²³ - \$2,755,030.77²⁴**a) Lack of segregation of duties**

We noted the Environmental Resources Specialist in charge of maintaining and monitoring bond forfeitures of posted reclamation bond instruments (cash, checks, surety bonds, self bonds, etc., hereinafter referred to as bonds) handled the entire process from opening the mail,

²¹ \$16,562,012.48 of the \$21,080,224.02 was for Special Reclamation Funds, but there is a lack of internal control over the entire transfer amounts from the State Tax Department.

²² Revenues were misclassified. See Finding 21 Revenue and Expenditure Misclassification.

²³ Our audit scope was limited by the inability of DEP to produce relevant, reliable reports from the ERIS database. Our audit scope was further limited by DEP's lack of internal controls over the database and the employees who enter the data. DEP provided us with information from this database to conduct our audit. Thus, we express no opinion on the reliability or validity of the ERIS database or any information provided from it. The findings in this report as well as findings in Legislative Post Audit's previously issued audit reports for DEP prove the ERIS database to be unreliable.

²⁴ Our review of Bond Forfeitures included both FY 2009 and FY 2010 because there was such a significant decline in bond forfeiture revenue from FY 2009 to FY 2010. This is the only line item in the audit, which includes revenues from FY 2009.

editing/removing the bond information from ERIS, authorizing the bond instruments, sending all collection correspondence to the financial institutions, and preparing the deposit of monies received.

b) Vague authority to collect forfeitures²⁵

c) All Show Cause items are not tracked

Only the items that actually end up in Show Cause Proceedings are tracked.

d) There are two sets of accounting records in addition to WVFIMS and none of them matched the actual deposits posted to WVFIMS

We obtained the ERIS listing of forfeited bonds as well as the 2nd set of records maintained by a DMR Environmental Resources Specialist to track bond forfeiture revenues and noted the following differences:

- For the ERIS to WVFIMS comparison we requested a list of all permits revoked from July 1, 2008 to February 28, 2011. The ERIS report provided totaled \$5,060,297.25 in bond forfeitures, but the total WVFIMS deposits for that period were only \$3,218,570.77. Once we removed the information we were told should not have been included in the report DEP gave us, the collections totaled \$3,409,297.25, but there was still an overall difference²⁶ of \$645,606.48.
- For the 2nd set of records Closed Progress Report and Forfeiture Report comparison to WVFIMS the two reports listed total collections of \$3,932,692.43 to the WVFIMS total of \$3,218,570.77, which showed an overall difference²⁶ of \$802,319.30.
- For the 2nd set of records Collections Report comparison to WVFIMS the collection report listed total collections of only \$2,919,407.67 to the WVFIMS total of \$3,218,570.77, which showed an overall difference²⁶ of \$330,361.20.
- For the 2nd set of records Closed Progress Report and Forfeiture Report comparison to ERIS, the two reports listed total collections of \$3,932,692.43 to the ERIS total of \$3,409,297.25, which showed an overall difference²⁶ of \$523,395.18.
- For the 2nd set of records Collections Report comparison to ERIS the collection report listed total collections of only \$2,919,407.67 to the ERIS total of \$3,409,297.25, which showed an overall difference²⁶ of \$920,689.58.
- When we inquired about these differences, DEP provided us with a second version of the ERIS report; however, it did not match WVFIMS either.

²⁵ See Finding 4 Vague Authority to Collect Bond Forfeitures & Write Offs of Uncollectible Securities.

²⁶ We did not allow the overstatements of one fiscal year to offset the understatements of a different fiscal year. We took the absolute value of each time period and added them together to get the overall difference.

- On the third version of the ERIS report, DEP was able to arrive back to the exact WVFIMS deposits, but we cannot ignore that we received two incorrect reports or that there was a 2nd set of records being kept.

e) **The employee mentioned in ‘a’ above signs the Director of the Division of Mining and Reclamation’s name to endorse the securities**

f) **No reconciliation is performed**

There is no reconciliation between ERIS and WVFIMS, the 2nd set of records and WVFIMS, or ERIS to the 2nd set of records.

g) **Lack of official and written procedures**

There are no official documented agency procedures for the entire bond forfeiture process.

h) **Other weaknesses found in bond maintenance²⁷**

i) **Other weaknesses found in bond inventory²⁸**

j) **Other weaknesses found in W.Va. Code §12-2-2 Noncompliance²⁹**

k) **There is an overall lack of oversight and monitoring**

DEP is not adequately overseeing and monitoring the Environmental Resources Specialist’s work related to the forfeiture process or some of the aforementioned items could have been prevented.

Fines and Penalties²³ - \$688,062.00

We were unable to determine if DEP should have received any additional revenues for fines and penalties due to the following weaknesses:

- There is not an effective overall numbering system used for Notice of Violations (NOVs) issued; once the NOV is entered into the ERIS database, it is assigned a sequential number. However, there is a lack of internal control to ensure that all NOVs issued were entered into the ERIS database;
- We noted one instance, totaling \$619.00, where the violation number on the Civil Penalty Assessments worksheet and ERIS listing of violations did not match;
- We noted one instance where the ERIS database allowed duplicate violations to be entered;
- We were not able to properly test NOVs issued and paid because adequate information could not be pulled from the ERIS database;

²⁷ See Finding 5 Weaknesses over Maintenance & Monitoring of Bonds Totaling \$905,711,559.89.

²⁸ See Finding 6, Finding 7, Finding 9, and Finding 10.

²⁹ See Finding 12 Noncompliance with W.Va. §12-2-2.

- We were unable to use the information in ERIS to compare the amount of money DEP should have received from fines and penalties to what DEP actually received;
- DEP does not adequately track delinquencies. Non-payment of violations results in a delinquent letter being mailed, and the coal company is blocked until payment is received. Based on limitations of the ERIS database, it appears nothing was done in regards to either collecting the penalty amount from the company or pursuing collections through legal action;
- We noted the process from the issuance of the violation to the collection of the penalty is not timely and can range from a few months to over a year;
- There is no segregation of duties over fines and penalties revenue. The Administrative Secretary opens the mail, prepares the deposit, enters the deposit into ERIS, and maintains the records; and
- There is no reconciliation between what is posted in ERIS and what is deposited in WVFIMS.

Criteria:

W.Va. Code § 5A-8-9(b), as amended, states in part:

“The head of each agency shall:

... (b) **Make and maintain records containing adequate and proper documentation** of the organization, functions, policies, decisions, procedures and essential transactions of the agency designed to furnish information to protect the legal and financial rights of the state and of persons directly affected by the agency’s activities...”

W.Va. Code §12-2-2, as amended, states in part:

"a) All officials and employees of the state authorized by statute to accept moneys due the State of West Virginia **shall keep a daily itemized record of moneys received** for deposit in the State Treasury and shall **deposit within twenty-four hours** with the State Treasurer all moneys received or collected by them for or on behalf of the state for any purpose whatsoever."

Management is responsible for establishing and maintaining effective internal controls. A fundamental concept of internal control is adequate segregation of incompatible duties. For adequate segregation of duties, management should ensure responsibilities for authorizing transactions, recording transactions, and maintaining custody of assets are assigned to different employees.

Cause:

According to DEP, for Coal Tonnage Fees, the reports from the Tax Department are the only documents DEP has to show what coal tonnage fees are received. There are no other documents or amounts to reconcile.

In regards to Administrative Settlements, DEP stated the Division of Mining and Reclamation only has one settlement agreement in place. They stated this is the only agreement of this type, therefore, they do not find it necessary to keep a list at this point in time.

For Court Settlements, there is an overall lack of internal control and effective oversight over the tracking, documenting, and recordkeeping of settlement agreements.

For Bond Forfeitures, there is a lack of effective internal control and oversight over the entire reclamation bond posting process.

In regards to Fines and Penalties, DEP stated there is an overall numbering system for NOVs, and ERIS has safeguards in place to prevent repeat use of the violation numbers. **However, DEP's numbering system consists of sequentially assigned numbers, which are separate for each permit and we observed an in ERIS where violation numbers were used more than once for different violations. There is also a lack of internal control to ensure all issued NOVs were entered into the ERIS database.** According to DEP, the violation number did not match on a Civil Penalty Assessments Worksheet and ERIS listing of violations because an inspector's laptop automatically assigned the incorrect number to the NOV when in the field. DEP also stated there are different records that would have been better to compare the amount of money DEP should have received for fines and penalties to what was actually received; **however, we told the Administrative Services Manager of DMR and other DEP employees exactly what we needed in order to carry out this comparison. It is also noted we did not receive this information in a timely fashion.** According to DEP, the comparison should have been made using the final penalty amount determined by the assessment officer in the assessment activity file. DEP did not give us records from the assessment activity file; **however, we did look at the final penalty amount determined by the assessment officer, as it was included in the record given to us by DEP.** There is an overall lack of internal control and effective oversight over the tracking, documenting, and recordkeeping of fines & penalties revenues.

Effect:

As a result of the significant internal control weaknesses listed above, we are unable to determine if DEP received all revenues for Coal Tonnage Fees, Administrative Settlements, Court Settlements, Bond Forfeitures, and Fines and Penalties. Monies not received timely results in less funds being available for other uses and potential loss of interest revenue. Without any reconciliation of coal tonnage fees, DEP cannot determine if all monies due were received. Thus, there is a greater risk that incorrect amounts could be received and allocated to the required funds. Inadequate tracking of monies, no segregation of duties, allowing an employee to sign the Division Director's name, and a lack of oversight increases the risk of fraud, theft, loss, misappropriation, etc., which could go unnoticed by management.

Recommendation:

We recommend DEP comply with W.Va. Code §5A-8-9(b), as amended, and maintain adequate revenue records. For Coal Tonnage Fees, we recommend DEP implement a reconciliation process to ensure amounts received by the Tax Department are equal to the amounts they should be receiving in coal tonnage fees before the monies are allocated to funds 3321, 3324, and 3482. For Administrative Settlements and Court Settlements, we recommend DEP maintain a list of all settlement and forbearance agreements regardless of whether revenue was due. We further recommend DEP implement procedures

to monitor and identify all uncollected payments that are a result of settlement or forbearance agreements.

For Bond Forfeitures, we recommend the agency adequately segregate the authorization, recording, custody, and reconciliation functions (the same employee cannot do the entire process). If adequate segregation of duties is not achievable due to staffing limitations, DEP must implement adequate internal controls to minimize the risk of fraud. Further, we recommend DEP implement a reconciliation process to reconcile amounts posted in ERIS to actual deposits in FIMS, revoke the signature authority to sign the Division Director's name, and stop keeping a 2nd set of accounting records.

For Fines and Penalties, we recommend DEP incorporate an overall numbering system for NOVs issued and perform a reconciliation between ERIS and WVFIMS. Further, we recommend DEP implement a way to properly track delinquent payments of fines and penalties and indicate blocked permits on the Assessment History Details Report. If adequate segregation of duties is not achievable due to staffing limitations, DEP must implement adequate internal controls to minimize the risk of fraud.

Spending Unit's
Response & Plan

For Corrective Action: *DEP Response has been included in Appendix A of this report.*

Auditor's Comments

to Response: *See Appendix B.*

Finding 2 Lack of Documentation & Updating Records for Approx. \$17 Million of Insolvent Surety Bonds

Condition: During our review of DEP's bond listing³⁰, we noted DEP holds 2,451 surety bonds totaling \$691,207,509.83, of which, 42 surety bonds totaling \$18,888,728.00 posted by 21 different coal companies were issued by a surety company, which was later declared insolvent³¹. Based on inquiry of DEP, it does not appear DEP was made aware by the surety company or the coal companies that United Pacific Insurance Company had been declared insolvent. Of the 42 securities:

- 21 surety bonds, totaling \$16,892,088.00, are still held by DEP and up to December 29, 2011, there was no additional documentation provided showing an active surety company acquired those specific surety bonds making them appear worthless; On December 29th, DEP provided replacement bond documentation for 16 surety bonds totaling \$16,628,840.00, but five bonds totaling \$263,248.00 still lacked replacement documentation. For the replacement documentation we noted the following weaknesses:
 - 15 replacement bonds were for 11 different companies and were all signed by the same person, whose name is not clearly written. Thus, we are unable to determine if the signature belongs to the president or vice-president of the company;
 - Each of the replacement bonds has the following statement at the top: "This Bond Replaces Bond #XYZ Effective" and lists dates anywhere from 11/13/2000 to 2/18/2002;
 - One replacement bond was executed on December 9, 2011 and 15 replacement bonds were executed on December 15, 2011; and
 - The replacement bonds have not yet been approved as to form by the Attorney General.
- 12 surety bonds, totaling \$1,657,440.00, have surety bond riders or replacement bonds issued from another active surety company, but the bond rider/replacement bond information was not updated in DEP's bond listing; and
- Nine surety bonds, totaling \$339,200.00, were released³², but not updated in DEP's bond listing.

³⁰ Our audit scope was limited by the inability of DEP to produce relevant, reliable reports from the ERIS database. Our audit scope was further limited by DEP's lack of internal controls over the database and the employees who enter the data. DEP provided us with information from this database to conduct our audit. Thus, we express no opinion on the reliability or validity of the ERIS database or any information provided from it. The findings in this report as well as findings in Legislative Post Audit's previously issued audit reports for DEP prove the ERIS database to be unreliable.

³¹ United Pacific Insurance Company, a subsidiary of Reliance Insurance Company, was declared insolvent by order of the Court on October 3, 2001.

³² W.Va. §22-3-23(c), as amended, states: If the secretary is satisfied that reclamation covered by bond or deposit or portion thereof has been accomplished as required by this article, he or she may release the bond or deposit, in whole or in part.

Criteria:

Legislative Rule §38-2, as amended, states in part:

“...11.2.b. All bonds shall provide a mechanism for a bank or surety company to give prompt notice to the Secretary and the permittee of any action filed alleging the **insolvency** or bankruptcy of the **surety company**, the bank, or the permittee; or alleging any violations which would result in suspension or revocation of the surety's license or bank's charter to do business.

11.2.c. Upon **incapacity of the bank or surety company** by reason of bankruptcy, **insolvency**, or suspension or revocation of a charter or license, the **permittee shall be deemed to be without bond coverage** and shall promptly notify the Secretary.11.2.d. The Secretary shall issue a notice of violation against any operator who is without bond coverage. The notice of violation shall specify a period of time to **replace bond coverage not to exceed fifteen (15) days**...If such a notice of violation is not abated in accordance with the specified time period, a cessation order shall be issued, at which time the operator shall initiate and complete as contemporaneously as possible total reclamation of all disturbed areas. Mining operations shall not resume until the Secretary has determined that an acceptable bond has been posted...”

W.Va. Code §5A-8-9(b), as amended, states in part:

“**The head of each agency shall:**

... (b) **Make and maintain records containing adequate and proper documentation** of the organization, functions, policies, decisions, procedures and essential transactions of the agency designed to furnish information to protect the legal and financial rights of the state and of persons directly affected by the agency's activities...”

Cause:

This finding resulted because DEP has not implemented adequate internal controls to ensure prompt notice is given by the financial institution and/or the coal company to DEP. In addition, there is a lack of oversight in monitoring of bond instruments. If we had not inquired with DEP about the aforementioned bonds, DEP would still not be aware of the issues.

According to DEP, Travelers Insurance Company acquired the surety and fidelity business of Reliance and subsidiaries in May 2000 and since the acquisition, Travelers has been liable on bonds issued by United Pacific. **However, DEP was unable to provide documentation showing that Travelers acquired the aforementioned bonds in question and based on our research, Travelers only acquired a portion not all of Reliance and subsidiaries.**

Effect:

As a result of DEP holding bonds issued by an insolvent surety company and not updating the records, 21 coal companies have been mining for more than ten years without adequate replacement bond coverage. As a result of not updating the bond listing for riders, replacement bonds, and releases, the records do not accurately reflect the actual circumstances making it appear DEP is holding approximately \$2 million in additional worthless surety bonds.

According to the aforementioned DEP bond listing, DEP currently holds \$691,207,509.83 in surety bonds. Of that total, \$514,245,068.44 represents sureties greater than \$500,000.00. Without proper notice of a financial institution's insolvency and a lack of adequate internal controls over maintaining updated adequate records, there is an increased risk DEP will hold worthless securities in the future and not know until the agency tries to cash them or they are uncovered during an audit.

Recommendation: We recommend DEP comply with Legislative Rule §38-2-11, as amended, and notify coal companies of financial institution insolvency and require the coal companies to replace the worthless bond instruments within 15 days, as required by the legislative rule. Also, we recommend DEP comply with W.Va. Code §5A-8-9(b), as amended, and make and maintain adequate and up to date records of all bond information. We further recommend DEP implement adequate internal controls to monitor the value of bonds and routinely compare the W.Va. Insurance Commissioner's listing³³ of active and inactive surety companies to the surety bonds held by DEP.

Spending Unit's
Response & Plan

For Corrective Action: *DEP Response has been included in Appendix A of this report.*

Auditor's Comments

to Response: *See Appendix B.*

³³ This active/inactive listing can be found on the W.Va. Insurance Commissioner's webpage.

Finding 3

Lack of Safeguarding of Certificates of Deposit & Letters of Credit

Condition:

During our review, we obtained information, which made it clear the FDIC considers DEP to be a general creditor/lien holder, and does not acknowledge the waiver DEP has permit holders sign for rights to bonding securities upon permit revocation. The FDIC only insures the depositor not general creditor/lien holders.

Of the approximately \$906 million in DEP's bond listing³⁴, \$24,073,632.40 is in the form of Certificates of Deposit (CDs) and Letters of Credit (LOCs) that, according to the above, DEP will recover little, if anything if the company putting up the bond has their permit revoked and the institution issuing the security is declared insolvent or files bankruptcy. Of that amount, even if DEP was able to collect from the FDIC, \$5,012,594.98 is in excess of the \$250,000.00 FDIC insured amount and would be uncollectable.

Criteria:

The FDIC website states in part:

..."FDIC insurance covers all types of deposits received at an insured bank, including deposits in a checking account, negotiable order of withdrawal (NOW) account, savings account, money market deposit account (MMDA) or time deposit such as a **certificate of deposit (CD)**."

..."The standard deposit **insurance amount is \$250,000 per depositor**, per insured bank, for each account ownership category."

FDIC's letter to DEP dated 03/25/2005, subject: 4637 – The First National Bank of Keystone NOTICE OF DISALLOWANCE OF CLAIM, states in part:

"The FDIC, as insurer, insures the interest of depositors, not lien holders. Moreover, the claim has been discharged as the payment of a joint account under West Virginia Code Section 31A-4-33.

We have considered your letter to be a general creditor claim against FDIC as Receiver for The First National Bank of Keystone.

On October 10, 2002, the FDIC determined that the proceeds that could be realized for the liquidation of the assets of the Keystone Receivership estate were insufficient to wholly satisfy the priority claims of depositors. After satisfaction of Depositor claims and claims that have priority over depositors under applicable law, no amount would remain or could be recovered sufficient to allow a dividend, distribution or payment to any claims of general creditors of the Keystone receivership. **As a result of the worthlessness determination, general creditor claims, such as yours, are worthless.** See 67 FR 63096-01.

³⁴ Our audit scope was limited by the inability of DEP to produce relevant, reliable reports from the ERIS database. Our audit scope was further limited by DEP's lack of internal controls over the database and the employees who enter the data. DEP provided us with information from this database to conduct our audit. Thus, we express no opinion on the reliability or validity of the ERIS database or any information provided from it. The findings in this report as well as findings in Legislative Post Audit's previously issued audit reports for DEP prove the ERIS database to be unreliable.

Pursuant to this final agency action and 12 USC 1821 (d)(3)(A), the Receiver has elected not to conduct a claims process for the types of claims determined to be worthless. All such claims were and are disallowed as worthless.

Moreover, a determination that general creditor claims are worthless is a final agency action. Such action is preclusive on this issue and binding on any court. Since your claim is “worthless”, any case would be moot and a court could not grant effective relief. Consequently, no “case or controversy “exist as required by Article III of the United States Constitution for any court to have subject matter jurisdiction.”

W.Va. Code §5A-8-9(b), as amended, states in part:

“The head of each agency shall:

... (b) Make and maintain records containing adequate and proper documentation of the organization, functions, policies, decisions, procedures and essential transactions of the agency designed to furnish information to protect the legal and financial rights of the state and of persons directly affected by the agency’s activities...”

Cause: According to DEP, the risk identified above exists only when a bond in the form of either a letter of credit (LOC) or certificate of deposit (CD) is forfeited by a mine operator and the banking institution that has issued the security is also insolvent. The DEP has taken measures to minimize this risk within the current laws and regulations. In the past, when DEP has learned that an obligor on any type of bond has become insolvent, the DEP has acted promptly to require permit holders to provide replacement bond coverage. **However, DEP does not have an adequate system of internal controls to identify when an obligor becomes insolvent. DEP was also unable to describe the ‘measures’ taken to minimize the risk and we found no language in the current laws and regulations which mitigates the risk regarding bonding instruments and protection of the interests of the State.**

Effect: As a result of the above finding, DEP and the State is at an increased risk of losing immense amounts of monies that have been put up to be used for reclamation in the event of revocation or if one of the financial institutions issuing a bond becomes financially insolvent. In the event this does occur, the State may not have sufficient funds available to reclaim the damage to the land and/or waters of the State, which has the potential to harm the public and the environment.

Recommendation: We recommend DEP ensure bonding instruments are safeguarded to the best of their ability. Also, we recommend DEP comply with W.Va. Code §5A-8-9(b), as amended, and make and maintain adequate records.

Spending Unit's
Response & Plan

For Corrective Action: *DEP Response has been included in Appendix A of this report.*

Auditor’s Comments
to Response:

See Appendix B.

Finding 4

Vague Authority to Collect Bond Forfeitures and Write-off of Uncollectible Securities

Condition:

There is a vague authority for DEP to collect bond forfeiture revenues totaling \$2,755,030.77 during fiscal years 2009³⁵ and 2010. W.Va. Code §22-3-17(b) specifically states the Attorney General will collect the forfeiture. However, DEP stated W.Va. Code §22-1-6(d)(8) gives the Secretary the authority to collect the forfeitures. It appears there are conflicting statements in the statute regarding who has the authority to collect bond forfeitures.

Upon revocation of a mining permit, the Environmental Resources Specialist initiates the collection process of the bond instrument (Certificate of Deposit, Letter of Credit, Surety Bond, etc.) and has the monies sent back to the Charleston office. The Attorney General is not involved in the actual collection of the monies.

If there is a problem collecting the bond instrument, DEP handles this with the in-house legal division, which will review the circumstances and provide the Division of Mining and Reclamation (DMR) with suggested actions to take. The decision whether to pursue collection or deem the instrument uncollectible is ultimately made by DMR not the legal division. Thus, we were unable to determine exactly how much had been written off as uncollectible because the DEP mining employee who initiated the collection process also will zero out the instrument in the records, and there is no oversight throughout the entire process³⁶. We contacted the Attorney General and were notified his office has not received any notices of forfeiture, or a list of any claims or debts to be dismissed or written off. We also contacted the Secretary of the Department of Administration in regards to claims or debts to be dismissed or written off and he was not aware of any such request by DEP.

Criteria:

W.Va. Code §22-3-17(b), as amended, states in part:

“...If the permit is revoked, the director shall initiate procedures in accordance with rules promulgated by the director to forfeit the entire amount of the operator’s bond, or other security posted pursuant to section eleven or twelve of this article, and **give notice to the attorney general, who shall collect the forfeiture without delay: *Provided, That the entire proceeds of such forfeiture shall be deposited to the credit of the special reclamation fund...***”

W.Va. Code §14-1-18, as amended, states in part:

“...The Commissioner of Finance and Administration, Auditor or other officer or official body having authority to collect the same may, with the advice of the

³⁵ Fiscal year 2009 forfeiture revenues totaling \$2,531,686.82 were added to the scope of the audit because there was such a significant decrease in revenues received in fiscal year 2010. Fiscal year 2010 collections totaled \$223,343.95.

³⁶ Numerous weaknesses were noted in the bond forfeiture process. See Finding 1 Scope Limitation over Revenues Received.

Attorney General, adjust and settle upon just and equitable principles without regard to strict legal rules any account or claim, in favor of the State, which may at the time have been standing upon the books of his or its office more than five years; and, with the like advice, **may dismiss any proceedings instituted by him or it...**"

W.Va. Code §14-1-18a, as amended, states in part:

"...Any account, claim or debt that an agency of this State is not able to collect within three months after trying with due diligence to do so may be referred to the Commissioner of Finance and Administration for consignment by the Commissioner to a responsible licensed and bonded debt collection agency or similar other responsible agent for collection..."

W.Va. Code §22-1-6(d)(8), as amended, states in part:

"Notwithstanding any provisions of this code to the contrary, employ in-house counsel to perform all legal services for the secretary and the department, including, but not limited to, representing the secretary, any chief, the department or any office thereof in any administrative proceeding or in any proceeding in any state or federal court. Additionally, the secretary may call upon the Attorney General for legal assistance and representation as provided by law."

Management is responsible for establishing and maintaining effective internal controls. A fundamental concept of internal control is adequate segregation of incompatible duties. For adequate segregation of duties, management should ensure responsibilities for authorizing transactions, recording transactions, and maintaining custody of assets are assigned to different employees.

Cause: There is a lack of adequate internal controls, proper segregation of duties, and no oversight in the collection of forfeited bonds, the determination of uncollectibles, and items being zeroed out in the DEP records. Also, the aforementioned statutes create ambiguity in who is supposed to be collecting bond forfeitures.

Effect: As a result of the vague authority to collect bond forfeitures, we are unable to determine if DEP or the Attorney General should have collected \$2,755,030.77. As a result of DEP writing off uncollectible bonds without involving the Attorney General or the Department of Administration, DEP is in noncompliance with W.Va. Code §14-1-18 and W.Va. Code §14-1-18a. Furthermore, by writing off bonds as uncollectible without using the proper procedures, the State's interests are not being adequately protected and the risk of fraud, theft, misappropriation, etc. is significantly increased. Without proper oversight, adequate internal controls, and proper segregation of duties, there is the risk an employee can forfeit the bond, pocket the monies, and zero out the bond as uncollectible without management knowing.

Recommendation: Due to the significant weaknesses mentioned above and the weaknesses noted in the forfeiture process in Finding 1, as well as DEP's vague authority, we

recommend the Legislature clarify the Statute and require DEP to comply with W.Va. Code §22-3-17(b), as amended, and allow the Attorney General to collect bond forfeitures on behalf of DEP without delay. We further recommend DEP comply with W.Va. Code §14-1-18 and W.Va. Code §14-1-18a, as amended and cease writing off any uncollectible amounts without following the proper process involving the Attorney General and the Department of Administration and maintain all documentation relating to uncollectible and written-off amounts.

Spending Unit's
Response & Plan

For Corrective Action: *DEP Response has been included in Appendix A of this report.*

Auditor's Comments

to Response: *See Appendix B.*

Finding 5

Weaknesses over Maintenance & Monitoring of Bonds totaling \$905,711,559.89

Condition:

During our inquiry of DEP's bond maintenance & monitoring procedures, we noted the following significant internal control weaknesses:

a) **Lack of segregation of duties and no backup when employee handling bond instruments is on leave.**

We noted the Environmental Resources Associate in charge of maintaining and monitoring posted reclamation bond instruments (cash, checks, surety bonds, self bonds, etc., hereinafter referred to as bonds) handled the entire process, from opening the mail, entering/editing the bond information in ERIS, filing pending and approved permits to making cash deposits with the State Treasurer's Office. Since there is no backup employee, the work waits until the employee returns.

b) **Bonding instruments, excluding cash, are kept in unsecured/unlocked filed cabinet(s) in the file room.**

Based on the bond report provided by DEP as of July 21, 2011, the State Treasurer's Office holds cash, checks, and Certificates of Deposit (CDs) equivalent to \$31,830,684.39 (3.5%) for safekeeping. DEP keeps the surety bonds, self bonds, and letters of credit equivalent to cash value of \$873,880,875.50 (96.5%) pertaining to approved permits in unlocked file cabinets. Access to these cabinets is not limited and any unauthorized employee can remove items without DEP's knowledge. (Note: as of August 2011, DEP started locking the cabinets and limited key access to several employees. However, this did not correct the weakness because we noted two occasions when the cabinets were not locked while the Environmental Resources Associate went to make copies and DEP gave keys to the employees that need their duties adequately segregated.

c) **DEP is unable to ensure all posted reclamation bonds are accounted for in both the source files and the ERIS database because no physical inventory of bonds is taken, and no reconciliation of actual bonds to the bonds recorded in ERIS³⁷ is performed.**

We were told that physical inventory of the bond instruments stored in the file room cabinets was not performed and reconciled against the bond information entered in the ERIS Permit Bond Maintenance module. According to DEP, for CDs, a reconciliation of ERIS to the Treasurer's vault inventory is performed quarterly. However, we noted numerous

³⁷ Our audit scope was limited by the inability of DEP to produce relevant, reliable reports from the ERIS database. Our audit scope was further limited by DEP's lack of internal controls over the database and the employees who enter the data. DEP provided us with information from this database to conduct our audit. Thus, we express no opinion on the reliability or validity of the ERIS database or any information provided from it. The findings in this report as well as findings in Legislative Post Audit's previously issued audit reports for DEP prove the ERIS database to be unreliable.

discrepancies between ERIS and the Treasurer's vault inventory³⁸, which would have been identified during DEP's reconciliation of CDs. Thus, based on DEP's inadequate recordkeeping and lack of inventory, DEP cannot be sure if all posted reclamation bonds have been entered into the ERIS database or that all posted reclamation bonds made it to the active bond file cabinets.

- d) **Unable to determine the amount of pending bond instruments associated with mining permits waiting for approval because bonds are accepted at field office locations and forwarded to the Charleston office to be filed and no pending list is maintained.**

Once the bonds are received at the Charleston office, bonding information for mining permits awaiting approval is entered in the ERIS Applications Activity Maintenance screen. However, the information is not detailed and DEP is unable to provide a list or generate a report of how many permits/bonds are on hold or pending.

- e) **Unable to determine if cash, official checks, etc. received were deposited within 24 hours due to DEP not maintaining a daily receipt log in accordance with statute.**

Monies posted for mining permits are deposited for safekeeping with the State Treasurer's Office. However, we noted a record of the incoming monies received by mail was not maintained.

- f) **Premature cashing of bond instruments without DEP's knowledge.**

Two bonds were prematurely cashed by mining companies without DEP's knowledge. The companies were required to re-post an adequate bond, but DEP did not put internal controls in place to prevent future occurrences.

- g) **There is an overall lack of oversight and monitoring.**

DEP is not adequately overseeing and monitoring the Environmental Resources Associate's work related to the bonding process or some of the aforementioned items could have been prevented.

Criteria:

W.Va. Code §5A-8-9(b), as amended, states in part:

"The head of each agency shall:

... (b) **Make and maintain records containing adequate and proper documentation** of the organization, functions, policies, decisions, procedures and essential transactions of the agency designed to furnish information to

³⁸ See Finding 10 Differences in DEP & STO Records.

protect the legal and financial rights of the state and of persons directly affected by the agency's activities ..."

W.Va. Code §12-2-2, as amended, states in part:

"...a) All officials and employees of the state authorized by statute to accept moneys due the State of West Virginia **shall keep a daily itemized record of moneys received** for deposit in the State Treasury and shall **deposit within twenty-four hours** with the State Treasurer all moneys received or collected by them for or on behalf of the state for any purpose whatsoever..."

Management is responsible for establishing and maintaining effective internal controls. A fundamental concept of internal control is adequate segregation of incompatible duties. For adequate segregation of duties, management should ensure responsibilities for authorizing transactions, recording transactions, and maintaining custody of assets are assigned to different employees.

Cause: There is a lack of effective internal control and oversight over the entire reclamation bond posting process.

Effect: As a result of the significant internal control weaknesses listed above, we are unable to determine if DEP is in possession of all bond instruments listed in the ERIS database or if all bond instruments stored in the DEP file room have been adequately entered in the ERIS database. Also, with no controls in place to prevent premature cashing of bonds, we are unable to determine if all bond instruments are still valid and have value. As a result of not maintaining a record of pending bonds, we are unable to determine the total amount of bond instruments pending approval.

Having only one employee in charge of the bond posting process without a backup creates a backlog of bonds especially for the ones that require deposits, which could cause DEP to be in noncompliance with W.Va. Code §12-2-2. Additionally, by not maintaining a record of cashier's checks/money orders, etc. received, we are unable to determine if the monies were deposited within 24 hours in compliance with statute. If the monies were delayed in depositing, they could be lost, misplaced, or misappropriated. Inadequate segregation of duties and an overall lack of adequate internal control increases the risk of fraud, theft, loss, misappropriation, etc. which could go unnoticed by management.

Recommendation: We recommend DEP comply with W.Va. Code §12-2-2, as amended, and maintain a log of daily receipts, deposit money within 24 hours, and reconcile the log to the actual cash deposited. Also, we recommend DEP comply with W.Va. Code §5A-8-9(b), as amended, and maintain adequate bond records. Further, we recommend the agency implement the following:

- Maintain record of all bond materials received, including the pending bonds,
- Keep the cabinets locked in the file room and maintain a record of when the permit file is placed in or removed from the cabinet,

- Limit key access to supervisors/upper management (employees directly involved in the process should not have key access); if this is not possible, DEP must implement internal controls over the handling of bond instruments;
- Adequately segregate the authorization, recording, custody, and reconciliation functions (the same employee cannot obtain the bond, enter the bond in the system, maintain/edit the records, maintain custody of the bonds, release the bond, perform the reconciliation, etc.); if adequate segregation of duties is not achievable due to staffing limitations, DEP must implement adequate internal controls to minimize the risk of fraud;
- Perform a physical inventory of all bonds maintained every two years as well as a spot check once a year with approval by a supervisor as an indication of oversight;
- Add a "Location" field to be able to determine where the bond instruments relating to approved permits are located, and
- Add "Pending" in the Status field drop-down box in the ERIS bond list to be able to provide a report of pending permits awaiting approval.

Spending Unit's
Response & Plan

For Corrective Action: *DEP Response has been included in Appendix A of this report.*

Auditor's Comments
to Response:

See Appendix B.

Finding 6 Unable to Determine Adequacy of Bond Amounts

Condition: During our review of reclamation bonds, we were provided an ERIS bond listing consisting of 2,380³⁹ permits totaling approximately \$906 million. Of those 2,380 permits, 1,764⁴⁰ totaling approximately \$887 million were mining permits. We attempted to analyze bonds for the 1,764 permits for compliance with W.Va. Code §22-3-11 and noted it appears that bond amounts were consistently improperly calculated, which would result in permits being under-bonded. However, based on the inability of DEP to produce relevant, reliable reports from the ERIS database and the lack of internal controls over the database, we were unable to determine whether bond amounts were calculated accurately in accordance with the statute.

Criteria: W.Va. Code §22-3-11, as amended, states in part:

“(a) After a surface mining permit application has been approved pursuant to this article, but before a permit has been issued, each operator shall furnish a penal bond ... The penal amount of the bond shall be not less than \$1,000 nor more than \$5,000 for each acre or fraction of an acre: Provided, That the minimum amount of bond furnished for any type of reclamation bonding shall be \$10,000. . .”

W.Va. Code §5A-8-9(b), as amended, states in part:

“The head of each agency shall:

... (b) Make and maintain records containing adequate and proper documentation of the organization, functions, policies, decisions, procedures and essential transactions of the agency designed to furnish information to protect the legal and financial rights of the state and of persons directly affected by the agency’s activities...”

Cause: We were unable to determine a cause because unreliable records were provided to conduct the audit.

Effect: As a result of being provided unreliable records, DEP is in noncompliance with W.Va. Code §5A-8-9(b). Also, we were unable to determine if DEP is in compliance with W.Va. Code §22-3-11. As a result of the appearance of not having an adequate bond in place, DEP may be risking millions of dollars the State will need to reclaim the damaged land and/or waters of the State if the under-bonded permit is revoked and the bond is forfeited under any circumstances.

³⁹ All information is based off of the ERIS information provided by DEP. For our attempted analysis, we used the Current Bond Rate, Current Bond Acres, and Current Bond Amount columns in the ERIS bond listing.

⁴⁰ 1,764 permits exclude Notices of Intent to Prospect and Quarry Permits.

Recommendation: We recommend DEP comply with W.Va. Code §22-3-11, as amended, and compare the official records to the ERIS database and determine whether bond amounts have been appropriately calculated and determine whether sufficient bonds have been posted. If bonds are not sufficient, we recommend DEP notify the permit holders of their insufficient bonds and request immediate action to provide adequate bond amounts. If a permit holder fails to do so, DEP should notify said permit holder to cease operation and immediately begin reclamation. Furthermore, we recommend DEP comply with W.Va. Code §5A-8-9(b), as amended, and maintain adequate records. In addition, DEP should revise the current ERIS database or adopt a new system for entering, calculating, and monitoring bond instruments. Information should be updated as changes occur and the changes should be documented.

Spending Unit's
Response & Plan

For Corrective Action: *DEP Response has been included in Appendix A of this report.*

Auditor's Comments
to Response:

See Appendix B.

Finding 7

Significant Weaknesses over Self-Bonding

Condition:

During our review of reclamation bonds, we interviewed DEP personnel to obtain an understanding of how self-bonds are processed and maintained by the DEP Division of Mining and Reclamation (DMR). During this time, we noted the following significant weaknesses:

- DEP does not have official or written procedures for processing self-bonds;
- DEP does not have official or written procedures for how a self-bond would be processed in the event of forfeiture;
- DEP stated the Attorney General does more than approve the Self-Bonding Application as to form⁴¹;
- DEP allows guarantors to submit financial data that lumps owned and leased rights together and DEP does not require a breakdown of what the total consists of in order to determine if the amounts contain any intangible items; only tangible items can be used to determine if the guarantor meets the financial requirements for self-bonding;
- There is a lack of proper oversight over the financial evaluation process;
- Changes to self-bonds are made via email, telephone conversation, etc.;
- Upon the merger of two guarantors, DEP allowed the transfer of self-bond amounts from one company to the other without approving the application for the required new amount of self-bonding;
- DEP did not require the acquiring company to post adequate bonds until the self-bond could be approved;
- According to the DEP bond listing⁴², DEP currently holds \$174,643,488.67 in self-bonds from one single guarantor, but documentation shows the guarantor is only approved for \$125 million; and
- Based on information obtained during the audit, DEP would likely be considered a general creditor/lien holder in any court proceeding and probably would only be able to recover little, if any of the amount of self-bond in the event of forfeiture.

⁴¹ According to DEP, the self-bond is considered approved once the Attorney General approves it. However, after contacting the Attorney General's Office for clarification on the approval process for self-bonds, we were told the Attorney General's Office is only approving the submitted documents as 'to form' in that all of the signatures are present, the corporate seals are present, etc.

⁴² Our audit scope was limited by the inability of DEP to produce relevant, reliable reports from the ERIS database. Our audit scope was further limited by DEP's lack of internal controls over the database and the employees who enter the data. DEP provided us with information from this database to conduct our audit. Thus, we express no opinion on the reliability or validity of the ERIS database or any information provided from it. The findings in this report as well as findings in Legislative Post Audit's previously issued audit reports for DEP prove the ERIS database to be unreliable.

Criteria: W.Va. Code §5A-8-9, as amended, states in part:

“ . . . The head of each agency shall:

... (a) Establish and maintain an active, continuing program for the economical and efficient management of the records of the agency.

(b) Make and maintain records containing adequate and proper documentation of the organization, functions, policies, decisions, procedures and essential transactions of the agency designed to furnish information to protect the legal and financial rights of the state and of persons directly affected by the agency's activities...”

Cause: This finding resulted from a lack of adequate internal controls and oversight over the self-bonding process.

Effect: Defining and documenting processes with well-written procedures is important to ensure (1) compliance with laws and regulations; (2) processes fundamental to an agency's success are properly guided by management; and (3) internal controls are in place and properly implemented in order to effectively manage risk.

Further, DEP stands to lose \$174,643,488.67 in self-bonds if the guarantor declares bankruptcy and DEP would run the risk of not having the necessary funds to reclaim land and/or water damage at that many additional sites. Without proper safeguards in place to ensure coal companies posting self-bonds help fund reclamation clean-up for damage they cause, the land and waters of the State are not being effectively protected.

Recommendation: We recommend the DEP comply with W.Va. Code §5A-8-9 as amended and maintain adequate records and protect the interests of the State. Further, based on the aforementioned significant weaknesses, we recommend the Legislature amend the statute to remove the allowance of self-bonding. If the statute cannot be amended, DEP must implement adequate internal controls and safeguards over self-bonding to protect the financial interests of the State.

Spending Unit's
Response & Plan

For Corrective Action: *DEP Response has been included in Appendix A of this report.*

Auditor's Comments
to Response:

See Appendix B.

Finding 8

Inaccurate Estimated Liabilities

Condition: During our audit of reclamation of non-State owned property, we reviewed 22 randomly selected bond forfeited sites⁴³ for fiscal year 2010, and noted liabilities were consistently underestimated due to various weaknesses including, but not limited to:

- Pertinent reclamation activities were contracted out and not included in the purchase order or the estimated liability report:
 - Tree planting;
 - Heavy equipment rental and labor;
 - Laboratory services;
 - NPDES and any other required permits;
 - Snow removal;
 - Sludge removal, etc;
- Posted bond was insufficient to cover the estimated reclamation cost. See Table 1, which shows the amount spent per the special reclamation database, the amount of posted bond, the amount of bond collected, and any excess cost over bond amount;
- Inaccurate tracking of specific site liabilities for cost recovery and accurate reporting. For the 22 permitted sites tested, DEP incurred \$1,280,703.24 in administrative costs for which they cannot provide documentation of exactly what these costs entail. Administrative costs are also not tracked by project number in WVFIMS;
- Estimated liabilities stay on record at the initial estimated amount and are not re-estimated until the site is ready to be contracted out, which is usually years after the site is initially estimated;
- Estimated liabilities for water reclamation have not been updated to reflect the loss of the NPDES lawsuit, which requires DEP to obtain an NPDES permit for reclamation sites and to reclaim the water at the same standards DEP requires of mining companies who damage the waters of the State. DEP stated they had until December 1, 2011 to obtain the estimate amounts, however, as of December 15, 2011, the amounts have not been added to the records;
- Some sites are on record as having \$0.00 land/water liability or the place where the land/water liability amount should be has been left blank; however, we were unable to determine the exact number of sites as having \$0.00 or left blank because of the lack of adequate recordkeeping; and
- An unreliable special reclamation database is used to track costs. Upon inquiry of the differences between amounts in the special reclamation database and the amounts spent according to WVFIMS, DEP stated there was an undocumented conversation between a Special Reclamation employee and a program manager who is no longer with the agency and the special reclamation database is a combination of three databases used in the past. DEP was unable to

⁴³ We are unable to determine the total number of bond forfeited sites, which are currently being reclaimed or will require reclamation due to the state of DEP's records for reclamation sites.

provide any additional documentation over the controls over the information entered into the database because none was available. DEP was also unable to tell us how they know the information entered into the database was reliable. See Table 2, which shows the differences in the special reclamation database and WVFIMS.

According to DEP, as of October 24, 2011, there are 117 sites that have known current and/or future liabilities and 27 different sites, which may require additional liabilities to be incurred.

Table 1 Excess Reclamation Costs				
Site	Special Reclamation Database Expenditures⁴⁴ to date Per DEP	Posted Bond Dollars	Collected Bond Dollars	Excess Reclamation Costs to date
1	\$2,007,309.83	\$180,000.00	\$180,000.00	(\$1,827,309.83)
2	\$572,777.49	\$306,000.00	\$306,000.00	(\$266,777.49)
3	\$919,675.49	\$266,000.00	\$266,000.00	(\$653,675.49)
4	\$407,953.03	\$10,000.00	\$10,000.00	(\$397,953.03)
5	\$527,158.53	\$10,000.00	\$0.00	(\$527,158.53)
6	\$1,377,089.93	\$132,000.00	\$132,000.00	(\$1,245,089.93)
7	\$688,939.43	\$32,402.00	\$0.00	(\$688,939.43)
8	\$936,844.33	\$10,000.00	\$0.00	(\$936,844.33)
9	\$890,516.40	\$27,000.00	\$0.00	(\$890,516.40)
10	\$528,638.74	\$98,000.00	\$98,000.00	(\$430,638.74)
11	\$555,539.94	\$41,600.00	\$41,600.00	(\$513,939.94)
12	\$188,974.19	\$34,320.00	\$33,000.00	(\$155,974.19)
13	\$183,043.19	\$21,740.00	\$21,740.00	(\$161,303.19)
14	\$948,569.68	\$82,080.00	\$82,080.00	(\$866,489.68)
15	\$288,259.95	\$10,000.00	\$10,000.00	(\$278,259.95)
16	\$526,159.51	\$47,600.00	\$47,600.00	(\$478,559.51)
17	\$1,738,183.43	\$200,000.00	\$200,000.00	(\$1,538,183.43)
18	\$596,151.55	\$70,000.00	\$7,000.00	(\$589,151.55)
19	\$305,406.78	\$11,000.00	\$2,310.00	(\$303,096.78)
20	\$883,927.17	\$40,000.00	\$40,578.00	(\$843,349.17)
21	\$940,709.51	\$34,800.00	\$34,800.00	(\$905,909.51)
22	\$425,929.45	\$43,000.00	\$0.00	(\$425,929.45)
Total	\$16,437,757.55	\$1,707,542.00	\$1,512,708.00	(\$14,925,049.55)

⁴⁴ Includes WVFIMS Administrative Costs totaling \$1,280,703.24 that are not assigned a project number.

Table 2 Special Reclamation Expenditures			
Site	Special Reclamation Database Total Including Adm. Cost Per DEP	WVFIMS Total	Difference
1	\$2,007,309.83	\$1,385,919.63	\$621,390.20
2	\$572,777.49	\$538,174.09	\$34,603.40 ⁴⁵
3	\$919,675.49	\$887,364.63	\$32,310.86 ⁴⁵
4	\$407,953.03	\$313,714.66	\$94,238.37
5	\$527,158.53	\$386,220.34	\$140,938.19
6	\$1,377,089.93	\$1,337,068.20	\$40,021.73
7	\$688,939.43	\$432,221.24	\$256,718.19
8	\$936,844.33	\$722,853.07	\$213,991.26
9	\$890,516.40	\$491,033.21	\$399,483.19
10	\$528,638.74	\$485,181.94	\$43,456.80 ⁴⁵
11	\$555,539.94	\$517,791.50	\$37,748.44 ⁴⁵
12	\$188,974.19	\$151,225.75	\$37,748.44 ⁴⁵
13	\$183,043.19	\$151,500.00	\$31,543.19 ⁴⁵
14	\$948,569.68	\$857,973.07	\$90,596.61 ⁴⁵
15	\$288,259.95	\$188,372.46	\$99,887.49 ⁴⁵
16	\$526,159.51	\$388,205.24	\$137,954.27
17	\$1,738,183.43	\$1,696,901.12	\$41,282.31 ⁴⁵
18	\$596,151.55	\$555,682.41	\$40,469.14
19	\$305,406.78	\$256,235.91	\$49,170.87
20	\$883,927.17	\$400,783.98	\$483,143.19
21	\$940,709.51	\$872,010.79	\$68,698.72
22	\$425,929.45	\$134,383.26	\$291,546.19
Total	\$16,437,757.55	\$13,150,816.50	\$3,286,941.05⁴⁴

Criteria:

W.Va. Code §5A-8-9, as amended, states in part:

“The head of each agency shall:

... (a) Establish and maintain an active, continuing program for the economical and efficient management of the records of the agency.

⁴⁵ \$449,177.54 of the \$1,280,703.24 Administrative Costs matched the difference between the special reclamation database and WVFIMS.

(b) **Make and maintain records containing adequate and proper documentation** of the organization, functions, policies, decisions, procedures and **essential transactions** of the agency designed to furnish information to protect the legal and **financial rights of the state** and of persons directly affected by the agency's activities..."

Cause: According to DEP, tree planting is a separate purchase order and done by work directives. All other items are operation and maintenance costs, which are highly variable and not included as capital costs. DEP stated all actual costs associated with each site are captured by project number, **although we found the project number does not accurately capture these costs.** Also, DEP stated certain employee expenditures were attributed to a specific permit where the employee was permanently assigned. DEP stated the initial estimated liability is for budgeting purposes only. Additionally, since water liabilities are not subject to the 60-day time limit, the field will remain blank until sufficient data is collected to develop an accurate liability estimate.

There is an overall lack of oversight and knowledge of key concepts concerning how to account for environmental liabilities. With the exception of water liabilities where the damage is uncertain, the land reclamation liabilities are probable because the damage has already occurred and land damage can be readily estimable. These types of liabilities must be recognized and reported.

Effect: Based on the weaknesses found in the 22 permitted sites reviewed and inquiry with Special Reclamation employees, most, if not all, of the reclamation sites are at high risk for reporting inaccurate estimated liabilities to the Legislature and the SRFAC. Keeping outdated information on the records and not updating the information until the reclamation goes out for contract bidding increases the risk that the liabilities will be severely underestimated and the actual status of the Special Reclamation Funds is not as it appears on paper. Thus, the State may not have sufficient funds available to reclaim the damage to the land and/or waters of the State, which has the potential to harm the public and the environment. Without adequate records depicting actual circumstances of the reclamation expenditures being made, the environmental liabilities reported in the Single Audit and the Consolidated Annual Financial Report may be understated.

Recommendation: We recommend DEP comply with W.Va. Code §5A-8-9, as amended, and make and maintain proper documentation relating to special reclamation estimated liabilities. Further, we recommend DEP do the following:

- Include estimated costs for services contracted out in estimated liabilities;
- Accurately track specific site liabilities for cost recovery and accurate reporting;
- Update estimated liabilities that have been on the books for an extended period of time to reflect a more accurate estimate;
- Update estimated liabilities for water reclamation sites to reflect the cost of obtaining the required NPDES permits;

- Utilize the Office of Surface Mining's (OSM) handbook for calculation of reclamation bond amounts and/or the estimation calculation sheets used by other states to estimate liabilities; and
- Make sure liability amounts for bond forfeited sites are not left blank and contain accurate estimated liabilities.

Spending Unit's
Response & Plan

For Corrective Action: *DEP Response has been included in Appendix A of this report.*

Auditor's Comments

to Response: *See Appendix B.*

Finding 9

Discrepancies of Bond Inventory Records

Condition:

During our review of documentation for 51 randomly selected bonds and 23 specifically selected⁴⁶ bonds in the bond listing⁴⁷ totaling \$49,017,979.17(5%) out of a population of approximately 4,005 bonds (based on bond ID⁴⁸) totaling \$905,711,559.89, we noted 53 bonds totaling \$20,146,006.81(41%) where supporting documentation was inconsistent with the bond listing. Based on an error rate of 71.6% and a population of 4,005 bonds, we are 95% confident the bond listing contains anywhere from 2,406 to 3,260 bond IDs with inconsistencies between the supporting documentation and bond listing. A summary of the inconsistencies found are listed below:

- Two bonds had inconsistent amounts on the bond listing, supporting documentation, and ERIS comments;
- One bond on the bond listing for which DEP indicated there was actually no bond required for the permit;
- One bond on the ERIS bond listing had supporting documentation in the permit file for a different bond;
- One bond totaling \$10,000.00 had documentation, but the bond was not on the ERIS bond listing or the ERIS database;
- 24 bonds totaling \$2,134,540.00, which had either been updated with riders or released, but it was not reflected in the bond listing;
- Several occurrences where the Bond Institution Party Name was entered as the company that wrote the check and several instances where it was entered as the bank from which the company wrote the check;
- Self bonds were listed as Self Bond by Company and did not specify the guarantor; and
- There was an inconsistent use of the terms Official Check, Company Check, etc.

⁴⁶ These 23 bonds were selected because they had United Pacific Insurance Company listed as the surety company. This company was declared insolvent on October 3, 2001. See Finding 2 Lack of Documentation & Updating of Records for Approx. \$17 Million of Insolvent Surety Bonds

⁴⁷ Our audit scope was limited by the inability of DEP to produce relevant, reliable reports from the ERIS database. Our audit scope was further limited by DEP's lack of internal controls over the database and the employees who enter the data. DEP provided us with information from this database to conduct our audit. Thus, we express no opinion on the reliability or validity of the ERIS database or any information provided from it. The findings in this report as well as findings in Legislative Post Audit's previously issued audit reports for DEP prove the ERIS database to be unreliable.

⁴⁸ This number does not account for any instances where DEP used the same bond Bond ID for different bonding instruments.

Criteria: W.Va. Code §5A-8-9(b), as amended, states in part:

“The head of each agency shall:

... (b) Make and maintain records containing adequate and proper documentation of the organization, functions, policies, decisions, procedures and essential transactions of the agency designed to furnish information to protect the legal and financial rights of the state and of persons directly affected by the agency’s activities...”

Cause: According to DEP, the ERIS database is maintained for the convenience of the agency and the public in compiling information from various sources in one location. DEP further stated, although DEP strives to maintain accurate information in ERIS, data entry errors can and do occur. For any particular bit of information, the DEP source file from which the information in ERIS has come is the agency’s official record. **However, since DEP provides information pulled directly from the unreliable ERIS database to the public, the Legislature, the SRFAC, the actuary, etc. and those various people rely on that data to make decisions, the ERIS database should contain any and all updates to information in the DEP source files.**

Effect: As a result of the above findings, we are unable to determine which bonds DEP should actually have in their possession or the correct details of the bonds they do have in their possession. Allowing a single bond to be put up for multiple permits could cause issues for tracking, releases, forfeitures, etc. Also, DEP is in noncompliance with W.Va. Code §5A-8-9(b).

Recommendation: We recommend DEP comply with W.Va. Code §5A-8-9(b) and make and maintain adequate documentation to support and verify the ERIS bond listing with the official source documents. Also, we recommend DEP perform an inventory of all bonds in their possession and compare it to the bond listing in ERIS so all records can be updated to accurately reflect the bonds DEP holds. Further, we recommend DEP use a consistent form of entering information into the database, update changes as they occur, and document these changes in the comment column to list details such as ‘Transfer’, ‘Amended’, etc.

Spending Unit's
Response & Plan

For Corrective Action: *DEP Response has been included in Appendix A of this report.*

Auditor’s Comments
to Response:

See Appendix B.

Finding 10

Differences in DEP & STO Records

Condition:

During our comparison of the ERIS bond listing⁴⁹ for Certificates of Deposit (CDs) and the West Virginia State Treasurer's Office (STO) Safekeeping Active Securities List of CDs, we noted the following:

- The STO list had a total of \$16,228,678.83 and the ERIS list had an original amount total of \$16,177,452.99; a difference of \$51,225.84;
- The Bond Issue Date did not match on 10 CDs totaling \$671,732.28;
- The DEP list had nine CDs totaling \$180,233.22 that were not on the STO list:
 - One CD totaling \$10,220.00 appeared to be a duplicate in the DEP bond list;
 - One CD totaling \$118,000.00 was not on the STO list due to a glitch in the STO system, but the STO provided us with documentation from the vault;
 - Five CDs totaling \$41,432.81 were released, but not removed from the DEP bond list;
 - One CD totaling \$10,080.41, according to DEP, is currently with the DEP legal division; and
 - One CD totaling \$500.00 was actually a check, which was entered incorrectly on the DEP bond list.
- The STO list had two CDs totaling \$63,500.00, which were not on the DEP list:
 - One CD totaling \$61,500.00 DEP has no record of this item ever being entered into the ERIS database and had no supporting documentation, yet documentation was provided by the STO; and
 - One CD totaling \$2,000.00 was revoked and removed from the DEP bond list because it was deemed uncollectible, but DEP did not request the STO to remove it from the STO list.

Criteria:

W.Va. Code §5A-8-9(b), as amended, states in part:

“The head of each agency shall:

... (b) Make and maintain records containing adequate and proper documentation of the organization, functions, policies, decisions, procedures and essential transactions of the agency designed to furnish information to

⁴⁹ Our audit scope was limited by the inability of DEP to produce relevant, reliable reports from the ERIS database. Our audit scope was further limited by DEP's lack of internal controls over the database and the employees who enter the data. DEP provided us with information from this database to conduct our audit. Thus, we express no opinion on the reliability or validity of the ERIS database or any information provided from it. The findings in this report as well as findings in Legislative Post Audit's previously issued audit reports for DEP prove the ERIS database to be unreliable.

protect the legal and financial rights of the state and of persons directly affected by the agency's activities..."

Cause: This finding resulted from a lack of adequate internal controls, lack of oversight, and lack of inventory of the bonds held. A proper reconciliation is not performed between the ERIS bond list and the STO list. According to DEP, the CD totaling \$10,220.00 was an incorrect entry, which should have been removed from the ERIS database and the CD totaling \$61,500.00 was for an obligation that does not involve a surface mine and the documentation referencing the surface mine permit number was erroneous. However, no additional detailed information was provided by DEP.

Effect: As a result of the above findings, DEP's list of securities could be overstated or understated and DEP is in noncompliance with W.Va. Code §5A-8-9(b).

Recommendation: We recommend DEP comply with W.Va. Code §5A-8-9(b), as amended, and make and maintain adequate documentation to support and verify the bond listings. Also, we recommend DEP perform an inventory of all bonds they hold and perform a reconciliation between ERIS and the STO listing regularly to identify and correct any differences in a timely manner. We further recommend DEP implement adequate internal controls and proper oversight.

Spending Unit's
Response & Plan

For Corrective Action: *DEP Response has been included in Appendix A of this report.*

Finding 11 **Improper Accounting and Application of Forfeited Bonds**

Condition: During our inquiry with various DEP employees and a review of the documentation maintained by DEP, it became apparent the Special Reclamation program does not properly account for forfeited bonds for reclamation sites. Also, the Special Reclamation program does not properly apply forfeited bonds to reclamation sites.

During fiscal years 2009 and 2010, the Special Reclamation program received approximately \$2,755,000.00 in forfeited bonds. We are unable to determine if bond amounts were specifically earmarked or ‘committed’ when received to prevent premature spending before reclamation is initiated at these sites. Forfeited bond amounts are reported in the Special Reclamation Funds and are used to make expenditures for reclamation sites other than those for which the bond was originally posted. In addition, DEP does not consider the amount of forfeited bond collection when assessing the specific reclamation site estimated liabilities.

Criteria: W.Va. Code §22-3-17 (b), as amended, states in part:

“... If the permit is revoked, the director shall initiate procedures in accordance with rules promulgated by the director to forfeit the entire amount of the operators bond, or other security posted pursuant to section eleven or twelve [22-3-11 or 22-3-12] of this article. . . **All forfeitures collected shall be deposited in the Special Reclamation Fund and shall be expended back upon the areas for which the bond was posted...**”

Cause: According to DEP, the 2000 lawsuit against the Department of Interior, Office of Surface Mining (DOI/OSM) stated West Virginia had an inadequate bonding system; therefore, WV created a new tax to supplement the forfeited bonds in the Special Reclamation Fund. DEP stated that while it appears funds are not spent for the forfeited site, they are actually spent for that site and others. This is due to timing differences between the time of forfeit and the commencement of the reclamation work. The State assumes all costs of the reclamation of sites that are forfeited, and money from the Special Reclamation Fund is used to pay for the associated expenditures.

Effect: Since bond amounts are not ‘committed’, amounts collected are used to make expenditures at reclamation sites other than those for which the bond was originally posted. By not complying with W.Va. Code §22-3-17, DEP may not have adequate funding available to reclaim a site for which a bond was posted. Based on our audit, reclamation costs far exceed bond amounts. If a posted bond is not applied to the specific site it was posted for, the bond will not be able to offset any reclamation costs. Also, not considering bond amounts collected for permitted sites results in inaccurate reporting of reclamation site estimated liabilities.

Recommendation: We recommend DEP comply with W.Va. Code §22-3-17, as amended, and commit and apply bonds to the site that originally posted the bond. Also, we

recommend DEP consider bonds collected when factoring reclamation site estimated liabilities.

Spending Unit's
Response & Plan

For Corrective Action: *DEP Response has been included in Appendix A of this report.*

Finding 12

Noncompliance with W.Va. Code §12-2-2

Condition: DEP did not maintain a daily itemized record of monies received totaling \$3,793,079.27 during fiscal year 2010 related to:

- Bond Forfeitures⁵⁰ \$2,755,030.77
- Fines & Penalties..... \$688,062.00
- Court Settlement Revenues \$335,496.96
- Administrative Settlements and
Miscellaneous Revenues \$13,984.00
- Cash Disbursements – Reimbursement \$505.54

Criteria: W.Va. Code §12-2-2, as amended, stated in part:

“a) All officials and employees of the state authorized by statute to accept moneys due the State of West Virginia **shall keep a daily itemized record of moneys received** for deposit in the State Treasury and shall **deposit within twenty-four hours** with the State Treasurer all moneys received or collected by them for or on behalf of the state for any purpose whatsoever.”

Cause: There is a lack of effective internal control and oversight over the collection of monies to ensure all monies received are entered into a daily itemized record and subsequently deposited within 24 hours in accordance with statute.

Effect: By not maintaining a record of when checks are received, we cannot determine if checks were deposited within 24 hours of being received in compliance with statute. If a check is not deposited within 24 hours it could be lost or misplaced, and the State will not have access to money it may need. In addition, the State cannot earn interest on monies that have not been deposited.

Recommendation: We recommend DEP comply with W.Va. Code §12-2-2, as amended, and maintain a record of daily receipts, deposit money within 24 hours, and reconcile the record to the actual cash deposited. Further, we recommend the deposit memo accompanying the checks to the Accounts Receivable Department include the following to enable a quick reference and an audit trail: (1) grantee/vendor name, (2) check number, and (3) check amount. Checks should be endorsed ‘For Deposit Only’ on the back of the check as soon as the check is received.

Spending Unit's
Response & Plan

For Corrective Action: *DEP Response has been included in Appendix A of this report.*

⁵⁰ Our review of Bond Forfeitures included both FY 2009 and FY 2010 because there was such a significant decline in bond forfeiture revenue from FY 2009 to FY 2010. This is the only line item in the audit, which includes revenues from FY 2009.

Finding 13

Weakness over Liability Reports

Condition: During our audit of reclamation of non-State owned property for fiscal year 2010, we reviewed 22 randomly selected bond forfeited sites⁵¹ and noted four (18%) of the sites did not have a Liability Report, so we were unable to determine if the report was completed within the required time.

Of the 18 bond forfeited sites we were able to test, we noted the following weaknesses:

- 14 (78%) of the Liability Reports were not completed in a timely matter;
 - Two (11%) of the Liability Reports did not have the required Environmental Resources Specialist's signature; and
- One (6%) of the Liability Reports was prepared before the permit had been revoked.

Criteria: W.Va. Code §5A-8-9(b), as amended, states in part:

"The head of each agency shall:

... (b) **Make and maintain records containing adequate and proper documentation** of the organization, functions, policies, decisions, procedures and essential transactions of the agency designed to furnish information to protect the legal and financial rights of the state and of persons directly affected by the agency's activities..."

WVDEP's Reclamation Permit Liability Report form, revised 12/01, states:

"This form is to be completed **within 60 days** of the permit revocation notice."

WVDEP's Reclamation Permit Liability Report form, revised 11/95, states:

"This form is to be completed **as soon** as the Special Reclamation Program **receives the revocation notice**. A "drive thru" inspection must be initiated to formulate this estimate."

Cause: According to DEP, liability reports could not be located for the four sites that did not have a Liability Report in their file. The Office of Special Reclamation (OSR) acknowledges the delay in completion of certain liability estimates and DEP stated the OSR attempts to complete liability estimates within 60 days of forfeiture. For the estimated liability prepared before the permit had been revoked, DEP stated that was due to the anticipation of mass forfeitures and OSR worked in coordination with DMR to complete the liability reports prior to the official forfeiture date. DEP also stated the Environmental Resources Specialist's (ERS) signature is optional and is only included if the ERS provides assistance in preparation of the report.

⁵¹ We are unable to determine the total number of bond forfeited sites, which are currently being reclaimed or will require reclamation due to the state of DEP's records for reclamation sites.

Effect: As a result of not completing Liability Reports in a timely manner or not completing the reports at all, liabilities for reclamation sites may not have been recorded properly resulting in inaccurate estimated liabilities (See Finding 8 Inaccurate Estimated Liabilities). Thus, the State may not have sufficient funds available to reclaim the damage to the land and/or waters of the State, which has the potential to harm the public and the environment. Also, without adequate supporting documentation, we were unable to determine if all Liability Reports were completed in accordance with the W.Va. Code or rules and regulations approved by the Legislature.

Recommendation: We recommend DEP comply with W.Va. Code §5A-8-9(b), as amended, as well as DEP internal policies and properly prepare Liability Reports for reclamation sites. Also, we recommend DEP ensure Liability Reports are filled out within the time period specified on the form. Further, we recommend the forms provide a space for the Environmental Resources Specialist and Environmental Resources Supervisor to print their name in addition to the space already provided for their signature.

Spending Unit's
Response & Plan

For Corrective Action: *DEP Response has been included in Appendix A of this report.*

Finding 14

Weakness over Inspections and Inspection Reports at Reclamation Sites

Condition:

During our audit of reclamation of non-State owned property for fiscal year 2010, we reviewed 391 inspection reports (214 Construction Inspection Reports, 174 Water Inspection Reports, and three Land Inspection Reports) from ten randomly selected reclamation sites and noted the following:

- Ten (100%) bond forfeited sites did not have a complete inspection report completed at least once quarterly;
- Seven (70%) bond forfeited sites did not have a partial inspection completed at least once a month;
- Two (1%) inspection reports were not signed by the DEP Representative that completed the inspection;
- 175 (82%) Construction Inspection Reports did not have the required Contract Representative Signature;
- 87 (22%) forms were left incomplete in various sections; (General Information, Construction/ Maintenance, etc.)
- 60 (15%) reports were not assigned an Inspection Report Number;
- Three (1%) reports shared a Report Number with another Report;
- At least 24 reports were missing according to Report Number;
- 58 (15%) reports did not have an Inspection Date specified;
- 20 (5%) reports had multiple dates listed for the Inspection Date;
- Evidence of reclamation work in progress, but no evidence of inspections during that time;
- Four different versions of the Construction Inspection Report and three versions of the Water Inspection Report all for the same time period;
- Overall inconsistent use of an inspection numbering system to allow for adequate tracking and management review;
- Lack of evidence of supervisory review;
- Inspection names were not clearly signed; and
- Evidence of expenditures for snow removal at two sites, but documentation stated inspectors were unable to get to the site due to weather conditions (snow).

A comparison was made between Monthly Compilation Reports and reclamation inspection documentation for the ten bond forfeited sites⁵² reviewed and the following was noted:

- Monthly Compilation Reports did not match the inspection report documentation for any of the sites reviewed;
- 852 total inspection reports were listed on the Monthly Compilation Reports, but only 391 inspection reports were documented in the files; and

⁵² We tested inspections for ten of the 22 selected bond forfeited sites. We are unable to determine the total number of bond forfeited sites, which are currently being reclaimed or will require reclamation due to the state of DEP's records for reclamation sites.

- Instances where inspection reports were completed, but not listed on the Monthly Compilation Reports.

Criteria:

Legislative Rule §38-2-20, as amended, states in part:

20.1.a.1. “An average of at least one partial inspection per month...”

20.1.a.2. “One complete inspection per calendar quarter of each active and inactive surface mining operation. “

20.1.a.6. “...When a permit has been revoked and is not under a reclamation contract . . . the Secretary shall inspect each revoked site on a set frequency commensurate with the public health and safety and environmental consideration present at each specific site, but in no case shall the inspection frequency be set at less than one complete inspection per calendar year . . . the Secretary shall prepare and maintain for public review a written finding justifying the alternative inspection frequency selected...”

Office of Surface Mining (OSM) 2010 Annual Report, states in part:

“... 8. ... **bond forfeiture sites must be inspected on a monthly basis to assess all performance standards and to ensure compliance with the revoked permit**, unless the inspection frequency has been reduced in accordance with the approved State program. . . the State must continue to conduct monthly inspections at bond forfeiture sites or comply with the criteria at CSR 38-2-20.1.a.6 before it can reduce inspection frequency at bond forfeiture sites within the State. Failure to reduce inspection frequency in accordance with its approved program has resulted in **WVDEP not meeting its required inspection frequency at bond forfeiture sites**...”

W.Va. Code §22-3-15, as amended, states in part:

“...c) All surface-mining operations **shall be inspected at least once every thirty days**. The inspections shall be made on an irregular basis without prior notice to the operator or the operators agents or employees, except for necessary on-site meetings with the operator. The inspections shall include the **filing of inspection reports adequate to enforce the requirements, terms and purposes of this article**. “

W.Va. Code §5A-8-9, as amended, states in part:

“The head of each agency shall:

... (a) **Establish and maintain an active, continuing program for the economical and efficient management of the records of the agency.**

(b) **Make and maintain records containing adequate and proper documentation** of the organization, functions, policies, decisions, procedures and essential transactions of the agency designed to furnish information to

protect the legal and financial rights of the state and of persons directly affected by the agency's activities..."

Cause: DEP stated partial inspections were not completed at least once a month for seven sites due to inadequate staffing. Also, DEP stated the Contract Representative signature is not required by OSR on the Construction Inspection Reports, even though there is a line for the signature on the form. DEP stated in certain areas of OSR responsibilities, complete snow removal is not achievable on a continuous basis due to the permits remote location, although they are still paying for snow removal. For everything else, DEP stated OSR is currently developing an automated inspection reporting system, which will alleviate many of the human errors that have occurred, including requiring supervisory approval on all inspections entered in the system, automatically printing the inspector's name on all reports, and automatically generating monthly compilation reports based on the inspections entered into the system.

Effect: As a result of the weaknesses noted above, DEP is in noncompliance with W.Va. Code §5A-8-9, and we were unable to determine if reclamation sites were properly inspected as required by Legislative Rule §38-2-20 and W.Va. Code §22-3-15, as amended. Without performing proper inspections as required by statute, there is an increased risk of harm to the environment and to residents of the State. Proper inspections enable timely identification and correction of issues that may harm the public.

Recommendation: We recommend DEP comply with Legislative Rule §38-2-20 and W.Va. Code §22-3-15 and §5A-8-9, as amended, and properly prepare inspection report forms for reclamation site inspections and monthly compilation reports. Further, we recommend the following:

- All DEP Representatives use a uniform Construction Inspection Report Form, Water Inspection Report Form, Land Inspection Report Form, and Monthly Compilation Report Form;
- All Forms should specify whether or not a complete or partial inspection was completed upon the visit;
- Inspection Forms need to provide a space for the DEP Representative and Contract Representative to print their name in addition to the space for their signature;
- Establish an overall numbering system for inspection reports, and administer it consistently;
- Reconcile monthly compilation reports with actual reports for every inspector each month;
- Require supervisory approval on completed inspection forms and monthly compilation reports.

Spending Unit's
Response & Plan

For Corrective Action: *DEP Response has been included in Appendix A of this report.*

Finding 15

Noncompliance with 180 Day Reclamation Requirement

Condition: During our audit of reclamation of non-State owned property, we tested 22 randomly selected bond forfeited sites⁵³ and noted that none (100%) of the reclamation operations were initiated within 180 days as specified by Legislative Rule §38-2-20;

- The longest time it took to initiate reclamation was approximately 8,476 days (23.5 calendar years) in excess of 180 days; and
- The shortest time it took to initiate reclamation was approximately 151 days (0.4 calendar years) in excess of 180 days.

Criteria: Legislative Rule §38-2-20, as amended, states in part:

“...**12.4.c.** After the **notice of forfeiture** has been served, the Secretary shall in a timely manner, but **not later than one hundred eighty (180) days** after such notice, **initiate reclamation operations to reclaim the site** in accordance with the approved reclamation plan or modification thereof...”

Cause: According to DEP, results from a lawsuit against the DOI/OSM indicated the Office of Special Reclamation (OSR) had an unacceptable number (306) of unreclaimed forfeited permits. This backlog of unreclaimed forfeited permits has prevented DEP from meeting this 180-day requirement to initiate reclamation. As new forfeitures are received and prioritized, this often changes the reclamation schedule as those with the most severe environmental impacts or that pose a danger to the public are given the highest priority.

However, during our audit we noted a lack of official procedures⁵⁴ over reclamation site prioritization.

Effect: Initiating reclamation operations in an untimely manner leads to estimated liability reports that are no longer applicable. The longer a site remains unreclaimed, the cost the State will have to pay to reclaim the land/waters will be greater than if the reclamation was initiated timely in accordance with the statute. Thus, the State may not have sufficient funds available to reclaim the damage to the land/waters of the State, which has the potential to harm the public and the environment. Additionally, by not reclaiming sites timely, there is also an increased risk of harm to the public and the environment because some reclamation sites are continuously rescheduled to be reclaimed at a later date. Also, DEP is in noncompliance with legislative rule §38-2-20.

Recommendation: We recommend DEP comply with Legislative Rule §38-2-20, as amended, and initiate reclamation operations to reclaim permitted sites in accordance with the approved reclamation plan or an approved modification thereof within 180

⁵³ We are unable to determine the total number of bond forfeited sites that are currently being reclaimed or will require reclamation due to the state of DEP's records for reclamation sites.

⁵⁴ See Finding 17 Lack of Official Procedures.

days after the notice of forfeiture. If the 180-day requirement is too stringent, DEP should seek modification of the rule to a more reasonable time constraint that DEP will be able to meet.

Spending Unit's
Response & Plan

For Corrective Action: *DEP Response has been included in Appendix A of this report.*

Finding 16

Noncompliance with Reclamation Plans & Lack of Documenting Changes

Condition: During our audit of reclamation of non-State owned property for fiscal year 2010, we reviewed ten of the 22 randomly selected bond forfeited sites⁵⁵ for compliance with reclamation plans and noted the following:

- The initial reclamation plan was not followed for any of the ten permitted sites;
- Modified reclamation plans consisted of a copy of the purchase order and additional items that were not included in the initial reclamation plan (excludes the trees that were in the initial reclamation plan). However, there was not an actual reclamation plan modified to reflect the changes made for any of the sites reviewed. For example, when DEP became responsible for a site, the initial reclamation plan should have been re-evaluated and modified to reflect any additional expenses and/or changes (heavy equipment rental, snow removal, using different grass and/or trees, laboratory water/soil analysis, etc.); and
- The actual reclamation plans did not specify which permit they were submitted with (only the filename indicated the permit number).

Criteria: W.Va. Code §5A-8-9, as amended, states in part:

“The head of each agency shall:

... (a) Establish and maintain an active, continuing program for the economical and efficient management of the records of the agency.

(b) Make and maintain records containing adequate and proper documentation of the organization, functions, policies, decisions, procedures and essential transactions of the agency designed to furnish information to protect the legal and financial rights of the state and of persons directly affected by the agency’s activities...”

W.Va. Code §22-3-10, as amended, states in part:

“... (a) Each reclamation plan submitted as part of a surface mining permit application **shall include, in the degree of detail necessary to demonstrate that reclamation required by this article can be accomplished...**”

Cause: According to DEP, water treatment was not part of the initial reclamation plan. Each permit was revoked during various phases of land reclamation based on the initial reclamation plan. Reclamation is completed according to the original reclamation plan or modifications thereof as per 38CSR 12.4c.

⁵⁵ We are unable to determine the total number of bond forfeited sites that are currently being reclaimed or will require reclamation due to the state of DEP’s records for reclamation sites.

However, we noted that DEP did not follow the original reclamation plan for any of the ten sites tested and there were no modified reclamation plans to reflect the changes DEP made to the original reclamation plan. Since the records do not reflect the statement made by DEP, this was likely caused by a lack of oversight on the part of DEP.

Effect: As a result of not providing proper supporting documentation, DEP is in noncompliance with W.Va. Code §22-3-10 and §5A-8-9. Also, we were unable to determine if reclamation for permitted sites was properly implemented as specified by the initial reclamation plan.

Recommendation: We recommend DEP comply with W.Va. Code §22-3-10 and §5A-8-9, as amended, and properly maintain adequate documentation for initial reclamation plans. Further, we recommend DEP to do the following:

- Use a standardized form with the permit application to specify the initial reclamation plans;
- Keep and maintain any and all documentation pertaining to the reclamation plan;
- Follow the initial reclamation plan; and
- Document any and all changes or modifications to the initial plan and indicate the reason the changes or modifications occurred.

Spending Unit's
Response & Plan

For Corrective Action: *DEP Response has been included in Appendix A of this report.*

Auditor's Comments
to Response:

See Appendix B.

Finding 17

Lack of Official Procedures

Condition: During our audit of reclamation of non-State owned property, we requested approved guidelines for inspections of reclamation sites and project prioritization. DEP informed us there were procedures in draft form only. When we requested copies of the drafts, we were only provided the draft Reclamation Prioritization Procedures. We did not receive a copy of the draft of procedures for inspections of reclamation sites. However, since both of these procedures are still in draft form they cannot be considered as **official** procedures for purposes of our audit.

Criteria: W.Va. Code §22-3-11 (g), as amended, states in part:

“... The secretary **shall develop a long-range planning process for selection and prioritization of sites to be reclaimed** so as to avoid inordinate short-term obligations of the assets in both funds of such magnitude that the solvency of either is jeopardized...”

W.Va. Code §5A-8-9, as amended, states in part:

“**The head of each agency shall:**

... (a) **Establish and maintain an active, continuing program for the economical and efficient management of the records** of the agency.

(b) **Make and maintain records containing adequate and proper documentation of the organization, functions, policies, decisions, procedures and essential transactions of the agency** designed to furnish information to protect the legal and financial rights of the state and of persons directly affected by the agency’s activities...”

Cause: According to DEP, they are currently in the process of finalizing an Office of Special Reclamation (OSR) procedure handbook. However, OSR is currently conducting operations according to the draft procedural handbook.

DEP did not provide draft procedures for inspections of reclamation sites, only the draft Reclamation Prioritization Procedures. The draft Reclamation Prioritization Procedure does not appear to be sufficient to guide agency personnel with the proper steps to be taken in order to prioritize reclamation sites. Since we were not provided a copy of the draft inspection procedures we cannot determine the draft exists. We were also not provided a copy of the Special Reclamation procedure handbook that DEP stated they were finalizing, thus we cannot determine if it exists either.

Effect: Defining and documenting processes with well-written procedures is important to ensure: compliance with laws and regulations, processes fundamental to an agency’s success are properly guided by management, and internal controls are in place and properly implemented in order to effectively manage risk. Also, without having an agency-wide policy or procedure for inspection of reclamation sites, there may not be consistency between inspectors for the

testing and inspection of sites. Further, without having an agency-wide policy or procedure for prioritization of reclamation sites, there may not be consistency in how each site is prioritized as to environmental severity and harm to the public. Finally, DEP is in noncompliance with the aforementioned criteria.

Recommendation: We recommend DEP establish and distribute procedures to ensure adequate and complete inspections are consistently being implemented for each reclamation site. We also recommend DEP comply with W.Va. Code §22-3-11 (g), as amended, and finalize and distribute the draft for Reclamation Prioritization Procedures. We also recommend DEP finalize the Office of Special Reclamation (OSR) procedure handbook DEP mentioned in their cause to this finding. Further, we recommend DEP comply with W.Va. Code §5A-8-9, as amended, and make and maintain proper records of policies and procedures.

Spending Unit's
Response & Plan

For Corrective Action: *DEP Response has been included in Appendix A of this report.*

Finding 18

Weakness Over Legislative Rule §38-2-20

Condition: Legislative Rule §38-2-20 is too vague in regards to inspection requirements for active and inactive permits and revoked permits under reclamation contract and not under reclamation contract. DEP has multiple different types of inspections, including Construction Inspections, Water Inspections, and Land Inspections. Each inspection has a different form and requires the inspector to look at different criteria. The Rule does not specify which type of inspection reports are required for each inspection or if all reports apply to all inspections.

Legislative Rule §38-2-20.1 uses the following definitions:

“1) Partial Inspection. For purposes of this section, a partial inspection is an on-site or aerial review of a person's compliance with **some** of the provisions of the Act, this rule, and the terms and conditions of the permit.

2) Complete Inspection. For purposes of this section, a complete inspection is an on-site review of a person's compliance with **all** the provisions of the Act, this rule, and the terms and conditions of the permit within the entire area disturbed or affected by the surface coal mining and reclamation operations.”

Criteria: Legislative Rule §38-2-20, as amended, states in part:

20.1.a.1. “An average of at least one partial inspection per month...”

20.1.a.2. “**One complete inspection per calendar quarter** of each active and inactive surface mining operation. “

W.Va. Code §22-3-15, as amended, states in part:

c) “All surface-mining operations shall be **inspected at least once every thirty days**. The inspections shall be made on an irregular basis without prior notice to the operator or the operators agents or employees, except for necessary on-site meetings with the operator. The inspections shall include the **filing of inspection reports adequate to enforce the requirements, terms and purposes of this article.**“

Cause: There is a lack of adequate internal controls to ensure all pertinent information relating to inspections of bond forfeited sites is included in the Legislative Rule.

Effect: As a result of the vague phrasing and lack of specific requirements for each type of inspection in Legislative Rule §38-2-20, we were unable to determine what each site requires for a complete inspection, whether it should include a Construction Inspection Report, a Water Inspection Report, a Land Inspection Report, or all three.

Recommendation: We recommend DEP seek modification to the rule to overcome the weaknesses stated above. Specifically, to add a separate section for each type of inspection (construction inspections, water inspections, and land inspections), which specifies the requirements and steps necessary to complete each inspection. In

lieu of the previous recommendation, DEP could create a new rule specifically for bond forfeited site reclamation and include a detailed section for inspections.

Spending Unit's
Response & Plan

For Corrective Action: *DEP Response has been included in Appendix A of this report.*

Finding 19

Noncompliance with Administrative Settlement Agreements

Condition: During our review of Administrative Settlements⁵⁶ totaling \$798,156.50, we noted DEP was in noncompliance with the settlement and forbearance agreement in regards to both timing and receipt of payments.

A written agreement between DEP and a coal company, dated February 10, 2003, stated the company would make payments to DEP to repay reclamation costs DEP incurred at one of the company's sites. This agreement set up a timeline for an initial payment and yearly payments after, but these payments were not received by DEP. As a result of not receiving any payments for this agreement, DEP lost approximately \$8 million in interest⁵⁷.

On March 20, 2008, DEP and the company entered into another agreement to repay these reclamation costs and set up a new timeline for payments to be received. Payments were still not received according to the timeline in this agreement and DEP lost approximately \$9,820.00 to \$13,185.00 in interest⁵⁷. On August 5, 2009, DEP and the company entered into one more agreement to repay these reclamation costs and set up a new timeline for receipt of payments. The payments are currently being made in accordance with the August 5, 2009 agreement.

Criteria: W.Va. Code §5A-8-9(b), as amended, states in part:

"The head of each agency shall:

... (b) **Make and maintain records containing adequate and proper documentation** of the organization, functions, policies, decisions, procedures and essential transactions of the agency designed to furnish information to protect the legal and financial rights of the state and of persons directly affected by the agency's activities..."

An agreement dated February 10, 2003 states in part:

"...3 ... The company agrees to execute a note payable to DEP, ... in which the company and any of its successors and assigns agree to pay to DEP:

- (a) the sum of \$3,000,000 dollars on the earlier of (i) the financial closing for the construction of a power plant on the Subject Property; or
- (ii) eighteen months from the date of the Bankruptcy Court's approval of this agreement; and

⁵⁶ Revenues were misclassified. See Finding 21 Revenue and Expenditure Misclassification.

⁵⁷ Interest was calculated based on historical interest rates of the W.Va. Money Markey Pool and the W.Va. Government Money Market Pool not factoring compounding or any additional provisions of the aforementioned agreements.

(b)four annual payments \$1,000,000, payable beginning on the one year anniversary date of the payment of the \$3,000,000, and continuing on the same thereafter, plus a final payment of \$787,061.17 in the fifth successive year after payment of the first \$1,000,000 ...”

A forbearance agreement dated March 20, 2008 states in part:

“... 1.a ... The company shall pay WVDEP a lump sum of five hundred thousand dollars (\$500,000) upon the earlier of (1) ten days of WVDEP’s issuance and delivery of the approval of the permit modification referred to in paragraph three herein or (10) ten months from the date hereof ...”

“... 5 ... The company shall pay the difference between said sum and the Scheduled Minimum Payment for that Contract Year to the WVDEP on the anniversary of the signing of this Forbearance Agreement at the end of that Contract Year.

<u>Contract Year</u>	<u>Scheduled Minimum Payment</u>
1 st	\$50,000
2 nd	\$250,000
3 rd	\$500,000
4 th through 10 th	\$800,000
11 th	remaining balance due WVDEP”

Cause: According to DEP, the reason for the multiple extensions on the agreement was because DEP has made business decisions as to how to have the best chance of recovering the full \$7.3 million of the original package of documents contemplated being paid to DEP.

Effect: As a result of not receiving any payment in accordance with the February 10, 2003 agreement, the State lost approximately \$8 million in interest. Further, as a result of not receiving any payment in accordance with the March 20, 2008 forbearance agreement, the State lost approximately \$9,820.00 to \$13,185.00 in interest. In addition, the State did not have timely access to the full amount of money it was due.

Recommendation: We recommend DEP comply with W.Va. Code §5A-8-9(b), as amended, and maintain adequate revenue records. In addition, we recommend DEP comply with all settlement and forbearance agreements. We further recommend DEP implement procedures to monitor and identify all uncollected payments, which are a result of settlement or forbearance agreements.

Spending Unit's
Response & Plan

For Corrective Action: *DEP Response has been included in Appendix A of this report.*

Finding 20

Noncompliance with Court Settlement Agreement

Condition: During our review of the Court Settlement revenues totaling approximately \$335,497.00, we noted DEP was in noncompliance with the settlement agreement in regards to both timing and receipt of payments.

A settlement agreement entered into dated September 14, 2005 and a stipulation agreement dated September 22, 2008, stated an individual permit holder would make monthly payments of \$10,000.00 until January 1, 2009, at which time the monthly amount would increase to approximately \$40,000.00. However, DEP continued to receive \$10,000.00 monthly up through March 2010 and a final restitution payment totaling \$245,496.96 in April 2010. No extension agreement stating approval for continued monthly payments of \$10,000.00 was available for the payments received between January 2009 and April 2010. As a result of the payments being short each month, the State lost between approximately \$3,450.00 and \$5,268.00 in interest⁵⁸ from January 2009 to April 2010.

Criteria: W.Va. Code §5A-8-9(b), as amended, states in part:

“The head of each agency shall:

... (b) Make and maintain records containing adequate and proper documentation of the organization, functions, policies, decisions, procedures and essential transactions of the agency designed to furnish information to protect the legal and financial rights of the State and of persons directly affected by the agency's activities ...”

A settlement agreement dated September 14, 2005, stated in part:

“1. Said Total Amount shall be paid as follows: ...(2) the company shall then pay to DEP \$10,000 per month for two consecutive months, (3) Following that initial two month payment period, the company shall pay \$40,968.56 to DEP per month until the entire \$875,496.96 settlement amount has been paid... It is anticipated that the company will have completed the payments to DEP within 18 months after signature of this agreement.”

A stipulation agreement dated September 22, 2008, stated in part:

“14. The company will continue to make monthly installment payments relative to the Payment Agreement in the amount of \$10,000 per month out of estate assets, until January 1, 2009, at which time the monthly installment amount will increase to \$40,000 per month. The company is committed to making the necessary installment payments on time and in the appropriate amounts...”

⁵⁸ Interest was calculated based on historical interest rates of the W.Va. Money Markey Pool and the W.Va. Government Money Market Pool not factoring compounding or any additional provisions of the aforementioned agreements.

Cause: According to DEP, the extension of monthly payments of \$10,000.00 for January 2009 to March 2010 was agreed to verbally.

Effect: As a result of neither complying with the settlement agreement nor documenting verbal extension agreements to receive payments less than previously agreed to, the State lost between approximately \$3,450.00 and \$5,268.00 in interest between January 2009 and April 2010. In addition, the State did not have timely access to the full amount of money it was due.

Recommendation: We recommend DEP comply with W.Va. Code §5A-8-9(b), as amended, and maintain adequate documentation to support verbal changes to settlement agreements or adhere to the documented agreed payment terms. We further recommend DEP implement adequate controls over monitoring of settlement agreements to ensure payments are received timely.

Spending Unit's
Response & Plan

For Corrective Action: *DEP Response has been included in Appendix A of this report.*

Finding 21**Revenue and Expenditure Misclassification**

Condition:

During our various tests during fiscal year 2010, we noted eight revenue transactions totaling \$801,342.56, 16 expenditure transactions totaling \$8,833.22, and 3 reimbursement/refund transactions totaling \$827.26 were misclassified. The tests and transactions are listed below.

Revenue Misclassification

1. We tested ten Administrative Settlements and Miscellaneous Revenues transactions totaling \$801,469.08 and noted seven transactions, totaling \$801,199.25, were misclassified. The transactions are detailed in the following table:

#	<u>Agency Code</u>	<u>Audited Code</u>	<u>Misclassified Amount</u>
1	696-399	874	\$1.50
2	696-282	874	\$248,156.50
3	696-399	874	\$90.00
4	696-399	874	\$861.75
5	696-399	874	\$891.75
6	696-399	874	\$1,197.75
7	696-282	874	\$550,000.00
Total			\$801,199.25

2. We tested 25 Coal Tonnage Revenue Transfers consisting of 6 D-documents, totaling \$12,580,679.42⁵⁹, to determine if allocations were made in accordance with statute. One of these transfers, totaling \$143.31, had a misclassification and is detailed in the following table:

#	<u>Agency Code</u>	<u>Audited Code</u>	<u>Misclassified Transfer Amount</u>	<u>Total D-Document Amount</u>
1	649	523	\$143.31	\$1,460,849.73
Total			\$143.31	\$1,460,849.73

Expenditure Misclassification

1. During our audit of cash disbursements, we tested 25 DLR documents totaling \$14,059.17 (53%) of a population totaling \$26,616.25 and noted two transactions totaling \$750.18 (5.3%) contained misclassified object codes. We also tested one reimbursement/refund deposit totaling \$505.54(56%) of a population totaling \$900.32 and noted two of the transactions on the deposit contained misclassified object codes. One of which, also contained a misclassified project ID.

⁵⁹ Coal tonnage transfers totaled \$21,080,367.34 for FY 2010. Of that, \$16,562,012.48 was transferred to Special Reclamation Funds.

The misclassified disbursements are detailed in the following table:

<u>#</u>	<u>Agency Code</u>	<u>Audited Code</u>	<u>Misclassified Transaction Amount</u>	<u>Invoice Amount</u>	<u>Description</u>
1	078	068	\$742.18	\$770.21 ⁶⁰	Gear Box, Tooth Sprocket & Gear Box Adapter
2	034	020	\$8.00	\$9.56 ⁶⁰	Engraved Signs with Employee's Names
Total			\$750.18	\$779.77	

The misclassified reimbursements/refunds are detailed in the following table:

<u>#</u>	<u>Agency Code</u>	<u>Audited Code</u>	<u>Agency Project ID</u>	<u>Audited Project ID</u>	<u>Misclassified Transaction Amount</u>	<u>Description</u>
1	020	210			\$(417.34)	FOIA Request Check ⁶¹
2	034	051/053 ⁶²	9144	4622	\$(88.20)	Partial Refund for Mechanical Plug and Shipping
Total					\$(505.54)	

2. During our test of Contractual & Professional expenses we found seven transactions totaling \$3,464.12 (5.8%) out of \$60,157.20 tested had incorrect object codes. The entire invoices, totaling \$4,932.09, containing these transactions were misclassified. We also noted one refund totaling \$(321.72) (23.3%) out of \$(1,382.52) tested was misclassified.

The transactions are detailed in the following table:

<u>#</u>	<u>Agency Code</u>	<u>Audited Code</u>	<u>Misclassified Transaction Amount</u>	<u>Invoice Amount</u>	<u>Description</u>
1	025	027	\$1,345.00	\$1,345.00	Blackwater Doser Remote Access
2	025	027	\$1,221.00	\$1,387.50	PC Programming
3	025	027	\$166.50	\$1,387.50	PC Programming
4	025	047	\$465.58	\$465.58	Heat for Aqua-Fix Bldg.
5	025	047	\$227.46	\$227.46	Heat for Aqua-Fix Bldg.
6	025	130	\$24.00	\$24.00	Stakes to Secure Road Fabric
7	025	051	\$14.58	\$95.05	First Aid
Total			\$3,464.12	\$4,932.09	

⁶⁰ The shipping charges of \$28.03 and \$1.56, respectively, were coded correctly.

⁶¹ This transaction should have been entered as a revenue not as a reimbursement/refund to an expenditure code.

⁶² DEP was unable to provide documentation showing how much of the \$(88.20) should have been allocated back into Object Codes 051 and 053.

The misclassified refund is detailed in the following table:

<u>#</u>	<u>Agency Code</u>	<u>Audited Code</u>	<u>Misclassified Transaction Amount</u>	<u>Invoice Amount</u>	<u>Description</u>
1	025	051	\$(321.72)	\$(321.72)	8"-12" Multi-Plug
Total			\$(321.72)	\$(321.72)	

3. During our test of Miscellaneous Expense transactions we found three transactions totaling \$610.90 (18.9%) out of \$3,237.62 tested had misclassified object codes. The entire invoices, totaling \$1,498.60, containing these transactions were misclassified. The transactions are detailed in the following table:

<u>#</u>	<u>Agency Code</u>	<u>Audited Code</u>	<u>Misclassified Transaction Amount</u>	<u>Invoice Amount</u>	<u>Description</u>
1	051	130	\$420.00	\$1,277.50	Groundwater Protection Fee, WVNPDES Annual Permit Fee
2	051	130	\$66.00	\$66.00	Groundwater Protection Fee, WVNPDES Annual Permit Fee
3	051	130	\$124.90	\$155.10 ⁶³	Fire Extinguisher & Inspection
Total			\$610.90	\$1,498.60	

4. We tested 33 purchasing card transactions totaling \$4,253.67 of a population of \$39,785.37 and noted two instances totaling \$336.55 (7.91%) had misclassification of object codes. These transactions are as follows:

<u>#</u>	<u>Agency Code</u>	<u>Audited Code</u>	<u>Misclassified Transaction Amount</u>	<u>Invoice Amount</u>	<u>Description</u>
1	035	034	\$40.50	\$90.00	Green Tactical Pants and Ranger Belt
2	035	036	\$296.05	\$538.28	Wrangler Silent Armor Tires
Total			\$336.55	\$628.28	

5. During our test of Repairs and Alterations we noted two transactions totaling \$1,293.32 (5.3%) out of the \$24,220.30 tested had misclassified object codes. The entire amount of these two invoices totaled \$1,315.80. The transactions are detailed in the following table:

⁶³ The \$25.00 portion of this invoice for the inspection fee should have been coded as object code 064.

<u>#</u>	<u>Agency Code</u>	<u>Audited Code</u>	<u>Misclassified Transaction Amount</u>	<u>Invoice Amount</u>	<u>Description</u>
1	068	067	\$753.70	\$753.70	Service on Doser Blackwater
2	068	067	\$539.62	\$562.10	SR3/P/T&T/6" Victaulic Coupler
Total			\$1,293.32	\$1,315.80	

Criteria:

DEP Extended Revenue Codes state:

“210 – FOIA Request”

The West Virginia Expenditure Schedule Instructions state in part:

Revenue Source Codes

“523 - *Investment Earnings*: Interest collected on short-term or long-term investments.”

“649 - *Coal Tonnage Fees*: Fees paid by coal companies on each ton of coal susceptible to the fee.”

“696 - *Other Collections, Fees, Licenses and Income*: Miscellaneous collections, fees, licenses, and income.”

“874 - *Court Settlement Revenues*: Proceeds from litigation, court and other legal settlements.”

Expenditure Source Codes

"020 - *Office Expenses*: Those supplies normally used in the operation of an office and are primarily considered expendable in nature, e.g., letterhead, copy machine paper, toner, typewriter cartridges, calculator ribbons, staplers ..."

"025 - *Contractual and Professional*: Services performed by individuals or firms considered to be professional or semiprofessional in nature."

"027 - *Computer Services*: Charges for computer services by IS&C, WVNET, State Auditor’s Office, legislative computer system, or any other authorized entity for contractual or professional support services for computers and software, programming, machine time, transaction fees, and/or other related computer services."

"034 - *Clothing, Household and Recreational Supplies*: Articles of clothing purchased or rented for state employees ..."

"035 – *Advertising and Promotional*: Newspaper ads for legal public notice requirements, procurement bids, radio and television spots, special sponsorships, publicity advertising to include pamphlets, road maps, and bill boards."

"036 – *Vehicle Operating Expenses*: For vehicle operating expenses..."

"047 - *Energy Expense Utilities*: Expenditures for natural gas, electric, fuel oil or any other substance used for heating, cooling, light, or power..."

"051 - *Miscellaneous*: ...those supplies or services which cannot be classified under any other object code."

"053 - *Freight*: Charges for either shipping or receiving material. This will include courier service charges, motor freight, air freight ..."

"058 - *Miscellaneous Equipment Purchases*: All purchases of equipment (including firearms, and medical equipment) with a dollar value less than \$5,000."

"064 - *Routine Maintenance of Buildings*: ...Includes inspection/ certification of fire hydrants, fire extinguishers, fire alarms and automated security systems."

"067 - *Farm and Construction Equipment Repairs*: Labor and/or material for repair and maintenance of heavy equipment such as dozers, tractors, end loaders, riding lawn mowers, etc."

"068 - *Other Repairs and Alterations*: Labor and/or materials for repairs to power tools, hand tools, and miscellaneous small equipment."

"078 - *Other Capital Equipment*: Any equipment purchases greater than \$5,000 not classified in any other object code."

"130 - *Reclamation of Non-State Owned Property*: Labor and/or materials to return areas disturbed by industries, businesses or private citizens to environmentally regulated standards. Ownership of the areas does not transfer to the State."

Cause:

Revenue Misclassification

According to DEP, the audited code of 874 for the seven administrative settlements in the table above is correct. Further, DEP stated the misclassification found for coal tonnage transfers resulted from a data entry error that was not caught.

Expenditure Misclassification

According to DEP, the misclassified transactions resulted for reasons such as cardholder coding errors, typos, and the employee who processed several of the invoices above has separated from agency. The coordinator for each program master statement is responsible to ensure the coding is correct for each program card purchase before the statement is sent to Accounts Payable for processing.

Effect:

Misclassification of transactions results in inaccurate financial reporting as well as DEP's noncompliance with the Expenditure Schedule Instructions.

Recommendation:

We recommend DEP strengthen internal controls over classification of revenues and expenditures to ensure transactions comply with the West Virginia State Expenditure Schedule Instructions. We further recommend DEP's accounting section audit invoices before processing them and not rely on coding at the program level and also ensure that correct project IDs are used. Additionally, DEP needs to review the internal revenue codes, evaluate their effectiveness, and remove any codes that are not necessary. In regards to NPDES permits and Groundwater Protection fees, if DEP does not want to code these transactions to Object Code 130, they need to request a specific object code be added. Regardless, these types of transactions should not be coded to Object Code 051. We also recommend DEP stays consistent when choosing object codes for similar items.

Spending Unit's
Response & Plan

For Corrective Action: *DEP Response has been included in Appendix A of this report.*

Finding 22 **Travel Reimbursements Not Submitted Within 15 Days**

Condition: During our audit of 30 travel and training expenditures totaling \$9,301.90, we noted ten instances totaling \$2,805.14 where DEP did not submit travel reimbursement requests to the Auditor’s Office within 15 days. Of the ten instances, six were submitted 16 to 21 days later and four were submitted approximately two and one-half years to four and one-half years later.

Criteria: The West Virginia State Travel Policy states in part:

 “**2.5** ... The state agency shall audit and submit an accurate expense account settlement for reimbursement to the Auditor’s Office **within fifteen (15) days** after completion of travel.”

Cause: DEP agrees that these travel reimbursements were not submitted within 15 days as stated in the WV State Travel Policy. Some of the instances involved DEP employees who were aware of the policy. However, the other instances involved Surface Mine Board Members who were not DEP employees, but DEP has made them aware they are not in compliance with the travel regulations.

Effect: By taking longer than 15 days to submit travel reimbursement requests to the Auditor’s Office, WVFIMS will not accurately reflect DEP’s financial state, resulting in inaccurate financial statements. Travel will be understated and cash will be overstated because of money owed to employees.

Recommendation: We recommend DEP comply with section 2.5 of the West Virginia State Travel Policy and submit all travel reimbursement requests to the Auditor’s Office within 15 days.

Spending Unit's
Response & Plan

For Corrective Action: *DEP Response has been included in Appendix A of this report.*

WEST VIRGINIA DEPARTMENT OF ENVIRONMENTAL PROTECTION
SPECIAL RECLAMATION FUNDS & FUND 8796
JULY 1, 2009 – JUNE 30, 2010

SUPPLEMENTAL INFORMATION FUND LISTING⁶⁴

SPECIAL REVENUE FUNDS

Our audit included the following special revenue accounts. These accounts represent funds from specific activities as required by law or administrative regulations:

3312 Special Reclamation Water Quality Fund

Coal fees from fund 3321, land sale & gas royalties for water quality ground improvements not to exceed 25% for clean-up and remedial action resulting from contamination of groundwater or related environment.

3317 Special Reclamation Administration Fund

Transfers from fund 3321 for reclamation administration not to exceed 10% of the total annual assets of fund 3321.

3321 Special Reclamation Trust Fund

Bond forfeitures, fines, investment income & special reclamation tax from fund 7057 for reclamation of lands subjected to surface mining operations.

3345 Special Reclamation Tax Clearing Account

Coal tax to assist in funding abandoned mine lands.

FEDERAL FUNDS

8796 Acid Mine Drainage Abatement & Treatment Fund

Federal funds, investment earnings and interest for acid mine drainage abatement, treatment plans and for administrative and personnel expenses associated with the program.

⁶⁴ Information obtained from the Budget Division's Digest of Revenue Sources for 2010.

WEST VIRGINIA DEPARTMENT OF ENVIRONMENTAL PROTECTION
SPECIAL RECLAMATION FUNDS & FUND 8796
JULY 1, 2009 – JUNE 30, 2010

APPENDIX A

DEPARTMENT OF ENVIRONMENTAL PROTECTION'S RESPONSE TO AUDIT FINDINGS



west virginia department of environmental protection

Executive Office
601 57th Street SE
Charleston, WV 25304
Phone: (304) 926-0440
Fax: (304) 926-0446

Earl Ray Tomblin, Governor
Randy C. Hoffman, Cabinet Secretary
dep.wv.gov

January 4, 2012

Aaron Allred, Legislative Auditor
Legislative Post Audit Division
Building 1, Room W-329
1900 Kanawha Boulevard, East
Charleston, West Virginia 25305-0610

Dear Mr. Allred:

Attached are the responses to the Division of Land Restoration audit.

Should you have any questions or need additional information, please let me know.

Sincerely,

Randy C. Hoffman
Cabinet Secretary

Promoting a healthy environment.

**Informational
Finding 1**

Lack of Communication with Special Reclamation Fund Advisory Council

Spending Unit's
Response:

The DEP strongly disagrees that this finding accurately or appropriately reflects the interactions or working relationship between the DEP and the Special Reclamation Fund Advisory Council (SRFAC). The DEP is fully transparent in providing detailed financial information and permit reclamation status during quarterly meetings with the SRFAC. Further, the DEP provides full access to the special reclamation data to the SRFAC, SRFAC contract support, and the required actuary studies.

With regard to the finding of "items removed from the records", this was an instance of the SRFAC fully supporting the removal of "outlier" data that inappropriately skewed a "variance" statistic used in financial analysis. The Auditors interviewed the SRFAC and a member provided an identical explanation as did DEP for the rationale of removing the estimated costs for 10 permits from the "variance" calculation. The SRFAC members supported the DEP statement.

The finding regarding the notification of the lawsuit settlement is explained by the Auditor.

The DEP had not discussed the Auditor's "issues" with the SRFAC because the DEP understood the preliminary discussions with the Auditors as informational discussions to explain the circumstances associated with the "issues".

The DEP did not report the Auditor findings to the Actuary because the Actuary has full access to DEP data in any manner that's requested. It should further be noted that a majority of the permits have been successfully reclaimed and thus the historical liability estimates are then replaced by actual expenses in the financial data. This makes the recommendation to update the liability estimates of less importance and also lessens the impact of the "variance" statistic. These are factors that were considered by the SRFAC and DEP in utilizing the variance statistic in lieu of routinely updating liability estimates as the backlog of forfeited permits were reclaimed.

Plan for
Corrective Action:

The DEP does not feel corrective action is necessary but the DEP will better document working decisions made by the SRFAC and the DEP.

**Informational
Finding 2**

No Aggregate Limit for Reclamation Sites Liability Insurance

Spending Unit's
Response:

The DEP disagrees with this finding. After consulting with a BRIM underwriting manager, they have recommended that we keep our policy as is.

Plan for

Corrective Action: *The DEP will continue to maintain insurance coverage for the agency.*

**Informational
Finding 3**

Lack of Documentation for Oaths and Reappointments to the Special Reclamation Fund Advisory Council

Spending Unit's
Response:

The DEP agrees with part and disagrees with part of this finding. The DEP agrees that there are members of the Council that have not been sworn in. These members will go to the Secretary of State's office to be sworn in. The DEP disagrees that the Department is responsible for the untimeliness of reappointments to the Council or that we were remiss in providing potential names to fill vacant seats on the Council.

Plan for

Corrective Action: *To correct this finding, the DEP will remind new members of the SRFAC to go to the Secretary of State's office to be sworn in.*

Finding 1

Scope Limitation over Revenues Received

Coal Tonnage Fees - \$21,080,224.02

The Tax Department sends DEP a report twelve times a year showing the amounts placed into fund 3345 from coal tonnage fees. DEP relies solely on these reports for coal tonnage amounts and DEP performs no additional reconciliation to ensure the amounts are correct before being allocated to funds 3321, 3324, and 3482 per statute.

The DEP disagrees with this finding. The DEP does not receive data from the State Tax Department to do a full reconciliation; however we do review the amount for reasonableness and do follow up with the Tax Department if there is a discrepancy.

Administrative Settlements – \$798,156.50

No list is maintained of all agreements regardless of whether revenue is due; therefore, we were unable to be certain that DEP received all revenues for settlement and forbearance agreements.

The DEP disagrees with this finding. There is only one agreement of this type. Therefore, maintaining a list of all such agreements is not necessary at this time. The DEP has developed standard operating procedures to more closely track amounts due under this agreement to assure that future payments are made on time. If DEP enters into additional agreements of this type in the future, it may consider establishing a list of such agreements at that time.

Court Settlements - \$335,496.96

No list is maintained of all agreements regardless of whether revenue is due; therefore, we were unable to determine if DEP should have received any additional revenues for settlement agreements.

The DEP disagrees with this finding. All payments that were due under this agreement have been made and the terms of the agreement have been completely fulfilled. Accordingly, there is no need for action by DEP on this finding at this time. The DEP has developed procedures to track amounts due under any agreements to assure that future payments are made on time. If DEP enters into additional agreements of this type in the future, it may consider establishing a list of such agreements at that time.

Bond Forfeitures - \$2,755,030.77

l) Lack of segregation of duties

We noted the person in charge of maintaining and monitoring bond forfeitures of posted reclamation bond instruments (cash, checks, surety bonds, self bonds, etc., hereinafter referred to as bonds) handled the entire process from opening the mail, editing/removing the bond information from ERIS, authorizing the bond instruments, sending all collection correspondence to the financial institutions, and preparing the deposit of monies received.

The DEP disagrees with this finding. One person is responsible for maintaining records of bonds on pending permit applications and active permits. A second person is responsible for maintaining records on bond forfeitures and collections. A third person is responsible for entering records of bond forfeitures into state and federal databases so as to cause those who have owned or controlled mining operations that have forfeited bonds to be blocked from receiving new permits, nationwide. A fourth person is responsible for querying this database on each pending application to assure that permits are not issued to persons or companies that are permit-blocked. These four employees are supervised by three different supervisors. The DEP notes that during the time of this audit, two of the three supervisors retired. While these positions were vacant, the employees may not have been as closely supervised as they might usually be. This situation is in the process of being remedied. One of the retirees has recently been replaced and the process is underway to replace the other one.

It should also be noted that the entire surface mining and reclamation program, including the bonding and collection function, is subject to active, continual oversight by the Federal Office of Surface Mining Reclamation and Enforcement. This provides additional external controls which help to assure that proper, accurate records are maintained.

To assure that all receipts are deposited within 24 hours, the DEP will appoint persons to back up the person identified above, as well as all Division employees who receive payments of any type, so that their mail is opened and deposits are made on a timely basis when these employees are on leave. In addition, the Division is in the process of implementing the Safekeeping Policy developed by the Fiscal Office to track payments received and deposited.

m) Lack of authority to collect forfeitures

The DEP disagrees with this finding. As a result of the actions described in Lawyer Disciplinary Bd. v. McGraw, 194 W.Va. 788, 461 S.E.2d 850 (1995), the Legislature added W.Va. Code § 22-1-6(d)(8) to the West Virginia Code in 1995. It provides the following authority to the Secretary of the DEP:

Notwithstanding any provisions of this code to the contrary, employ in-house counsel to perform all legal services for the secretary and the department, including, but not limited to, representing the secretary, any chief, the department or any office thereof in any administrative proceeding or in any proceeding in any state or federal court. Additionally, the secretary may call upon the Attorney General for legal assistance and representation as provided by law.

This provision supersedes the previously adopted W.Va. Code § 22-3-17(b), which directs bond forfeitures to be collected by the Attorney General, and provides in-house counsel employed by the DEP Secretary with full authority to pursue collection of bond forfeitures in court.

n) All Show Cause items are not tracked

Only the items that actually end up in Show Cause Proceedings are tracked.

DEP disagrees with the comment. It is difficult to determine what the Legislative Post Audit is suggesting or hopes to derive from this comment. A request for Show Cause is initiated only where the Secretary determines that a pattern of violations of the Act, the West Virginia Surface Mine Reclamation Rules (Rules) or the terms and conditions of the permit exist or has existed, and that the violations were caused willfully or through an unwarranted failure to comply as required. All non-compliances observed during the course of a Mine Site Inspection Report (MR-6) and as required under §22-3-17(a) of the Act are documented on a Notice of Violation (MR-15). Each violation has the needed number of follow-ups or Inspection of Notice of Violations (MR-16) as are necessary to document remedial measure taken throughout the full term of abatement and termination of the violation. The Inspector Supervisor, as required in the Inspection and Enforcement Handbook section 20, on a monthly basis, reviews violation histories for the permits within their territories and reports to the Assistant Director of Enforcement confirming adherence with the pattern of violations policy.

All inspection reports and enforcement action are provided to the permit holder and distributed to the file which is public record as is any Request for Show Cause (MR-10, 10A, 10B) that is prepared by the Inspector. The request is reviewed by both the Inspector Supervisor and the Assistant Director over the regional office before being forwarded to headquarters for the Assistant Director of Enforcement to consider. The violation history

is reviewed with the issuance of each Notice of Violation issued by the inspector in that it is a required field on the MR-15.

If the Assistant Director of the regional office or the Assistant Director of Inspection and Enforcement determines that the request does not constitute a pattern as defined by 38CSR Section 20.4.b.1 - 3. They may terminate the process, documenting the reason for their determination in the record. If they determine that a pattern may exist under the Rule, the Assistant Director of Inspection and Enforcement initiates the order to show cause, if any, why the permit should not be suspended or revoked. The following procedure is adhered to for all permits ordered to show cause:

- *Show Cause Number from MR-10 log.doc is assigned.*
- *Show Cause Order is prepared for Asst. Directors signature.*
- *Letter sent by certified mail to the permittee and copied to the Inspector, Assessment Officer, and the permit file.*
- *Bond type is checked to check bonding instrument. If surety bond, a letter is prepared to the surety company with a copy of the Order.*
- *File folder for the proceeding is started.*
- *The Order is entered into the Show Cause Progress Report.*
- *The Order is entered into ERIS under Permits and Bonds as well as Inspection and Enforcement.*

This procedure is in writing (effective 6/16/93) and all inspection and enforcement staff have been provided copies. All actions taken by Inspection and Enforcement staff are documented in writing and all actions are dated. There is nothing related to a show cause proceeding that cannot be tracked as by their very design, they build a record.

o) There are two sets of accounting records in addition to WVFIMs and none of them matched the actual deposits posted to WVFIMs

The DEP disagrees with this finding. The DEP cannot be responsible for every employee that maintains a separate listing for their use in performing their duties. We will continue to use the State's financial system (WVFIMS) for our financial records and reconcile those records with the ERIS database records.

Multiple reports were provided based on the auditor's requests. After DEP was advised as to what the auditors were trying to accomplish, a (3rd) report was provided which balanced to the amounts in question.

p) The employee mentioned in 'a' above signs the Director of the Division of Mining and Reclamation's name to endorse the securities

The DEP agrees with this finding and will revise our procedure. The DEP will halt this practice and require endorsements to be made by the Director of the Division of Mining and Reclamation or his designee in the future.

q) No reconciliation is performed

There is no reconciliation between ERIS and WVFIMS, the 2nd set of records and WVFIMS, or ERIS to the 2nd set of records.

The Fiscal Office of the DEP has implemented a reconciliation process to reconcile WVFIMS and ERIS.

r) Lack of official and written procedures

There are no official documented agency procedures for the entire bond forfeiture process.

The DEP disagrees with this comment. The Assistant Director of Enforcement directly supervises the bond forfeiture specialist and had established written procedures with the individual which clearly outlined the process. – see additional information in response to Finding 7.

s) Other weaknesses found in bond maintenance

See response to finding 5 below

t) Other weaknesses found in bond inventory

See response to findings 6, 7, 9 and 10 below

u) Other weaknesses found in W.Va. Code §12-2-2 Noncompliance

See response to finding 12 below

v) There is an overall lack of oversight and monitoring.

DEP is not adequately overseeing and monitoring employees work related to the forfeiture process or some of the aforementioned items could have been prevented.

The DEP disagrees with this comment. While we will readily modify our procedures to be more uniform and allow for greater ease of review, we cannot agree, nor has it been shown that ineffective management resulted in any shortfalls in either the collection of penalties or bonds. Both assessments and bond collections are under the direct supervision of the Assistant Director of Enforcement and clear written procedures were in place and provided to the employees and no instance of discrepancy with penalty collection or deposit was identified by the Legislative Post Audit. Our bonding procedures are under the direct supervision of the Assistant Director of Administration and as shown by our ability to validate that adequate bonding was in place as required by the Rules and Act clearly demonstrates that our procedures and the oversight of such were adequate.

Fines and Penalties - \$688,062.00

We were unable to determine if DEP should have received any additional revenues for fines and penalties due to the following weaknesses:

- There is not an effective overall numbering system used for Notice of Violations (NOVs) issued; Once the NOV gets entered into the ERIS database it is assigned a sequential number. However, there is a lack of internal control to ensure that all NOVs issued were entered into the ERIS database;

There is an effective numbering system in place that has been essentially the same format for more than thirty (30) years and assures that the violation history of each individual permit can be consistently tracked. In their comments the individuals conducting the audit suggested that the agency should maintain a simple sequential numbering system. While counting is quite simplistic, it is not an adequate mechanism to assure the violation histories can be linked to a specific site as is required to ensure future monitoring and environmental diagnostics if warranted.

We disagree with the second part of this finding. Since the full implementation of electronic Inspection and Enforcement by the mining division of the DEP more than a year and a half ago, all NOVs have been generated from ERIS in the first place. NOVs originate from the ERIS system. This is the internal control.

- We noted one instance, totaling \$619.00, where the violation number on the Civil Penalty Assessments worksheet and ERIS listing of violations did not match;

This situation was explained in detail to the individuals conducting the audit. This instance occurred when, following the issuance of a Notice of Violation (form MR-15) by a lesser experienced Inspector, the Inspector Specialist (a position that is commonly referred to the Senior Inspector) assigned to the work group conducted an Inspection of the Violation (form MR-16). The initial Inspection of the Violation is where the enforcement officer must recommend the civil penalty that is associated with the violation. Thinking he would assist the lesser experienced Inspector and in fulfilling his obligation to maintain a written record of all inspections, the Inspector Specialist completed the Inspection of the Violation and made the assessment recommendation. Prior to being informed of the Specialist's actions, the Inspector also conducted an Inspection of this Notice of Violation and as appropriate, completed the required documentation and assessment recommendation. It was not a circumstance of separate violations being assigned a duplicate number, but a circumstance where two different enforcement officers conducted separate follow-up investigations, resulting in two independent assessment recommendations.

This error was readily discovered by the assessment officer during his administrative review of the violation, thanks to the effective violation numbering system used by the agency, and corrected. The mistake did not result in any additional expenditure to the company or erroneous collection of fines by the agency.

- We noted one instance where the ERIS database allowed duplicate violations to be entered;

The duplication noted by the Legislative Post Audit occurred at a time when the agency was implementing electronic inspection reporting. To initiate the new electronic format, all inspectors were required to download the most current version of ERIS into their laptops. This download procedure was scheduled to coincide with the Inspector's scheduled office day. The situation occurred when the assigned inspector, who had already been switched over to the electronic system, was not available to respond to a suspected noncompliance and a different inspector, who had not yet been incorporated into the system, conducted the investigation leading to the issuance of an NOV. Since the officer that issued the NOV had not yet downloaded the most current version of ERIS prior to the occurrence, the violation was not synced into ERIS and a duplicate NOV number resulted with the next enforcement action. This error was corrected and reoccurrence is not possible now that transition to the electronic format is complete.

- We were not able to properly test NOVs issued and paid because adequate information could not be pulled from the ERIS database;

Individuals conducting the audit attempted to derive assessment information from the part of the ERIS database that stores violation details. Assessment information is under a different tab. All the information needed to test the NOVs issued and assessments paid is in the system and the data field could be queried to provide a report detailing the information, if a request for this had been made by Legislative Post Audit.

- We were unable to use the information in ERIS to compare the amount of money DEP should have received from fines and penalties to what DEP actually received;

Again this information is relatively easy to derive if the appropriate questions are directed through the appropriate people under reasonable circumstances. The money the DEP should receive can be determined by final assessment summation for the violations issued. The money received for assessments is readily available from ERIS with hard copy backup maintained by the administrative assistant assigned to perform those duties. The assessment tabs in ERIS also contains this information.

- DEP does not adequately track delinquencies. Non-payment of violations results in a delinquent letter being mailed and the coal company is blocked until payment is received. Based on limitations

of the ERIS database it appears nothing was done in regards to either collecting the penalty amount from the company or pursuing collections through legal action;

The process for assessment and collection of civil penalties is outlined in 38CSR2 Sections 20.9 – 20.11 of the Rule. If payments are not received within thirty (30) days they are delinquent. When penalties are delinquent, ERIS generates a letter. This letter is also forwarded to the Applicant Violator System (AVS) clerk for entry into the Federal AVS. When payment is received for the penalties, the payment is entered into ERIS and the information is forwarded to the AVS clerk who removes the violation from the delinquency list.

The DEP has also been active in filing proofs-of-claim and otherwise pursuing its interests in bankruptcy court with regard to bankrupt coal operators.

The Federal AVS system has proven to be one of the most useful and beneficial systems developed to ensure that the provisions of SMCRA are being adhered to. To suggest that nothing is done in regards to collecting delinquent penalty amounts or pursuing collections through legal action is inaccurate as listing on the AVS places the violator on a nationwide block list for any mining application type.

- We noted the process from the issuance of the violation to the collection of the penalty is not timely and can range from a few months to over a year;

The time frame for receipt of a penalty can vary for a multitude of reasons including request for informal conference to review the assessment amount or reassessment. Additionally, scheduling conflicts frequently occur as do last minute cancelations by outside parties. It is the practice of the Division of Mining and Reclamation to make every effort for parties wishing to participate in the conference be given the opportunity to do so.

- There is no segregation of duties over fines and penalties revenue. The Administrative Secretary opens the mail, prepares the deposit, enters the deposit into ERIS, and maintains the records; and

The DEP disagrees with this finding. The procedure for assessments has oversight and segregation at every step along the process and is directly monitored by the Assistant Director of Enforcement. The initial recommendation for penalty is done by the enforcement officer who issued the violation and is done as outlined by 38CSR2 Section 20.1 of the Rule. Copies of the recommendations, along with all supporting documentation are provided to the Company and the Assessment Officer. The Assessment Officer then conducts an administrative review of the violation and penalty recommendation and prepares a civil penalty worksheet to finalize the amount of the recommended penalty. The amount of the assessment is then

provided to the violator, giving thirty (30) days to remit payment or request an informal conference to contest the amount or the fact of the violation. At this conference, attended by anyone with an interest in the violation, the Assessment Officer obtains testimony from all parties and determines final penalty amount. The issuing officer, the company and the assessment officer all sign the final worksheet and the information is entered into ERIS.

When money related to assessment is received, the administrative assistant immediately enters payment information into the ERIS data base, which again provides for the requirement to maintain a daily itemized log of money received and provides a deposit slip that is immediately forwarded to accounting along with the payment. Accounting then e-mails a deposit receipt to the administrative assistant to confirm the deposit. All information is then printed out and a hard copy is retained for each individual assessment, allowing for review by the Assistant Director.

This clearly shows that the process is segregated with the enforcement staff, administrative staff, and administrators responsible for the process.

- There is no reconciliation between what is posted in ERIS and what is deposited in WVFIMS.
The DEP has begun implementing procedures to reconcile ERIS and WVFIMS records.

Spending Unit's
Response:

The DEP responses are listed above.

Plan for
Corrective Action:

To correct the agreed upon portions of this finding, the DEP will implement actions as stated above.

Finding 2

Lack of Documentation & Updating Records for Approx. \$17 Million of Insolvent Surety Bonds

Spending Unit's
Response:

The DEP disagrees with this finding.

Reliance Insurance Company, including its subsidiary United Pacific Insurance Company, was declared insolvent on October 3, 2001 in the courts of the State of New York. The DEP's research, however, indicates that Travelers Insurance Company acquired the surety and fidelity business of Reliance and subsidiaries in May, 2000 and that, since that acquisition, Travelers has been liable on bonds issued by United Pacific. Travelers remains solvent. Accordingly, the active United Pacific bonds DEP holds do not appear to be "worthless", as the finding states. A review of the DEP's records reveals that Travelers had issued a rider affirming its liability on all but twenty (20) of the United Pacific bonds the DEP held. To assure there is no dispute as to the liability on these twenty bonds, the

DEP requested that the mining companies involved either supply the agency with a rider from Travelers, formally affirming its liability, or provide other evidence of bond coverage. The DEP has since received riders from Travelers affirming liability on all United Pacific bonds or substitute bond coverage for all amounts bonded by United Pacific, except for four bonds. For these four bonds, Travelers has provided a letter affirming that it is providing bond coverage.

Plan for

Corrective Action: *The DEP has acquired the 20 riders mentioned above or received a letter affirming evidence of bond coverage.*

Finding 3

Lack of Safeguarding Certificates of Deposit & Letters of Credit

Spending Unit's

Response:

The DEP disagrees with this finding. The title of this finding is very misleading. The situation described is not an issue of the DEP failing to follow the statutes and regulations governing these types of bonds or a failure to maintain accurate records on these types of bonds. Instead, the issue Legislative Post Audit identifies is a risk associated with the way the law, itself, is written. In this regard, it should be noted that State law in this area is substantially the same as the parallel provisions in federal law. The risk identified by Legislative Post Audit with the limits of FDIC coverage exists only when a bond in the form of either a letter of credit or a certificate of deposit is forfeited by a mine operator AND the banking institution that has issued the letter of credit or certificate of deposit is also insolvent. The DEP has taken measures to minimize this risk within the current law and regulations. In the past, when it has learned that an obligor on any type of bond has become insolvent, the DEP has acted promptly to require permit holders to provide replacement bond coverage. Occasions in which a bond has been forfeited and the bond obligor has been insolvent have been rare. When this has occurred, the DEP has protected the State's interest by making claims in the legal insolvency proceedings and, as a result, obtaining payment of a portion of the bond proceeds.

The Legislature has mitigated the risk to the State from concurrent bond forfeiture and bond obligor insolvency by establishing what is known under the surface mining laws as an "alternative bonding system". Under this system, the State is protected against the liability resulting from a bond forfeiture by both the proceeds of the bonds associated with a bond forfeiture and a bond pool known as the Special Reclamation Fund which is supported by fees paid by the coal industry on coal production. The alternative bonding system represents an acknowledgement that bond proceeds by themselves will be insufficient to cover the liability associated with bond forfeitures and must be supplemented by money from the Special Reclamation Fund. To assure that this fund remains adequately funded, the Legislature has established the Special Reclamation Advisory Council which makes recommendations for adjustment in the rates paid by the coal industry based on advice from experts in business trends in the coal industry and actuarial studies.

Plan for

Corrective Action: *The DEP will implement any changes in the law that the Legislature decides are necessary to reduce the risk to the State and the DEP, if it is determined that the*

- j) **No physical inventory of bonds is taken and no reconciliation of actual bonds to the bonds recorded in ERIS is performed.**

We strongly disagree that DEP is unable to determine that all coal companies have posted the required bonds. The agency has required bond instruments to be in place before any permit is approved.

Random bond file to ERIS reconciliation is done at the time any changes to the permit require a change in the bond. We will implement procedures to reconcile ERIS with the bond file when any change is made to the permit that affects the bond and at permit renewal time. Reconciliation between ERIS and the WV State Treasurer's office is conducted on a quarterly basis.

- k) **Unable to determine the amount of pending bond instruments associated with mining permits waiting for approval because bonds are accepted at field office locations and forwarded to the Charleston office to be filed and no pending list is maintained.**

The DEP agrees with this finding and has begun maintaining an inventory of pending/on-hold bond instruments.

- l) **Unable to determine if cash, official checks, etc. received were deposited within 24 hours due to DEP not maintaining a daily receipt log in accordance with statute.**

The DEP agrees with this finding and has begun implementing the Safekeeping Policy developed by the Fiscal Office of the DEP.

- m) **Premature cashing of bond instruments without DEP's knowledge.**

The DEP agrees with the part of the finding that two bonding instruments were cashed by a mining company without the DEP's knowledge. We disagree that this requires any change in procedure or additional safeguards. This situation involved wrongful, and possibly illegal, acts by the individual with the mining company, a bank employee or both. Existing procedures enabled the DEP to replace these bonds.

- n) **There is an overall lack of oversight and monitoring.**

The DEP disagrees with this finding. See discussion above.

Spending Unit's
Response:

See responses above to individual items.

Plan for
Corrective Action:

To correct the agreed upon portions of this finding, the DEP will implement actions as stated above.

Finding 6

Unable to Determine Adequacy of Bond Amounts

Spending Unit's
Response:

The DEP disagrees with this finding. The analysis conducted by Legislative Post Audit does not indicate their understanding of the complexity of bonding for surface mine permits. As indicated by its footnote to this finding, Legislative Post Audit has simply multiplied the permit acreage listed in one field of the ERIS database by the bond rate listed in another field of the ERIS database and compared the result to the dollar amount listed in a third field in the ERIS database, ignoring information on different phases of bond release that had been granted, bond releases granted on permit increments, permit revisions or amendments, incremental bonding and the existence of multiple bonding instruments covering an individual permit.

Legislative Post Audit has spent months conducting this analysis of the bonds for over two thousand permits. It has continually revised its findings and the numbers of permits and bonds it claims to have analyzed – giving the DEP a moving target for an agency response. The final version of this analysis provided the DEP limited time to respond. The DEP began to respond by analyzing the twenty largest alleged deficiencies Legislative Post Audit claimed to have found. These twenty deficiencies totaled \$68,392,064.08, according to Legislative Post Audit's analysis at the time. In performing its analysis of these twenty items, the DEP identified a deficiency in bonding of \$2,880. This resulted from a failure to apply the proper bonding rate to a single acre on a single permit, likely from rounding the permit acreage down to the next lower whole number where the permitted acreage includes a partial acre instead of rounding it up to the next higher acreage, as the law requires. The bond on all of the other nineteen permits the agency examined was correctly calculated.

In the case of the largest alleged deficiency Legislative Post Audit identified, \$21,200,000 on a permit for an underground mining operation, the acreage listed in ERIS and used by Legislative Post Audit is 10,000 acres. This results from an obvious data entry error in ERIS. The actual permit acreage for this permit is ten acres. Utilizing this permit acreage and the proper bond rate per acre, the DEP is holding precisely the correct amount of bond for this permit. On four of the twenty permits with the largest alleged deficiencies, Legislative Post Audit appears to have not included the total of all bonding instruments that serve as bond on these permits in its analysis. If the total value of all instruments comprising the bond for these permits is considered, the bond amounts the DEP is holding for these permits are adequate. On the other fifteen of the permits with the largest alleged deficiencies, Legislative Post Audit did not take into account that some phase of bond release had been granted on all or some increments of the permit. The DEP's bond release files contain detailed calculations supporting the current bond amounts on these permits. The auditors neither requested nor reviewed the files containing this information.

Based on the results of its review of the work Legislative Post Audit has done, the agency does not believe a broader effort on its part to check the analysis of Legislative Post Audit on the remaining couple thousand permits it examined would be a good use of agency resources. This is particularly so in light of the

existing requirement of law that the agency verify that the existing bond is adequate at the time of permit renewal, which occurs every five years for all surface coal mine permits.

Plan for

Corrective Action: *The DEP will re-examine the bond calculations for each permit at permit renewal, consistent with the law. In addition, the DEP will re-examine the bond amount sooner for any permit for which there is a permit revision being sought which will require the DEP to re-examine the bond amount.*

Finding 7

Significant Weaknesses over Self-Bonding

- DEP does not have official or written procedures for processing self-bonds;

The DEP's Fiscal Office has Standard Operating Procedures (SOP) for its duties and has a SOP for the determination of qualifications of self-bonding. The DEP's Division of Mining and Reclamation intends to draft a SOP to clarify the proper procedures for processing self-bonds.

- DEP does not have official or written procedures for how a self-bond would be processed in the event of forfeiture;

The DEP has written procedures for bond forfeitures in general. In the event of forfeiture of a self-bond, the same process for forfeiture of any type of bond would be followed, beginning with a demand for payment by the bond obligor. In addition, there is guidance on bond forfeiture in the Self Bond Indemnity Agreement IV.C. (on page 3) and in the Self Bond Corporate Guarantee V.C the DEP utilizes.

- DEP was unable to provide us with documentation showing the DEP Cabinet Secretary signed off to approve any form of application by a company to obtain self-bonding;

The law does not provide for an application and approval process for the DEP to follow that is specific to self-bonding. The DEP Secretary's acceptance of a self-bond occurs when the agency approves a permit application which identifies the bonding mechanism as self-bonding in the permit application. As with other forms of bonding, permit applications which contemplate self-bonding are not approved until after the Attorney General has approved the agreements establishing the self-bonding arrangement as to form.

- One guarantor did not have the required affidavit certifying that the agreement is valid under all applicable State and Federal laws;

This alleged deficiency is immaterial because this guarantor has provided substantially the same certification in Self Bond Corporate Guarantee form section XV (on page 5), which states "This

Corporate Guarantee is a binding contract and shall be construed under and subject to the laws of the United States of America”.

- DEP stated the Attorney General does more than approve the Self-Bonding Application as to form;

The DEP assumes that the Attorney General performs the duties required of him by law when he approves bond instruments as to form. After his approval of self-bonding documents as to form, the DEP regards the self-bond as available for use as a bonding mechanism for permits sought by the obligor or its affiliates that are addressed in the self-bonding documents, in amounts up to the ceiling for self-bonding capacity established by the agreements.

- DEP considers leasehold rights in their analysis of tangible net worth, when leasehold rights are intangible;

The DEP’s practice of considering coal leasehold rights as tangible assets in the determination of tangible net worth is consistent with accounting practices in the coal industry that are supported by independent audits of the books of coal companies that are engaged in self-bonding. For example, the books of the company with the largest self-bonding capacity in West Virginia, Alpha Natural Resources, include leasehold coal interests along with “owned” coal in its tangible net worth. The practice has not been questioned by the national accounting firm which performed the last independent audit of Alpha, KPMG LLP. The DEP’s reliance on the accounting practices reflected in these audited financials is also supported by the fact that the same audited financials (audited by KPMG LLP) which the DEP evaluates in determining Alpha’s self-bonding capacity form the basis of Alpha’s reporting of its financial condition to the Securities Exchange Commission in accordance with federal securities laws.

- There is a lack of proper oversight over the application process, the financial evaluation process, and the actual bonding process;

The DEP disagrees. See, all other DEP responses to this finding.

- Changes to self-bonds are made via email, telephone conversation, etc.;

The DEP employees may discuss potential changes in self-bonding arrangements with representatives of industry via email and telephone conversations, but no actual changes are made unless they are properly reflected in the records of the DEP and in accordance with self-bonding documents that have been approved by the attorney general.

- Self bonds are riskier than other securities;

The observation is made without any supporting documentation and appears to be purely a matter of opinion. It is not borne out by the DEP's experience. The DEP has yet to be unable to collect on a forfeited self-bond. By contrast, the DEP has seen both surety companies that were obligated on bonds and banks that were obligated on bonds become insolvent.

- Upon the merger of two guarantors, DEP allowed the transfer of self-bond amounts from one company to the other without approving the application for the required new amount of self-bonding;

The DEP believes Legislative Post Audit is referring to the Massey-Alpha merger. Massey and Alpha both met the requirements for self-bonding before the companies were merged and both were well within the self-bonding capacity provided by their respective self-bonding agreements, \$250,000,000 for Massey and \$125,000,000 for Alpha. DEP's review of Alpha's unaudited balance sheets of 6/30/11, just following the merger, indicated they met the requirements for self-bonding for the merged companies in the amount Alpha is seeking, \$375,000,000. Alpha's pending self-bond agreement gives it a self-bonding capacity of \$375,000,000. The amount applied against the self-bonds when DEP did the review of their 6/30/11 statements was \$112,881,386 for Massey and \$73,165,783 for Alpha (\$186,047,169, combined). The amount may have decreased since the auditors review to the amount listed.

- DEP did not require the acquiring company to post adequate bonds until the self-bond could be approved; and

Again, the DEP believes Legislative Post Audit is referring to the Massey-Alpha merger. Massey and Alpha both met the requirements for self-bonding before the companies were merged and both were well within the self-bonding capacity provided by their respective self-bonding agreements. DEP's review of Alpha's unaudited balance sheets of 6/30/11, just following the merger, indicated it met the requirements for self-bonding for the merged companies. Alpha's pending self-bond agreement is \$375,000,000. The amount applied against the self-bonds when DEP did the review of their 6/30/11 statements was \$112,881,386 for Massey and \$73,165,783 for Alpha (\$186,047,169, combined). The amount may have decreased since the auditors review to the amount listed. The DEP is in the process of substituting Alpha-guaranteed bonds for those guaranteed by the Massey organization. The self-bonds that were guaranteed by the Massey organization, for which Alpha-

guaranteed self-bonds have not been substituted, remain valid and in full force and effect.

- According to the DEP bond listing, DEP currently holds \$174,643,488.67 in self-bonds from one single guarantor.

Again, the DEP believes Legislative Post Audit is referring to the Massey-Alpha merger. Alpha's pending self-bond agreement is \$375,000,000. The amount applied against the self-bonds when DEP did the review of their 6/30/11 statements was \$112,881,386 for Massey and \$73,165,783 for Alpha (\$186,047,169, combined). The amount may have decreased since the auditors review to the amount listed.

- Based on information obtained during the audit, DEP would likely be considered a general creditor/lien holder in any court proceeding and probably would only be able to recover little, if any of the amount of self-bond in the event of forfeiture.

See DEP's response to Finding 3.

Spending Unit's
Response:

The DEP responses are listed above.

Plan for
Corrective Action:

The DEP will document and implement standard operating procedures.

Finding 8

Inaccurate Estimated Liabilities

Spending Unit's
Response:

The DEP disagrees that the finding accurately distinguishes between the history of the forfeited permit site backlog and the current reclamation status. Many of the previous liability estimates have since been replaced by actual expenses in the financial data as the backlog of sites were successfully reclaimed. The DEP and the SRFAC also addressed the liability estimate issue by utilizing a "variance" statistic. Further, the DEP staff has no means to predict a variety of expenses such as snow removal or flood damage, etc. It should also be noted that the accuracy of the liability estimates are impacted by the state of the economy at the time of the reclamation that influences the competitiveness of the actual contract price.

The DEP has an OSM approved Alternative Bonding System that does not rely exclusively on reclamation bonds, and further has statutory limitations on bond amounts.

The DEP has provided the SRFAC and the Actuary with costs related to the NPDES permits.

Plan for

Corrective Action: *The DEP will continue to improve record keeping practices and continue to evaluate liability estimate methodologies with the SRFAC input.*

Finding 9

Discrepancies of Bond Inventory Records

- Two bonds had inconsistent amounts on the bond listing, supporting documentation, and ERIS comments;
The DEP assumes this bullet refers to previous information supplied by Legislative Post Audit for LCC West Virginia LLC and Hobet Mining LLC. For LCC West Virginia, the Legislative Post Audit proposed finding stated: "Permit D008082, Bond ID 036681, LCC WEST VIRGINIA, LLC, had inconsistent amounts on the bond listing, supporting documentation, and ERIS comments." For Hobet Mining LLC, the Legislative Post Audit proposed finding stated: "Permit S500396, Bond ID A56575, HOBET MINING LLC, had inconsistent amounts on the bond listing, supporting documentation, and ERIS comments."

According to the DEP's records, a series of orders entered by a United States Bankruptcy Court in Kentucky authorized and required a trust fund to serve as bond for two permits held by LCC West Virginia LLC, permit nos. D008082 and D008882. Copies of the documents establishing this trust fund are in the bond files for these permits. This arrangement is also reflected in a comment in ERIS for each of these permits.

According to the DEP's records, the Hobet permit has 4 active bonds. The one listed above is a cash bond. The other three bond instruments are in the form of surety bonds. In 2004, the permittee had bonds posted that were in excess of the required bond amount by \$500,000. At that time, the cash bond, then in the amount of \$2,033,360, was reduced by \$1,500,000. At the same time, a rider was added to an existing surety bond, Bond ID 1005564, that increased the amount of this surety bond by \$1,000,000, resulting in complete bond coverage for this permit. This is all shown in the bond file for this permit. The information in ERIS is consistent with what is shown in this bond file.

- One bond on the bond listing for which DEP indicated there was actually no bond for the permit;
The DEP assumes this bullet refers to the following information previously supplied by Legislative Post Audit: "Permit Q009073, Bond ID NONE, PACIFICO STONE QUARRY INC, was on the bond list, but it was indicated by the DEP that there is no bond for the permit."

The DEP's records indicate that this is a quarry permit that was issued in 1973 when no bond was required for quarries. This permit was revoked in 2000 before a bond was required for it.

- One bond on the ERIS bond listing had supporting documentation in the permit file for a different bond:

This bullet does not provide enough information for the DEP to be able to form a response. The DEP believes that, as is the case with all other bonds Legislative Post Audit has identified issues with, there is accurate information in the DEP's files with respect to this bond.

- One bond totaling \$10,000 had documentation, but the bond was not on the ERIS bond listing or the ERIS database:

The DEP assumes this bullet refers to the following information previously supplied by Legislative Post Audit: "Bond ID SU-1572290, NATIONAL MINES CORP, was pulled randomly from the DEP file cabinet and traced back to the bond listing. This bond had documentation, but was not on the bond listing and had no permit information in the DMR database. The company name is in the ERIS DMR database; however, all other fields are blank making it appear the company put up a bond, but never received a permit. Thus, there is a possibility that the company may be mining without a permit."

All permits held by National Mines Corp. have been completely released for years. The DEP's records reflect this.

- 24 bonds totaling \$2,134,540 which had either been updated with riders or released, but it was not reflected in the bond listing;

This appears to be a data entry issue with the ERIS database. The DEP believes its official files for each of these bonds contain accurate information.

- Several occurrences where the Bond Institution Party Name was entered as the company that wrote the check and several instances where it was entered as the bank from which the company wrote the check;

In each case in which a check has been accepted as a bond, the bond has been a cash bond. In each case, the DEP believes its bond files contain accurate information. Where the State is holding cash as a bond, the differences in the way ERIS entries are made for Bond Institution Party Name are immaterial.

- Self bonds were listed as Self Bond by Company and did not specify the guarantor; and

The DEP believes its files for self-bonding situations accurately identify any guarantors. That ERIS does not include a field for specification of a guarantor does not diminish the accuracy of the agency's official records.

- There was an inconsistent use of the terms Official Check, Company Check, etc.

In each case in which a check has been accepted as a bond, the bond has been a cash bond. In each case, the DEP believes its bond files contain accurate information. Where the State is holding cash as a bond, the differences in the way ERIS entries are made for Official Check versus Company Check are immaterial.

Spending Unit's
Response:

This finding appears to be similar to a previous proposed finding Legislative Post Audit identified for the DEP in Memo DLR-258. In proposed Finding 2 of this Memo, Legislative Post Audit similarly raised a number of issues in bullet points as to unidentified permittees, permits and bonds. After Legislative Post Audit provided the specifics of its proposed findings, the DEP was able to respond and provided a response to Legislative Post Audit on December 15, 2011. Assuming that the issues this finding addresses are the same as those for which Legislative Post Audit previously provided specific information, the DEP makes the following response.

As a general matter, it should be noted that the primary information resource upon which Legislative Post Audit relied, ERIS, is a database into which information from various DEP files on specific mining permits, permit revisions, bonds and bond release applications has been entered. The ERIS database is maintained for convenience of the agency and the public in compiling information from these and a multitude of other sources in one location. Although the DEP strives to maintain accurate information in ERIS, data entry errors can and do occur. For any particular bit of information, the DEP's source file from which the information in ERIS has come is the agency's official record. In the case of any discrepancies between information in ERIS and the source file(s), the information in the agency's source file(s) should be regarded as the agency's official record.

Some, if not most, of the issues Legislative Post Audit has raised appear to be data entry issues in a complex extensive database that has evolved over time. Other issues Legislative Post Audit has raised appear to result from a misunderstanding of how records are maintained in the extensive ERIS database. DEP has always been willing to assist Legislative Post Audit in obtaining accurate information from the DEP's files. The oral requests made by the Legislative Post Auditors for specific pieces of information were made to lower level employees who, while trying to be helpful, often do not have the full picture of agency operations. These employees have given Legislative Post Auditors what they asked for. Some time ago, the DEP requested that the Legislative Post Auditor's make all their requests in writing to enable the DEP to ask questions so that there was an understanding of the requests and to enable DEP to track these requests. However, the Legislative Post Auditors continued to address its requests for reports and information orally to lower level employees which may have resulted in a misunderstanding of the DEP processes. The purported "error rate" Legislative Post Audit states above appears to stem from a misunderstanding of the DEP's record system and lack of discussion with people

at the DEP who do understand the information database. The DEP's records do not support and, in fact refute, the conclusions made.

Plan for

Corrective Action: *The DEP will continue to work with the Legislative Post Auditors to verify the data.*

Finding 10

Differences in DEP & STO Records

- The STO list had a total of \$16,228,678.83 and the ERIS list had an original amount total of \$16,177,452.99; a difference of \$51,225.84;

The DEP needs to review the STO list to identify and resolve any discrepancies.

- The Bond Issue Date did not match on 10 CDs totaling \$671,732.28;

The DEP acknowledges that data entry errors may exist and we have and will continue to correct any errors. However, we do not acknowledge that the amount of \$671,732.28 is in question.

- The DEP list had nine CDs totaling \$180,233.22 that were not on the STO list:

- One CD totaling \$10,220 appears to be a duplicate in the DEP bond list;

Bond ID 0701112300315 was never a legitimate number. It was entered into ERIS by mistake and will be removed to correct this. Bond ID 07011123003159 is the correct number and is already in ERIS for the correct amount of \$5,110.00

- One CD totaling \$118,000 was not on the STO list due to a glitch in the STO system, but the STO provided us with documentation from the vault;

Our research concurs with this being a glitch in the STO system and our records indicate that both our bond file and ERIS is correct.

- Five CDs totaling \$41,432.81 were released, but never removed from the DEP bond list;

Our records indicate these bonds to be final released and ERIS properly reflects the bonds as being inactive. They should not appear on the STO list as they have been released.

- One CD totaling \$10,080.41, according to DEP, is currently with the DEP legal division; and

This CD should not have been on the STO list because it was being collected by the DEP Office of Legal Services. It was collected on 10/14/2011.

- One CD totaling \$500 was actually a check and it was entered incorrectly on the DEP bond list.
This was erroneously entered into ERIS as a CD and has been corrected
- The STO list had three CDs totaling \$224,620 that were not on the DEP list:
 - One CD totaling \$61,500 DEP has no record of this item ever being entered into the ERIS database and had no supporting documentation, yet documentation was provided by the STO;
This CD is for an obligation not related to the reclamation requirement of permit number S200904.
 - One CD totaling \$2,000 was revoked and removed from the DEP bond list because it was deemed uncollectible, but DEP did not request the STO to remove it from the STO list.
The DEP should have advised the STO of this determination.

Spending Unit's
Response:

While we acknowledge the discrepancies identified above, research of the complete record allowed us to easily reconcile all items specifically identified by the Legislative Post Audit.

Plan for
Corrective Action:

The DEP will continue to reconcile our records to ensure accuracy.

Finding 11

Improper Accounting and Application of Forfeited Bonds

Spending Unit's
Response:

The DEP agrees with the finding of historical DEP practice. The DEP has previously adhered to the Actuary's financial position that "The bond recoveries are considered as an income item rather than an adjustment to the liabilities as the Fund is responsible for the reclamation from first dollar regardless of bond collection."

Plan for
Corrective Action:

To correct this finding, the DEP will determine if the financial system is capable of applying a specific site bond to specific site reclamation.

Finding 12

Noncompliance with W.Va. Code 12-2-2

Spending Unit's
Response:

The DEP agrees with this finding.

Plan for
Corrective Action: *To correct this finding, a Safekeeping Policy has been implemented. The Fiscal Office has worked with sections of the agency to install a check log system and will continue to work with others until all sections are logging checks when received to assure that all receipts are deposited within 24 hours. In addition, the DEP will appoint persons to back up all Division employees who receive payments of any type, so that their mail is opened and deposits are made on a timely basis when these employees are on leave.*

Finding 13 Weakness over Liability Reports

Spending Unit's
Response: *The DEP agrees that the elimination of the historical backlog of site forfeitures will allow for future practices to be improved.*

Plan for
Corrective Action: *To correct this finding, the DEP will implement the Auditor's recommendation.*

Finding 14 Weakness over Inspections and Inspection Reports

Spending Unit's
Response: *The DEP agrees that the inspection reporting system needs updated.*

Plan for
Corrective Action: *To correct this finding, the DEP will complete the development and implementation of an automated inspection reporting system.*

Finding 15 Noncompliance with 180 Day Reclamation Requirement

Spending Unit's
Response: *The DEP agrees that the historical backlog resulted in reclamation schedules that exceeded 180 days.*

Plan for
Corrective Action: *To correct this finding, the DEP will stay committed to the current reclamation schedule that has all site reclamation current in 2015.*

Finding 16 Noncompliance with Reclamation Plans and lack of Documenting Changes

Spending Unit's
Response: *The DEP does not agree that this finding appropriately reflects the practical reality of permit revoked/bond forfeited sites. The permit was revoked for lack of compliance with regulatory requirements quoted in the finding, including the initial reclamation plan. Updated reclamation plans are not needed because DEP does not continue the mine operation, but instead the DEP reclamation practices return the site into compliance with the applicable regulatory requirements, and receive oversight by the Federal OSM.*

Plan for
Corrective Action: *The DEP will continue to reclaim the revoked permits to ensure compliance with applicable regulatory requirements.*

Finding 17 **Lack of Official Procedures**

Spending Unit's
Response: *The DEP agrees that the procedure guidelines and handbooks are in draft format.*

Plan for
Corrective Action: *The DEP will finalize procedure guidelines and handbooks.*

Finding 18 **Weakness Over Legislative Rule §38-2-20**

Spending Unit's
Response: *The DEP agrees that regulations written for active mining operations are not always germane to permit revoked/bond forfeited sites.*

Plan for
Corrective Action: *To correct this finding, the DEP will continue discussion with the Federal OSM to ensure that any proposed regulatory changes will not trigger adverse OSM findings.*

Finding 19 **Noncompliance with Administrative Settlement Agreements**

Spending Unit's
Response: *See response to Finding 1, Administrative Settlements, above.*

The \$250,000 payment described above is an annual minimum payment that is due following the end of a "contract year", as defined in the agreement. The agreement provides that monthly payments made during a contract year are to be credited against the annual minimum payment due for that year. Review of the agency's records reveals that the coal company failed to credit all of the monthly payments it made during the contract year against the \$250,000 annual minimum when it made this annual payment. Accordingly, the coal company overpaid on this annual minimum payment.

The contention that the State lost an undeterminable amount of interest between February 2003 and August 2009 is incorrect. Had the DEP exercised its contractual rights upon forfeiture in 2003, it would have been forced to sell the property in which it holds a deed of trust as security at a "fire sale price" in an auction on the court house steps in Welch. This property is the location of an abandoned coal refuse area. In 2003, the market for the type of coal waste in this refuse area was depressed and astute buyers may have looked upon the property as a net liability, making the property unlikely to sell for any amount approaching what DEP has realized as a result of the wise business decisions it has made regarding the property and this liability, the same decisions which the Legislative Post Audit now questions. DEP has now recovered \$1.4 million as a result of exercising sound business judgment. The DEP now has reason to believe that, in time, it will be able to recover the full \$7.3 million it is due under its agreements. Beyond the benefits to DEP from recovering these sums, there are tax and employment benefits the State will realize and the environmental

benefit from virtually eliminating a huge coal waste pile that should also be considered. In time, this is likely to be heralded as one of the most, if not the most, outstanding examples of successful cost recovery actions on a SMCRA bond forfeiture site in the country.

Plan for
Corrective Action: *The DEP will more closely monitor administrative settlements.*

Finding 20 Noncompliance with Court Settlement Agreement

Spending Unit's
Response: *See, response to Finding 1, Court Settlements, above.*

Plan for
Corrective Action: *Since the full amount of the settlement agreement has been paid, no further action is necessary in regards to this particular agreement. However, to prevent future occurrences of noncompliance with settlement agreements, the DEP has established procedures between the Accounts Receivable section and the program office for notification of monies due and late payments.*

Finding 21 Revenue and Expenditure Misclassification

Spending Unit's
Response: **Revenue Misclassifications**

The DEP agrees with the audited code of 874. This change has been made.

The DEP agrees with the finding on the Coal Tonnage being misclassified. This was a data entry error.

A special revenue code for FOIA requests was distributed on 8/26/09.

Expenditure Code Misclassifications

The DEP agrees with the cause of the expenditure misclassification but disagrees in part with recommendations. The Accounts Payable section audits invoices before they are processed and paid in WVFIMS. The exception to this procedure is the pcard transactions. The pcard coordinator is the party required to audit the financial coding of all transactions that are part of their master statement before the master statement is paid. Corrections to any miscoded pcard transactions are done on a post audit basis.

Plan for
Corrective Action: *To correct this finding, the DEP will implement appropriate actions where necessary.*

Finding 22

Travel Reimbursements Not Submitted Within 15 Days

Spending Unit's
Response:

The DEP agrees with the recommendation. The Accounts Payable section does process all travel in a timely manner once it is received. Emails have been sent reminding employees of the 15 day requirement.

Plan for
Corrective Action:

To correct this finding, the DEP will continue to make travelers aware of the requirement to submit their travel expense forms within 15 days. This includes board members.

WEST VIRGINIA DEPARTMENT OF ENVIRONMENTAL PROTECTION
SPECIAL RECLAMATION FUNDS & FUND 8796
JULY 1, 2009 – JUNE 30, 2010

APPENDIX B

AUDITOR'S COMMENTS ON DEP'S RESPONSE TO AUDIT FINDINGS

Finding 1: Scope Limitation over Revenues Received

Bond Forfeitures

w) Lack of segregation of duties

Although DEP's response mentions four separate employees and what each employee is responsible for, the segregation of duties portion of this finding specifically relates to the Environmental Resources Specialist who is responsible for maintaining records on bond forfeitures and collections. We interviewed the Environmental Resources Specialist over the bond forfeiture process and drafted a 15-page procedural document detailing her job duties and we have documentation from her confirming our understanding. This finding is not applicable to the other three employees mentioned in DEP's response. However, the Environmental Resources Associate responsible for maintaining records of bonds on pending permit applications and active permits also had a lack of segregation of duties and is specifically mentioned in Finding 5. We cannot express an opinion on the adequacy of segregation of duties for the employee who is responsible for entering records into the state and federal databases or the employee who is responsible for querying the database on pending applications because we did not audit the Division of Mining and Reclamation (DMR). We only interviewed certain DMR employees who performed job duties, which directly or indirectly affected the funds under audit.

c) All Show Cause items are not tracked

In our attempt to audit bond forfeitures we tried to obtain an understanding through a procedural interview with the Environmental Resources Specialist over how a permit gets revoked and the bond subsequently is forfeited. It was noted Request for Show Cause (MR-10) packets are prepared by inspectors at the regional offices and are submitted to the Assistant Director of Enforcement at the Charleston office (headquarters) for review. The Charleston office does not track incoming MR-10 packets and only the MR-10s resulting in a Show Cause Order are entered onto the MR-10 log.doc mentioned in the DEP response. Thus, there is a risk items could get lost in the mail. When we asked the Environmental Resources Specialist how would the Charleston office know if a MR-10 got lost or went missing, we were told eventually she would eventually know because the regional offices would call headquarters. This is not an adequate internal control to ensure all MR-10s made it to the Charleston office for review because there is always the possibility the inspector will be occupied with other job duties and will not call the Charleston office.

d) There are two sets of accounting records in addition to WVFIMs and none of them matched the actual deposits posted to WVFIMs

In response to DEP's statement of multiple reports being provided based on the auditor's requests, we requested the records for forfeited bonds and the request did not change. DEP provided a report from ERIS listing the forfeited bonds. We attempted to reconcile the ERIS record provided to WVFIMs and noted the discrepancies listed in the finding above. We informed DEP the ERIS record provided did not match WVFIMs and inquired about the differences. DEP then provided a second ERIS record, which had red text throughout. DEP stated the red text was for the corrected data with the exception of the red text stating 'Remove this Row' for multiple rows. Even when we removed the columns as suggested by DEP, the second record still did not match WVFIMs.

Further, we inquired with the Environmental Resources Specialist in February 2011 to determine if she continued to maintain a separate set of books outside of ERIS and WVFIMs and she said yes and emailed

them to us. We attempted to reconcile the separate set of books provided to WVFIMS and to the ERIS records and none of them matched. We then met with the Chief of the Office of Administration regarding the differences in the both of the ERIS records provided and the 2nd set of books.

Our initial request for records was made on March 1, 2011. DEP provided an ERIS record mid-March. The second ERIS record was received on July 27, 2011. DEP provided us with a 3rd ERIS report, which matched exactly on September 14, 2011.

The statement made by DEP "After DEP was advised as to what the auditors were trying to accomplish, a (3rd) report was provided which, balanced to the amounts in question" is incorrect. We met with DEP and informed them of what we were trying to accomplish before the request for records was made. Providing multiple reports resulted from DEP's inability to produce adequate reports from the ERIS database for the initial document request, not from miscommunication or multiple requests from the auditors.

k) **There is an overall lack of oversight and monitoring.**

Finding 1 specifically **is disclaiming** both Bond Forfeiture Revenues and Fines & Penalties Revenues. Legislative Post Audit did not identify any instances of discrepancies with penalty collection or deposit because we were **unable to audit** those revenue sources due to the significant internal control weaknesses described in the finding. Thus, the audit does not support DEP's statement "nor has it been shown that ineffective management resulted in any shortfalls in either the collection of penalties or bonds ... and no instance of discrepancy with penalty collection or deposit was identified by the Legislative Post Audit."

In regard to DEP's statement "as shown by our ability to validate that adequate bonding was in place as required by the Rules and Act clearly demonstrates that our procedures and the oversight of such were adequate" be it noted:

- Finding 6 states Legislative Post Audit was not able to determine the adequacy of bond amounts. Thus, the audit does not support DEP's statement.
- DEP's statement is irrelevant to this finding because the finding is in regard to bond forfeitures for permits, which have already been revoked and does not have anything to do with validating adequate bonding was in place.

Fines and Penalties

DEP states the numbering system for NOV's is effective; however, there are no internal controls to make sure all NOV's issued are entered into ERIS. Without adequate internal controls, it is possible an inspector could be paid off in order to not enter a potential NOV into the ERIS database without the knowledge of DEP's management. Also, based on the limitations of the ERIS database to generate sufficient, reliable reports for review and the lack of adequate internal controls over the database, we cannot rely on data going in or out of ERIS.

DEP states in their explanation regarding one instance where the violation number on the Civil Penalty Assessments worksheet and ERIS listing of violations did not match that the situation was explained in detail to the individuals conducting the audit. Prior to receiving DEP's final responses, we were never given the explanation DEP provided in the audit report. Previously, DEP used an explanation regarding a

laptop/database issue. However, the response provided does not change the circumstances of the finding.

DEP states we should have used a different tab in the ERIS database to test NOVs issued and assessments paid. We spoke with the Chief of the Office of Administration who directed us to the Administrative Services Manager I in the Division of Mining and Reclamation to get the information we needed to test NOVs. We met with the Administrative Services Manager I to explain exactly what we needed to do in order to test Fines & Penalties and we discussed information, which would be necessary to test NOVs and were told there would be no problem getting this information. DEP provided multiple NOV ERIS reports, which did not contain sufficient information needed for the audit. It took over a month to get an ERIS report that appeared to contain sufficient data in order for us to attempt to audit NOVs issued. We believe there is no additional audit work necessary considering ERIS is not a reliable database because there is a lack of internal controls over the database and the database is limited in its ability to generate sufficient, reliable reports.

DEP did not seem to understand the part of the finding stating there is no segregation of duties over fines and penalties revenue. They responded by giving the entire process for issuing NOVs, assessing penalty amounts, and holding conferences when the company contests the penalty amount. We were solely referring to the collection process, which is handled by only one person, the Administrative Secretary. Our issue is this one person handles the entire collection process from opening the mail, preparing the deposit, entering the deposit into ERIS, and maintaining the records. The information provided in DEP's response is irrelevant to the finding.

Finding 2: Lack of Documentation & Updating Records for Approx. \$17 Million of Insolvent Surety Bonds

The statement "DEP's research indicates that Travelers Insurance Company acquired the surety and fidelity business of Reliance and subsidiaries in May 2000", is inaccurate. Legislative Post Audit's research on the declaration of insolvency for Reliance Insurance Company and all of its subsidiaries yielded an article in an insurance journal on July 20, 2000, which stated 'Travelers Insurance has reached an agreement in principle with Reliance Group Holdings to purchase the renewal rights to a portion of Reliance Insurance Group's commercial lines middle-market book of business.' Upon this discovery we contacted Travelers and they were able to confirm only a portion of Reliance's businesses were purchased by Travelers in 2000. Further, as mentioned above in the finding, 15 of these sureties did not receive replacement coverage from Travelers until December 15, 2011, weeks after Legislative Post Audit informed DEP Reliance was declared insolvent in October of 2001, which, therefore makes the aforementioned sureties appear to be worthless during the period of our audit. There remain five United Pacific sureties, of which, Post Audit has not received any documentation of a rider, release, or replacement from Travelers or any other surety company. Moreover, DEP would have not been aware United Pacific/Reliance had been declared insolvent in 2001 had the Legislative Auditor not informed DEP in a letter to the Cabinet Secretary and the sureties would have remained on the books and in the files as they were, making the aforesaid sureties appear to be worthless.

Finding 3: Lack of Safeguarding Certificates of Deposit & Letters of Credit

The title is not misleading; Part of our audit procedure was to identify areas where the State's interest had a risk of being unprotected. Further, it was our objective to determine whether internal controls are functioning as described. In addition, it should be noted in 2005 there was an instance where a CD totaling \$25,469.43 was forfeited and the bond obligor was insolvent. DEP was unable to

recover this amount from the FDIC because DEP was viewed by the FDIC as a general creditor/lienholder. DEP subsequently deemed this CD uncollectible. As a result of DEP's inability to collect from the FDIC, DEP is not adequately protecting the State's interest.

Finding 4: Vague Authority to Collect Bond Forfeitures and Write-off of Uncollectible Securities

It should be noted a majority of DEP's response is not applicable. DEP's response refers to the DEP response to Finding 1, which cites an ethical opinion that resulted in the addition of W.Va. Code §22-1-6(d)(8). This particular code section is part of our criteria because it conflicts with W.Va. Code §22-3-17(b). Additionally, DEP's in-house counsel is not involved unless the Environmental Resources Specialist actually completing the process of collection encounters a problem. (See Finding 1 regarding issues for lack of segregation of duties)

Finding 5: Weaknesses over Maintenance & Monitoring of Bonds totaling \$905,711,559.89

It should be noted if an adequate reconciliation was conducted quarterly, as DEP states is done, the differences noted in Finding 10 would have been identified prior to our audit. The differences noted in Finding 10 did not occur within the last quarter and the documents do not support DEP's statement.

Finding 6: Unable to Determine Adequacy of Bond Amounts

DEP's response is completely irrelevant. It took Legislative Post Audit less than one week to conduct an attempted analysis of the bond calculation for permits. During that time, we concluded the ERIS database was not a reliable source of information over bonds because there is a lack of internal control over the database itself as well as the data entry process, no adequate reconciliation of bonds is performed, the ERIS record did not reflect phase releases, and a lack of updating ERIS records to match the source files. In addition, the ERIS record does not accurately reflect DEP's statement that ERIS did not contain any bonds under \$10,000 in accordance with the requirement of a \$10,000 minimum bond, but we noted at least five instances where mining permits did not meet the \$10,000 minimum requirement in the ERIS record provided. Thus, it did not take Legislative Post Audit months to conduct an analysis as DEP states.

Further, the 20 largest deficiencies DEP refers to in the DEP response were never alleged by Legislative Post Audit to be issues. Had DEP looked at all information provided by Legislative Post Audit, on at least three separate occasions, they would have been able to identify Legislative Post Audit did in fact take into account the existence of multiple bonding instruments covering individual permits. Also, DEP states they were given "a moving target for agency response", which is not the case because DEP did not adequately communicate with Legislative Post Audit resulting in two different analysis calculation reports, one with quarry permits and notices of intent to prospect and one without. Furthermore, upon reviewing phase release documentation provided by DEP, it appeared the bond was calculated incorrectly when it was posted with the permit application. Thus, Legislative Post Audit attempted to analyze the original bond amount in the ERIS record by multiplying the original rate by the original acres and comparing it to the original bond amount and still found multiple discrepancies. Based on the discrepancies noted, the inability to generate sufficient, reliable data, and the lack of internal controls over the ERIS database, Legislative Post Audit removed all calculations and reworded the finding to be a disclaimer. Finally, in regard to DEP's statement "... the acreage listed in ERIS and used by Legislative Post Audit is 10,000 acres. This results from an obvious data entry error in ERIS", it should be noted

Legislative Post Audit can only audit the information provided by DEP and cannot make assumptions regardless of how 'obvious' something in the record may seem.

Finding 7: Significant Weaknesses over Self-Bonding

It should be noted the guidance on bond forfeiture in the Self-Bond Indemnity Agreement IV.C. does not explain the detail for the forfeiture process, therefore, it is not official written procedures for the self-bond forfeiture process. Also, DEP seems to avoid the issue of changes being made to self-bonds via email, telephone conversation, etc. Legislative Post Audit is not saying the changes are not reflected as DEP responds, Legislative Post Audit is simply stating there is not a formal request from the company documenting changes made. Since self-bonding is solely based on each company's financial statements, when two companies merge, each company's financial status changes. Therefore, a new application should have been required to be approved before the acquiring company's approved self-bonding amount was increased. The approval amount of one company cannot be added to the acquiring company because the financial status changed during the merger. In regards to the referenced Finding 3 in DEP's response, see the Auditor's comment to Finding 3.

Finding 8 Inaccurate Estimated Liabilities

In regard to DEP's statement "The DEP and the SRFAC also addressed the liability estimate issue by utilizing a "variance" statistic" be it noted:

- There were two "variance" records. One record deleted 10 bond forfeited sites completely from the "variance" listing and the other record included those 10 bond forfeited sites. We were **unable to recalculate** DEP's figures for either record.
- Some of the sites DEP excluded did not fall outside of two standard deviations of the mean and should not have been excluded, while other sites, which fell outside of two standard deviations, were not excluded.
- The amounts are stagnate and the sites DEP has identified as 'outliers' remain the same each quarter, making the "variance" ineffective. Further, the "variance" is not a true variance because as new sites are added the mean would be changing as would two standard deviations of the mean, ultimately changing the 'outliers.'
- DEP first told us the variance was built into the Cash Flows, but later told us it was just used for job scheduling. Thus, we are unable to determine the true purpose of the "variance" statistic.

In regards to DEP's statement "the DEP staff has no means to predict a variety of expenses such as snow removal or flood damage, etc." be it noted:

- Flood damage is not mentioned anywhere in the finding and is not relevant to the weaknesses identified.
- We reviewed other states to see how they handled environmental liabilities and some states had as many as 20-page estimate forms, which factored in heavy equipment rentals, water analysis, and other pertinent reclamation costs.
- Based on the extent of the damage involved, location, and the knowledge obtained from reclaiming other sites, DEP should be able to determine a more accurate estimate, which includes pertinent reclamation costs.

Finding 9: Discrepancies of Bond Inventory Records

Overall, a majority of DEP's response to this finding is not relevant. This finding is specifically regarding instances where the ERIS records and the agency source file **do not** match. No reasonable explanation provided by DEP would change the facts of the finding, which identifies the discrepancies found in comparing the ERIS records to the sources files. Furthermore, oral requests were rare and there were less than five instances. Legislative Post Audit issued 83 request memos, of which, were either sent directly to the agency delegated contacts, the Controller and/or the Chief of Administration at DEP, or the contacts were carbon copied (cc) on the memo. Also, DEP stated Legislative Post Audit went directly to the 'lower level employees' when in fact, Legislative Post Audit was sent to said employees by Legislative Post Audit's aforementioned contacts. Further, it should be noted there is a difference between what management believes is being done and what the person performing the work is actually doing. DEP's statement "the purported "error rate" Legislative Post Audit states above appears to stem from a misunderstanding of the DEP's record system and a lack of discussion with people at the DEP who do understand the information database" is incorrect. The error rate used by Legislative Post Audit was a simple calculation: we reviewed 74 bonding instruments of which 53 had issues, 53/74 gives an error rate of 72%. Further, DEP's statement "the DEP's records do not support and, in fact refute, the conclusions made" is incorrect. Based on the evidence obtained from both ERIS and the DEP source files this finding is adequately supported.

In regard to DEP's statement "as a general matter, it should be noted that the primary information resource upon which Legislative Post Audit relied, ERIS, is a database into which information from various DEP files on specific mining permits, ... The ERIS database is maintained for convenience of the agency and the public in compiling information from these and a multitude of other sources in one location. Although DEP strives to maintain accurate information in ERIS, data entry errors can and do occur. For any particular bit of information, the DEP's source file from which the information in ERIS has come is the agency's official record. In the case of any discrepancies between information in ERIS and the source file(s), the information in the agency's source file(s) should be regarded as the agency's official record" be it noted:

- Based on the current audit and on previous Post Audits of DEP, Legislative Post Audit has identified a significant weakness in DEP's ERIS database. Based on the limitation of the ERIS database to produce relevant, reliable reports, the lack of internal control over the ERIS database, and lack of internal control over the employees who enter information into the database make it an unreliable system, of which Legislative Post Audit must disclaim.
- A system of convenience, which is not continually updated as the source files are updated, cannot be considered a form of reliable information to provide to outside sources. Thus, information from the system should not be provided to the public, the Legislature, the Federal government, the Special Reclamation Fund Advisory Council, etc. to use the information to make decisions affecting the Special Reclamation Funds, the State, etc. until controls are in place to ensure the information entered into the database is reliable.

In regard to DEP's response to the first item regarding two bonds with inconsistent amounts on the bond listing, supporting documentation, and ERIS comments, the majority of DEP's response is not applicable. The statement that says "information in ERIS is consistent with what is shown in this bond file" is incorrect. A cash bond totaling \$861,197 was received by DEP and was separated out between two permits, one permit was assigned \$1.00 and the other permit was assigned \$861,197 (the entire

amount). The comments in ERIS for both permits state a dollar amount of \$860,197, which is off by \$1,000.

DEP's response to the second item regarding the bond where there was not a bond required is also not applicable. Legislative Post Audit's issue with this item was it was on the active bond listing although the permit was revoked. DEP's response to the third item regarding the bond with supporting documentation in the source file for a different bond is not accurate. Legislative Post Audit provided detailed information in memo DLR-258 to DEP on every inconsistency noted. Although DEP stated "the DEP believes that, as is the case with all other bonds Legislative Post Audit had identified issues with, there is accurate information in the DEP's files with respect to this bond", DEP failed to provide documentation for the bond in question.

Further, DEP's response to the fourth item regarding the bond in the cabinet and not on the ERIS bond listing is completely irrelevant. Upon request, DEP provided us ERIS documentation, of which DEP stated belonged to the bond in question. However, the ERIS document provided was for a notice of intent to prospect, which was released before the bond in question was ever issued by the surety company. Thus, we know the ERIS document provided was not for the bond in question.

Also, in the seventh item, although DEP's response states "ERIS does not include a field for specification of guarantor", ERIS does include a field for responsible party and the guarantor is the responsible party for self-bonds.

Finding 16: Noncompliance with Reclamation Plans and lack of Documenting Changes

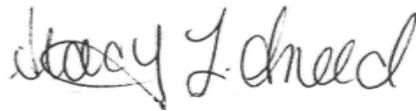
DEP's response is not applicable. Post Audit's issue is changes to the reclamation plans were not documented.

STATE OF WEST VIRGINIA

OFFICE OF THE LEGISLATIVE AUDITOR, TO WIT:

I, Stacy L. Sneed, CPA, CICA, Director of the Legislative Post Audit Division, do hereby certify that the report appended hereto was made under my direction and supervision, under the provisions of the West Virginia Code, Chapter 4, Article 2, as amended, and that the same is a true and correct copy of said report.

Given under my hand this 6th day of January 2012.



Stacy L. Sneed, CPA, CICA, Director
Legislative Post Audit Division

Notification of when the report was released and the location of the report on our website was sent to the Secretary of the Department of Administration to be filed as a public record. Report release notifications were also sent to the Special Reclamation Fund Advisory Fund Council; West Virginia Department of Environmental Protection; Federal Office of Surface Mining; Pinnacle Actuarial Resources, Inc.; Governor; Attorney General; and State Auditor.