OBM | Office of Internal Audit

Department of Natural Resources
Coal Mining Program Audit

Audit Period: January through December 2017

Results Summary:

Objective	Conclusion*
Initial Bonding	**Well-Controlled**
Coal Severance Revenue	**Improvement Needed**

* Please refer to Appendix A for classification of audit objective conclusions.

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Executive Summary

Background

The Ohio Department of Natural Resources (DNR) is charged with overseeing the use, preservation, and conservation of the State's natural resources through a wide variety of recreational and regulatory programs. The mission of the Division of Mineral Resources Management (DMRM) is to provide for the safe and environmentally sound development and restoration of mineral and fossil fuel extraction sites. Program and support services include permitting, bonding, inspection, enforcement, mine safety rescue support and training, hydrology, soils, blasting, archaeology, engineering, design, information technology and administrative support. Funding for the Division's programs comes from severance taxes on coal and industrial minerals, federal grants, general revenue funds, fees, fines, bonds and reimbursements.

State law requires Ohio mine operators to have a state-issued permit to mine coal in Ohio. There were 201 issued coal permits as of December 2017, per the DNR website. After DMRM approves an application, but before a permit is issued, the operator must provide a performance security guaranteeing reclamation to the standards of the Ohio Revised and Administrative Codes. Performance securities provide financial resources to reclaim a site if a mine operator fails in their responsibility to properly reclaim the land under conditions of the permit. DMRM collects the forfeited bond monies from the mine operators and then contracts with a third party to reclaim areas. During 2017, the DMRM collected and deposited 78 bond receipts totaling $17 million.

Coal production tonnage has continued to decrease over the last five years. Coal production in tons for 2015 was 17,303,128 and for 2016 was 15,991,883. Coal Severance Tax Revenues for 2015 were $4.9 million and for 2016 were $3.7 million.

During the audit, OIA identified opportunities for DNR to strengthen internal controls and improve business operations. OIA conforms with the *International Standards for the Professional Practice of Internal Auditing*. OIA would like to thank DNR staff and management for their cooperation and time in support of this audit.

This report is solely intended for the information and use of agency management and the State Audit Committee. It is not intended for anyone other than these specified parties.

Scope and Objectives

OIA staff was engaged to perform an assurance audit related to the controls over DNR's coal mining program. This work was completed December 2017 through March 2018. The following summarizes the objectives for the review:

- Evaluate the design and effectiveness of controls over initial bonding.

- Evaluate the design and effectiveness of controls over coal severance revenue.

Detailed Observations and Recommendations

The Observations and Recommendations include only those risks which were deemed high or moderate. Low risk observations were discussed with individual agency management and are not part of this report. However, the low risk observations were considered as part of the audit objective conclusions.

Observation 1 – Lack of Reconciliation of Quarterly Coal Tonnage Reports, Annual Reports and Severance Tax Paid

Ohio Revised Code (ORC) § 5749.06 (1) states: a separate return shall be filed for each calendar quarter, or other period, or any part thereof, during which the severer holds a permit or has registered, or is required to hold the permit or registration, or during which an owner is required to file a return. The return shall be filed on or before the fifteenth day of the second month following the end of each return period.

A well-designed system of internal controls includes procedures to ensure completeness and accuracy of data received. Reconciliations are necessary to help ensure various records are in agreement and to aid in operating effectiveness.

The DNR Division of Mineral Resources Management (DMRM) is responsible for the monitoring of the Coal Regulatory Program. Coal permittees are responsible for filing applicable severance tax returns with the Ohio Department of Taxation (TAX) based on coal tonnage severed, as well as filing annual reports with DMRM.

DMRM does not reconcile the active coal permit data to severance tax returns to ensure all required coal permittees are filing.

Additionally, DMRM does not reconcile the coal tonnage reported on severance tax returns filed to the coal tonnage reported on annual reports to ensure the accuracy of the coal tonnage reported by the permittees.

Formal policies and procedures to outline completion of a reconciliation of coal permittees to the required severance tax returns and annual reports do not exist.

During our review and comparison of the active coal permits to the severance tax returns filed and annual reports filed, the following exceptions were noted:

- 61 out of 103 (59%) active coal permittees did not file severance tax returns.
    - 21 out of 61 (34%) active coal permittees not filing severance tax returns were prep plants or refuse sites, which should not be mining coal per DMRM. However, three prep plants/refuse sites filed severance tax returns and/or paid severance tax.

Comparing the coal tonnage reported on the severance tax returns to the annual reports filed can be difficult since the annual reports are filed based on the anniversary of the permit issuance date and the coal severance tax returns are filed based on calendar year quarters. OIA could not quantify the potentially unpaid coal severance tax due to the nature of how the coal tonnage is reported on the annual reports filed. However, OIA tested a sample of permittees and compared the average quarterly coal tonnage reported on the severance tax revenue returns to the average annual report quarterly tonnage to determine if the amounts appeared reasonable. The following discrepancies were noted:

- Average annual report tonnage compared to average severance tax quarterly tonnage resulted in annual reports showing approximately 36% more coal tonnage reported compared to the quarterly severance tax returns. Five out of 11 (45%) annual reports reviewed had a greater than 10% difference in coal tonnage reported on the annual reports compared to the quarterly severance tax return filings.

Failure to reconcile increases the risk of undetected fraud or errors, uncollected severance tax revenue, and inaccurately reported coal tonnage.

Recommendation

Develop and implement a formal procedure for comparing the coal severance tax quarterly tonnage reports to the annual reports to ensure filings are reasonable.

- When comparing the coal tonnage, the quarterly severance tax returns that match the closest with the annual filing dates should be used to check the reasonability of the coal tonnage reported on the severance tax returns filed. Also, DMRM should look for anomalies on the coal tonnage reports that could indicate underreporting.
- Consider developing and implementing a quarterly tonnage reporting form requiring the coal permittees to use that is based on the calendar year to help to reconcile the coal tonnage claimed on the severance tax returns.

Develop and implement a formal procedure for comparing the coal severance tax quarterly tonnage reports to the master permit list to ensure all permittees are registered and filing the required severance tax returns. Also, procedures should indicate the steps to take if discrepancies are found (i.e., who to contact at TAX to notify non-filing coal permittees, what should be provided to TAX as verification, etc.).

- DMRM should investigate the active permittees who are currently not filing severance tax returns to determine if they should be filing returns. Also, work with TAX to get the severance tax accounts registered.

Procedures should detail the timing of the review and how to maintain evidence of the reconciliations performed.

Consider working with the DMRM coal inspectors to verify the accuracy of coal tonnage reported by the permittees since they are more aware of coal mining site activity.

Management Response

The ODNR, Division of Mineral Resources Management (DMRM) plans to develop formal procedures for comparing quarterly severance reports from the Ohio Department of Taxation (ODT) with mining reports required by DMRM. DMRM will coordinate with ODT to compare permits lists to verify that all permits requiring severance reports are accurate. The procedures will include the following items: • Require inspectors to document in their inspection reports when coal is being mined on each permit to compare with quarterly ODT reports. • Require quarterly tonnage reporting to DMRM. This can be a copy of the reports sent to ODT. • The procedures will outline when and how the reconciliations of permits and coal tonnages are to be completed, how it's documented and how discrepancies will be handled. • The procedures will explain when and how taxation will be notified of new and finaled permits. • The procedures will explain how the Permit Status Spreadsheet will be maintained and compared to the quarterly ODT report. The audit identified 61 active permits that were not reporting to ODT. The Division further reviewed these permits and found the following information: Seventeen (17) of the permits are preparation plans, coal waste facilities, and river docks that do not mine coal. Twenty (20) of the permits are issued permits that have not started operations and not yet mining. Several other permits have special situations where they are considered active, but mining is not occurring. These are some of the situations that DMRM will discuss with ODT and include in the procedures.

Risk*	Remediation Owner	Estimated Completion Date
Moderate	Section Chief, DNR DMRM	April 2018

Due to the limited nature of our audit, we have not fully assessed the cost-benefit relationship of implementing the observations and recommendations suggested above. However, these observations reflect our continuing desire to assist your department in achieving improvements in internal controls, compliance, and operational efficiencies.

* Refer to Appendix A for classification of audit observations.

Appendix A – Classification of Conclusions and Observations

Classification of Audit Objective Conclusions

Conclusion	Description of Factors
Well-Controlled	The processes are appropriately designed and/or are operating effectively to manage risks. Control issues may exist, but are minor.
Well-Controlled with Improvement Needed	The processes have design or operating effectiveness deficiencies but do not compromise achievement of important control objectives.
Improvement Needed	Weaknesses are present that compromise achievement of one or more control objectives but do not prevent the process from achieving its overall purpose. While important weaknesses exist, their impact is not widespread.
Major Improvement Needed	Weaknesses are present that could potentially compromise achievement of its overall purpose. The impact of weaknesses on management of risks is widespread due to the number or nature of the weaknesses.

Classification of Audit Observations

Rating	Description of Factors	Reporting Level
Low	Observation poses relatively minor exposure to an agency under review. Represents a process improvement opportunity.	Agency Management; State Audit Committee (Not reported)
Moderate	Observation has moderate impact to the agency. Exposure may be significant to unit within an agency, but not to the agency as a whole. Compensating controls may exist but are not operating as designed. Requires near-term agency attention.	Agency Management and State Audit Committee
High	Observation has broad (state or agency wide) impact and possible or existing material exposure requiring immediate agency attention and remediation.	Agency Management and State Audit Committee