

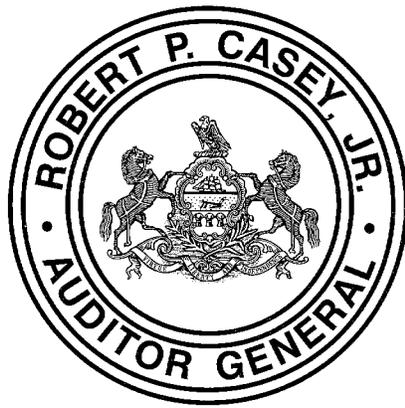
A SPECIAL AUDIT OF:

**THE PENNSYLVANIA DEPARTMENT
OF CONSERVATION AND NATURAL
RESOURCES' OIL AND GAS LEASE
FUND PROGRAM**

August 2004

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August 10, 2004

The Honorable Edward G. Rendell
Governor
Commonwealth of Pennsylvania
Main Capitol, Room 225
Harrisburg, PA 17120

Dear Governor Rendell:

Enclosed is the final report of a special audit of the Department of Conservation and Natural Resources' Oil and Gas Lease Fund conducted by our Department's Office of Special Investigations.

The Oil and Gas Lease Fund is a special fund, established by the General Assembly and consisting of revenue paid by private firms for oil and natural gas leases, royalties and storage on lands owned by the Commonwealth. In recent years, approximately three million dollars has been paid into the Fund annually. By statute, revenue from the Fund is to be used exclusively for conservation, recreation, dams and flood control projects on Commonwealth lands.

Our special audit, which was the first ever conducted of the management of the Fund, disclosed several troubling findings. First, DCNR has failed to exercise reasonable oversight of royalty payments to the Fund by neglecting to conduct audits of the royalty payments and allowing a previously established audit program to lapse during the past five years.

DCNR's decision to discontinue its established program of contract audits after 1998 was highly irresponsible. It suggests gross disregard for sound business management practices as well as indifference to the public interest and DCNR's responsibilities as the guardian of Commonwealth lands.

I am encouraged by the statements in DCNR's response to the draft audit report that the audit program will be reestablished. I urge that you direct DCNR to do so as soon as possible and also that you require the Comptroller's Office to monitor the audits closely.

Second, the special audit included a review of expenditures by DCNR from Fund revenues during the three-year audit period (the fiscal years ending June 30, 2000, through June 30, 2002). We found no evidence of fraud or wasteful spending. However, DCNR failed to ensure and document that the purchases made with the Fund's revenues were for the specific purposes set out by the General Assembly in Act 256, the governing statute. We found that, during the audit period, approximately \$948,000 was spent for inappropriate purchases, or that there was inadequate justification for the purchases in DCNR's records. The expenditures included items such as salaries, clothing and other costs which do not appear to be within the purposes set out in Act 256 and were of questionable direct benefit to the physical enhancement and conservation of the Commonwealth's state parks and forests, the intended beneficiaries of the Fund's revenues.

In DCNR's response, it was argued, without substantiation, that the expenditures were appropriate. At the same time, DCNR admitted that some of the purchases were for administrative purposes and that it was receptive to the need to closely examine the focus and direction of its spending of Fund revenues. I welcome that acknowledgement and ask that you direct DCNR, as well as the Office of the Budget, to closely scrutinize DCNR's spending of Fund revenues.

Both DCNR's response and the special audit report noted that DCNR's responsibilities are less diverse than those of its predecessor, the Department of Environmental Resources, and that the creation of DCNR may have affected the way to measure correctly whether expenditures of Fund revenues are within the specific purposes of Act 256. It may, therefore, be prudent to review the purposes of Act 256 and the use of Fund revenues in the context of DCNR's mission. Such a review would do much to ensure that Fund revenues are not siphoned away from specific and much-needed conservation projects into purchases that should be paid for from funds provided to DCNR through the regular budget process. In this way, the citizens of Pennsylvania can be assured that revenue obtained from public lands is used to conserve the land itself and for the benefit of the public.

Sincerely,

Robert P. Casey, Jr.
Auditor General

enclosure

INTRODUCTION AND BACKGROUND

The Department of the Auditor General (the Department) conducts special audits of the affairs of Commonwealth Departments pursuant to the Department's authority under the Fiscal Code.¹

The Department of Conservation and Natural Resources (DCNR) is responsible for the management of two million acres of state forestland and over 280,000 additional acres of public land and waters in state parks. DCNR administers a special fund, known as the "Oil and Gas Lease Fund" (the Fund), established by the General Assembly through legislation enacted in 1955, and referred to as Act 256. The Fund is to be used exclusively for conservation, recreation, dams or flood control, or to match federal grants for such purposes. In 1991, the Attorney General issued a letter to the State Treasurer providing informal guidance concerning appropriate expenditures of Fund revenues.² Money for the Fund is obtained from rents and royalties paid by private parties for oil and gas leases, royalties and storage on lands owned by the Commonwealth.³ In recent years, approximately three million dollars annually has been paid into the Fund. There are currently between 450 and 500 wells on state-owned land.

Initially, the Commonwealth's Department of Forest and Waters, and later the Department of Environmental Resources (DER), were responsible for the Fund's management and use. In 1995, DCNR was established through the passage of the Conservation and Natural Resources Act and thereby received powers and duties related to the acquisition and establishment of state forestlands and other Commonwealth-owned resources, including responsibility for the Fund and its use.⁴ DCNR is empowered to make and execute contracts or leases in the name of the Commonwealth for the mining or removal of any valuable minerals "whenever it shall appear to the satisfaction of the department that it would be for the best interest of the Commonwealth to make such disposition of those materials."⁵ The money in the Fund is appropriated to DCNR to be used for the purposes stated in Act 256.

The Department's interest in the Fund arose out of a prior special audit of a DCNR land purchase paid out of the Fund and a controversial oil and gas leasing initiative by DCNR:

In September 2000, the Department issued a report of a special audit of DCNR's acquisition of property for Blue Knob State Park. DCNR used the Fund to pay for property that was owned, at the time of the sale, by a relative of the director of DCNR's

¹ 72 P.S. § 402.

² The Attorney General's letter is discussed in detail in Finding No. 2 (see p. 16).

³ 71 P.S. §§ 1331-1333.

⁴ 71 P.S. §§ 1340.101 *et seq.*

⁵ 71 P.S. § 1340.302(6)

Bureau of State Parks (BSP). The special audit found no evidence that the BSP director exercised any improper direct influence over the purchase and that there was a reasonable basis for the acquisition and the purchase price. However, we were concerned by DCNR's lack of policies and procedures for handling land purchase transactions in which there were related parties and/or conflicts of interest. We specifically pointed out that no mechanism existed to transfer responsibility for negotiating the purchase to another part of DCNR or to another agency (e.g., the Department of General Services) in such cases. It appeared to us that DCNR administered the process of making land purchases paid for by the Fund with few, if any, controls or oversight and that the process was subject to misuse. We did not audit the Fund's revenues or other expenditures made from the Fund during that special audit.

In May 2002, the then-Secretary of DCNR announced plans to conduct a lease auction for rights to drill for oil and gas on approximately 500,000 acres of state forestland. This was, reportedly, the largest lease auction of public land in the history of the state. Concern over the unprecedented scope of the plan and the absence of an opportunity for the public to get more information resulted in delays and a scaling down of the proposal. In August 2002, DCNR conducted an auction which resulted in the award of drilling rights to about 51,000 acres on 17 tracts in Fayette, Potter and Cameron Counties, about one-tenth of the original acreage in the proposal. DCNR also adopted lease requirements designed to ease environmental concerns about the effects of drilling. According to a DCNR press release, nearly all of the leased acreage was awarded to one company.

As part of the information provided to the public in connection with the proposal, DCNR stated that, while it was not possible to predict how much revenue the Commonwealth ultimately would receive from the leases, the revenue would be deposited into the Fund and such revenues "by law are earmarked for recreation, conservation, and flood control projects." DCNR's press release announcing the results of the auction stated that all money received from the leases and royalties "will be deposited into the . . . Fund to be used for conservation projects in state park and forestlands."

Our preliminary review of available information concerning the Fund disclosed no evidence of previous audits of the Fund or of DCNR's management of expenditures of Fund revenue.

In November 2002, the Department's Office of Special Investigations (OSI) began a special audit of the Fund, particularly DCNR's management of royalty payments for natural gas leases and policies, procedures and internal controls relating to Fund expenditures. The time period covered by the audit was July 1, 1999, through June 30, 2002. The audit's objectives included (1) determining compliance with appropriate statutes, regulations, directives, guidelines and procedures and (2) assessing internal

controls relating to expenditures from the Fund and the receipt of royalty payments. The special audit was conducted in accordance with *Government Auditing Standards* issued by the Comptroller General of the United States.

Audit fieldwork was conducted between November 2002 and August 2003. Records were obtained from DCNR and several lessees that paid royalties to the Fund. DCNR officials with specific duties related to the Fund were interviewed, as were representatives of lessees and a contractor who had provided consulting services to DCNR. On June 1, 2004, a copy of the draft special audit report was provided to DCNR for review and comments prior to release of the final report. Copies of the draft report were also sent to the Office of the Budget and the Comptroller's Office for Public Protection and Recreation. DCNR waived the opportunity for an exit conference and submitted a written response to the draft report on July 13, 2004. Relevant portions of DCNR's response have been incorporated into the narrative under each Finding. Those specific responses are followed by the Department of the Auditor General's comments related to those responses. DCNR's complete response is included on pp. 27-30. The draft audit report contains five recommendations. A sixth recommendation has been added to the final report based on DCNR's response to Finding No. 2.

EXECUTIVE SUMMARY

DCNR failed to exercise reasonable oversight concerning royalty payments to the Oil and Gas Lease Fund by neglecting to conduct audits and allowing a previously established program of contract audits to lapse during the past five years.

DCNR failed to ensure and document that purchases made with revenue from the Oil and Gas Lease Fund were for purposes allowed under Act 256.

RECOMMENDATIONS

These recommendations also appear at the end of the Finding to which they relate.

1. DCNR should develop and implement a lease royalty audit program that includes a specific minimum number of required audits each fiscal year. Audit reports, as well as records of action taken by DCNR in response to audits, should be reviewed by the Comptroller's Office annually and should be made available to the appropriate committees of General Assembly and to this Department on request. (Finding No. 1.)
2. DCNR should review lease royalty payments and agreements with lessees to determine whether lessees made the required payments due to the Fund during the audit period as well as the subsequent years. (Finding No. 1.)
3. DCNR should adhere strictly to the requirements of Act 256 and the Attorney General's letter in its management of Fund expenditures. Transactions should be documented with reference to specific projects as described in Act 256, i.e., land acquisition, construction of facilities, other improvements to land necessary for such projects, and the subsequent purchase of equipment, supplies and services necessary to maintain or enhance such projects. (Finding No. 2.)
4. DCNR should adopt written procedures to ensure that it complies with requirements for the selection of Fund expenditures. The procedures should (a) be in accordance with Act 256 and the Attorney General's letter; (b) assign responsibility for management of Fund expenditures; and (c) include monitoring requirements to ensure compliance with Act 256 and the Attorney General's letter. (Finding No. 2.)
5. DCNR and the Comptroller's Office should review questionable Fund expenditures described in the report and the Fund should be reimbursed for all expenditures made for purposes other than those permitted by Act 256 and the Attorney General's letter. (Finding No. 2.)

6. DCNR should seek the assistance of the Governor's Office, and if necessary, the advice of the Office of Attorney General and the State Treasury in examining the direction and focus of DCNR's annual spending plans for Fund revenues in accordance with Act 256. (Finding No. 2 and DCNR's response.)

FINDING NO. 1 – DCNR FAILED TO EXERCISE REASONABLE OVERSIGHT CONCERNING ROYALTY PAYMENTS TO THE OIL AND GAS LEASE FUND BY NEGLECTING TO CONDUCT AUDITS AND ALLOWING A PREVIOUSLY ESTABLISHED PROGRAM OF CONTRACT AUDITS TO LAPSE DURING THE PAST FIVE YEARS.

During our audit period (July 1, 1999 through June 30, 2002), the Fund received a total of \$9,269,221⁶ in revenues, or an average of \$3,089,740 per fiscal year, for leases, royalties and storage. According to DCNR, there are 235,000 acres of leased land, 450 royalty-producing wells and 71,000 leased storage areas. During the fiscal years ending June 30, 2000, June 30, 2001 and June 30, 2002, Fund revenue was received from at least 35 companies and other organizations. The totals by fiscal year are shown in Table No. 1.

Table No. 1 – Fund Revenues

FYE	Total Revenue
06/30/00	\$ 2,869,470
06/30/01	\$ 3,349,678
06/30/02	\$ 3,050,073
TOTAL	\$ 9,269,221

Leases

Leases are for a 10-year period and are intended to provide land access to conduct exploration. Wells have not been drilled on these leased lands. Private companies seeking to explore for oil and natural gas on Commonwealth property make a competitively-bid lease rental payment for the first year and then pay an annual fee of \$10 per acre once a year for the remaining nine years of the lease. The first well must be drilled within the first five years of the lease. The rental payments constituted approximately five percent, or about \$443,184, of the Fund's revenue for the audit period.

Royalties

Once a well is drilled, lease rental payments are halted and the lessee has to begin making royalty payments. During the audit period, all of the royalty payments were for natural gas based on production measured in thousands of cubic feet (MCF). The amount is usually one-eighth (12.5 percent) of the market price of the gas. Royalty payments are

⁶ The Fund had an additional \$1,214,117 in receipts during the audit period from three non-revenue funding sources described as: Refund of Expenditures, Adjustment Memorandums and Transfer Vouchers. These transactions were not included in the audit.

made by lessees on a monthly basis. Royalty payments made up approximately 42 percent of the Fund's revenues, or \$3,928,732, during our audit period.

Storage

A large number of existing wells are depleted or empty. Gas companies use the depleted wells as containers for large-scale storage. The fees paid by the companies using these wells for storage are made annually and constituted approximately 53 percent of the Fund's revenues, or \$4,897,204, during the audit period.

* * *

Our audit focused on royalty payments in connection with the production of natural gas, primarily because such royalties appear to be susceptible to underpayments caused by fraud, negligence and/or mistakes due, in part, to the difficulty of determining the amount of gas taken from the wells and the price the lessee obtains for it.

Once a well is drilled and starts producing, the lessee installs a monitoring meter and connects the well to an existing natural gas pipeline. The wells pump 24 hours a day, seven days a week. The monitoring meter measures the amount of gas that the well is producing, recording and printing the total on a chart. Every 30 days, the charts are changed manually by the lessee or an independent outside company. *DCNR does not obtain copies of the charts.* Meters are calibrated by the lessee.

DCNR receives a monthly report from each lessee stating how much gas has been produced at the well and the sale price. The reports are usually received by DCNR three to four months after the production actually occurs.

DCNR has no policies or procedures in place to determine whether the Commonwealth is receiving the correct amount of royalty revenue from the leases. DCNR staff does not audit royalty revenue (although it has used contract auditors in the past, as is discussed below). We found no records or other evidence of audit activity relating to the royalties.

DCNR's State Forester told us that DCNR assumes that meters measuring well production are correct. He stated that the lessees calculate and submit royalty payments on their own and that DCNR does not check the payments for accuracy because it is not worth the time.

The standard lease used by DCNR for oil and gas royalty payments contains language that gives DCNR the right to audit records and accounts of lessees for the purpose of verifying the accuracy of reports and checking the amount of royalty payments. The standard lease terms include a requirement that the lessees shall pay the costs of the audit, as well as the amount of the deficiency, if the audit discloses “any gross error or fraud.” Prior to our audit period (from at least 1987 to 1998), audits were conducted. DCNR (and during the pre-1995 period, DER) entered into consulting contracts with private individuals for services which included audits of lease royalty payments. There were two consultants; both were members of Pennsylvania State University’s engineering faculty. DCNR stopped contracting for the audits as of June 30, 1998, the end of the 1997-1998 fiscal year. A management official in DCNR’s Bureau of Forestry told us that he did not know why the audits were suspended and stated they were always cost-effective.

We interviewed one of the Pennsylvania State University’s faculty members who conducted the lease royalty audits prior to 1998.⁷ He described the audit procedure, which included reviews of well production charts and recalculation of numbers related to well production. Once the audits were completed, the documentation was turned over to DCNR.

According to the consultant, the deregulation of the natural gas system in the United States has made it difficult to determine gas market prices. Therefore, the audits focused on each well’s production figures. According to the consultant, major problems in overseeing lease royalties include: (1) failure of some lessees to install meters to measure volume at the time a well begins operating; and (2) misrepresentation of production figures caused by changing the temperature of the gas after it leaves the well and before it arrives at the meter, thereby decreasing the volume.

According to the consultant, the prior audits resulted in millions of dollars of savings to the Commonwealth. He expressed particular concern in regard to leases obtained through DCNR’s auction program in 2002 and the possibility of substantial lost royalties unless those leases are managed properly by the Commonwealth.

In August 2002, DCNR entered into a service purchase contract with the consultant. The contract included performing audits. The contract specifications called for the consultant to:

Provide gas well meter chart auditing to determine the accuracy of produced gas volumes reported and the accuracy of the gas royalties paid to the Commonwealth of Pennsylvania by gas

⁷ The other individual died in 2001.

company lessees of wells located on state forest and park lands. Gas volume calculation sheets shall be submitted for each chart audited reporting the results of the audits.

The total contract price for the audits listed on the service purchase contract was \$25,000. An additional \$10,000 was to be paid for “special diagnostic studies.” Payment was to be made for actual services performed. The contract was a sole source contract. The fact sheet included as part of the contract records states that “the audit process is the only verification mechanism available to the Department [DCNR] to assure that the Commonwealth receives its contracted share of the production royalty revenues from the producers.” The fact sheet also refers to the consultant as “a preeminent authority in the field of gas measurement and gas engineering.”

*Despite the fact that, after a four-year lapse, DCNR once again entered into a contract for audits of the lease royalties, DCNR did not request to have any audits conducted during the 2002-2003 fiscal year. In March 2003, the consultant told us he expected to start the audits at the end of the 2002-2003 academic year. In **October 2003**, the consultant told us that no audits were conducted during the entire 2002-2003 fiscal year and that he had no contract with DCNR to conduct audits during the current fiscal year (2003-2004). In March 2004, the consultant told us that a DCNR official had informed him that DCNR wanted him to do audits but could not enter into a new audit contract due to budget constraints.*

We found very little information within DCNR to explain the reasons for the cessation of audits in 1998, the failure to conduct audits over the next four years, the failure to restart the audits in the 2002-2003 fiscal year despite the contract and the failure to obtain a new contract for the current fiscal year. A DCNR document included with the consultant’s September 2002 contract contained an entry that audits were “not on the approved spending plan for oil and gas 2000.”

The cost of the audits, assuming \$35,000 for each annual contract (a figure which includes additional non-audit services), would constitute about 2.6 percent of the total average revenue received by the Fund from lease royalties.⁸

We requested that DCNR provide us with copies of prior audits conducted by the contract auditors. DCNR refused to do so. The consultant made available to us copies of worksheets from an audit of one lessee’s production and royalty figures conducted in 1990 and 1991. The documents included a May 20, 1992, letter from the then-Chief of the Mineral Section in DER’s Bureau of Forestry stating that the consultant’s “excellent work . . . was well worth the time, effort and cost” and that, as a result of the audit, DER now knew that the lessee had not been underpaying royalties.

⁸ The actual cost of the audits to the Commonwealth could, in some cases, be less due to the previously noted (see p. 10) standard lease requirement that lessees shall pay the costs of an audit if it discloses “any gross error or fraud.”

As part of the special audit, we obtained information from four companies selected judgmentally from those that paid royalties to the Fund during the audit period. The amount of the royalty payments to the Fund by the four companies we contacted varied considerably depending upon the amount of production. We picked companies that made a range of payments, from relatively large to small amounts. For example, one firm's records showed that it paid a total of approximately \$102,329 to the Fund during the audit period.⁹ Another made \$3,056 in royalty payments during the audit period. We did not audit the companies' leases or production, pricing or other records related to calculation of royalties. Our purpose was to determine the lessees' procedures for reporting royalties and what audit or oversight activities took place.

The company representatives we spoke to knew of no DCNR or Commonwealth audits of their firms' royalties. The lessees themselves have audit and oversight activities: According to one lessee, its parent firm and an independent accounting firm audit the lessee's operations annually and employees of the lessee, or the parent firm, monitor the lessee's gas well meters for accuracy. According to representatives of the other three lease companies, a private outside firm, Gas Analytical Services (GAS), monitors and/or maintains the lessees' gas well meters.

Representatives of several of the lessee companies said that two meters are used for each well and, if the monitoring conducted either by GAS or the lessee's own staff shows a variance of five percent or more, corrective action is required. One of the companies allows a two-percent variance.

Conclusions and Recommendations

DCNR's failure to conduct audits of lease royalties over a five-year period was an unwise abdication of its role as guardian of Commonwealth-owned mineral resources. DCNR's failure to ensure that audits were conducted in fiscal year 2002-2003, when it had a contract with a consultant to do so, is even more inexplicable. The contract with the consultant was signed in August 2002, at a time of increased public concern about DCNR's management of the Oil and Gas Lease Fund Program resulting from the publicity about the unprecedented lease auction. There is no direct evidence of a connection between the auction and the contract to restart audits of lease royalties. However, the timing of the two events, and the failure of DCNR to ensure that audits were conducted, raises questions of whether the purpose of the contract was only to give the appearance that DCNR was exercising oversight over royalties and whether there was any real intention to conduct audits.

⁹ According to the company's records, it paid an additional \$74,815 in royalties to the Fund during the fiscal year (2002-2003) following the period covered in our audit.

A well-coordinated and consistent program of audits would be reasonable and appropriate and the need for such a program seems to be clear: DCNR's own previous statements of the importance of audits, as well as the views of members of its staff and the consultant, support such a conclusion. Additionally, there have been recent reports of unpaid and/or underpaid mineral royalties related to leases on land owned by the United States either in its own right or in trust for Native Americans. For example, according to the April 2000 Semi-Annual Report of the Office of Inspector General of the U.S. Department of the Interior, the federal government was reimbursed \$147 million by two major oil companies for unpaid royalties during that year. The same report noted another case in which the Office of Inspector General and auditors from three states found possible underpayment of \$43 million based on a review of 20 oil-producing properties. In November 2003, according to a Department of the Interior news release, "a routine government audit" of royalty payments made by oil and gas companies drilling on Indian lands resulted in an order directing several companies to pay an additional \$2 million in royalties to tribes and individual owners. Those disclosures underscore the need for, and usefulness of, a program of consistent and thorough audits of royalty payments to the Fund.

Accordingly, it is recommended that DCNR develop and implement a lease royalty audit program that includes a specific minimum number of required audits each fiscal year. Audit reports, as well as records of action taken by DCNR in response to audits, should be reviewed by the Comptroller's Office annually and should be made available to the appropriate committees of the General Assembly and to this Department on request.

DCNR should also review lease royalty payments and agreements with lessees to determine whether lessees made the required payments due to the Fund during the audit period as well as subsequent years.

DCNR's Response to Finding No. 1¹⁰

DCNR generally agreed with the Finding and will begin efforts to establish an audit program for lease royalties, using outside auditors.

The response stated that lease agreements and royalty payments are reviewed annually for accuracy and appropriateness and that DCNR's policy and procedures to determine whether the Commonwealth was receiving the correct amount of royalty payments are contained in the language of the leases themselves.

¹⁰ The text of DCNR's response to Finding No. 1 appears on p. 28.

The Department of the Auditor General's Comments

We urge DCNR to establish a comprehensive audit program for lease royalties as soon as possible and to ensure that the program is used consistently.

We disagree with the response's assertion that lease agreements are reviewed annually for accuracy and appropriateness. As pointed out in the Finding, for at least the past five years, DCNR has not included analyses of meter charts or measurements in review of the leaseholders' production reports. The chart and meter measurement data is an essential audit component. Without it, it is highly unlikely that fraud or errors can be detected.

While it is correct that the language of the lease documents is adequate to inform leaseholders of the requirements, DCNR needs to establish a clear policy to guide *its own staff* and to ensure that DCNR *itself* is overseeing the program effectively.

Finally, DCNR's response to Finding No. 1 did not address our recommendation that audit reports should be made available for review by the Comptroller's Office, appropriate committees of the General Assembly and the Department of the Auditor General (part of Recommendation No. 1) and the need for DCNR to review lease royalty payments during the audit period (July 1, 1999, through June 30, 2002), as well as prospectively (Recommendation No. 2).

FINDING NO. 2 – DCNR FAILED TO ENSURE AND DOCUMENT THAT PURCHASES MADE WITH REVENUE FROM THE OIL AND GAS LEASE FUND WERE FOR PURPOSES ALLOWED UNDER ACT 256.

Act 256 provided that the Fund was to be used for conservation, recreation, dams and flood control. However, we found discrepancies between the intended purpose of Fund expenditures and DCNR's actual practices. The discrepancies involved approximately \$2,065,606 in spending from the Fund during the audit period. This total includes \$947,789 in specific transactions questioned during the audit testing as well as \$1.1 million in overall expenditures for salaries and benefits paid from the Fund.

Initially, we reviewed DCNR's procedures for use of Fund revenue. DCNR has no written policies or procedures concerning the process for deciding on expenditures from the Fund. According to DCNR officials, the procedures used are as follows:

- A spending plan for the Fund is submitted annually to the DCNR Secretary for approval. The plan includes anticipated revenues and expenditures.
- After the Secretary approves the plan, it is sent to the Comptroller's Office so that the expenses can be encumbered (i.e., a restriction is put in place limiting use of the amounts called for in the plan to the designated purposes).
- Individual DCNR bureaus prepare and submit project requests to the DCNR Director of the Bureau of Administrative Services who reviews the requests for consistency with the spending plan and compliance with statutes.
- Specific requests to make expenditures from the Fund are then forwarded to the DCNR Executive Secretary for approval and then to the Comptroller's Office. A copy is also sent to the Department of the Treasury (Treasury).

According to DCNR's Director of the Bureau of Administrative Services, DCNR follows guidelines set out in a 1991 letter from the Attorney General in the development of the annual spending plan for the Fund and approval of the expenditures paid from the Fund.

In a February 7, 1991, letter to then-State Treasurer, the Attorney General provided "informal guidance" concerning expenditures from the Fund (the February 7, 1991, letter is referred to as "the Attorney General's letter"). The guidance was in response to a request from the State Treasurer for a legal opinion explaining why charges to the Fund for items purchased for general support of management and maintenance of state parks were not in violation of Act 256.

According to the Attorney General's letter, Act 256 authorizes expenditures from the Fund to acquire land for conservation, recreation, dam or flood control projects; Act 256 also authorizes expenditures for construction of facilities and other improvements to land "necessary for such projects" and "for the subsequent purchase of equipment, supplies and services necessary to maintain or enhance such projects" (emphasis added).

The Attorney General's letter further states that it is:

beyond the authority of the Act to expend Fund receipts for a purpose not attributable to a specific project undertaken pursuant to the Act. It is not enough that expenditures from the Fund should relate to conservation, recreation, dam or flood control. If it were, then the . . . Fund would be little more than a general funding source for the broad range of statutory functions performed by DER [DCNR's predecessor]; and the Act, while, imprecise in its expression of intent, certainly suggests otherwise.

In my judgment, the General Assembly's establishment of this special fund and its focus on geographically-identifiable projects reflects an intent that revenues derived from the depletion of the Commonwealth's natural resources should be dedicated directly to the physical enhancement or conservation of the Commonwealth's natural resources. Viewed in this light, Act 256 would not authorize the use of Fund receipts to support DER's regulatory or enforcement activities, its general administrative or legal operations, or any other function not related directly to a project undertaken pursuant to the Act.

The Attorney General's letter noted that the Fund could be used to support "the expanding operational costs of old projects previously begun with Fund receipts" and that Act 256 would authorize use of Fund receipts for state parks that were originally developed with Funds from other sources, given the recreational purpose of the parks. The letter also recommended that the Treasurer call on the DER Secretary "to identify the projects that he presently considers to be projects properly supported by Fund receipts."

The limited and specific purposes for which Fund revenues are to be used are also expressed in the 2004-2005 Governor's Budget (" . . . this Fund is to be used to finance conservation, recreation, dams or flood control projects or to match any federal grants made for these purposes . . .") The language is essentially unchanged from that used in previous years' budgets.

According to DCNR's records, it spent approximately \$9.7 million from the Fund during the audit period as shown in Table No 2.

Table No. 2 – Total Fund Expenditures by Fiscal Year

FYE	Total Expenditures
06/30/00	\$ 2,800,102
06/30/01	2,488,313
06/30/02	4,427,254
TOTAL	\$ 9,715,669

We determined DCNR’s total expenditures from the Fund during the audit period, the identification of the descriptive categories of the goods and services received in return for the expenditures, and the calculated amount and percentage spent for each category. (See Table No. 3.)

Table No. 3 – Fund Spending for Fiscal Years Ending June 30, 2000 through June 30, 2002

CATEGORY TYPE	AMOUNT EXPENDED	% OF TOTAL
Land Acquisition	\$ 3,313,649	34.11%
Trucks	2,849,825	29.33%
Salaries and Benefits	1,162,061	11.96%
Specialized Services	877,733	9.03%
Wearing Apparel	350,333	3.61%
Maintenance Materials and Supplies	300,029	3.09%
Agricultural Equipment and Machinery	246,410	2.54%
Other Services and Supplies	200,191	2.06%
Buildings and Structures	104,976	1.08%
EDP Contractual Services – Vendor Provided	78,907	0.81%
Heavy Equipment (off-road)	55,659	0.57%
Equipment and Machinery	59,696	0.62%
Purchase of EDP Equipment – Computers and Peripherals	27,366	0.28%
Printing	25,102	0.26%
Office Supplies	25,000	0.26%
EDP Software – Vendor Provided	15,765	0.16%
Legal Fees	8,622	0.09%
Advertising	8,599	0.09%
Interfund Disbursements	5,000	0.05%
Contracted Repairs	485	0.00%
Purchasing Services	248	0.00%
Interest/Utility Late Charge Penalties	13	0.00%
Total	\$ 9,715,669	100.00%

We then tested 104 specific purchasing transactions and three pay period transactions, a total of almost \$2.5 million, or 25 percent of the overall number of transactions paid for from the Fund during the audit period.¹¹ The testing consisted of reviewing the detailed documentation provided to the State Treasury by DCNR for each of the transactions.

As a result of the testing, we found no basis to question 50 of the transactions (totaling \$1,505,499) because they appeared to fall within the purposes of Act 256 and the parameters of the Attorney General's letter.

In regard to the other 54 transactions, DCNR appears to have used the Fund for purposes that were not related to specific projects as required by Act 256. We questioned a substantial number of those expenditures from the Fund because they were related to general operations of DCNR, rather than specific geographically-identifiable projects related "directly to the physical enhancement or conservation of the Commonwealth's natural resources." In some of these purchases, DCNR appears to have used the Oil and Gas Lease Fund as a means to supplement its general fund appropriations, rather than for the specific purposes set out in Act 256 and the Attorney General's letter.¹² We did not audit the expenditures in regard to appropriate cost or overall reasonableness in relation to DCNR. However, we do question whether such expenditures constituted proper or appropriate use of the Fund's revenues.

In DCNR's records of the spending plans for Fund purchases during the audit period, the word "projects" is used as a general descriptive term for the activities and purposes for which the money was to be spent without reference to a geographically specific project. Cover memoranda accompanying the plans state that the "plan is a compilation of proposed projects for recreation and conservation." However, in many cases, the documentation in the records was absent or did not substantiate the generic descriptions and general statements.

Based on the criteria set out in Act 256 and the Attorney General's letter, we found that Fund expenditures during the audit period totaling approximately \$947,789 were questionable because (1) the expenditures constituted inappropriate use of the Fund based on the transactions themselves or the information in available records; and/or (2) there was insufficient justification or explanation of the purchases included in DCNR's records, and/or the information DCNR sent to the State Treasury in connection with the transactions, to establish that the expenditures were appropriate uses of the Fund.¹³

¹¹ The transactions were judgmentally selected in order to ensure that the testing included a representative sample of category types for which more than \$5,000 was expended during the audit period.

¹² General fund appropriations are funds drawn from revenues of the state not earmarked for specific purposes and which the General Assembly has voted to be used to pay the general expenses of DCNR.

¹³ The \$947,789 figure represents the sum of the total expenditures listed in the subheadings on pp. 19-22.

Furthermore, in addition to the specific transactions that were reviewed, approximately \$1.1 million in other expenditures from the Fund for DCNR employees' salaries and benefits also may have been an inappropriate use of the Fund's revenues.¹⁴

The expenditures we found to be questionable in our review consist of the following:

Wearing Apparel - \$100,039

The Fund was used to purchase items of clothing for staff of DCNR bureaus in accordance with policies of DCNR relating to the wearing of uniforms. Items purchased included:

- 4,106 shirts
- 936 hats
- 929 embroidered emblems
- 601 pairs of pants
- 302 coats and jackets
- 57 winter arctic vests
- 52 classic leather belts

Purchases of clothing for DCNR staff do not appear to be within the purposes of Act 256. According to DCNR's records, one of the purchases (documented as a September 1999 request for \$37,500), was to fund the cost of replacement uniforms for employees of DCNR's Bureau of Forestry assigned to forest districts and to Penn Nursery.¹⁵ In the records of another of the specific clothing purchases totaling \$3,900, the detailed description of the justification for the purchase stated that it was an "[o]fficial DCNR uniform replacement item for field personnel engaged in public speaking engagements, public informational meetings and public contact."

The above expenditures may have been warranted if made from DCNR's general appropriations. However, they do not relate to a project undertaken pursuant to Act 256. We also noted that, in connection with the September 1999 purchase of replacement uniforms, the record of the Bureau of Forestry's request identifies the transaction as an "activity or project." The use of the word "project" does not by itself justify the expenditure as a proper use of the Fund and may be misleading in this context. Expenditures from the Fund are limited to *geographically specific* projects.¹⁶

¹⁴ The exact figure is \$1,117,817, the total amount spent from the Fund for salaries and benefits during the audit period (see Table No. 3) minus the amount spent on salaries and benefits that we reviewed as part of the audit (see p. 20).

¹⁵ Penn Nursery is a forest tree nursery in Spring Mills, PA, operated by DCNR's Bureau of Forestry.

¹⁶ According to DCNR's records, during the audit period an additional \$339,461 in the fund was encumbered (i.e., set aside) for purchases of uniforms for employees of the Bureau of Forestry and the Bureau of State Parks.

Salaries and Benefits - \$44,244 in Specific Expenditures

We tested and questioned \$44,244 in expenditures for salaries and benefits paid on three different dates to two DCNR employees. We found no evidence that DCNR attempted to pro-rate or allocate expenditures to the Fund based on the hours the employees spent on specific projects under Act 256. One of the employees was a DCNR attorney. From the records DCNR made available to us, it cannot be determined whether the attorney's work was directly related to specific projects as those terms are used in Act 256.

In addition to the specific expenditures for salaries and benefits in our sample, we noted that \$1,117,817 from the Fund, or almost 12 percent of the total expenditures during the audit period, was spent on employee salaries and benefits (see Table No. 3). Use of the Fund's revenues for those purposes appears inappropriate and well outside of the specific purpose of Act 256. According to the Attorney General's letter, "Act 256 would not authorize the use of Fund receipts to support DER's regulatory or enforcement activities, its general administrative or legal operations, or any other function not related directly to a project undertaken pursuant to the Act."

Expert Witness and Consulting Services - \$1,251

According to DCNR's records, payment was made from the Fund for a July 2001 invoice for an expert witness fee and consulting services. Payment of these costs from the Fund does not appear to be permissible. There was no record that the activities related directly to a project as defined in Act 256. In fact, DCNR's records listed the project's purpose as "Admin. of the Program/Generation of Revenue." As stated in the Attorney General's letter, Act 256 does not authorize use of the Fund to support general administrative operations.

EDP Contractual Services - \$55,326

Based on the information in DCNR's records, the purpose of the expenditures was for administrative support and not directly related to a geographically identifiable project.

The expenditures were related to three invoices for work performed for DCNR's Bureau of Topographic and Geologic Survey. One invoice was a final payment of \$41,055 based on a 1998 request for approximately \$80,000 to obtain vendor services for transfer of a computer information system. According to DCNR's records, the information system was located in a regional office of the Bureau of Topographic and

Geologic Survey and was to be used to house oil and gas well records maintained by that Bureau. According to the justification, the data was used to support “management decisions made in accordance with [Act 256]” and to make the data more easily accessible. According to DCNR’s records, the expenditure was previously coded “to regular state money” (i.e., DCNR’s general fund appropriation) and the transfer of the expenditure to the Fund restored nearly \$80,000 to DCNR’s general fund appropriation for other “badly needed” expenses.

The other two invoices, totaling \$14,271, were for payments related to a request to transfer data from one operating system to another.

EDP Software - \$15,765

According to the invoice, computer software was sold to the Bureau’s Topographic and Geologic Survey in May 2002. No explanation or justification for the purchase was included with the invoice submitted to Treasury by DCNR. The documentation in DCNR’s records merely states that the purchase of a software package was approved.

Equipment and Machinery - \$5,895

According to the two invoices, the items were purchased in May 2002 by DCNR’s Bureau of Topographic and Geologic Survey. The explanation given for the purchases consisted of the statement, “geochemical whole rock analysis used for land use planning and conservation.” There was no reference to specific geographic projects. A total of \$180,000 was encumbered for the purchases.

Printing of Booklets - \$6,769

According to the June 22, 1999, invoice, 10,670 educational booklets about sinkholes in Pennsylvania were printed for use by DCNR’s Bureau of Topographic and Geologic Survey. The project’s purpose was described in DCNR’s records as “Publication of geologic/hydrographic aerial reports and maps that include state parks and forest lands and that provide baseline data for conservation and recreation management decisions.” While that description could possibly cover items within the requirements of Act 256, there is no basis in DCNR’s records to explain or document how educational booklets about sinkholes are reasonably related to either the above description or the specific purposes of Act 256.

Specialized Services – Mapping Activities - \$613,903

The specific invoices ranged in amounts from \$38,903 to \$300,000 and were for work performed in May 2000 and September 2001. The explanation for the

expenditures was that the funds were for Pennsylvania's share of expenses incurred in mapping activities conducted in accordance with a joint funding agreement between the United States Geological Survey (part of the U.S. Department of Interior) and DCNR. The documentation lists specific forest districts by number. However, there is no documentation supporting a conclusion that the purchases were necessary to maintain or enhance specific conservation, recreation, dam or flood control projects, as Act 256 requires.

Other Equipment - \$104,597

Among the specific Fund expenditures we reviewed were purchases of equipment, such as a backhoe (\$60,644), a heavy duty trailer (\$6,032) and maintenance supplies (\$26,780), for which no explanation or justification was provided in the documentation provided to the State Treasury by DCNR. According to DCNR's records, the purposes were for replacement (presumably, replacement of equipment) and personal protection.

From the nature of the equipment, it could have been intended for use on specific conservation projects and other activities within the purposes of Act 256 and consistent with the Attorney General's letter. However, DCNR failed to provide any specific explanation or justification for the expenditures.

It should be noted that the appropriate specificity was not always lacking: Among the records we reviewed were those related to purchases of other maintenance supplies from the Fund (about \$1,378) for which a specific project was identified in the records. This indicated that DCNR staff was aware of the limitations on use of the Fund and had the ability to document expenditures accordingly, i.e., by specific geographically identifiable project.

It was also noted that, in at least seven cases, the records disclosed that funding for the purchase of equipment was split between other DCNR funding sources and the (Oil and Gas) Fund. In each case, no explanation was given on the State Treasury documentation for the split, or why a portion of the costs should be paid for from the Fund. Examples of such transactions include the following purchases:

- Two trucks were purchased for a total of \$30,048. DCNR split the payment between the Fund, (\$14,734) and a separate fund for State Park Operations (\$15,314).
- A van was purchased for \$16,806. DCNR split the expense between the Fund, (\$13,946) and the previously-mentioned State Park Operations fund (\$2,860).

- Office furniture was purchased for a total of \$22,414. The furniture was for a Bureau of Forestry district office. DCNR split the expense between the Fund, (\$11,142) and the general fund (\$11,272).

Splitting the purchases between the Fund and other sources may have been an attempt to properly allocate costs to the Fund. However, in the absence of adequate records, no determination can be made about the appropriateness of the allocation. In any case, the use of the Fund to pay any portion of the cost of office furniture appears inappropriate.

Of the records of the specific individual transactions we tested, only ten contained a justification or other documentation that they were related to a specific geographically-identifiable undertaking, i.e., a project, location or area, specific purpose and reason for the expenditure, when DCNR provided the information to the State Treasury. These ten transactions totaled \$106,160, or 4.3 percent of the total amount of all expenditures that were tested.

Conclusions and Recommendations

DCNR maintained that it followed the requirements of Act 256 and the Attorney General's letter concerning Fund expenditures. However, the audit found that DCNR failed to do so consistently. *Portions of the revenues obtained from the depletion of publicly-owned mineral resources are not being used directly for physical enhancement or conservation of natural resources as intended; instead, they are being used to supplement DCNR's general fund budget.* Use of the Oil and Gas Lease Fund for such questionable or inappropriate expenditures undermines the Fund's purpose and lessens its availability for desirable or needed specific projects to benefit the environment and the public. Additionally, DCNR's practices mislead the public, as well as the General Assembly, about the benefits of leasing Commonwealth-owned lands for oil and gas drilling.

DER, DCNR's predecessor, had a broad range of responsibilities in addition to those relating to conservation activities. The establishment of DCNR as a separate department in 1995 narrowed the differences between the overall activities of the department responsible for the Fund and the purposes of Act 256. *However, the proper uses of the Fund remain limited and specific and are not as broad as DCNR's overall responsibilities.* The Fund should not be used by DCNR's management to fill general administration, personnel and equipment needs that should or could be paid for through general fund appropriations or from other sources.

It is recommended that DCNR adhere strictly to the requirements of Act 256 and the Attorney General's letter in connection with Fund expenditures. Transactions should be documented with reference to specific projects as described in Act 256, i.e., land

acquisition, construction of facilities, other improvements to land necessary for such projects, and the subsequent purchase of equipment, supplies and services necessary to maintain or enhance such projects. Furthermore, DCNR should adopt written procedures to ensure that it complies with requirements for the selection of Fund expenditures. The procedures should (a) be in accordance with Act 256 and the Attorney General's letter, (b) assign responsibility for management of Fund expenditures; and (c) include monitoring requirements to ensure compliance with Act 256 and the Attorney General's letter.

It is also recommended that DCNR, and the Comptroller's Office, review questionable Fund expenditures described in the report and take action to have the Fund reimbursed for all expenditures made for purposes other than those permitted by Act 256 and the Attorney General's letter.

DCNR's Response to Finding No. 2

DCNR disagreed with the finding and recommendations.¹⁷

According to DCNR, the review procedure for purchases made using Fund revenue is sufficiently rigorous to safeguard expenditures and ensure proper authorization of annual spending plans and the "process demonstrates that these projects are clearly open to review and do not violate the broad purposes of the Act." DCNR stated that, while there is no requirement in the Act that "specific location be a factor in approving or reporting the use of expenditures," DCNR has generally tied expenditures to the various operations that enhance projects involving "conservation, recreation, dams or flood control."

DCNR's response also states that since the creation of DCNR and the resulting separation of its responsibilities from the broad range of duties of the former DER, "the potential for expenditures to stray from the purposes of the Act was greatly reduced."

According to DCNR's response, it "does not dispute that it uses some of these funds for administrative purposes, however, these purposes are in direct support of conservation and recreation, with each item in the spending plan having a definable link to the purposes authorized by the legislation."

The response closed with the following statement:

Nevertheless, DCNR is receptive to the need to closely examine the direction and focus of our annual spending plans. Furthermore, we will

¹⁷ The text of DCNR's response to Finding No. 2 appears on pp. 29-30.

continue to be vigilant in our approval of expenditures for inclusion in the Oil and Gas Fund. Accordingly, the new administration of DCNR will use this audit report as an opportunity to review the spending under this program to ensure that expenditures comport with the letter and spirit of the Act.

The Department of the Auditor General's Comments

There is no disagreement concerning the fact that the requirements to be followed to ensure that Fund expenditures are in accordance with the purposes of the Act are rigorous. However, the audit disclosed that DCNR has not *consistently* followed those requirements.

The audit report lists and describes 54 transactions costing approximately \$948,000 in which either the purpose was an inappropriate use of the Fund or there was insufficient justification or explanation in the records to confirm that the purpose was appropriate.

We obtained and reviewed DCNR's spending plans for the Fund during the audit period. The plans are merely lists of items and do not link expenditures to the purposes of the Act in most cases.

Additionally, the audit found that about \$1.1 million was taken from the Fund for DCNR employees' salaries and benefits, without any attempt to provide a justification for use of Fund revenues for such purpose.

DCNR's response failed to address any of those specific findings.

We do not disagree with DCNR's claim that its mission is more specific than of its predecessor, DER (see p. 23). However, the requirement of the Act that Fund revenues be used for specific limited purposes has been undermined by DCNR's use of "some of these funds for administrative purposes." We disagree with DCNR's assertion that each item in its spending plan has "a definable link to the purposes authorized" by the Act. In many cases, the link was not defined and/or does not appear to exist.

Because of the absence of "clearly definable" links, we urge DCNR to closely examine its annual spending plans for the Fund. Such an examination is especially warranted in view of the increasing need for direct improvement and enhancement of conservation, recreation and flood control projects on public lands, the purposes for which the Fund was established.

DCNR's reluctance to acknowledge that it has not always used the Fund properly is somewhat offset by the statement in the response that it is "receptive to the need to closely examine the direction and focus of [its] annual spending plans." We urge DCNR to seek the assistance of the Governor's Office, and if necessary, the advice of the Office of Attorney General and the State Treasury, in examining the direction and focus of DCNR's annual spending plan in accordance with Act 256 to ensure that Fund revenues are being spent for the improvement of public lands and the benefit of the public.

DCNR'S RESPONSE TO THE DRAFT SPECIAL AUDIT REPORT



Pennsylvania Department of Conservation and Natural Resources

Rachel Carson State Office Building, P.O. Box 8767, Harrisburg, PA 17105-8767
Office of the Secretary

July 13, 2004

717-772-9084
Fax: 717-705-2832

The Honorable Robert P. Casey
Auditor General
229 Finance Building
Harrisburg, Pennsylvania 17120

Dear Auditor General Casey:

We have received the draft summary report of the Special Audit of the Department of Conservation and Natural Resources' Oil and Gas Lease Program conducted by your Department. Our response to the findings of your audit are enclosed, and we appreciated the opportunity to present them to you for inclusion in the final audit report.

We have decided to decline the opportunity to hold an exit conference for this audit and wish to thank your staff for granting an additional week extension for the response date. Please contact Mr. Dana Datres, Director, Bureau of Administrative Services, at 787-2362, or Mr. John Koller, audit coordinator, at 783-6352 if you have any questions or wish to follow up on this audit.

Sincerely yours,

A handwritten signature in black ink that reads "Michael DiBerardinis". The signature is written in a cursive, flowing style.

Michael DiBerardinis
Secretary

Enclosures

cc: Peter J. Smith, Deputy Auditor General
Harvey Eckert, Deputy Secretary for Comptroller Operations
Mary K. DeLutis, Comptroller, Public Protection and Recreation
Dana Datres, Director, Bureaus of Administrative Services
John Koller, DCNR Audit Coordinator

Finding No. 1: DCNR FAILED TO EXERCISE REASONABLE OVERSIGHT CONCERNING ROYALTY PAYMENTS TO THE OIL AND GAS LEASE FUND BY NEGLECTING TO CONDUCT AUDITS AND ALLOWING A PREVIOUSLY ESTABLISHED PROGRAM OF CONTRACT AUDITS TO LAPSE DURING THE PAST FIVE YEARS.

Agency Response:

DCNR generally agrees with the findings of the auditors and will begin efforts to reestablish an audit program of lease royalties, using outside auditors to ensure proper oversight. This corrective action will resolve this issue.

Nevertheless, it must be emphasized, as mentioned in the auditor's findings (p. 5), that all of the nearly 110 lease agreements and royalty payments are reviewed annually for accuracy and appropriateness. Furthermore, a determination is made as to the soundness of the lessees' payments.

The conclusions for Finding Number 1 also indicate that there were no policies or procedures in place to determine whether the Commonwealth is receiving the correct amount of royalty payments from the leases. It should be noted that DCNR feels the leases are sufficiently stringent in their requirements to protect the Commonwealth. In effect, the terms of our lease are the policy.

As noted in the audit findings, the lease does give DCNR the right to audit records and accounts of lessees for the purposes of verifying accuracy and checking payment. Together with the appropriate audit program, the lease will provide adequate oversight of the collection of royalty payments.

Finding No. 2: DCNR FAILED TO ENSURE AND DOCUMENT THAT PURCHASES MADE WITH THE REVENUE FROM THE OIL AND GAS LEASE FUND WERE FOR PURPOSES ALLOWED UNDER ACT 256.

Agency Response:

DCNR disagrees with the findings and recommendations of Finding No. 2. Although the importance of documenting purchases made from the Fund is recognized, the conclusions in Finding No. 2 do not follow from either the terms of Act 256 or the policy that has been in place for over ten years. In short, it is submitted that the expenditures by DCNR are in conformance with the purposes of the Act, which grant the Secretary broad discretion to determine the need for and location of projects.

Because the recommendations of the auditors are substantially based on the letter of February 7, 1991 from the Attorney General to the Treasurer, a closer examination of the chronology and context of all the relevant correspondence is necessary. It is respectfully suggested that the following summary addresses the concerns of the auditors.

First of all, on November 1, 1990, the Treasurer simultaneously requested advisory opinions from the Attorney General and the General Counsel. The response from the Office of General Counsel, dated November 2, 1990, stated that all the complained of expenses were "consistent with 71 P.S. §1331 because all of the items are intended to be used in support of various recreational projects." The response further expressed confidence that the Attorney General would agree and copied him with the opinion.

Ultimately, the Attorney General's response, on February 7, 1991, offered only "informal guidance" to the Treasurer and the General Counsel "for the purpose of encouraging the cooperative resolution of [the Treasurer's] concern." Although the response substantially approved DCNR's use of the Fund for "equipment, supplies and services necessary to maintain or enhance such projects," the Attorney General felt the funds should be tied to projects and not merely used "for the broad range of statutory functions performed by DER." However, even the Attorney General prefaced his remarks by stating "the Act presents substantial interpretive difficulties."

Following a meeting with the Treasurer, Secretary Arthur Davis sent a letter to the Treasurer on April 15, 1991, agreeing to restrict expenditures to "capital or operational costs directly supporting new or existing ... "projects" [within] a geographically identifiable undertaking." He also noted that it was "understood" that the Fund could be used for "land, facilities, equipment or services." Acknowledging that cooperative efforts were necessary to better serve the purposes of the Fund, a procedure was developed by the agency, the Comptroller and the Treasurer to monitor the purchases. Pursuant to that jointly developed policy, an annual spending plan is presented to the Secretary and thereafter submitted to the Comptroller for concurrence and oversight. This spending request is also forwarded to the Treasurer, and together these agencies resolve any questions regarding the spending plan.

This procedure was accurately described in the audit report (p.10) and DCNR feels that this procedure sufficiently rigorous to safeguard the expenditures and ensure proper authorization of the spending plan. This process demonstrates that these projects are clearly open to review and do not violate the broad purposes of the Act. Although there is no requirement in the Act that specific location be a factor in approving or reporting the use of expenditures, DCNR has generally tied expenditures to the various operations that enhance projects involving “conservation, recreation, dams or flood control.”

It should be noted that the auditors did find a significant number of transactions with which they had no problem, indicating that many of the expenditures are clearly within the even a narrowly defined interpretation of the Attorney General’s letter. In light of the “interpretive difficulties” associated with the Act (and apparently with the Attorney General’s informal guidance), DCNR is satisfied that the costs questioned by the auditors are appropriate.

Secondly, the Attorney General’s letter must be viewed in light of the nature of the agency in 1991 vis a vis today. At that time, the Oil and Gas Fund, was part of the Department of Environmental Resources (DER). It was one fund in a department that controlled many special funds. The conservation and resources management effort was largely centered under a single deputy secretary, in a Department with several Deputies.

In 1991, a burgeoning DER was responsible for a variety of regulatory and enforcement activities as well as a number of non-conservation related programs, regulatory programs and Federally mandated programs. The informal guidance was written to address this larger role and cannot be read apart from these circumstances. The Oil and Gas Fund was being used for a multiplicity of purposes by DER and the letter appropriately suggests a narrower use of the Fund. Given the potential drains on the Fund, the Attorney General suggested that DER focus on conservation, recreation, dams or flood control expenditures.

With the creation of DCNR out of the old DER, the potential for expenditures to stray from the purposes of the Act was greatly reduced. DCNR does not dispute that it uses some of these funds for administrative purposes, however, those purposes are in direct support of conservation and recreation, with each item in the spending plan having a definable link to the purposes authorized by the legislation.

Nevertheless, DCNR is receptive to the need to closely examine the direction and focus of our annual spending plans. Furthermore, we will continue to be vigilant in our approval of expenditures eligible for inclusion in the Oil and Gas Fund. Accordingly, the new administration of DCNR will use this audit report as an opportunity to review the spending under this program to ensure that expenditures comport with the letter and spirit of the Act.

DISTRIBUTION LIST

This report was distributed initially to the following:

The Honorable Edward G. Rendell
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Secretary
Department of Conservation and Natural
Resources

Harvey C. Eckert
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Mary K. DeLutis
Comptroller
Public Protection and Recreation

The Honorable Mary Jo White
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The Honorable Raphael J. Musto
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The Honorable William F. Adolph, Jr.
Majority Chair
Environmental Resources and Energy
Committee
Pennsylvania House of Representatives

The Honorable Camille (“Bud”) George
Minority Chair
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