

memorandum

DATE: July 24, 2009

Audit Report: OAS-L-09-13

REPLY TO

ATTN OF: IG-32 (A08OR028)

SUBJECT: Report on "Revenue Sharing at the Great Plains Synfuels Plant"

TO: Principal Deputy Assistant Secretary for Fossil Energy, FE-1

INTRODUCTION AND OBJECTIVE

In the early 1980's, the Department of Energy (Department) guaranteed a \$1.5 billion loan for the construction of a facility for converting coal into synthetic natural gas near Beulah, North Dakota. After about a year of operations, the developers of the Great Plains Synfuels Plant (Plant) experienced financial difficulties and defaulted on their loan. The Department repaid the lender and operated the facility from 1985 through 1988.

In October 1988, the Department sold the Plant and the associated coal mining assets to the Dakota Gasification Company and the Dakota Coal Company for \$85 million, a share of future revenues, and a waiver of tax credits valued at about \$750 million. Both of these companies are subsidiaries of Basin Electric Power Cooperative, an electric power generating and transmission company based in Bismarck, North Dakota. The Department's right to receive revenue sharing payments was specified in Article III, *Revenue Sharing Payments*, of the 1988 Asset Purchase Agreement (Agreement). Specifically, the Department was entitled to receive revenue sharing payments from the sale of synthetic natural gas through 2009, except for the period 1990 through 1994. Between 1988 and 2007, Dakota Gasification Company reported synthetic natural gas revenues, subject to the Agreement's revenue sharing provisions, of about \$2.1 billion and revenue sharing payments of about \$292 million.

Due to the significant amount of revenue sharing payments, we conducted this audit to determine if the Department received its share of revenue from operations at the Plant.

CONCLUSIONS AND OBSERVATIONS

We reviewed Dakota Gasification Company revenue sharing records for the period 2002 through 2007. Nothing came to our attention to indicate that there were material errors in revenue sharing payments.

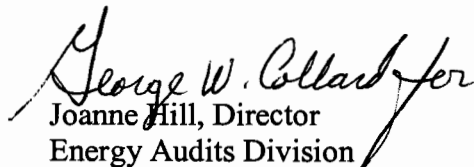
However, we determined that the Office of Fossil Energy (Fossil Energy) had not formally approved a Dakota Gasification Company proposal for deducting two new expense

elements from revenue sharing payments. Specifically, starting in October 2003, Dakota Gasification Company began deducting "transportation gas" and "transportation dollars" from revenue sharing payments. Dakota Gasification Company notified the Department in January 2004, that it had acquired transportation rights on the Northern Border Pipeline to sell natural gas at other locations and believed it would be appropriate to subtract these cost elements from revenue. Dakota Gasification Company asked Fossil Energy to acknowledge whether this was an appropriate manner in which to treat these expenses. Neither Fossil Energy nor Dakota Gasification Company could locate a formal response to the request. According to Fossil Energy, they effectively accepted and approved the proposal by signing Dakota Gasification Company's independent public accountant's agreed-upon procedures for annually reviewing revenue sharing payments that included the two new expense elements. Further, Fossil Energy did not believe this proposal represented a significant change to the revenue sharing payment process or that the Agreement's revenue sharing provisions needed to be amended.

Although the Department benefited monetarily from Dakota Gasification Company's acquisition of pipeline transportation rights, we believe Fossil Energy's acceptance of the proposal should have been formally approved and documented. According to *Standards for Internal Control in the Federal Government*, internal control activities include actions such as approval, authorization, and verification of transactions. Transactions or other events that impact revenue sharing payments, should be authorized and executed only by persons acting within the scope of their authority and authorizations should be clearly communicated.

Since the Agreement's revenue sharing provisions expire in 2009, we are not making any recommendations. Because no formal recommendations are being made, a formal response is not required.

We appreciate the cooperation provided by your staff during the course of this review.


George W. Callender
Joanne Hill, Director
Energy Audits Division
Office of Inspector General

Attachment

cc: Chief of Staff

Chief Financial Officer, CF-1

Audit Liaison, Fossil Energy, FE-3

Team Leader, Audit Liaison Team, CF-1.2

Dianne Williams, Office of Internal Review, CF-1.2

SCOPE AND METHODOLOGY

The audit was performed from March 2008 through April 2009 at the Office of Fossil Energy in Germantown, Maryland; and the offices of Dakota Gasification Company in Bismarck, North Dakota. The scope of the audit was limited to synthetic natural gas revenue and revenue sharing payments for calendar years 2002 through 2007.

To accomplish the audit objective, we:

- Reviewed the 1988 Asset Purchase Agreement and amendments;
- Reviewed the Secretary of Energy delegation granting the Assistant Secretary for Fossil Energy authority to act as the Contracting Officer for the Agreement;
- Analyzed Dakota Gasification Company synthetic natural gas billing records and other documents related to calculating annual revenue sharing payments;
- Analyzed the agreed-upon procedures reports prepared by Dakota Gasification Company's independent accountant; and,
- Discussed the revenue sharing payment calculation process with Dakota Gasification Company, Office of Fossil Energy, and Office General Counsel personnel.

We conducted this performance audit in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objective. We believe the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objective. The audit included tests of controls and compliance with laws and regulations to the extent necessary to satisfy the audit objective. Because our review was limited, it would not necessarily have disclosed all internal control deficiencies that may have existed at the time of our audit. Also, we considered the establishment of performance measures in accordance with the Government Performance and Results Act of 1993 and concluded that specific performance measures related to revenue sharing did not exist. Finally, we did not rely on computerized data to accomplish the audit objective.

An exit conference was held with Department officials on July 10, 2009.