U.S. Department of Energy
Office of Inspector General
Office of Audits and Inspections

Audit Report

The Department of Energy's American Recovery and Reinvestment Act – Arizona State Energy Program

OAS-RA-L-12-03 January 2012

Department of Energy
Washington, DC 20585

January 26, 2012

MEMORANDUM FOR THE ACTING ASSISTANT SECRETARY FOR ENERGY EFFICIENCY AND RENEWABLE ENERGY

FROM: David Sedillo
Director, Western Audits Division
Office of Inspector General

SUBJECT: INFORMATION: Letter Report on "The Department of Energy's American Recovery and Reinvestment Act – Arizona State Energy Program"

BACKGROUND

The Department of Energy's (Department) Office of Energy Efficiency and Renewable Energy (EERE) provides grants to states, territories, and the District of Columbia (states) in support of their energy priorities through the State Energy Program (SEP). The SEP allows the states to implement energy efficiency and renewable energy projects that meet their unique energy needs. The American Recovery and Reinvestment Act of 2009 (Recovery Act) significantly expanded the SEP by providing an additional $3.1 billion for states' projects. This expansion necessitated a new level of oversight to ensure that resources were used in a timely and appropriate manner and that projects were started and completed during the life of the Recovery Act funds. The SEP Recovery Act objectives were to preserve and create jobs, save energy, increase renewable energy sources, and reduce greenhouse gas emissions. The Department's program guidance emphasized that states were responsible for administering the SEP and for implementing controls over the use of Recovery Act funds.

The Department allocated $55.4 million in SEP funds under the Recovery Act to the State of Arizona (Arizona), which allocated $25.2 million in grants for energy savings and renewable energy projects in schools. The remaining $30.2 million was to fund other energy savings and renewable energy projects, such as retrofits for public buildings and non-profit organizations, and renewable energy products manufactured in Arizona. As specified by the Department in its grant agreement and program guidance, SEP funding was to be obligated by September 30, 2010, and spent by April 30, 2012. Arizona met the obligation deadline and reported that as of December 2011, it had spent $38.2 million (69 percent) of its SEP Recovery Act funds.

Due to the significant level of Recovery Act funding, we initiated this review to determine whether Arizona was accomplishing the objectives of the Recovery Act and the SEP efficiently and effectively.

CONCLUSIONS AND OBSERVATIONS

We found that Arizona had developed a number of processes and controls to accomplish the objectives of the SEP and the Recovery Act. For example, Arizona established a plan to select projects that would save energy and increase renewable energy sources; leveraged Recovery Act funds to increase economic stimulus and reduce project risk; and, tracked the number of jobs created by projects. However, we identified several concerns that could impact Arizona's success in accomplishing SEP and Recovery Act objectives. Specifically, we noted that Arizona had not always ensured:

- Timely commencement of project work at schools;
- Applicable Recovery Act provisions were included in sub-recipient agreements; and,
- Historic preservation office approvals were obtained prior to spending Federal funds to alter structures or sites.

The following paragraphs discuss these concerns in detail and the actions taken to mitigate the impact on SEP and Recovery Act objectives.

Spending Delays for Project Work at Schools

School districts have declined or delayed the installation of energy efficiency measures, such as upgrading lighting and climate control systems. The State of Arizona School Facilities Board (SFB), which administers the Energy Efficiency in Schools Program, required local school boards to provide matching funds for project work. According to an SFB official, some of the school districts that were awarded energy efficiency grants were unable to obtain the matching funds or the approval of their local school district boards and/or have declined to participate. As of November 2011, SFB had cancelled five school projects totaling $2.6 million; and $14.9 million (59 percent) of the $25.2 million school program total had not been spent. For example, the SFB awarded a $576,737 grant to the Tuba City Unified School District in October 2010 for energy efficiency projects. However, according to a SFB official, this award was cancelled in August 2011 because the School District's board was unresponsive. In addition, some projects have been delayed for over a year. For example, in January 2010, SFB awarded a Recovery Act grant of $430,355 to the Dysart Unified School District for energy efficiency projects. However, the school district did not approve a project financing agreement until 20 months later in September 2011.

A SFB official stated that they had not acted sooner to address school district delays in spending funds because they wanted to provide the districts with flexibility in implementing the grants due to their general lack of contracting experience. In addition, a funding reallocation also contributed to delays. Specifically, in September 2010 Arizona reallocated $5.9 million of its Recovery Act funding to SFB, over one year after the initial ($19.3 million) August 2009 award. Lengthy delays in starting project work could put the Recovery Act funds at risk of not being fully expended by the April 30, 2012 Recovery Act expenditure deadline. To its credit, on November 2, 2011, SFB approved a plan to reallocate $1.2 million from recently cancelled energy efficiency projects to school solar projects.

While the Department had performed monitoring reviews and site visits, it had yet to specifically address the spending delays. In support of EERE's monitoring role, the Department's National Energy Technology Laboratory (NETL) performed a financial monitoring desk audit in June 2010, and found that Arizona had not conducted a timely review of all sub-grantees. NETL recommended that Arizona establish a sub-grantee financial monitoring program. In response to the finding, Arizona developed the July 2010 Accountability and Compliance Plan. The Plan included monitoring policies and procedures intended to measure and ensure sub-recipient compliance with contract terms, conditions, and requirements. Because the plan was directed at addressing the financial monitoring issue raised by NETL, it did not address the timely start of project construction activities, which had not been identified as an issue as of June 2010, when the NETL review was performed.

Missing Provisions in Sub-recipient Agreements

Required Recovery Act regulatory provisions and Federal financial assistance rules were not always included in Arizona's sub-recipient agreements for school projects. The award agreement between the Department and Arizona required the State to include special terms and conditions required by the Recovery Act and SEP in any sub-award. Our review disclosed that Arizona included the required terms and conditions in its agreement with SFB. However, SFB did not always flow-down the required terms and conditions in its sub-recipient agreements with school districts. Specifically, we found that the seven SFB sub-recipient agreements we reviewed were missing certain provisions required by the Recovery Act and Federal regulations (10 CFR 600, *Financial Assistance Rules*). For example, the terms and conditions in SFB's subcontract with the Kirkland Elementary School District did not include required Recovery Act provisions such as segregation of costs, protection of whistleblowers, and Davis-Bacon Act requirements.

We also found that school district agreements with subcontractors did not always include required regulatory provisions. Specifically, we noted that of the eleven subcontracts that we reviewed, six subcontracts did not incorporate any of the required regulatory provisions and the remaining five subcontracts were missing multiple provisions. Further, terms and conditions in SFB's subcontracts with school districts did not include compliance with the Copeland Anti-Kickback Act and Contract Work Hours and Safety Standards Act. We did not identify any regulatory violation occurrences related to the omitted contract provisions. We also noted that two school districts did not have signed agreements with their solar project contractors that were performing work under their grant agreements.

A lack of local experience with Federal requirements led to the omission of key contract requirements despite controls established by the State. As previously discussed, Arizona developed an Accountability and Compliance Plan to monitor and ensure sub-recipient compliance with contract terms, conditions, and requirements. The State entered into a service agreement with SFB to provide oversight for the school projects and the agreement required compliance with all applicable laws and regulations. However, according to a SFB official, key contract requirements were omitted because SFB lacked experience with such requirements for Federal projects.

The lack of flow-down of regulatory requirements to sub-recipients and sub contractors, as well as the lack of signed contracts, increased the risk that grant funds would not fully achieve the goals and objectives of the Recovery Act. We discussed our results with Arizona's Energy Program Administrator who informed us that Arizona intends to ensure that sub-recipients incorporate required regulatory provisions and Federal financial assistance rules into all open sub-agreements. Additionally, Arizona SEP officials informed us that they had sent proposed flow-down text to SFB and directed SFB to include the text in all open contracts as an amendment to the awards. As of January 2012, SFB's attorney had completed reviewing the proposed flow-down text and contract revisions were underway.

Historic Preservation Approvals

SFB was required to obtain State Historic Preservation Officer (SHPO) approval prior to spending Federal funds to alter any structure or site. To comply with the National Historic Preservation Act, recipients of Federal funding were required to coordinate with the SHPO to ensure there were no adverse effects on historic property. However, SHPO approvals for small school solar projects at Yavapai County High School, Kirkland Elementary School, and the Yarnell Elementary School District were all received and dated after construction had started for the projects. In addition, SFB did not obtain SHPO approvals until after we requested the supporting documentation on August 4, 2011. A SFB official stated that this occurred because SFB had no prior experience with managing projects that required SHPO approval. An Arizona SEP official also noted that there was some initial confusion due to an assumption that small school solar projects were exempt from historic preservation requirements. Starting projects without SHPO approvals could risk possible litigation if approvals are not obtained and there are adverse effects on historic property. As of December 2011, Arizona informed us that SFB had received concurrence letters from SHPO for 40 of the 49 school solar projects and that the remaining school projects were being submitted to SHPO for review and approval.

Path Forward

We believe that the ongoing actions by Arizona and SFB to improve administration of SEP Recovery Act funds appear reasonable. However, because of the delay in starting some projects, we suggest that the Department closely monitor SEP spending in order to meet Recovery Act objectives and ensure that all funds are expended by Department deadlines. In addition, we suggest that the Department ensure that Arizona completes actions to include the required provisions in all open contracts. Further, we suggest that Arizona ensure that SFB obtains the required State Historic Preservation Office approvals.

Since no formal recommendations are being made in this report, a response is not required. We appreciate the cooperation of your staff and the various Departmental elements that provided information or assistance.

Attachment

cc: Deputy Secretary
Associate Deputy Secretary
Acting Under Secretary of Energy
Chief of Staff

OBJECTIVE, SCOPE AND METHODOLOGY

OBJECTIVE

The objective of the audit was to determine whether the State of Arizona (Arizona) was accomplishing the objectives of the American Recovery and Reinvestment Act of 2009 (Recovery Act) and the State Energy Program (SEP) efficiently and effectively.

SCOPE

The audit was performed from May 2011 to December 2011. The scope of the audit was limited to Arizona's SEP. We conducted work at Arizona's Department of Commerce (now the Governor's Office of Energy Policy) in Phoenix, Arizona; and obtained information from the Department of Energy's (Department) Office of Energy Efficiency and Renewable Energy (EERE), and the National Energy Technology Laboratory.

METHODOLOGY

To accomplish the audit objective, we:

- Reviewed Federal regulations and Departmental guidance and information related to the SEP and the Recovery Act;
- Reviewed Arizona State legislation, plans and procedures related to the SEP and the Recovery Act;
- Reviewed Arizona's documents for sub-recipients of Recovery Act funds;
- Interviewed personnel from the offices of Arizona's Department of Commerce, Department of Administration, and School Facilities Board; and,
- Held discussions with the EERE Project Officer responsible for Arizona's SEP Program.

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 that the evidence obtained provides a reasonable basis for our conclusions based on our audit objective. The audit included tests of controls and compliance with laws and regulations to the extent necessary to satisfy our 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. We did not rely on computer processed data to accomplish our audit objective. We briefed Arizona's Energy Program Administrator on September 29, 2011 and the Department's EERE Project Officer on October 4, 2011.

Management waived an exit conference.

IG Report No. OAS-RA-L-12-03

CUSTOMER RESPONSE FORM

The Office of Inspector General has a continuing interest in improving the usefulness of its products. We wish to make our reports as responsive as possible to our customers' requirements, and, therefore, ask that you consider sharing your thoughts with us. On the back of this form, you may suggest improvements to enhance the effectiveness of future reports. Please include answers to the following questions if they are applicable to you:

1. What additional background information about the selection, scheduling, scope, or procedures of the inspection would have been helpful to the reader in understanding this report?
2. What additional information related to findings and recommendations could have been included in the report to assist management in implementing corrective actions?
3. What format, stylistic, or organizational changes might have made this report's overall message more clear to the reader?
4. What additional actions could the Office of Inspector General have taken on the issues discussed in this report which would have been helpful?
5. Please include your name and telephone number so that we may contact you should we have any questions about your comments.

Name ______________________________ Date ______________________________

Telephone __________________________ Organization ________________________

When you have completed this form, you may telefax it to the Office of Inspector General at (202) 586-0948, or you may mail it to:

Office of Inspector General (IG-1)
Department of Energy
Washington, DC 20585

ATTN: Customer Relations

If you wish to discuss this report or your comments with a staff member of the Office of Inspector General, please contact our office at (202) 253-2162.

This page intentionally left blank.

The Office of Inspector General wants to make the distribution of its reports as customer friendly and cost effective as possible. Therefore, this report will be available electronically through the Internet at the following address:

U.S. Department of Energy Office of Inspector General Home Page

http://energy.gov/ig

Your comments would be appreciated and can be provided on the Customer Response Form attached to the report.