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 – Tennessee State Energy Program

OAS-RA-L-12-04

April 2012

Department of Energy
Washington, DC 20585

April 30, 2012

MEMORANDUM FOR THE ASSISTANT SECRETARY FOR ENERGY EFFICIENCY AND RENEWABLE ENERGY

Daniel M. Weeber

Daniel M. Weeber, Director
Eastern Audits Division
Office of Inspector General

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

BACKGROUND

The Department of Energy's Office of Energy Efficiency and Renewable Energy (EERE) provided grants to states, territories, and the District of Columbia (states) through the State Energy Program (SEP). The American Recovery and Reinvestment Act of 2009 increased the SEP by $3.1 billion using the existing grant formula. Grant awards to states were designed to achieve a number of Recovery Act objectives including preserving and creating jobs, saving energy, increasing renewable energy sources, and reducing greenhouse gas emissions. EERE program guidance held each state responsible for administering the SEP and for implementing sound internal controls over the use of Recovery Act funds.

The State of Tennessee's Department of Economic and Community Development (Tennessee) received $62.5 million of Recovery Act SEP grant funds. This was a significant increase from the $467,000 received prior to the Recovery Act. Tennessee planned to use these funds as part of a broader strategy to stimulate short term economic activity and growth. To implement the SEP grant, Tennessee awarded two contracts to the University of Tennessee (University). The first contract, for $31 million, was for developing the 5 megawatt West Tennessee Solar Farm (Solar Farm). The second contract, for $29.3 million, was for establishing the Tennessee Solar Institute (Solar Institute) at the University to spur growth in the State's solar industry by awarding installation and innovation grants to State companies and conducting various training activities. The University in turn awarded the University of Tennessee Research Foundation (Research Foundation), an independent not-for-profit public benefit corporation, two separate contracts to construct the Solar Farm and operate the Solar Institute. Tennessee planned to retain $2.2 million of SEP grant funding for its oversight activities. The SEP grant to Tennessee and the contracts with the University and Research Foundation were set to expire on April 30, 2012.

As part of the Office of Inspector General's strategy for reviewing the Department's implementation of the Recovery Act, we initiated this review to determine if Tennessee was using its funds in accordance with Federal requirements and the SEP grant.

CONCLUSIONS AND OBSERVATIONS

Overall, Tennessee had developed processes and controls to manage its SEP Recovery Act grant. However, we determined that, contrary to Federal requirements, Tennessee provided funds to the University in excess of what was immediately needed to pay for actual expenses. In December 2011, the University and Research Foundation had about $18.3 million of unexpended grant funds in their possession. Further, the University and Research Foundation had earned over $650,000 in interest on these funds and had not remitted any of the interest to the Government. Our review also noted that a substantial amount of funds provided for Solar Institute initiatives had not been spent, calling into question whether the funds can be expended before expiration of the grant.

Payments to the University and Research Foundation

We found that the University and Research Foundation had accumulated funds beyond what was immediately needed. In December 2011, Tennessee reported paying out about $57.7 million under its two contracts with the University. However, the University and Research Foundation had actually only spent about 69 percent of the funds. The University and Research Foundation had accumulated over $18 million not immediately needed to make payments for goods, services and salaries. Federal regulations require that advances be limited to the amounts needed for actual, immediate cash requirements and that the timing and amount of advances be close to actual disbursements. The regulations further state that sub-recipients are to minimize the elapsed time between transfer of funds and disbursements. Department SEP guidelines also state that contracts for SEP work should be tailored, as needed, and that funds are to be disbursed only when sub-recipients have demonstrated a need for reimbursement.

These excess funds accumulated because of the billing and payment terms negotiated in the contracts between Tennessee and the University, and between the University and Research Foundation. For example, the Solar Institute contracts allowed the University and Research Foundation to bill for deliverables according to a pricing schedule. However, these deliverables had no clear relationship to the actual cost of performing the work. For instance, the schedules in both contracts contained four billing milestones of $3.63 million each for approving solar innovation grant merit reviews and four billing milestones of $2.25 million each for obligating funds to solar installation grants. These eight milestones alone allowed Tennessee to be billed $23.5 million, regardless of the costs actually incurred for obtaining merit reviews or obligating funds to grants. The State's Solar Farm contract contained even less restrictive payment terms. Tennessee was required to transfer 50 percent of the estimated cost of developing the Solar Farm to the University after project cost estimates were approved by the State Building Commission. Further, the contract required Tennessee to release the remaining funds prior to the first 50 percent being exhausted.

According to Tennessee, the Department was provided weekly updates on the development and implementation of these contracts. Additionally, Tennessee stated the Department actively encouraged the development of contracts using a milestone payment process and could not recall any concerns being raised about contract payment terms, payment methodologies or project milestones that were ultimately finalized. The Departmental contract specialist involved with the Tennessee SEP grant did not recall reviewing or accepting Tennessee's contracts with the

University. While agreeing that states had been encouraged to expend funds quickly, the contract specialist said that Tennessee was still expected to be familiar with grant regulations governing the draw down of funds and interest earned.

<u>Interest Earned on Funds</u>

We also noted that through December 2011, the University and Research Foundation earned $652,104.03 in interest on the unexpended funds in their possession. Specifically, $345,582.29 was earned on unexpended funds related to the Solar Institute and another $309,521.74 was earned on funds from the Solar Farm. Federal regulation 10 CFR 600.124, *Program Income,* Subpart B – *Uniform Administrative Requirements for Grants and Cooperative Agreements with Institutions of Higher Education, Hospitals, and Other Non-Profit Organizations,* states that income earned by a recipient can generally be retained and used for eligible project objectives; but, it also notes that interest earned on advances of Department funds is not program income. Furthermore, 10 CFR 600.221(i), *Interest Earned on Advances,* Subpart C – *Uniform Administrative Requirements for Grants and Cooperative Agreements to State and Local Governments*, states that interest earned on grant funds should be remitted to the Federal government on a quarterly basis.

In April 2011, we notified the Department of our concern regarding the amount of SEP grant funds in the University and Research Foundation's possession and also expressed concerns about interest earnings. The Department's contracting officer subsequently notified Tennessee on June 9, 2011, that the Solar Farm and Solar Institute contracts are considered as sub-recipients based on 10 CFR 600.101, *Definitions*, Subpart B. The contracting officer reminded Tennessee that sub-recipients are to minimize the time elapsing between the transfer of funds and disbursement. Any Federal funds in excess of immediate disbursement needs should be promptly refunded. The project officer's June 13, 2011, on-site grant monitoring report also noted that no interest payments had been returned to the U.S. Department of Treasury (Treasury) and the contracting officer was working with general counsel to resolve the issue.

In responding to the Department in June 2011, Tennessee and University officials stated they believed that they were in compliance with Federal requirements. The officials also stated that they strove to be good stewards of all monies received and would comply with Department guidance on how to handle the interest earned. In December 2011, the Department's contracting officer issued a final determination regarding interest earned on SEP grant funds, stating that any interest earned in excess of $250 must be returned to the Department. Further, the contracting officer reminded Tennessee that it was required to minimize the time between the transfer of funds and disbursement. On January 25, 2012, the University remitted 3 separate checks totaling $652,104.03 to the Department for interest earned by the University and Research Foundation on the unspent funds in the Solar Farm and Solar Institute accounts.

<u>SEP Grant Progress</u>

In addition to the above issues, we noted that the University and Research Foundation may have difficulty spending all Recovery Act funds allocated to the Solar Institute prior to contracts expiring on April 30, 2012. In December 2011, the Solar Institute reported awarding 152 solar installation grants to businesses for purchasing small scale solar power systems and 82 solar innovation grants to provide qualified businesses with funds for a range of activities, including facility improvements, work force development, process improvements and technical assistance. Although 105 of 152 installation grants had been completed, only 7 of 82 innovation grants were complete as of December 7, 2011. Overall, about $12.9 million of the $29.3 million (44 percent) allocated remained unspent as of December 8, 2011. In January 2012, Tennessee requested that the Department extend the SEP grant through September 2013. The Department approved Tennessee's request in February 2012.

PATH FORWARD

We believe that the contracting officer's recovery of interest earned and direction to minimize the amount of time between the transfer of funds and disbursement is reasonable and addresses the issues we identified. However, to help ensure that Recovery Act goals are met, we suggest that the Department closely monitor the progress of Tennessee's grant and ensure that all Recovery Act funds are properly expended or returned to the Department/Treasury, as appropriate.

No formal recommendations are being made in this report; therefore, a response is not required. We appreciate the cooperation of your staff during our audit.

Attachment

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

OBJECTIVE, SCOPE AND METHODOLOGY

OBJECTIVE

The objective of this audit was to determine if the State of Tennessee's Department of Economic and Community Development was using its funds in accordance with Federal requirements and the State Energy Program (SEP) grant.

SCOPE

The audit was performed from March 2011 through April 2012. The scope of the audit was limited to the State of Tennessee's American Recovery and Reinvestment Act (Recovery Act) funded SEP grant. We conducted work at the Department of Economic and Community Development (Tennessee) in Nashville, TN; and, the University of Tennessee (University) and the University of Tennessee Research Foundation (Research Foundation) in Knoxville, TN.

METHODOLOGY

To accomplish the audit objective, we:

- Reviewed Federal regulations and Department of Energy (Department) guidance related to the SEP and the Recovery Act;
- Reviewed the terms of the Tennessee SEP grant;
- Reviewed the contracts between Tennessee and the University, and between the University and its Research Foundation; and,
- Analyzed invoices, grants and status reports for activities funded by the Tennessee SEP grant.

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 objectives. We believe the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objective. Accordingly, the audit included test of controls and compliance with laws and regulations to the extent necessary to satisfy the objective. In particular, we assessed the implementation of the *GPRA Modernization Act of 2010* as it relates to the audit objective and found that the Department had established performance measures related to the SEP. 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 the audit objective.

We held an exit conference with Department officials on April 3, 2012.

IG Report No. OAS-RA-L-12-04

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