



U.S. Department of Energy
Office of Inspector General
Office of Audit Services

Audit Report

Management Controls over the
Department of Energy's American
Recovery and Reinvestment Act –
Michigan State Energy Program



OAS-RA-10-18

September 2010



Department of Energy
Washington, DC 20585

September 29, 2010

MEMORANDUM FOR THE ASSISTANT SECRETARY FOR ENERGY EFFICIENCY AND RENEWABLE ENERGY

A handwritten signature in black ink, appearing to read "Rickey R. Hass".

FROM: Rickey R. Hass
Deputy Inspector General
for Audit Services
Office of Inspector General

SUBJECT: INFORMATION: Audit Report on "Management Controls over the Department of Energy's American Recovery and Reinvestment Act - Michigan 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) to support their energy priorities through the State Energy Program (SEP). Traditionally, SEP received \$40 to \$50 million in annual appropriations. The American Recovery and Reinvestment Act of 2009 (Recovery Act) expanded the SEP by authorizing an additional \$3.1 billion to states using the existing distribution formula. EERE awarded the grants after reviewing state plans summarizing activities for achieving SEP Recovery Act objectives, including preserving/creating jobs; saving energy; increasing renewable energy sources; and, reducing greenhouse gas emissions. States are encouraged to use these funds not only to support current energy projects but also to aid sustainable programs that will provide lasting benefits. EERE program guidance emphasizes that states are responsible for administering the SEP within each state, and requires each state to implement sound internal controls over the use of Recovery Act funds.

The State of Michigan (Michigan) received \$82 million in SEP Recovery Act funds – a more than 30-fold increase over Michigan's Fiscal Year 2008 SEP funding of \$2.7 million. Per the Recovery Act, this funding must be obligated by September 30, 2010, and spent by April 30, 2012, in accordance with the grant agreement. 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 whether Michigan had internal controls in place to provide assurance that the goals of the SEP and Recovery Act will be met and accomplished efficiently and effectively.

OBSERVATIONS AND CONCLUSIONS

We found that Michigan had established adequate internal controls over selecting Recovery Act projects and accounting for related expenditures. However, the accomplishment of Recovery Act goals could be impeded by Michigan's lack of effective procedures for assessing and monitoring high-risk SEP projects. Further, we found that a year after being granted access to Recovery Act SEP funding, Michigan had expended only a fraction of its funding.

Internal Controls

Michigan had, for the most part, designed internal controls to effectively manage its SEP projects. Michigan's controls ensured adequate separation of duties, appropriate segregation of Recovery Act costs, and transparency in SEP reporting. Further, we found that Michigan selected appropriate projects to receive Recovery Act funds in that they employed a systematic process to evaluate, rank, and select the projects that best met their SEP Recovery Act goals.

However, we identified weaknesses in procedures Michigan developed related to monitoring projects to ensure they are accomplished effectively. For example, Michigan's Bureau of Energy Systems, the state agency responsible for administering the program, had not identified high-risk sub-recipients/projects. To ensure sub-recipient compliance with SEP grant terms and conditions, Michigan planned to perform on-site monitoring of SEP projects it determined to be high-risk. This determination was to be based on a risk assessment that considered the grant recipient's financial position and business performance measures.

Although Michigan officials stated that they planned to develop a schedule for performing on-site monitoring of high-risk sub-recipients, they had not performed a risk assessment to identify such projects. Further, the procedures for performing this assessment were not developed until May 20, 2010, and many of the risk factors in the assessment were vague and subjective in nature. For example, one of the assessment factors labeled "Otherwise Responsible" was to be answered with a simple yes, no, or manager comment. There was no explanation or guidance provided to enable an objective response for the risk factor. Additionally, the assessment factor labeled "Internal Controls" was to be answered with yes or no responses, but there was no identification of what internal controls were to be considered or guidance in how to assign the response. Specific risk assessment criteria and guidance for their use should be developed to ensure consistent, objective application for determining high-risk projects.

Also, the Bureau of Energy Systems had not developed guidance for performing on-site monitoring of high-risk sub-recipients. Bureau of Energy Systems personnel told us they did not plan to develop new on-site monitoring procedures until the designated monitor had made at least one site visit to a sub-recipient. They felt that this approach would result in a more effective monitoring process. However, the lack of any procedures prior to performing initial site visits to the sub-recipients may diminish monitoring effectiveness. Therefore, it may be more effective to develop initial procedures and modify or enhance them based upon knowledge gained during the first site visits. Delays in identifying high-risk projects and developing an adequate monitoring plan increase the likelihood that SEP Recovery Act funds could be misused.

Additionally, our review revealed that the existing procedures for invoice review to be used by grant managers in evaluating sub-recipient expenditures did not specifically address verification of compliance with SEP Recovery Act requirements such as Buy American provisions and Davis-Bacon wage requirements. However, after we informed Michigan officials of this oversight, to their credit, the existing procedures were appropriately modified.

Obligating and Expending Recovery Act Funds

Michigan received access to its SEP funding in April 2009, and as of June 30, 2010, \$68 million (83 percent) had been obligated, but only \$7.3 million (9 percent) had been expended. One of the key goals of the Recovery Act was to stimulate the national economy with the expedient influx of Federal funds. Michigan's strategy for utilizing SEP Recovery Act funding includes reducing energy consumption in state buildings, stimulating sustainable private industry manufacturing in the renewable energy sector, and creating opportunities for wind energy.

Bureau of Energy Systems officials told us that they initially focused on renewable energy manufacturing projects in order to create jobs and facilitate sustainable business growth in the private sector. However, these manufacturing projects required an EERE programmatic review and National Environmental Policy Act (NEPA) determinations, which were not obtained until December 2009. Subsequent to obtaining the NEPA determinations, Michigan began awarding renewable energy manufacturing grants and grants to reduce energy consumption in state buildings in the latter half of December 2009. As we observed in our recent audit report *Status Report: The Department of Energy's State Energy Program Formula Grants Awarded Under the American Recovery and Reinvestment Act* (OAS-RA-10-17, September 2010), regulatory requirements new to SEP have contributed to the slow pace of Recovery Act SEP spending.

EERE Oversight

The internal control weaknesses discussed in this report can be attributed, at least in part, to insufficient Department monitoring. EERE is required to perform monitoring of each state's SEP activities annually; however, EERE had not performed on-site monitoring of Michigan's SEP activities since the passage of the Recovery Act. Further, the EERE Project Officer for Michigan told us the last on-site monitoring visit was in 2005, but was unable to provide us with any documentation regarding the visit. EERE has provided Michigan state officials with guidance on Recovery Act projects and visited the state to meet with Bureau of Energy Systems officials to review project progress and meet sub-recipients; however, the Project Officer noted that this did not serve as on-site monitoring. Timely on-site monitoring by EERE may have identified the internal control weaknesses we discovered.

RECOMMENDATIONS

To improve on-going oversight and help ensure the success of Michigan's use of Recovery Act funds, we recommend that the Deputy Assistant Secretary for Energy Efficiency, EERE, ensure that:

1. Annual on-site monitoring of Michigan's SEP activities is performed; and,
2. Appropriate internal controls and procedures are in place to prevent inappropriate expenditures of Recovery Act funding, to include identifying and monitoring high-risk Recovery Act projects.

MANAGEMENT COMMENTS

EERE concurred with the audit recommendations and stated that they will continue their close oversight of Michigan's SEP activities. They stated that they have already conducted three monitoring visits to Michigan under the Recovery Act and will continue regular on-site visits at least twice a year moving forward. They added that Michigan has now refined or developed the internal controls necessary to address the weaknesses identified in the report, including establishing a system to identify and monitor any high-risk sub-recipients under the program. They committed to work closely with the state to monitor the program and each project to ensure the success of Michigan's SEP. EERE's comments are included verbatim in Attachment 2. Michigan's verbatim comments are included as Attachment 3.

AUDITOR RESPONSE

EERE's comments are responsive to our recommendations.

Attachments

cc: Deputy Secretary
Under Secretary of Energy
Chief of Staff

OBJECTIVE, SCOPE, AND METHODOLOGY

OBJECTIVE

The objective of our audit was to determine whether the State of Michigan (Michigan) had internal controls in place to provide assurance that the goals of the State Energy Program (SEP) and the American Recovery and Reinvestment Act of 2009 (Recovery Act) will be met and accomplished efficiently and effectively.

SCOPE

The audit was performed from January 2010 to May 2010. The scope of the audit was limited to Michigan's SEP. We conducted work at the Michigan Department of Energy, Labor, and Economic Growth and the Bureau of Energy Systems in Lansing, Michigan; and, obtained information from the Department of Energy's (Department) Office of Energy Efficiency and Renewable Energy (EERE) in Washington, DC.

METHODOLOGY

To accomplish the audit objective, we:

- Reviewed Federal regulations and Department guidance related to the SEP and the Recovery Act;
- Reviewed Michigan state legislation, plans, and procedures related to SEP and the Recovery Act;
- Reviewed Michigan's grant files for sub-recipients of Recovery Act funds;
- Interviewed personnel in Michigan's Department of Energy, Labor, and Economic Growth, Bureau of Energy Systems and Finance and Administration Services; and Internal Audit Services; and,
- Held discussions with the EERE Project Officer related to the oversight of the Michigan SEP.

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 findings based on our 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. We did not rely on computer processed data to accomplish our audit objective.

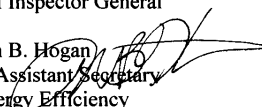
We briefed Michigan officials on July 28, 2010, and Department officials on August 4, 2010. An exit conference was held with Department officials on September 21, 2010.



Department of Energy
Washington, DC 20585

SEP 10 2010

MEMORANDUM FOR: Ricky R. Haas
Deputy Inspector General
for Audit Services
Office of Inspector General

FROM: Kathleen B. Hogan 
Deputy Assistant Secretary
For Energy Efficiency
Office of Technology Development
Energy Efficiency and Renewable Energy

SUBJECT: Response to the Office of Inspector General Draft Report on
"Management Controls over the Department of Energy's American
Recovery and Reinvestment Act – Michigan State Energy Program"

The Office of Energy Efficiency and Renewable Energy (EERE) appreciates the opportunity to review the Office on Inspector General's (IG) Draft Audit Report "Management Controls over the Department of Energy's American Recovery and Reinvestment Act – Michigan State Energy Program."

The Department of Energy takes very seriously its responsibility to oversee and manage each of our Recovery Act projects to ensure that funds are being well spent to stimulate the economy and promote America's clean energy future. DOE concurs with the Inspector General's recommendations and will continue to closely oversee the work under Michigan's State Energy Program. DOE has already conducted three monitoring visits in Michigan under the Recovery Act and will continue to conduct regular on-site visits at least twice a year moving forward. In addition, DOE will continue to communicate frequently with the state and will review all state reports at least quarterly.

DOE also agrees with the Inspector General that having appropriate internal controls and procedures in place is necessary for any grant program to ensure that funds are being used appropriately. DOE has implemented a robust monitoring plan for all states, including tracking findings across the country to identify any trends among grantees. Whenever necessary, DOE acts quickly to address any issues, including increasing oversight and providing technical assistance. Michigan has, with the help of DOE and the IG, now refined or developed the internal controls necessary to address the weaknesses identified in the report. The state now has a system in place to identify and monitor any high-risk sub-recipients under the program.

The Department will continue to work closely with the state to monitor the program and each of the projects to ensure the success of Michigan's State Energy Program.

Should you have any questions, please contact Mark Bailey at 202-586-9424.

Attachment



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Response to Inspector General Audit Report:

“Management Controls over the Department of Energy’s American Recovery and Reinvestment Act – Michigan State Energy Program”

Recommendation 1

Annual on-site monitoring of Michigan's SEP activities is performed.

Response

Concur

Recipients of American Recovery and Reinvestment Act (ARRA) State Energy Program (SEP) awards are monitored on an annual basis, in accordance with the program’s monitoring manual. SEP leadership has established, as a minimum requirement, that each grantee’s offices receive an on-site visit by the DOE Project Officer on average every six months.

Michigan has received three (3) monitoring-related visits by its DOE Project Officer since the state’s ARRA SEP award was signed. Peter Ashley, DOE Project Officer for Michigan, performed on-site monitoring of Michigan from July 26 through July 30, 2010. During this visit, the Project Officer completed EERE on-site monitoring requirements, including documentation and eight (8) visits to Michigan SEP ARRA sub-recipient projects. In addition to this on-site monitoring visit, Mr. Ashley also visited Michigan on two occasions during late 2009 and 2010 to monitor readiness for program implementation. Mr. Ashley was in Lansing, Michigan, on November 19, 2009, for an all-day meeting with individuals from Michigan’s Bureau of Energy Systems and technical experts from the Department of Energy’s Headquarters office to discuss the implementation of projects under Michigan’s SEP ARRA award. Mr. Ashley and Henry Fowler (DOE Project Officer for Missouri and Iowa) visited Michigan from January 25 through January 29, 2010, to meet with individuals from Michigan’s Bureau of Energy Systems to discuss on-site monitoring requirements and practices, National Environmental Policy Act (NEPA) requirements, financial monitoring, and general issues related to the state’s SEP ARRA award. During this readiness visit, Mr. Ashley, Mr. Fowler, and representatives from Michigan conducted four (4) site visits to SEP ARRA sub-recipients in order to discuss project implementation, monitoring practices and Federal expectations.

Recommendation 2

Appropriate internal controls and procedures are in place to prevent inappropriate expenditures of Recovery Act funding, to include identifying and monitoring high-risk Recovery Act projects.

Response

Concur

The program concurs that having appropriate internal controls and procedures in place is necessary for

any grant program to ensure that fraudulent activities do not occur and that funds are used appropriately. SEP leadership continues to implement a robust plan for DOE monitoring of States. The program tracks monitoring findings on a biweekly basis to identify trends and, where appropriate, to ensure attention to corrective actions identified as necessary during monitoring visits. Where the need for corrective action is identified, this plan calls for the provision of technical assistance to as well as increased oversight of grantees.

While the Inspector General (IG) audit of Michigan's SEP ARRA award concluded that "Michigan had, for the most part, designed internal controls to effectively manage its SEP projects...ensur[ing] adequate separation of duties, appropriate segregation of Recovery Act costs, and transparency in SEP reporting," the audit did identify some weaknesses in the state's internal controls related to the identification of high-risk sub-recipients and the development of guidance for conducting on-site monitoring of sub-recipients.

Michigan has, with the help of DOE and the IG, refined or developed the internal controls necessary to address those weaknesses. Michigan now has a system in place which identifies high-risk sub-recipients and sets out monitoring procedures to be used with high risk sub-recipients. Michigan's Bureau of Energy Systems has copies of Michigan's internal controls and procedures, most of which the DOE IG has already reviewed.

Recognizing the importance of monitoring *by* States of their sub-recipients, SEP is providing additional relevant resources for grantees. The program expects to issue sub-recipient monitoring guidance in September 2010. SEP is also coordinating with DOE's Office of Risk Management in the Office of the Chief Financial Officer to permit grantees to benefit from an automated, service that DOE is developing to identify high-risk sub-recipients.

SEP is also performing risk analysis that is consistent with the Risk Management framework developed by the Office of Risk Management in the Office of the Chief Financial Officer. The SEP risk analysis will define Risk profiles to identify low-, minimal- and high-risk grantees and sub-grantees as well as to tailor monitoring approaches, technical assistance delivery, and oversight management.



JENNIFER M. GRANHOLM
GOVERNOR

STATE OF MICHIGAN
DEPARTMENT OF ENERGY, LABOR & ECONOMIC GROWTH
LANSING

ANDREW S. LEVIN
ACTING DIRECTOR

September 22, 2010

Mr. Rickey R. Hass
Deputy Inspector General for
Audit Services
DOE Office of Inspector General
Washington DC 20585

Ms. Sharon Ashe
DOE Office of Inspector General
Environment, Technology, Corporate, and
Financial Audits Division
Aiken, SC 29802

SUBJECT: Draft Report on "Department of Energy's American Recovery and Reinvestment Act – Michigan State Energy Program".

Dear Mr. Hass and Ms. Ashe:

This correspondence is in response to the subject draft report. While the date on the letter we received is August 24, 2010, the Director of the Bureau of Energy did not receive the subject report until September 1, 2010. Therefore, a response today meets the 15 working day timeline as requested.

Internal Controls

"Lack of effective procedures for assessing and monitoring high-risk State Energy Program (SEP) American Recovery and Reinvestment Act (ARRA) projects."

With the significant increase in SEP funding made available to the state, Michigan was able to greatly expand the types and volumes of energy efficiency and renewable energy projects funded in the public and private sectors. This effort required expanded policies and procedures to be put in place. The Office of Inspector General Audit was commenced within 60 days of the state's authorization to spend the SEP dollars (December 2009). As such, Michigan was preparing and documenting the process for assessing and monitoring high-risk SEP project recipients. This process and procedure has been documented, field tested, and used for state energy projects.

While a staff person may have indicated that the procedure would be developed after the fact, this approach was not verified with management and is not the approach that was taken. The additional specificity noted in this report, and through conversations with the auditors is being integrated into an updated procedure.

The timing of this development has not impeded the state's progress in meeting the obligation and expenditure targets established by the Department of Energy (DOE). In fact, 100 percent of the state's SEP allocation has been obligated and greater than 20 percent will be expended as of September 30, 2010, even given authorization to spend was not received until December 2009.

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The state was also quickly responded to and adopted suggested recommendations by the auditors which has strengthened the internal controls and procedures as they were identified.

Obligating and Expending Recovery Act Funds

"A year after being granted access to ARRA SEP funding, Michigan had only expended a fraction of its funding."

The state received its SEP award allocation in April 2009. The initial access was only for administrative costs based on the initial application. A final application was submitted in May 2009, and subsequent award amendment in late June 2009, awarded the full \$82 million to the state; however, the funds were conditioned, and not available to the state for a number of reasons. The DOE, in particularly the Golden Colorado Field Office, and the state has worked collaboratively to address these new regulatory requirements and ensure due diligence. From the point of award, the Bureau of Energy Systems (BES) has also worked in concert with the Michigan Economic Development Corporation, DOE Oakridge National Laboratory, and the financial markets to establish criteria to implement clean energy advanced manufacturing (CEAM) and create innovative tools for financing these projects. Since the beginning of 2010, the BES has funded over \$35 million for CEAM projects which focus on manufacturing of renewable energy systems and components, and efficiency energy systems and components. These projects will result in over 1900 new jobs and leverage over \$38 million in private capital.

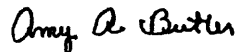
Since December 2009, the state has made substantial progress in meeting the ARRA goals and will have 100 percent of the funds obligated and nearly 30 percent (greater than the 20 percent target) costed by the September 30, 2010 deadline.

EERE Oversight

While this comment is not necessarily within the prevue of the state's response, the DOE has conducted a program monitoring on-site review and financial on-site review. In addition, regular telephone updates are held with the project officer, and the regular project visits continue to be held. Michigan has also had at least four program visits from DOE program officials, as well as visits with the General Accounting Office.

Thank you for the opportunity to provide comments and response to the draft report. We hope that this will be included or referenced in the final report.

Sincerely,



Amy A. Butler, Bureau Director
Bureau of Energy Systems
517-335-2823

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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.

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