STATE OF WASHINGTON

June 6, 2011

The Honorable Brian Sonntag
Washington State Auditor
P.O. Box 40021
Olympia, WA 98504-0021

Dear Auditor Sonntag:

Thank you for the opportunity to provide this official management response to the performance audit on the State Energy Program at the Washington State Department of Commerce (Commerce).

The purpose of the American Recovery and Reinvestment Act of 2009 was to aid the economy by creating and saving jobs through investments in areas such as infrastructure and energy. The State Energy Program received a grant of $60.9 million of which $38.5 million was allocated to the Energy Efficiency and Renewable Energy Loan and Grant Program. As your audit confirms, the State Energy Program met the federal requirement to obligate all of these funds by September 30, 2010. In doing so, Commerce received an award from the U.S. Department of Energy (DOE) for getting funds into our local economy quickly and responsibly. Commerce also met the legislative intent to invest in high-quality, newer technology projects in the private sector through open, competitive bidding.

Given the extremely tight timelines, changing federal guidance, and strict accountability requirements, we are also pleased the audit found that this program followed the majority of practices for competitive loan and grant programs as identified by the Auditor during the audit. A programmatic and financial evaluation, as well as a Davis-Bacon compliance review, by DOE stated the program met the standards, and therefore, received zero findings. The evaluation commended Commerce for its excellent work with the State Energy Program, specifically on the monitoring process for sub-recipients.

We recognize there is always room for improvement. Several actions to strengthen practices have already been completed. We agree that better documentation would have been helpful in certain areas. Although it is unlikely this program will have to manage a similar influx of funds in the near future, Commerce staff will evaluate where better-documented policies and procedures are warranted and implement as necessary.

Sincerely,

Rogers Weed, Director
Department of Commerce

Marty Brown, Director
Office of Financial Management

Attachment

cc: Jay Manning, Chief of Staff, Office of the Governor
Jill Satran, Deputy Chief of Staff, Office of the Governor
Wendy Korthuis-Smith, Director, Accountability & Performance, Office of the Governor
Kimberly Cregeur, Governor's Liaison on Performance Audits, Accountability & Performance, Office of the Governor

OFFICIAL AGENCY RESPONSE TO THE PERFORMANCE AUDIT ON COMMERCE'S STATE ENERGY PROGRAM

JUNE 2011

This coordinated management response is provided by the Department of Commerce (Commerce) and the Office of Financial Management (OFM) for the audit report received on May 23, 2011.

ISSUE 1: Program administrators followed many of the sound practices we identified. However, in an effort to meet tight federal deadlines, they did not follow some important practices in awarding the funds.

COMMERCE RESPONSE: Commerce's plan for distributing $38.5 million in American Recovery and Reinvestment Act (Recovery Act) funds included an aggressive schedule both to conduct two competitive solicitations to the private sector and to ensure we would meet the critical U.S. Department of Energy (DOE) deadline to have all funds obligated by September 30, 2010. **Commerce met this deadline and successfully obligated all of the $38.5 million available to the State Energy Program.**

We agree that some steps were not thoroughly documented and some best practices were not followed, due in part to extremely tight timelines and changing federal guidance. Despite not having the information identified in *Appendix E: Sound Processes* prior to awarding the funding, Commerce still met 75 percent of the elements identified in the audit report.

Several of the items marked as "did not follow" in the appendix were in fact followed by staff throughout the process; however, they were not documented specifically as unique steps. This information will be beneficial going forward for any future competitive grant and loan program that might be administered by the State Energy Office.

Given the aggressive schedule and one-time nature of the award, the program-specific application guidelines developed for Rounds 1 and 2 were used by the program manager and office staff in conjunction with agency policies and procedures, rather than developing a program-specific policy and procedure manual. Commerce has agency-level policies and procedures in place for awarding program funds. Divisions within Commerce follow these rather than establish numerous new program-specific policies and procedures. This helps prevent silos and ensure continuity across the agency. Using agency policies and procedures in conjunction with the application guidelines ensured the award process was consistently communicated to the applicants and applied during the award process.

Risk assessment was included in the application review and scoring process; however, it was not a specific scoring category or formally documented. As documented in the State Energy Office sub-recipient monitoring plan, risk assessment is an ongoing component of our monitoring process, and we now track risk level in our monitoring documents.

In consultation with and approval from DOE, the statements of work in three projects cited in the audit were narrowed to allow for early use of the Recovery Act funds in a much larger project to accommodate time constraints associated with the funding. These projects were still required to meet all applicable federal environmental and wage requirements. All three projects have met the National Environmental Policy Act (NEPA) requirements and received approval from DOE. One project is completing a full environmental assessment, and the project subject to Davis-Bacon is in full compliance.

As noted in the audit, one sole-source project was awarded a $2 million grant for energy-efficient equipment in a plant that will make carbon fiber material for a car manufacturer. With the support of this award, this $100 million manufacturing facility was successfully located in Washington rather than in Canada, bringing an estimated 80 jobs by the end of 2011. While this process was outside the original plan to issue awards through two competitive rounds, it was consistent with Commerce's goals in the State Energy Plan and was fully approved by DOE. The project is expected to create jobs, reduce energy consumption in manufacturing through the purchase of energy-efficient equipment, and reduce energy use in the transportation sector through a new approach to building vehicles. The company recently announced the production facility has been completed and its plan is to start producing carbon fiber in the third quarter of this year.

Action Steps and Time Frame

- Incorporate and document risk assessment as part of monitoring plan. Completed.
- Review website documentation and update with current information. By August 1, 2011.

OFM RESPONSE: Given the extremely tight timelines, changing federal guidance, and strict accountability requirements of the Recovery Act, we are pleased that the State Energy Program followed the majority of practices for competitive loan and grant programs as identified by audit staff. DOE conducted a programmatic and financial evaluation, as well as a Davis-Bacon compliance review. It stated the program met the standards, and therefore, received zero negative findings.

ISSUE 2: The State Energy Office did not require or receive all the information it will need to ensure it can appropriately monitor and oversee these projects.

COMMERCE RESPONSE: We agree that during the initial period of monitoring, not all information was received to support detailed monitoring. This was very early on in the process, and since that time, the State Energy Office has implemented tighter controls specifically related to Recovery Act sub-recipient monitoring.

To ensure greater control over invoice monitoring and documentation, Commerce implemented the following measures:

- On September 1, 2010, monitoring of invoice payments on the Energy Office's Recovery Act contracts was transferred to Commerce's Contracts Administration Unit (CAU). CAU has experienced staff dedicated to reviewing all requests for payments and the supporting documentation before payments are approved.
- All requests for reimbursement are reviewed and approved by the program manager for consistencies with the statement of work and project activities, and for ongoing status tracking.
- Invoices are also monitored by the invoice payer in the CAU prior to approval for payment to ensure all costs are allowable and the appropriate level of documentation has been provided for verification.

All recipients from Rounds 1 and 2 were monitored on-site by the program manager and technical staff, when available, to review the contract template and discuss each project, including the federal and state requirements associated with the award. This was part of our post-award risk assessment. We agree more detailed documentation would have been appropriate for the sub-recipient file. The information gained from this process has informed the contracting process and ongoing monitoring activities.

Since completion of the award process, staff efforts have been focused on desktop and on-site monitoring. The State Energy Office has conducted at least one on-site monitoring visit for all State Energy Program loan and grant recipients in Rounds 1 and 2. Seven of these visits were in conjunction with DOE as part of the federal agency's monitoring of the Recovery Act grant. After reviewing our sub-recipient monitoring plan and observing successful execution of the plan on several visits, DOE found Commerce to be in compliance with the general administration of the Recovery Act grant. In a letter to Commerce in March of 2011, **DOE commended the Energy Office for its "excellent work with the State Energy Program…specifically on your sub-recipient monitoring process."** No corrective action was recommended.

Action Steps and Time Frame

- Document risk assessment as part of monitoring plan. Completed.
- Strengthen desktop monitoring for review and approval of invoices. Completed.

OFM RESPONSE: We support the use of sound practices to monitor all projects administered by the state. We appreciate the steps taken by Commerce staff to strengthen their oversight of these projects.

ISSUE 3: Commerce did not meet a goal to loan two-thirds of the Recovery Act funds provided to the Loan and Grant Program, which will reduce by $8.5 million the amount of funds available for future energy projects.

COMMERCE RESPONSE: As part of the application for Recovery Act funding, Commerce set an agency goal to maximize loans by distributing two-thirds of the funding via loans and one third via grants. This was one of nine goals identified in the plan based upon the information available at the time. It was unclear at that time if private sector applicants would be willing to accept loans and meet the stringent requirements of federal funding. Commerce achieved its original target for the loan-to-grant award ratio in the first competitive round by awarding $13.6 million in loans and $6.5 million in grants.

Unfortunately, because of a variety of factors including significant federal requirements, complexity, timing, and an unwillingness on the part of the applicants to accept loan terms, several applicants dropped out. This resulted in funding for Round 1 at $9.0 million in loans and $6.5 million in grants, reducing the level of funding awarded for loans.

The Legislature required Commerce to consult with the Clean Energy Leadership Council (CELC), whose primary job is to prepare a strategy for expanding Washington's clean energy technology sector. As the guidelines for Round 2 were being developed, the CELC urged Commerce to emphasize grants over loans, indicating grants would be more helpful in stimulating innovative projects.

Based on these factors, along with the sense of urgency on the part of Commerce to meet the DOE obligation deadline, Commerce chose to award a higher percentage of awards as grants rather than risk losing the funding altogether. While this reduces the funding available for similar future projects, achieving the deadline to obligate all of the Recovery Act funds allowed Commerce to provide more immediate and essential funding to private businesses in Washington to create and save jobs.

Action Steps and Time Frame

- No recommendations made in the audit report.

OFM RESPONSE: The issue cited in the report gives the impression that Commerce missed a primary goal of the Recovery Act – which it did not. On the contrary, Commerce's State Energy Program **met the overarching goals set by the Recovery Act and the Governor** to quickly distribute funds to communities to preserve and create jobs. By successfully obligating all the funds on time, the program avoided having to return any of the $38.5 million awarded by the federal government.

Likewise, the program successfully responded to the Legislature's direction for investing in high-quality, newer technology projects in the private sector. Other goals in the plan, such as leveraging Recovery Act funds and selecting projects across a range of risk, were also met.

As noted in the State Energy Plan, funds for the State Energy Program can be used for a broad range of energy efficiency and renewable energy loans and grants. Setting an original goal of distributing more funds through loans made sense given the limited information both federal and state program staff had to work with at the time.

Commerce did strive to meet its original goal, and in fact, did meet the goal of awarding more loans than grants in the first competitive round (see Appendix G). The report explains why the number of loans was less than originally planned. Despite a rapidly changing environment, staff responded quickly and appropriately to ensure the primary goals of the Recovery Act were met. As a result, none of the $38.5 million in Recovery Act funding for the State Energy Program was forfeited.