A Report
to the
Montana
Legislature

Performance Audit

State Building Energy Conservation Program

Department of Environmental Quality

November 2009

Legislative Audit
Division

09P-06

Performance Audits

Performance audits conducted by the Legislative Audit Division are designed to assess state government operations. From the audit work, a determination is made as to whether agencies and programs are accomplishing their purposes, and whether they can do so with greater efficiency and economy.

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 that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

Members of the performance audit staff hold degrees in disciplines appropriate to the audit process. Areas of expertise include business and public administration, journalism, accounting, economics, sociology, finance, political science, english, anthropology, computer science, education, international relations/security, and chemistry.

Performance audits are performed at the request of the Legislative Audit Committee which is a bicameral and bipartisan standing committee of the Montana Legislature. The committee consists of six members of the Senate and six members of the House of Representatives.

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November 2009

The Legislative Audit Committee
of the Montana State Legislature:

This is our performance audit of the State Building Energy Conservation Program. This report includes recommendations for the program, including clarifying the collection of estimated energy cost savings from participating agencies, and improving management controls for the program. A written response from the Department of Environmental Quality is included at the end of the report.

We wish to express our appreciation to Department of Environmental Quality and Department of Administration officials and staff for their cooperation and assistance throughout the audit.

Respectfully submitted,

/s/ Tori Hunthausen

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Legislative Auditor

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Report Summary

The State Building Energy Conservation Program

The Department of Environmental Quality's authority to collect approximately $1.2 million in additional energy cost savings should be clarified and management controls should be developed.

Audit Findings

In Montana, the State Building Energy Conservation Program (SBECP) was designed to reduce energy costs in state facilities. From 1993 to 2006, the SBECP issued General Obligation bonds to finance energy improvement projects, using estimated energy cost savings to service bond debt. Due to statutory ambiguity, the program collected estimated energy cost savings beyond the retirement of these bonds. By fiscal year 2017, the program will collect approximately $1.2 million beyond bond debt from participating agencies. And while state law directs participating agencies to transfer these additional energy cost savings to the Long Range Building Program (LRBP), the SBECP has directly collected these savings from participating agencies and only transferred portions to the LRBP. For example, the SBECP collected $56,500 after bond retirement in fiscal year 2005; however, the SBECP only transferred approximately $36,000 to the LRBP that year.

Audit work indicated the program has historically operated on an informal basis, with limited program oversight, no policies or procedures, and a lack of a structured filing system, which has resulted in limited information supporting how program decisions are made. These limited management controls impacted our ability to determine if the program is working as the legislature intended. The SBECP has relied on the activities of the LRBP to implement SBECP activities, including the identification, selection, and implementation of SBECP projects. Audit work identified coordination issues between the SBECP and LRBP, including the process for transferring funds to the LRBP. The focus of the SBECP has been on the day-to-day activities of the program, rather than on a coordinated set of policies and procedures to ensure the SBECP functions in compliance with applicable laws and in accordance with management directives. The department should develop stronger controls, including formalizing SBECP and LRBP interactions.

In 2009, the legislature appropriated approximately $22 million in funds leveraged from the American Recovery and Investment Act. These funds will be utilized to establish a revolving loan fund to finance future SBECP projects. This move is a significant departure from the bonds that have historically financed projects, mainly in terms of

the amount of funding administered by the SBECP. These additional funds further illustrate the value in developing formal management controls to guide its ongoing activities.

Audit Recommendations

Audit recommendations address the need for the department to:

- Seek legislation to clarify the retirement or continuation of the collection of estimated energy cost savings beyond the retirement of bond payments
- Comply with state law regarding the transfer of funds to LRBP
- Develop management controls for the SBECP, including formalizing its interaction with LRBP

Chapter I – Introduction

Introduction

Energy efficiency—and conservation by extension—is about realizing the same amount of work or benefit with less energy. Recognizing that government is a large consumer of energy, many states have chosen to lead by example, targeting the reduction of energy consumption as a significant goal. While energy reduction can be realized through many activities such as fleet management, procurement practices, and employee practices, reducing facility energy use can provide some of the most considerable reductions in energy consumption. Building renovations which incorporate energy efficient equipment can use significantly less energy. For example, a modern double-paned window loses around ten times less heat in the winter than an older single-paned window. In Montana, the State Building Energy Conservation Program (SBECP) was designed to reduce energy costs in state facilities by identifying and funding cost-effective energy efficiency improvement projects. The program is located within the Department of Environmental Quality (DEQ). Based on the high level of interest in energy stewardship on the part of government, the Legislative Audit Committee identified a performance audit of the SBECP as a priority.

Audit Objectives

We developed two objectives for examining the SBECP:

- Determine whether the SBECP is meeting statutory criteria which guide program activities.
- Identify management controls for SBECP operations.

Audit Scope and Methodologies

Audit scope focused on the activities of the SBECP relative to energy improvements on existing state-owned buildings, including whether the SBECP is meeting criteria outlined in statute to guide the program. In addition, audit assessment work identified limited management controls for the program. During audit planning, we noted the SBECP and Long Range Building Program (LRBP) are complementary programs which work closely together on energy improvement work for state-owned buildings. The LRBP also informally provides several management controls for the SBECP. As part of our audit, we reviewed the management of SBECP activities provided by SBECP and LRBP. We limited our examination to the General Obligation (GO) bonding for the program. To accomplish our audit objectives, we completed the following methodologies:

- Reviewed applicable laws and statutorily required reports to the Governor which summarize SBECP activities

- Examined SBECP project files, which document operations and activities
- Interviewed SBECP and LRBP staff
- Evaluated bonding and billing processes
- Interviewed staff from agencies which have utilized the SBECP
- Evaluated SBECP training activities to train facility maintenance staff in energy saving techniques and maintaining energy improvements
- Assessed the role of the Governor's 20x10 Initiative to reduce state government executive branch facility energy requirements relative to the SBECP
- Examined similar energy conservation programs for government in other states
- Assessed the management controls for SBECP activities

Potential Areas for Future Audit Work

During the course of audit work, we determined there were a couple of issues related to the SBECP which would merit attention for future audit work. Those issues included:

- **Independent Energy Improvements.** Audit assessment work indicated state agencies perform energy improvements on state-owned buildings independent of the SBECP. Future audit work could examine the criteria which guide energy improvement work across state government, including an evaluation of whether there should be a centralized process for identifying, implementing, and reporting energy improvements for state government buildings and facilities.
- **State Government Utility Data**. Utility data is not readily available in order to track energy costs and consumption for state government buildings and facilities. As part of the Governor's 20x10 Initiative, DEQ has purchased a software application to manage utility data which will track progress towards meeting the initiative. In addition, this software will aid the SBECP in project identification and monitoring activities. Future audit work could assess the design, implementation, and utility of the software.

Report Contents

The remainder of this report includes a background chapter followed by chapters detailing our findings, conclusions and recommendations, in the following areas:

- Chapter III presents information regarding the collection of estimated energy cost savings from participating agencies.
- Chapter IV presents information on improving the management controls for the SBECP.

Chapter II – Program Background

Introduction

This chapter provides background information on energy efficiency renovation efforts for state-owned buildings identified through the State Building Energy Conservation Program (SBECP), the interaction between the SBECP and the Long Range Building Program (LRBP), and the financing and repayment of SBECP projects.

Energy Improvements for State-Owned Buildings

For state government, there are two main programs which support energy efficiency renovation work in state-owned buildings, namely the SBECP and the LRBP. State agencies may also independently perform energy improvement work as part of their general facility management duties. In addition, in 2007 Governor Schweitzer established the 20x10 Initiative (20x10) to reduce state government's executive branch agencies' facility energy requirements by 20 percent by the end of 2010. While the work of the SBECP and LRBP is not specific to 20x10, their work will likely provide the most significant impacts in terms of measuring the progress of 20x10.

The State Building Energy Conservation Program

Established in 1989, the SBECP was developed to improve state facilities and equipment under the State Buildings Energy Conservation Act. Initially, the program was placed within the Department of Natural Resources and Conservation. In the mid 1990's, as part of a reorganization of state government, the SBECP was moved to the Department of Environmental Quality's (DEQ) Planning, Prevention and Assistance (PPA) Division. The SBECP provides funding and technical expertise for energy improvements on state-owned buildings and was designed to reduce energy costs in state facilities by identifying and funding cost-effective energy efficiency improvement projects. The program is for renovations or retrofits on existing state-owned buildings. Examples of energy efficiency improvements include: replacing old boilers, upgrading lights, increasing ventilation system efficiency, insulating buildings, and providing more effective temperature controls. State agencies pay the program back with the estimated energy cost savings generated from installing an energy efficiency improvement. According to the SBECP's most recent report to the governor in the fall of 2008, the program has completed 84 projects since its inception. There are 1.93 FTE which work on SBECP activities.

The Long Range Building Program

The LRBP is also involved in energy conservation work for state-owned buildings. As emphasis on energy efficiency in state-owned buildings has increased over time, the

activities of the SBECP and LRBP have become intertwined for major renovation work. The LRBP, located within the Department of Administration (DOA) Architecture and Engineering (A&E) Division, was initiated in 1965. The program was developed in order to present a single, comprehensive and prioritized plan to allocate state resources for the purpose of capital construction and maintenance of state-owned buildings.

SBECP Project Funding and Energy Cost Savings

The SBECP was originally funded in 1989 with one-time-only funding from federal oil overcharge on oil companies from the federal Department of Energy. From 1993 to 2006, the SBECP was supported by the sale of General Obligation (GO) bonds. In 2007 and 2009, the legislature funded the SBECP with general fund moneys. The following table illustrates the SBECP's investments in energy conservation projects over time:

Table 1
Historical Funding for SBECP

Year	Oil Overcharge Funds	General Obligation Bonds	General Fund
1989	$4,400,000	--	--
1993	--	$1,500,000	--
1994	--	$1,600,000	--
1996	--	$1,650,000	--
1998	--	$1,250,000	--
2001	--	$1,250,000	--
2003	--	$1,250,000	--
2005	--	$2,500,000	--
2006	--	$3,750,000	--
2007	--	--	$3,000,000
2009	--	--	$3,000,000
Totals	**$4,400,000**	**$14,750,000**	**$6,000,000**
Total All Sources	**$25,150,000**		

Source: Compiled by the Legislative Audit Division from department program records.

Since the inception of the SBECP, the program has reported over $12 million in cumulative energy cost savings for state government through fiscal year 2009. These savings are based on the energy cost-savings estimates developed as part of energy studies implemented in the project selection process. DEQ utilizes the energy cost savings it collects from agencies to service the debt on the GO bonds that finance SBECP projects.

SBECP Agency Repayments

GO bonds finance SBECP projects, and DEQ collects estimated energy cost savings from agencies to service bond debt. However, service on the bond debt is not the basis for agency repayments. Estimated energy cost savings form the basis for agency repayments. What generally makes a SBECP project viable is the estimated energy cost savings for a project must be greater than the debt service of the bond utilized to finance a project. For example, if a SBECP project were financed with a ten-year bond at a cost of $100,000 with an estimated annual energy cost savings of $11,000, the estimated annual energy cost savings is the basis for the agency's annual repayment. This amount is utilized to service bond debt. Per state law, estimated energy cost savings collected in excess of bond debt are transferred to the LRBP.

SBECP Receives an Additional $22 Million from 2009 Legislature

In 2009, the legislature provided a significant increase in funds appropriated to the SBECP, including funds leveraged from the American Recovery and Reinvestment Act (ARRA). These ARRA funds will be utilized by DEQ to establish a revolving loan fund to finance future SBECP projects. The ARRA funds total approximately $22 million. This move is a significant departure from the bonds historically utilized to finance projects, mainly in terms of the amount of funding administered by the SBECP.

Chapter III – Estimated Energy Cost Savings Collection

Introduction

From 1993 to 2006, the State Building Energy Conservation Program (SBECP) issued $14.75 million in General Obligation (GO) bonds to finance SBECP projects. While the SBECP no longer issues bonds to finance projects, the program will continue to collect estimated energy cost savings from participating agencies to service bond debt through fiscal year 2025. As part of our audit activities, we examined the program's bond repayment process. This chapter presents information on the collection of estimated energy cost savings from state agencies which participate in the SBECP.

Collection of Energy Cost Savings Based on the Life of an Improvement

Section 90-4-614, MCA, outlines the appropriation of energy cost savings from agencies which participate in the SBECP. The statute provides authority for participating agencies to transfer funds to a state special revenue account in an amount equal to an agency's projected debt service. SBECP collects estimated energy cost savings from participating agencies to service this bond debt. While the service debt on the majority of SBECP projects is tied to a ten-year bond, the SBECP, in some circumstances, collects energy cost savings based on the life of an energy improvement rather than on the term of the bond. The life of an improvement is the life expectancy of a particular energy improvement based on industry equipment standards.

When estimated energy cost savings are collected based on the life of an improvement, the SBECP collects energy cost savings after bond retirement. For example, the SBECP began collecting energy costs savings for updating a central heating plant for one agency in fiscal year 1996. The project was financed with a ten-year bond, with an expected life of 25 years. While the bond utilized to finance the project was retired in fiscal year 2006, the SBECP is still collecting energy cost savings for the project. As of fiscal year 2009, the SBECP has collected $171,000 after bond retirement and plans to collect another $114,000 in energy cost savings through fiscal year 2011. The SBECP has not collected energy cost savings for any project after 15 years.

SBECP Will Collect $1.2 Million After Bond Retirement

Based on program information analyzed during the audit, the SBECP has collected approximately $600,000 after bond retirement through fiscal year 2009. In addition, the SBECP is planning to collect an additional $600,000 by 2017. The SBECP will collect approximately $1.2 million after bond retirement. The following table illustrates

the collection of energy cost savings after bond retirement to date, including projected collections:

Table 2
SBECP Collection of Energy Cost Savings After Debt Service Retired

Fiscal Year	After Debt Service Collections	Projected After Debt Service Collections
2004	$59,000	--
2005	$56,500	--
2006	$54,700	--
2007	$96,000	--
2008	$172,000	---
2009	$152,300	--
2010	--	$154,900
2011	--	$171,100
2012	--	$108,000
2013	--	$71,900
2014	--	$51,300
2015	--	$29,700
2016	--	$15,000
2017	--	$1,000
Totals	**$590,500**	**$602,900**

Source: Compiled by the Legislative Audit Division from department program records.

Per state law, estimated energy cost savings are to be transferred to the Long Range Building Program (LRBP) in excess of projected debt service. However, due to limited management controls in place for the SBECP, we were unable to verify if estimated energy cost savings collected after bond retirement are transferred to the LRBP.

SBECP Cites Statutory Authority for Collections Based on Life of the Improvement

According to SBECP staff, while GO bonds are utilized to finance energy improvement projects, the program does not collect debt service; rather the SBECP collects estimated energy cost savings from improvements. As such, since energy improvements often have an expected life beyond bond debt, SBECP staff believe it is an appropriate practice to collect estimated energy savings after the retirement of the bond. SBECP staff cite §90-4-614, MCA, as providing them direction on energy cost savings and debt service on the bonds. Staff indicate state law does not specifically direct them to stop collecting energy cost savings once bond debt has been retired. SBECP staff also

claim the Memorandum of Understanding (MOU) developed between the SBECP and a participating agency is further rationale for the collection of energy cost savings based on the life of an improvement.

The Limits of Collection Authority

While SBECP staff cite both statute and MOUs as the authority and basis of collecting estimated energy costs savings based on the life of an improvement, neither of these sources directly speak to this practice. As part of audit work, we reviewed state law and found no direct authorization for the practice. In fact, existing statute is silent and does not provide any specific direction regarding the collection of estimated energy cost savings after bond retirement.

Existing Statute Silent Regarding the Collection of Estimated Energy Cost Savings Beyond Bond Retirement

Section 90-4-614(1), MCA, outlines how each biennium the governor includes in the executive budget an estimate of the energy cost savings and projected bond debt for each state agency participating in SBECP. The statute speaks to the inclusion of estimated cost savings and projected bond debt for participating projects; however, it does not clearly outline how estimated cost savings are to be handled after the term of bond repayment. While §90-4-614(1)(b), MCA, in part states that "debt service is zero after the term of the bond," it does not specifically direct the governor to stop including estimated energy cost savings in the executive budgeting process. Consequently, the SBECP has continued to collect estimated energy cost savings from participating agencies and report those savings to the governor for inclusion in the executive budgeting process. State law does not provide direction as to the retirement or continuation of the collection of estimated energy cost savings beyond the retirement of the bond payments. Existing statute is silent regarding the collection of estimated energy cost savings from participating agencies after bond debt. As a result, it is unclear what should happen to estimated energy cost savings collected after the term of bond repayment.

Recommendation #1

We recommend the Department of Environmental Quality seek legislation to clarify the retirement or continuation of the collection of estimated energy cost savings beyond the retirement of the bond payments.

Compliance With State Law Regarding the Transfer of Energy Savings to LRBP

Section 90-4-614 (2)(b), MCA, outlines the authority for each agency participating in the SBECP to transfer funds to the LRBP in an amount equal to the difference between the estimated energy cost savings to the agency and the projected debt service apportioned to that agency. However, §90-4-614(4), MCA, states participating agencies shall transfer appropriations in accordance with §90-4-614(2), MCA, upon the request of DEQ. In other words, estimated energy cost savings in excess of projected debt service are to be transferred by a participating agency to the LRBP at the request of DEQ. While statute indicates participating agencies transfer these additional savings directly to LRBP upon request from DEQ, in practice the SBECP has collected estimated energy cost savings directly from participating agencies and only transferred portions of the difference between the estimated energy cost savings and projected debt service to the LRBP.

As noted, statute provides for the transfer of additional estimated energy cost savings in excess of debt service to the LRBP. Presumably, after bond retirement, all estimated energy cost savings from participating state agencies would be transferred to the LRBP. However, due to limited management controls in place for the SBECP, we were unable to verify if estimated energy cost savings collected after bond retirement are transferred to the LRBP. For example, the SBECP collected $56,500 after bond retirement in fiscal year 2005; however, we found the SBECP transferred approximately $36,000 to the LRBP that year. In addition, while the SBECP collected over $400,000 after bond retirement from fiscal years 2007 to 2009, there have not been any corresponding transfers to the LRBP during that period.

Recommendation #2

We recommend the Department of Environmental Quality comply with statute regarding the transfer of funds to the Long Range Building Program.

Chapter IV – Improving SBECP Management Controls

Introduction

As part of our audit objectives, we reviewed the management controls in place for the State Building Energy Conservation Program (SBECP) and evaluated if the program is meeting statutory criteria. While the program has an operating history of approximately 20 years, audit work indicated there are limited management controls in place to guide the program's activities. This chapter proposes improving the management controls for the program.

Limited Management Controls Exist for the SBECP

Management controls are organizational controls developed and implemented by management to ensure programs achieve intended results, programs and resources are utilized effectively and managed appropriately, and laws and regulations are followed. During the audit, Department of Environmental Quality (DEQ) and SBECP staff indicated the SBECP has historically operated on an informal basis, with an emphasis placed on the institutional knowledge of staff. This informal approach has resulted in limited management controls as illustrated below:

- No goals or objectives, project timelines, or a work plan to guide the program's activities
- Limited program oversight
- Limited management information to evaluate SBECP project impact and progress

Is the SBECP Working as Legislature Intended?

To accomplish our audit objectives, we reviewed a judgmental sample of 14 SBECP project files to evaluate whether the program is working as the legislature intended and identify management controls for the program. Sixty-three SBECP projects were actively billed for bond repayment in fiscal year 2009. These 63 projects formed the basis of our sampling population. Overall, a lack of management controls for the program, such as policies and procedures and a structured filing system, limited our ability to determine if the program is working as the legislature intended. For example, we noted there was no formal process for maintaining program documentation which resulted in missing and incomplete files, files housed in multiple locations, and limited information regarding how program decisions were made. The following represents areas of statute specific to SBECP responsibilities and duties which lacked program documentation:

- Five of 14 files (36 percent) did not contain documentation regarding the analyses of state utility data and performing energy analyses on state-owned buildings (§90-4-607(1-2), MCA).
- Eight of 14 files (57 percent) did not contain documentation regarding the transfer of funds and authority to the Department of Administration (DOA) (§90-4-607(3), MCA).
- Fourteen of 14 files (100 percent) did not contain documentation regarding how the SBECP monitors SBECP improvements to ensure energy cost savings are realized (§90-4-607(4), MCA).

SBECP staff cited a number of reasons for incomplete or missing file documentation, including the program's small size, recent physical location moves, and a lack of priority to develop filing procedures. According to SBECP staff, project files generally would not contain evidence of the process by which SBECP projects are identified, selected, and implemented. Staff indicated that evidence of this process may be located in legislation or the program's report to the governor. However, audit review of this material did not provide any additional information.

Conclusion

We were unable to determine if the SBECP is complying with state law and working as the legislature intended due to limited management controls.

SBECP Relies On the Long Range Building Program

During the course of audit work, the close relationship between the activities of the SBECP and the Long Range Building Program (LRBP) became apparent. The LRBP is located within DOA's Architecture and Engineering Division. The SBECP has historically relied on the LRBP for a number of program activities, including the identification, selection, and implementation of SBECP projects. The LRBP was initiated to provide funding for construction and maintenance of state buildings. The program was developed in order to present a single, comprehensive and prioritized plan to allocate state resources for the purpose of capital construction and maintenance of state-owned buildings. Furthermore, LRBP is responsible for projects which will increase the capacity, effect a major change in use, increase the efficiency or economy of operation, or extend the life of an existing fixed asset to a major degree.

SBECP projects focus on improving state-owned facilities by achieving improved building efficiency through identifying potential energy savings, a function which aligns with LRBP responsibilities. While the SBECP and LRBP are complementary programs which work closely together on energy improvement work for state-owned buildings, their joint activities are carried out on an informal basis. Audit work

identified coordination issues between the SBECP and LRBP, including the process by which estimated energy cost savings beyond projected debt service are to be transferred to the LRBP. In order to address the informal nature of the relationship between the SBECP and LRBP and any coordination issues, a memorandum of understanding should be developed between DEQ and DOA to formally define how the two programs interact.

State Policy Directs Agencies to Establish Management Controls

According to state accounting policy, management is responsible for establishing and maintaining agency internal controls. The policy defines internal control as a coordinated set of policies and procedures used by managers and line workers to ensure that their agencies, programs, or functions operate efficiently and effectively. Internal controls ensure programs are in conformance with applicable laws and regulations, and that the related transactions are accurate, properly recorded and executed in accordance with management's directives. Per the policy, agency management is responsible for the extent of the efficiency and effectiveness of internal controls, as well as any deficiencies. The focus of the SBECP has been on the day-to-day activities of the program, rather than on a coordinated set of policies and procedures to ensure the SBECP functions in compliance with applicable laws and in accordance with management directives.

Similar Programs in Other States Have Established Management Controls

During our audit, we also reviewed management controls in place for similar programs in other states. The concept of energy conservation and efficiency is a common practice for government facility management. Other states generally have a formalized control structure and procedures in place which guide their energy efficiency work. For example, in Oregon, the State Energy Efficiency Design Program provides technical consulting services to state agencies to ensure cost-effective energy conservation measures are included in significant renovation of public buildings. The Oregon program has also established formal operating guidance. In Wyoming, the Energy Conservation Improvement Program, which works with facility owners to facilitate energy savings performance contracting, is guided by a comprehensive operations manual.

Recommendation #3

We recommend the Department of Environmental Quality develop management controls for the State Building Energy Conservation Program, including formalizing its interaction with the Long Range Building Program.

Department of Environmental Quality

Department Response

Montana Department of
ENVIRONMENTAL QUALITY

Brian Schweitzer, Governor

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October 30, 2009

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RE: State Building Energy Conservation Program
Legislative Audit Division Report #09P-06, dated November 2009

Dear Ms. Hunthausen:

Thank you for the audit on the State Buildings Energy Conservation Program, and for the opportunity to respond. This letter serves as the official department response to the audit.

I'd like to first compliment the professionalism and expertise of the audit team. The audit process was thorough and fair, and the communication from the audit team with the department was very good.

The audit points out areas for the department to address. We agree with all findings. Our response summarizes our actions and plans resulting from the audit recommendations, and we will also be available to address these at the November 18 audit committee.

Recommendation #1
We recommend the Department of Environmental Quality seek legislation to clarify the retirement or continuation of estimated energy cost savings beyond the retirement of the bond payments.

The department concurs with this recommendation. The existing legislation does not provide clear direction whether savings should be collected for the useful life of the measures or only for the period of debt service. Through the Executive Planning Process the department will submit proposed legislation to clarify disposition of savings beyond the retirement of bond payments. The various options include different policy considerations. The department will present its recommended option in the proposed legislation. The legislative proposal and subsequent testimony will discuss policy considerations related to the various alternatives.

Recommendation #2
We recommend the Department of Environmental Quality comply with statute regarding the transfer of funds to the Long Range Building Program.

The department concurs with this recommendation. The department will work with the Office of Budget and Program Planning to ensure only the amount of savings equal to an agency's portion of the debt service will be transferred to the department. Any savings in excess of the

debt service will be transferred directly to the Long Range Building Program in the Department of Administration.

The audit report cites instances in which the department transferred less than the full amount of incremental savings to the Long Range Building Program. In those cases, any additional savings collected were used to help cover initial debt service for subsequent bond issuances until those savings streams were realized. This was necessary to keep the program operating without a negative cash flow when it increased volume of retrofits due to increased demand and improved economics. As the audit report points out, statute does not contemplate this approach. However, this approach – having savings from one cycle of projects cover the debt service from the next round of projects – was explicitly stated in early testimony authorizing this program. The program was initiated by using a one-time appropriation of Petroleum Violation Escrow Account (oil overcharge) funds from the federal government to pay for the first round of projects. Although there was no debt incurred using these funds, savings were collected once they began to be realized. These savings were used to cover debt service on the second round of projects, funded with bonds. Savings from the second round were used to cover the debt service from the third round, and so on. Without such an approach, the program would operate on a short-term negative cash flow each cycle until the retrofits were completed and the savings began to be realized. The Legislature understood and supported this concept in early Long Range Planning Subcommittee hearings, although the statute was not properly crafted to reflect this approach.

Given the above rationale, the department will consider whether to offer proposed legislation that would provide explicit statutory authority for the practice of using savings from one round to cover debt service from another. This also would mitigate risk of short-term negative cash flow should any individual project incur delays or unforeseen complications, thus reducing its savings.

Recommendation #3
We recommend the Department of Environmental Quality develop management controls for the State Building Energy Conservation Program, including formalizing its interaction with the Long-Range Building Program.

The department concurs with this recommendation. We have begun addressing the shortcomings pointed out in the audit. Actions taken to date include:

- Hired a part-time temporary employee to organize project files and identify missing or incomplete information.
- Currently recruiting an administrative specialist to assist in writing Memoranda of Understanding with agencies and to track progress on projects. Interviews have been conducted for this recruitment.
- Met with the Architecture & Engineering Division within Department of Administration to discuss the need for and to obtain their agreement for a Memorandum of Understanding between our agencies outlining procedures, controls, and respective responsibilities.

In addition, we have identified staff from other parts of the department with expertise in program management to provide expertise and time on a short-term basis to help develop and enhance management and financial controls for the SBECP. These controls will be developed consistent with the department's existing protocols for quality management and internal financial controls. Also, the department has been developing and updating flow charts for all its major program processes. This is being done for several reasons: for transparency, for documentation, as a basis for process and efficiency improvement, and to ensure that adequate controls and consistency are in place. This process mapping began with our permitting functions and is moving to other programs, including SBECP. Process mapping in the Planning, Prevention and Assistance Division will begin in November.

Thank you again for the audit and the professionalism of the audit team. The findings and recommendations will help the department make substantial program improvements.

Sincerely,

Tom Livers

Tom Livers
Deputy Director

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Louise Moore, EPP Bureau Chief
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