

# LEGISLATIVE AUDIT DIVISION

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## MEMORANDUM

**TO:** Legislative Audit Committee Members  
**FROM:** John Harrington, Performance Auditor  
**CC:** Tracy Stone-Manning, Director, Department of Environmental Quality  
George Mathieus, Administrator, Planning, Prevention, and Assistance Division  
Louise Moore, Chief, Energy Pollution and Prevention Bureau  
**DATE:** April 2014  
**RE:** Performance Audit Follow-Up 14SP-10: The Alternative Energy Revolving Loan Program (orig. 12P-08)  
**ATTACHMENTS:** Original Performance Audit Summary

### Introduction

The Alternative Energy Revolving Loan Program (12P-08) report was issued to the Legislative Audit Committee in November 2012. The audit included three recommendations to the Department of Environmental Quality (department). In March 2014, we conducted follow-up work to assess implementation of the report recommendations. This memorandum summarizes the results of our follow-up work.

### **Overview**

Audit work addressed the need for improved compliance with administrative rules and policies to ensure program projects were being completed and loan funds used appropriately. Through a combination of revised administrative rules and program policies, the Department of Environmental Quality has implemented the three recommendations included in the original audit report.

### Background

The Alternative Energy Revolving Loan Program, established by the legislature in 2001, supports the development of alternative energy in Montana by providing loan financing to install alternative energy systems. The term alternative energy generally refers to the act of obtaining energy from a source other than fossil fuels. Systems typically funded by the program include those that generate energy from solar, wind, geothermal, and biomass sources. The program is located with the department's Planning, Prevention, and Assistance Division. The program is funded by a combination of air quality violation penalties collected over time by the department (approximately \$3.3 million at the time of the audit), as well as a 2009 infusion of stimulus funding from the American Recovery and Reinvestment Act (an additional \$1.2 million). Prospective participants can borrow up to \$40,000 for a qualified alternative energy project, and must pay the loan back within 10 years. Since its inception, the program has loaned over \$5 million in state and federal funds.

### **Audit Follow-up Results**

The following sections summarize the progress toward implementation of the report recommendations. During our follow-up we reviewed revised policies and documentation of procedures. We also interviewed program staff and reviewed a sampling of loan files for proper documentation and compliance.

#### **RECOMMENDATION #1**

**We recommend the Department of Environmental Quality comply with administrative rules for the Alternative Energy Revolving Loan Program by completing an environmental review prior to executing a service agreement for loans issued by the program.**

#### **Implementation Status – Implemented.**

At the time of the original audit report, administrative rules required the department to determine if approving a project may result in significant effects to the quality of the human environment by conducting an environmental review of a project prior to loan issuance. However, department staff did not routinely complete these reviews as required. Department staff indicated that systems funded by the program had little potential impact to the environment, due to the small scale and types of systems. In response to the audit, the department amended its administrative rules to allow certain projects to receive a categorical exclusion and to be approved for loans through the program without undergoing an environmental review. The department subsequently established a categorical exclusion to reflect this change in requirements for environmental reviews. A categorical exclusion may be applied to a project that falls beneath certain established thresholds for size, generation, or disturbance. In our follow-up work, we reviewed several loan files and found environmental reviews had been performed on qualifying projects, while other projects were appropriately excluded from this requirement (and the exclusion noted in the loan files).

#### **RECOMMENDATION #2**

**We recommend the Department of Environmental Quality document compliance with administrative rules and program policy for project verification for the Alternative Energy Revolving Loan Program, including:**

- A. An accounting of loan expenditures upon the completion of construction or installation of a program project;**
- B. Photos to verify that a renewable energy system was installed as agreed to in the loan documents; and**
- C. Site visits as outlined in program policy which document the date of site visit and description of installed measures, anecdotal information about system performance and occupant satisfaction, and verification of specific programmatic requirements.**

#### **Implementation Status – Implemented.**

Audit work determined that the department did not routinely verify project completion and performance as required by administrative rules and program policy. Department staff reported that they were more concerned with approving quality projects than with verification requirements. In response to the audit, the department amended its administrative rules to no longer require borrowers to proactively provide an accounting of all loan expenditures. (However, borrowers are still required to retain all records and documents to account for expenditure of loan funds, subject to audit or review by the department, Legislative Audit Division, or the legislative fiscal analyst.) Borrowers are now required to provide photos of the completed project, and a review of files showed that borrowers are complying with this requirement and submitting photos of their completed installations. The department also amended the

administrative rules to allow for potential site visits and to compel borrowers to allow access to projects for these visits. According to the department's 2013 Annual Outcomes Report, staff conducted eight site visits in fiscal year 2013. As part of our follow-up work, a review of files showed that site visits are being appropriately documented. In interviews, staff indicated they try to coordinate site visits with other department business in the area of projects, in order to minimize travel costs.

### **RECOMMENDATION #3**

**We recommend the Department of Environmental Quality:**

- A. Comply with administrative rules and program policy and collect information from loan recipients on an annual basis regarding system performance and reliability, or**
- B. Establish an alternative method to measure the effectiveness of the program on an ongoing basis to ensure the program is achieving intended results and approved systems are operating as expected.**

### **Implementation Status – Implemented.**

Citing an inability to collect meaningful and accurate data from loan recipients regarding system performance, department staff did not routinely collect performance information from borrowers. In response to the audit, the department elected to implement Part B of this recommendation, and amended its administrative rules to change its method for determining the estimated energy use of the systems funded by the program and thus measure the effectiveness of the program. Previously, borrowers were required to submit annual surveys to the department throughout the term of the loans, estimating the amount of energy produced by the system in the previous year and providing other information about system and component reliability. The department believed the information it received was incomplete and inaccurate. Under the new rule, the department uses standard engineering practices to calculate estimated energy production based on the system specifications and capacity and climate data. For example, the energy production of solar systems is estimated using the National Renewable Energy Lab's PV Watts program, based on the average solar radiation in Great Falls. This information is reported in the department's annual Outcomes Report, and our review of the 2013 Outcomes Report determined that information on estimated energy production was included.