



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

Audit Report

The Department of Energy's Loan
Guarantee Program for Innovative
Energy Technologies



Department of Energy

Washington, DC 20585

February 17, 2009

MEMORANDUM FOR THE SECRETARY

FROM:

Greg Friedman
Gregory H. Friedman
Inspector General

SUBJECT:

INFORMATION: Audit Report on: "The Department of Energy's
Loan Guarantee Program for Innovative Energy Technologies"

BACKGROUND

The Energy Policy Act of 2005 authorized the Department of Energy to guarantee loans for new or significantly improved energy production technologies that avoid, reduce, or sequester air pollutants and other greenhouse gases. As of December 2008, Congress authorized the Department to make \$42.5 billion in loan guarantees to support innovative energy projects. These guarantees were authorized for up to 80 percent of the total project costs and were designed to promote the commercial use of innovative technologies. Under the terms of the Act, the loan guarantees are contingent upon reasonable prospect of repayment by the borrower.

Consistent with the Energy Policy Act, the Department is responsible for soliciting and evaluating loan applications, approving loan guarantees, and monitoring project and loan guarantee performance. Through December 2008, the Department had issued five solicitations for projects that support innovative clean coal technologies, energy efficiency, renewable energy, advanced electricity transmission and distribution, and nuclear and fossil energy projects. These solicitations were issued in three phases with the first in August 2006, and the final in September 2008. Eleven substantially complete applications requesting approximately \$8.2 billion in loan guarantees had been received by the Department in response to the first solicitation. The Department had begun the review of applications and was in the process of completing due diligence procedures necessary to evaluate projects received in response to the first solicitation. Under current plans, the Department is to issue its first loan guarantees in the spring of 2009.

Because of the importance of this program as part of an effort to address the Nation's most challenging and pressing energy needs; and, the potential risk of loss to the United States taxpayers should default occur, we initiated this review to evaluate the Department's progress in establishing internal and operational controls over its Loan Guarantee Program (Program).

RESULTS OF AUDIT

While it had developed and implemented some key programmatic safeguards, the Department had not yet completed a control structure necessary to award loan guarantees and to monitor associated projects.



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In terms of positive steps, the Department established a Credit Review Board to make recommendations to the Secretary of Energy for approval of loan guarantees; issued final regulations for the guarantee program; hired staff with experience in Federal loan and capital investment programs; and, identified eligible independent consultants to advise the Department on major aspects of the projects.

However, in a number of critically important areas, the Department had not fully developed and implemented controls necessary to successfully manage the Program. Specifically, the Department had not yet:

- Finalized policies and procedures for evaluating loan applications, approving loan guarantees, monitoring project and loan guarantee performance, qualifying potential lenders and monitoring participating lenders;
- Formally documented portions of its applicant reviews, including information about potential changes to an applicant's business environment; and,
- Formalized procedures for disbursing loan proceeds to successful applicants.

Notably, the Department had not finalized procedures necessary to estimate potential losses in the event of loan default. After 15 months of negotiations, the Department received approval from the Office of Management and Budget regarding the design and implementation of a "Credit Subsidy Model" that is intended to estimate potential default losses. This is an essential step since the estimated losses are to be used to determine the amount an applicant must pay in advance of receiving a loan guarantee, thereby mitigating risk to the taxpayer.

The Department had drafted but not finalized procedures for, among other things, evaluating project financing and cash flow, and estimating potential recoveries in the event of default, which are important data inputs to the Credit Subsidy Model since they form the basis for the credit subsidy cost. According to management, these procedures could not be finalized until final approval of the Credit Subsidy Model was obtained from the Office of Management and Budget. Management further stated that it expected to have the Credit Review Board approve the procedures in January 2009, prior to presentation of the first loan guarantee to the Board. Subsequent to the completion of our fieldwork, management informed us that they had finalized the "Title XVII of the Energy Policy Act of 2005 Loan Guarantee Program Credit Policies and Procedures" manual and that the Board approved the manual on January 15, 2009.

The Department had also not fully staffed the Loan Guarantee Program Office. As of January 2009, the Program had 16 full-time federal employees, augmented by full and part-time contract employees. According to Program officials, that staffing level was sufficient to complete due diligence and credit reviews of the applicants to the 2006 solicitations and to manage the 2008 solicitations. However, it was their judgment that the current staffing level was not adequate to, among other things, monitor disbursed loans and to complete the due diligence and credit underwriting for applicants responding to the 2008 solicitation. Accordingly, the Program identified the need to hire an

additional 21 employees in Fiscal Year (FY) 2009. While the Department plans to hire 14 additional staff by the end of March 2009, management told us that it will be unable to hire staff after that date unless additional funds requested in the Department's FY 2009 budget are actually provided.

The Department focused its efforts on issuing new solicitations for renewable energy, nuclear and nuclear fuel facilities and clean coal projects. Program officials told us that the emphasis on issuing solicitations was driven by the September 30, 2009, expiration date of the 2008 loan authority of \$38.5 billion, and concerns expressed by Congress, industry and the public about rising energy costs and the availability of capital to finance innovative energy projects. In recognition of the realities of the environment in which it was operating, management chose to focus available resources on issuing new solicitations – a path that absorbed staffing resources that could have been otherwise directed towards finalizing important internal controls.

In a prior report, *Loan Guarantees for Innovative Energy Technologies* (DOE/IG-0777, September 2007), we concluded that the experience of other Federal agencies managing loan guarantee programs demonstrated the importance of ensuring such programs are adequately staffed and guided by robust administrative safeguards. The Department told us that it was establishing the Program in a manner consistent with the "lessons learned" outlined in our report.

Finally, the importance of adequate staffing and effective project and loan monitoring policies and procedures has become even more critical since the Department told us that it planned to make the Program Office responsible for parts of the credit evaluation and monitoring of yet to be awarded direct loans to automobile manufacturers and suppliers. The Energy Independence and Security Act of 2007 authorized the Department to make up to \$25 billion in direct loans to automobile manufacturers and suppliers to re-equip, expand, or establish manufacturing facilities for advanced technology vehicles.

Under challenging circumstances, the Department had made progress toward designing and implementing the Program. In conducting this audit, it became clear that the Department faced a number of challenges in implementing the Loan Guarantee and related programs. These pressures will likely increase as the Department expands its loan guarantee activities to implement the recently enacted American Recovery and Reinvestment Act of 2009 which provides for the expeditious infusion of significant new energy-related funding. On one hand, prompt action is needed to stimulate the U.S. economy by implementing programs to advance U.S. energy interests. On the other hand, the Department needs to ensure that its programmatic responsibilities are carried out prudently and responsibly so as to reduce taxpayer exposure to financial loss. In this context, we provided a number of recommendations to ensure that the Loan Guarantee and related programs are supported by effective internal control structures. We recognize that the goals of expediency and accountability may prove to be difficult to fully reconcile. As such, the Department's decision makers will have to make challenging risk/reward decisions as they proceed. It is our intent that the recommendations included in this report will be helpful in this regard.

MANAGEMENT REACTION

Management concurred with the recommendations and stated that it was in the process of implementing corrective actions. Additionally, management stated that it is committed to managing the Loan Guarantee Program Office carefully to maintain the integrity of and to promote the objectives of the Program while protecting the American taxpayer.

Actions taken or planned by management to improve controls over the Loan Guarantee Program are responsive to our recommendations. These actions, if successfully implemented, should help to reduce the Government's significant financial risk exposure and assist the Loan Guarantee Program in meeting its overall objective of promoting the use of innovative energy technologies.

Attachment

cc: Office of the Deputy Secretary
Office of the Under Secretary
Chief of Staff
Office of the Chief Financial Officer
Director, Loan Guarantee Program

AUDIT REPORT ON THE DEPARTMENT OF ENERGY'S LOAN GUARANTEE PROGRAM FOR INNOVATIVE ENERGY TECHNOLOGIES

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LOAN GUARANTEE PROGRAM STRUCTURE

Introduction

The Energy Policy Act of 2005 (Energy Policy Act) authorized the Department of Energy (Department) to guarantee loans for new or significantly improved energy production technologies that avoid, reduce, or sequester air pollutants and other greenhouse gases. In August 2006, the Department issued its first solicitation for loan guarantees, and invited 16 respondents to the solicitation to submit full applications for loan guarantees in October 2007. The Department also announced three solicitations for nuclear power facilities, front end nuclear facilities for the production of nuclear fuel, and energy efficiency, renewable energy, and advance electricity transmission and distribution technologies in June 2008. The Department issued a solicitation for advanced fossil energy projects in September 2008. Collectively, the Department's solicitations make \$42.5 billion available in loan guarantees to support innovative energy projects.

As of November 2008, the Department had received 11 substantially complete applications for projects requesting approximately \$8.2 billion in debt financing in response to the 2006 solicitation. The Department also received 19 applications (part one of a two part process) for the construction of nuclear power plants and two applications for front end nuclear fuel cycle facilities. The Department planned to rank proposed projects based upon information provided by applicants in the first part of the application. The Department also planned to provide the ranking information to the applicants so that they could decide whether to continue seeking a guarantee by completing the second part of the application. Applicant responses to the 2008 advanced fossil energy technologies solicitation were due on December 22, 2008, and the applications for the energy efficiency, renewable energy and advanced electricity transmission and distribution technologies are due to the Department in February 2009.

The Energy Policy Act required the Secretary of Energy to make a determination that there is a "reasonable prospect" of repayment of the guaranteed debt. As part of its "due diligence" to support such a determination, the Department had begun reviewing technical information, business and financial plans, and proposed project organization and staffing information provided by applicants for projects resulting from the 2006 solicitation. The Department expects to approve and issue the first loan guarantees in

response to the 2006 solicitation during the spring of 2009. In response to the 2008 solicitations, the Department has reviewed the first part of the 19 applications for nuclear power plants and has provided an initial ranking of the projects to the applicants. The Department is also reviewing the two applications for the front end nuclear fuel cycle facilities.

Program Structure

As of December 2008, the Department had not fully established controls necessary to award loan guarantees and to monitor guaranteed projects. Specifically, the Department had yet to:

- Finalize policies and procedures for evaluating loan applications, approving loan guarantees, monitoring project and loan guarantee performance; qualifying potential lenders and monitoring participating lenders;
- Formally document portions of its applicant reviews, including information about potential changes to an applicant's business environment; and,
- Formalize procedures for disbursing loan proceeds to successful applicants.

Policies and Procedures

The Department had not finalized key policies and procedures needed for loan application review and approval, project and portfolio management, qualifying potential lenders and monitoring participating lenders. To protect the Government's interest, Title XVII of the Energy Policy Act of 2005, required that "no guarantee shall be made unless the Secretary determines that there is a reasonable prospect of repayment of the principal and interest on the obligation by the borrower." The Department had drafted, but not finalized those policies and procedures necessary to make a "due diligence" determination, including those related to project screening, underwriting, recovery analysis, estimating credit subsidies, credit monitoring and management, credit approval, and environmental requirements reviews. Further, accounting procedures for loan guarantees and procedures for qualifying potential lenders and monitoring participating

lenders had not been finalized. Management told us that they plan to have these policies and procedures approved by the Credit Review Board by January 2009.

In one area particularly important to the financial viability of the program, the Department had not finalized procedures necessary to estimate potential losses in the event of loan default. After 15 months of negotiations, the Department received approval from the Office of Management and Budget regarding the design and implementation of a Credit Subsidy Model that is intended to estimate potential losses to the Government in the event of project failure and/or applicant default. The estimated losses will be used to determine the amount an applicant must pay in advance of receiving a loan guarantee – a fee designed to mitigate, to some extent, the financial risk to the taxpayer. The amount is important to both the Department and the applicants because it is designed to defray potential losses to the government and represents a cost to the borrower.

However, the Department had not finalized procedures for, among other things, evaluating project financing and cash flow, and estimating potential recoveries in the event of default. The data produced by these procedures are important inputs to the Credit Subsidy Model and are therefore critical to determining applicant fees. According to management, these procedures have been drafted, but could not be finalized until final approval of the Credit Subsidy Model was obtained from the Office of Management and Budget. Management also indicated that it expects to have the Credit Review Board approve the procedures in January 2009, prior to presentation of the first loan guarantee to the Credit Review Board.

Ensuring that the Department has established policies and procedures for applying the Credit Subsidy Model are important since delays in determining the amount of cost to be paid by applicants could adversely affect projects to be financed through guaranteed loans. For example, one applicant to the 2006 solicitation informed the Department in September 2008 that it needed a rough estimate and range of the credit subsidy cost since a high credit subsidy cost could negatively affect the applicant's ability to move forward. Specifically, the applicant noted that delays in obtaining an estimate of the credit subsidy cost could jeopardize its ability to move forward with the project and

would adversely affect key decisions such as purchasing land on which the facility would be built and commissioning architects to prepare engineering plans and design. According to management, it provided an estimate of the credit subsidy cost for this particular project to the applicant in December 2008.

Finally, the Department had not issued guidance for when project reviewers should use independent outside advisory consultants to assist in the review of loan applications. The Department plans to use consultants to analyze market, legal, financial and engineering aspects of the projects. Loan Guarantee Program Office managers told us that in general, independent advisory consultants for legal and engineering services would always be used; however, consultants for market and financial services would be used on a case-by-case basis, depending on the complexity of the project. Formal guidance on the use of independent advisory consultants would help ensure consistent underwriting and project monitoring for each of the applicants.

Subsequent to the completion of our fieldwork, management informed us that it had finalized the "Title XVII of the Energy Policy Act of 2005 Loan Guarantee Program Credit Policies and Procedures" manual. The Credit Review Board approved the manual on January 15, 2009.

Application Review Documentation

The Department had not fully documented or recorded the results of reviews of loan guarantee applicants. Documents and analyses relevant to the Department's review of applications were not always included in the Loan Guarantee Program Office's official electronic data repository. In one instance, for example, a site visit was conducted by Department personnel, but was not documented in the data repository. Further, notable events relative to applicants' operations including changes in senior management, company reorganization, and pending litigation were not documented in the system. The Department's recent solicitations note that application reviews will include a detailed analysis of, among other things, the applicant's organization and staffing, and changes in the project since the application information was submitted. As a result of our audit, the Loan Guarantee

Program Office prepared a guidance document to be used when documenting its due diligence reviews in the project management system. Also, project managers updated selected files to reflect the results of due diligence efforts.

Loan Disbursement Mechanism

The Department is required to use the Federal Financing Bank as the provider of funds in cases where the loan is fully financed through the Loan Guarantee Program. Specifically, Office of Management and Budget Circular A-129 requires that agency guarantees of 100 percent of the loan amount must be financed through the Department of the Treasury's Federal Financing Bank. Department regulations for the loan guarantee program permit guarantees of up to 100 percent of the loan amount. In fact, the 11 substantially complete applications received by the Department are for 100 percent guarantees. As of December 2008, Loan Guarantee Program officials had not reached an agreement with the Federal Financing Bank establishing the details on how loans will be disbursed. The Loan Guarantee Program Office had the standard forms used by the Federal Financing Bank to establish a loan disbursement mechanism. However, the Loan Guarantee Program Office had not completed the forms and formalized its working relationship with the Federal Financing Bank – both of which were required prior to disbursing funds to loan guarantee recipients.

Program Staffing and Competing Priorities

The Department had not fully established controls because it had not fully staffed the Loan Guarantee Program Office and experienced competing demands for its limited staff and resources. As of January 2009, the Loan Guarantee Program had 16 full-time federal employees that were augmented by 7 full-time and 4 part-time contractor staff. According to the Loan Guarantee Program, the number of onboard staff is not adequate to, among other things, monitor disbursed loans and to complete the due diligence and credit underwriting for applicants to the 2008 solicitation. Accordingly, the Loan Guarantee Program identified the need for an additional 21 employees in fiscal year (FY) 2009. Management stated that it has sufficient funding under the FY 2009 Continuing Resolution to hire 14 additional staff by the end of March 2009. Management also stated that it will be unable to hire additional staff after that date without the enactment of its proposed FY 2009 budget request.

The Department focused its efforts on issuing new solicitations for renewable energy, nuclear and nuclear fuel facilities and clean coal projects. In February 2007, the Government Accountability Office reported that the Department focused on initiating the Loan Guarantee Program by soliciting pre-applications for proposed projects rather than taking and completing key steps to ensure that the Loan Guarantee Program would be well managed and accomplish its objectives. We noted that in 2008, the Department continued its focus on issuing solicitations for projects. Specifically, in 2008, the Department issued four solicitations totaling \$38.5 billion in loan guarantee authority. Three of these solicitations were issued on June 30, 2008, and the final solicitation was issued September 22, 2008. Loan Guarantee Program officials told us that the emphasis on issuing solicitations was driven by the September 30, 2009, expiration date of the 2008 loan authority of \$38.5 billion, and concerns expressed by Congress, industry and the public about rising energy costs and the availability of capital to finance innovative energy projects.

In recognition of the realities of the environment in which it was operating, management chose to focus resources on issuing new solicitations – a path that absorbed staffing resources that could have been otherwise directed towards finalizing important internal controls.

RECOMMENDATIONS

The Department had not completed the development and implementation of controls necessary to manage the Government's significant financial risk exposure and to ensure the success of the Loan Guarantee Program in meeting its overall objective of promoting the use of innovative energy technologies. To help ensure the ultimate success of the Loan Guarantee Program, we recommend that the Director, Loan Guarantee Program:

1. Finalize policies and procedures needed to complete the evaluation of loan applications, approval of loan guarantees, monitoring project and loan guarantee performance, qualifying potential lenders and monitoring participating lenders;

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2. Prepare a policy or guidance document establishing the conditions requiring the use of independent advisory consultants;
 3. Document material aspects of loan application reviews, such as site visits, in the official electronic project files;
 4. Formalize procedures for disbursing loan proceeds with the Federal Financing Bank; and,
 5. Take action necessary to ensure that the Loan Guarantee Program is fully staffed and capable of meeting all requirements.

**MANAGEMENT
REACTION**

Management concurred with the recommendations and stated that it was in the process of implementing corrective actions. Additionally, management stated that it is committed to managing the Loan Guarantee Program Office carefully to maintain the integrity of the Loan Guarantee Program as well as to promote the objectives of the Title XVII program while protecting the American taxpayer. Subsequent to our fieldwork, management finalized and obtained approval for "Title XVII of the Energy Policy Act of 2005 Loan Guarantee Program Credit Policies and Procedures" manual (Manual). The Manual was approved by the Credit Review Board on January 15, 2009. According to management, the Manual defines the specific procedures for the utilization of independent advisory consultants.

Management stated that as a result of our audit, the Loan Guarantee Program Office issued "Guidelines for Populating LGPO's E-Docs Filing System" for the purpose of providing a central, readily accessible, and current source of relevant documents and information generated, or received, by the Loan Guarantee Program Office in conducting business. Management also stated that the E-Docs system is not meant to capture every piece of project-related guidance correspondence ever produced or all public information generated during the life of a project. Management committed to work with the Federal Finance Bank and other parties to ensure that procedures for disbursing loan proceeds are finalized in accordance with applicable rules and regulations. Finally, management stated it will continue to recruit and hire

qualified personnel of the highest caliber to complete the project origination, monitoring and oversight activities of applicants to the 2008 solicitations.

**AUDITOR
COMMENTS**

Management comments are responsive to our recommendations. In response to management comments on finalizing policies and procedures for the Loan Guarantee Program Office, we acknowledge the completion of the Credit Policies and Procedures Manual on January 15, 2009. As noted in our report, however, the Department needs to complete its accounting procedures for loan guarantees and its procedures for disbursing loan proceeds.

Appendix 1

OBJECTIVE The objective of our audit was to evaluate the Department's progress in establishing internal and operational controls over its Loan Guarantee Program.

SCOPE The audit was performed between September and December 2008, at the Loan Guarantee Program Office at the Department of Energy's Headquarters in Washington, D.C. The scope of the audit included activities performed by the Loan Guarantee Program since inception through December 2008.

METHODOLOGY To accomplish the audit objective, we:

- Reviewed laws and regulations applicable to the Loan Guarantee Program;
- Reviewed key documents such as the Credit Policies and Procedures Manual and the Concept of Operations Manual;
- Analyzed the technical and financial review sheets for the applicants that responded to the 2006 solicitation;
- Reviewed the Credit Review Board Meeting Minutes;
- Evaluated the audit recommendation tracking spreadsheet;
- Reviewed the procurement files for advisory services;
- Reviewed the official project files contained in the electronic data repository;
- Interviewed key personnel in the Loan Guarantee Program and the Department's Office of Management and Administration;
- Met with representatives from the Federal Financing Bank;

Appendix 1 (continued)

- Coordinated with personnel from the United States Department of Agriculture and Export-Import Bank Office of Inspector General; and,
- Observed a "mock" application of the Draft Credit Subsidy Cost Model.

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 finding and conclusion based on our audit objective. We believe that the evidence obtained provides a reasonable basis for our finding and conclusion based on our audit objective. The audit included test of controls and compliance with laws and regulations related to the Loan Guarantee Program. 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. Also, we examined the establishment of performance measures in accordance with the *Government Performance and Results Act of 1993*, as it related to the audit objective. The Loan Guarantee Program had not established performance measures regarding the establishment of controls. We did not rely on computer processed data to satisfy our audit objective.

We met with management and discussed the results of our work during the course of the audit. Management waived the exit conference.

PRIOR REPORTS

Office of Inspector General

- *Loan Guarantees for Innovative Energy Technologies* (DOE/IG-0777, September 19, 2007). The Office of Inspector General conducted this special review to identify lessons learned from prior Departmental loan guarantee and related programs and obtained information from other Federal agencies with experience in such agreements. The Department of Energy's Loan Guarantee Program is a multi-year, multi-billion dollar program that is complex and contains certain inherent financial and programmatic vulnerabilities. Under these circumstances, and based on past experience, the Department's Loan Guarantee Program needs to be closely managed. While the actions taken by the Department to date were commendable, the report concluded that there were a number of additional steps that should have been taken to foster the success of the loan guarantee program. These included finalizing a staffing plan, developing risk mitigation strategies, implementing and executing a monitoring system, and promulgating procedures relating to loan defaults.

Government Accountability Office

- *New Loan Guarantee Program Should Complete Activities Necessary for Effective and Accountable Program Management*, (GAO-08-750, July 7, 2008). The Government Accountability Office (GAO) report acknowledged that it would take some time to create a new office and hire staff to implement such a program. However, instead of working to ensure that controls were in place and mitigate risks, the Department of Energy had focused its efforts on accelerating program operations. Moreover, because loan guarantee programs generally pose financial risk to the federal government, and this program had additional inherent risks, it was critical that the Department of Energy complete basic management and accountability activities to help ensure that it would use taxpayer resources prudently. These included establishing sufficient evaluation criteria and guidance for the selection process, resource estimates, and methods to track costs and measure program progress. Without completing these activities, the Department was hampered by its ability to mitigate risks of excessive or unnecessary losses to the federal government and American taxpayers.
- *Observations on Actions to Implement the New Loan Guarantee Program for Innovative Technologies*, (GAO 07-798T, April 24, 2007). The Government Accountability Office found that the Department of Energy had begun implementation of the Loan Guarantee Program without a specific appropriation. GAO raised serious questions about whether the Program and its financial risks would be well managed. At the time of the GAO review, the Department had not taken steps to ensure that it had in place the critical policies, procedures, and mechanisms necessary to ensure the program's success. Specifically, the Department had not issued regulations to include: (1) programmatic, technical, and financial

Appendix 2 (continued)

factors for selecting projects for loan guarantees; (2) policies and procedures for selecting and monitoring lenders and loan performance; and, (3) any other policies or information necessary to implement the Program.

- *The Department of Energy: Key Steps Needed to Help Ensure the Success of the New Loan Guarantee Program for Innovative Technologies by Better Managing Its Financial Risk*, (GAO-07-339R, February 28, 2007). The GAO report on the Department of Energy's current approach to the Loan Guarantee Program raised questions about whether the Program and its financial risks would be well managed. The Department's efforts to date focused on expediting the Program's implementation. For example, the Loan Guarantee Program Office issued guidelines and solicited pre-applications for loan guarantees, rather than making certain the Department had in place the critical policies, procedures, and mechanisms necessary to better ensure the Program's success. GAO stated that the Department could better ensure that the Program would be successful and financial risks to the federal Government would be well managed by taking key steps before selecting projects and issuing guarantees.



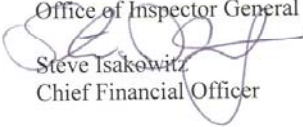
Department of Energy
Washington, DC 20585

January 29, 2009

MEMORANDUM FOR

George W. Collard
Assistant Inspector General
for Performance Audits
Office of Inspector General

FROM:


Steve Isakowitz
Chief Financial Officer

SUBJECT:

Management Decision for Office of Inspector General
Report A08FR043 Audit of the Department of Energy's
Loan Guarantee Program for Innovative Energy
Technologies

This memorandum provides the Title XVII Loan Guarantee Program Office's (LGPO) Management Decision in response to the recommendations contained in the Office of the Inspector General's (OIG) draft report on Audit No. A08FR043, "The Department of Energy's Loan Guarantee Program for Innovative Energy Technologies". In addition to the Management Decision, the LGPO is suggesting technical comments which are provided in Appendix A.

I appreciate the efforts of the Office of Inspector General on this Audit. I want to assure you that I am committed to managing the LGPO carefully to maintain the integrity of the program as well as to promote the objectives of the Title XVII program while protecting the American taxpayer.

The OIG Report contains five recommendations for action. The Loan Guarantee Program concurs with the recommendations and has or is in the process of implementing them. The LGPO's Management Decision and corrective actions are as follows:

Recommendation 1:

Finalize policies and procedures needed to complete the evaluation of loan applications, approval of loan guarantees, monitoring project and loan guarantee performance, and selecting and monitoring participating lenders.

Management Decision:

Concur

The LGPO agrees with the recommendation and has already finalized a policies and procedures document. The LGPO devoted a considerable amount of time in establishing program regulations and developing internal administrative and management systems, policies, procedures and controls that are consistent with the Federal Credit Reform Act of 1990 and related Office of Management Budget circulars to adequately manage the loan



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Appendix 3 (continued)

guarantees that will extend, in most cases, through the life of each related project while also protecting the interests of the U.S. taxpayer.

On January 15, 2009, the Credit Review Board for the Loan Guarantee Program Office acknowledged completion of the "Title XVII of the Energy Policy Act of 2005 Loan Guarantee Program Credit Policies and Procedures" manual and approved use of the manual. The document will be updated as needed. These policies and procedures cover the activities related to the LGPO's credit activities, starting with loan guarantee solicitations and ending with project monitoring activities.

Recommendation 2:

Prepare a policy or guidance document establishing the conditions requiring the use of independent advisory consultants.

Management Decision:

Concur with comment

The LGPO will undertake a rigorous underwriting process to evaluate the legal, technical, financial, market and environmental attributes of each project and will ensure adherence to its Credit Policies and Procedures. The specific LGPO procedures for utilizing independent advisory consultants are outlined in Chapter 3, pages 8-9, of the "Title XVII of the Energy Policy Act of 2005 Loan Guarantee Program Credit Policies and Procedures" manual.

The LGPO agrees that independent advisory consultant expertise must be defined so that it is available when needed. However, the precise expertise is going to vary from project to project.

Recommendation 3:

Document material aspects of loan application reviews, such as site visits, in the official electronic project files.

Management Decision:

Concur

The LGPO agrees that the official electronic project files (E-Docs system) must be populated and maintained on a regular basis to capture material aspects of the due diligence process. As a result of this audit, on November 20, 2008 the LGPO issued "Guidelines for Populating LGPO's E-Docs Filing System". The primary purpose of the E-Docs is to provide a central, readily accessible, and current source of relevant documents and information generated, or received, by the LGPO in conducting its business. The E-Docs System is not meant to capture every piece of project related correspondence or documentation ever produced or all public information ever generated during the life of the project. As such, the right types and amount of information will be collected. The five general areas of information that are currently being maintained in the E-Docs system are: Environmental Documentation; General Correspondence; Loan Monitoring; Pre-commitment Project Review; and Transaction Documentation.

Appendix 3 (continued)

Recommendation 4:

Formalize procedures for disbursing loan proceeds with the Federal Financing Bank.

Management Decision:

Concur

The LGPO agrees with this recommendation. On December 19, 2008, the LGPO met with representatives from the Federal Financing Bank (FFB), DOE accounting, and DOE General Counsel to discuss and comment on documents required for disbursing loan proceeds such as the: Program Financing Agreement; Note Purchase Agreement; and Note. The LGPO will continue to work with the FFB and other DOE offices and will ensure that procedures for disbursing loan proceeds are finalized in accordance with the rules and regulations governing the FFB for disbursing loans. The conditions concerning the disbursement of each individual loan guarantee will be unique and will be approved by the Credit Review Board on a project by project basis.

Recommendation 5:

Take action necessary to ensure that the program is fully staffed and capable of meeting all requirements.

Management Decision:

Concur

The LGPO agrees with this recommendation and is continuing to recruit and hire qualified personnel of the highest caliber to complete the project origination, NEPA compliance, due diligence, credit underwriting and monitoring and oversight activities of applicants to the 2008 solicitations. As of January 21, 2009, there are 18 full time federal employees on board. This includes two recently hired Senior Investment Officers that will support project origination activities. The LGPO expects a junior Investment Officer to join the team in early February and is currently evaluating applications for three positions in the NEPA Division. The LGPO intends to advertise for additional Senior Investment Officer and Investment Officer positions in February 2009. The LGPO has requested funding in the FY 2009 Budget Request to support a total of 35 FTEs. The continuing resolution that we are currently operating under for FY 2009 funding has required that we bring people on-board as funds are available. We anticipate however, to hire the necessary positions if our FY 2009 funding request is enacted in March 2009.

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2. What additional information related to findings and recommendations could have been included in the report to assist management in implementing corrective actions?
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?
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