



Audit Report



OIG-12-069

RECOVERY ACT: Audit of Moraine Wind II LLC Payment Under 1603 Program

August 23, 2012

Office of
Inspector General

Department of the Treasury

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Abbreviations

MW	megawatt
NREL	National Renewable Energy Laboratory
OFAS	Office of the Fiscal Assistant Secretary
OIG	Office of Inspector General
Treas. Reg.	Treasury Regulation

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*The Department of the Treasury
Office of Inspector General*

August 23, 2012

Richard L. Gregg
Fiscal Assistant Secretary

As part of our ongoing oversight of the Department of the Treasury's (Treasury) 1603 Program – Payments for Specified Energy Property in Lieu of Tax Credits (1603 Program)¹ authorized by the American Recovery and Reinvestment Act of 2009 (Recovery Act),² we are conducting audits of selected award recipients. In this regard, we have audited the award made to Moraine Wind II, LLC (Moraine II) for a wind energy property in Pipestone County, Minnesota. Moraine II submitted its claim for payment in lieu of tax credit in the amount of \$28,019,520 and was awarded that amount by Treasury on September 1, 2009. Our audit objectives were to assess the eligibility and accuracy of that award by determining whether (1) the property existed, (2) the property was placed into service during the eligible timeframe, and (3) the award amount was appropriate.

Results in Brief

We verified that the subject property described by Moraine II in its 1603 Program application existed and was placed in service on February 15, 2009, which was within the eligible timeframe. We also concluded that the award amount was appropriate. Overall, Moraine II complied with the eligibility requirements set forth in Section 1603 of the Recovery Act and Treasury's 1603 Program

¹ Treasury's Office of the Fiscal Assistant Secretary administers this program.

² Pub. L. No. 111-5, 123 Stat. 364-366 (Feb. 17, 2009). Under section 1603 of the Recovery Act, Treasury makes grants (payments) to eligible persons who place in service specified energy property and apply for such payments. The payments reimburse eligible applicants for a portion of the expense of such property and are made in lieu of tax credits that could potentially be claimed by the awardees.

guidance.³ Subsequent to our visit to Iberdrola Renewables Inc. (Iberdrola), the parent company of Moraine II, we reviewed Moraine II's annual performance reports submitted to Treasury for 2010 and 2011, certifying that the subject property was not disposed of and that it continued to qualify as a specified energy property. It should be noted that in accordance with the terms and conditions of the award, Moraine II must continue to certify that (1) the property has not been sold, transferred, or disposed of to a disqualified person and (2) the property continues to qualify as a specified energy property.

As part of our reporting process over 1603 Program awardees, we provided Moraine II an opportunity to comment on a draft of this report. Moraine II agreed with the results of our audit; its response can be found in appendix 1. After incorporating Moraine II's response into this report, we provided it to Treasury management for comment. Treasury management also concurred with our audit results; its response is provided in appendix 2.

Background

Eligibility Under the 1603 Program

Applicants are eligible for a 1603 Program award if a specified energy property is placed in service during calendar years 2009, 2010, or 2011,⁴ and the amount awarded is in accordance with provisions of the Internal Revenue Code for determining the appropriate cost basis. Under the 1603 Program, applicants submit an application to Treasury that reports the total eligible cost basis of a specified energy property placed in service. If approved, award

³ Office of the Fiscal Assistant Secretary, "Payments for Specified Energy Property in Lieu of Tax Credits under the American Recovery and Reinvestment Act of 2009 Program Guidance", (July 2009/ Revised March 2010/ Revised April 2011)

(<http://www.treasury.gov/initiatives/recovery/Pages/1603.aspx>)

⁴ Section 707 of the Tax Relief, Unemployment Insurance Reauthorization and Job Creation Act of 2010 (Pub. L. 111-312, 124 Stat. 3312 (December 17, 2010)), extended Treasury's 1603 Program for 1 year. To be eligible, a property must be placed in service in 2009, 2010, or 2011 or placed in service after 2011 but only if construction of the property began during 2009, 2010 or 2011 and the credit termination date of the property has not expired. The application deadline was extended to September 30, 2012.

amounts are based on a percent of the eligible cost basis. For the type of property claimed by Moraine II, the percentage of the cost basis eligible for award is 30 percent. According to Treasury's 1603 Program guidance, the cost basis of the subject property is ascertained in accordance with the general rules for determining the cost basis of property for federal income tax purposes. Specifically, for this type of property, applicants follow the capitalization procedures found in Treas. Reg. §1.263A-1, "Uniform Capitalization of Costs."⁵

The terms and conditions of award require applicants to certify annually for a period of 5 years following the property's in-service date that the claimed property (1) has not been sold, transferred, or disposed of to a disqualified person and (2) continues to qualify as a specified energy property. Otherwise, the 1603 Program payment will be subject to full or prorated recapture.

Moraine II

Iberdrola developed the Moraine Wind II wind farm property located in Pipestone County, Minnesota. The subject property is a 49.5 megawatt (MW) wind farm which utilizes 33 General Electric wind turbines capable of generating about 169 gigawatt hours of electrical output annually. Moraine II's generated power is sold to a local utility provider.

As of the end of our fieldwork, Iberdrola affiliates received \$1.6 billion in 1603 Program awards for 22 specified energy properties – Penascal Wind Power, Farmers City Wind, Barton Chapel Wind, Locust Ridge II, Hay Canyon Wind, Pebble Springs Wind, Barton Windpower, Dry Lake Wind Power, Rugby Wind, Star Point Wind, Streator-Cayuga Ridge Wind Power, Penascal II Wind, Big Horn II Wind, Dry Lake Wind Power, Buffalo Ridge II, Elm Creek Wind II, Leaning Juniper Wind Power II, Juniper Canyon Wind Power, Hardscrabble Wind Power, Copper Crossing Solar, South Chestnut, and Moraine Wind II.

⁵Treas. Reg. § 1.263A-1(a)(3) (ii), Property produced: "Taxpayers that produce real property and tangible personal property (producers) must capitalize all the direct costs of producing the property and the property's properly allocable share of indirect costs (described in paragraphs (e)(2)(i) and (3) of this section), regardless of whether the property is sold or used in the taxpayer's trade or business.

Objectives, Scope, and Methodology

To assess the eligibility and accuracy of the award made to Moraine II under the 1603 Program, we determined whether (1) the property existed, (2) the property was placed into service during the eligible timeframe, and (3) the award amount was appropriate.

In performing our work, we visited Moraine II's parent company, Iberdrola in Portland, Oregon; interviewed key personnel of Iberdrola and key personnel associated with its independent public accounting firm; reviewed the application and related documents reviewed by the Department of Energy's National Renewable Energy Laboratory (NREL);⁶ reviewed documentation used to support the property's existence, its placed in service date, and the costs claimed by Moraine II; and reviewed the annual performance reports submitted by the awardee for 2010, 2011 and 2012. We performed our work between February 2010 and May 2012.

We conducted this performance audit in accordance with generally accepted government auditing standards. Those standards require that we plan and perform an 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.

Audit Results

We verified that the subject property described by Moraine II in its 1603 Program application existed, was properly placed in-service within the eligible timeframe, and the award amount was appropriate.

⁶ NREL is a national laboratory of the Department of Energy. Under an interagency agreement between Treasury and the Department of Energy, NREL performs the technical review of 1603 Program applications and advises Treasury on award decisions.

Property Existence

We confirmed the subject property's existence through our review of Moraine II's wind turbine monitoring system located at Iberdrola headquarters in Portland, Oregon. We noted active monitoring of 33 wind turbines. We also found that the subject property included the wind turbines that had the 1.5 MW capacity each as described in the subject property's application.

Placed In-Service

We determined that the subject property was placed in service during the eligible time frame through review of documentation supporting Moraine II's in-service date of February 15, 2009. Specifically, we reviewed (1) documentation detailing the completion status for each turbine, and (2) the inter-connection agreement between Moraine II and respective third parties for interconnection service.

Appropriate Award Amount

We concluded that the award amount of \$28,019,520 awarded to Moraine II was appropriate through our review of documentation supporting the subject property's cost basis. During our review, we obtained a schedule of all costs in the subject property's cost basis of \$93 million and tested supporting documentation for cost transactions totaling \$65.8 million and verified that the selected costs were allowable and eligible. Accordingly, we believe the amount awarded to Moraine II was appropriate.

Since our visit to Iberdrola headquarters, we also reviewed Moraine II's "Annual Performance Report and Certification" for 2010, 2011 and 2012 to ensure compliance with Treasury's reporting requirements contained in the applicant's terms and conditions of award. As required for continued eligibility, Moraine II certified that the property had not been sold, transferred, or disposed of to a disqualified person and that the property continues to qualify as a specified energy property. The next annual report is due March 7, 2013.

* * * * *

We appreciate the courtesies and cooperation provided to our staff during this audit. If you wish to discuss this report, you may contact me at (202) 927-5400 or Donna Joseph, Director, at (202) 927-5784. See appendix 3 for major contributors to this report.

/s/

Marla A. Freedman
Assistant Inspector General for Audit

Appendix 1
Moraine Wind II, LLC's Response



July 27, 2012

Marla A. Freedman
Assistant Inspector General for Audit
Department of the Treasury Office of Inspector General
740 15th Street, N.W., Suite 600
Washington, D.C. 20220


Dear Ms. Freedman,

Iberdrola Renewables appreciates the opportunity to review the draft report dated July 11, 2012 for the audit of the award made to Moraine Wind LLC under the Department of the Treasury's 1603 Program – Payments for Specified Energy Property in Lieu of Tax Credits.

Iberdrola Renewables concurs with the audit results in the draft report.

Please feel free to contact me if any further correspondence on this matter is required.

Sincerely,



Ralph Currey
President and Chief Executive Officer

Appendix 2
Management's Response



ASSISTANT SECRETARY

DEPARTMENT OF THE TREASURY
WASHINGTON, D.C.

August 6, 2012

Marla Freedman
Assistant Inspector General for Audit
Department of the Treasury
Office of Inspector General
740 15th Street, N.W., Suite 600
Washington, D.C. 20220

Dear Ms. Freedman:

Thank you for the opportunity to comment on the draft audit report of the Section 1603 award made to Moraine Wind II, LLC. We concur with the report's findings.

Sincerely,

Richard L. Gregg
Fiscal Assistant Secretary

Appendix 3
Major Contributors To This Report

Donna Joseph, Director
Cynthia Milanez, Audit Manager
Erica Wardley, Audit Manager
James Hodge, Auditor-in-Charge
Cheryl Sroufe, Auditor
Alexander Milne, Auditor
Christen Stevenson, Referencer

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Fiscal Assistant Secretary
Deputy Chief Financial Officer
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Office of Management and Budget

OIG Budget Examiner

Iberdrola Renewables Inc.

President and Chief Executive Officer

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