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November 25, 2009

Elaine M. Howle
State Auditor
Bureau of State Audits
555 Capitol Mall, Suite 300
Sacramento, CA 95814

Dear Ms. Howle,

Thank you for the opportunity to comment on your draft report *California Energy Resources Conservation and Development Commission: It Is Not Fully Prepared to Award and Monitor Millions in Recovery Act Funds and Lacks Controls to Prevent Their Misuse*. The Energy Commission provides the following response to address issues raised by the Bureau of State Audits (BSA) regarding the State Energy Program (SEP).

- The SEP implementation has taken longer than anticipated because the requirements of an open, public process have necessitated extensive public interaction through workshops and meetings throughout the state. The Energy Commission however sought and received legislative authorization to implement the program through guidelines rather than regulations, cutting months out of the process.
- Extensive public and stakeholder input in developing innovative programs will ensure a more transparent, equitable and beneficial use of ARRA funds.
- It is critical for a successful program to follow state mandated processes and procedures that are in place to ensure a fair and competitive process, even though compliance with these requirements impacts the schedule.
- The majority of SEP funds will be obligated by April 2010, nearly five months before the federal obligation deadline.
- At a November 16, 2009 meeting, senior U.S. Department of Energy (DOE) officials and program experts commented that the Energy Commission's progress with the SEP since July 2009 was impressive.

In summary, we agree that additional internal controls should be implemented to meet federal ARRA requirements and that further work is needed to finalize our preparations to disburse the ARRA SEP funds. The Energy Commission however has made significant strides in obtaining public input, developing program guidelines and releasing program solicitations. Given the legal and transparency framework within which the Commission must operate, it has not been slow in developing guidelines, and according to DOE the state is not at risk to lose funds. The Energy Commission did not wait to begin work on guidelines until the requisite legislation was enacted, but proceeded efficiently and expeditiously in anticipation of enactment. The Energy Commission must

comply with numerous state laws, including the Administrative Procedures Act (APA) that requires due public process for adopting regulatory requirements, the Warren-Alquist Act requiring the Energy Commission to make all decisions in an open public setting with ample opportunity for public input, the trailer bill exempting the Commission from some, but not all APA requirements when adopting guidelines, the Energy Commission's regulations for adopting rules and guidelines, and state contracting law.

More detailed comments are provided regarding several major topic areas mentioned in the report.

Internal controls. The Energy Commission agrees that its internal controls can and should be strengthened to fully comply with ARRA guidelines and ensure proper expenditure of funds and collection of required data. These additional internal controls will be developed and documented over the next several months with the assistance of a contractor who will review existing processes and procedures and assist staff in developing adequate procedures and documentation.

We note that the Energy Commission has an established internal control structure in place for its existing programs. However, BSA is correct that these internal controls are not adequately documented. The adequacy of existing internal controls has been demonstrated by the following:

- The Department of Finance (DOF) conducts an annual Financial Statement Audit of the Energy Commission's Renewable Resource Trust Fund (RRTF) and internal controls. DOF's latest audit report dated January 2009 stated that the "financial statements are fairly presented for the fiscal year ended June 30, 2008" and the audit did not identify any reportable internal control or compliance weaknesses." The audit tests expenditures, disbursements, revenue collection and reconciliation, financial report preparation and other fiscal controls. These fiscal control processes are not unique to the Renewable Resource Trust Fund. The same internal controls, processes, and staff in the financial operations of the Energy Commission are for all programs, regardless of fund source. It should also be noted that in more than ten years, there has never been a material finding by DOF in their audit of the RRTF.

- The Energy Commission successfully implemented and administered a similar size program effort during the energy crisis of 2000/2001. Approximately $345 million in general funds were awarded by the Energy Commission to public and private entities to reduce electricity consumption, demand and increase electricity generation. During this crisis, the Energy Commission developed 12 new programs and expedited program guidelines to effectively and efficiently implement the programs. Approximately 240 projects were funded through contract, grant and loan agreements. These extraordinary efforts were conducted with minor staffing increases (eight limited term positions) and existing processes and procedures. In fact, fiscal reporting systems in place today are more robust than the fiscal reporting systems in place during the energy crisis.

- The State Controller's Office (SCO) has recognized the Energy Commission's Accounting Office with its "Award for Achieving Excellence in Financial Accounting" on numerous occasions for numerous fund financial statements. Most recently, the SCO presented the Energy Commission with its excellence in Financial Reporting award for 11 funds for the fiscal year ending June 30, 2008.

Progress in implementing the program. The Energy Commission agrees that program implementation should be expedited to maximize the economic benefits of the Recovery Act. The BSA, however, does not recognize the efforts and significant progress made to date by the Energy Commission to develop new, innovative programs. Unlike other state departments receiving and expending ARRA funds, the Energy Commission did not have existing programs in place (except for the Energy Conservation Assistance Account loan program) to readily expend ARRA funds. Additionally, state law requires the Energy Commission to maintain a transparent and open, public process when designing and developing programs and approving funding awards.

Once the ARRA was enacted, the Energy Commission moved quickly to assemble a core team to begin working on program design and complete the Department of Energy grant application. Contrary to BSA's assertion, the Energy Commission did not wait until legislation was signed late July 2009 to begin guideline development. Stakeholder meetings occurred in early April 2009 and the first SEP public workshop was held in late April 2009. Additional public workshops were held in early May to solicit public input on broad SEP program concepts. Staff took the input from these workshops and developed program guidelines from mid-May through June 2009. These draft program guidelines were presented in a series of statewide public workshops during July 2009. Further input from these workshops was incorporated into the draft guidelines and then the final, draft guidelines were posted for the required 30-day timeframe in August 2009. As legally required, the Commission adopted these guidelines in September 2009.

The BSA's report also implies that the Energy Commission chose a public and open guideline development process at the expense of expediency. As we explained to the BSA, the Energy Commission is required to conduct such matters as guideline development and funding award approval through a public process and received strong encouragement and support from both the Governor's Office and Legislature to do so through a guideline process authorized by trailer bill language as opposed to the lengthier regulation process. This allowed the Energy Commission to conduct a meaningful public process while saving considerable time. The BSA does not acknowledge that we must comply with administrative procedure and contracting law. Where appropriate and consistent with applicable law, the Energy Commission has negotiated expedited approval processes with control agencies such as Department of General Services for expenditure of ARRA funds. However, the Energy Commission recognizes and the state benefits from the important public process served by these laws and must fully comply with their requirements.

Additionally, state expenditure authority for the SEP funds was not received until passage of the budget trailer bill passed in late July 2009 and only half of the program expenditure authority was approved at that time. The remaining $113 million was recently authorized in a legislative bill that becomes effective January 1, 2010. We believe the majority of SEP funds will be obligated by April 2010, nearly five months before the federal obligation deadline.

On November 16, 2009 members of the California Recovery Task Force and the Energy Commission met with senior U.S. Department of Energy officials to discuss the SEP. The primary purpose of DOE's visit was to get an update on the Energy Commission's implementation of the SEP grant and to determine if there was anything DOE could do to assist in the process. At the meeting, DOE representatives acknowledged that further guidance will be forthcoming on job calculations and reporting and compliance with Davis-Bacon and prevailing wage issues as well as National Historic Preservation Act and National Environmental Protection Act certifications that have delayed states obligating SEP funds. At the close of the November 16 meeting, DOE representatives expressed that they were very impressed with the progress the Energy Commission has made since the late July meeting and stated the Energy Commission has made "100 percent progress." Also during this meeting, DOE expressed support for the Energy Commission's work-to-date and did not state, suggest or imply that the Energy Commission risked losing any ARRA funding based on the status of program delivery.

The Energy Commission agrees with the BSA's recommendation that the support solicitations should be completed as soon as possible. The audit solicitation was released on November 24 and we anticipate releasing the monitoring, verification and evaluation (MV&E) solicitation within the next 10 days. With the assistance of the audit contract, we expect to enhance our internal controls. Existing internal controls are adequate; however we believe there are opportunities to further strengthen existing controls that will enhance the delivery of programs and project success.

Finally, we provide some additional examples of progress expending the ARRA SEP funds not reflected in the BSA's report:

- The Employment Development Department, in coordination with the Energy Commission, awarded 27 ARRA/SEP funded grants on October 2, 2009 totaling $14.5 million. These grants also leveraged $10 million in federal Workforce Investment Act funds. All of these projects are expected to begin training efforts in December 2009 and January 2010.

- The SEP Energy Conservation Assistance Account Revolving Loan Program was launched on September 16, 2009. To date, the Energy Commission has received applications totaling $35 million, an oversubscription of currently available program funds.

Progress in executing support contracts. The Energy Commission recognizes that it would be preferable to have the support contracts in place to assist with the

implementation of ARRA funded programs. Development of the solicitation packages for the audit and fraud work and the monitoring, verification and evaluation (MV&E) contracts have taken longer than anticipated. As mentioned, the solicitation for the audit and fraud work was released on November 24, 2009 and the MV&E solicitation should be released in the next 10 days.

We believe the timing of the planned commencement of the audit and MV&E contracts complement when we expect to execute the bulk of the funding awards. A quicker selection and execution of the competitively bid support contracts will result from contract teams who will conduct concurrent reviews/edits, and an expedited approval process. Additionally, we have negotiated a more streamlined approval process with the Department of General Services (DGS) that allows for the approval of draft contracts that can be performed concurrent with Commission Business Meeting approval, further expediting the execution process. The "standard process for executing a contract" as referenced by the BSA will not be the standard operating procedure for the SEP support contracts or other SEP funding agreements.

Prepared to meet federal reporting requirements. The BSA incorrectly stated that the Energy Commission is not prepared to comply with the federal Office of Management and Budget (OMB) 1512 reporting requirements. The Energy Commission met the OMB reporting deadline for the quarter ending September 30, 2009. Additionally, a support contractor has been working closely with administrative and information technology staff to develop a comprehensive reporting system that captures OMB, DOE and other data elements. This system is in the final stages of testing before rollout. Training of interagency staff – DGS, EDD and ETP – is planned for December 1, 2009. Additional training of internal staff is planned for the first two weeks of December. The Energy Commission will develop a documented process for reviewing and validating federal reported data.

We appreciate the BSA's efforts to identify areas where the Energy Commission can improve its internal controls, reduce risks for misuse of ARRA funds while meeting the federal objectives to spur economic activity, save and create new jobs in a transparent and accountable manner.

Sincerely,

Melissa Jones

Melissa Jones
Executive Director