

Audit Report

---

**Maryland Energy Administration**

August 2008

---



**OFFICE OF LEGISLATIVE AUDITS**  
DEPARTMENT OF LEGISLATIVE SERVICES  
MARYLAND GENERAL ASSEMBLY

- 
- This report and any related follow-up correspondence are available to the public through the Office of Legislative Audits at 301 West Preston Street, Room 1202, Baltimore, Maryland 21201. The Office may be contacted by telephone at 410-946-5900, 301-970-5900, or 1-877-486-9964.
  - Electronic copies of our audit reports can be viewed or downloaded from our website at <http://www.ola.state.md.us>.
  - Alternate formats may be requested through the Maryland Relay Service at 1-800-735-2258.
  - The Department of Legislative Services – Office of the Executive Director, 90 State Circle, Annapolis, Maryland 21401 can also assist you in obtaining copies of our reports and related correspondence. The Department may be contacted by telephone at 410-946-5400 or 301-970-5400.
-



Karl S. Aro  
Executive Director

DEPARTMENT OF LEGISLATIVE SERVICES  
OFFICE OF LEGISLATIVE AUDITS  
MARYLAND GENERAL ASSEMBLY

Bruce A. Myers, CPA  
Legislative Auditor

August 27, 2008

Senator Verna L. Jones, Co-Chair, Joint Audit Committee  
Delegate Steven J. DeBoy, Sr., Co-Chair, Joint Audit Committee  
Members of Joint Audit Committee  
Annapolis, Maryland

Ladies and Gentlemen:

We have audited the Maryland Energy Administration (MEA) for the period beginning March 2, 2005 and ending November 4, 2007. MEA manages various programs related to the reduction of energy consumption, use of renewable energy resources, and promotion of energy efficiency. MEA also provides grants and loans to governmental units, nonprofits, and private entities.

We noted that there was a lack of timely follow-up on the collection of delinquent Community Energy Loan Program (CELP) loans, and security or collateral was not obtained from borrowers as permitted. In addition, an improper transfer of \$900,000 out of CELP has not been corrected since our preceding audit. Finally, MEA has accumulated and retained funds from the Environmental Trust Fund.

MEA's response to this audit is included as an appendix to this report. We wish to acknowledge the cooperation extended to us during our audit by MEA.

Respectfully submitted,

Bruce A. Myers, CPA  
Legislative Auditor



# Table of Contents

<b>Background Information</b>	4
Agency Responsibilities	4
Status of Findings From Preceding Audit Reports	4
<b>Findings and Recommendations</b>	5
<b>Community Energy Loan Program</b>	
Finding 1 – MEA’s Collection Process and Expenditure Monitoring for the Community Energy Loan Program Was Inadequate	5
* Finding 2 – Funds Improperly Transferred From the Community Energy Loan Program to the State Agency Loan Program Have Not Been Returned	7
<b>Environmental Trust Fund</b>	
Finding 3 – Funds From the Environmental Trust Fund Were Accumulated and Retained	7
<b>Audit Scope, Objectives, and Methodology</b>	9
<b>Agency Response</b>	Appendix

\* Denotes item repeated in full or part from preceding audit report

## **Background Information**

### **Agency Responsibilities**

The Maryland Energy Administration (MEA) manages programs which help reduce energy consumption in State facilities and operations, encourage the use of renewable energy resources, and promote energy efficiency in the industrial, commercial, and residential sectors. MEA also provides grants and loans for State agencies, local governments, nonprofit organizations, and the commercial sector. MEA's alternative fuel vehicles programs work to develop the infrastructure to support alternative fuel vehicles while encouraging the use of alternative fuel vehicles in the public and private sectors. MEA advises the Governor's Office on energy policy and managing energy disruptions and emergencies. MEA is the state conduit for federal energy programs from the U.S. Department of Energy. According to the State's records, operating expenditures for fiscal year 2007 totaled \$5.8 million.

As part of its energy management responsibilities, MEA manages the Energy Overcharge Restitution Fund (EORF). The State established the EORF to receive funds related to the settlement of federal lawsuits against certain oil companies that overcharged the public for petroleum products in the late 1970s. MEA transfers funds from the EORF to the Community Energy Loan Program (CELP) and to the State Agency Loan Program (SALP) after federal and State approvals. The CELP provides low interest loans to nonprofit entities and local governments for energy conservation projects, while the SALP provides interest-free loans for similar projects at State agencies.

### **Status of Findings From Preceding Audit Reports**

Our audit included a review to determine the status of the three fiscal/compliance findings contained in our preceding audit report dated July 8, 2005. We determined that MEA satisfactorily addressed two of the three findings. The remaining finding is repeated in this report.

We also conducted a review to determine the status of a finding from our preceding audit report related to a previous performance audit that we conducted addressing the State's compliance with the Federal Energy Policy Act of 1992 and the use of alternative fuels in State agencies' fleet vehicles. Our current audit follow-up disclosed that MEA satisfactorily addressed this finding.

# Findings and Recommendations

## Community Energy Loan Program

### Background

The Community Energy Loan Program (CELP) is a self-sustaining program which provides low-interest loans to schools, local governments, and nonprofit organizations for energy conservation improvements. According to the Maryland Energy Administration's (MEA) records, CELP disbursements totaled approximately \$794,000 during fiscal year 2007. Effective July 1, 2008, with limited modifications, CELP was consolidated with the Energy Efficiency and Economic Development Loan Program into the newly created Jane E. Lawton Conservation Loan Program.

### **Finding 1**

**MEA's collection process and expenditure monitoring for CELP was inadequate.**

### Analysis

Our audit disclosed that MEA did not have a process in place to ensure timely repayments for loans awarded from CELP nor did MEA obtain information that would enable it to assess whether the loans resulted in energy savings. According to MEA's records, as of November 30, 2007, CELP's outstanding balance, including interest, on 17 loans totaled \$3.5 million, with six additional approved loans totaling \$1.8 million, for which funds had not yet been drawn. Our audit disclosed the following conditions:

- Our review of all outstanding loan balances as of November 30, 2007 disclosed that no collections had been received since inception for two loans totaling \$642,529 that required semi-annual payments, beginning in May 2005 and in February 2006. As of December 2007, the borrowers should have repaid approximately \$215,000 on these loans; however, MEA had taken no action to collect the outstanding amounts. Since CELP is self-sustaining, the failure to pursue the collection of outstanding loans limits the funding of new loans. State regulations generally require that three written demands for payment be made on accounts at 30-day intervals, and that outstanding accounts be transferred to the Department of Budget and Management's Central Collection Unit for further collection efforts within 75 days of the original demand for payment.

- Our test of five outstanding CELP loans with original loan amounts plus interest totaling \$3.1 million disclosed that MEA could not provide documentation to support periodic monitoring of the use of the loan proceeds by the debtors for two loans totaling \$1.3 million. Since these loans are to be used for energy conservation improvements, the loan agreements include provisions for MEA monitoring to ensure they are used for the intended purpose. For a third loan (one of the delinquent loans previously noted) totaling \$430,646, while there was evidence that the loan proceeds were used for legitimate design costs related to energy efficiency improvements on a building, the actual improvements were never made. We were advised that when awarding a loan for design costs, MEA does not have a process to help ensure that a debtor has adequate funding in place to carryout the resultant planned energy improvements.
- MEA did not require borrowers of CELP funds to provide security or collateral as allowed by State regulations. Such security would help to ensure loan repayment in the event of a default. We were advised by MEA management that MEA has never required security on its loans.

State law provides that MEA manage, supervise, and administer CELP. It further states that MEA attach specific terms to any loan to assure that the purpose of CELP is fulfilled and develop procedures for monitoring projects to assess whether the improvements or modifications made by a sponsor have resulted in a measurable reduction in energy consumption.

### **Recommendation 1**

**We recommend that MEA take immediate action to collect amounts that are past due. We also recommend that written demands for payment be sent to the appropriate borrowers and delinquent accounts be transferred to CCU, as required by State regulations. We further recommend that MEA assess whether CELP loans resulted in energy savings as required and that MEA perform periodic documented monitoring reviews of all loans. For loans requested for design costs, MEA should establish procedures to help ensure that the debtor has sufficient funding available to execute the related plan. Finally, we recommend that MEA require borrowers to provide security or collateral when obtaining CELP loans or document why obtaining security/collateral from the borrower is not warranted.**

**Finding 2**

**CELP funds totaling \$900,000 that were improperly transferred to the State Agency Loan Program during the prior audit have not been returned.**

**Analysis**

In our preceding audit report, we commented that MEA improperly transferred funds totaling \$900,000 (\$500,000 in December 2001 and \$400,000 in November 2004) from CELP to the State Agency Loan Program (SALP). This was done to provide additional loan funds for SALP.

In response to our audit finding, MEA obtained an opinion from the Office of the Attorney General regarding the propriety of transferring funds between the CELP and SALP loan programs. In an Opinion dated January 25, 2006, the Attorney General concluded that the CELP funds could only be legitimately transferred if the General Assembly passed a law authorizing the transfer, or if a budget amendment is approved in accordance with State law authorizing the transfer. Subsequent to that Opinion, legislation was not initiated nor had MEA obtained a budget amendment or transferred the funds from SALP back to CELP. MEA management could not explain why no additional action had been taken.

**Recommendation 2**

**We recommend that MEA take immediate action to transfer \$900,000 to CELP from SALP or take other appropriate action.**

**Environmental Trust Fund****Finding 3**

**Funds from the Environment Trust Fund were accumulated and retained.**

**Analysis**

As of October 31, 2007, MEA had accumulated and retained unspent Environmental Trust Fund (ETF) money totaling approximately \$380,000, which was provided to MEA by the Department of Natural Resources (DNR), the administrator of the ETF. Most of these funds, (\$354,409) have been on hand for more than two years.

In addition, MEA lacked sufficient documentation to support that other ETF funds spent were used for the purpose established by law. For example, 90 percent of the funding received in fiscal year 2007 was used for MEA salary expenses, based on an allocation of salary for various MEA employees. However, there was no

documentation to support that these salary expenses incurred related to actual time or effort by employees for ETF approved projects.

State law provides for MEA to receive up to \$250,000 annually from the ETF for administrative and fiscal support for studies relating to conservation or production of electric energy. To account for the use of this funding, MEA entered into a Memorandum of Understanding with DNR which requires that MEA annually outline the projects to be performed by MEA and the related estimated costs of each project and invoice DNR at least quarterly for expenses incurred.

**Recommendation 3**

**We recommend that unspent funds be reverted to the ETF, unless authorization to retain funds is obtained. In addition, we recommend that MEA maintain documentation supporting the charges to the ETF such as the basis for the salary expenses.**

## **Audit Scope, Objectives, and Methodology**

We have audited the Maryland Energy Administration (MEA) for the period beginning March 2, 2005 and ending November 4, 2007. The audit was conducted 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.

As prescribed by the State Government Article, Section 2-1221 of the Annotated Code of Maryland, the objectives of this audit were to examine MEA's financial transactions, records and internal control, and to evaluate its compliance with applicable State laws, rules, and regulations. We also determined the status of the findings in our preceding audit report.

In planning and conducting our audit, we focused on the major financial-related areas of operations based on assessments of materiality and risk. Our audit procedures included inquiries of appropriate personnel, inspections of documents and records, and observations of MEA's operations. We also tested transactions and performed other auditing procedures that we considered necessary to achieve our objectives. Data provided in this report for background or informational purposes were deemed reasonable, but were not independently verified.

Our audit did not include an evaluation of internal controls for federal financial assistance programs and an assessment of MEA's compliance with federal laws and regulations pertaining to those programs because the State of Maryland engages an independent accounting firm to annually audit such programs administered by State agencies, including MEA. Our audit also did not include certain support services provided to MEA by the Executive Department – Governor. These support services (such as maintenance of FMIS accounting records and related fiscal functions) are included within the scope of our audits of the Executive Department – Governor.

Our audit scope was limited with respect to MEA's cash transactions because the Office of the State Treasurer was unable to reconcile the State's main bank accounts during a portion of the audit period. Due to this condition, we were unable to determine, with reasonable assurance, that all of MEA's cash transactions prior to July 1, 2005 were accounted for and properly recorded on the related State accounting records as well as the banks' records.

MEA's management is responsible for establishing and maintaining effective internal control. Internal control is a process designed to provide reasonable assurance that objectives pertaining to the reliability of financial records, effectiveness and efficiency of operations including safeguarding of assets, and compliance with applicable laws, rules, and regulations are achieved.

Because of inherent limitations in internal control, errors or fraud may nevertheless occur and not be detected. Also, projections of any evaluation of internal control to future periods are subject to the risk that conditions may change or compliance with policies and procedures may deteriorate.

Our reports are designed to assist the Maryland General Assembly in exercising its legislative oversight function and to provide constructive recommendations for improving State operations. As a result, our reports generally do not address activities we reviewed that are functioning properly.

This report include a finding related to a condition that we consider to be a significant deficiency in the design or operation of internal control that could adversely affect MEA's ability to maintain reliable financial records, operate effectively and efficiently and/or comply with applicable laws, rules, and regulations. Our report also includes findings regarding significant instances of noncompliance with applicable laws, rules, or regulations.

The response from MEA to our findings and recommendations is included as an appendix to this report. As prescribed in the State Government Article, Section 2-1224 of the Annotated Code of Maryland, we will advise the MEA regarding the results of our review of its response.

APPENDIX

Martin O'Malley, *Governor*  
Malcolm D. Woolf, *Director*



1623 Forest Drive, Suite 300  
Annapolis, MD 21403  
p.410.260.7655  
800.72.ENERGY  
f.410.974.2250  
[www.energy.state.md.us](http://www.energy.state.md.us)

August 25, 2008

Mr. Bruce A. Myers, CPA  
Office of Legislative Audits  
301 West Preston Street, Room 1202  
Baltimore, MD 21201

Dear Mr. Myers,

We are in receipt of the July 2008 audit report for the Maryland Energy Administration. We are pleased to note that all the findings from the previous audit conducted in 2005 were satisfactorily addressed with the exception of the transfer from CELP to SALP, which we are continuing to address. We appreciate the recommendations made by the Office of Legislative Audits and will implement the necessary changes.

Regards,

A handwritten signature in black ink that reads "M. Woolf". The signature is written in a cursive style with a vertical line extending downwards from the end of the name.

Malcolm Woolf,  
Director

cc: R. Platky  
M. Li  
L. Binkley

Current Status of Findings from the Discussion Notes:

Finding 1

MEA's collection process and expenditure monitoring for CELP was inadequate.

Recommendation 1

We recommend that MEA take immediate action to collect amounts that are past due. We also recommend that written demands for payment be sent to the appropriate borrowers and delinquent accounts be transferred to CCU, as required by State regulations. We further recommend that MEA assess whether CELP loans resulted in energy savings as required and that MEA perform periodic documented monitoring reviews of all loans. For loans requested for design costs, MEA should establish procedures to help that then debtor has sufficient funding available to execute the related plan. Finally, we recommend that MEA require borrowers to provide security or collateral when obtaining CELP loans or document why obtaining security/collateral from the borrower is not warranted.

Response 1

MEA agrees with the findings of the audit and will make the appropriate changes in response. We agree to take the recommended actions on the delinquent accounts. We also agree that periodic documented monitoring of all loans and assessments of energy savings be done. MEA will increase its diligence when reviewing loans for design costs, and will ensure that the debtor has sufficient funds to execute a design plan.

Finding 2

CELP funds totaling \$900,000 that were improperly transferred to the State Agency Loan Program during the prior audit have not been returned.

Recommendation 2

We recommend that MEA take immediate action to transfer \$900,000 to CELP from SALP or take other appropriate action.

Response 2

MEA will develop a plan to make the transfer of \$900,000 from SALP to CELP. The transfer of the full amount will occur over several years, so as not to disrupt the operations of MEA and eliminate SALP for the current fiscal year.

For fiscal year 2009, MEA has transferred \$450,000 from SALP to CELP. Based on our projections, this will allow MEA to maintain a positive year-end balance for SALP. At the close of fiscal year 2009, MEA will make a fund projection for fiscal year 2010, and transfer a second amount at that time. MEA will continue this process until the full \$900,000 has been transferred to CELP (now the Jane E. Lawton Conservation Loan Program).

### Finding 3

Funds from the Environmental Trust Fund were accumulated and retained.

### Recommendation 3

We recommend that unspent funds be reverted to the ETF, unless authorization to retain funds is obtained. In addition, we recommend that MEA maintain documentation supporting the charges to ETF such as the basis for the salary expense.

### Response 3

MEA has the authority from the Department of Natural Resources and the Department of Budget and Management to retain the funds in the ETF. MEA has submitted a budget amendment for fiscal year 2009 to use a portion of the funds, and we plan to use the remainder in the fiscal year 2010 budget.

When MEA became an independent agency in 1992, Section 3-302 of the Natural Resources Article was amended to provide MEA with up to \$250,000 from the Environmental Trust Fund each fiscal year. It provides that the Maryland Energy Administration shall receive administrative and fiscal support from the fund for studies related to the conservation or production of electric energy.

As set forth in its enabling legislation, MEA's primary mission is to develop and promote energy efficiency and conservation, and the vast majority of our activities focus on programs that target conservation and efficiency goals and objectives. In prior fiscal years, MEA was able to utilize federal grant funds, supplemented with energy overcharge funds and ETF monies, to adequately fund each fiscal year's program and to reserve some ETF revenue. However, that scenario has changed. Federal grant monies have been significantly reduced and the oil overcharge funds are largely expended. In order for the State of Maryland to continue its efforts to further energy conservation and efficiency, MEA must retain and utilize the prior unspent ETF monies for on-going activities that support existing programs. It is MEA's statutory interpretation that the retained funds may be used to continue funding appropriate energy conservation and efficiency programs. The Department of Natural Resources and the Department of Budget and Management concur with this position. This is especially true now in light of negative impact that current energy prices are having on the public. It is our position that MEA has the authority to use the residual ETF monies for MEA programs that mitigate these impacts.

MEA concurs with the second recommendation, and we will maintain documentation supporting the charges to the ETF.

### Closing

The Maryland Energy Administration appreciates the chance to respond to the Audit report. If there are any questions, please contact either myself or Michael Li at 410-260-7655.

AUDIT TEAM

**Phyllis M. Clancy, CPA**  
Audit Manager

**Joseph E. Adriani**  
Senior Auditor

**Julia M. Keefer**  
Staff Auditor