

January 12, 1998

Re: An Audit Report on Contract
Administration at the State Energy
Conservation Office of the General
Services Commission (Petroleum
Violation Escrow Funds)

Members of the Legislative Audit Committee:

The State Energy Conservation Office (Energy Office) of the General Services Commission needs to improve fiscal management of the LoanSTAR Revolving Loan Program to ensure that it meets statutory requirements. The LoanSTAR Revolving Loan Program was established to finance energy efficient retrofits for state agencies, hospitals, public schools, and private industry. The LoanSTAR Revolving Loan Program allows borrowers to repay the loans through energy cost savings realized from the projects financed through the program. We also identified opportunities for the Energy Office to improve some of its contract administration practices.

The objective of this audit was to assess contract administration practices and determine if they were sufficient to accomplish the Energy Office's objective of supporting the State of Texas in achieving an efficient, affordable, and sustainable energy future. The scope of this audit included review of various contracts and loans in effect during fiscal years 1996 and 1997. Over the last two bienniums, the Energy Office distributed over \$160 million in grants, contracts, and loans for a variety of energy management programs.

As of August 31, 1997, the Energy Office had over \$47 million available to distribute through loans, grants, and contracts for a variety of energy management programs. Of the \$47 million, approximately \$25 million was designated to fund loans for the LoanSTAR Program, the largest program administered by the Energy Office. Enabling legislation for the LoanSTAR Program requires that the interest rate charged for the loans be sufficient to cover the costs of administering the program. The remainder of the \$47 million is available for distribution through grants and contracts with other state agencies, school districts, or city governments.

Summary of Issues:

- **Fiscal management of the LoanSTAR Revolving Loan Program should be improved to ensure it meets statutory requirements.**

Energy Office management needs to improve its ability to track, forecast, and analyze the financial operations of the LoanSTAR Revolving Loan Program. Although the Energy Office has controls in place to ensure the accuracy of its financial data, a more effective system of evaluating program operations is needed. The lack of such a system results in the loans not generating enough interest income to cover the administrative costs of the LoanSTAR Program as required by statute. Inability to achieve self-sufficiency has required operating costs to be

expended from funds intended for other energy savings programs. For fiscal years 1996 and 1997, these amounts were \$1.6 million and \$795,586 respectively.

The interest revenue generated by loans covered only 30 percent of the LoanSTAR Program's costs during fiscal year 1996 and 44 percent in fiscal year 1997. Energy Office management recognizes that the LoanSTAR Program is not self-sufficient, and during the course of our audit management developed a plan designed to reduce the deficit conditions. The Energy Office estimates that implementation of the plan will generate enough loan interest income to cover the costs of administering the LoanSTAR Program by the year 2000. However, this estimate may not be reliable because the Energy Office has not established financial criteria and benchmarks to evaluate options and make decisions such as when to raise interest rates or reduce operating costs.

Improving the fiscal management system is even more important considering a new legislative requirement that the LoanSTAR Program maintain a minimum balance of \$95 million. The Energy Office has not developed and implemented a process to routinely forecast, analyze, and evaluate the operations of the LoanSTAR Program to ensure that the statutory minimum balance is maintained. The balance of the LoanSTAR Program revolving loan fund was over \$96 million as of August 31, 1997. However, ongoing planning, evaluation, and analysis is necessary to ensure continued compliance with the statutory requirement.

We also noted that the Energy Office relies on an inefficient automated system to track fiscal data. For example, basic information, such as "total loan receivables," requires cumbersome manual calculations each time the figure is requested either externally or internally.

To ensure it meets its statutory requirements, the Energy Office should:

- Develop a consistent fiscal management methodology and perform a regular analysis of program operations. The methodology should include factors such as benchmarks to use in adjusting interest rates, forecasting interest income, and evaluating program costs. To assist in the development of this methodology, we recommend that the Energy Office contact other state agencies who have implemented similar revolving loan programs, such as the Water Development Board.
- Identify the data necessary and develop a system to track information to be used in the ongoing analysis of the fund. We recommend that the Energy Office be included in the information needs analysis study that is scheduled to be performed at the General Services Commission.
- **Contract administration practices should be enhanced.**

While nothing came to our attention to indicate inappropriate uses of contract and grant funds, we did identify areas that should be improved to ensure that the funds are used for the best

purposes. Specifically, the Energy Office should enhance its contract administration practices by:

- Better defining criteria for the selection of contractors to ensure that program objectives are met.
- Developing a risk assessment process to use in monitoring its contractors to provide the most effective monitoring functions given limited resources.
- Taking corrective actions when problems are identified to ensure accountability with program requirements.

We communicated these issues to Energy Office management, along with specific examples of the control weaknesses identified and recommendations for improvement in a separate document.

Legislation effective September 1, 1997, streamlined the number of programs administered by the Energy Office and provided guidelines for the allocation of funds between the various programs. Based on estimates included in the General Appropriations Act, the Energy Office will receive approximately \$14 million in additional funds during the 1998-1999 biennium. The new legislation also mandated that the LoanSTAR Program revolving loan fund maintain a minimum balance of \$95 million, which includes both loan commitments and cash on hand.

Summary of Management's Response

Management concurs with the recommendations included in the report and is taking steps to implement the recommendations. The full text of management's response is attached.

Sincerely,



Lawrence F. Alwin, CPA
State Auditor

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cc: General Services Commission Commissioners
Mr. Tom Treadway, Executive Director, General Services Commission

Attachment