



Audit Report



OIG-12-062

RECOVERY ACT: Audit of Panther Creek Wind Farm III Payment Under 1603 Program

August 1, 2012

Office of
Inspector General

Department of the Treasury

Contents

Audit Report	1
Results in Brief	1
Background	3
Objectives, Scope, and Methodology	4
Audit Results	5
Recommendations.....	6

Appendices

Appendix 1: Schedule of Questioned Cost.....	8
Appendix 2: Panther Creek III Response.....	9
Appendix 2: Management Response.....	10
Appendix 3: Major Contributors to This Report.....	11
Appendix 4: Report Distribution.....	12

Abbreviations

E.ON	E.ON Climate and Renewables North America, LLC
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 1, 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 EC&R Panther Creek Wind Farm III, LLC (Panther Creek III) for a wind energy property spanning Glasscock and Sterling counties, Texas. Panther Creek III submitted its claim for payment in lieu of tax credit in the amount of \$107,636,863 and was awarded that amount by Treasury on January 08, 2010. 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 Panther Creek III in its 1603 Program application does exist and was placed in service on August 31, 2009, which was within the eligible timeframe.

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.

We also concluded that Panther Creek III's reported cost basis of \$358,789,544 for the subject property included \$2,488 for cost related to window blinds that did not comply with Treasury Regulation (Treas. Reg.) §1.263A-1.³

As a result, we are questioning \$746 of Treasury's 1603 Program award to Panther Creek III (30 percent of \$2,488). (See appendix 1 for the definition of a questioned cost.) Consequently, we are recommending that the Fiscal Assistant Secretary (1) ensure that Panther Creek III reimburse Treasury \$746 for the excessive 1603 Program payment received and (2) direct Panther Creek III, E.ON Climate and Renewables North America, LLC (E.ON), and affiliated companies not to include in applications for 1603 Program awards inappropriate or otherwise ineligible costs in the claimed cost basis.

Subsequent to our visit to E.ON, the parent company of Panther Creek III, we reviewed Panther Creek III'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, Panther Creek III 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 Panther Creek III an opportunity to comment on this report. Panther Creek III's response can be found in appendix 2. Panther Creek III concurred with the cost that we questioned.

Treasury management also concurred with our recommendations and, among other things, will take action to seek repayment from Panther Creek III in the amount of \$746. Management's response is provided in appendix 3.

³Treas. Reg. § 1.263A-1(a)(3) (ii), Property produced, states: "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."

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 amounts are based on a percent of the eligible cost basis. For the type of property claimed by Panther Creek III, 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."

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.

Panther Creek III Wind Farm

E.ON developed the Panther Creek III wind farm located in Glasscock and Sterling counties, Texas. The subject property is a 199.5 megawatt (MW) wind farm which utilizes 133 General Electric wind turbines capable of generating about 677 gigawatt

⁴ Section 707 of the Tax Relief, Unemployment Insurance Reauthorization and Job Creation Act of 2010 (Pub. L. 111-312, 124 Stat. 3312 (Dec 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.

hours of electrical output annually. Panther Creek III is connected to the Electric Reliability Council of Texas grid.

During our fieldwork, E.ON had 10 operational wind farms in its portfolio. As of the end of our fieldwork, E.ON affiliates had received \$576 million in 1603 Program payments for six specified energy properties – Panther Creek III Wind Farm, Pyron Wind Farm,⁵ Inadale Wind Farm,⁶ Papalote Creek I, Papalote Creek II, and Stony Creek Wind Farm.

Objectives, Scope, and Methodology

To assess the eligibility and accuracy of the award made to Panther Creek III 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 Panther Creek III's parent company, E.ON in Chicago, Illinois; interviewed key personnel of E.ON and key personnel associated with its independent public accounting firm; reviewed the application and related documents used by the Department of Energy's National Renewable Energy Laboratory (NREL);⁷ reviewed documentation used to support the property's existence, its placed in service date, and the costs claimed by Panther Creek III; and reviewed the annual performance reports submitted by the awardee for 2010 and 2011. We also obtained clarification from Office of the Fiscal Assistant Secretary (OFAS) and Internal Revenue Service personnel on eligible costs under the program. We performed our work between April 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

⁵ OIG-11-110, *RECOVERY ACT: Audit of Pyron Wind Farm LLC Payment Under 1603 Program* (September 28, 2011)

⁶ OIG-11-111, *RECOVERY ACT: Audit of Inadale Wind Farm LLC Payment Under 1603 Program* (September 30, 2011)

⁷ 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.

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 Panther Creek III in its 1603 Program application does exist, was properly placed in-service within the eligible timeframe, and the award amount was appropriate.

Property Existence

We confirmed the subject property's existence through our review of Panther Creek III's wind turbine monitoring system located at E.ON headquarters in Chicago, Illinois. We noted active monitoring of 133 wind turbines. We also concluded 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 Panther Creek III's in-service date of August 31, 2009. Specifically, we reviewed (1) documentation detailing the completion and commission dates for each turbine, (2) correspondence from Panther Creek III's transmission provider supporting the date Panther Creek III commenced operation, and (3) the inter-connection agreement between Panther Creek III and respective third parties for interconnection service.

Appropriate Award Amount

We concluded that the amount of \$107,636,863 awarded to Panther Creek III 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 total cost basis of \$358.7 million and tested

supporting documentation for cost transactions totaling \$231.7 million. We verified that the selected costs were allowable and eligible with one exception. Panther Creek III included \$2,488 of ineligible cost for window blinds in the cost basis. Window blinds are neither a direct nor an allocable indirect cost of producing the subject property. Accordingly, we believe the amount awarded to Grand Ridge III was appropriate with the exception of \$746 (30 percent of \$2,488).

Since our visit to E.ON headquarters, we also reviewed Panther Creek III "Annual Performance Report and Certification" for 2010 and 2011 to ensure compliance with Treasury's reporting requirements contained in the applicant's terms and conditions of award. As required for continued eligibility, Panther Creek III certified that the property had not been sold or 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 September 20, 2012.

Panther Creek III Response

Panther Creek III management concurred with our recommendation and agreed to reimburse \$746 to Treasury for the excessive payment it received.

Recommendations

We recommend that the Fiscal Assistant Secretary do the following:

1. Ensure that Panther Creek III reimburse Treasury \$746 for the excessive 1603 Program payment received for the subject property.
2. Direct Panther Creek III, E.ON Climate and Renewables North America LLC, and affiliated companies not to include in applications for 1603 Program awards inappropriate or otherwise ineligible costs in the claimed cost basis.

Management Response

Management concurred with our recommendation and noted that it will take action to seek repayment from Panther Creek III in the amount of \$746. Management also noted that the 1603 Program Guidance advised applicants and their affiliates not to include inappropriate or otherwise ineligible costs in their applications for awards.

OIG Comment

Management's response meets the intent of our recommendations.

* * * * *

We appreciate the courtesies and cooperation provided to our staff during the audit. If you wish to discuss this report, you may contact me at (202) 927-5400 or Donna Joseph, Audit Director, at (202) 927-5784. Appendix 4 lists the major contributors to this report.

/s/

Marla A. Freedman

Assistant Inspector General for Audit

A questioned cost is a cost that is questioned by the auditor because of an audit finding: (1) which resulted from an alleged violation or possible violation of a provision of a law, regulation, contract, grant, cooperative agreement, or other agreement or document governing the use of Federal funds, including funds used to match Federal funds; (2) where the cost, at the time of the audit, is not supported by adequate documentation; or (3) where the cost incurred appear unreasonable and does not reflect the actions a prudent person would take in the circumstances. Questioned costs are to be recorded in the Joint Audit Management Enterprise System (JAMES). The questioned costs will also be included in the next Office of Inspector General Semiannual Report to the Congress.

<u>Recommendation Number</u>	<u>Questioned Cost</u>
Recommendation 1	\$746

The questioned cost relates to excessive funds that Treasury awarded to Panther Creek III under the 1603 Program. The amount questioned is 30 percent of the excessive costs included in Panther Creek III's cost basis. As discussed in the audit report, the questioned costs in the cost basis consisted of \$2,488 associated with window blinds.

Appendix 2
Panther Creek III Response



July 17, 2012

Ms. 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:

We have reviewed the draft audit report for Panther Creek III dated July 9, 2012 and do not have any comments on its contents. We accept the recommendations outlined in the report.

Please provide us with the relevant US Treasury wire information, and we will reimburse the \$746 outlined in the report.

Thank you and please feel free to contact me at 312-245-3029 if you have any questions.

With kind regards,

A handwritten signature in blue ink that reads "Mark A. Frigo".

Mark A. Frigo
Vice President, Risk & Investment

Appendix 3
Management Response



ASSISTANT SECRETARY

DEPARTMENT OF THE TREASURY
WASHINGTON, D.C.

July 23, 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 Panther Creek III, LLC (Panther Creek). We concur with the recommendations contained in the report.

The draft report recommends that the Office of the Fiscal Assistant Secretary (OFAS) ensure that Panther Creek reimburse Treasury in the amount of \$746 from a Section 1603 payment of \$107,636,863 made in January, 2010. We concur and will take action to seek repayment. The report also recommends that OFAS direct Panther Creek and its affiliates not to include in applications for Section 1603 awards inappropriate or otherwise ineligible costs in their claimed basis. All applicants are so advised in the Program Guidance.

Sincerely,

Richard L. Gregg
Fiscal Assistant Secretary

Appendix 4
Major Contributors To This Report

Donna Joseph, Director
Cynthia Milanez, Audit Manager
Erica Wardley, Audit Manager
James Hodge, Auditor-in-Charge
Cheryl Sroufe, Auditor
Angelo Arpaia, Referencer

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