



Audit Report



OIG-11-077

RECOVERY ACT: Audit of Sierra SunTower LLC Payment Under
1603 Program

July 7, 2011

Office of
Inspector General

Department of the Treasury

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Abbreviations

eSolar	eSolar Inc.
NREL	National Renewable Energy Laboratory
OFAS	Office of the Fiscal Assistant Secretary
OIG	Office of Inspector General
Recovery Act	American Recovery and Reinvestment Act of 2009
Sierra SunTower	Sierra SunTower, LLC
Treasury	Department of the Treasury
Treas. Reg.	Treasury Regulation

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*The Department of the Treasury
Office of Inspector General*

July 7, 2011

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 Sierra SunTower, LLC (Sierra SunTower) for a solar energy facility in Lancaster, California. Sierra SunTower submitted a claim for payment in lieu of tax credit in the amount of \$19,543,649 on September 18, 2009, and was awarded that amount by Treasury on February 26, 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 Sierra SunTower in its 1603 Program application does exist and was placed in service on July 23, 2009, which was within the eligible timeframe. Sierra SunTower's reported cost basis of \$65,145,499 for the subject property included \$117,497 for costs that we believe do not comply with Treasury Regulation (Treas. Reg.) §1.263A-1. Ineligible costs are as follows:

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

² Pub. L. No. 111-5, 123 Stat. 115 (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 purpose of the payments is to 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.

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- \$80,285 for general contractor settlement
 - \$25,856 for permit fees
 - \$8,550 for potable water/septic sewer system labor
 - \$2,806 for engineering labor cost

As a result, we are questioning \$35,249 of Treasury's 1603 Program award to Sierra SunTower (30 percent of \$117,497). We are recommending that your office (1) ensure that Sierra SunTower reimburse Treasury \$35,249 for the excessive 1603 Program payment received and (2) direct Sierra SunTower, eSolar, and affiliated companies not to include in applications for 1603 Program awards inappropriate or otherwise ineligible costs in the claimed cost basis.

As part of our reporting process over 1603 Program awardees, we provided Sierra SunTower management an opportunity to comment on this draft report. Its comments are included in their entirety and can be found in appendix 2. In brief, Sierra SunTower concurred with the costs that we questioned.

Treasury management concurred with our recommendations and will take the appropriate action to seek reimbursement from Sierra SunTower in the amount of \$35,249. Management's response is provided in appendix 3.

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 2011³ and the amount awarded is in accordance with provisions of the Internal Revenue Code of 1986 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.

³ Section 707 of the "Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010," extended Treasury's 1603 Program for one 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. The application deadline was extended to September 30, 2012.

For the type of property claimed by Sierra SunTower, the percentage of the cost basis eligible for award is 30 percent. According to Treasury’s program guidance, the cost basis of the subject property is determined 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.”⁴

Sierra SunTower

Sierra SunTower, LLC, wholly owned by eSolar, Inc. (eSolar), is a 5 megawatt solar facility located in Lancaster, California. The solar facility consists of 24,000 sun-tracking heliostats that reflect solar heat to thermal receivers and generates approximately 4,270 megawatt hours of electricity annually.

Objectives, Scope, and Methodology

To assess the eligibility and accuracy of the award made to Sierra SunTower 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 Sierra SunTower’s headquarters in Burbank, California, and the subject property in Lancaster, California; interviewed key personnel of Sierra SunTower and eSolar; reviewed the application and related documents used by the Department of Energy’s National Renewable Energy Laboratory (NREL);⁵ and reviewed documentation used to support the costs claimed by Sierra SunTower. We performed our work between August 2010 and March 2011.

⁴Treas. 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.

⁵ 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.

Our audit was conducted in accordance with generally accepted government auditing standards for performance audits. 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

Questioned Costs⁶ in Sierra SunTower's Claimed Cost Basis

Cost Description	Cost Basis	Notes
Total claimed cost basis	\$65,145,499	
Questioned costs:		
General contractor settlement	\$80,285	1
Permit fees	\$25,856	2
Potable water & septic/sewer system labor cost	\$8,550	3
Unsupported engineering labor cost	\$2,806	4
Total questioned cost basis	(\$117,497)	
Recalculated cost basis	\$65,028,002	
Recalculated award (30% of recalculated cost basis)	\$19,508,400	
Amount awarded	(\$19,543,649)	
Overpayment resulting from questioned costs	(\$35,249)	

Note 1. General Contractor Settlement (\$80,285 questioned cost)

Sierra SunTower included a general contractor settlement of \$80,825 in the subject property's cost basis. eSolar contracted Irwin Industries to act as its general contractor for the Sierra SunTower solar facility project. As a result of contractual disputes, eSolar and Irwin Industries entered into a settlement agreement in November 2009, which reduced the overall project cost. However, the subject property's 1603 cost basis was not in turn reduced by the settlement adjustment. Therefore, the excess cost claimed is neither a direct nor allocable indirect cost of producing the property and should not be included in the subject property's cost basis.

⁶ See appendix 1 for the definition of questioned costs.

Sierra SunTower Response

Sierra SunTower management concurred with our finding and agreed that the amount questioned does not belong in the cost basis.

Note 2. Permit Fees (\$25,856 questioned cost)

Sierra SunTower included in the subject property's cost basis permit fees of \$25,856 for buildings and machinery that were ineligible to be claimed. The permit fees are neither a direct nor allocable indirect cost of producing the subject property and should not be included in the subject property's cost basis.

Sierra SunTower Response

Sierra SunTower management concurred with our finding and agreed that the amount questioned does not belong in the cost basis.

Note 3. Potable Water & Septic/Sewer System Labor Cost (\$8,550 questioned cost)

Sierra SunTower included engineering labor cost of \$8,550 in the subject property's cost basis for the installation of potable water and septic/sewer systems in a building that was ineligible to be claimed. According to management, the potable water and septic/sewer systems were installed to provide drinking water and support the staff restrooms in the control room building which, by itself, is not an eligible cost. The project cost for drinking water and restrooms is neither a direct nor allocable indirect cost of producing the subject property. Moreover, because it was ineligible, Sierra Sun Tower did not include the cost of the control room building structure in the subject property's cost basis.

Therefore, the engineering labor cost for Sierra SunTower's potable water and septic/sewer systems should not be included in the subject property's cost basis.

Sierra SunTower Response

Sierra SunTower management concurred with our finding and agreed that the amount questioned does not belong in the cost basis.

Note 4. Unsupported Engineering Labor Cost (\$2,806 questioned cost)

Sierra SunTower included \$2,806 of unsupported labor cost in the subject property's cost basis. Sierra SunTower approved two invoices with labor hours that exceeded the engineering consultants' timesheets by 31.88 hours at a rate of \$88 per hour. No explanation or supporting documentation was provided to support the excess hours. Therefore, the unsupported labor cost should not be included in the subject property's cost basis.

Sierra SunTower Response

Sierra SunTower management concurred with our findings and agreed that the amount questioned does not belong in the cost basis.

See appendix 2 for Sierra SunTower's response in its entirety.

Recommendations

We recommend that the Fiscal Assistant Secretary do the following:

1. Ensure that Sierra SunTower reimburse Treasury \$35,249 for the excessive 1603 Program payment received for the subject property.
2. Direct Sierra SunTower, eSolar, 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 recommendations and will take the appropriate action to seek reimbursement from Sierra SunTower in the amount of \$35,249.

OIG Comment

Management's response meets the intent of our recommendations.

* * * * *

The information in this report should not be used for purposes other than what was originally intended without prior consultation with the Office of Inspector General regarding its applicability. Information contained in this report may be confidential. The restrictions of 18 U.S.C. §1905 should be considered before the information is released to the public. 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 costs, at the time of the audit, are not supported by adequate documentation; or (3) where the costs incurred appear unreasonable and do 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 Costs</u>
Recommendation 1	\$35,249

The questioned costs relate to excessive funds that Treasury awarded to Sierra SunTower under the 1603 Program. The amount questioned is 30 percent of the excessive costs included in Sierra SunTower's cost basis. As discussed in the audit report, the questioned costs in the cost basis consist of four components: (1) \$80,285 for a general contractor settlement adjustment per the settlement agreement, (2) \$25,856 for permit fees related to ineligible buildings and machinery, (3) \$8,550 for engineering labor for potable water and septic/sewer systems in an ineligible building, and (4) \$2,806 for unsupported engineering labor hours. These costs are not a direct or indirect allocable cost to produce the subject property.

Appendix 2
Sierra SunTower LLC's Response



May 12, 2011

Marla A. Freedman, Assistant Inspector General for Audit
Department of the Treasury Office of Inspector General
740 15th Street, N.W., Suite 800
Washington, D.C. 20220

Dear Ms. Freedman,

I am in receipt of the draft report on the Treasury's audit of the award made to Sierra SunTower, LLC, under the Department of the Treasury's 1603 Program – Payments for Specified Energy Property in Lieu of Tax Credits. I am in agreement that there were costs of \$117,497 that do not comply with Treasury Regulations that resulted in an overpayment of \$35,249 based on engineering costs, permit fees, and a settlement from the contractor that were not properly reflected in the claimed cost basis.

The bulk of the disputed amounts were related to two separate events. The first being a settlement amount with the main contractor associated with the project after completion of a materials audit. The resulting settlement of \$80,285 was not contemplated or known when the submission was completed. The other main issue, the permit fees of \$25,858, were mistakenly left in the grant basis when the buildings and equipment to which they applied were pulled out of the grant application during the Treasury review process. We, as well PricewaterhouseCoopers, still feel that the structures for which the permits applied should have been included in the basis, but we agreed to remove them in order to allow the grant to move forward. When the structures were removed from the calculation, the permit fees were inadvertently left in.

What is not reflected in the findings are the additional qualified costs that were not claimed as part of the cost basis because the invoices had not been received by the time the grant application was submitted. I'm not expecting the amount to offset the overpayment above, however, I wanted to call attention to the fact that there were additional qualified charges that were not included in the calculation based on invoice timing. I'm detailing some of the larger items below just for informational purposes:

Distributed Control System/Instrumentation	\$203,126
Turbine Housing	\$158,874
Valves and Piping	\$49,337
Cooling Tower and Chemical Feed System	\$39,889

In summary, I am not disputing the findings of the audit team and agree that the basis included amounts that should have been excluded. In this response I merely want to show that although the claimed basis amount was

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Appendix 2
Sierra SunTower LLC's Response

overstated by \$117,497 per the audit team's findings, there were qualified charges well in excess of the overstated amount that were not included as part of the basis due to timing of when the invoices were received.

Sincerely yours,



John Faieta

Appendix 3
Management's Response



ASSISTANT SECRETARY

DEPARTMENT OF THE TREASURY
WASHINGTON, D.C.

June 9, 2011

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 Sierra SunTower LLC.

We generally concur with the recommendations contained in the report and will take all appropriate action to seek reimbursement from Sierra SunTower LLC in the amount of \$35,249.

Sincerely,

A handwritten signature in black ink, appearing to read "Richard L. Gregg".

Richard L. Gregg
Fiscal Assistant Secretary

Appendix 4
Major Contributors to This Report

Donna Joseph, Director
Erica Wardley, Audit Manager
James Hodge, Auditor-in-Charge
Cheryl Sroufe, Auditor
Alexander Milne, Auditor
Rachael Draper, Auditor
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Fiscal Assistant Secretary
Deputy Chief Financial Officer
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