September 8, 2016

Dear Oregon Legislators,

More than 35 years ago a Business Energy Tax Credit (BETC) was established in the Oregon tax code. In 2007 the program was expanded; in 2011 that program was curtailed, and in 2014, the program ended.

During those years of expanded operation, over $1 billion in tax credits were issued under the BETC program by the Oregon Department of Energy for more than 14,000 projects.

Much has already been written and publicly discussed about the BETC program, including the legislative history behind the expansion, the contraction and ultimate conclusion of the program, the staff turnover at the Energy Department during this period, and the agency’s struggle to administer this high-dollar, high-volume program. As you already know, the Department of Justice has determined that at least one project shows evidence of fraudulent activity and legal remedies are being pursued.

In a meeting with my office earlier this year, leadership at the Department of Energy was candid that the state of the BETC project files did not inspire confidence that there were no further instances of fraud or other problems with tax credits granted. However, there was concern that additional research into the high number of files might not provide sufficient useful information to support any appropriate recovery for the state.

Thus, to assess the state’s options for follow up regarding questionable credits, the Secretary of State’s Audit Division commissioned a third-party independent financial investigation of the program’s records. In May we contracted with Marsh Minick Financial Crime Consulting Services for the purpose of providing an independent examination of a statistically significant set of records, evaluating financial controls within the program, and identifying which projects and credits may have been most at risk of any wrong-doing.

It is important to note that this investigation was not charged with evaluating whether the expanded BETC program met its legislative goals of producing energy savings, growing alternative energy sources, or creating jobs at the time of a great recession. Like any investigation, the evaluation is narrowly focused and does not reach conclusions about the overall value the program provided to Oregonians.
The report released today confirms what has already been widely reported: that the major program controls employed by the Department were limited to those found in the terms of the statute passed by the Legislature. The records show that the priority for Department management was achieving the goals of the program as directed by state leadership. Past leadership of the agency did not further refine the boundaries of the program by employing formalized risk management assessments or by establishing management controls to assure that projects and credits met high standards of financial management. As a result, there were many financial risks for which there were no adequate controls.

Here are the key findings related to BETC projects outlined in the independent report:

- Through a forensic data analysis performed on all 14,494 BETC projects, the investigators found that out of the $1 billion in tax credits issued, there are $347 million worth of tax credits where records contain evidence of risk factors that were “concerning.” Areas of concern discovered by the investigators included: direct conflicts of interest; projects that were never operational; businesses that closed or went out of business; indistinguishable, missing or suspicious eligible cost documents; projects with unaccounted for equipment; brokering conflicts and intermediary issues; and illogical projects.

- More than 25 percent of large projects – those involving project costs over $1,000,000 – exhibited at least one characteristic of concern for the investigators. About 97 percent of projects of this size were reviewed individually; this consisted of 311 project files that accounted for $773 million in tax credits issued of which $340 million were of concern.

- In contrast, of 3,150 smaller project files that were reviewed, only 2.7 percent (86 projects) exhibited at least one characteristic of concern for the investigators. Extrapolating this sample to the overall population of smaller BETC projects estimates a total of $7.2 million in tax credits of concern out of $266 million in credits issued for these smaller projects.

- The examination identified no direct evidence of fraud. However, out of the 14,494 total BETC projects, this statistical and direct examination of records identified 79 large and small projects combined where there was circumstantial evidence of suspicious behavior. The evidence was sufficient to warrant referral to the Oregon Department of Justice for further review.

This independent report is of value in three separate ways:

It provides an assessment of whether previously unidentified instances of inappropriately issued credits, including likely fraud, could still be identified for this now-closed program. Additionally, the report provides a pathway to reinvigorate management of remaining active BETC tax credits. And finally, of even greater importance, are the recommendations regarding financial controls that must be put into place for programs such as the BETC in the future.

It is my assessment that this independent report provides a valuable, outsider look at a program that has been rife with concerns. It is my hope that both the Executive Branch and legislative
leadership will use the recommendations attached to evaluate future legislative proposals establishing tax credit programs and will make financial controls an essential part of program start-up in the future.

Sincerely,

Jeanne P. Atkins
Oregon Secretary of State
Recommendations for managing credits that are still viable

- ODOE should consider enforcing any existing performance agreements for BETC credits outstanding.
- ODOE may find it beneficial to determine which credits should still be viable, and seek out and assess whether the projects are meeting the 5-year operational requirement.

Recommendations for follow up to determine whether additional legal action should be considered

- For tax credits projects determined not viable, that is, failing to be operational for 5-years, ODOE should consider whether to pursue possible revocation of the tax credit or other options per ORS 469.205(2)(a)(O)(b) and 469.225(1)-(2).

Recommendations for controls that should be implemented in any future program

Overall, we recommend the Department develop a risk management program that includes the following for new and existing programs it administers: a detailed understanding of program requirements, identification of risks, identification and development of controls to mitigate program risks, implementation of controls, and periodic evaluation of controls to determine if they are working as intended.

- Consider a qualified risk and compliance officer, whose sole function is to oversee risk and compliance at the Department. This officer should stay abreast of best practices related to Department programs and related industries.
- Evaluate workflow compared to staffing levels on a regular basis to ensure adequate staffing. Ensure staff have the skills and expertise necessary to successfully manage programs.
- Consider establishing a financial crime compliance program and, at minimum, perform quarterly prevention and detection measures. Any red flag should immediately be reviewed for site inspections and other preventive measures.
- Eliminate rubber-stamping of documents and approvals; prohibit the use of whiteout and other forms of document manipulation.
- Reconsider accepting complex financial arrangements as proof of payment for a project. At minimum, require these to be put through an additional due diligence process conducted by a qualified risk or legal professional, or both.
- Implement controls on the services of CPAs. Require the CPAs to furnish all material used to attest to the eligible project costs to determine accuracy in their reporting. Implement rules around CPAs, including a rule to prevent the same CPA firm from attesting to project costs and brokering tax credits. Create a CPA verification process. Continue to perform site inspections using random and risk-based approaches.
- Require energy incentive project owners to maintain original wrapping or packaging of materials for jobs, as additional proof of purchase, and consider auditing as needed.
- Perform an annual internal audit and risk assessment of energy incentive programs.
- Work with the Department of Justice to ensure agreements for tax credits provide recourse authority when there are improper incentive tax credit claims.