Department of the Treasury
Board of Public Utilities
Clean Energy Fund

January 1, 2004 to November 30, 2006

Richard L. Fair
State Auditor
The Honorable Jon S. Corzine  
Governor of New Jersey

The Honorable Richard J. Codey  
President of the Senate

The Honorable Joseph J. Roberts, Jr.  
Speaker of the General Assembly

Mr. Albert Porroni  
Executive Director  
Office of Legislative Services

Enclosed is our report on the audit of the Department of the Treasury, Board of Public Utilities, Clean Energy Fund for the period of January 1, 2004 to November 30, 2006. If you would like a personal briefing, please call me at (609) 292-3700.

Richard L. Fair  
State Auditor  
February 2, 2007
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Department of the Treasury
Board of Public Utilities
Clean Energy Fund

Scope

We have completed an audit of the Clean Energy Fund (CEF) for the period January 1, 2004 to November 30, 2006. Pursuant to New Jersey’s Electric Discount and Energy Competition Act and by its order in March 2003, the New Jersey Board of Public Utilities (BPU) established the New Jersey Clean Energy Program (CEP), which is a statewide initiative that provides education, information, and financial incentives to customers who choose to install prescribed energy efficiency or renewable energy technologies. The Office of Clean Energy (OCE) was created by the BPU to handle the general administrative duties of the CEP as well as program control, outreach and education, and protocol development. In December 2003 the BPU established, by board order, a bank as the fiscal agent to act as the trustee in accepting the renewable energy portion of program funds from NJ utilities and disbursing them as directed by the OCE. The utility companies continued as program managers for the CEP energy efficiency programs. Control of the renewable energy program funds was transferred to the Department of the Treasury bank accounts in March 2005 and deposits were made to the credit of the newly created Clean Energy Fund.

The audit included financial activities of the renewable energy program accounted for in the state’s Clean Energy Fund and monies maintained by the BPU fiscal agent. The financial activities of the Clean Energy Program administered by the public utility companies were not audited by us. Revenues and expenditures of the Clean Energy Fund in fiscal year 2006 relating to the Clean Energy Program were both $160 million. The scope of our audit included approximately $65 million of this amount. We also reviewed the 2003 grant award process since expenditures occurred during our audit period.
Objectives

The objectives of our audit were to determine whether financial transactions were related to the Clean Energy Fund, were reasonable, and were recorded properly in the accounting systems.

This audit was conducted pursuant to the State Auditor’s responsibilities as set forth in Article VII, Section 1, Paragraph 6 of the State Constitution and Title 52 of the New Jersey Statutes.

Methodology

Our audit was conducted in accordance with Government Auditing Standards, issued by the Comptroller General of the United States.

In preparation for our testing, we studied legislation, administrative code, circular letters promulgated by the State Comptroller, BPU orders, and policies of the office. Provisions that we considered significant were documented and compliance with those requirements was verified by interview, observation, and through our samples of financial transactions. We also read the budget message, reviewed financial trends, and interviewed office personnel to obtain an understanding of the programs and internal controls.

A statistical and nonstatistical sampling approach was used. Our samples of financial transactions were designed to provide conclusions about the validity of transactions as well as internal control and compliance attributes. Some sample transactions were judgmentally selected.

Conclusions

We found that the Clean Energy Fund financial transactions included in our testing were related to the programs, were reasonable, and were recorded properly in the state’s accounting systems. However, prior to the establishment of the Clean Energy Fund in March 2005 financial transactions administered by the BPU’s fiscal agent were not reflected in the state’s accounting system. In making these determinations, we noted certain internal control weaknesses relating to the Office
of Clean Energy operations meriting management's attention.

Grant Accounting Procedures

The OCE provided $2.7 million of funding in 2003 and $763,000 in 2004 to develop renewable energy markets, businesses, and technologies in New Jersey through the Clean Energy Program. The goal was to leverage private and public funding to advance renewable energy technologies.

The 2003 grant solicitation received 33 proposals of which nine were funded. Records critical to the 2003 evaluation process were no longer available and as a result we were unable to independently verify that decisions made in the evaluation process were fair, unbiased, and were merited based on the scoring procedures established by the OCE. We also found that the OCE deemed ten of the 2003 grant proposals as "non-responsive" because there was no co-funding in the grant proposal, even though the grant solicitation states that co-funding is not required. Documentation supporting the 2004 award process was available; however, summaries as to how the OCE arrived at final recommendations to the board were not available. The lack of documented grant award procedures prevents the OCE from exhibiting a transparent award process. Treasury Circular Letter 06-16-DPP requires that agencies maintain documentation showing that a contract was competitively awarded. In addition, all documents relating to the solicitation and award of the contract must be retained for a period of seven years.

The BPU has a written agreement with each grant recipient. The agreement includes general terms and conditions, post award, and award closeout requirements. Our review of the 2003 grant awards disclosed that three of the nine grantees
received initial payments that were between 33 percent and 50 percent more than the stipulated payment per the grant agreement. These "advances" were offset by reduced payments in the remainder of the grant period. We also noted seven grants did not have the required final financial data and two grants did not have the required final reports. The OCE did not have adequate monitoring controls to ensure that grant terms and conditions were completed as required.

**Recommendation**

The OCE should establish written policies and procedures for the grant award process which ensures transparency and the retention of appropriate documentation. In addition, the OCE should initiate procedures to ensure compliance with all grant requirements.

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**Related Party Transactions**

Our review of the OCE expenditures disclosed transactions with individuals who have a relationship with the office. Transactions between related parties commonly occur during the normal course of business. The BPU's accounting policies and procedures do not address doing business with related parties. Our review identified a number of OCE expenditures which involved REED grant recipients and vendors who had relationships with the OCE, or contracts with individuals who were former employees. The lack of clear policies and procedures limits the OCE’s ability to provide adequate assurance that related party transactions were handled at arms length.

**Recommendation**

The BPU should establish adequate controls and procedures to identify related parties and include guidance of when and how business should be conducted with these individuals.
Contracted Services and Vendor Payments

The BPU authorized the OCE to utilize contracts for administrative functions in the development of the Clean Energy Program. We noted two services where cost savings and improved control of the functions could be achieved if the services were performed internally by BPU employees. We also noted payments to one vendor that were insufficiently documented and therefore may not be reasonable.

One contracted service was for the processing of Customer Onsite Renewable Energy (CORE) applications. The CORE program encourages NJ homeowners, businesses, institutions or non-profit facilities to install an on-site solar electric, sustainable biomass, fuel cell, or a wind energy generation system. As of June 2006 over $146 million was budgeted for the program. The work being performed by the contractor included a review of applications for completeness, discussions with installers or homeowners, and the data entry of the information. All of this work was performed by the vendor’s employees at the OCE office using OCE equipment. An analysis of the cost of the services disclosed that for the period March 2005 to February 2006 the total cost was $165,000. The cost per application escalated from an average cost of $47 in March 2005 to $105 in February 2006. Utilizing job titles currently in use by the BPU, we calculate that the total cost of this function including fringe benefits would have been $95,000 if performed by BPU staff, resulting in a $70,000 savings.

We also reviewed the contract for the services of an advisor with knowledge of the utilities administration of the Clean Energy Program (CEP). The services were needed to assist the OCE in the transition from utility control of the renewable energy program. The cost of the services began at $8,000 a month in January 2004 and has risen to an average of $16,000 per month.
in 2006. Our analysis of the contract cost for one year of service disclosed that it exceeded the annual salary, including fringe benefits, of the President of the Board of Public Utilities. The CORE program and the administration of the CEP are integral responsibilities of the OCE. Attempts should be made to perform these functions with OCE personnel.

Our review also disclosed payments to one vendor that were insufficiently documented. The vendor payments included salary advances totaling $99,000. We found no evidence of reconciliations between actual hours worked and amounts advanced. We also noted expenditures for sub-contracted services by this vendor in the amount of $37,000. The OCE was unable to document what sub-contracted services were provided or whether the vendor’s action to sub-contract was approved by the office. In addition, the OCE could not provide documentation for the approval of vendor charges for employee travel. Our review of transactions processed after the transfer of Clean Energy Fund monies into the Treasury bank accounts disclosed none of the exceptions noted above.

**Recommendation**

The OCE should obtain the necessary expertise to perform its basic responsibilities and thereby reduce its needs for contract services that are not cost beneficial. The OCE should also require and maintain adequate documentation to support all vendor payments and ensure that payments are reasonable and relate to the Clean Energy Program.
Utility Company Program Expenditures

Utility company expenditures are not monitored.

The OCE does not monitor expenditures reported by the utility companies for the energy efficiency program that the utilities continue to process. Total expenditures for these programs as reported by the utilities in fiscal year 2006 were $95 million. OCE policies and procedures for the transfer of funds into and out of the Clean Energy Fund require that program managers submit all relevant documentation to support claimed expenditures. The policies and procedures dated 2004 identify the utility companies as the New Jersey Clean Energy Program energy efficiency program managers. We found that reports submitted by the utility companies do not provide details of expenditure data including administrative cost. By not reviewing and monitoring expenditure data, the OCE has no assurance that utility expenditures for the Clean Energy Program are accurate and relate to energy efficiency programs.

Recommendations

The OCE should establish procedures which require detailed expenditure reports from utility companies. Procedures should include monitoring and analysis of these reports, and require site visits or audits to determine the reasonableness of program activities and accuracy of reports.

Federal Reporting Requirements

The Internal Revenue Service (IRS) requires reporting of payments for services performed for a trade or business by people not treated as its employees when said payments are $600 or more. IRS Form 1099 Miscellaneous Income is to be utilized. The OCE did not provide Form 1099s to vendors that were paid in excess of $600 from the fiscal agent bank account in 2004. Our review
disclosed that 15 vendors were paid $550,000 in 2004 and Form 1099s were not issued. In 2005 two vendors were paid $21,000 and no Form 1099 was issued. When the OCE assumed control of renewable energy funds from the utility companies, procedures were not established to ensure compliance with the IRS reporting requirements. The appropriate reporting has been accomplished since March 2005 when payments started to be processed through the Department of the Treasury bank account.

Recommendation

Treasury should issue the required Form 1099s for calendar year 2004 and 2005.

Fiscal Agent Bank Account

In February 1999 the Electric Discount and Energy Competition Act (EDECA) was signed into law. EDECA directed the BPU to determine the appropriate Energy Efficiency and Class 1 Renewable Energy programs in New Jersey along with the appropriate level of funding. The funding for this Clean Energy Program is provided through a social benefits charge collected by utilities from the ratepayers. In September 2003 the BPU authorized, per board order, the Office of Clean Energy to contract for the services with a bank to act as the fiscal agent to manage the renewable energy program funds and disburse them at the direction of the OCE.

This mechanism was to revise the structure in which the utilities collected, held, and disbursed funds. The utilities continued collecting the funds from ratepayers; however, these funds were remitted to the BPU’s fiscal agent. The BPU’s action for this change in policy stated in part that the funds transferred to the fiscal agent were not intended to become state funds, but rather funds subject to disbursement as directed by the BPU.
and the OCE. From February 2004 through March 2005 the fiscal agent received $122 million and disbursed $21 million. The remaining balance of $101 million was transferred to the NJ Clean Energy Fund.

Treasury Circular Letter 00-12-OMB requires that all units of state government requiring any form of new banking services must submit their request to the Office of Management and Budget (OMB), Cash Management Unit. OMB is the only state office authorized to deal directly with banks in establishing or changing banking services, and negotiating or contracting for payment of banking services. The BPU believed that OMB Circular Letter 00-13, Delegated Purchase Authority, was applicable in the procurement of banking services and did not notify OMB that the fiscal agent bank account was established.

**Recommendation**

Any future banking requirements of the OCE should be processed in accordance with OMB banking regulations.
February 2, 2007

Mr. Stephen M. Eells  
Assistant State Auditor  
Office of the State Auditor  
125 South Warren Street  
PO Box 067  
Trenton, New Jersey 08625-0067


Dear Mr. Eells:

Thank you for providing the draft audit of the Clean Energy Fund. I appreciate that you agreed to BPU’s request to evaluate the Clean Energy Program first as a part of the periodically scheduled routine audit of the agency as a whole. This represents the first audit of the Fund prepared by the Office of the State Auditor. The Clean Energy Fund handles an average of more than 50,000 transactions each year for renewable and energy efficiency projects, totaling about $160,000,000 in grants and rebates in calendar year 2006 alone. I value the scope and complexity of the work your office has done.

With respect to improvements recommended in the audit report, the enclosed response outlines the relevant actions that the BPU has already taken, and further actions to come. The response also provides additional facts and documentation that may help to put the report and the response in context.

The recommendations contained in this audit will be used as a management tool to further enhance the governance of this Program. BPU senior management has carefully deliberated on these recommendations, and will take actions that will assist in our continual efforts to enhance this new but highly successful program.

Sincerely,

Jeanne M. Fox  
President
BPU Agency Response
to the Draft Report of the Office of the State Auditor
Clean Energy Fund, January 1, 2004 to November 30, 2006

1. Grant Accounting Procedures

In 2003, the Board approved Market Development and Infrastructure (MDI) grants. These grants were renamed in 2004 as the Renewable Energy Economic Development (REED) grants. These grants provide funding for renewable energy companies to assist in the market development of the renewable energy (RE) programs in New Jersey or to commercialize a RE product in New Jersey.

A Board Order (Docket Number EX03070548, Order dated August 7, 2003, copy available at http://www.nj.gov/bpu/wwwroot/cleanEnergy/EX03070548_20030807.pdf) approving the 2003 grants summarizes the evaluation process for those grants. The Order states that each proposal was reviewed by a team of external reviewers and Board Staff consistent with the evaluation criteria in the solicitation. Specifically, the review process began with an evaluation from outside experts sought out specifically because of their expertise in renewable energy technologies, followed by internal review of the external recommendations by Board Staff. The Office of Clean Energy (OCE) reached its recommendations to the Board for projects to be funded based on the assessments from the evaluation committee of external reviewers and Board Staff.

The Order also states that 23 projects were either deemed to be non-responsive to the solicitation, or received a low evaluation by Board Staff and the external reviewers. The Order incorrectly states that “the major reason for a determination of non-responsive was the lack of co-funding within the proposal.” The availability of co-funding added points to the evaluation score (and conversely, the lack of co-funding placed projects at a disadvantage in the evaluation), but was not grounds for a determination that the project was non-responsive.

In order to stay within the approved budget, the evaluation committees determined that ten of the 33 proposals best met the evaluation criteria and the objectives of the solicitation as established by the Board. In the Order, the Board authorized the award of grants for those ten projects, in the amounts specified in the Order.

Action:

In working with Treasury since 2004, the OCE is continually updating its procurement processes and procedures to more clearly define each step in the grant process. These revisions will ensure transparency of the grant process by further specifying the procedures currently utilized by the OCE to arrive at the final recommendations it presents to the Board. Treasury also provides routine training for staff on procurement guidance, and the OCE will continue to participate in this training program. OCE is developing a centralized filing system for all procurement records to ensure the appropriate documentation is maintained in a specific location for the required timeframe.
The BPU agrees with the importance of ensuring compliance with all grant requirements. As of the date of this response, eight of the nine 2003 grantees have submitted final reports. For the ninth project, we expect that the data and reports will be submitted following completion of the project. Since January of 2004, all grants require certification by the OCE staff prior to any payment. This certification describes the activities that occurred during the payment period. Final payments are not authorized without the final report and final financial report as certified by staff. OCE maintains a monthly contract tracking report which is circulated to upper management and the Board. This process is set forth in the Board’s approved Policies and Procedures for the Clean Energy Program and in the OCE procurement processes and procedures. The OCE has revised its procedures to clearly require a final financial report to close out the grant account, in addition to the final report prior to any payments.

2. Related Party Transactions

A series of Board Orders has established and implemented an open public stakeholder process, including publicly announced open meetings to ensure that the input, opinions, advice and recommendations of all stakeholders were considered in the development of the Clean Energy Program and continue to be considered as the program evolves. The Board established a Clean Energy Council (CEC or Council), comprised of a diverse array of stakeholders, by Board Order to provide advice and input into the operations of the overall Program.

As part of its ongoing and routine dialogue with the CEC and its committees and work groups, the OCE has made it clear publicly that any member of the Clean Energy Council or its committees must disclose any business interest in any matter being discussed. Further, the OCE has used the expertise of members of the CEC and its committees and work groups as OCE develops the Clean Energy Program budget; however, the specific procurements and grant documents have always been developed solely by the BPU, its contractor staff, and Treasury, without participation by members of the CEC, its committees, or its workgroups.

Action:

BPU agrees with the recommendation that these standard operating practices need to be set down by the Board as written policies and procedures. Work is currently under way to do so. In addition, OCE will modify its existing written processes and procedures to show clearly how it ensures that related parties are clearly identified and receive no favorable treatment.
3. **Contracted Services and Vendor Payments**

The BPU agrees that it is necessary for OCE to obtain the staffing and expertise needed to perform its basic responsibilities. However, when the volume of work is expected to vary widely, and the work is expected to be temporary, BPU believes that it is more cost-effective to retain contracted services that can be deployed more flexibly as the workload fluctuates and then eliminated when the need for the work ends. However, although BPU maintains that temporary work is more efficiently performed by contracted services rather than permanent state employees, BPU agrees that additional staffing of OCE would enhance the Office's ability to manage the administrative end of this growing program.

The Customer Onsite Renewable Energy (CORE) program has grown from six installations when the program was initiated in 2001 to over 2,000 installations today (predominantly solar). Since the OCE was ordered by the Board to directly manage and administer the renewable energy programs four years ago, the CORE program has experienced triple digit growth annually for the last four years, issuing approximately $130,000,000 in rebates over this same time period. In addition, the average number of applications processed each month has increased from 20 in 2003 to over 100 in 2006. Accordingly, the contract staff providing this service was increased from one application processor to three application processors.

In addition, the CORE rebate program has always been considered temporary. The BPU is beginning a transition intended to, among other things, phase out the rebates for the renewable energy projects funded by CORE, and instead base financial assistance for these projects on renewable energy certificates (RECs) that will be traded actively in open markets. The changes needed to make this transition have been in development for over a year. The staffing needed under this approach will be considerably less than with the rebate model. Therefore, if state employees had been hired for this work it would become necessary in the near future to reduce the number of workers which would require a reduction in force.

The cost for processing an onsite renewable energy rebate application has increased because the onsite rebate application requirements as set forth by the Board have significantly increased as the program has expanded in scope. However, with a typical 10 kilowatt home photovoltaic system currently costing $77,500 and the Clean Energy Program currently providing a rebate of $38,500, the application processing cost of $105 is approximately 0.1% of the total cost of the system and approximately 0.2% of the amount of the rebate.

As noted in the audit, OCE does require and maintain documentation to support payments for invoices submitted by vendors. Invoices are checked by at least four separate individuals before payment. The payment of $99,000 in salary advances to one vendor was made under a contract which is still active. At the close of this contract, the salary advance will be reconciled. Travel for the contractor’s employees was approved by OCE in order to attend national conferences to promote New Jersey’s program, to attract
more installers to do business in New Jersey, and to acquire additional training. While
the expenditures for a subcontractor for this vendor of $37,000 were not fully
documented at the time, additional documentation has been obtained and internal controls
are now in place to ensure accurate record keeping. It is important to note that this
subcontractor provided the technical expertise that enabled the Board to create New
Jersey’s nationally recognized Net Metering and Interconnection regulations at N.J.A.C
14:8.

Action:
Currently, the BPU has a plan to increase staffing so OCE will have additional resources
to maintain adequate documentation to support all vendor payments, and ensure that
payments are reasonable and relate to the Clean Energy Program.

In addition, the OCE has supplemented its records with further documentation in regards
to the $37,000 subcontractor.

4. Utility Company Program Expenditures

It is important to note that rate making principles are significantly different than the
agency budgeting process, and are managed similarly across the country. Tariffs
approved by the Board at public agenda meetings authorize utilities to use deferred
accounting treatment for certain costs. To cite one recent example, in August 2006, a
Board Order approved a stipulation for Elizabethtown Gas Company to defer for future
recovery in a base rate case certain costs of replacing gas mains in its Pipeline
Replacement Program. Another example is a Board Order allowing New Jersey
American Water Company to defer certain increased costs for water it purchases, with the
ratemaking treatment and the amount of the deferral to be addressed in a base rate case.

The Clean Energy Program follows a similar process, with Board-approved tariffs for the
seven electric and gas utilities which authorize these companies to use deferred
accounting for costs incurred related to the delivery of services under the Clean Energy
Program. The tariffs spell out the costs that may be included in the deferred accounts, the
process for recovery of expenses, the process for reconciliation adjustments, and the
computation of interest on any over/under recoveries. In practice, deferred accounting
treatment results in utilities expensing costs when they are incurred in an account that is
subject to adjustment and true-up in a rate case or subsequent audit findings. That is,
expenses included in these accounts are reviewed in a subsequent rate case or are
examined in an audit and are subject to adjustment based on those reviews or
examinations.

Beginning in March 2001, the Board established a process through a series of Board
Orders for reporting, tracking and adjusting utility revenues and expenses related to the
Clean Energy Program. A January 2004 Order refined that process to include the
following key components:

1. The Board issues an Order that sets monthly funding levels for each utility.
2. The Board issues an Order approving tariffs for each utility that define the various expenses that may be charged to the Societal Benefits Charge (SBC) and that provide for deferred accounting for the Clean Energy Fund portion of SBC expenses.

3. The Board issues an Order approving program descriptions that define the programs to be implemented by each utility.

4. The Board issues an Order approving detailed budgets for each utility, for each program managed by a utility.

5. Utilities report program expenses to the Board quarterly and report monthly expenses to the BPU’s Contract Manager.

The following components occur with all ratemaking processes, while the above are specific to CEP.

6. The Board reviews any program expenses recorded on the utilities’ books in a subsequent rate proceeding and may adjust the deferred balance to remove any expenses improperly included in the account. In practice, any expenses reported by the utilities to the Board’s Contract Manager are considered interim, subject to adjustment based on subsequent rate cases or audits.

7. The Board has established the right to audit any expenses recorded on the utilities books and may adjust the deferred balance to remove any expenses improperly included in the account.

**Action:**

The Board at its April 12, 2006 Board meeting approved Treasury to issue a Request for Proposal (RFP) for an NJCEP Funding Reconciliation 2001 through 2005. The Department of Treasury released the RFP on May 31, 2006, and bids were opened on July 19, 2006. At the August 16, 2006 Board meeting, the Board concurred with the evaluation committee’s recommendation and authorized Treasury to award a contract for an accounting firm to reconcile program expenses reported to the Board and to the Board’s Contract Manager with the expenses recorded on the books of each utility. This reconciliation is expected to be completed in February of 2007. The results of this reconciliation will be the basis for a full audit of all the Clean Energy Program managers, including the seven electric and natural gas utilities and all state agency managers. Any discrepancies between program expenses recorded on the utilities’ books and those reported to the Board and to the Board’s Contract Manager will be trued-up through an adjustment to the deferred balance.

5. **Federal Reporting Requirements**

**Action:**

The OCE has provided Treasury with reports containing taxpayer ID numbers and amounts distributed in order for Treasury to process the required Form 1099s for calendar year 2004 and 2005.
6. **Fiscal Agent Bank Account**

The BPU acknowledges that the financial transactions administered prior to the establishment of the Clean Energy Fund in March 2005 were not reflected in the state’s accounting system. As noted, the reason is that the Board had directed funds to be transferred to a fiscal agent, and that the funds were not to become state funds, but rather funds subject to disbursement by the OCE, similar to the way the utilities functioned when they were managing the renewable portion of the fund. The fund was set up in this manner through a unanimous vote via Board Order based on the recommendations of the Clean Energy Council and written comments submitted from stakeholders, after a series of public meetings specifically regarding the options for the management of the funds (to be managed through a state account, a nonprofit agency, or a fiscal agent.) The Board issued the Order after reviewing public comments, showing a consensus that the fiscal agent was the most appropriate method. The fiscal agent was selected by the OCE based on its low bid pursuant to an OMB Circular Letter 001-13, Delegated Purchase Authority.

The OCE set up the fund in this manner with the belief that OMB Circular Letter 001-13, which authorizes agency expenditures under $25,000, was applicable in the procurement of banking services at a cost of $1,000 per month to manage the funds. After being contacted by the former Treasurer in 2004, BPU agreed with Treasury’s recommendations to move the funds into a Treasury managed account, where the funds currently reside.

**Action:**

The BPU agrees with the audit recommendation that any future banking requirements of the OCE should be processed in accordance with OMB banking regulations. OCE has in fact been following OMB banking regulations since March of 2005 and will continue this as the regular practice.

In addition, as with the utility funds, a full reconciliation of Clean Energy Program funds prior to March 2005 is currently taking place. When complete, this reconciliation will be published on the OCE website.