



GAO

Accountability \* Integrity \* Reliability

United States Government Accountability Office  
Washington, DC 20548

---

February 28, 2007

The Honorable Peter J. Visclosky  
Chairman  
The Honorable David L. Hobson  
Ranking Minority Member  
Subcommittee on Energy and Water Development  
Committee on Appropriations  
House of Representatives

Subject: *The Department of Energy: Key Steps Needed to Help Ensure the Success of the New Loan Guarantee Program for Innovative Technologies by Better Managing Its Financial Risk*

In May 2006, the Department of Energy (DOE) proposed transferring appropriations from some DOE accounts to begin a new loan guarantee program (LGP) authorized by the Energy Policy Act of 2005 (EPAct 05). Title XVII of EPAct 05—Incentives for Innovative Technologies—authorized the LGP to guarantee loans for projects intended to (1) decrease air pollutants or man-made greenhouse gases by reducing their production or by sequestering them (storing them to prevent their release into the atmosphere), (2) employ new or significantly improved technologies compared with current commercial technologies, and (3) have a “reasonable prospect” of repayment. Such projects could include renewable energy systems, advanced fossil energy technologies, and production facilities for fuel-efficient vehicles. Although EPAct 05 authorized the LGP, the Federal Credit Reform Act of 1990 requires that Congress appropriate budget authority for loan guarantee program costs before loans can be made. In appropriating budget authority for the LGP, Congress would be not only authorizing DOE to issue the loan guarantees but also establishing policy by setting limits on the dollar amount of loans that can be guaranteed. Congress can also specify limits on the amount of LGP administrative costs DOE can incur each year.

In a July 2006 letter to DOE on the department’s proposed funds transfer to begin the LGP, this subcommittee expressed its concern about the lack of a strategy for instituting the program. Furthermore, the subcommittee stated that the department had not adequately explained such basic management policies as the criteria it will use to select projects for loan guarantees and the number of loans to be guaranteed. Nevertheless, in August 2006, DOE issued a solicitation for preapplications to the

loan guarantee program, announcing its intention to issue up to \$2 billion in loan guarantees. At the same time, DOE issued guidelines for proposals submitted in response to this first solicitation, stating that DOE expects borrowers to pay for program costs.<sup>1</sup>

In this context, you asked that we report on the (1) sources and use of funds for the LGP in fiscal years 2006 and 2007, (2) extent to which the LGP could result in a financial risk to taxpayers, and (3) steps DOE has taken to ensure that the LGP will be well managed.<sup>2</sup> On January 4, 2007, we briefed this subcommittee on the results of our work. Enclosure I contains the briefing slides we used, with minor revisions to incorporate technical comments we subsequently received from DOE. This report summarizes the briefing and recommends steps DOE should take to help ensure that the program, and its exposure to financial risk, will be well managed.

To identify the sources and use of funds for DOE's LGP, we reviewed and analyzed relevant DOE budget documentation, as well as department LGP guidance and planning documents, and interviewed DOE LGP and budget officials. To examine the extent to which the LGP could result in financial risks to taxpayers, we analyzed DOE's plans and guidance for implementing the LGP and discussed them with DOE and Office of Management and Budget (OMB) officials. To assess the steps DOE has taken to help ensure that the LGP will be well managed, we compared DOE's plan with OMB budget guidance, internal control and accounting standards, and practices used by other selected agencies that manage loan guarantee programs. We performed our work in accordance with generally accepted government auditing standards from October 2006 through January 2007.

In summary, in fiscal year 2006, and continuing through October 2006, DOE used about \$503,000 from three separate appropriation accounts to fund LGP activities: about \$347,000 from its Departmental Administration appropriation and Science appropriation accounts and about \$156,000 from its Energy Supply and Conservation appropriation and Science appropriation accounts. DOE used these funds for the salaries of three staff detailed to the LGP office and for contracts to support program development, including the development of an LGP Web site. DOE is continuing to pay for task order support services to respond to program inquiries; these payments are in addition to the \$503,000 already spent to initiate the program. However, DOE has discontinued other funding, and the staff on detail have returned to their home units. Nevertheless, according to the deputy general counsel for energy policy, he and others continue to work on the program by, for example, preparing a notice of proposed rulemaking and reviewing preapplications for completeness. Regarding future activities, DOE officials said they are awaiting appropriations before taking additional steps to implement the LGP.

---

<sup>1</sup>For the first round of loan guarantees, the guidelines state that DOE anticipates that borrowers will pay the subsidy costs and that those borrowers will be assessed fees to cover some administrative costs.

<sup>2</sup>You also asked us to issue a legal opinion on certain questions regarding DOE's implementation of the LGP under section 1702 of the Energy Policy Act of 2005 and section 301 of the Energy and Water Development Appropriations Act of 1993. This work is under way and an opinion should be issued by the end of April 2007.

Although LGP guidelines call for borrowers to be charged fees to cover program costs, the program could result in substantial financial costs to taxpayers if DOE underestimates total program costs. These include the administrative cost associated with evaluating applications; offering, negotiating, and closing guarantees; and servicing and monitoring the guarantees. DOE is required to recover applicable administrative costs, but it has not developed a plan to determine how it will calculate any fees to charge borrowers to cover these costs or how it will cover shortfalls if it does not charge borrowers enough. Appropriated funds may be necessary to cover shortfalls in administrative costs. The other type of program cost is the subsidy cost, which is the estimated net present value of the long-term cost to the federal government of guaranteeing loans over the entire period that the loans are outstanding, excluding administrative costs. The subsidy cost takes into account (1) estimated federal payments to cover defaults, delinquencies, or other payments and (2) estimated payments to the government, including origination and other fees, penalties, and recoveries on defaults. DOE will have to estimate the subsidy cost to determine the fees to charge borrowers, but it currently has no policies or procedures for doing so. Estimating this cost could be difficult because the program targets innovative energy technologies and loan performance could depend heavily on future economic conditions, including energy prices, which are hard to predict accurately. Any shortfalls in subsidy costs would be automatically funded by the federal government under the terms of the Federal Credit Reform Act of 1990, not through the annual appropriations process.

Rather than taking and completing key steps to ensure that the LGP will be well managed and accomplish its objectives, DOE has focused on initiating the LGP by soliciting preapplications for proposed projects. From OMB budget guidance, internal control and accounting standards, and the experience of other loan guarantee programs, we identified the following key steps that can provide greater program accountability and reasonable assurance that program objectives will be met. For each step, we also describe the actions DOE has taken.

- *Issuing regulations.* DOE has not issued regulations for implementing the LGP, relying instead on its guidelines to award the first \$2 billion in loan guarantees. Unlike guidelines, regulations (1) go through the public notice and comment process and thus are transparent to the public, oversight agencies, and Congress and (2) carry the force of law and hold the agency implementing the program and program participants accountable to the terms specified in the regulations. DOE officials told us that they would enforce the guidelines through the terms of the loan guarantee contracts and thus see no need to issue regulations before issuing the first \$2 billion in loan guarantees. The officials also told us they would have regulations in place for later guarantees.
- *Establishing a credit review board.* DOE has drafted a charter for a credit review board, but it has not yet been provided to the Secretary of Energy for approval. This board is to coordinate credit management and debt collection activities and ensure full consideration of credit management and debt collection issues.

- *Setting policies and procedures for selecting and monitoring loans and lenders.* DOE has taken some steps towards establishing such policies and procedures through its guidelines, but it has not completed them. These policies and procedures should protect the government's interests by, among other things, establishing mechanisms to screen and select applicants and lenders and monitor loan and lender performance.
- *Setting policies and procedures for estimating administrative and subsidy costs and accounting for loan guarantees.* As noted above, DOE has not developed policies or procedures for estimating administrative or subsidy costs. In addition, it has not developed policies or procedures for accounting for loan guarantees. In the interim, DOE is asking potential borrowers—who have an incentive to underestimate the costs—to provide preliminary estimates of subsidy costs so that it can gain experience in developing them. DOE expects the necessary accounting policies and procedures to be in place before guarantees are issued.
- *Setting program goals and objectives tied to outcome measures to determine program effectiveness.* DOE has not established outcome measurements. Instead, it has set the broad objectives of furthering the policy goals generally set forth in EAct 05 and promoting the President's Advanced Energy Initiative. This initiative supports clean energy technology research to reduce reliance on oil and address high natural gas and electricity prices.

EAct 05 requires DOE to issue regulations defining conditions for determining when a borrower has defaulted on a loan and requirements for the documentation borrowers must make available for audits. According to DOE officials, the department plans to include these requirements in its final regulations. If DOE issues guarantees before the regulations are final, officials said they would issue procedural rules covering these requirements before they issued the guarantees.

## **Conclusions**

DOE's current approach to the LGP raises questions about whether this program and its financial risks will be well managed. DOE's efforts to date have focused on expediting program implementation—for example, issuing guidelines and soliciting preapplications for loan guarantees—rather than ensuring the department has in place the critical policies, procedures, and mechanisms necessary to better ensure the program's success. DOE can better ensure that the LGP will be successful and financial risks to the federal government will be well managed by taking key steps before selecting projects and issuing guarantees. Such steps would also give Congress a basis for making more informed policy decisions related to the program, including the total amount of loans to guarantee.

## Recommendations for Executive Action

To better ensure that the LGP is well managed, we recommend that the Secretary of Energy ensure that the department takes the following five actions before selecting eligible projects for loan guarantees:

- Issue final program regulations that protect the government's interests, manage risk, and ensure that borrowers are aware of program requirements.
- Establish policies and procedures for selecting lenders and loans to guarantee and for monitoring lenders and loans once the guarantees have been issued.
- Establish policies and procedures for developing subsidy and administrative cost estimates.
- Establish policies and procedures to account for loan guarantees.
- Further define program goals and objectives tied to outcome measures for determining program effectiveness.

## Agency Comments

We provided a draft of this report to the Department of Energy for review and comment. DOE generally agreed with the findings, conclusions, and recommendations in the report and provided technical comments that were incorporated, as appropriate. The acting chief financial officer stated that with funding provided for the LGP in the Revised Continuing Appropriation Resolution, 2007, enacted on February 15, 2007, DOE intends to move forward as promptly as possible to implement the program and, in doing so, affirmatively address the recommendations contained in our report. DOE's comments are reproduced in enclosure II.

- - - - -

We are sending copies of this report to congressional committees with responsibilities for energy and federal credit issues; the Secretary of Energy; and the Director, Office of Management and Budget. We are also making copies available to others upon request. This report will be available at no charge on GAO's Web site at <http://www.gao.gov>.

If you or your staffs have any questions about this report, please contact James Cosgrove at (202) 512-3841 or [cosgrovej@gao.gov](mailto:cosgrovej@gao.gov) or Robert Martin at (202) 512-2600 or [martin@gao.gov](mailto:martin@gao.gov). Contact points for our Offices of Congressional Relations and Public Affairs may be found on the last page of this report. Key contributors to this report are listed in enclosure III.



James C. Cosgrove  
Acting Director, Natural  
Resources and Environment



Robert E. Martin  
Director, Financial  
Management and Assurance

Enclosures



---

DOE Loan Guarantee Program for Projects That  
Employ Innovative Technologies

---

Briefing for the Subcommittee on Energy and Water  
Development, House Committee on Appropriations  
January 4, 2007

---



- 
- Introduction
  - Objectives, Scope and Methodology
  - Results in Brief
  - Objective 1: Sources and Uses of Funds for LGP
  - Objective 2: Financial Risks Posed by the LGP
  - Objective 3: Steps DOE Has Taken to Manage the LGP



- The Energy Policy Act of 2005 (EPAct 05), Title XVII—Incentives for Innovative Technologies—authorizes a new federal loan guarantee program (LGP) to be implemented by the Secretary of Energy.
  - Eligible projects must
    - decrease air pollutants or man-made greenhouse gases by reducing their production or by sequestering them (storing them to prevent their release into the atmosphere),
    - employ new or significantly improved technologies compared with commercial technologies currently used, and
    - have a “reasonable prospect” of repayment.



- Title XVII identifies 10 categories of projects that are potentially eligible for a loan guarantee:
  - Renewable energy systems.
  - Advanced fossil energy technologies.
  - Hydrogen fuel cell technologies.
  - Advanced nuclear energy facilities.
  - Carbon capture and sequestration practices and technologies.
  - Efficient electrical generation, transmission, and distribution technologies.
  - Efficient end-use energy technologies.
  - Production facilities for fuel efficient vehicles.
  - Pollution control equipment.
  - Refineries.



- Federal loan guarantee programs help borrowers get credit from private sector lenders. The federal government guarantees to pay lenders if the borrowers default on loans, which makes extending credit more attractive to lenders.
- Loan guarantee programs have two types of costs:
  - Administrative: costs associated with evaluating applications; offering, negotiating, and closing guarantees; and servicing and monitoring guarantees.
  - Subsidy: the estimated net present value of the long-term cost to the government of guaranteeing the loans over the entire period the loans are outstanding, excluding administrative costs.<sup>1</sup> It is to take into account estimated payments by the government to cover defaults, delinquencies, or other payments; and estimated payments to the government, including origination and other fees, penalties, and recoveries on defaults.

<sup>1</sup>Present value is the worth of the future stream of costs or returns in terms of money paid immediately. In calculating present value for subsidy cost calculations, prevailing interest rates provide the basis for converting future amounts into their "money now" equivalents.



- EPAct 05 establishes how subsidy and administrative costs will be covered in DOE's LGP:
  - No loan guarantee shall be made unless Congress appropriates funds to cover the costs. The act provides that a borrower can pay fees to cover the full cost of the obligation, referred to in this briefing as the "borrower pays" option.
  - Borrowers are to be charged fees to cover DOE's administrative costs.



- While DOE has not yet approved any loan guarantees under the LGP, on August 8, 2006, DOE issued program guidelines and solicited pre-applications. DOE plans to invite applications for full proposals only from the preapplications it received by the December 31, 2006, deadline. DOE will review the preapplications while awaiting congressional action on (1) appropriations to cover the administrative costs of establishing the program, (2) authority for using/limiting the Title XVII "borrower pays" provisions, and (3) authority to use administrative fees to fund the continued operation of the loan guarantee program.
- DOE's program guidelines specify:
  - DOE will consider projects funded under the "borrower pays" option.
  - Potential borrowers will provide preliminary estimates of the subsidy costs.
  - DOE will limit the total value of loan guarantee commitments under the first round to \$2 billion.
  - DOE will guarantee no more than 80 percent of a project's costs, as specified in EPLA 05; DOE prefers not to guarantee more than 80 percent of the loan amount.



- DOE last managed loan guarantees issued in the mid-1970s to 1980, after the Organization of Arab Petroleum Exporting Countries embargoed oil exports to the United States. Like those of EPAct 05, the loan guarantees were extended to spur new energy technologies. According to DOE, at that time it guaranteed 14 loans for coal gasification, ethanol plants, and other projects. DOE data show that 10 of the 14 borrowers defaulted and the federal government repaid the lenders.<sup>2</sup>

<sup>2</sup>After defaulting on their loans, two of the companies became profitable. One is now paying on the loan and the other is revenue sharing with DOE.



- Objectives:
  - Identify sources and use of funds for DOE's LGP in fiscal years 2006 and 2007.
  - Examine the extent to which the LGP could result in financial risks to the taxpayer.
  - Assess the steps DOE has taken to ensure that the LGP will be well managed.
- Scope and methodology:
  - Reviewed and analyzed DOE documentation on funding and activities undertaken, to date, to prepare for the LGP.
  - Interviewed DOE and Office of Management and Budget (OMB) program and budget officials.
  - To determine key practices essential to loan guarantee programs, we examined OMB and budget and internal control guidance; prior GAO, CRS, and CBO reports on federal loan and loan guarantee programs; and work by a leading expert on federal loan and loan guarantee programs. We compared DOE's plans to the key practices we identified.
  - Furthermore, for the 7 loan guarantee programs reviewed by DOE in preparation for its LGP, we examined whether the programs used guidelines or regulations.
  - Our work was performed in accordance with generally accepted government auditing standards from October 2006 to January 2007.



- From March through October 2006, DOE spent about \$503,000 for the LGP.
- DOE used funds from the Departmental Administration appropriation and the Science appropriation accounts to pay for three staff detailed from elsewhere in DOE—the Office of Management, Office of Policy and International Affairs, and Office of Science.
- The Energy Supply and Conservation appropriation and the Science appropriation accounts paid for task order support services for, among other things, a LGP Web site.
- DOE reports it has stopped most spending for the program while it is waiting for appropriations and more specific congressional direction.



- Although DOE plans to charge borrowers fees to cover the LGP's costs, the government may still incur costs. For example, if DOE does not adequately assess the risk of borrower default, DOE may not charge borrowers enough fees to cover actual LGP costs and the government would have to fund the shortfall. Estimating the subsidy cost with any certainty that borrower fees will cover LGP costs will be difficult because, among other reasons, the LGP targets innovative energy technologies. Furthermore, loan performance could depend heavily on future economic conditions, including energy prices, which are hard to accurately predict.



- DOE has not completed key steps to ensure that the program will be well managed and accomplish its objectives:
  - DOE plans to issue its first round of guarantees under guidelines rather than regulations. However, other loan guarantee programs we examined are primarily implemented using regulations, which, unlike guidelines, are legally binding on program participants. DOE program officials say they plan to use guidelines instead of regulations because it will be easier to make minor changes to the program.
  - DOE lacks certain policies and procedures—for example, for monitoring lender and loan performance, reviewing and revising subsidy cost estimates submitted by potential borrowers, and measuring program effectiveness. Program officials said such policies and procedures are important but that they have not had the resources to date to take these steps and they do not intend to take further action on developing policies and procedures until the agency receives appropriations for the LGP.



- 
- From March through September 2006, DOE spent a total of about \$430,000 for the LGP:
    - About \$309,000 paid for salaries and expenses for three staff detailed from the Office of Management, Office of Policy and International Affairs, and Office of Science.
    - \$121,194 from the Science appropriation and the Energy Supply and Conservation appropriation accounts paid for task order support services.
  - During October 2006, DOE spent about \$73,000:
    - About \$38,000 paid for salaries and expenses for three staff detailed from the Office of Management, Office of Policy and International Affairs, and Office of Science.
    - \$34,829 from the Science appropriation and the Energy Supply and Conservation appropriation accounts paid for task order support services.
-



- DOE reported taking several actions to begin the LGP in fiscal years 2006 and 2007, including
  - program planning and developing policy, including reviewing practices of other federal loan guarantee programs;
  - developing program guidelines and soliciting preapplications; and
  - communicating about the program by, for example, developing a Web site, and responding to inquiries from the private sector, Congress, and other stakeholders.



- Fiscal year 2007 (November through December 2006):
    - Staff details expired October 31 and DOE has reduced but not eliminated LGP activities.
    - According to the Deputy General Counsel for Energy Policy, he and other staff continue to work on issues related to the program, such as preparing a notice of proposed rulemaking and reviewing preapplications for completeness. In addition, DOE staff in the Office of the Chief Financial Officer are maintaining the LGP Web site.
    - DOE continues to pay for task order support services to respond to program inquiries. This support is funded through the Energy Supply and Conservation appropriation account.
    - DOE officials said they are waiting for appropriations and more specific congressional direction to decide next steps for the program.
-



- Although DOE guidelines call for borrowers to pay both the estimated subsidy and administrative costs associated with the LGP, financial risks to the government remain because of the potential for
  - underestimated subsidy costs and
  - underestimated administrative costs.
- According to the Under Secretary for Energy, Science, and Environment, the LGP’s “borrower pays” option “in theory, reduces the need for appropriations... [but] the ultimate cost to the taxpayer could be significantly higher than...” DOE’s original estimate.<sup>3</sup>

---

<sup>3</sup>Testimony before the Committee on Energy and Natural Resources, U.S. Senate, May 1, 2006.



---

**Underestimated Subsidy Costs**

- Under the Federal Credit Reform Act of 1990 (FCRA), agencies must estimate the net cost of extending or guaranteeing credit (the subsidy cost), based on the net present value of estimated payments to and from the government, excluding administrative costs. To estimate this cost, an agency would consider potential loan performance—that is, potential defaults, recoveries on defaults, fees paid by borrowers, and other cash flows.



- OMB guidance generally requires agencies to annually update or “reestimate” subsidy costs based on actual loan performance and expected changes in future loan performance.
  - If the reestimate indicates that subsidy costs are higher than previously estimated, the additional cost must be funded.
  - FCRA provides permanent indefinite budget authority for reestimates that reflect increased costs; that is, funding for additional costs identified through the reestimation process does not require an annual appropriation.



- If DOE were to initially underestimate subsidy costs, it would not charge borrowers enough fees to cover the subsidy costs. Any shortfalls would be automatically funded through the reestimation process and be a cost to the government.
  - Several factors could affect DOE's ability to estimate subsidy costs, including factors within DOE's control, such as having a sound method to assess risk and estimate subsidy costs; and factors outside of DOE's control, such as economic conditions and energy prices.
  - To the extent that any of these factors cause DOE to underestimate the subsidy costs, the increased costs recognized in the reestimation process represent an increased cost to the government.



- GAO has repeatedly reported over the last decade that agencies have had difficulty estimating subsidy costs. (A list of relevant GAO products is included at the end of this briefing.) Factors contributing to this difficulty include
  - simplistic models and faulty assumptions that caused estimates to be too low;
  - limited historical data, such as having a small number of guarantees from which to gather performance data needed to make reasonable estimates; and
  - deficient policies and procedures for assessing risks and estimating subsidy costs.
- DOE could be at risk for these types of problems because DOE does not have experience estimating subsidy costs and lacks historical data for the LGP.
- DOE officials told us that they have researched FCRA requirements but have not determined specifically how subsidy costs would be estimated.



---

**Underestimated Administrative Costs**

- The government may also be at financial risk if DOE underestimates administrative costs:
  - To determine the fees to charge borrowers to cover administrative costs, DOE would have to estimate administrative costs over the life of the loan.
  - As a new program dealing with new technologies, LGP administrative costs are uncertain.
  - DOE has no plan to determine how to (1) initially calculate fees to cover administrative costs or (2) charge borrowers more if actual administrative costs over the life of the loan are higher than initially estimated. DOE officials said it was premature to determine either of these. OMB officials said it is not clear how shortfalls in fees for administrative costs would be funded.
  - Appropriated funds may be necessary to cover any increase in administrative costs because FCRA does not provide permanent indefinite budget authority for administrative costs.



---

### **Limiting Financial Risks**

- Congress can limit the government’s exposure to financial losses from loan guarantees by (1) providing an appropriation for subsidy costs that limits the subsidy amount available to fund loan guarantees or (2) when a program does not have a subsidy cost, as could be the case of DOE’s LGP “borrower pays” option, providing for commitment authority in an appropriation that limits the total dollar volume of new loans that an agency can guarantee.
- Currently, there is no congressional limit for DOE’s LGP. DOE guidelines indicate that DOE will not issue more than \$2 billion in guarantees during the first round.



- Because of the potential financial risks of a loan guarantee program, it is important that DOE take appropriate key steps to ensure that its LGP will be well managed and accomplish its objectives while also managing the government’s financial risks. DOE has taken some actions in this regard but has not completed any of these key steps.
- To manage loan guarantee programs, OMB, budget and accounting guidance, and practices used by other agencies for loan guarantee programs, include certain key steps to provide accountability for program operations and provide reasonable assurance that program objectives will be met. The following table shows these steps and the status of DOE’s related actions.



**Key Steps to Manage a Loan Guarantee Program**

Key steps	Status of DOE activities
Issue regulations for implementing a loan guarantee program.	Issued guidelines to award the first \$2 billion in guarantees; plans to issue regulations for awarding subsequent guarantees.
Establish a credit review board to set policies for and implement a program.	Credit review board charter drafted but not yet approved by the Secretary of Energy.
Set policies and procedures for selecting and monitoring lenders and loans.	Policies and procedures are incomplete.
Set policies and procedures for estimating subsidy and administrative costs and accounting for loan guarantees.	No policies or procedures developed.
Set program goals and objectives tied to outcome metrics for determining program effectiveness.	Broad objectives set but no outcome metrics have been developed.
Issue rules defining default conditions and audit documentation requirements.	Has not completed the rules but plans to prior to issuing any loan guarantees.

Source: GAO analysis of OMB, budget and internal control guidance; GAO, CRS, and CBO reports; and work by an expert on federal credit programs.



---

**Regulations**

- Regulations that implement federal programs go through the public notice and comment process and are thereby transparent to the public, oversight agencies, and Congress. Because regulations carry the force of law, they also hold both the agency implementing the program and program participants accountable to the terms specified in the regulations.
- Agencies that implement five of seven loan guarantee programs that DOE reviewed for their practices began and continue to manage their programs using regulations.
  - The five programs with regulations are the Department of Transportation’s infrastructure finance program; the Maritime Administration program; and the Department of Agriculture’s renewable energy and energy efficiency, business and industry, and rural utilities programs.
  - The two programs without regulations are the Overseas Private Investment Corporation and Export-Import Bank. Unlike the five programs with regulations, these two guarantee loans to foreign entities.
- The “emergency relief” programs for the steel and oil and gas industries (both of which first issued guarantees in 2001) and the airline industry (which first issued guarantees in 2002) were initiated under regulations.



---

**Regulations (cont.)**

- DOE intends to issue the first round of guarantees under published administrative guidelines. In parallel, DOE will begin a rulemaking based, in part, on feedback for subsequent rounds.
- DOE sees guidelines as enabling (a) quick start-up, (b) flexibility, and (c) learning by doing so that changes can be easily incorporated into proposed rules. DOE officials said they will enforce the guidelines through the terms of the loan guarantee contracts and regulations are not needed to issue the first \$2 billion in loan guarantees.
- EAct 05 requires DOE to issue regulations defining borrower default conditions and audit documentation requirements. According to DOE officials, they expect to include these items in the rulemaking process. If DOE issues guarantees before finalizing the regulations, officials said they will issue procedural rules covering these issues prior to issuing the guarantees.



---

**Regulations (cont.)**

- Disadvantages of using guidelines rather than regulations:
  - Changes DOE makes, and the rationale for them, may not be transparent to the public, oversight agencies, and Congress. For example, currently the guidelines' loan sale provisions prohibit separately selling, or "stripping," the guaranteed portion of the loan from the nonguaranteed portion. This helps protect the government's interest by ensuring that lenders, because they have risk in the loan (the nonguaranteed portion), have an incentive to diligently monitor the loan. Because these provisions are in guidelines, rather than regulations, DOE could change them without public or congressional input. In contrast, if the guidelines were issued as regulations, DOE would have to provide public notice and comment periods, and to respond to comments received before issuing final rules implementing the change.
  - The use of guidelines creates potential restrictions on enforcement ability.
    - Regulations generally carry force of law but guidelines do not.
    - DOE's LGP guidelines state that "most provisions of today's guidelines are not legally binding." DOE officials told us they will include provisions in the loan contracts to ensure that relevant provisions of the guidelines are enforceable. However, regulations could help ensure that DOE includes necessary provisions in the loan contracts.



---

**Credit Review Board**

- OMB guidance calls for agencies to establish a board, as appropriate, to coordinate credit management and debt collection activities and ensure full consideration of credit management and debt collection issues. Representation on the board should include, but not be limited to, the agency chief financial officer and the senior officials for program offices with credit activities.
- DOE has drafted a charter for the LGP’s credit review board. The stated purpose and board membership mirror OMB guidance. According to DOE officials, the charter has not been approved by the Secretary of Energy and the board has not yet convened.



---

### **Selecting and Monitoring Lenders and Loans**

- To effectively oversee the government’s interests in loan guarantee programs, OMB guidance and agency practices call for managers to establish policies and procedures for selecting lenders and loans to guarantee and for monitoring their performance. These include
  - establishing policies and procedures for screening applicants to prevent defaults and delinquencies;
  - determining that lenders meet all applicable financial and program requirements for eligibility, such as not being delinquent on government debts; and
  - establishing mechanisms for monitoring loan performance, such as a process for reviewing borrowers’ financial statements and timeliness of loan payments.



---

**Selecting and Monitoring Lenders and Loans (cont.)**

- DOE's policies and procedures for selecting and monitoring lenders and loan performance are incomplete. For example:
  - Program guidelines specify factors DOE will consider when selecting projects: for example, whether and to what extent the project avoids, reduces, or sequesters air pollutants or greenhouse gases, and whether the project sponsors have made a significant financial commitment. However, DOE officials have yet to determine how these factors will be ranked or used for selecting projects.
  - Program guidelines contain lender eligibility requirements that generally mirror those set out by OMB and contain an additional requirement that lenders must demonstrate experience with energy-related projects. However, DOE has not established procedures for monitoring either lenders or loan performance. According to DOE officials, they recognize the importance of these procedures and will develop them before issuing guarantees.



---

**Estimating Costs and Accounting for Loan Guarantees**

- The Financial Accounting Standards Advisory Board’s guidance on preparing subsidy estimates and reestimates lists procedures to estimate and reestimate subsidy costs, including
  - procedures to calculate the subsidy estimate;
  - review and approval processes for the subsidy estimate;
  - documentation of underlying assumptions, including historical support for the assumptions; and
  - documentation of the cash flow model used to develop the estimates.



---

**Estimating Costs and Accounting for Loan Guarantees (cont.)**

- DOE does not have policies and procedures in place for estimating subsidy and administrative costs and accounting for loan guarantees.
  - DOE guidelines call for potential borrowers to provide an initial estimate of subsidy costs.
    - DOE officials explained that they expect to benefit from the experience that some borrowers may have with federal loan guarantees.
    - However, because the borrower fee is based on the subsidy cost estimate, the potential borrower has an incentive to underestimate the initial subsidy cost estimate it submits to DOE as part of its application for a loan guarantee.
  - According to DOE officials, they, in conjunction with OMB, have yet to decide how to estimate subsidy and administrative costs and to determine the fees to charge borrowers to cover administrative costs. DOE will design its approach to reflect any expertise gained from the borrowers' submissions.
  - According to DOE's Director of Finance and Accounting, DOE has not developed policies and procedures to account for loan guarantee activities. He expects the policies and procedures will be ready before any guarantees are issued.



---

**Objectives and Outcomes**

- OMB guidance, the Government Performance Results Act, and agency practices for loan guarantee programs call for agencies to set program goals and objectives and tie them to measurable outcomes to determine program effectiveness.
  - In particular, OMB guidance for loan guarantee programs calls for agencies to develop clearly defined objectives and outcomes expected.
- DOE established broad program objectives in its solicitation for pre-applications:
  - promote the President’s Advanced Energy Initiative (which supports clean-energy technology research to reduce reliance on oil and address high natural gas and electricity prices) and
  - further the policy goals of EPAct 05 generally and Title XVII specifically.
- According to DOE officials, it is premature to further define the objectives and outcomes expected for the program.



- *Small Business Administration: Improvements Made, but Loan Programs Face Ongoing Management Challenges.* GAO-06-605T. Washington, D.C.: April 6, 2006.
- *Mortgage Financing: FHA's \$7 Billion Reestimate Reflects Higher Claims and Changing Loan Performance Estimates.* GAO-05-875. Washington, D.C.: September 2, 2005.
- *Housing Finance: Options to Help Prevent Suspensions of FHA and RHS Loan Guarantee Programs.* GAO-05-227. Washington, D.C.: March, 15, 2005.
- *Maritime Administration: Weaknesses Identified in Management of the Title XI Loan Guarantee Program.* GAO-03-657. Washington, D.C.: June 30, 2003.
- *Internal Control Standards: Internal Control Management and Evaluation Tool.* GAO-01-1008G. Washington, D.C.: August 2001.
- *Farm Loan Programs: Improvements in the Loan Portfolio but Continued Monitoring Needed.* GAO-01-732T. Washington, D.C.: May 16, 2001.
- *Guaranteed Loan System Requirements: Checklist for Reviewing Systems Under the Federal Financial Management Improvement Act.* GAO-01-371G. Washington, D.C.: March 2001.
- *Department of Veterans Affairs: Credit Costs and Risks of Proposed VA Small Business Loan Guarantee Program.* GAO/GGD-00-158. Washington, D.C.: June 30, 2000.



- *SBA Loan Monitoring System: Substantial Progress Yet Key Risks and Challenges Remain.* GAO/AIMD-00-124. Washington, D.C.: April 25, 2000.
- *Rural Development: Rural Business Cooperative Service Business Loan Losses.* GAO/RCED-99-249. Washington, D.C.: August, 25, 1999.
- *Credit Reform: Key Credit Agencies Had Difficulty Making Reasonable Loan Program Cost Estimates.* GAO/AIMD-99-31. Washington, D.C.: January 29, 1999.
- *Small Business Administration: Few Reviews of Guaranteed Lenders Have Been Conducted.* GAO/GGD-98-85. Washington, D.C.: June 11, 1998.
- *Credit Reform: Greater Effort Needed to Overcome Persistent Cost Estimation Problems.* GAO/AIMD-98-14. Washington, D.C.: March 30, 1998.
- *Rural Utilities Service: Opportunities to Operate Electricity and Telecommunications Loan Programs More Effectively.* GAO/RCED-98-42. Washington, D.C.: January 21, 1998.
- *Status of the Great Plains Coal Gasification Project -- Dec. 31, 1984.* GAO/RCED-85-92. Washington, D.C.: May 28, 1985.
- *Geothermal Loan Guarantee Program: Need for Improvements.* EMD-80-26. Washington, D.C.: January 24, 1980.



**Department of Energy**  
Washington, DC 20585

**FEB 16 2007**

Mr. James C. Cosgrove  
Acting Director, Natural  
Resources and Environment  
Government Accountability Office  
Washington, DC 20548

Dear Mr. Cosgrove:

This letter is in response to the Government Accountability Office's Draft Report entitled, "Steps Needed to Better Manage the Financial Risk and Help Ensure the Success of the New Loan Guarantee Program for Innovative Technologies," (GAO 07-339R) provided to the Department of Energy for review and comment on February 1, 2007. We have also solicited input from the Office of Management and Budget and have incorporated their views in this response.

As you are aware, on May 22, 2006, the Department requested Congressional approval for an appropriations transfer of \$2.7 million from the Department's Science, Fossil Energy Research and Development, and Energy Supply and Conservation accounts to fund the start-up of a Loan Guarantee Office to manage implementation of the authority provided in Title XVII of the Energy Policy Act of 2005. As noted on page 2 of your report, the House Energy and Water Development, and Related Agencies Appropriations Subcommittee, in a July 2006 letter, stated it was concerned with the lack of a strategy for instituting the loan guarantee program and that the Department had not adequately explained such basic management policies as the criteria it will use for selecting projects for loan guarantees and the number of loans to be guaranteed. What the report does not indicate is that in this same letter the Subcommittee disapproved the Department's appropriations transfer request. As a result of the Subcommittee's disapproval of the Department's appropriations transfer request, we were not able to fully carry out the activities that the draft GAO report criticizes DOE for not doing.

Representatives of the Department continued to work with Subcommittee staff well into August 2006 in an effort to allay their concerns and to secure the Subcommittee's approval of a substantially reduced appropriations transfer request to start up this program. At the same time, the Department issued the program guidelines and solicitation discussed in the report with the expectation that our request would ultimately be funded. However, the Subcommittee never approved the reduced request and DOE therefore was not able to effectively and promptly move forward with this program.

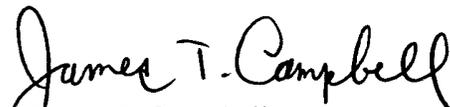
Nonetheless, we share GAO's views expressed in the report that several key steps need to be implemented before the Department will be positioned to guarantee loans under the

Title XVII authority. Clearly, had we received the funding requested of the Congress, more progress in addressing some of these steps would have been made. In fact, absent the requested funding, we have developed a draft charter for the Department's Credit Review Board which will soon be presented to the Secretary for approval and have begun to develop draft proposed regulations for the program. Further, as pointed out in the report, program guidelines were promulgated and a program solicitation was issued in August 2006. In response to that solicitation, over 100 pre-applications for loan guarantees have been received reflecting the tremendous interest in this program and validating its potential for major contributions toward the statutory Title XVII objectives of decreasing emissions of air pollutants or greenhouse gases and employing new or significantly improved energy technologies.

We are encouraged by the action of the Congress in the FY 2007 Continuing Resolution, H.J. Res. 20, which was signed into law by President Bush on February 15, 2007 and which will provide funding for the Loan Guarantee Office as well as the requisite authority to issue loan guarantees and recover administrative costs from borrowers. Now that the Department has been provided funding and the necessary legal authority to fully implement the Title XVII program, we intend to move forward as promptly as possible. In doing so, we intend to exercise our authority prudently, fully comply with the provisions of all applicable law, and affirmatively address the recommendations contained in the report.

Attached are additional technical comments for your consideration in finalizing the report. Thank you for the opportunity to review the draft report. If you have any questions, please contact me at (202) 586-4171

Sincerely,

  
James T. Campbell  
Acting Chief Financial Officer

Enclosure

**GAO Contacts and Staff Acknowledgments**

**GAO Contacts**

James Cosgrove (202) 512-3841 or [cosgrovej@gao.gov](mailto:cosgrovej@gao.gov)

Robert E. Martin (202) 512-8341 or [martinr@gao.gov](mailto:martinr@gao.gov)

**Staff Acknowledgments**

In addition to the individuals named above, Marcia Carlsen and Karla Springer, Assistant Directors, and Quindi Franco, Marcia Brouns McWreath, Barbara Timmerman, and Carol Herrnsstadt Shulman made key contributions to this report.

---

---

This is a work of the U.S. government and is not subject to copyright protection in the United States. It may be reproduced and distributed in its entirety without further permission from GAO. However, because this work may contain copyrighted images or other material, permission from the copyright holder may be necessary if you wish to reproduce this material separately.

---

---

## GAO's Mission

The Government Accountability Office, the audit, evaluation and investigative arm of Congress, exists to support Congress in meeting its constitutional responsibilities and to help improve the performance and accountability of the federal government for the American people. GAO examines the use of public funds; evaluates federal programs and policies; and provides analyses, recommendations, and other assistance to help Congress make informed oversight, policy, and funding decisions. GAO's commitment to good government is reflected in its core values of accountability, integrity, and reliability.

---

## Obtaining Copies of GAO Reports and Testimony

The fastest and easiest way to obtain copies of GAO documents at no cost is through GAO's Web site ([www.gao.gov](http://www.gao.gov)). Each weekday, GAO posts newly released reports, testimony, and correspondence on its Web site. To have GAO e-mail you a list of newly posted products every afternoon, go to [www.gao.gov](http://www.gao.gov) and select "Subscribe to Updates."

---

## Order by Mail or Phone

The first copy of each printed report is free. Additional copies are \$2 each. A check or money order should be made out to the Superintendent of Documents. GAO also accepts VISA and Mastercard. Orders for 100 or more copies mailed to a single address are discounted 25 percent. Orders should be sent to:

U.S. Government Accountability Office  
441 G Street NW, Room LM  
Washington, D.C. 20548

To order by Phone: Voice: (202) 512-6000  
TDD: (202) 512-2537  
Fax: (202) 512-6061

---

## To Report Fraud, Waste, and Abuse in Federal Programs

Contact:

Web site: [www.gao.gov/fraudnet/fraudnet.htm](http://www.gao.gov/fraudnet/fraudnet.htm)

E-mail: [fraudnet@gao.gov](mailto:fraudnet@gao.gov)

Automated answering system: (800) 424-5454 or (202) 512-7470

---

## Congressional Relations

Gloria Jarmon, Managing Director, [JarmonG@gao.gov](mailto:JarmonG@gao.gov) (202) 512-4400  
U.S. Government Accountability Office, 441 G Street NW, Room 7125  
Washington, D.C. 20548

---

## Public Affairs

Paul Anderson, Managing Director, [AndersonP1@gao.gov](mailto:AndersonP1@gao.gov) (202) 512-4800  
U.S. Government Accountability Office, 441 G Street NW, Room 7149  
Washington, D.C. 20548