

Audit Report

Public Service Commission

April 2010



OFFICE OF LEGISLATIVE AUDITS
DEPARTMENT OF LEGISLATIVE SERVICES
MARYLAND GENERAL ASSEMBLY

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DEPARTMENT OF LEGISLATIVE SERVICES
OFFICE OF LEGISLATIVE AUDITS
MARYLAND GENERAL ASSEMBLY

Karl S. Aro
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Bruce A. Myers, CPA
Legislative Auditor

April 15, 2010

Senator Verna L. Jones, Co-Chair, Joint Audit Committee
Delegate Steven J. DeBoy, Sr., Co-Chair, Joint Audit Committee
Members of Joint Audit Committee
Annapolis, Maryland

Ladies and Gentlemen:

We have audited the Public Service Commission (PSC) for the period beginning December 11, 2006 and ending October 26, 2009. The PSC regulates public utilities (such as gas, electric, water, and telephone companies) operating within the State. The PSC also regulates common carriers engaged in the public transportation of passengers in the State and has jurisdiction over taxicabs operating in Baltimore City, Baltimore County, Cumberland, and Hagerstown. The PSC consists of five members who are appointed by the Governor, with the advice and consent of the Senate.

Our audit disclosed that certain procedures the PSC had implemented for periodically reviewing utility company billings to consumers were not comprehensive. In addition, we noted that the PSC's controls over certain purchasing and disbursement transactions, as well as its collections and accounts receivable, were not sufficient.

The PSC's response to this audit is included as an appendix to this report. We wish to acknowledge the cooperation extended to us during the course of this audit by the PSC.

Respectfully submitted,

Bruce A. Myers, CPA
Legislative Auditor

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* Denotes item repeated in full or part from preceding audit report

Background Information

Agency Responsibilities

The Public Service Commission (PSC), which functions under the provisions of the Public Utility Companies Article of the Annotated Code of Maryland, regulates public utilities (such as gas, electric, water, and telephone companies) operating within the State. The PSC also regulates common carriers engaged in the public transportation of passengers in the State and has jurisdiction over taxicabs operating in Baltimore City, Baltimore County, Cumberland, and Hagerstown. The PSC consists of five members who are appointed by the Governor, with the advice and consent of the Senate.

In accordance with State law, the operating expenses of the PSC, as well as the Office of People's Counsel (OPC), are paid for by annual assessments which are calculated and issued by the PSC to regulated companies. According to the State's records, during fiscal year 2009, the operating expenses of the PSC and the OPC totaled \$17.6 million and \$2.5 million, respectively. The OPC, which we audit separately, is responsible for protecting the interests of residential and non-commercial users of these regulated services relating to matters and proceedings before the PSC and the courts.

Status of Findings From Preceding Audit Report

Our audit included a review to determine the status of the seven findings contained in our preceding audit report dated July 17, 2007. We determined that the PSC satisfactorily addressed six of these findings. The remaining finding is repeated in this report.

Findings and Recommendations

Review of Utility Companies' Billings

Finding 1

Procedures implemented by the Public Service Commission (PSC) for reviewing consumer billings from utilities were not comprehensive.

Analysis

Procedures implemented by the PSC for reviewing consumer billings from utilities were not comprehensive. Specifically, the PSC periodically reviewed selected billings issued by utilities receiving approval for fuel rate adjustments to ensure that only approved rates were being used. However, we were advised that normally these reviews did not include a verification of other fee and surcharge amounts, such as the environmental trust fund surcharge, which also are authorized by the PSC. In addition, since all utilities do not routinely implement fuel rate adjustment charges, all billings would not be subject to these periodic reviews. In this regard, 5 of the 11 electricity suppliers and 3 of the 8 gas suppliers subject to PSC rate regulation did not receive fuel rate adjustments during our audit period and, thus, were not subject to the review.

Although some billings are reviewed, we believe a more comprehensive approach would provide needed assurance that only approved rates and other authorized charges are billed by regulated utilities to consumers. According to the PSC's records, revenues of electricity and gas providers from Maryland consumers totaled approximately \$10 billion during fiscal year 2009.

Recommendation 1

We recommend that the PSC develop a comprehensive process for reviewing billings issued by all utilities to help ensure that only approved rates and other authorized charges are billed to consumers.

Purchases and Disbursements

Finding 2

Proper internal controls were not established over the processing of certain purchasing and disbursement transactions.

Analysis

The PSC did not fully use available security features of the State's Financial Management Information System (FMIS) to establish proper internal controls over certain purchasing and disbursement transactions. Specifically, PSC's established online approval rules allowed two employees with the capability to initiate purchase orders to also make changes to those transactions (such as vendors and amounts) after independent approvals were obtained. Furthermore, five employees had access capabilities to initiate and approve certain disbursement transactions on FMIS without independent online approval, and one of those employees had the ability to adjust approval paths on FMIS, as well as release disbursement transactions to the Comptroller's General Accounting Division for payment. In addition, although we were advised that a manual review of all disbursement transactions was performed by the employee who normally released the transactions to the General Accounting Division, the review was not documented.

Under these conditions, errors or other discrepancies could occur without timely detection. According to the State's accounting records, during fiscal year 2009, the PSC used FMIS to process disbursement transactions totaling approximately \$3.7 million.

Recommendation 2

We recommend that the PSC

- a. establish approval requirements that prevent individuals with the capability of initiating purchasing transactions from modifying the transactions after related approvals have been obtained,**
- b. establish independent online approval requirements for all critical disbursement transactions,**
- c. ensure that employees who have the capability to process transactions do not have the ability to adjust approval paths on FMIS or release transactions for payment, and**
- d. document the aforementioned review by the employee who releases disbursement transactions to the General Accounting Division.**

Finding 3

The PSC did not always obtain competitive bids when procuring goods and services as required by State procurement regulations.

Analysis

The PSC did not always follow State procurement regulations when procuring goods and services. For example, our test of selected procurement transactions disclosed that the PSC procured temporary personnel services totaling approximately \$204,000 from one vendor without using competitive sealed bidding, which is generally required by State procurement regulations for procurements exceeding \$25,000. In addition, a formal contract was not established for these services as required. These services were obtained in increments over a period of approximately 30 months.

Recommendation 3

We recommend that the PSC ensure compliance with State procurement regulations when procuring goods and services.

Finding 4

Adequate supporting documentation was not obtained to support certain payments to a contractor.

Analysis

Adequate supporting documentation was not obtained by the PSC to verify certain payments to a contractor. Our review of nine payments totaling approximately \$1.6 million made to one contractor for various consulting services, disclosed that a large portion of those payments (\$654,000) represented amounts paid for the service of other consultants and experts used by the contractor. Although the contractor's agreements with the PSC permitted the use of other consultants and the amounts charged to the PSC for these services were shown separately on the contractor's invoices, other documentation supporting the amounts billed, such as itemized invoices, a description of the specific work performed, or who performed the work was not provided. In the case of one invoice examined, costs for consultants and experts represented \$199,000 of the \$269,000 invoice total.

Considering the significance of the amounts billed by the contractor for work performed by other consultants and experts, the PSC should obtain adequate documentation to support the validity of these charges.

Recommendation 4

We recommend that the PSC obtain adequate documentation supporting amounts billed by primary contractors for work performed by consultants, experts, and other subcontractors.

Cash Receipts and Accounts Receivable

Finding 5

Controls over cash receipts and related accounts receivable records were not sufficient.

Analysis

Internal controls over cash receipts and accounts receivables were not sufficient. Specifically, we noted that several employees had incompatible access to collections and accounts receivable records. For example, the employee who initially received collections had the capability to update the accounts receivable records, and the employee responsible for posting collections and non-cash credits to the accounts receivable records regularly handled collections prior to deposit. In addition, there was no procedure in place to ensure that only authorized non-cash credits were recorded, and an adequate accounts receivable control account was not maintained since the data used to update the account was derived directly from the corresponding detail records. Under these conditions, errors or other discrepancies could occur without timely detection.

Similar conditions regarding the lack of separation of critical duties and access capabilities were commented upon in our preceding audit report. According to the PSC's records, collections for fiscal year 2009 totaled approximately \$20.1 million, and the accounts receivable balance as of October 28, 2009 totaled approximately \$10 million. Non-cash credits processed during fiscal year 2009 totaled approximately \$473,000.

Recommendation 5

We recommend that PSC

- a. ensure employees who have access to collections not have the capability to update the related accounts receivable records (repeat),**
- b. establish procedures to ensure the propriety of non-cash credit adjustments recorded in the accounts receivable records by verifying system generated reports of adjustments processed to approved source documentation, and**

- c. maintain an independent accounts receivable control account on a current basis and periodically reconcile the account balance to the aggregate sum of the related detail records.**

We advised the PSC on accomplishing the necessary separation of duties using existing personnel.

Audit Scope, Objectives, and Methodology

We have audited the Public Service Commission (PSC) for the period beginning December 11, 2006 and ending October 26, 2009. The audit was conducted in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

As prescribed by State Government Article, Section 2-1221 of the Annotated Code of Maryland, the objectives of this audit were to examine the PSC's financial transactions, records and internal controls, and to evaluate its compliance with applicable State laws, rules, and regulations. We also determined the status of the findings included in our preceding audit report.

In planning and conducting our audit, we focused on the major financial-related areas of operations based on assessments of materiality and risk. The areas addressed by the audit included cash receipts, accounts receivable, procurements and disbursements, payroll, assessments charged to regulated utilities, and the PSC's role in certain trust funds and service programs established by law. Our audit procedures included inquiries of appropriate personnel, inspections of documents and records, and observations of the PSC's operations. We also tested transactions and performed other auditing procedures that we considered necessary to achieve our objectives. Data provided in this report for background or informational purposes were deemed reasonable, but were not independently verified.

PSC management is responsible for establishing and maintaining effective internal control. Internal control is a process designed to provide reasonable assurance that objectives pertaining to the reliability of financial records, effectiveness and efficiency of operations including safeguarding of assets, and compliance with applicable laws, rules, and regulations are achieved.

Because of inherent limitations in internal control, errors or fraud may nevertheless occur and not be detected. Also, projections of any evaluation of internal control to future periods are subject to the risk that conditions may change or compliance with policies and procedures may deteriorate.

Our reports are designed to assist the Maryland General Assembly in exercising its legislative oversight function and to provide constructive recommendations for improving State operations. As a result, our reports generally do not address activities we reviewed that are functioning properly.

This report includes findings relating to conditions that we consider to be significant deficiencies in the design or operation of internal control that could adversely affect the PSC's ability to maintain reliable financial records, operate effectively and efficiently, and/or comply with applicable laws, rules, and regulations. Our report also includes a finding regarding significant instances of noncompliance with applicable laws, rules, or regulations. Another less significant finding was communicated to the PSC that did not warrant inclusion in this report.

The PSC response to our findings and recommendations is included as an appendix to this report. As prescribed in the State Government Article, Section 2-1224 of the Annotated Code of Maryland, we will advise the PSC regarding the results of our review of its response.

STATE OF MARYLAND



COMMISSIONERS
DOUGLAS R.M. NAZARIAN
CHAIRMAN

HAROLD D. WILLIAMS
SUSANNE BROGAN
LAWRENCE BRENNER
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PUBLIC SERVICE COMMISSION

April 14, 2010

Bruce A. Myers, CPA
Department of Legislative Audits
Office of Legislative Audits
301 West Preston Street, Room 1202
Baltimore, Maryland 21201

Re: Public Service Commission Response – Legislative Audit

Dear Mr. Meyers:

Attached please find the Public Service Commission's ("Commission") responses to the Department of Legislative Services' ("DLS") draft audit for the period beginning December 11, 2006 and ending October 26, 2009.

An electronic version of this document has been sent to response@ola.state.md.us as requested in your March 31, 2010 letter. If you have any questions regarding this matter, please do not hesitate to contact Terry J. Romine (410-767-8067).

Sincerely,

A handwritten signature in black ink, appearing to read "Douglas R.M. Nazarian", with a long, sweeping flourish extending to the right.

Douglas R.M. Nazarian
Chairman

Attachments



Findings and Recommendations

Review of Utility Companies' Billings

Finding 1

Procedures implemented by the Public Service Commission (PSC) for reviewing consumer billings from utilities were not comprehensive.

Recommendation 1

We recommend that the PSC develop a comprehensive process for reviewing billings issued by all utilities to help ensure that only approved rates and other authorized charges are billed to consumers.

Public Service Commission Response

The Commission agrees with this finding and is in the process of developing procedures to conduct periodic reviews, on a test basis, of billings issued by all utilities to ensure that only authorized rates and charges are utilized.

Implementation Schedule

A comprehensive process for reviewing billings issued by all utilities to help ensure that only approved rates and other authorized charges are billed to consumers will be completed and implemented by July 1, 2010.

Purchases and Disbursements

Finding 2

Proper internal controls were not established over the processing of certain purchasing and disbursement transactions.

Recommendation 2

We recommend that the PSC

- a. establish approval requirements that prevent individuals with the capability of initiating purchasing transactions from modifying the transactions after related approvals have been obtained,**
- b. establish independent online approval requirements for all critical disbursement transactions,**
- c. ensure that employees who have the capability to process transactions do not have the ability to adjust approval paths on FMIS or release transactions for payment, and**
- d. document the aforementioned review by the employee who releases disbursement transactions to the General Accounting Division.**

Public Service Commission Response

- a. The Commission agrees with this recommendation and will make the appropriate security adjustment.
- b. The Commission will work with the Department of Information Technology to establish independent online approval requirements for all critical disbursement transactions.
- c. The Commission will ensure that employees who have the capability to process transactions do not have the ability to adjust approval paths on FMIS or release transactions for payment.
- d. The Commission will document the review by the employee who releases disbursement transactions to the General Accounting Division by having this employee sign the aforementioned document.

Implementation Schedule

The Commission will implement its response by July 1, 2010.

Finding 3

The PSC did not always obtain competitive bids when procuring goods and services as required by State procurement regulations.

Recommendation 3

We recommend that the PSC ensure compliance with State procurement regulations when procuring goods and services.

Public Service Commission Response

The Commission agrees with this finding and will comply with State procurement regulations when procuring goods and services.

Implementation Schedule

The Commission has implemented a process for ensuring compliance with State procurement regulations when procuring goods and services.

Finding 4

Adequate supporting documentation was not obtained to support certain payments to a contractor.

Recommendation 4

We recommend that the PSC obtain adequate documentation supporting amounts billed by primary contractors for work performed by consultants, experts, and other subcontractors.

Public Service Commission Response

The Commission agrees with this finding and has instituted a procedure that will require primary contractors to provide documentation supporting amounts billed for work performed by consultants, experts, and other subcontractors.

Implementation Schedule

The Commission has implemented this response by including the requirement for documentation from subcontractors in both the contract and the award letter to the primary consultant. Additionally, the Commission is developing a guide to contract managers which will include instructions that they obtain supporting subcontractor documentation from the prime consultant.

Cash Receipts and Accounts Receivable

Finding 5

Controls over cash receipts and related accounts receivable records were not sufficient.

Recommendation 5

We recommend that PSC

- a. ensure employees who have access to collections not have the capability to update the related accounts receivable records (repeat),**
- b. establish procedures to ensure the propriety of non-cash credit adjustments recorded in the accounts receivable records by verifying system generated reports of adjustments processed to approved source documentation, and**
- c. maintain an independent accounts receivable control account on a current basis and periodically reconcile the account balance to the aggregate sum of the related detail records.**

We advised the PSC on accomplishing the necessary separation of duties using existing personnel.

Public Service Commission Response

- a. The Commission agrees with this recommendation and is currently working with its IT section to place the appropriate restrictions on accounts to prohibit the person initially receiving collections from updating accounts.
- b. The Commission agrees with this recommendation and is currently working with its IT section to develop an online approval path for non-cash adjustments. The new process will automatically update an account once it is approved and approval will be based on a review of the source documents.
- c. The Commission will maintain an independent aggregate sum accounts receivable control account on a current basis and will periodically reconcile the account balance to the aggregate sum of the related detail records.

Implementation Schedule

The Commission will complete the process of implementing its response by July 1, 2010.

AUDIT TEAM

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