

Audit Report

Public Service Commission

July 2007



OFFICE OF LEGISLATIVE AUDITS
DEPARTMENT OF LEGISLATIVE SERVICES
MARYLAND GENERAL ASSEMBLY

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Karl S. Aro
Executive Director

DEPARTMENT OF LEGISLATIVE SERVICES
OFFICE OF LEGISLATIVE AUDITS
MARYLAND GENERAL ASSEMBLY

Bruce A. Myers, CPA
Legislative Auditor

July 17, 2007

Delegate Steven J. DeBoy, Sr., Co-Chair, Joint Audit Committee
Senator Nathaniel J. McFadden, 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 January 9, 2004 and ending December 10, 2006.

Our audit disclosed that the PSC did not calculate annual assessments billed to public utility companies to cover the operating expenses of the PSC and Office of the People's Counsel in accordance with the intent of State law. Specifically, annual assessments were not reduced by certain other collections and, as a result, approximately \$2.2 million in excess collections had accumulated in the Public Utility Regulation Fund as of June 30, 2006.

Our audit also disclosed that the PSC lacked adequate controls over its cash receipts, frequently did not deposit collections in a timely manner, and failed to transfer accounts receivable to the Department of Budget and Management - Central Collection Unit as required. In addition, the PSC awarded a legal services contract in the amount of \$453,000 without obtaining the required approval from the Board of Public Works.

Respectfully submitted,

Bruce A. Myers, CPA
Legislative Auditor

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Executive Summary

Legislative Audit Report on Public Service Commission (PSC) July 2007

- **The PSC did not calculate, in accordance with the intent of State law, annual assessments billed to public utility companies to cover the operating expenses of the PSC and of the Office of the People’s Counsel. As a result, the PSC estimated that, as of June 30, 2006, it had accumulated approximately \$2.2 million in excess collections in the Public Utility Regulation Fund.**

The PSC should calculate public utility company assessments in accordance with the law’s intent and should consult with legal counsel to determine the appropriate disposition of the excess collections.

- **The PSC awarded a sole source contract, totaling \$453,000, and paid a \$27,000 court-ordered judgment without obtaining required approvals from the Board of Public Works and other applicable control agencies.**

The PSC should comply with State Procurement Regulations when awarding contracts and written advisories issued by the Board of Public Works prior to paying judgments.

- **The PSC lacked adequate controls over cash receipts and related accounts receivable. In addition, cash receipts were not always deposited timely. During fiscal year 2006, the PSC collected cash receipts totaling approximately \$15 million.**

The PSC should take the recommended action to establish proper internal controls over its cash receipts and accounts receivable and should deposit its cash receipts in a timely manner, as required.

- **The PSC did not transfer delinquent accounts to the State Central Collection Unit (CCU) as required. For example, as of December 2006, the PSC had not transferred accounts totaling approximately \$255,000, which had been delinquent for periods from 1 to 10 years, to CCU.**

The PSC should transfer delinquent accounts to CCU as required by State regulations.

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 of 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 2006, the operating expenses of the PSC and OPC totaled \$11.5 million and \$2.6 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.

Current Status of Findings From Preceding Audit Report

We reviewed the current status of the six items from our preceding audit report dated July 29, 2004. We determined that the PSC satisfactorily addressed four of these items. The remaining two items are repeated in this report.

Findings and Recommendations

Public Utility Regulation Fund

Finding 1

Annual assessments billed to public utility companies to cover the operating costs of the PSC and the Office of People's Counsel (OPC) were not calculated in accordance with the intent of State law.

Analysis

Based on our review of annual assessments billed by the PSC to public utility companies to cover its operating costs and those of the OPC, the amounts calculated were not in accordance with the intent of State law. Specifically, the PSC did not reduce these annual assessments by certain fee revenues it collected, such as document filing fees of \$286,000 and \$364,000, respectively, for fiscal years 2006 and 2007. As a result, excess collections have accumulated in the Public Utility Regulation Fund (PURF). Although the PSC did not have a formal analysis prepared of the PURF to definitively indicate the composition of the fund balance, PSC management estimated that approximately \$2.2 million of the \$3.4 million that was in the PURF as of June 30, 2006 related to excess collections. We believe that it is the intent of State law to require that the annual assessments be adjusted for other fee revenues, and our legal counsel concurs with this interpretation.

The PURF was established as a special, non-lapsing fund to pay the operating costs of the PSC and the OPC, and includes all revenue received, including the collection of assessments, fees for filing documents, and other miscellaneous revenues collected by the PSC. State law provides that, when calculating the annual assessment amounts to be billed to regulated public utility companies doing business in Maryland, the PSC should adjust for certain other revenue sources.

Recommendation 1

We recommend that, in the future, the PSC calculate assessments in accordance with the intent of the law. We also recommend that the PSC consult with legal counsel to determine the appropriate disposition of the excess collections in the PURF.

Procurement and Legal Settlement

Finding 2

The PSC awarded a \$453,000 sole source contract and paid a lawsuit judgment of approximately \$27,000 without obtaining required approvals from the Board of Public Works.

Analysis

During fiscal year 2004, the PSC awarded a sole source contract for legal services, totaling \$453,000, without obtaining approval from the Board of Public Works (BPW) and without publishing the award, as required. Documentation related to the contract provided to us by the PSC indicated that these services were needed due to pending bankruptcy litigation in another state involving a company that was regulated by the PSC. In addition, during fiscal year 2005, the PSC paid a court-ordered judgment, totaling approximately \$27,000, to a former PSC employee without obtaining BPW approval. The PSC was required to pay this sum as back pay because the court ruled that the former employee had been wrongfully terminated by the PSC. Furthermore, the PSC did not submit the judgment to the Office of the Attorney General (OAG) or to the Department of Budget and Management (DBM) for their review, as required by a BPW advisory.

State Procurement Regulations require that service contracts awarded on a sole source basis for amounts greater than \$100,000 be approved by the BPW. The Regulations also require that such awards be published in the *eMaryland Marketplace*. In addition, a BPW advisory, issued on January 2, 2002 to all State agencies requires, in part, that judgments in excess of \$10,000 be reviewed by the Civil Division of the OAG, be submitted to DBM, and be approved by BPW prior to payment.

Recommendation 2

We recommend that the PSC comply with the State Procurement Regulations and written advisories issued by BPW. Specifically, we recommend that the PSC seek required reviews and obtain BPW approval, when applicable, prior to awarding sole source contracts and rendering payments for judgments. We also recommend that the PSC retroactively submit the aforementioned contract and judgment to the OAG, DBM, and BPW, for review and/or approval. Finally, we recommend that the PSC publish contract awards in the *eMaryland Marketplace* as required.

Cash Receipts and Accounts Receivable

Background

According to the State's accounting records, PSC fiscal year 2006 cash receipts, which were derived primarily from annual assessments to regulated companies, totaled approximately \$15 million; the related accounts receivable balance at June 30, 2006 totaled approximately \$920,000.

Finding 3

The PSC lacked adequate controls over cash receipts and related accounts receivable records.

Analysis

Internal controls over cash receipts and accounts receivable were not adequate:

- Duties were not properly segregated as the employee who initially received collections, as well as two other employees who had access to those collections, could also update the related accounts receivable records. As a result of these conditions, accounts receivable may not be adequately controlled.
- The procedures for verifying that all collections were deposited were inadequate. Specifically, the documents on which collections were initially recorded, as well as the related collections, were forwarded to the employee who prepared the deposits and then to a third employee for additional review. After the deposits were taken to the bank, this third employee was responsible for verifying collections to the validated deposit slips. Because the documents were not forwarded directly from the individual who prepared them to the employee responsible for verifying the deposits, there was a lack of assurance that all recorded collections were deposited. Similar conditions regarding incompatible duties were commented upon in our preceding audit report.
- An accounts receivable control account was not maintained. Specifically, PSC discontinued maintaining its control account in May 2006. A control account provides a continuing summary of transactions and a total dollar value control over amounts recorded in the detail accounts.

Recommendation 3

We recommend that employees who receive collections be denied access to the related accounts receivable records. We also recommend that the employee who prepares the initial recordation of collections forward those

documents (or copies) directly to the employee who performs the deposit verifications, and that these documents be used in the verification process. We also again recommend that the employee who performs verifications of deposits be denied access to cash. Finally, we recommend that the PSC maintain an 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.

Finding 4
Cash receipts were not deposited timely.

Analysis

The PSC did not deposit cash receipts in a timely manner. Our test of collections received during fiscal years 2005 through 2007, totaling approximately \$4.9 million, disclosed that receipts totaling \$3.1 million were deposited from two to nine business days after the dates of receipt.

The Comptroller of the Treasury's *Accounting Procedures Manual* requires that receipts be deposited no later than the first business day after receipt. Untimely deposits increase the possibility of loss or misappropriation and result in a loss of investment income to the State.

Recommendation 4

We recommend that the PSC deposit all cash receipts in a timely manner as required by the *Accounting Procedures Manual*.

Finding 5
The Commission did not transfer delinquent accounts to the Department of Budget and Management's Central Collection Unit (CCU) as required.

Analysis

The PSC did not transfer delinquent accounts to CCU for collection assistance as required. We noted the following conditions:

- As of December 2006, the PSC had not transferred \$255,000 in delinquent accounts that ranged from 1 to 10 years old to CCU.

- During August and November 2006, the PSC deleted certain accounts, totaling approximately \$358,000 applicable to fiscal year 2007, from its records without referring them to CCU for collection assistance or abatement.
- The PSC did not assess interest on unpaid accounts as provided in the law. Based on the accounts receivable balances in the PSC records, we estimated that interest charges totaling approximately \$29,000 could have been assessed on unpaid accounts during the three-year period ended June 30, 2006. Furthermore, assessing interest is a valuable tool which could help collect unpaid accounts.

State Regulations require that State agencies transfer delinquent accounts receivable to the CCU for collection assistance and obtain approval from CCU prior to writing off any unpaid accounts. In addition, the Public Utility Companies Article of the Annotated Code of Maryland generally requires the PSC to charge interest for billed amounts not paid within 30 days of the payment due date.

Recommendation 5

We recommend that the PSC transfer delinquent accounts to CCU for collection assistance as required. We also recommend that the PSC obtain written authorization from CCU prior to writing off as uncollectible any outstanding accounts. We further recommend that, in the future, the PSC assess interest on unpaid accounts in accordance with State law.

Equipment

Finding 6

The PSC did not complete a physical inventory of sensitive equipment and did not maintain an equipment control account, as required.

Analysis

The PSC did not comply with certain requirements contained in the Department of General Services *Inventory Control Manual*. According to its records, the PSC equipment inventory balance totaled approximately \$1.9 million as of June 30, 2006. Specifically, we noted the following conditions:

- The PSC did not perform a complete physical inventory of its sensitive equipment during our audit period.

- An equipment control account, which provides a continuing summary of all related transactions and a total dollar value control over amounts recorded in the detail records, was not maintained. According to its records, the PSC last maintained an equipment control account in May 2001.

Similar conditions were commented upon in our preceding audit report. The *Manual* requires that State agencies annually complete a physical inventory of sensitive equipment and that any missing items be investigated. The *Manual* also requires that an independent control account be maintained and that the account balance be periodically reconciled to the aggregate balance of the related detail records.

Recommendation 6

We again recommend that the PSC comply with the requirements of the *Inventory Control Manual*.

Corporate Purchasing Cards

Finding 7

Adequate controls were not established over corporate purchasing cards.

Analysis

The PSC lacked adequate controls over its corporate purchasing cards. Specifically, the employee designated as the Purchasing Card Program Administrator (PCPA), who approved and ordered new cards, also received the cards from the bank. In addition, this employee reconciled the monthly Program bank statements to the related charges recorded on the State's accounting records (FMIS) and this reconciliation was not independently reviewed and approved. As a result of these conditions, this employee could order a card and make unauthorized purchases that may not be readily detected by PSC management.

The Comptroller of the Treasury's *Corporate Purchasing Card Manual* requires that the duties of ordering and receiving new purchasing cards from the bank be separated. The *Manual* also requires that monthly reconciliations of Program bank statements to amounts recorded on FMIS be performed by the agency's fiscal officer (that is, an employee separate from the PCPA). During fiscal year 2006, the PSC made corporate card purchases totaling approximately \$164,000.

Recommendation 7

We recommend that the employee responsible for ordering purchasing cards from the bank not also receive the cards. We also recommend that the monthly reconciliations of the Program bank statements with the related State accounting records be reviewed and approved by the PSC fiscal officer. 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 January 9, 2004 and ending December 10, 2006. The audit was conducted in accordance with generally accepted government auditing standards.

As prescribed by the 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 control, and to evaluate its compliance with applicable State laws, rules, and regulations. We also determined the current status of the findings contained 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. 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.

Our audit scope was limited with respect to the PSC cash transactions because the Office of the State Treasurer was unable to reconcile the State's main bank accounts during the audit period. Due to this condition, we were unable to determine, with reasonable assurance, that all of the PSC cash transactions were accounted for and properly recorded on the related State accounting records as well as the banks' records.

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 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 findings regarding significant instances of noncompliance with applicable laws, rules or regulations.

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.

APPENDIX
STATE OF MARYLAND

MARTIN O'MALLEY
GOVERNOR

ANTHONY G. BROWN
LIEUTENANT GOVERNOR



PUBLIC SERVICE COMMISSION

COMMISSIONERS

STEVEN B. LARSEN
CHAIRMAN

HAROLD D. WILLIAMS
ALLEN M. FREIFELD
SUSANNE BROGAN
LAWRENCE BRENNER

July 16, 2007

HAND DELIVERY AND ELECTRONIC MAIL

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

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 January 9, 2004 and ending December 10, 2006.

An electronic version of this document has been sent to response@ola.state.md.us as requested in your June 21, 2007 letter. If you have any questions regarding this matter, please do not hesitate to contact Donald P. Eveleth (410-767-8057).

Sincerely,

A handwritten signature in black ink, appearing to read "S. Larsen", written over a horizontal line.

Steven B. Larsen
Chairman

Attachments



Findings and Recommendations

Public Utility Regulation Fund

Finding 1

Annual assessments billed to public utility companies to cover the operating costs of the PSC and the Office of People's Counsel (OPC) were not calculated in accordance with the intent of State law.

Recommendation 1

We recommend, in the future, the PSC calculate assessments in accordance with the intent of the law. We also recommend that the PSC consult with legal counsel to determine the appropriate disposition of the excess collections in the PURF.

Public Service Commission Response

The Commission intends to comply fully with the letter and spirit of the law. The Commission will consult with counsel to analyze the issues and determine the appropriate disposition of any excess collections in the Public Utility Regulation Fund.

Procurement and Legal Settlement

Finding 2

The PSC awarded a \$453,000 sole source contract and paid a law suit judgment of approximately \$27,000 without obtaining required approvals from the Board of Public works.

Recommendation 2

(a) We recommend that the PSC comply with State Procurement Regulations and written advisories issued by BPW. Specifically we recommend that the PSC seek required reviews and obtain BPW approval, when applicable, prior to awarding sole source contracts and rendering payments for judgments. (b) We also recommend that the PSC retroactively submit the aforementioned contract and judgment to the OAG, DBM, and BPW for review and /or approval. (c) Finally, we recommend that the PSC publish contract awards in the eMaryland Marketplace as required.

Public Service Commission Response 2

(a) The Commission is currently discussing sole source procurements under COMAR 21.05.05.02E, such as the \$453,000 contract mentioned in the finding, with the Department of Budget and Management Secretary, the Board of Public Works, and their respective counsel. With regard to the payment of a judgment the Commission will comply and submit all future judgments to DBM and the BPW as appropriate.

(b) See (a) above. This situation highlights what appears to be some historical and legislative confusion regarding the role of the Attorney General in the Commission's procurement process

and the extent to which the source of the funding for a contract or settlement may influence the Commission's obligation to seek approval from other agencies before proceeding. The Commission is reviewing these matters to ensure compliance with applicable laws and regulations going forward. In light of the age of the specific contract and settlement at issue, however, the Commission respectfully believes that it is neither necessary nor appropriate to require it to submit them retroactively to the Board of Public Works, Department of Management and Budget and Office of the Attorney General

(c) The Commission will publish contract awards in eMaryland Market Place as required.

Cash Receipts and Accounts Receivable

Finding 3

The PSC lacked adequate controls over cash receipts and related accounts receivable records.

Recommendation 3

We recommend that employees who receive collections be denied access to related accounts receivable records. We also recommend that the employee who prepares the initial recordation of collections forward those documents (or copies) directly to the employee who performs the deposit verifications, and that these documents be used in the verification process. We also again recommend the employee who performs the verifications of deposits be denied access to cash. Finally, we recommend that the PSC maintain an 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 3

The Commission has already made most of the recommended change and will comply with all of the above recommendations by the end of July 2007.

Finding 4

Cash receipts were not deposited timely.

Recommendation 4

We recommend that the PSC deposit all cash receipts in a timely manner as required by the *Accounting Procedures Manual*.

Public Service Commission Response 4

The Commission is in compliance with this recommendation as of May 2007. Cash receipts are deposited daily.

Finding 5

The Commission did not transfer delinquent accounts to the Department of Budget and Management's Central Collection Unit (CCU) as required.

Recommendation 5

We recommend that the PSC transfer delinquent accounts to the CCU for collection assistance as required. We also recommend that the PSC obtain written authorization from CCU prior to writing of as uncollectible any outstanding accounts. We further recommend that, in the future, the PSC assess interest on unpaid accounts in accordance with State law.

Public Service Commission Response 5

The Commission will comply. The Commission has transmitted some uncollectible accounts to CCU and is awaiting their approval of the transmittal process to fully implement this requirement. Going forward interest will be charged as appropriate on unpaid accounts.

Equipment

Finding 6

The PSC did not complete a physical inventory of sensitive equipment and did not maintain an equipment control account, as required.

Recommendation 6

We again recommend that the PSC comply with the requirements of the *Inventory Control Manual*.

Public Service Commission Response 6

The Commission will comply with the requirements of the Inventory Control Manual. All property, including sensitive equipment has been inventoried. An inventory control account has been implemented and will be maintained.

Corporate Purchasing Cards

Finding 7

Adequate controls were not established over corporate purchasing cards.

Recommendation 7

We recommend that the employee responsible for ordering purchasing cards from the bank not also receive the cards. We also recommend that the monthly reconciliations of the Program bank statements with the related State accounting records be reviewed and approved by the PSC fiscal officer. We advised the PSC on accomplishing the necessary separations of duties using existing personnel.

Public Service Commission Response

The Commission has taken steps to have credit cards delivered to its fiscal officer and will implement a process of review and approval of monthly reconciliations of the Program.

AUDIT TEAM

Peter J. Klemans, CPA
Audit Manager

Amando J. Virata, CPA
Senior Auditor

Jason A. Harris
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