



Transmitted via e-mail

January 10, 2013

Mr. Paul Clanon, Executive Director
California Public Utilities Commission
505 Van Ness Avenue
San Francisco, CA 94102

Dear Mr. Clanon:

Final Report—California Public Utilities Commission Performance Audit

The Department of Finance, Office of State Audits and Evaluations, has completed its performance audit of the California Public Utilities Commission's (CPUC) budget process for the fiscal year 2012-13 and 2013-14 budget cycles.

The enclosed report is for your information and use. CPUC's response and our evaluation of the response are incorporated into this final report. This report will be placed on our website.

A detailed Corrective Action Plan (CAP) addressing the observations and recommendations is due within 90 days from receipt of this letter. The CAP should include milestones and target dates to implement all recommendations.

We appreciate the assistance and cooperation of CPUC. If you have any questions regarding this report, please contact Cheryl McCormick, Manager, or James Kong, Supervisor, at (916) 322-2985.

Sincerely,

Original signed by:

David Botelho, CPA
Chief, Office of State Audits and Evaluations

Enclosure

cc: Mr. Michael R. Peevey, President, California Public Utilities Commission
Mr. Edwin Quan, Deputy Executive Director for Administration and Operations, California Public Utilities Commission
Ms. Michelle Cooke, Director, Administrative Services Division, California Public Utilities Commission
Mr. Joseph Como, Acting Director, Division of Ratepayer Advocates

Audit Report

California Public Utilities Commission Budget Process Performance Audit



Source: California Public Utilities Commission

Prepared By:
Office of State Audits and Evaluations
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Final reports are available on our website at <http://www.dof.ca.gov>

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TABLE OF CONTENTS

Executive Summary iv

Background, Scope and Methodology..... 1

Results..... 5

Appendix A 16

Appendix B 18

Appendix C 20

Response..... 31

Evaluation of Response 39

EXECUTIVE SUMMARY

In accordance with the Department of Finance's (Finance) fiscal responsibilities, Finance audited the California Public Utilities Commission's (CPUC) budgeting practices and procedures.

The audit objectives were to:

- Evaluate whether CPUC's budget process for developing the fiscal year 2012-13 and 2013-14 Governor's Budgets results in reliable and accurate information to Finance, the Governor, the Legislature, and other stakeholders.
- Evaluate the adequacy of CPUC's fund condition statement reconciliation process of the seven funds with variances (between State Controller's Office and Finance records) greater than \$1 million, to ensure accurate fund balances as of June 30, 2011.
- Provide recommendations to assist CPUC in strengthening its budgeting practices and procedures.

Results Summary

We identified significant weaknesses within CPUC's budget operations which compromise its ability to prepare and present reliable and accurate budget information. Weaknesses include:

- Ineffective management over budgeting functions
- Budget forecasting methodologies need improvement
- Budget monitoring needs improvement
- Fiscal management practices need improvement
- Appropriation adjustments may not be equitably allocated among funds
- Non-compliance with statutory requirements specific to the Division of Ratepayer Advocates

Further, CPUC's fund condition statement reconciliation process for the seven funds with \$1 million or greater variances as of June 30, 2011, lacked sufficient instructions from CPUC management, resulting in inconsistent and inadequately prepared reconciliations for five of the seven funds. However, most reasons for the variances were identified.

CPUC must implement and strengthen the fiscal controls over its budgeting practices and procedures in order to produce reliable and accurate budgetary information for the Governor, the Legislature, Finance, and other stakeholders. To improve operations, CPUC must develop a corrective action plan within 90 days to address the observations and recommendations noted in this report.

BACKGROUND, SCOPE AND METHODOLOGY

BACKGROUND

The California Public Utilities Commission (CPUC), headquartered in San Francisco, regulates privately owned electric, natural gas, telecommunications, water, railroad, rail transit, and passenger transportation companies. CPUC was established in 1911 by Constitutional Amendment as the Railroad Commission. The Public Utilities Act of 1912 expanded CPUC's regulatory authority to include natural gas, electric, telephone, and water companies as well as railroad and marine transportation companies. CPUC serves the public interest by protecting consumers and ensuring the provision of safe, reliable utility service and infrastructure at reasonable rates, with a commitment to environmental enhancement. CPUC is organized into 11 divisions and administers 14 special funds¹. CPUC is overseen by five commissioners, who serve staggered six-year terms to ensure experience on the board. The Governor appoints one of the five to serve as commission president.

Included in the 11 divisions is the Division of Ratepayer Advocates (DRA). DRA was established to represent and advocate on behalf of the interests of public utility customers and subscribers within the jurisdiction of CPUC. DRA's goal is to obtain the lowest possible rate for service consistent with reliable and safe service levels, and advocate for customer and environmental protections. The Ratepayer Advocate Account (Fund 3089) is to be used exclusively by DRA in the performance of its duties. Monies from the Public Utilities Commission Utilities Reimbursement Account (Fund 0462) are transferred to Fund 3089 in the annual Budget Act. The DRA director is appointed by the Governor.

In July 2012, when special fund reporting discrepancies were discovered at the Department of Parks and Recreation, Governor Brown immediately directed the Department of Finance (Finance) to undertake a fund-by-fund review of more than 500 special funds. Finance's review focused on two principal areas:

- The extent to which there were differences in special fund balances as of June 30, 2011, reported by departments to Finance and to the State Controller's Office (SCO).
- The reason or reasons for any variance in the two reported year-end balances.

¹ See Appendix A for CPUC's organization chart and list of special funds.

The results of that review² identified variances greater than \$1 million for 7 of the 14 funds CPUC administers. The following table summarizes these variances.

Fund Balance as of June 30, 2011				
(\$ in thousands)				
Fund Number	Fund Name	Governor's Budget Ending Fund Balance	SCO's Fund Balance³	Variance
0462	Public Utilities Commission Reimbursement Account	\$ 4,008	\$ 20,689	\$ (16,681)
0470	California High-Cost Fund-B Administrative Committee Fund	103,480	13,480	90,000
0471	Universal Lifeline Telephone Service Trust Administrative Committee Fund	305,737	147,169	158,568
0483	Deaf and Disabled Telecommunications Program Administrative Committee Fund	46,132	5,759	40,373
0493	California Teleconnect Fund Administrative Committee Fund	44,482	(29,826)	74,308
3015	Gas Consumption Surcharge Fund	31,056	29,966	1,090
3141	California Advanced Services Fund	115,336	40,336	75,000

In August 2012, CPUC began reconciling the funds to provide explanations for those variances. While a portion of the variances were attributable to methodology, timing, and human error, a significant portion were unexplainable. This raised concerns in Finance resulting in an audit of CPUC's budgeting practices and procedures.

SCOPE

In accordance with Finance's fiscal responsibilities, the Office of State Audits and Evaluations (OSAE) audited CPUC's budgeting practices and procedures.

To develop our audit objectives, we performed a risk assessment that included interviewing key staff to gain a general understanding of CPUC operations and budgeting processes, and reviewing documentation such as historical Governor's Budgets, CPUC financial reports, and other budget-related documents. We identified the following high-risk areas related to CPUC's budgeting process:

- Budget process management practices
- Budget forecasting methodologies
- Budget monitoring practices
- Fiscal management practices
- Fund balance reconciliation methodologies and support

² Special Fund Balance Reconciliation – August 3rd results are located on Finance's website at www.dof.ca.gov.

³ To obtain an accurate comparison, the fund balances reported by SCO were adjusted to eliminate encumbrances and deferred payroll.

Because CPUC consists of 11 divisions that administer 14 funds, we further defined our scope to select a representative sample of CPUC funds to apply detailed procedures. We selected the following ten funds based on the variances identified by Finance's Special Fund Balance Reconciliation Report, interviews with CPUC staff, and type of program:

CPUC Funds Selected		
	Fund Number	Fund Name
1	0462	Public Utilities Commission Utilities Reimbursement Account
2	0464	California High-Cost Fund-A Administrative Committee Fund
3	0470	California High-Cost Fund-B Administrative Committee Fund
4	0471	Universal Lifeline Telephone Service Trust Administrative Committee Fund
5	0483	Deaf and Disabled Telecommunications Program Administrative Committee Fund
6	0493	California Teleconnect Fund Administrative Committee Fund
7	3015	Gas Consumption Surcharge Fund
8	3089	Public Utilities Commission Ratepayer Advocate Account
9	3141	California Advanced Services Fund
10	0995 ⁴	Reimbursements

Other funds maintained by CPUC were not included in our review. Our audit objectives were as follows:

- Evaluate whether CPUC's budget process for developing the fiscal year 2012-13 and 2013-14 Governor's Budgets results in reliable and accurate information to Finance, the Governor, the Legislature, and other stakeholders.
- Evaluate the adequacy of CPUC's fund condition statement reconciliation process of the seven funds with variances (between SCO and Finance records) greater than \$1 million, to ensure accurate fund balances as of June 30, 2011.
- Provide recommendations to assist CPUC in strengthening its budgeting practices and procedures.

Our audit was limited to the practices and procedures related to the Governor's Budget Fund Condition Statements. Our audit did not include a review of the Governor's Budget positions or program descriptions.

Additionally, we did not perform procedures to validate the information reported in CPUC's financial records. Review of financial information was limited to CPUC's encumbrances, accruals, recording of specific transactions such as Surplus Money Investment Fund or loan transfers, the accounting classification of shared or non-shared funds, and information supporting budget documents.

CPUC management is responsible for ensuring accurate financial reporting and compliance with applicable laws, regulations, and administrative requirements.

⁴ Fund 0995 was created by Finance for budgetary purposes only and is not a fund in the State Treasury System; however, we include it as a fund administered by CPUC.

METHODOLOGY

To address the audit objectives, we performed the following general procedures. Appendix B lists specific procedures as they relate to each audit objective.

- Interviewed key personnel to gain an understanding of CPUC programs, budget development, monitoring, and external reporting processes, and their respective responsibilities and duties.
- Reviewed applicable legal provisions, regulations, management policies, procedures, and program guidelines significant to the audit objectives.
- Reviewed relevant websites to gain an understanding of CPUC operations.
- Reviewed audit reports and other publications significant to the audit objectives.

Except as discussed in the following paragraph, we conducted this performance audit 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.

In connection with our audit, there are certain disclosures required by generally accepted government auditing standards. Finance is not independent of CPUC, as both are part of the State of California's Executive Branch. As required by various statutes within the California Government Code, Finance performs certain management and accounting functions. These activities impair independence. However, sufficient safeguards exist for readers of this report to rely on the information contained herein.

Significant weaknesses exist within CPUC's budget operations which compromise its ability to prepare and present reliable and accurate budget information. Further, CPUC's fund condition statement reconciliation process for the seven funds with \$1 million or greater variances as of June 30, 2011, lacked sufficient instructions from CPUC management resulting in inconsistent and inadequately prepared reconciliations for five of the seven funds.

CPUC's Administrative Services Division director acknowledges weaknesses exist in its budget operations and displayed a general willingness to improve operations. Additionally, we observed the CPUC Budget Office has begun reviewing and questioning operating practices and is working to improve communication and transparency between program and budget staff.

To further improve its operations, we provide the following observations and recommendations. The results of our audit are based on our review of documentation, other information made available to us, and interviews with key staff.

Observation 1: Ineffective Management Practices over Budgeting Functions

The State Administrative Manual (SAM) section 20050 requires state entity heads, by reason of their appointments, to be accountable for activities carried out in their agencies. This responsibility includes establishment and maintenance of internal accounting and administrative controls. We observed inadequate internal controls over CPUC's budget process hindering its ability to operate effectively and efficiently, and produce reliable and accurate budget information to its stakeholders. Since fiscal year 2001-02, CPUC's administration of special funds has grown from 4 to 14. However, management did not adequately respond to the related administrative challenges of the increased budgetary complexity and workload. This has contributed to a break down in fiscal controls and fund administration as follows:

Ineffective Organizational Structure and Assignment of Budgeting Responsibilities

CPUC's organizational structure does not facilitate centralized, cohesive budgeting practices. CPUC's Budget Office is insufficiently staffed as it consists of one employee responsible for managing the budget responsibilities for 14 funds. Insufficient staffing levels have resulted in budget office tasks being assigned to part-time retired annuitants, members of executive management and program staff. The Budget Office provides limited to no guidance or oversight for these tasks. We observed general confusion and lack of knowledge by the Budget Office, program staff and management regarding the responsible parties for certain budget tasks. For example, budget control officer (BCO) positions have been established in the program divisions; however, the position responsibilities are not defined in staff duty statements nor is it apparent what the duties of the position entail.

Unclear lines of authority among executive management performing budgeting duties also exist. Specifically, the Deputy Executive Director for Administration and Operations (Deputy Executive Director), who reports to the CPUC Executive Director, performs and makes executive management decisions regarding the budget; however, he does not have oversight of the Budget Office. Oversight of the Budget Office lies with the Administrative Division Director, who reports to the CPUC Executive Director. While the Administrative Division Director stated she works collaboratively with the Deputy Executive Director regarding budget matters, it was unclear who has ultimate responsibility or authority over CPUC's budget operations.

Further, with little to no guidance and oversight provided by the Budget Office, combined with deficiencies in CPUC's written policies and procedures (described below), this organizational structure promotes key person dependencies. For example, the Deputy Executive Director is heavily involved in the preparation and approval of Budget Change Proposals¹ (BCP). If the Deputy Executive Director should leave unexpectedly, it could be difficult to continue the processes for which he is responsible.

The current organizational structure and assignment of budgeting responsibilities hinders the Budget Office's ability to ensure the information presented in the Governor's Budget is reflective of CPUC's short and long range goals, useful for decision makers, and in conformance with Finance's budgetary requirements. Further, it prohibits the Budget Office from timely responding to budget related requests from CPUC's executive management and Finance.

Ineffective Communication and Coordination

Procedures do not exist to ensure coordination of the budget process or the communication of policies and guidelines to guide the budget preparation. Processes have also not been established to facilitate information sharing between those responsible for budget development, monitoring and reporting. For example, program staff responsible for budget preparation and monitoring were not informed of the process or the purpose for completing and submitting Supplementary Schedules of Appropriations (Schedule 10s) and Supplementary Schedules of Revenues and Transfers (Schedule 10Rs) to the Budget Office. We also identified an instance where a Fiscal Office request for year-end accrual information did not reach the intended parties for two funds. Other instances include the Fiscal Office not being notified of errors in the accounting records for federal reimbursements, and information communicated to Finance without the Budget Office's knowledge. Without proper coordination and communication, duplication of efforts may exist and information gathered and presented may not be complete, representative of current practices/decisions, or in compliance with Finance budget requirements.

Insufficient Staff Training

CPUC does not provide comprehensive training to staff responsible for developing, monitoring, and reporting budget information. This includes a basic understanding of budget processes and procedures as well as specific budgetary tasks for which staff are responsible. We identified an overall lack of understanding by non-Budget Office staff of how tasks performed contribute to the information reported in the Governor's Budget. Similarly, the Budget Office lacks knowledge of the processes and methodologies used by program staff to develop and monitor their respective funds' budgets. As a result, staff with budgeting responsibilities may not fully understand the implications of their budgeting decisions.

¹ A BCP is a proposal submitted to Finance to change the level of service or funding sources for activities authorized by the Legislature, or to propose new program activities not currently authorized.

Additionally, we observed that although staff responsible for monitoring fund budgets are provided with monthly CALSTARS reports (i.e. accounting records) detailing fund transactions, most staff have not been trained in how to interpret the information and therefore do not use the reports. As a result, program staff rely on program expenditure databases that are not periodically reconciled with fiscal accounting records for budget development.

Further, program staff are not trained regarding the reporting of encumbrance and accrual information to the Fiscal Office, which increases the risk that incorrect and inaccurate information may be communicated to and relied on during budget preparation by decision makers.

Moreover, no policy or process is in place requiring cross-training of key budget responsibilities, further fostering key person dependencies.

Outdated Duty Statements

We observed duty statements for staff performing budgeting tasks were outdated and not reflective of their current duties. Some staff reported not knowing a duty statement for their position existed. Duty statements serve as a mechanism for management to outline responsibilities and communicate expectations as well as assist staff in understanding their roles and responsibilities.

Limited Written Policies and Procedures

CPUC does not maintain adequate policies and procedures governing the preparation and monitoring of its budget or Fiscal Office operations. Policies and procedures are not always documented, regularly reviewed and updated, approved by management, or representative of current practices. Sufficiently written policies and procedures allow staff to clearly understand their roles and responsibilities, ensure consistency and compliance, provide a training and succession tool, and allow management to guide operations without constant intervention.

Recommendations:

Strong management practices relating to the administrative functions of an organization are an essential component for success. CPUC management should strengthen its fiscal controls over its budget process and fund administration as follows:

- A. Increase staffing in the Budget Office to enable more of the budget functions to be under the direct oversight of the Budget Office and Administrative Services Division Director. Key functions of the budget process and associated tasks should be identified and workload studies performed to determine the necessary staffing levels. Tasks should be assigned to those with a level of education and experience that is commensurate with their assigned duties.
- B. Establish and clearly define the roles, responsibilities, and authority of those performing budgeting tasks within and between program divisions, Fiscal Office, Budget Office and executive management.
- C. Develop processes to ensure the Budget Office is knowledgeable and apprised of key decisions and methodologies which impact fund budgets. The Budget Office should be the sole unit within CPUC responsible for all budget functions and equipped to respond to CPUC management and Finance regarding matters involving its budget.

- D. Develop processes and procedures to facilitate effective horizontal and vertical communication and coordination among those responsible for budget development, monitoring, and reporting. Processes should be detailed so that staff are apprised of the appropriate contact persons and their associated responsibilities. This information should be communicated and readily accessible to staff to avoid duplication of efforts and confusion.
- E. Develop a comprehensive training program for staff with budgeting responsibilities. The training program should focus on the internal and external budget process and tasks and the importance of staff's role in the process. Training should include, but not be limited to, guidance on compiling and reviewing budget related information such as Schedule 10s and 10Rs, CALSTARS reports and accrual and encumbrance processes.
- F. Implement policy to provide cross-training of essential budget functions to alleviate the development of key person dependencies.
- G. Update duty statements so that roles and responsibilities are representative of the tasks performed and management expectations are clearly defined. Further the roles and responsibilities of budget control officers should be clarified. Duty statements should be periodically reviewed and revised to remain current. Further, should staff change positions and/or promote, a new duty statement should be developed specific to that staff's new role. Additionally, CPUC should develop a process whereby the contents of duty statements are communicated to staff both verbally and in writing and evidence of this communication documented.
- H. Document and regularly update key budget and fiscal policies and procedures. Policies and procedures should be regularly reviewed and revised, approved by executive management, and communicated and readily accessible to staff. Specific components of CPUC's budgeting process policies and procedures should include at a minimum:
 - Overall CPUC budget policy describing the budgeting goals, direction, and priorities of the organization.
 - Overall budget process identifying tasks, responsible parties and timelines.
 - Methodologies for developing fund budget forecasts.
 - Fund balance reserve policy consistent with state laws and regulations.
 - Processes for resolving negative or excessive fund balances.
 - Development and processing of BCPs.

Observation 2: Forecasting Methodologies Need Improvement

Finance Budget Letter 12-15 and SAM section 6315 provide that departments should control costs and increase efficiency to ensure the state's fiscal stability; and its budgets should be reflective of the anticipated costs for carrying out its current levels of service.

We observed that over the past seven budget cycles (fiscal years 2005-06 through 2011-12), CPUC's forecasting models have produced results that significantly differ from the actual revenues, reimbursements, and expenditures as published in the Governor's Budget. Identified variances were as much as 73 percent and \$189 million in revenues, and as much as 99 percent and \$212 million in expenditures. See Appendix C for charts displaying these comparisons. While program staff were able to explain some variances, most were found to be unexplainable.

Because of deficiencies in its forecasting models, CPUC is not always able to reliably project the revenues, reimbursements, or expenditures for the funds it administers. Many of the funds reviewed included one or more of the following deficiencies in its forecasting models:

- Forecasting for all potential programmatic scenarios, without regard to the viability of the assumption. For example, CPUC forecasted \$40 million for reimbursement expenses pertaining to energy efficiency contracts beginning in fiscal year 2010-11; however, the contracts have yet to be executed. Additionally, a fund forecasted approximately \$33 million in fiscal year 2012-13 and \$64.8 million in fiscal year 2013-14 for wireless services expenditures that lacked a specific timeframe for implementation. Also, we observed an instance where a fund's forecast for marketing/outreach expenses was increased by \$4 million; however, the amount was not supported by sufficient documentation or analysis to justify the increase.
- Not performing year-to-year trend analyses. We found that CPUC reviewed information on a monthly basis and/or analyzed information over several months which pertained to short term averages rather than long term trends. As a result, CPUC is not able to assess whether forecasts are consistent with long term trends and, if not, whether reassessment of their forecasts is warranted.
- Not considering overall fund condition including budgeted revenues/expenditures, cash reserves, or fund balances. We identified that although components of fund condition were analyzed, overall fund condition was not considered for eight of the ten funds reviewed. Not analyzing a fund's overall fund condition impacts CPUC's ability to prevent fund balance deficits or excessive reserves.
- Not performing reviews of previously budgeted amounts to actual revenues or expenditures and investigating significant variances.

We also observed supervisory reviews were not always performed. This practice increases the risk of errors. For example, we found an \$81 million typographical error in one fund's forecast that had been communicated to Finance via a Schedule 10R for the current budget year. Upon notification, CPUC corrected the error.

Further, forecasts were not prepared for Funds 0462 and 3089, and Fund 0995's reimbursement expenditures.

Forecasting deficiencies have impacted CPUC's budgeting process by causing projected or actual negative fund balances, or conversely, excessive fund balance reserves. The Governor, Legislature, Finance and CPUC's management and commissioners rely on the information generated to make budgeting decisions. Inaccurate forecasts diminish the confidence in CPUC's budgeting information, and prevent stakeholders from knowing the actual performance of CPUC's funds and programs.

Recommendations:

Effective forecasting methodologies can assist CPUC in producing information that is reflective of its current levels of service. To improve its forecasting process, CPUC should:

- A. Develop and document key policies and procedures for forecasting all funds' revenue and expenditure activity. Policies and procedures developed should be consistent with the Governor's policy direction described in Finance's annual Budget Letters, periodically reviewed and revised, and approved by executive management. Policies and procedures should be communicated and readily accessible to staff.
- B. Ensure forecasting models include:
 - Assessing the viability of assumptions. Only probable and supported assumptions should be included in the forecast. If an unexpected situation arises, the fund's budget can be revised through the BCP process.
 - Performing year-to-year trend analyses of budgeted and actual revenues and expenditures. Trend analyses provide information over the long-term and help supplement the estimating process by evaluating the significance of increases/decreases, including whether they are expected to be temporary or longer-term in duration.
 - Considering the impact of forecasts on overall fund condition, including cash reserves, fund balances, and surcharge rates, to maintain fund solvency and prudent reserves.
 - Comparing previously budgeted revenues and expenditures to actual amounts and investigating variances. Reasons for variances should be considered when assessing the reasonableness of budget year forecasts.
 - Maintaining adequate supporting documentation and rationale for budget forecasts, in accordance with CPUC's record retention policy and SAM.
- C. Consider using the expenditure forecasting model implemented by Fund 0493 as an underlying basis for development.
- D. Develop procedures to ensure supervisory and management review of forecast projections.

Observation 3: Budget Monitoring Practices Need Improvement

Finance Budget Letter 12-15 and SAM section 6315 provide that departments should control costs and increase efficiency to ensure the state's fiscal stability; and its budgets should be reflective of the anticipated costs for carrying out its current levels of service. The Governor's Budget Fund Condition Statements include a Current Year column where departments have the opportunity to adjust budgeted revenues or expenditures based on updated estimates of activity. CPUC does not have adequate monitoring policies and procedures or controls in place to appropriately update the Current Year columns of the Governor's Budget Fund Condition Statements.

CPUC monitors its funds to ensure the availability of cash to meet current obligations and that operations do not exceed the appropriation authority, but its efforts do not include adjusting the Current Year expenditure amounts of the Fund Condition Statements to more accurately reflect anticipated current levels of service. Prior to the 2012-13 Governor's Budget, CPUC's practice

had been to only adjust Current Year amounts if a negative fund balance was projected in the Budget Year column.

For the 2012-13 Governor's Budget, we observed most funds did not have updates to their Current Year expenditures, and Funds 0462 and 3089 did not have updates to their Current Year revenues and reimbursements. Further, most monitoring practices did not include:

- Analysis of budget to actual revenues, expenditures, or reimbursements to identify significant deviations and evaluate whether adjustments to the Current Year column of the budget are warranted.
- Consideration of fund balances in conjunction with revenues and associated surcharge rates.

Deficiencies in CPUC's monitoring practices could result in budget information that is misleading and unreliable. Further, if revenues or expenditure levels are not appropriately adjusted, negative and/or excessive fund balances may be falsely projected.

Recommendations:

Effective monitoring practices can help CPUC ensure Current Year revenues and expenditures are updated to reflect anticipated levels of service. Accurate Current Year information in the Governor's Budget provides stakeholders a realistic picture of CPUC's expected revenue and expenditure activity.

To strengthen its monitoring process, CPUC should:

- A. Develop and document policies and procedures for monitoring all funds' revenue and expenditure activity. Policies and procedures developed should be consistent with the Governor's policy direction described in Finance's annual Budget Letters, periodically reviewed and revised, and approved by executive management. Policies and procedures should be communicated and readily accessible to staff.
- B. Ensure monitoring methodologies include:
 - Comparing budget to actual revenues or expenditures and analyzing if budgeted amounts are likely to materialize.
 - Monitoring fund balances and surcharge rates to maintain fund solvency and prudent reserves.
 - Adjusting the Current Year column of the Governor's Budget according to the results of monitoring processes.

Observation 4: Fiscal Management Practices Need Improvement

SAM section 20050 and Government Code section 13403 provide that internal accounting and administrative controls include a system of authorization and record keeping procedures adequate to provide effective accounting control over assets, liabilities, revenues and expenditures. Further, the Financial Integrity and State Manager's Accountability Act, Government Code section 13405 et seq., requires state agencies to maintain effective systems of internal control as an integral part of its management practices to ensure the reliability of financial information. This responsibility includes documenting the system through flowcharts, narratives and desk procedures as specified in SAM section 20050.

In addition to the policies and procedures weaknesses described in Observation 1, we observed inadequate internal controls over several of CPUC's fiscal management practices. These weaknesses hinder CPUC's ability to operate effectively and efficiently, and produce reliable and accurate financial information. We identified weaknesses in the following areas:

Incorrect Fund Classification and Recording of Transactions

Incorrect fund classifications and lack of recording transactions caused CPUC's accounting records to misrepresent the true financial condition of the funds and did not support the amounts reported in the Governor's Budget. We identified the misclassification of Funds 0462 and 0493 as shared funds. We also identified accounting records for Funds 0462, 0483, 0493, and 3015 did not include Deposits in Surplus Money Investment Fund (SMIF) transactions or the short term portion of General Fund loans receivable in its Due From Other Funds' account. As a result, the funds' accounting records were materially misstated. For example, as of June 30, 2011, unrecorded SMIF transactions ranged from approximately \$40,000 to \$275 million.

Outdated Cost Allocation Plan

CPUC's cost allocation plan is outdated and does not include the methodologies or rationale supporting the plan components. CPUC's last documented cost allocation plan is from fiscal year 1998-99, when it administered four funds. CPUC currently administers 14 funds. Staff were uncertain if the plan had been revised or if CALSTARS cost allocation tables were representative of this plan. As a result, CPUC could not explain how indirect costs are being allocated or if those costs are being equitably allocated to the funds.

Deficient Encumbrance Practices

We identified the following deficiencies in CPUC's encumbrance practices:

- Policies and procedures regarding the liquidation of multiple year contract encumbrances are inconsistently followed. CPUC's written policy is to apply expenditures to the earliest available encumbrance. However, in practice, the earliest available encumbrance was not always liquidated. As a result, program staff are not always aware of the encumbrance year to which expenditures are applied, which can hinder their ability to effectively monitor and forecast.
- Encumbrance balances are not always updated or adjusted to reflect anticipated expenditures. As a result, a fund's obligations may be overstated resulting in a misrepresentation of the fund's true financial condition.
- Encumbrances for Fund 3141 grant awards were not established in the accounting records which understated the expenditure obligations of the fund.

Recommendations:

Reliable and accurate accounting data is imperative for budget development, monitoring and reporting. CPUC should strengthen its fiscal management practices to ensure the accuracy and reliability of its accounting data as follows:

- A. Work with Finance to ensure proper classification of its shared and non-shared funds.
- B. Develop procedures to record Deposits in SMIF and short term loan receivable transactions in its accounting records that are in accordance with CALSTARS and SAM policy.

- C. Develop a written cost allocation plan that is in conformity with SAM section 9203 guidance. Specifically, the cost allocation plan should include detailed information regarding the costs being allocated, the allocation methodology, the frequency of the allocation, and the rationale for the allocation base. The plan should be supported by appropriately cross-referenced working papers or system documentation, updated periodically, and retained for reference.
- D. Document encumbrance policies and procedures and ensure those procedures:
- Are consistently applied by CPUC staff.
 - Include a periodic evaluation of encumbrances to ensure balances are appropriately adjusted to reflect expected expenditures.
 - Are communicated to CPUC staff responsible for managing encumbrances.
 - Recognize Fund 3141 grant award resolutions as a valid encumbering document. Per SAM 8340, the resolution can be considered an “other document” by which an appropriation can be encumbered.
 - Are consistent with SAM requirements.

Observation 5: Appropriation Adjustments May Not be Equitably Allocated Among Funds

SAM section 20050 and Government Code section 13403 provides that internal accounting and administrative controls include a system of authorization and record keeping procedures adequate to provide effective accounting control over assets, liabilities, revenues and expenditures. As such, CPUC’s management is responsible for the equitable distribution of appropriation adjustments mandated by Finance through Budget Letters or Budget Act Control Sections. We observed fiscal year 2012-13 and 2013-14 appropriation adjustments were applied to only 7 of the 14 CPUC administered funds. The Budget Office does not have a documented methodology or rationale for these allocations. As a result, funds may be allocated a disproportionate share of these adjustments, while other funds are not affected by the adjustments.

Recommendation:

- A. CPUC should develop, document, and implement a methodology that equitably distributes appropriation adjustments among CPUC’s funds.

Observation 6: Non-Compliance with Statutory Requirements

Public Utilities Code Section 309.5 (c) specifies that the director of the Division of Ratepayer Advocates (DRA) shall develop the DRA budget which shall be subject to final approval by the commission. We observed that DRA does not prepare the budget for Fund 3089 nor is its budget reviewed or approved by the commission as required. Instead, with minimal input from DRA, the CPUC Budget Office prepares and communicates the budget to DRA and Finance. However, the process has lacked transparency and CPUC has not been able to explain or support to DRA’s satisfaction how the various budgeted cost categories were determined. As a result, DRA is not able to adequately explain or defend its own budget.

Recommendations:

- A. DRA should assume responsibility for the development of the Fund 3089 budget consistent with state laws, regulations, and Finance budget policies and direction.

- B. DRA's budget development process should be documented, identify all the responsible parties and their duties, and budgeting methodologies should be logical and supported.
- C. DRA and CPUC should develop processes and procedures to facilitate the coordination and transparency of information shared during the budget process since both parties are dependent on one another to complete their respective budget tasks. Information shared should be appropriately supported and understandable by both parties.
- D. DRA's budget should be submitted to the commission for approval.

Observation 7: Inadequate Fund Balance Reconciliations

As a result of Finance's identification of variances between the June 30, 2011 fund balances reported in the Governor's Budget and SCO's records, CPUC initiated reconciliations to identify reasons and/or explanations for the identified variances. Specifically, CPUC reconciled its accounting records with the SCO records and its accounting records with the Governor's Budget for the seven funds identified with \$1 million or greater variances.

We found CPUC's reconciliations lacked sufficient instructions from CPUC management resulting in inadequately prepared reconciliations for five of the seven funds reviewed. Two reconciliations (Fund 3141 and Fund 0471) were found to be adequately performed. For the other five funds, we identified inconsistencies in the methodologies used to perform the reconciliations, mathematical errors, and transfer errors. While these deficiencies caused CPUC to inaccurately calculate variance amounts, most underlying reasons for the variances were identified.

Because of the incorrect calculations, we reperformed the reconciliations. Our analysis included using the information provided by CPUC, requesting additional CALSTARS reports, obtaining SCO reports, and correcting mathematical and transfer errors to determine the amount of the variance and verify associated causes/explanations.

Many factors contributed to the variances. The following table details the results of the seven funds' reconciliations:

CPUC Fund Balance Reconciliation	
Fund	Explanation
0462	Variance due to a combination of not recording SMIF or General Fund loan transactions, and unsupported prior year adjustments in the Governor's Budget.
0470	Variance due to timing differences in recording of General Fund loan transactions and unsupported prior year adjustments in the Governor's Budget.
0471	Variance due to unsupported prior year adjustment in the Governor's Budget.
0483	Variance due to not recording SMIF or General Fund loan transactions, and unsupported prior year adjustments in the Governor's Budget.
0493	Variances due to not recording SMIF transactions and unsupported prior year adjustments in the Governor's Budget.
3015	Variance unable to be determined.
3141	Variance due to timing differences in recording of General Fund loan transactions and unsupported prior year adjustments in the Governor's Budget.

Further, CPUC's accounting records did not support the beginning and ending fund balances or prior year adjustments recorded in the Governor's Budget Fund Condition Statement for 2010-11. For several funds, the revenues and expenditures reported were also not supported by the accounting records.

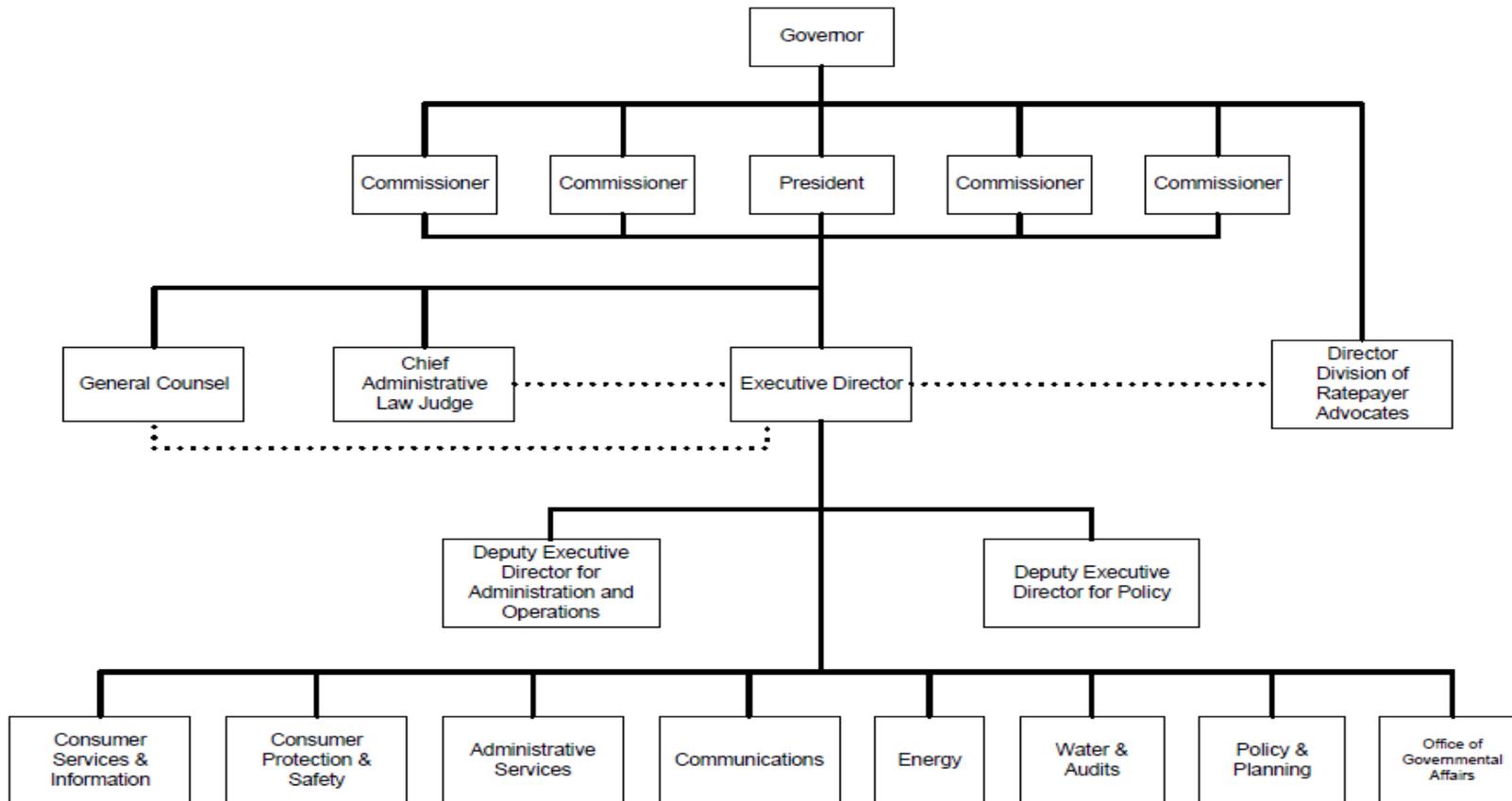
On September 6, 2012, Finance issued Budget Letter 12-22 to remind and inform state departments of existing and new requirements for reporting past/prior year financial data when submitting budget documents during development of the Governor's Budget. The letter also requires that information provided to Finance be accurate and reconciled between accounting and budget records. As a result, CPUC's Budget Office established a policy to only use CALSTARS reports produced by its Fiscal Office to report information in the Governor's Budget.

Recommendations:

- A. To prevent or resolve future variances between the Governor's Budget, CPUC and SCO fund balances, CPUC should:
- Adhere to Budget Letter 12-22.
 - Ensure SMIF related transactions, loans, and transfers are appropriately recorded.
 - Implement processes so that regular reconciliations between SCO and CPUC Fiscal Office accounting records are performed, and corrective action is taken to resolve variances.
 - Continue to ensure reconciliations performed are reviewed by appropriate levels of management.
 - Ensure the Budget Office uses data for the Governor's Budget from Fiscal Office records that agree to SCO records, including prior year adjustments, and beginning and ending fund balances.

California Public Utilities Commission

October 1, 2012



Source: California Public Utilities Commissions website, www.cpuc.ca.gov

Special Funds Administered by CPUC

	Fund Number	Fund Name	CPUC Division
1	0051	Propane Safety Inspection and Enforcement Program Trust Fund	Pass through to Fund 0462
2	0412	Transportation Rate Fund	Consumer Protection and Safety
3	0461	Public Utilities Commission Transportation Reimbursement Account	Consumer Protection and Safety
4	0462	Public Utilities Commission Utilities Reimbursement Account	Various
5	0464	California High-Cost Fund-A Administrative Committee Fund	Communications
6	0470	California High-Cost Fund-B Administrative Committee Fund	Communications
7	0471	Universal Lifeline Telephone Service Trust Administrative Committee Fund	Communications
8	0483	Deaf and Disabled Telecommunications Program Administrative Committee Fund	Communications
9	0491	Payphone Service Providers Committee Fund	None
10	0493	California Teleconnect Fund Administrative Committee Fund	Communications
11	0995 ¹	Reimbursements	N/A
12	3015	Gas Consumption Surcharge Fund	Energy
13	3089	Public Utilities Commission Ratepayer Advocate Account	Division of Ratepayer Advocates
14	3141	California Advanced Services Fund	Communications

¹ Fund 0995 is created by Finance for budgetary purposes only and is not a fund in the State Treasury System; however, we include it as a fund administered by CPUC.

Audit Objectives and Procedures

To determine whether CPUC’s processes for developing the fiscal year 2012-13 and 2013-14 Governor’s Budgets results in reliable and accurate budgeting information to stakeholders, and that budget processes are in compliance with relevant criteria, we performed the following procedures on the ten sampled funds and related divisions. Procedures were developed based on the identified key controls within the high risk areas. We also developed recommendations based on our observations.

Risk Area	Key Control	Procedures
Budget process management practices	Control environment	<ul style="list-style-type: none"> • Interviewed CPUC executive management to gain an understanding of their roles in CPUC budgeting, monitoring, and reporting processes. • Reviewed organizational charts.
	Policies and procedures	<ul style="list-style-type: none"> • Evaluated written policies and procedures to determine if they exist and are representative of current practices. • Determined how policies and procedures are established, communicated, implemented, monitored, updated, and approved. • Evaluated whether policies and procedures are in compliance with State Administrative Manual and Public Utilities Code requirements. • Assessed whether current processes and procedures are designed to provide sufficient administrative controls over the budget process.
	Communication between CPUC divisions	<ul style="list-style-type: none"> • Selected samples of information exchanged between CPUC fiscal, budget, and program divisions to determine the sufficiency and timeliness of communication. • Assessed whether current processes and procedures resulted in timely and sufficient distribution of information related to budgeting processes.
	Competent and knowledgeable staff	<ul style="list-style-type: none"> • Interviewed staff to determine their length of time performing budgeting functions and the percent of their time spent on budgeting duties on a monthly basis. • Documented staff training, cross training, and experience related to performing budgeting functions. • Reviewed duty statements to ensure budgeting responsibilities are commensurate with position levels and duties. • Concluded whether the competency and knowledge of staff with budgeting responsibilities are adequate to prepare a reliable and accurate budget.
Budget forecasting methodologies	Revenue, expenditure, and reimbursement forecasting	<ul style="list-style-type: none"> • Gained an understanding of CPUC’s forecasting methodologies for each of the ten funds included in our audit. • Evaluated whether forecasting methodologies included considerations of: <ul style="list-style-type: none"> ○ Trend analyses of increases or decreases in actual revenues, expenditures, or reimbursements over time. ○ Comparisons of appropriated to actual revenues, expenditures, or reimbursements in previous budget years. ○ Consideration of fund balances, cash reserves, surcharge levels, or expenditures. ○ Sufficient levels of supervisory review. • Evaluated whether forecasting methodologies were in compliance with statutory regulations and CPUC policies. • Verified 2013-14 Budget Year forecasts agreed to supporting documentation. • Evaluated reasonableness of forecasts by comparing appropriated to actual revenues, expenditures, and reimbursements for fiscal years 2005-06 through 2011-12. See Appendix C for charts comparing appropriated to actual amounts. • Concluded whether forecasting methodologies are logical, supported, and result in projections that reflect current levels of service.

Risk Area	Key Control	Procedures
Budget monitoring practices	Revenue, expenditure, and reimbursement monitoring	<ul style="list-style-type: none"> • Gained an understanding of CPUC’s monitoring methodologies for each of the ten funds included in our audit, including methodologies for updating Current Year information in the Governor’s Budget. • Evaluated whether monitoring methodologies included considerations of: <ul style="list-style-type: none"> ○ Trend analyses of forecasted to actual revenues, expenditures, or reimbursements. ○ Consideration of fund balances, cash reserves, surcharge levels, or expenditures. ○ Reconciliations of program records with fiscal records, when applicable. ○ Sufficient levels of supervisory review. • Evaluated whether monitoring methodologies were in compliance with statutory regulations and CPUC policies. • Verified for the 2012-13 Governor’s Budget, the 2011-12 Current Year amounts agreed to supporting documentation and Schedule 10s and 10Rs. • Concluded whether monitoring methodologies are logical, supported, and result in projections that reflect current levels of service.
Fiscal management practices	Recording of financial information	<ul style="list-style-type: none"> • Agreed 2012-13 Governor’s Budget Fund Condition Statements to CPUC supporting documentation, for a sample of funds. • Determined if CPUC funds are appropriately classified as shared or non-shared. • Determined if Surplus Money Investment Fund and Due From Other Funds transactions are appropriately recorded, for a sample of funds. • Evaluated CPUC’s encumbrance and accrual processes and procedures to determine if encumbrances and accruals are valid, accurately reflect CPUC’s expected expenditures, and comply with State Administrative Manual requirements.
	Cost allocation methodologies	<ul style="list-style-type: none"> • Interviewed staff and reviewed documentation to determine if CPUC implements a cost allocation plan that results in the equitable distribution of indirect costs to CPUC funds. • Interviewed staff and reviewed documentation to determine how CPUC allocates appropriation adjustments among its funds and determined if the methodology results in an equitable distribution of adjustments.

To evaluate the adequacy of CPUC’s fund condition statement reconciliation process, we performed the following procedures:

- Interviewed personnel who performed the reconciliations to gain an understanding of the methodologies used to complete the reconciliations.
- Evaluated the reconciliations performed to ensure they were mathematically accurate, adequately supported, and reviewed by a supervisor.
- Reperformed reconciliations to determine variance amounts and verify the identified reasons.

Comparison of Budget to Actual Revenues and Expenditures

The following charts compare budget to actual revenues and expenditures for the ten CPUC funds included in this audit. Budget and actual revenues and expenditures were obtained from historical Governor's Budgets for fiscal years 2005-06 through 2011-12¹, with the exception of actual revenues and expenditures for fiscal year 2011-12, which were obtained from the Supplementary Schedule of Appropriations for Prior Year 2011-12 (Schedule 10) and the Supplementary Schedule of Revenues and Transfers for Prior Year 2011-12 (Schedule 10R). The revenues presented are CPUC's largest revenue categories, generally regulatory fees. The expenditures presented are CPUC state operations expenditures and reimbursement expenditures.

The charts are presented to illustrate how closely CPUC's budget revenues and expenditures approximate their actual revenues and expenditures over the last seven completed budget cycles. For Funds 0462 and 3089 where a baseline budgeting approach was used, the variances are less since budgeting for these funds is essentially the current level of funding adjusted for incremental changes such as Finance Budget Letters and Budget Change Proposals. Conversely, for Funds 0464, 0470, 0471, 0483, 0493, 0995, 3015, and 3041, there is much more variability due largely to the methods and assumptions used by CPUC to estimate future program revenues and expenditures for these funds. While the causes of these variances could not always be adequately explained, we believe the recommendations noted in Observations 2 and 3 will help CPUC minimize future variances by adopting better forecasting methodologies and monitoring activities.

For the few funds and years that indicate actual expenditures exceeded budget expenditures, the actual expenditures did not, in fact, exceed the final budget appropriation. Since the budget amounts used in the schedules are from the proposed Governor's Budgets, they do not reflect changes that may have occurred subsequent to the issuing of the Governor's Budget.

¹ Budgets for Funds 3089 and 3141 are presented for fiscal years 2006-07 through 2011-12 and 2009-10 through 2011-12, respectively.

Fund 0462 – Public Utilities Commission Utilities Reimbursement Account²

Chart 1

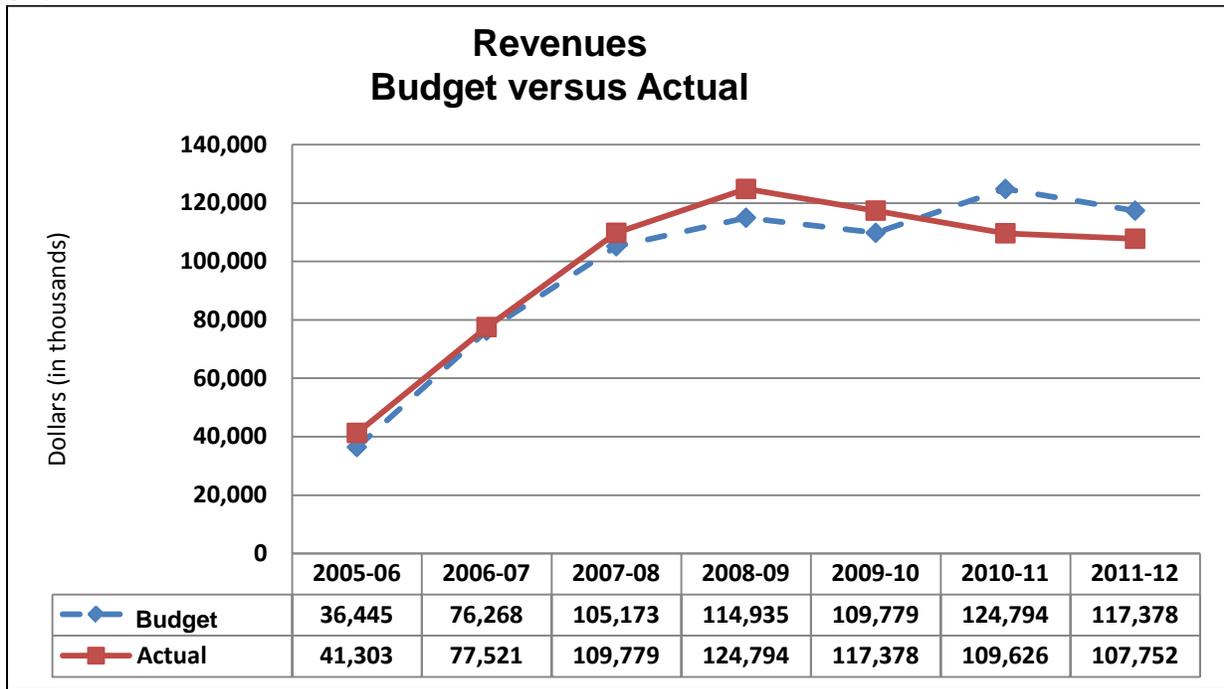
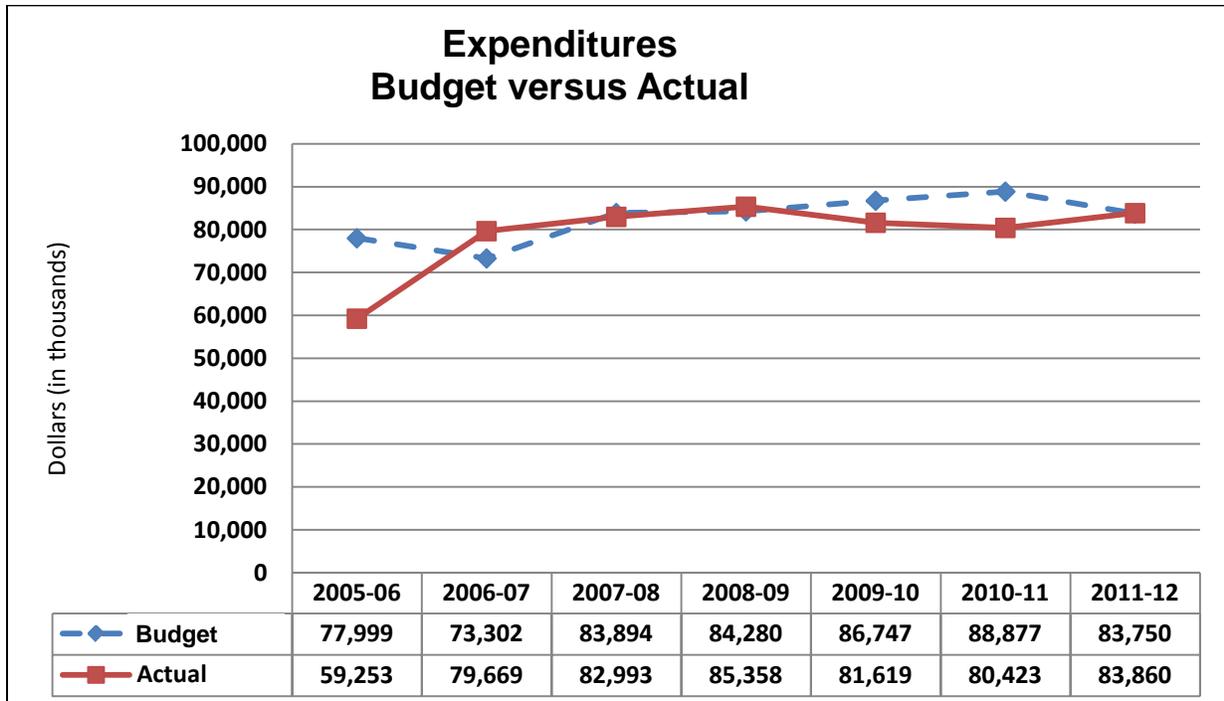


Chart 2



² Revenues are from the 120600 Quarterly Public Utility Commission Fees line item of the Governor's Budget. Expenditures are from the 8660 Public Utilities Commission (State Operations) line item of the Governor's Budget.

Fund 0464 – California High Cost Fund-A³

Chart 3

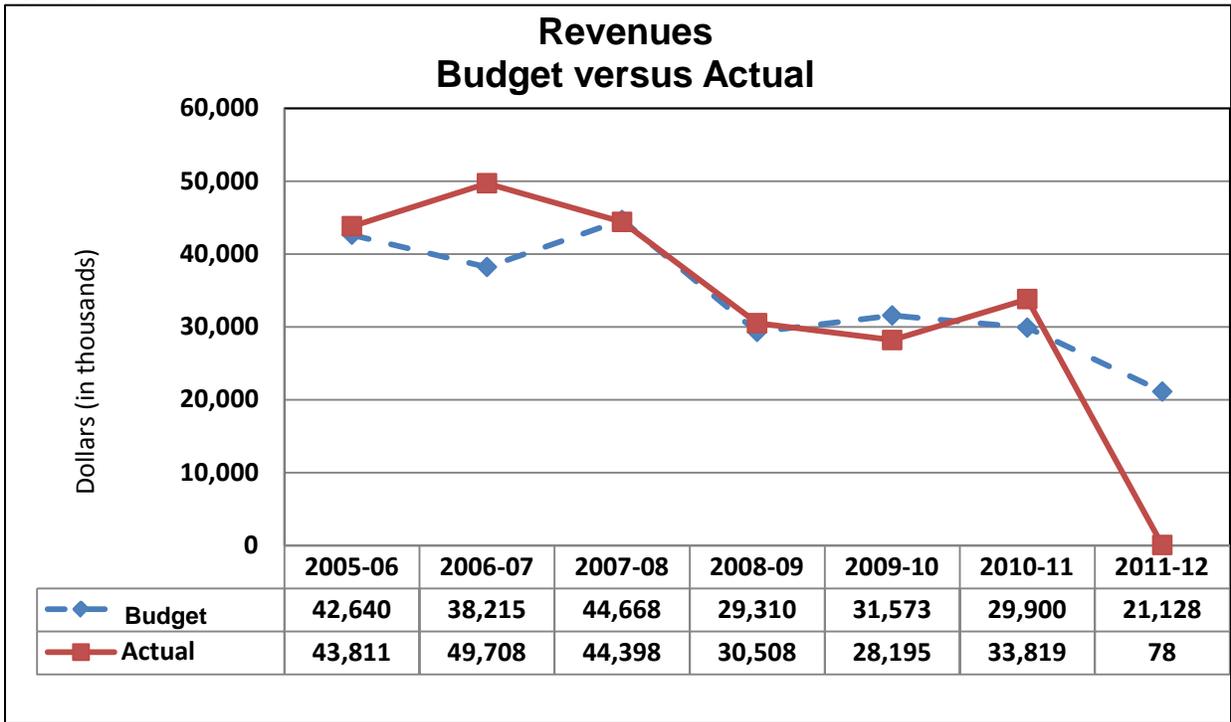
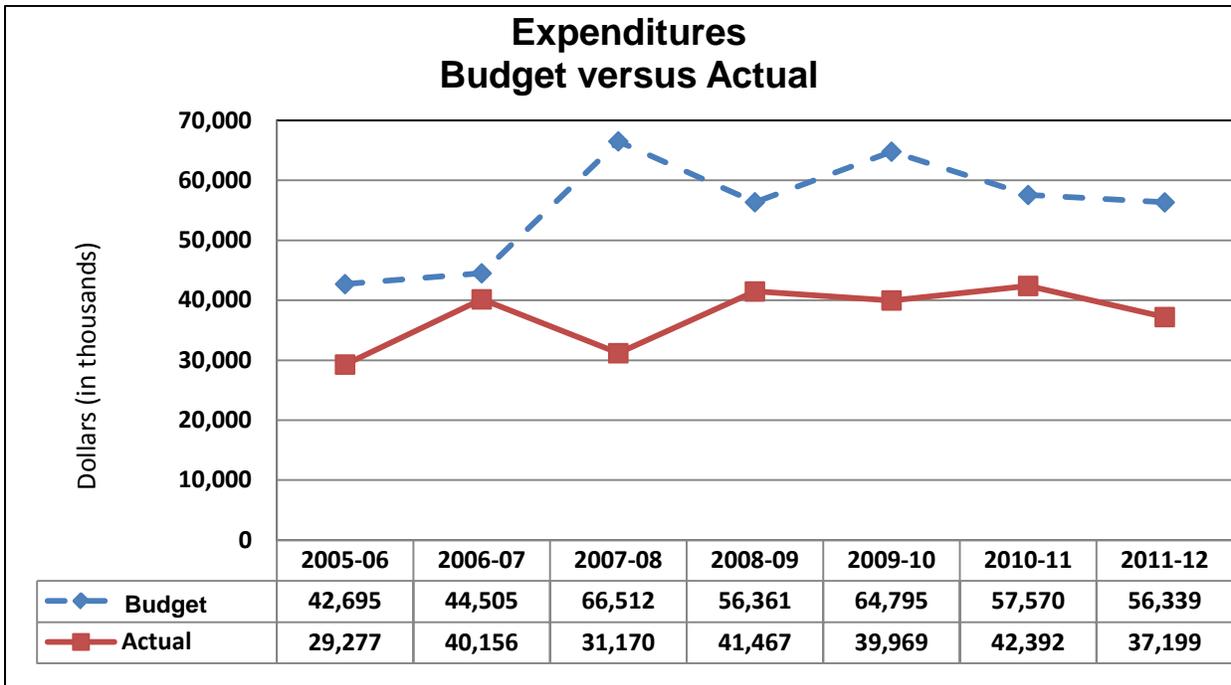


Chart 4



³ Revenues are from the 125600 Other Regulatory Fees line item of the Governor's Budget. Expenditures are from the 8660 Public Utilities Commission (State Operations) line item of the Governor's Budget.

Fund 0470 – California High Cost Fund-B⁴

Chart 5

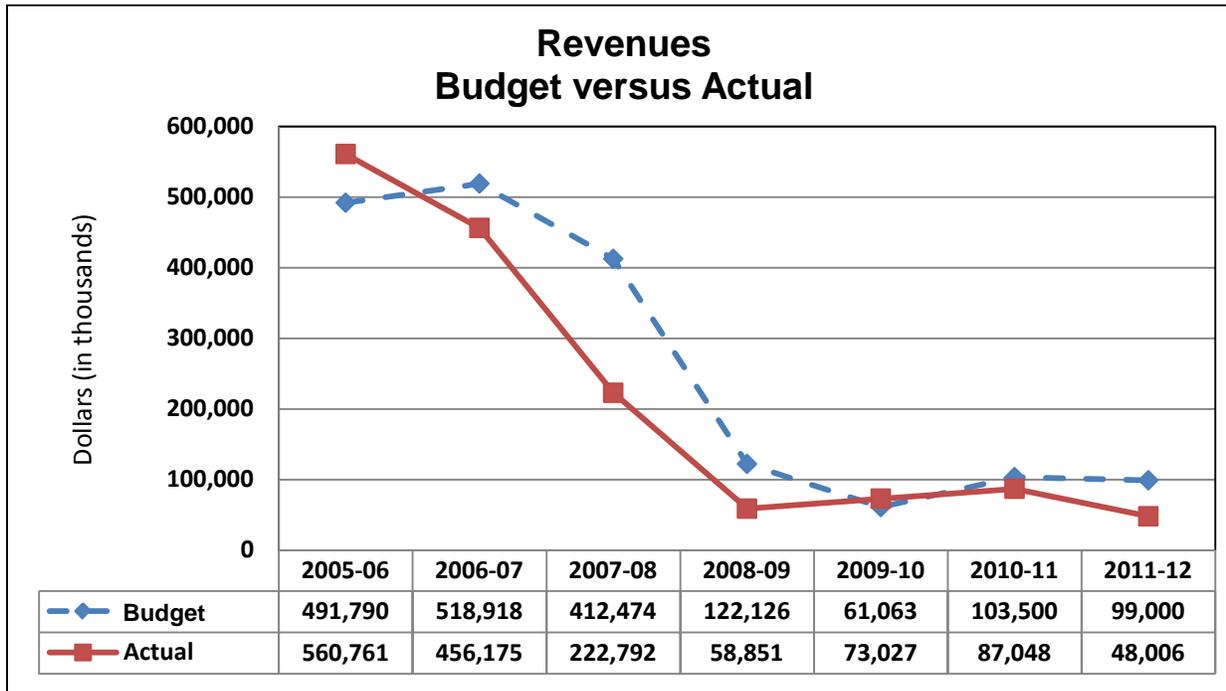
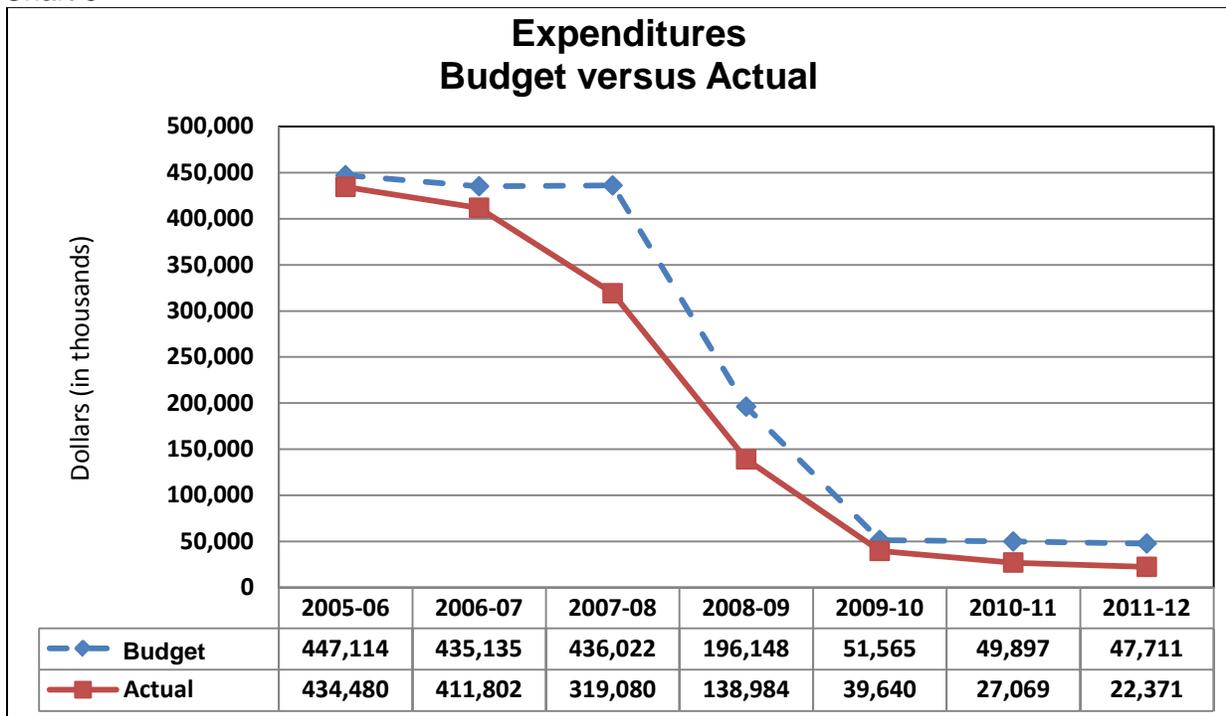


Chart 6



⁴ Revenues are from the 125600 Other Regulatory Fees line item of the Governor's Budget. Expenditures are from the 8660 Public Utilities Commission (State Operations) line item of the Governor's Budget.

Fund 0471 – Universal LifeLine Telephone Service⁵

Chart 7

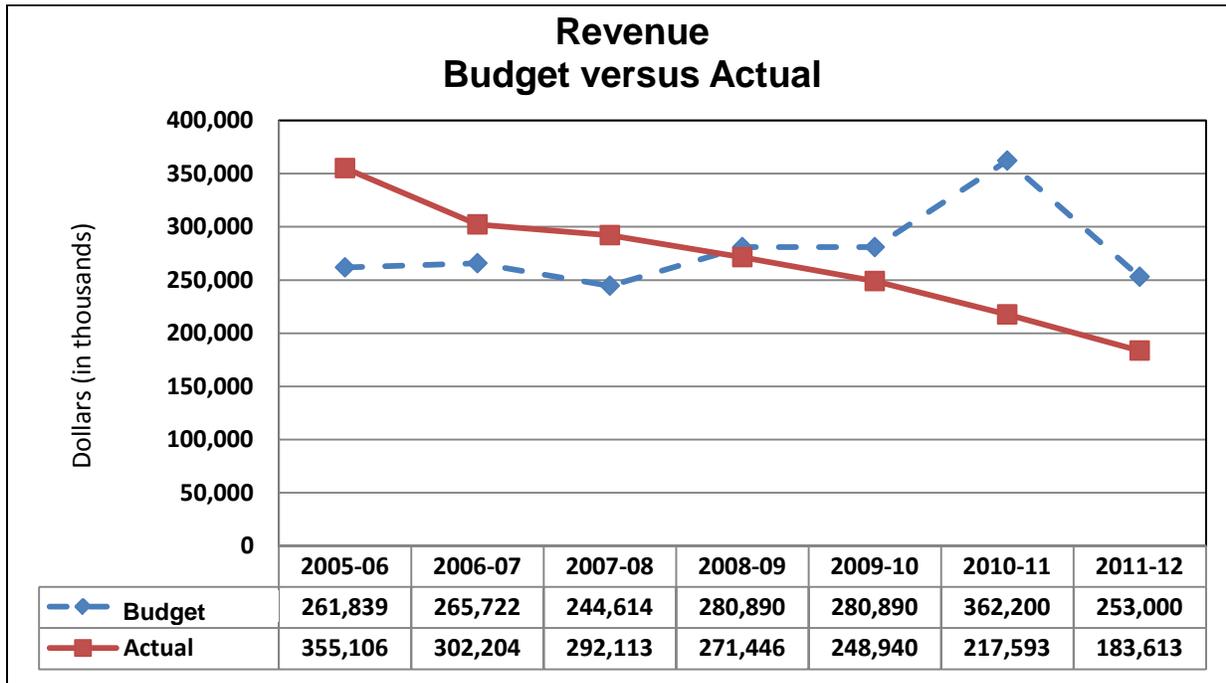
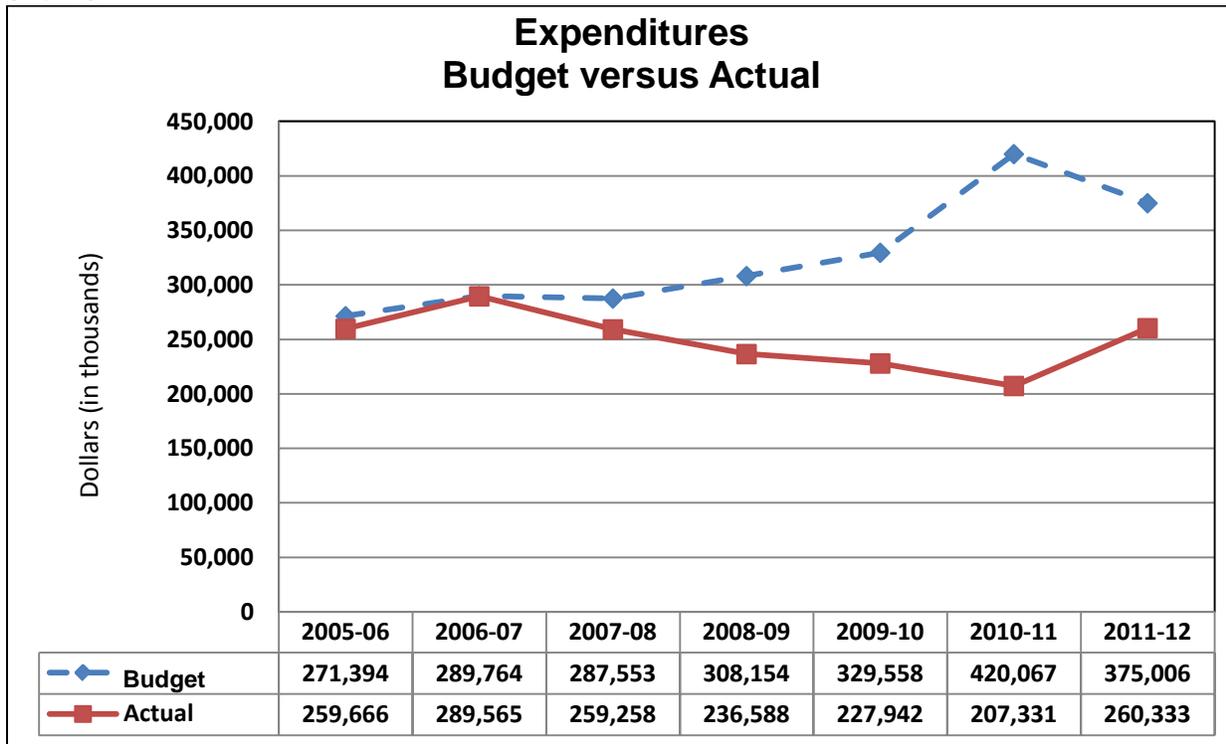


Chart 8



⁵ Revenues are from the 125600 Other Regulatory Fees line item of the Governor's Budget. Expenditures are from the 8660 Public Utilities Commission (State Operations) line item of the Governor's Budget.

Fund 0483 – Deaf and Disabled Telecommunications Program⁶

Chart 9

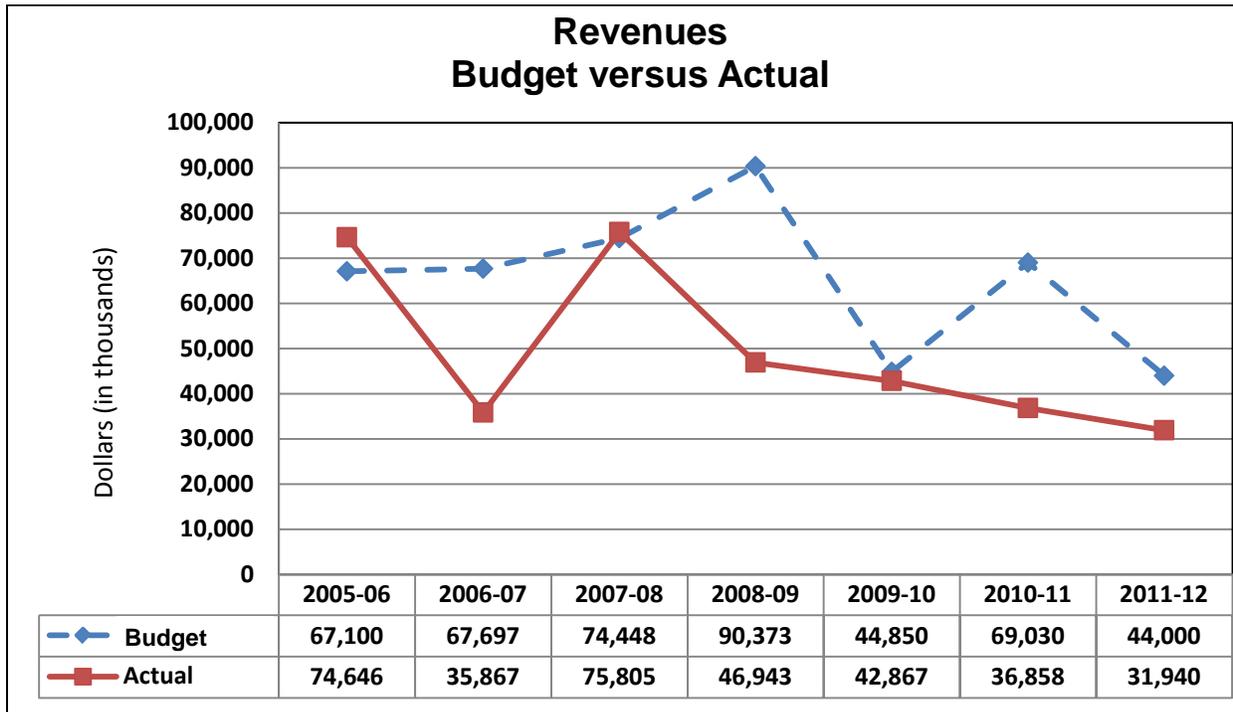
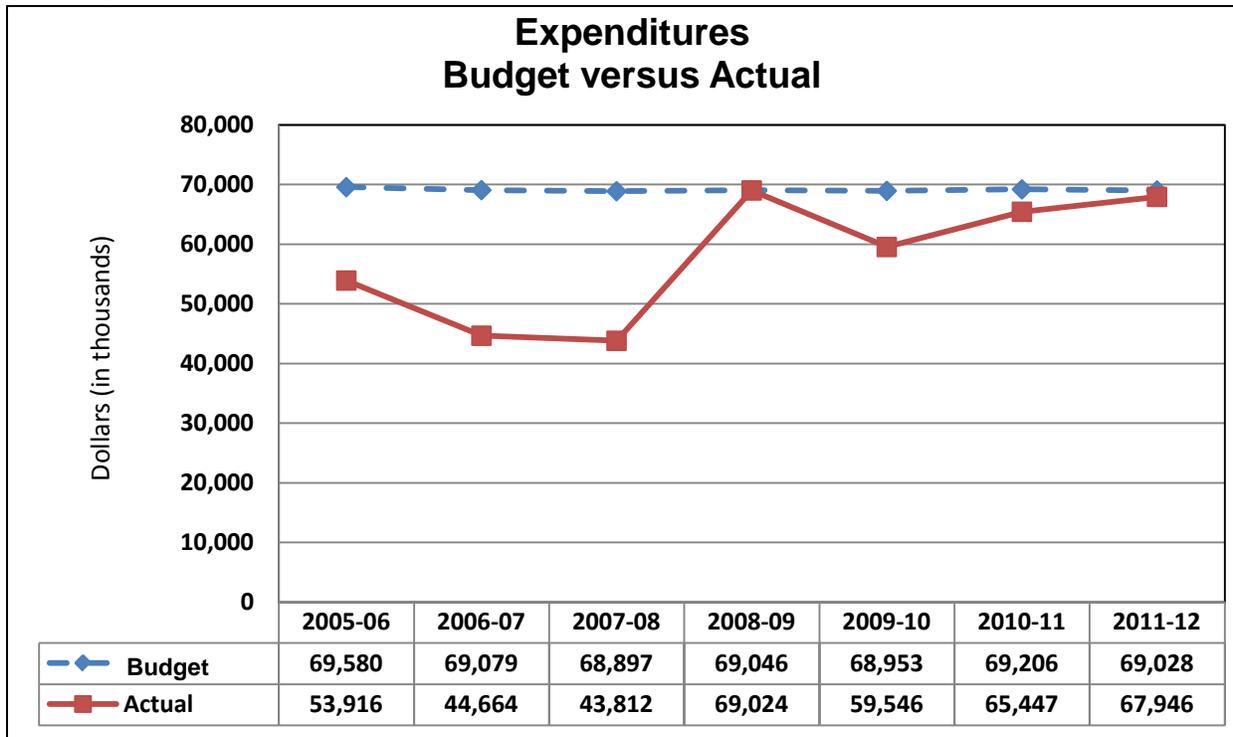


Chart 10



⁶ Revenues are from the 125600 Other Regulatory Fees line item of the Governor's Budget. Expenditures are from the 8660 Public Utilities Commission (State Operations) line item of the Governor's Budget.

Fund 0493 – California Teleconnect Fund⁷

Chart 11

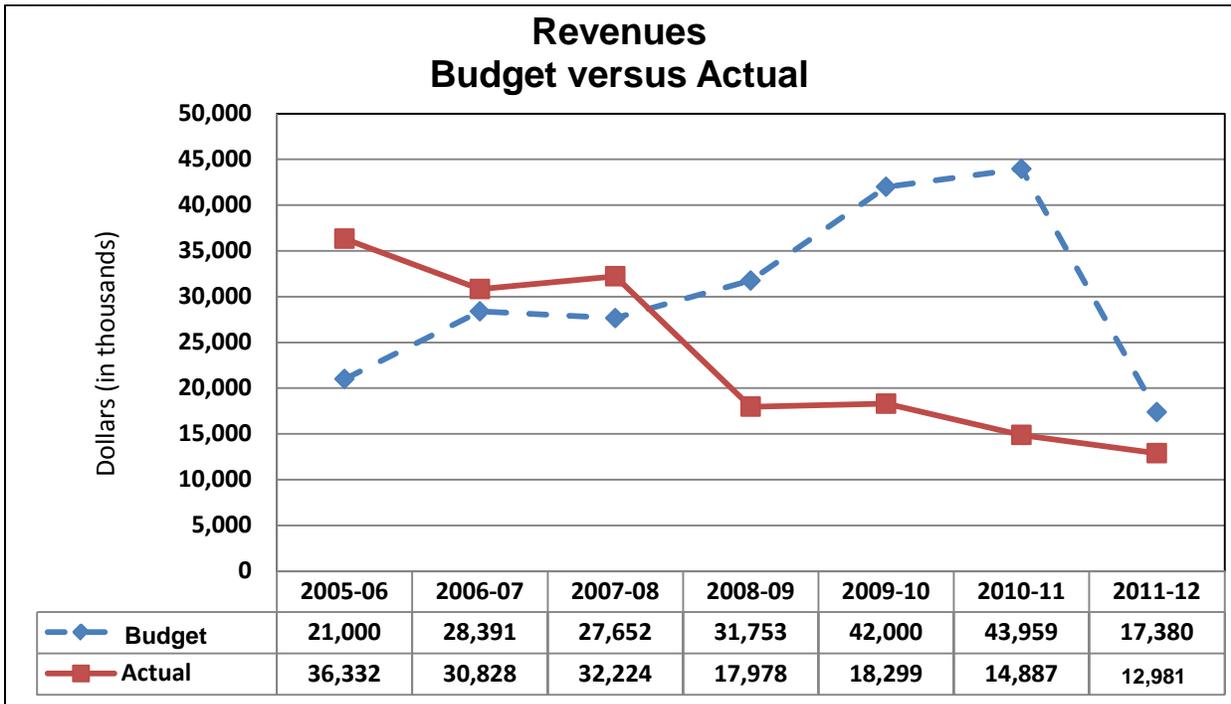
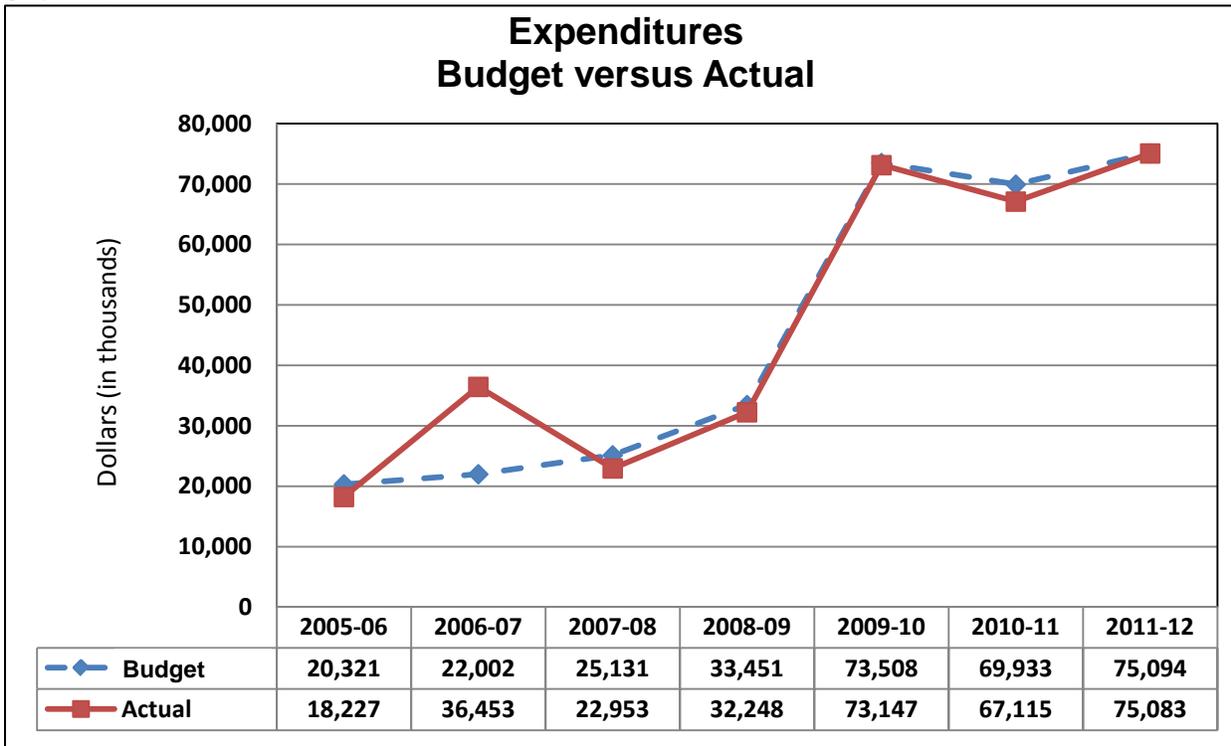


Chart 12



⁷ Revenues are from the 125600 Other Regulatory Fees line item of the Governor's Budget. Expenditures are from the 8660 Public Utilities Commission (State Operations) line item of the Governor's Budget.

Fund 3015 – Gas Consumption Surcharge Fund⁸

Chart 13

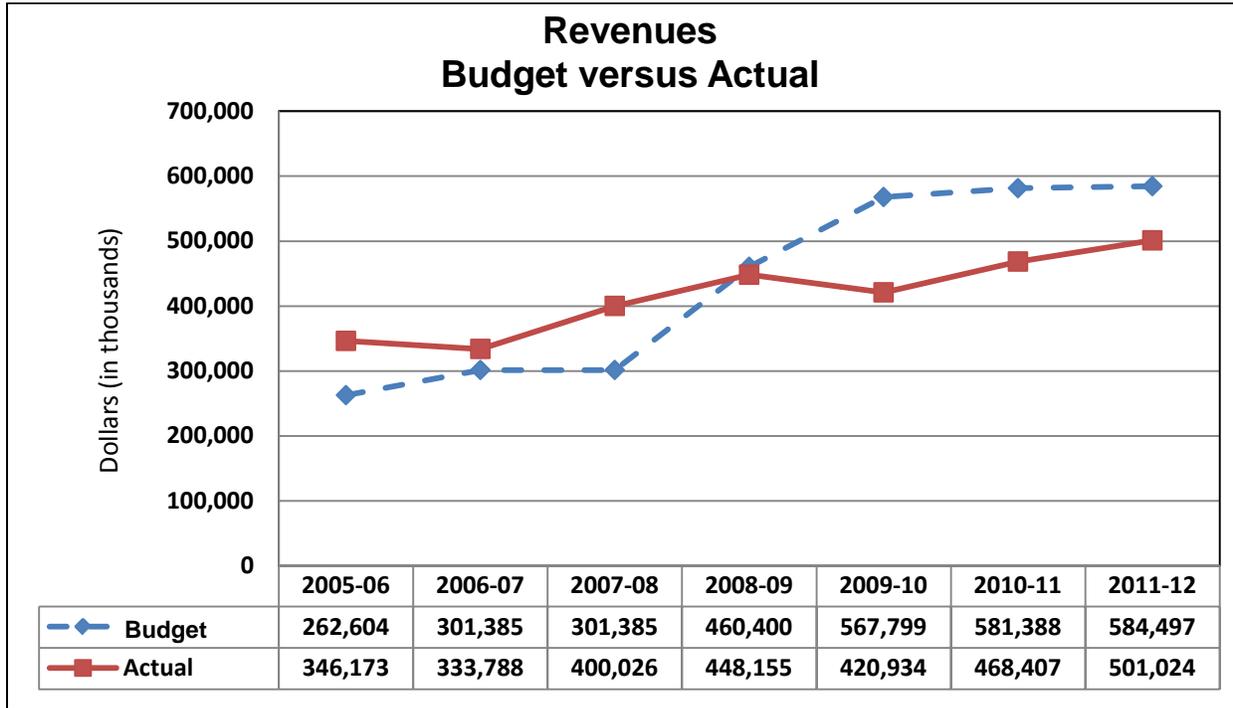
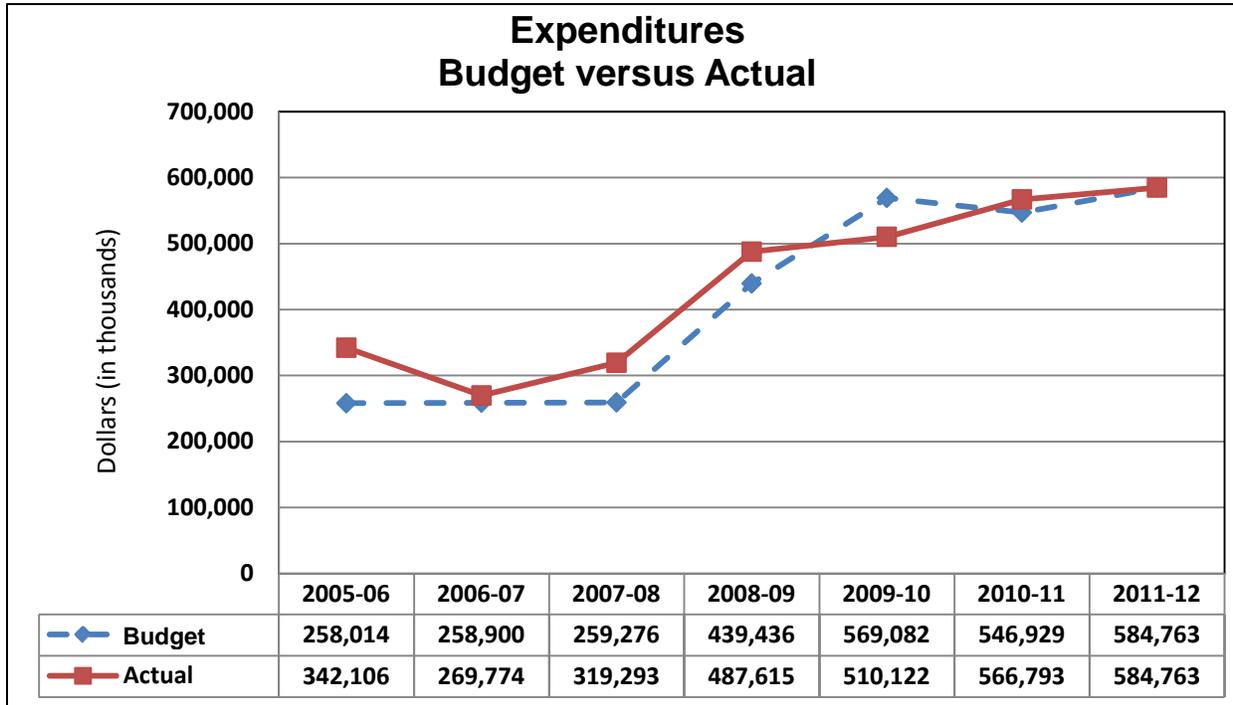


Chart 14



⁸ Revenues are from the 120300 Energy Resource Surcharge line item of the Governor's Budget. Expenditures are from the 8660 Public Utilities Commission (State Operations) line item of the Governor's Budget.

Fund 3089 – Public Utilities Commission Ratepayer Advocate Account⁹

Chart 15

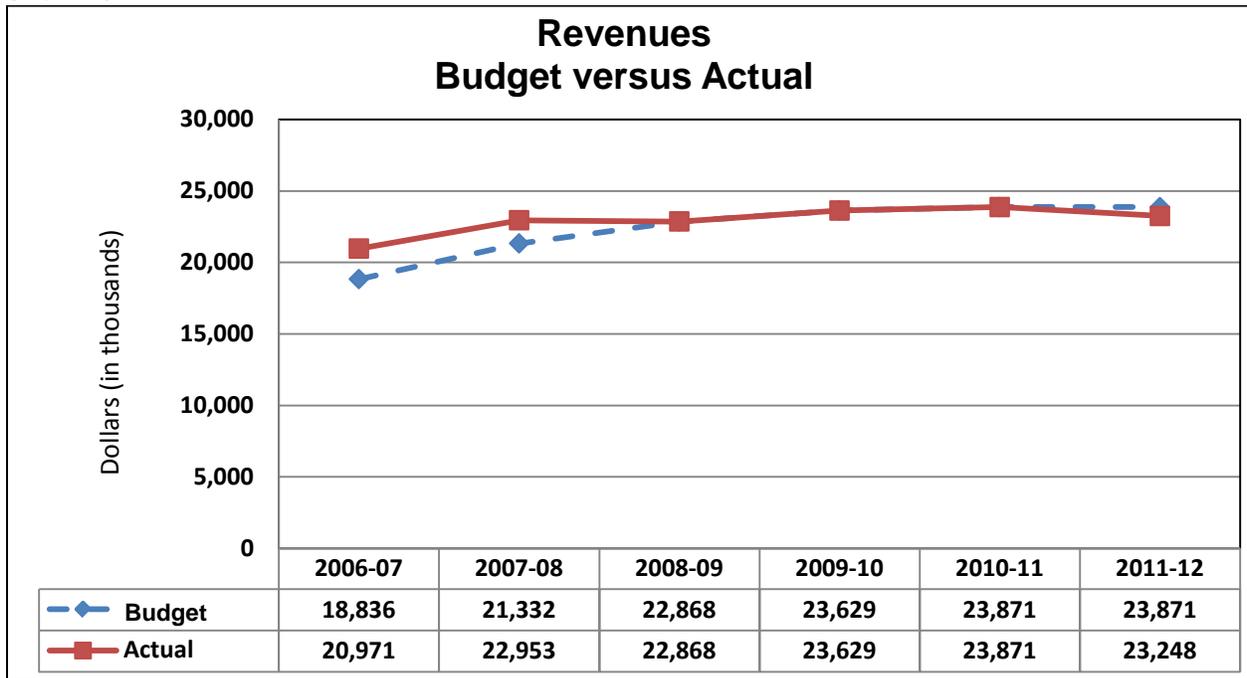
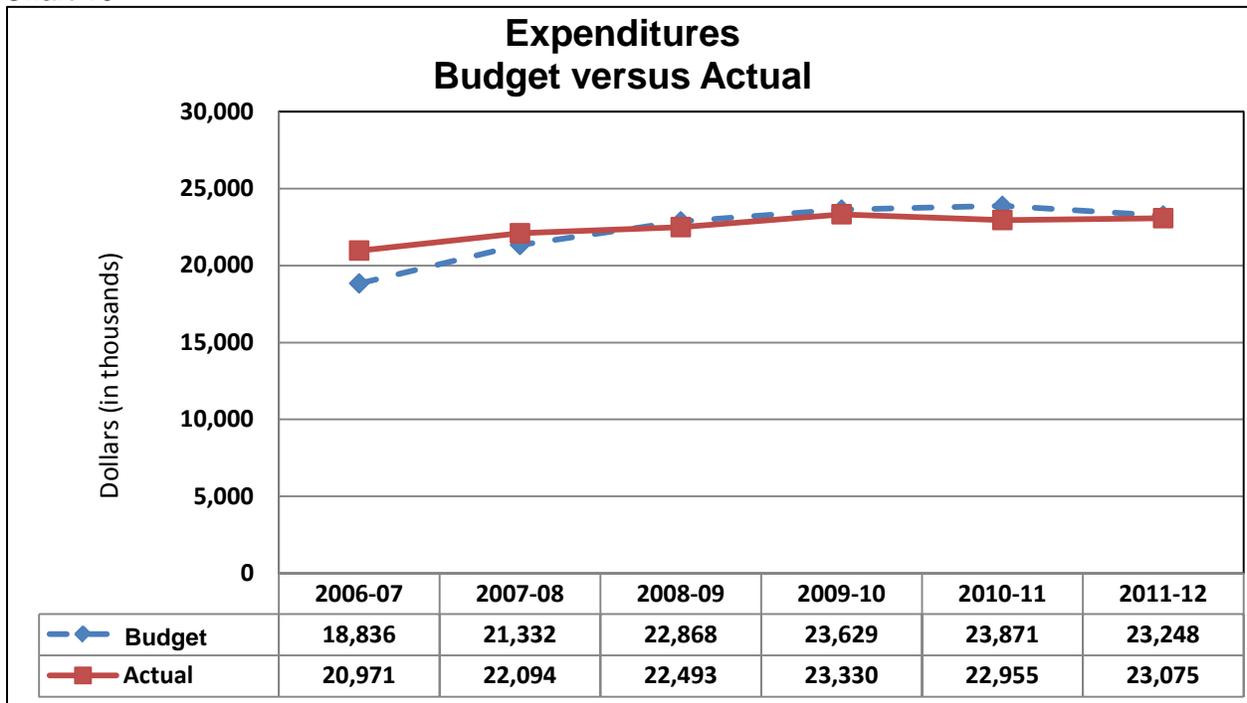


Chart 16



⁹ Revenues are transferred from Public Utilities Commission Utilities Reimbursement Account per Item 8660-011-0462, Budgets Acts. Expenditures are from the 8660 Public Utilities Commission (State Operations) line item of the Governor's Budget. Fund 3089 was first presented in the 2006-07 Governor's Budget.

Fund 3141 – California Advanced Services Fund^{10, 11}

Chart 17

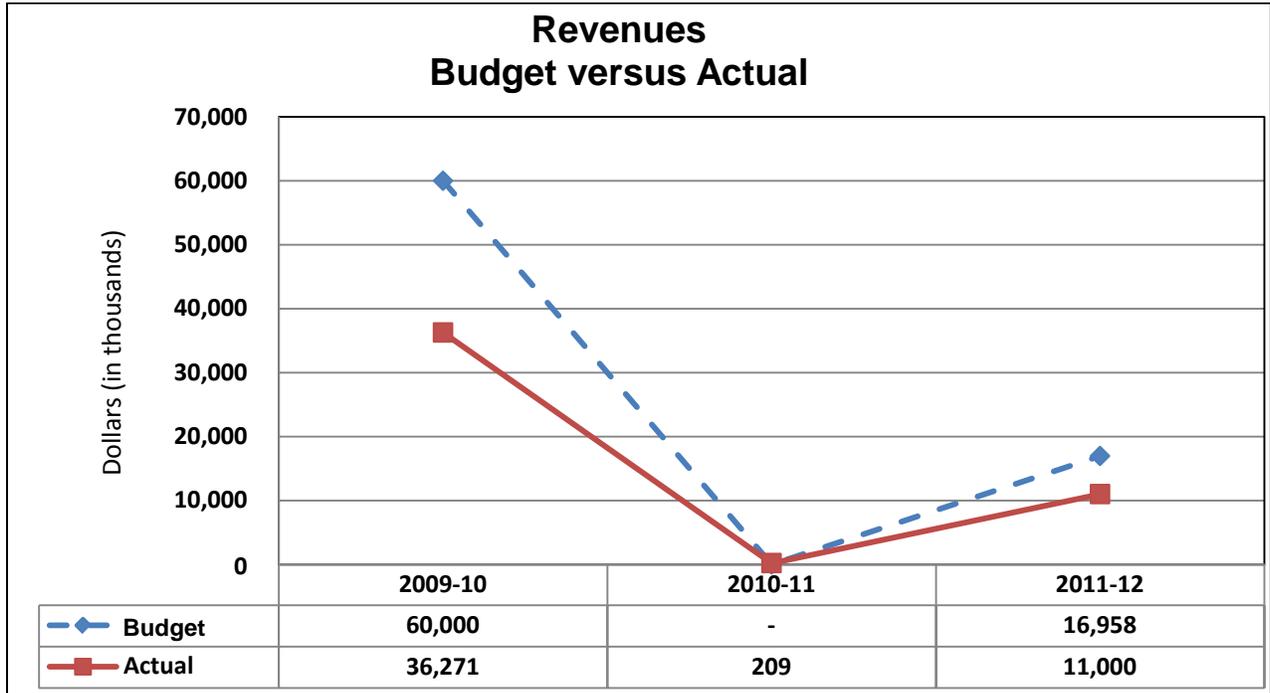
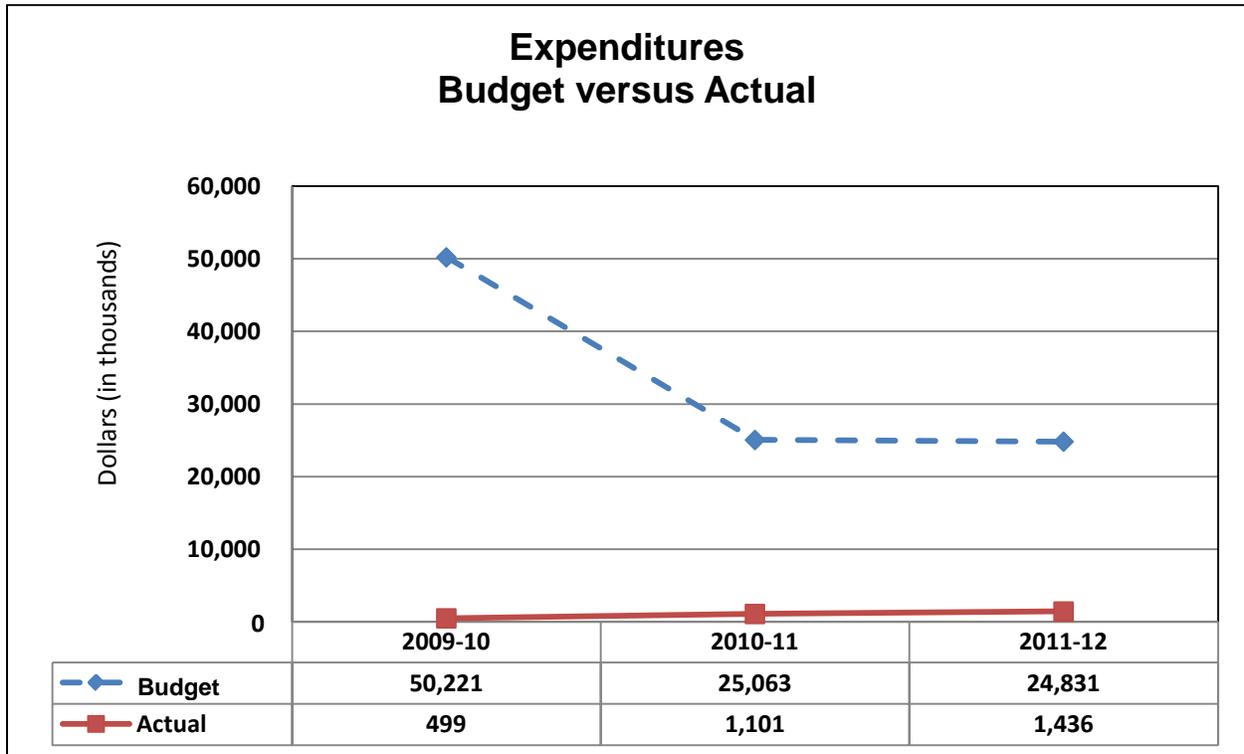


Chart 18

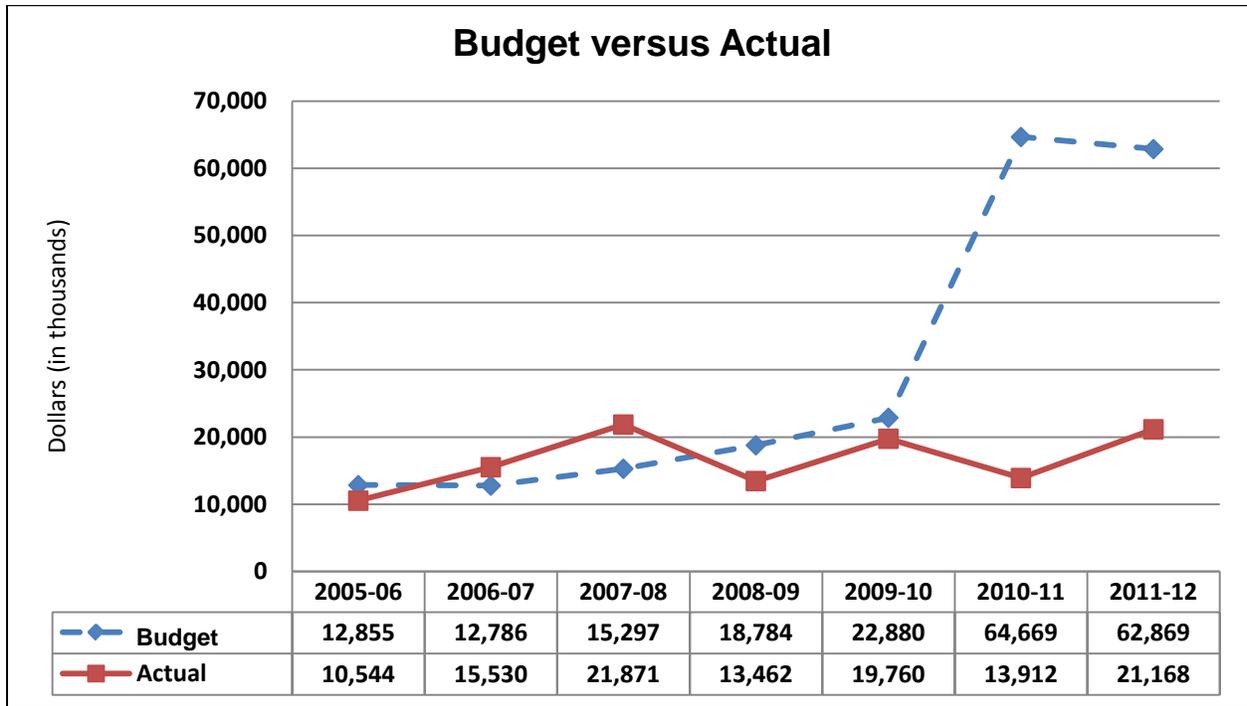


¹⁰ Revenues are from the 125600 Other Regulatory Fees line item of the Governor's Budget. Expenditures are from the 8660 Public Utilities Commission (State Operations) line item of the Governor's Budget. Fund 3141 was first presented in the 2009-10 Governor's Budget.

¹¹ Expenditure variances due primarily to not encumbering obligations, see Observation 4 for details.

Fund 0995 – Reimbursements^{12, 13}

Chart 19



¹² Reimbursements are from the 3 Year Expenditures and Personnel Years, Funding section of Governor's Budgets.

¹³ The 2010-11 and 2011-12 variance is due to budgeted energy efficiency contracts that have yet to be executed, see Observation 2 for details.

PUBLIC UTILITIES COMMISSION

505 VAN NESS AVENUE
SAN FRANCISCO, CA 94102-3298



January 8, 2013

Mr. David Botelho, CPA
Chief, Office of State Audits and Evaluations
Department of Finance
915 L Street
Sacramento, CA 95814-3706

Re: Response to the Department of Finance, Office of State Audits and Evaluations Draft Report on California Public Utilities Commission Budget Process Performance Audit

Dear Mr. Botelho:

The California Public Utilities Commission (CPUC) provides the following information and response to the December 28, 2012 letter from the Department of Finance regarding the audit of Budget Process Performance. We appreciate the thoroughness of the Audit and the constructive recommendations for improvements. We have already begun mapping out our corrective actions to respond to the observations and recommendations with the goal of having completed the necessary changes in process and procedures, and documentation to address all recommendations, by the end of this calendar year. We look forward to providing you with a detailed corrective action plan that sets forth our specific implementation milestones over this transition year.

Observation 1a: Ineffective Management Practices over Budgeting Functions- Ineffective Organization Structure and Assignment of Budgeting Responsibilities

The Audit identifies that the CPUC has not directed sufficient management resources or staffing to budget administration as the complexity and number of special funds it administers has grown. The Audit identifies that the CPUC lacks clear lines of authority over budget matters.

Response: The CPUC agrees with this observation. Most state agencies with responsibility for administration of the number of special funds and dollars have between 5 and 10 staff assigned to budget functions while the CPUC has only one individual in the Budget Office. This has resulted in budget responsibilities' being dispersed throughout the agency without sufficient oversight or training. Working with the Governor's Office and the Department of Finance, the CPUC is seeking to augment its staffing in the Budget Office to centralize responsibility for budgetary functions and provide clearer responsibility for budget functions.

To compensate for the lack of budget staff and other deficiencies identified in subsequent observations, management oversight has been dispersed between the Administrative Services

Director and the Deputy Executive Director for Administration and Operations, resulting in unclear lines of authority. The anticipated increase in staffing will enable more of the budget functions to move under the direct oversight of Administrative Services. In the short term, the Deputy Executive Director will handle issues related to internal allocation of the CPUC's operational budget (generally from Fund 0462). The Administrative Services Director will handle all issues related to the Governor's Budget and supporting FY 13-14 Budget Change Proposals, all funds other than 0462, and Fund Conditions. Over time, all functions will move under the Administrative Services Director.

Observation 1b: Ineffective Management Practices over Budgeting Functions- Ineffective Communication and Coordination

The Audit notes that processes have not been established to facilitate information sharing between those responsible for budget development, monitoring, and reporting.

Response: The CPUC agrees with this observation. The Audit has resulted in Administrative Services and Communications Division (the division that oversees the programs operated by several of the CPUC administered special funds) communicating more frequently and identifying knowledge and process gaps. The Budget Officer is now responsible for training program staff on the purposes of the various schedules prepared for the Governor's Budget, and new processes have been implemented in the receipt and disbursement of information between the divisions and the Budget Office to promote additional communication and knowledge sharing. For example, this budget year, upon receiving direction from the Department of Finance for the submittal of Schedule 10 (expenditure) and Schedule 10r (revenue), the Budget Officer set a meeting with the affected Divisions to discuss the purpose of such schedules and their impact in the Governor's Budget. An internal deadline was set to allow the Budget Officer time to review input from the Divisions before submitting final schedules to the Department of Finance. All schedules and additional supporting documents from Divisions to the Budget Officer were sent via email to ensure transparency in the internal exchange of all Governor's Budget information. All these procedures will be documented and implemented every budget cycle.

Observation 1c and d: Ineffective Management Practices over Budgeting Functions- Insufficient Staff Training and Outdated Duty Statements

The Audit notes that there is no training program for staff responsible for developing, monitoring, and reporting budget information and that duty statements are not reflective of their budgetary responsibilities.

Response: The CPUC agrees with this observation. The Chief of Management Services (the manager to whom the Budget Office directly reports) is in the process of developing a Budget Control Officer Desk Manual that is designed to ensure that program personnel that interact with the budget process have an understanding of their responsibilities, access to the correct resources, and the tools to use them to perform their duties. The manual will address all of the deficiencies described in these two observations and is also expected to improve the communication and coordination issues identified in Observation 1b. After the Budget Control Officer Desk Manual is completed, Desk Manuals will be prepared for Budget Office positions.

In addition, if expansion of the Budget Office is authorized, the Budget Office staff will be given sufficient training and time necessary to allow them to work closely with division staff and provide the necessary support for them to properly perform their budget-related duties. The problem of outdated duty statements and insufficient communication of duties to employees will be addressed on an agency-wide basis with the goal that all duty statements will be reviewed and updated no less than every two years.

Observation 1e: Ineffective Management Practices over Budgeting Functions- Limited Written Policies and Procedures

The Audit notes that policies and procedures are not always documented, regularly reviewed, updated, and approved by management, or representative of current practices.

Response: The CPUC agrees with this observation. The Budget Control Officer Desk Manual described above is designed to begin this documentation process for the budget functions. In addition, the CPUC has redirected one of the Budget Control Officers part time to document processes, procedures, and prepare desk manuals for Fiscal Office operations. The CPUC is in the process of bringing on additional resources to assist in documenting existing practices and is committed to implementing changes that better reflect best practices and provide more effective management and oversight of both budgeting and fiscal functions.

Observation 2: Forecasting Methodologies Need Improvement

The Audit notes that actual revenues, expenditures, and reimbursements have differed significantly from forecasts over the past six fiscal years, making the validity of the forecasting models suspect.

Response: The CPUC agrees with this observation. Some of the inaccuracies in the forecasting for the telecommunications public purpose funds are attributable to the fact that the policy approaches to many of the programs have changed significantly over that time period, with the budgets attempting to anticipate the potential policy changes to the programs. When program changes have not occurred, or programs were changed in ways not anticipated, expenditure forecasts were not realized. That in turn caused the CPUC to lower the user fees that collect the revenue, resulting in the actuals and forecasted levels not matching. The CPUC agrees that it should engage in a more effective forecasting approach and supervisory review of forecasts of all funds.

Several of the funds rely on contracts (either for goods or personal services) to fulfill their obligations. In some cases, the timing of recording of these contract-related costs will result in costs being attributed to an earlier fiscal year for fiscal operations purposes, but for program forecasting purposes it is considered a current cost. Communications Division and Administrative Services are working closely together to try to reconcile these different approaches during this transition year. In FY 13-14, the CPUC expects that we will utilize consistent approaches for fiscal and program purposes that will allow for more effective forecasting going forward.

Regarding reimbursements, the identified discrepancy is attributable to the fact that \$40 million in energy efficiency contracts that were forecast to be brought on-budget during FY 10-11 have not yet been brought on-budget. The process of bringing them on-budget has proven more complex than anticipated, and the projects are currently pending at Department of General Services. The CPUC anticipates that the contracts will be on budget in FY 2013-14.

Observation 3: Budget Monitoring Practices Need Improvement

The Audit notes that the CPUC does not have adequate monitoring policies, procedures or controls in place to update the Current Year columns of the Governor's Budget Fund Condition Statements.

Response: The CPUC agrees that its historical practice did not include updating of Current Year column information unless a negative fund balance was projected in the Budget Year column and that insufficient policies and procedures were in place to ensure monitoring of the fund condition. This was in large part due to lack of training and communication between budget and program staff and management about the purpose of the Current Year column. Practices and procedures will include adjustment of Current Year data starting with the FY 14-15 Budget Year. The CPUC does believe that monitoring of fund reserves and surcharge rates to ensure solvency did occur, but given the absence of documented procedures and adjustments, it is understandable that monitoring appears insufficient.

Observation 4a: Fiscal Management Practices Need Improvement- Incorrect Fund Classification and Recording of Transactions

The Audit notes that because certain funds were misclassified as "shared" funds or treated as shared funds, the CPUC did not record deposits in Surplus Money Investment Fund (SMIF) transactions or the short term portion of General Fund loans receivable in its accounting records and that this resulted in material misstatements in the CPUC accounting records.

Response: The CPUC agrees that its Fund Condition Statements and accounting records did not reflect the above identified transactions which resulted in inadvertent material misstatements in its accounting records. This error occurred because of reliance on historical directions from control agencies regarding recording SMIF provided to the CPUC Fiscal Office that were not regularly confirmed for continued validity. This error has now been remedied and written procedures are in place to record deposits in SMIF and short term loan receivable transactions.

Observation 4b: Fiscal Management Practices Need Improvement- Outdated Cost Allocation Plan

The Audit notes that the last documented revision to the CPUC's cost allocation plan is from FY 1998-1999 and that it is unclear whether the CALSTARS cost allocation tables are consistent with this plan.

Response: The CPUC agrees that its last written cost allocation plan is from FY 1998-1999 and that an updated cost allocation plan should be prepared and include detailed information regarding the costs being allocated, the allocation methodology, the frequency of the allocation, and the rationale for the allocation base. Once revised, the CPUC will ensure that its CALSTARS tables match the cost allocation plan and that the agency adopts a regular schedule under which it will review and update the cost allocation plan consistent with recommended state guidelines.

Observation 4c: Fiscal Management Practices Need Improvement- Deficient Encumbrance Practices

The Audit notes that the CPUC's encumbrance policies regarding multiyear contracts were not consistently followed, encumbrance balances were not consistently updated to reflect actual or anticipated expenditures, and that grant awards in Fund 3141 were not encumbered.

Response: The CPUC agrees that its encumbrance practices were deficient. During this transition year we will be documenting procedures and training staff in the Fiscal Office and program staff about their responsibilities as it relates to encumbrances and introducing additional management controls over liquidating encumbrances. We believe that this effort will also assist us in ensuring that forecasts and actual expenditures are more accurate.

Observation 5: Appropriation Adjustments May Not Be Equitably Allocated Among Funds

The Audit notes that the Budget Office does not have a documented methodology for allocating appropriation adjustments and therefore some funds may be allocated a disproportionate share of the adjustments.

Response: The CPUC agrees that there is currently no written methodology to distribute appropriation adjustments among the CPUC administered funds. Although the CPUC has followed a consistent approach over the last several years, it needs review and needs to be documented to ensure the methodology remains sound.

Observation 6: Non-Compliance with Statutory Requirements

The Audit states that the Division of Ratepayer Advocates (DRA) does not independently prepare its budget for Fund 3089 and that it is not approved by the commission as described in Public Utilities Code Section 309.5(c). The Audit Report characterizes this as non-compliance with Public Utilities Code Section 309.5(c).

Response: The CPUC respectfully disagrees with the observation that it has not complied with Public Utilities Code Section 309.5(c). On the contrary, the statute appears to support the existing and longstanding practice of having DRA's budget approved by the Executive Director. The fact that the Legislature has not objected to this existing practice would seem to add legitimacy to this conclusion.

Section 308 governs the duties of the Executive Director and states "The executive director shall be responsible for the commission's executive and administrative duties and shall organize,

coordinate, supervise, and direct the operations and affairs of the commission and expedite all matters within the commission's jurisdiction.” The CPUC’s budget is one of the many administrative functions that the Executive Director handles without a vote of the five-member Commission, on behalf of “the commission.” Because DRA’s budget is transferred from the CPUC’s primary user fee account, having just one portion of the overall budget approved by the five-member Commission could result in the Executive Director’s not being able to perform his duties in the CPUC’s overall administration.

The CPUC agrees that there is a need for additional transparency in its budgeting process to allow DRA to fully understand its costs and budgetary needs consistent with Observation 1 and Section 309.5(c). The Budget Control Officer Desk Manual described earlier will ensure that each division is able to understand its expenditures and more effectively forecast its budgetary needs. In addition, updating of the cost allocation plan and appropriation adjustment methodology will further ensure transparency and accuracy of DRA’s budget. The CPUC will work with DRA to jointly develop processes and procedures to complete their respective budget tasks by ensuring information is shared and “appropriately supported and understandable by both parties” as outlined in Observation 6, Recommendation C. DRA’s budget request must ultimately be coordinated with the overall CPUC budget. Although the CPUC recognizes DRA’s budgetary independence, the CPUC believes that continuing and improving the transparency of a process where the Executive Director approves DRA’s budget on behalf of the commission is the appropriate way to interpret the applicable law in light of the overall CPUC budgetary process.

DRA concurs in this response.

Observation 7: Inadequate Fund Balance Reconciliations

The Audit notes that fund balance reconciliation efforts by the CPUC were not performed in a consistent manner and included various errors but that in general, the CPUC did accurately identify the reason for the variances between State Controller’s Office records and the Governor’s Budget.

Response: The CPUC agrees with this observation.

Summary of Response

The Audit correctly identifies that the primary issue the CPUC must address is that its management practices over the budget functions were ineffective. All subsequent observations stem from this shortcoming. In June, even prior to the identification of the fund balance variances, we began the process of committing additional management attention to our administrative functions, with the appointment of a new director for Administrative Services. The CPUC is in the process of bringing on additional resources to assist in developing and shoring up documentation of its practices and procedures.

The CPUC is committed to ensuring that all of our staff can perform their duties effectively and efficiently and to providing the proper training to make that happen. We will ensure that our program staff, administrative staff, and management communicate effectively and that lines of authority are clear. We know that it will take time to get there given the scope of issues identified

David Botelho
January 8, 2013

Page | 7

in the Audit, but expect all recommendations to be accomplished by December 31, 2013. We have already begun taking corrective actions and are preparing a comprehensive corrective action plan to ensure that all observations and recommendations are addressed and remedied. We look forward to continuing to work with you and your staff to improve the CPUC's budget practices.

Should you have any questions, please feel free to contact Michelle Cooke, Administrative Services Director, at (415) 703-2163.

Sincerely,

ORIGINAL SIGNED BY:

Paul Clanon
Executive Director

cc: Michael R. Peevey, President, CPUC
Edwin Quan, Deputy Executive Director, CPUC
Michelle Cooke, Administrative Services Director, CPUC
Joseph Como, Acting Director, Division of Ratepayer Advocates

EVALUATION OF RESPONSE

The California Public Utilities Commission's (CPUC) response to the draft audit report has been reviewed and incorporated into the final report. We acknowledge CPUC's willingness to implement our recommendations and prepare a comprehensive corrective action plan to be submitted for review by our office. In evaluating CPUC's response, we note CPUC concurred with all observations except for Observation 6. We provide the following comments:

Observation 6: Non-Compliance with Statutory Requirements

CPUC disagrees it has not complied with Public Utilities Code (PUC) section 309.5 (c) stating the statute appears to support the existing and longstanding practice of the CPUC Executive Director approving the Division of Ratepayer Advocates' (DRA) budget. CPUC further states that since the Legislature has not objected to the existing practice, the lack of objection seems to add legitimacy.

The Legislature's lack of objection to an existing practice does not make the practice acceptable or appropriate. Although PUC section 308 states "The executive director shall be responsible for the commission's executive and administrative duties"; section 309.5 (c) explicitly states the DRA director shall develop its budget with final approval by the commission. PUC section 20 defines "commission" as meaning the Public Utilities Commission created by section 1 of Article XII of the California Constitution. Article XII, section 1 identifies the Public Utilities Commission as consisting of five members appointed by the Governor.

CPUC also states the CPUC budget is one of the many administrative functions the Executive Director handles without a vote of the five-member commission, on behalf of "the commission"; and having one portion of the overall budget approved by the five-member commission could result in the Executive Director not being able to perform his CPUC administrative duties. However, we note that budget resolutions are currently submitted to the Commissioners for four of CPUC's telecommunication funds. The resolutions cite the reason for submittal as compliance with PUC section 273 (a) which states "Submit an annual budget to the commission..." In these instances the CPUC interprets "commission" as the Commissioners, which is inconsistent with how CPUC interprets section 309.5 (c). Further, it contradicts CPUC's claim that the budget is handled without a vote of the five-member commission. Additionally, we did not observe any instances during our audit where the five-member commission's approval of fund budgets hindered the Executive Director's ability to perform his CPUC administrative duties.

As such, our observation and recommendations will remain as originally reported.

Appendix C

We added a footnote to Fund 0995 – Reimbursements chart to clarify that fiscal years 2010-11 and 2011-12 variance is due to budgeted energy efficiency contracts that have yet to be executed.