California State Auditor

BUREAU OF STATE AUDITS

California Public Utilities Commission:

It Does Not Know Its True Costs of Regulating Transportation Companies

December 1998

98021

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CALIFORNIA STATE AUDITOR

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December 8, 1998 98021

The Governor of California
President pro Tempore of the Senate
Speaker of the Assembly
State Capitol
Sacramento, California 95814

Dear Governor and Legislative Leaders:

As required by the California Public Utilities Code, Section 421(f), the Bureau of State Audits presents its audit report concerning the Public Utilities Commission's (commission) expenditure of fees paid by freight railroad and passenger transportation companies to the commission's Public Utilities Commission Transportation Reimbursement Account. This report concludes that the fees the commission collects from privately owned railroad and passenger transportation companies may not sufficiently cover the costs of regulating these companies. As a result, the commission's other fee payers, such as trucking and utility companies, may be subsidizing railroad and passenger transportation regulation.

Respectfully submitted,

KURT R. SJOBERG
State Auditor

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SUMMARY

Audit Highlights . . .

Our review of Public Utilities Commission (commission) expenditures for transportation regulation found that:

- ☑ ***Other fee-payers may have subsidized up to $919,000 in transportation regulation costs.***
- ☑ ***Allowable railroad costs of $2.9 million fell below the $3 million cap established by the Public Utilities Code.***
- ☑ ***The commission is not properly allocating $5.1 million of its overhead expenses.***

RESULTS IN BRIEF

The fees the Public Utilities Commission (commission) collects from privately owned freight railroad and passenger transportation companies (transportation companies) may not sufficiently cover the costs of regulating these companies. As a result, the commission's other fee-payers, such as trucking and utility companies, may subsidize freight railroad and passenger transportation regulation.

Because its former accounting system did not isolate expenditures for the commission's various funds, the commission does not know the true cost of transportation regulation during fiscal year 1997-98. Consequently, its other fee-payers may have subsidized up to $919,000 for these costs. In addition, fees received from railroad corporations did not cover all of the commission's corresponding expenses because the Public Utilities Code (code) limits the amount and types of costs for which the commission can use such moneys. Nonetheless, the commission spent approximately $2.9 million on allowed railroad costs—$119,000 less than the $3 million cap established by the code.

Finally, the commission installed a new accounting system in July 1998 that allows it to separate costs by fund. However, in determining which costs it should allocate to its various funds, the commission excluded $5.1 million in overhead expenses for facilities. Unless it properly allocates all relevant costs on the new accounting system, the commission will continue to be unable to determine the true costs of providing services to transportation companies and other fee-payers.

RECOMMENDATIONS

To ensure that its other fee-payers are not subsidizing railroad safety regulation, the commission should press for legislation allowing it to use railroad corporation fees to pay a fair share of its overhead costs.

To determine its true costs of regulating utility and transportation companies, the commission should equitably allocate all relevant overhead costs, including rent for its headquarters building, to its various funds.

AGENCY COMMENTS

The commission does not dispute the findings or conclusions in this report and plans to implement the recommendations. ■

INTRODUCTION

BACKGROUND

In addition to regulating all privately owned utilities, the commission enforces safety and service standards for freight and passenger transportation companies, such as railroads, limousines, and chartered buses. Until fiscal year 1983-84, general taxes funded most of the commission's activities. However, in 1983 the Public Utilities Code (code) was amended to allow the commission to set fees for privately owned utility and transportation companies to cover the costs budgeted for regulating their industries, minus certain adjustments.

The commission uses a number of funds for its operations. One of these, the Public Utilities Commission Utilities Reimbursement Account (utilities fund), is the depository for fees collected from utility companies. Although designated as the utilities fund, the commission uses it as the principal operating fund and makes all monthly payroll and operating-expense payments from it. Once a month, the commission reimburses the utilities fund by transferring from its other funds the estimated amounts spent on their behalf to the utilities fund.

The commission's Public Utilities Commission Transportation Reimbursement Account (transportation fund) collects fees paid by privately owned freight railroad and passenger transportation companies (transportation companies) subject to the commission's jurisdiction. For fiscal year 1997-98, the commission's budgeted transportation fund expenditures were approximately $7.2 million. By law, the commission cannot reimburse the utilities fund more than the budgeted amount. The code sets further limits on the amount of reimbursable expenses for the transportation fund because it restricts the type and amount of costs that can be paid with railroad fees to $3 million.

To estimate regulatory costs for the transportation fund, the commission used the Standard Time Reporting (STR) system. The STR system used employees' monthly time sheets to accumulate direct personnel charges and automatically calculated labor hours attributable to each fund. Using percentages based on the labor hours the STR system generated, the commission estimated total expenditures, including salaries, benefits, and operating costs, for each of its funds. It then charged each fund the lesser of the estimated or budgeted expenditures.

SCOPE AND METHODOLOGY

Section 421 of the code requires the Bureau of State Audits (bureau) to perform an annual audit of the expenditures of fees paid by transportation companies to the transportation fund beginning in fiscal year 1996-97. This audit, our second of the transportation fund, covers fiscal year 1997-98. (Refer to the Appendix for a summary of the commission's actions on our recommendations from the fiscal year 1996-97 audit.)

To perform our audit, we reviewed pertinent state laws and regulations related to the transportation fund. We also interviewed the commission's budget and accounting staff to determine how the commission sets the transportation fund's annual budget and records related revenues and expenditures. In addition, we interviewed supervisors of the units regulating transportation companies to understand their programs.

During fiscal year 1997-98, the commission allocated salaries, benefits, and operating costs to all of its funds on the basis of direct labor hours because its automated accounting system did not accumulate expenditures by fund. To test the validity of the allocation, we compared direct labor hours recorded in the commission's STR system to employees' monthly time sheets and reviewed the STR system data for compatibility with task-related codes and employee listings. We then reviewed the reasonableness and mathematical accuracy of the commission's allocation of costs to its funds. Finally, we reviewed the fees received in the commission's transportation fund.

Because the accounting system did not accumulate expenditures by fund, we identified the railroad fee expenditures using other means. Specifically, we compared railroad inspection activities for fiscal year 1997-98 to those in fiscal years 1995-96 and 1996-97 to determine whether the commission maintained a consistent level of inspections during the comparison period. We also reviewed employee time charges to the transportation fund for railroad safety to determine whether these charges were appropriate. Further, we estimated building rental and maintenance costs for the railroad safety program based on the number and location of its employees, and we calculated travel and state vehicle expenses related to the railroad safety program based on invoices and travel expense claims. Finally, we compared our calculation of total railroad safety expenditures to the statutory limits on these expenditures.

In July 1998, the commission installed a new automated accounting system. To determine whether the new system would accurately accumulate cost data, we reviewed the commission's allocation methods for reasonableness. Because the new system was not in place during our audit period, unless otherwise stated, all references to the automated accounting system and related procedures pertain to the system and procedures in place during fiscal year 1997-98. ■

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AUDIT RESULTS

The Commission's Transportation Fees May Not Cover All Related Costs

The commission does not know the true costs of regulating privately owned freight railroad and passenger transportation companies (transportation companies). This is because, until recently, its automated accounting system was unable to separately identify Public Utilities Commission Transportation Reimbursement Account (transportation fund) expenditures. Nonetheless, if the commission's estimate of the fund's costs for fiscal year 1997-98 is accurate, its other fee-payers, such as trucking and utilities companies, may have funded up to $919,000 in freight railroad and passenger transportation regulation costs.

The commission's other fee-payers may have subsidized up to $919,000 in transportation regulation costs.

The accounting system identified the commissions's costs by branches or divisions. However, the system was not designed to separate branch and division costs by fund. For example, the rail safety branch's costs were charged to a separate code in the accounting system, but branch staff perform tasks financed by several funds, including the transportation fund, the State Highway Account, and the Transportation Planning and Development Account. Because of these deficiencies, the accounting system could not split costs among the different funds.

Nonetheless, every month, using information from the STR system, the commission estimated the costs each of its funds would reimburse the utilities fund, as discussed in the Introduction. However, by law, the commission cannot transfer to the utilities fund more than the amount budgeted. Table 1 on page 8 compares the results of the commission's fiscal year 1997-98 calculation of estimated expenses for the transportation fund with its budget.

As Table 1 shows, the commission's estimate of the transportation fund's share of actual expenditures suggests that the costs of regulating transportation companies were approximately $919,000 greater than the amount budgeted for fiscal year 1997-98. Nonetheless, the chief of the commission's Management Services Branch stated that the budget more accurately reflects the transportation fund's expenditures because the estimate overstates the fund's overhead costs, such as its portion of executive management salaries. However, he could not provide us with any evidence to support his claim.

TABLE 1

Estimated Costs of Regulating Transportation Companies Exceeded the Budget in Fiscal Year 1997-98 (In Thousands)

Transportation Companies	Budgeted Expenditures	Estimated Expenditures	Amount Over Budget
Passenger	$4,196	$4,925	$729
Railroad	3,000	3,190*	190
Total	**$7,196**	**$8,115**	**$919**

*These expenditures do not include $335,000 paid by the Transportation Planning and Development Account.

THE CODE RESTRICTS SPENDING OF RAILROAD FEES

Not only is the commission unsure of the true costs of regulating transportation companies, the code limits the amount and types of expenditures for which the commission can use its railroad corporation fees. The code restricts spending of railroad fees to the safety personnel that inspect railroads and enforce rail safety regulations, the safety inspection clerical and support staff, the legal personnel pursuing safety violations, and our audit. It also limits the amount of these expenses to $3 million.

The code does not allow railroad fees to reimburse railroad safety's proportionate share of the commission's overhead costs, which include costs associated with accounting, personnel, and executive management activities. Therefore, for fiscal year 1997-98, the commission obtained $335,000 from the Transportation Planning and Development Account to cover this portion of railroad safety costs. Based on the commission's estimate and information from the STR system, however, railroad safety's pro rata share may have been significantly higher. For example, for salaries and benefits alone, the STR system allocated overhead costs totaling $652,000 to railroad safety, or $317,000 more than the amount funded. Because the commission cannot use the railroad fees to pay overhead costs, any shortfall in funding is passed on to its other fee-payers.

In fiscal year 1997-98, the commission sponsored Assembly Bill 1605, which required railroad corporations to pay their proportionate share of commission overhead costs. Although the Legislature passed the bill, the governor vetoed it because certain provisions conflicted with other recently passed legislation. However, the governor called on the Legislature to reintroduce the measure in its December 1998 session as an urgency bill.

THE COMMISSION'S ALLOWABLE RAILROAD COSTS WERE WITHIN LEGAL LIMITS

Railroad safety expenditures of $2.9 million fell below the $3 million cap established by the code.

The commission's expenditures for allowable railroad safety activities did not exceed the cap established in law. In addition to restricting how the commission uses railroad fees, the code, as previously mentioned, also limits the amount that the commission can spend on these allowable costs to $3 million. According to our calculation, expenditures for allowed railroad safety costs totaled $2.9 million in fiscal year 1997-98. Table 2 on page 10 details these expenditures.

Because actual expenditures fell below the $3 million cap, the commission plans to refund the $119,000 difference to the railroad corporations. The chief of the Management Services Branch said that, as in past years, the commission will adjust future railroad fees for any money collected but not spent on railroad safety in fiscal year 1997-98. For example, the commission has reduced fiscal year 1998-99 railroad fees by $180,000—the amount of unspent fiscal year 1996-97 fees.

THE COMMISSION DOES NOT PROPERLY ALLOCATE SOME OVERHEAD COSTS

Although the new automated accounting system, installed in July 1998, apportions costs by fund, the commission may still not know the true costs of regulating transportation. This is because the commission has not properly identified all overhead

TABLE 2

Allowable Railroad Safety Costs
Fiscal Year 1997-98
(In Thousands)

Category	Allowable Costs
Salaries and wages	$1,724
Benefits	460
Operating expenses and equipment	622
Audit costs for Bureau of State Audits	75
Total	**$2,881**

Annual rent of $5.1 million is not properly charged to all funds.

costs it should allocate to its various funds. Specifically, it did not include $5.1 million in annual rent for the commission's headquarters building in its allocated overhead costs. Instead, the commission plans to charge the entire $5.1 million rent, which represents approximately 5.1 percent of the commission's total $99 million budget, to the utilities fund. The commission's budget officer said this cost was not allocated because it is budgeted as a cost of the utilities fund alone. However, as with its other rent costs, it should charge a percentage of rent for the headquarters building to the appropriate funds based on square footage. Aside from failing to allocate these rent costs, we found that the methods the system uses to assign other costs to the various funds are sound.

RECOMMENDATIONS

To ensure that its other fee-payers are not subsidizing railroad safety regulation, the commission should press for legislation allowing it to use railroad corporation fees to pay a fair share of its overhead costs.

To determine its true costs of regulating utility and transportation companies, the commission should equitably allocate all relevant overhead costs, including rent for its headquarters building, to its various funds.

We conducted this review under the authority vested in the California State Auditor by Section 8543 et seq. of the California Government Code and according to generally accepted governmental auditing standards. We limited our review to those areas specified in the audit scope section of this report. The information in this report was shared with the commission, and we considered its comments.

Respectfully submitted,

KURT R. SJOBERG
State Auditor

Date: December 8, 1998

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APPENDIX

The Commission's Actions on the Fiscal Year 1996-97 Audit Report Prepared by the Bureau of State Audits

Recommendations	Commission's Actions
To verify that the fees it charges transportation companies cover the costs of regulating these companies, the commission should do the following:	
• Make certain that its new automated accounting system separately identifies expenditures by fund.	The commission established a new accounting system in July 1998 that separately identifies expenditures by fund.
• Ensure that it develops and documents methods to allocate costs, such as facilities and overhead, to the funds included in its new accounting system.	The commission developed and documented methods to allocate facilities and overhead costs included in its new accounting system.
To ensure that the other fee-payers are not subsidizing railroad regulation, the commission should seek legislation to include overhead costs in the commission's budget for spending railroad fees.	The commission sponsored legislation requiring railroad corporations to pay their pro rata share of overhead costs. The governor vetoed this legislation but recommended that the Legislature reintroduce the bill in its December 1998 session.
To ensure that it spends its railroad fees only for authorized purposes, the commission should perform a detailed review of its railroad safety expenditures and reimburse the utilities fund only for allowable costs.	The commission reduced fiscal year 1998-99 railroad corporation fees by $180,000, the amount by which fees exceeded allowable expenditures in fiscal year 1996-97.

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Agency's response to the report provided as text only:

STATE OF CALIFORNIA PETE WILSON, Governor

PUBLIC UTILITIES COMMISSION
505 VAN NESS AVENUE
SAN FRANCISCO, CA 94102-3298

November 23, 1998

Kurt R. Sjoberg
State Auditor
Bureau of State Audits
555 Capitol Mall, Suite 300
Sacramento, California 95814

Dear Mr. Sjoberg:

This letter is in response to your letter dated November 19, 1998 in which you request that the Commission respond in writing to your draft report entitled "*California Public Utilities Commission: It Does Not Know Its True Cost of Regulating Transportation Companies*." The Commission does not dispute the findings and conclusions contained in your report and will make every effort to implement the recommendations expressed therein. I would also like to take this opportunity to provide some context for those findings and recommendations.

Your finding that CPUC expenditures for passenger carrier regulation exceeded budgeted costs by $729,000 is not unanticipated. Your prior audit of 1996-97 transportation program costs concluded that estimated actual expenditures for passenger carrier regulation exceeded budgeted expenditures by $1.1 million. I believe that these findings are attributable to the transition period during which trucking regulation was transferred to CHP and DMV pursuant to Chapter 1042, Statutes of 1996 (AB 1683, Conroy). As mentioned in my response to your prior report, the issue of CPUC staff transfer versus staff reduction was not resolved by the State Personnel Board until December 1997. During the 1997 calendar year, CPUC staff previously assigned to trucking regulation were redirected to passenger carrier regulation pending a decision by SPB.

In addition, your audit found that the new accounting system (California State Accounting and Reporting System) implemented at the Commission effective July 1, 1998 reasonably allocated costs, but did not identify all allocable overhead costs. Specifically, $5.1 million in annual rent for the Commission's headquarters building in San Francisco was not allocated among the various support funds, but was allocated to the utilities fund only. I agree that the San Francisco State Building costs should be allocated among all programs and funds, and CPUC funding levels for the PUC Utilities Reimbursement Account, PUC Transportation Reimbursement Account and Transportation Rate Fund reflect these costs. However, effective with the 1997 Budget Act, bond and interest payments for the San Francisco State Building which previously
1* were included in the support budget under operating expenses and equipment category - facilities operation, were separately identified as a capital outlay expense funded exclusively from the utilities fund. Under the Budget Act, the Commission had no alternative than to charge these costs to the utilities fund. However, the Department of Finance recently indicated

*California State Auditor's comment on this response is on page R-3.

that this would be changed for the 1999-2000 Budget Bill to reflect support from the Commission's other funds.

Finally, to ensure that other utilities and transportation companies are not subsidizing railroad corporation overhead costs, your report again recommended that the Commission pursue legislation to require railroad corporations to pay their share of CPUC overhead costs. As your report states, and as stated in my one-year status report dated November 20, 1998 on the Commission's efforts to implement the recommendations in your 1997 report, CPUC sponsored 1998 legislation (AB 1605) to implement this recommendation. This bill was vetoed by the Governor because of a technical conflict with another bill. In his veto message, the Governor called on the legislature to reintroduce this bill and the Commission will again sponsor such legislation.

I was pleased to see in the Appendix to your report that the Commission has complied with or has attempted to comply with all the recommendations in your 1997 report. Thank you for this opportunity to respond in writing to your draft which I understand will be included in your final report.

Sincerely,

Signed by Wesley M. Franklin

WESLEY M. FRANKLIN
Executive Director

COMMENT

California State Auditor's Comment on the Response From the Public Utilities Commission

To provide clarity and perspective, we are commenting on the Public Utilities Commission's (commission) response to our audit report. The number corresponds to the number we have placed in the response.

1 It is true that the 1997 Budget Act requires the commission to charge the bond and interest payments for the San Francisco Headquarters building to the utilities fund. As we state on page 10, this is the reason the commission gave for not allocating these costs to its other funds. However, the commission is silent regarding its responsibility in developing the budget. The commission never asserted, either in its response or during the audit, that it suggested to the Department of Finance (department) that a proportionate share of these costs be reimbursed by its other funds. The fact that the department is planning to make such a change in the fiscal year 1999-2000 budget bill suggests that, had the commission proposed the change earlier, the department would have made it.

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