California State Auditor

BUREAU OF STATE AUDITS

California Public Utilities Commission:

Most of Its Transportation Regulation Costs Were Appropriate, But It Needs to Better Allocate Indirect Costs

December 1999
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CALIFORNIA STATE AUDITOR

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December 16, 1999 99021

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 (commission) expenditure of fees paid by freight railroad and passenger transportation companies to the commission's Public Utilities Commission Transportation Reimbursement Account (transportation fund). This report concludes that most transportation fund expenditures are appropriate, but that the commission needs to allocate its indirect costs more equitably.

Respectfully submitted,

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State Auditor

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SUMMARY

RESULTS IN BRIEF

The California Public Utilities Commission (commission) spent the fees it collected from transportation and railroad companies in fiscal year 1998-99 for authorized purposes. In addition, the commission's new accounting system accurately recorded direct and indirect costs and properly allocated indirect costs. However, total fiscal year 1998-99 expenditures recorded in the Public Utilities Commission Transportation Reimbursement Account (transportation fund) are overstated. This is because the commission used faulty criteria for reallocating building-related costs when it tried to correct a deficiency in its cost allocation plan. In addition, it inappropriately shifted into the transportation fund overhead costs that had originally been allocated to another fund. In total, the commission overstated expenditures by $348,000, which is 5 percent of the total reported transportation fund expenditures of $7.2 million for fiscal year 1998-99.

Audit Highlights . . .

Our review of the Public Utilities Commission's (commission) expenditures for its Transportation Reimbursement Account (transportation fund) found that:

- ☑ ***The commission spent fees collected from transportation and railroad companies for authorized purposes.***
- ☑ ***Fiscal year 1998-99 expenditures for the transportation fund were overstated by $348,000.***
- ☑ ***The fiscal year 1999-2000 cost allocation plan will overallocate rental expenditures to the transportation fund by an estimated $202,000.***
- ☑ ***The commission cannot provide detailed support for adjustments that reduced its recorded cash balances by $297,000.***

The commission's plan for allocating indirect costs in fiscal year 1999-2000 is reasonable, except for its methods of allocating building-related costs. This deficiency will result in an estimated $202,000 overallocation to the transportation fund in fiscal year 1999-2000.

In preparing to implement its new accounting system in fiscal year 1998-99, the commission made unsubstantiated adjustments to its cash accounts to make them match its bank statements. Taken together, these adjustments reduced the commission's recorded cash balances by $297,000. This difference could be the result of a bank error or an error at the commission. The cause of the cash shortage cannot be determined until the commission does further research.

RECOMMENDATIONS

To properly determine the costs of regulating transportation and railroad companies, the commission should take these steps:

- Use a reasonable and consistent methodology for allocating indirect costs so that all funds pay an appropriate share of these costs.
- Avoid making unwarranted reallocations of expenditures.

To support the adjustments it made to its cash accounts, the commission should research its cash transactions to substantiate purported errors and modify its records if necessary.

AGENCY COMMENTS

The commission agrees with the findings in this report and plans to implement the recommendations. ■

INTRODUCTION

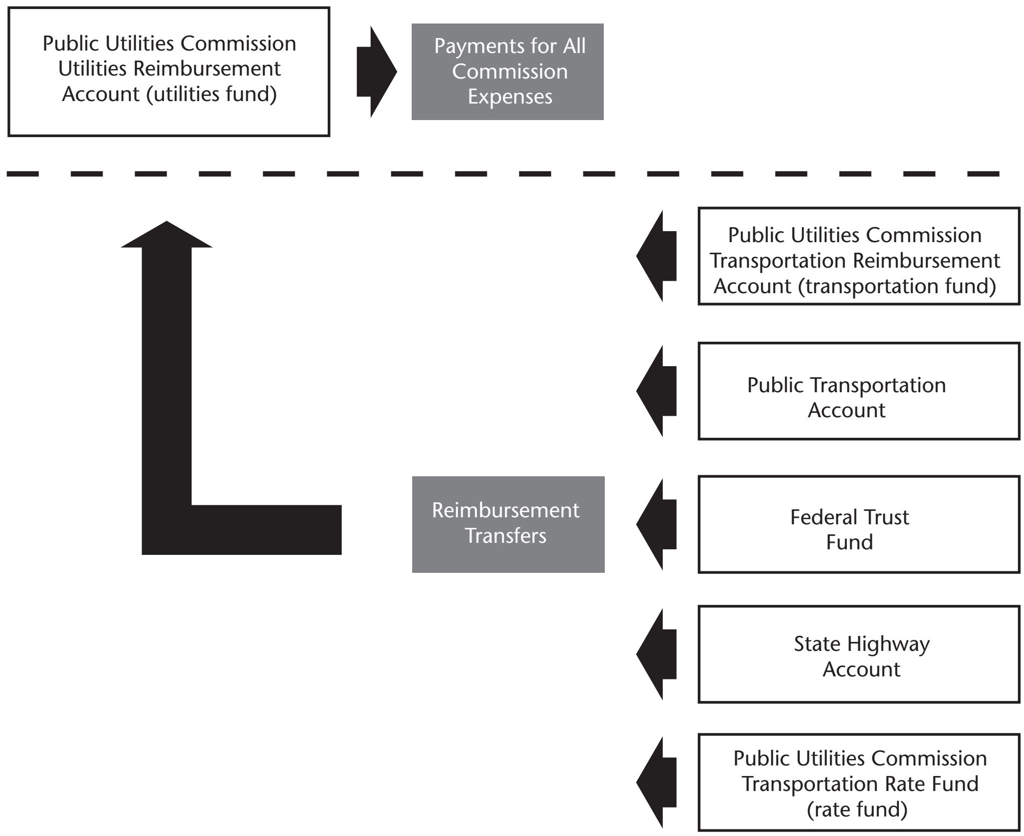
BACKGROUND

In addition to regulating all privately owned utilities, the California Public Utilities Commission (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 and collect fees from privately owned utility and transportation companies to cover the commission's costs of regulating their industries.

The commission uses six funds to pay for the costs of its day-to-day operations. One of these funds, the Public Utilities Commission Utilities Reimbursement Account (utilities fund), is the principal operating fund from which the commission makes all monthly payroll and operating-expense payments. Once a month, the commission reimburses the utilities fund for costs related to the other funds, as calculated by the commission's accounting system. As such, the utilities fund acts as a pass-through for the costs of its sister funds. The Figure on the following page illustrates this payment and reimbursement structure.

FIGURE

Five Commission Funds Reimburse the Utilities Fund for the Expenses It Pays



The commission uses a separate fund, the Public Utilities Commission Transportation Reimbursement Account (transportation fund), to collect fees paid by privately owned freight railroad and passenger transportation companies (transportation companies) that are subject to its jurisdiction. For fiscal year 1998-99, the commission budgeted $7.3 million for transportation fund expenditures. By law, the commission cannot reimburse the utilities fund more than the amount of budgeted expenditures. The law sets further limits on the expenses that can be reimbursed to the utilities fund by limiting reimbursement payments from railroad fees to the direct costs of the commission's railroad safety operations. Because of this spending restriction, the commission separately tracks railroad and nonrailroad expenditures within the transportation fund.

In the past, the commission's accounting system did not isolate expenditures for the commission's various funds. Instead, the commission estimated expenditures based on each fund's proportion of direct labor hours accumulated in a time-reporting system. However, in fiscal year 1998-99, the commission began using the automated California State Accounting and Reporting System (Calstars) to record expenditures for each fund. Maintained by the Department of Finance, Calstars is used by a wide variety of state agencies that electronically submit transactions for processing. Under Calstars, direct costs are attributed to a particular fund and indirect costs, such as facilities costs and administrative salaries, are distributed to funds according to the commission's cost allocation plan. For example, the commission's plan states that building-related costs for its Sacramento office be allocated to various funds based on square foot use.

SCOPE AND METHODOLOGY

Section 421 of the Public Utilities Code requires the Bureau of State Audits, beginning in fiscal year 1996-97, to perform an annual audit of the expenditure of the fees transportation companies pay to the transportation fund. This audit, our third in a series of four, covers fiscal year 1998-99 transactions. (Refer to the Appendix for a summary of the commission's actions on our prior recommendations from the fiscal year 1997-98 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 that regulate transportation companies to understand their programs.

During fiscal year 1998-99, the commission recorded direct costs and allocated indirect costs by using Calstars. To determine the validity of expenditures, we tested a sample of direct and indirect charges to see if they were reasonable, accurate, and properly recorded to the transportation fund. We then reviewed indirect charges to identify whether they were subsequently distributed to the commission's various funds according to the commission's cost allocation plan. In addition, we reviewed railroad safety expenditures to determine whether they included only allowable costs. In our prior audits, we recommended that the commission seek legislation to broaden railroad safety expenditures to include a reasonable share of indirect costs. The commission was successful in winning approval of such legislation in October 1999, as noted in the Appendix.

In our prior audit, we reviewed the cost allocation plan for fiscal year 1998-99 indirect costs and found it reasonable, except for the allocation of rent for the commission's headquarters. During our current audit, we reviewed the reasonableness of the cost allocation plan for fiscal year 1999-2000. Finally, we reviewed the fees received in the commission's transportation fund to see if they were properly calculated and recorded. ■

AUDIT RESULTS

EXCEPT FOR SOME REALLOCATED INDIRECT COSTS, TRANSPORTATION FEES PAID FOR APPROPRIATE EXPENSES

During fiscal year 1998-99, the California Public Utilities Commission (commission) properly spent transportation fees on Public Utilities Commission Transportation Reimbursement Account (transportation fund) expenditures, as identified by its new accounting system. Direct costs for the transportation fund, such as salaries for railroad safety inspectors, were reasonable and accurately recorded. Indirect costs, such as salaries for computer technology staff, were reasonable and were accurately posted and properly allocated to the transportation fund according to the commission's cost allocation plan. In addition, railroad safety expenditures included only allowable costs. However, management made two cost reallocations that caused the transportation fund's expenditures to be overstated. In these two cases, the commission inappropriately reallocated $348,000 of indirect costs to the nonrailroad operations of the transportation fund. This figure represents 5 percent of the fund's reported expenditures of $7.2 million.

In the first instance, the commission decided to reallocate certain building-related costs to the transportation fund. This was done in an attempt to correct an underallocation of rental charges for the commission's headquarters. As we noted in last year's audit, the commission planned to allocate all fiscal year 1998-99 rent for its headquarters building to one fund—the Public Utilities Commission Utilities Reimbursement Account (utilities fund)—despite the fact that six of its funds, including the transportation fund, use the building. At the same time, the commission planned to allocate other rental and building-related costs to all funds according to use. We concluded that the commission should equitably and consistently allocate headquarters rent to its various funds.

To correct the underallocation of headquarters rent to its nonutility funds, the commission decided to reallocate other building-related costs for its headquarters, such as building maintenance, to the five funds left out of the rental allocation. Allocations to these funds were based on the relative size of each fund's budget rather than on each fund's use of commission buildings. Consequently, the final allocation of building-related costs to the transportation fund was significantly higher than it would have been if all headquarters costs, including rent, had been allocated according to use. As the Table shows, the estimated overallocation was about $208,000.

TABLE

The Commission Overallocated Indirect Costs to the Transportation Fund's Nonrailroad Operations in Fiscal Year 1998-99 (in Thousands)

Expenditure Type	Nonrailroad Expenditures	Railroad Expenditures	Total Expenditures
Personnel services	$2,285	$2,164	$4,449
Operating expenses and equipment	1,931	825	2,756
Reported expenditures	**4,216**	**2,989**	**7,205**
Building overallocation	(208)	0	(208)
General overhead overallocation	(140)	0	(140)
Total overallocation	**(348)**	**0**	**(348)**
Adjusted expenditures	**$3,868**	**$2,989**	**$6,857**

The Table also shows a second overallocation of $140,000. In this case, the commission inappropriately shifted that amount in administrative overhead costs from the Public Utilities Commission Transportation Rate Fund (rate fund) to the transportation fund in July 1999, when it found that the rate fund would otherwise be overexpended. Calstars had originally allocated these costs to the rate fund, which regulates another segment of the transportation industry, according to a reasonable cost allocation method. These costs were therefore not appropriate costs of the transportation fund. One of the reasons the commission implemented Calstars was to determine expenditures accurately on a fund-by-fund basis. When the commission reallocated system-generated expenditures rather than adjusting its budgets, it ignored the best information available on the actual costs related to these particular funds.

THE COMMISSION'S FISCAL YEAR 1999-2000 COST ALLOCATION PLAN DOES NOT PROPERLY ALLOCATE ITS HEADQUARTERS RENTAL COSTS

Although the commission's cost allocation plan for fiscal year 1999-2000 is generally reasonable, the commission's method for allocating headquarters rent remains inadequate. Instead of allocating this cost to the utilities fund alone (as it did in fiscal year 1998-99), the commission now plans to allocate it among three funds. This is an improvement on the old allocation method, but the plan still leaves out three other funds that use the building. According to the commission's budget officer, the commission decided to split the rental cost among only three funds because that was the way the cost had been allocated at some time in the past. In addition, the allocation will be based on the relative size of each fund's budget rather than the space each fund uses, making it inconsistent with the commission's method for allocating other building-related charges. The planned method will overallocate building-related costs to the transportation fund by an estimated $202,000 in fiscal year 1999-2000.

THE COMMISSION MADE UNEXPLAINED ADJUSTMENTS TO ITS CASH ACCOUNT

The cash for the commission's six funds is held in one joint account for ease of administration. The commission uses its accounting system to keep track of the portion of the joint account that belongs to each individual fund. In preparing for implementation of Calstars in fiscal year 1998-99, the commission decided to review its accounting records before transferring them to the new accounting system. Part of this effort involved reconciling cash balances on the accounting records to those on its bank statements and then adjusting its records. When the commission found that its cash balances exceeded those in the bank by $297,000, it reduced the cash account for its utilities fund by that amount. When we reviewed the adjusting entries, the commission could not provide detailed support justifying those entries. In other words, the commission cannot explain why its accounting records indicated a higher cash balance than that reported by the bank. This difference could be the result of a bank error or an error at the commission. It is impossible to determine the cause of the cash shortage until the commission does further research.

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 government auditing standards. We limited our review to those areas specified in the audit scope section of this report.

Respectfully submitted,

KURT R. SJOBERG
State Auditor

Date: December 16, 1999

Staff: Catherine Brady, CPA, Audit Principal
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Brian Kishiyama

APPENDIX

The Commission's Actions on the Fiscal Year 1997-98 Audit Report Prepared by the Bureau of State Audits

Recommendations	Commission's Actions
To ensure that the other fee payers are not subsidizing railroad safety regulation, the California Public Utilities Commission (commission) should press for legislation allowing it to use railroad corporation fees to pay a fair share of its overhead costs.	The governor approved legislation sponsored by the commission that will allow it to use railroad corporation fees to pay indirect costs. However, because these changes will not take effect until fiscal year 2000-01, other fee payers continued to subsidize railroad safety regulation in fiscal year 1998-99.
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.	In fiscal year 1998-99, the commission reallocated some building-related costs in an attempt to correct for the inadequate allocation of headquarters rent. However, the commission wound up overallocating building-related costs in total for the Public Utilities Commission Transportation Reimbursement Account (transportation fund). (See current year audit results for the estimated overallocation.) In its fiscal year 1999-2000 cost allocation plan, the commission intends to allocate headquarters rental costs to only three of six funds using the building. The plan therefore continues to fall short of a proper allocation to all funds. (See current year audit results for the estimated potential overallocation to the transportation fund.)

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Agency's comments provided as text only.

STATE OF CALIFORNIA GRAY DAVIS, Governor

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

December 1, 1999

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 29, 1999 in which you request that the Commission respond in writing to your draft report entitled "California Public Utilities Commission: Most of Its Transportation Costs Were Appropriate But It Needs to Better Allocate Indirect Costs." This report included the following findings:

- CPUC spent the fees it collected from transportation and railroad companies for authorized purposes
- CPUC used faulty criteria for reallocating building-related costs in trying to correct a deficiency in its cost allocation plan, and was not consistent in its allocation of these costs among its various funds.
- CPUC made unsubstantiated adjustments to its cash accounts to make them match its bank statements

Public Utilities Code Section 421 requires that the Bureau of State Audits conduct an annual audit of CPUC transportation program expenses. Legislative intent in requiring this audit is to ensure that transportation fees were used only for authorized purposes. Further, it is reassuring to know that implementation of CALSTARS has resulted in accurately recorded direct and indirect costs, and properly allocated indirect costs.

With respect to the second finding, the Commission concurs that a uniform method of allocating building-related indirect costs should be utilized based on usage, consistent with the CPUC cost allocation plan. The basis used in 1998-99 for allocating bond and interest costs was the 1999-2000 budgeted allocation of these costs. The Commission will seek to change the future allocation of these costs to include all funding sources based on usage.

Finally, the adjustments made to its cash accounts occurred during CPUC's transition from its manual accounting system to the automated CALSTARS system. The Commission believes that the discrepancy between its cash accounts and bank records may have been ongoing and was discovered only when the transition to CALSTARS required that cash accounts match the bank statements. The Commission will continue to research its cash transactions to provide documentation in support of the adjustment, or to modify its records if necessary, as recommended in your report. The outcome of this research will be reported in our periodic status reports on implementing the recommendations in your report.

Thank you for this opportunity to provide a written response to your draft, to be included in your final report. The Commission will provide 60-day, 6-month and one year status reports on its efforts to implement the recommendations in your report.

Sincerely,

(Signed by: Wesley M. Franklin)

WESLEY M. FRANKLIN
Executive Director

cc: Members of the Legislature
Office of the Lieutenant Governor
Attorney General
State Controller
Legislative Analyst
Assembly Office of Research
Senate Office of Research
Assembly Majority/Minority Consultants
Senate Majority/Minority Consultants
Capitol Press Corps