

California State Auditor

B U R E A U O F S T A T E A U D I T S

California Public Utilities Commission:

*Weaknesses in Its Contracting Process
Have Resulted in Questionable Payments*



March 2000
99117.2

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March 16, 2000

99117.2

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 requested by the Joint Legislative Audit Committee, the Bureau of State Audits presents its audit report concerning the California Public Utilities Commission (commission).

This report concludes that the commission does not adequately develop and manage its contracts. For example, it sometimes fails to perform important steps in developing its contracts, such as seeking competitive bids, including a clearly defined scope of work, and preparing reasonably detailed budgets and progress schedules. It also does not always review its consultants' invoices to make sure that the charges are appropriate and sufficiently supported. As a result, the commission has made hundreds of thousands of dollars in questionable payments to its consultants.

Respectfully submitted,

MARY P. NOBLE
Acting State Auditor

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SUMMARY

Audit Highlights . . .

Our review of the California Public Utilities Commission's (commission) contracting practices disclosed that:

- The commission does not always adequately develop and manage its contracts and as a result made more than \$662,000 in questionable payments to its consultants.*
 - Despite the Bureau of State Audits' previous scrutiny of a problematic contract, the commission overpaid the consultant \$12,500 and paid another \$330,000 without adequately reviewing the contractor's invoices.*
 - The commission did not subject one of its contracts to the State's standard contracting process.*
-

RESULTS IN BRIEF

The California Public Utilities Commission (commission) does not always adequately develop and manage its contracts. For example, it does not consistently seek competitive bids, clearly define the scope of contracted work, and prepare reasonably detailed budgets and progress schedules. It also does not always review its consultants' invoices to ensure that all charges are appropriate and sufficiently supported. As a result, the commission has paid hundreds of thousands of dollars on invoices that included improper charges or lacked sufficient detail. Because the commission receives most of its funding from assessments on utility companies—which pass the costs on to consumers—when it makes improper payments the public ends up paying higher utility rates than necessary.

The commission, which has broad authority to regulate the State's investor-owned utility companies, employs a diverse staff of more than 800 people, including economists, engineers, administrative law judges, accountants, lawyers, and support personnel. Despite the range of expertise on its staff, the commission needs to contract with consultants when it does not have the necessary resources to provide certain services. In fiscal year 1998-99, the commission allotted more than \$11 million of its \$106 million budget to contracted services.

Although the commission consistently monitored the progress of its consultants' work, weaknesses in its contracting process were evident in our review of a sample of 25 commission contracts amended or entered into during fiscal year 1998-99 as well as in our previous review of the commission's contract to have an outside consultant investigate the 1998 San Francisco power outage. By failing to obtain competitive bids on contracts, inadequately reviewing invoices, and not requiring consultants to adhere to state travel guidelines, the commission made more than \$662,000 in questionable payments to its consultants. During fiscal years 1997-98 and 1998-99, the commission approved payments totaling more than \$650,000 to one consultant, even though the consultant did not provide adequate supporting documents for more than \$350,000 of the costs. More than \$70,000 of these unsupported charges were approved

for payment in fiscal year 1998-99. We also found significant weaknesses in one consumer education contract that the commission handled outside the State's normal systems of control.

An internal audit of the commission's consultant contracting process, conducted after our previous audit, identified several weaknesses we include in this report. The commission has begun to address these weaknesses through training and the development of a procedures manual. However, the commission must sustain these efforts to make sure that meaningful change occurs within its organization.

RECOMMENDATIONS

To ensure that it properly develops and manages its contracts, the commission should establish controls over its contracting process. For example, it should include clearly defined scopes of work in all contracts, solicit competitive bids whenever possible, and properly review consultant invoices to verify that its needs are being met and that payments are made only for appropriate services received.

The commission should require all contractors to comply with state travel guidelines and should pay only for allowable travel expenses. In addition, it should recover amounts it has overpaid to contractors for travel expenses.

The commission should use the State's contracting process for all contracts it develops or manages, including contracts for consumer education programs.

The commission should continue to implement the recommendations contained in the internal audit report on its contracting process.

AGENCY COMMENTS

The commission agrees with the report's conclusions and notes that it has already taken several actions to strengthen its contracting. ■

INTRODUCTION

BACKGROUND

The California Public Utilities Commission (commission) consists of five commissioners appointed by the governor, with Senate approval, for six-year terms. The commission has broad powers to regulate investor-owned and operated natural gas, electric, telephone, water, sewer, steam, and transportation companies in California. During fiscal year 1997-98, the commission had jurisdiction over more than 5,000 utilities and carriers. The commission's regulatory activities—such as establishing operating authority, overseeing service standards, authorizing rate changes, and monitoring safety—benefit consumers by giving them increased choices among new and upgraded utility products and services and by protecting them where competition otherwise does not. The commission employs more than 800 people, including economists, engineers, administrative law judges, accountants, lawyers, and support staff. It is generally organized along industry lines, with a division dedicated to monitoring each regulated industry.

The Commission Contracts for Services Its Staff Cannot Provide

Despite its diverse staff, the commission contracts with consultants when it does not have the resources to provide required services. Normally, when a division identifies a need for a contract, it appoints a contract manager who has knowledge of the services to be provided. The contract manager consults with the commission's contracts office to determine the type of contract needed and the process required to identify a contractor. The contract manager also contacts the commission's fiscal staff to ensure that funds are available for the desired work. Once the work has begun, the contract manager monitors the work of the consultant to make sure that the commission's needs are being met and reviews the related invoices to verify that the billed costs are appropriate. To ensure that billed costs do not exceed available funds, the contract manager, contracts office, and fiscal office need to maintain payment ledgers.

Some commission contracts are not part of the State’s usual contracting process because they are exempt from competitive bidding requirements or Department of General Services approval. For example, the Public Contract Code exempts expert witness contracts—which pay consultants to provide expert guidance and testimony for matters pending before the commission—from competitive bidding requirements. The Public Contract Code also exempts from competitive bidding any emergency contract, defined as “a sudden, unexpected occurrence that poses a clear and imminent danger, requiring immediate action to prevent or mitigate the loss or impairment of life, health, property, or essential public services.” Finally, the Public Utilities Code states that the Public Contract Code sections that require Department of General Services approval on all consultant and advisory service contracts do not apply when the commission finds that extraordinary circumstances justify expedited contracting. When the commission does not solicit competitive bids or receive approval from the Department of General Services, it is still responsible for ensuring that it follows proper contracting practices.

A Previous Bureau of State Audits’ Report Noted Problems With One of the Commission’s Contracts

In May 1999, the Bureau of State Audits issued a report concluding that the commission did not effectively manage a consulting contract for investigating the massive power failure that occurred in San Francisco in December 1998. In this report, we found that the commission poorly monitored its contract and could not substantiate the cost of the consultant’s investigation. Specifically, we stated that the commission failed to review the qualifications of subcontractors, did not ensure the quality of the resulting investigative report, and was not able to substantiate the cost of the investigation. Since the consultant had not yet invoiced the State when we issued our report, we could not validate the total costs of the investigation or determine whether the consultant complied with the contract’s billing specifications. Therefore, we recommended that the commission conduct another review of the investigative report before paying the consultant for services rendered. We also stated that, in performing the review, the commission should determine whether the report complied with the contract’s specifications and that, before paying the consultant’s invoices, the commission should audit all charges to determine whether they were appropriate and complied with contract provisions.

Additionally, we found that there was confusion regarding jurisdiction over the investigation of the San Francisco power outage. Both the commission and the California Independent System Operator, a nonprofit corporation that controls the State's electrical power grid, claimed jurisdiction. We recommended that the commission continue to work with the California Independent System Operator to address the jurisdictional issues that surfaced during the investigation of the outage.

SCOPE AND METHODOLOGY

The Joint Legislative Audit Committee (committee) requested that the Bureau of State Audits review the commission's contracting practices. Specifically, the committee was interested in how the commission identifies the need for contracts; how it develops the scope of work to be performed; how it ensures that the work is completed, meets its needs, and is cost-effective; and whether the commission complies with Public Contract Code requirements such as using competitive bidding and avoiding conflicts of interest.

To obtain an understanding of the commission's contracting requirements, we reviewed applicable laws, regulations, and manuals. We interviewed key commission staff to identify the commission's contracting practices, and we reviewed contracting documents.

To determine whether the commission's contracting practices are appropriate, we selected a sample of 25 contracts that were entered into or amended during fiscal year 1998-99. Our sample included consulting contracts, information technology contracts, a master service agreement, and an interagency agreement.

To ascertain whether the commission had adequately developed and managed the contracts in our sample, we interviewed the contract managers and reviewed the contracts, related invoices, and evidence of delivered goods and services.

The committee also asked us to determine whether the commission ever hired consultants to perform work that the consultants themselves had recommended while performing previous contracts. These situations present a potential conflict because a consultant's recommendation may not always be in the commission's best interest. We determined that, although the

commission had contracted with certain consultants more than once, the contracts were not for services recommended in previous engagements.

We also followed up on the corrective action taken by the commission in response to our May 1999 report of the commission's handling of a consultant hired to investigate the 1998 San Francisco power outage. Specifically, we examined whether the commission had performed an additional review of the product received from the consultant to ensure that it met the commission's needs and that the associated costs were appropriate.

Furthermore, we inquired about the actions the commission had taken to clarify jurisdictional issues that arose between it and the California Independent System Operator during the investigation of the San Francisco power outage. We found that the two agencies have together drafted a list of protocols to follow should another outage occur and are currently in the process of formally adopting mutually acceptable protocols.

Finally, to identify how the commission has responded to its own internal audit of its consulting contract process, we interviewed key executive and line staff and reviewed related documents provided by the commission. ■

AUDIT RESULTS

The Commission's Weak Contracting Practices Have Led to Questionable Payments to Consultants

SUMMARY

The California Public Utilities Commission (commission) allotted more than \$11 million to contracts during fiscal year 1998-99. However, it did not always adequately develop and manage its contracts and as a result made questionable payments for some consultant services. Although the commission was diligent in documenting its need for each contract and monitoring the work being performed to ensure that its needs were met, the commission did not always ensure that it received the best value for its contracting dollar. Weaknesses, such as a lack of competitive bidding and inadequate review of consultant invoices, resulted in the commission making at least \$662,000 in questionable payments for fiscal year 1998-99. Because the commission is financed primarily by fees assessed on utility companies—which pass the costs on to consumers—when it makes improper payments the public pays more than necessary for utilities.

These weaknesses in contract practices were present in a commission contract that we reviewed last year and in another contract that the commission had not subjected to the state contracting process. Since our audit last year, the commission has conducted an internal audit that identified similar weaknesses, and it has begun to address many of the concerns we raise in this report. However, the commission should continue to strengthen its contract development and management activities and ensure that all its contracts are processed through the state contracting system.

THE COMMISSION HAS NOT DEVELOPED SOME CONTRACTS ADEQUATELY

Although the commission did consistently identify its need for contracts, it did not always perform other important steps in developing the contracts that we reviewed. As a result, it could

not ensure that the resulting contracts clearly established what was expected from the contractor and provided the best value. We measured the commission's performance by determining the extent to which it performed each of the following six key steps when developing its contracts:

- Identify the need for the contract.
- Develop a detailed scope of work to be performed.
- Identify schedules for the progress and completion of the work.
- Determine a reasonably detailed budget.
- Determine how a contractor will be selected.
- Review the qualifications of contractors and subcontractors.

The commission did not use proper methods to select contractors, or establish adequately detailed progress schedules or budgets for some contracts.

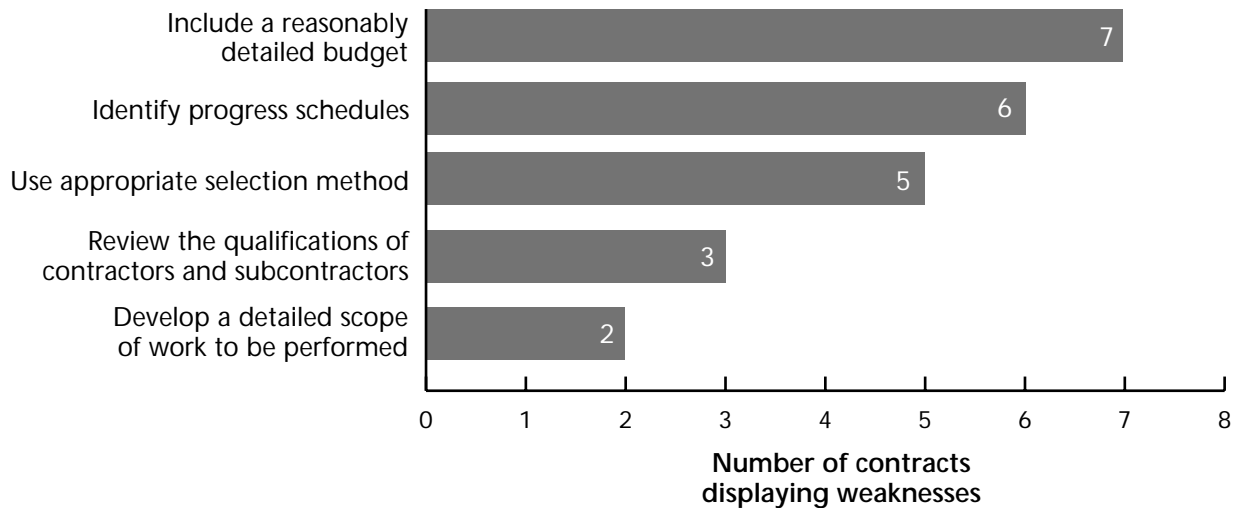
Each step is critical to the eventual success of the contract. For example, if an agency does not adequately identify its need for a contractor's services, it cannot determine whether that need is satisfied by the services the contractor provides. If an agency does not review a contractor's qualifications, it cannot ensure that the contractor has the knowledge and experience needed to complete the contracted tasks. Conversely, if an agency adequately performs all the steps in developing a contract, it is contributing to the success of the resulting contract.

Our review of 25 contracts for fiscal year 1998-99 showed that the commission consistently identified the need for its contracts and almost always developed a detailed scope of work and reviewed the qualifications of contractors. However, the commission did not consistently use appropriate selection methods, establish progress schedules, and set reasonably detailed budgets. Figure 1 presents the results of our review of the commission's development of these 25 contracts.

The commission did not always select its contractors appropriately. Of the 25 contracts we reviewed, 20 were not opened to competitive bidding because the commission claimed that they were exempt. However, the commission did not have valid reasons to exempt 5 of the 20 contracts from competition and thus should have used the competitive bid process. Without competitive bidding, the commission cannot ensure that it is receiving the best value for its contracting dollar.

FIGURE 1

Number of Contracts in Our Sample in Which the Commission Failed to Perform Key Steps



For example, one contract for \$66,500 was not awarded by competitive bid because the commission invoked its authority under the Public Utilities Code, finding that extraordinary circumstances justified the exemption. These extraordinary circumstances, however, appear simply to have been a lack of planning on the part of the commission. The consultant was hired to study the feasibility of “overlaying” a telephone area code in Southern California rather than splitting up an existing area code. Although the commission had started planning the overlay as early as May 1998, it did not initiate the contract until January 1999, three months before the scheduled implementation of the overlay. Rather than seeking competitive bids, the commission chose to use a consultant who had done previous work for the commission.

Extraordinary circumstances cited by the commission to justify not using a competitive bid process to award one contract appears simply to be a lack of planning.

The commission also did not always ensure that its contracts included reasonably detailed budgets and progress schedules. Of the 25 contracts we reviewed, 7 lacked reasonably detailed budgets and 6 did not include progress schedules. For example, one commission contract with a consultant who provided expert witness services in evaluating utility public safety programs included neither a budget nor a progress schedule. Although the commission established the contract in September 1998 for \$50,000, it amended the contract three times during fiscal year 1998-99, adding a total of \$99,500 to

the original amount. Each amendment was made to allow the consultant to perform services in addition to those envisioned in the original contract.

Without a reasonably detailed budget and progress schedule, the commission cannot adequately determine whether amendments to a contract are justified. Budgets ensure that contractors contain costs within reasonable limits, and progress schedules ensure that contractors are on track and will be able to provide the services or products when the commission needs them.

ALTHOUGH THE COMMISSION MANAGED ITS CONSULTANTS' WORK ADEQUATELY, ITS INCONSISTENT REVIEW OF INVOICES RESULTED IN QUESTIONABLE PAYMENTS

Although in our review of 25 fiscal year 1998-99 contracts we found that the commission generally monitored the work performed under its contracts and ensured that the work met its needs, it did not always adequately review its contractors' invoices. The commission paid over \$5 million on these 25 contracts for work performed in fiscal year 1998-99. Due to inadequate review, the commission made at least \$650,000 in questionable payments to its consultants. Because the commission receives most of its funding from fees assessed on utility companies--which pass the costs on to the public--when it makes improper payments the public ends up paying higher utility fees than necessary.

Good contract management ensures that the contractor is satisfactorily performing all services and receives payment only for services performed. The following are key elements of effective contract monitoring:

- Examining contractor work performance, for both quantity and quality, in relation to the contract terms and conditions.
- Reviewing requests for payment to ensure that payment is consistent with the deliverables received as well as with the terms of the contract.
- Evaluating completed contracts to determine whether contract objectives have been met.

The commission made at least \$650,000 in questionable payments to its consultants.

In 19 of the 25 cases we looked at, contract managers did not adequately review invoices prior to payment.

One way an agency can make sure that a contract is monitored effectively is to designate a contract manager who acts as a liaison with the contractor and ensures that the contractor is fulfilling the agency's needs. The contract manager must be familiar with the services the contractor provides as well as with the contract terms. For each of the 25 contracts we reviewed, the commission designated a contract manager. Usually the contract manager chosen was the staff member closest to the project, and that person was involved in the contract from its development stages until its completion. This control helps the commission verify that the contractor performs the work according to the contract terms. A commission contract manager is also expected to review and approve invoices that the contractor submits, thus preventing the State from paying inappropriate charges.

Our review found that the contract managers generally maintained contact with their contractors and were able to keep them focused, ensuring that the commission received the product that it expected in the amount of time allowed. However, the contract managers did not always adequately review invoices submitted by contractors. In fact, they did not do so in 19 of the 25 cases we examined. One reason that we found fault with the commission's invoice review process is that it did not establish guidelines to specify the level of detail that its contractors' invoices must contain. As a result, invoices we reviewed ranged from those containing detailed descriptions of the work being billed, cross-referenced to specific contract objectives, to others providing no information other than the month and amount being billed.

For example, one contract manager approved payments to a consultant amounting to more than \$650,000 during fiscal years 1997-98 and 1998-99, even though the consultant did not provide adequate supporting information for more than \$350,000 of the amount. This consultant provided descriptions of work performed by only a few of the participants in the project and did not provide details or receipts for other expenses such as travel costs, postage, and other administrative costs. More than \$70,000 of the \$350,000 in unsupported charges was approved for fiscal year 1998-99. This was not an isolated example. We found that for 14 of the 25 contracts we reviewed, the contract managers approved invoices for payment without getting detailed descriptions of the work performed or supporting documentation for consultants' expenses. In total, the unsupported payments we noted in our sample of fiscal year 1998-99 contracts amounted to more than \$600,000.

The commission paid one contractor over \$30,000 more in markup fees than the contract allowed.

In addition, the contract managers did not always review invoices adequately to ensure that payments were only for appropriate costs. As a result, the commission paid contractors almost \$50,000 in charges that should not have been allowed. For example, the commission paid one contractor over \$30,000 more than the contract allowed for subcontractor markup fees, which a contractor charges to the commission to manage subcontractors for a project. In another example, the commission reimbursed one contractor for first-class airfare, which cost approximately \$460 more than the typical coach fare for the same flight.

The contract managers' invoice reviews also failed to detect inaccuracies in invoices that included supporting information. In one case, because the commission did not follow the rules contained in the State Administrative Manual, it overpaid another state agency \$10,900. In this instance, the commission temporarily used the services of an employee of another state agency to assist the commission in its strategic planning. When the agency billed the commission, it included charges for vacation, sick leave, and holiday pay, although these amounts were already included in the hourly reimbursement rate. The contract manager did not detect this error and approved the invoice. According to the commission, it requested and received reimbursement from the agency after we notified it of the error.

DESPITE THE BUREAU OF STATE AUDITS' PREVIOUS SCRUTINY OF A PROBLEMATIC CONTRACT, THE COMMISSION OVERPAID THE CONSULTANT

In May 1999, we issued an audit report criticizing the commission's handling of a contract related to an investigation of the massive San Francisco power outage in December 1998. In the report, we recommended that the commission audit all charges when the consultant submitted invoices to determine their appropriateness and compliance with contract provisions. Although the commission did review the invoices after the consultant submitted them, the commission's review was not effective. Specifically, the commission did not require the consultant to invoice the State according to contract specifications. Rather, it accepted the consultant's invoices and used three commission staff members to prepare the state forms required to reimburse the contractor for out-of-pocket expenses, such as

meals and lodging. Despite this effort, the commission still overpaid the consultant by more than \$12,500. Furthermore, the commission paid the consultant over \$330,000 without adequately reviewing the invoices to ensure that it was paying for proper services.

The Commission Did Not Require the Consultant to Submit Proper Invoices

Despite our recommendations and the likelihood that we would further scrutinize this contract, the commission did not require the consultant to comply with contract requirements when invoices were finally submitted. Specifically, the consultant did not abide by state travel rules and regulations or reference the work order related to the services that were being billed. It is important that the commission address these weaknesses because on December 27, 1999, four days before the contract with the consultant was to expire, the commission extended the contract to include another year and an additional \$110,000. This was done to allow the consultant to continue investigating the causes of the power outage. Specifically, the consultant will review and analyze the utility's rebuttals to the consultant's March 1999 investigative report, address concerns arising from any subsequent power outages, and assist commission staff in preparing for commission hearings on the power outage.

The commission did not require the consultant to abide by state travel rules or reference the work order related to the services being billed.

Our previous audit reported that the consultant had not yet submitted an invoice for the first four months of the contract term, even though the contract required monthly invoicing. The consultant did finally submit to the commission six invoices covering various periods between January and June 1999. However, the consultant's invoices did not comply with contract provisions. For example, one invoice included a hotel bill for almost \$290 a night, three times the allowable rate of \$79 a night. In addition, the consultant did not use the required state expense report form and did not include receipts for many of the claimed items, even though state rules require them. Furthermore, although the contract required the consultant to reference the task related to each claimed expense, the commission did not enforce this requirement. The commission needs this information to ensure that claimed expenses are reasonable. Finally, the consultant resubmitted an invoice for more than \$14,000 that the commission had previously disallowed because it lacked supporting information. The commission paid this invoice, even though expenses totaling \$3,700 were still unsupported.

The Commission Used Its Staff to Review the Invoices and Prepare the Proper Forms Yet Still Overpaid the Consultant

Even though its own auditors prepared the expense claims, the commission overpaid a consultant more than \$12,500.

Rather than insisting that the consultant submit invoices that complied with state rules and regulations, as required by the contract, the commission dedicated more than 80 hours of staff time to review the invoices and expenses and fill out the proper expense claim forms for the consultant. The commission assigned three auditors from its water division to review the invoices and supporting documentation and then prepare travel expense claims for the consultant. The auditors were to review the expenses claimed by the consultant, determine the extent to which they were reimbursable under state rules and regulations, and then prepare an expense claim on the standard state form required under the contract.

Even though its own auditors prepared the expense claims, the commission overpaid the consultant more than \$12,500 for such expenses as lodging that exceeded allowable rates, airfare for which no receipt was provided, and payments for services for which the consultant had not billed. In addition, the commission reimbursed the consultant for meals not claimed on any invoice. The auditors explained to us that because the commission disallowed more than \$20,000 in expenses claimed on one of the consultant's invoices, they felt compelled to pay the maximum amounts allowable for meals and incidentals, even though the consultant did not always claim these costs. The consultant's receipts did not contain sufficient detail for us to determine the actual amount of unclaimed expenses the commission paid, but we estimate it to be at least \$2,500 of the total \$12,500 overpayment.

Moreover, the commission's contract managers did not adequately review the consultant's invoices. Rather, the commission relied on its auditors' review. As a result, the commission paid the consultant more than \$330,000, or 85 percent of the invoiced amounts, without adequate review to ensure that it was paying for proper services. The commission used its auditors so a more detailed review of the invoices could be performed. Although commission auditors may have the training needed to review the out-of-pocket expenses included on the consultant's invoices, they do not have the expertise necessary to determine whether the consultant's time charges complied with contract provisions. The contract managers would have been best suited for this review because of their frequent and direct contact with the consultant.

A COMMISSION CONTRACT WAS NOT SUBJECT TO SUFFICIENT CONTROLS

During our review of the commission's contracts, we learned that several contracts related to consumer education, including one for a program called Near Term Effort, were not subject to the State's usual contracting process. Selecting the consultants and developing the scopes of work for most of these contracts were not done by the commission but by advisory panels comprising industry representatives and other interested parties. Therefore, we did not review this type of contract.

In the case of the Near Term Effort program, however, the commission, not an advisory panel, developed the scopes of work, selected the contractors, and reviewed and approved invoices. Therefore, we did review this program. The Near Term Effort program was a short-term effort to educate the public about options available to them under the deregulation of the electric industry. It was intended to bridge the gap between two other similar education efforts that were administered by advisory panels. We found that the commission's contracts for this program did not receive proper oversight, and consultants under these contracts received payments before they provided services.

The Commission Has Several Contracts That Are Not Subject to the State's Standard Contracting Process

The commission is involved in many programs, usually focusing on consumer education activities, that are carried out by consultants hired outside the state contracting process. The commission authorizes the establishment of the programs and approves their objectives, but the contracts are usually administered by advisory panels consisting of independent members, such as industry and consumer representatives. Utility companies are often required, sometimes by the commission and sometimes by statute, to provide consumer education programs when significant changes occur in the utility marketplace. The contracts for services needed by the programs are between the affected utilities and the consultants, and payments are made directly by the utilities.

The Near Term Effort bridged the gap between similar consumer education programs.

When the commission authorized the Near Term Effort program, it gave its Consumer Services Division (division) the responsibility for developing a plan to continue educating the public regarding deregulation of electrical utilities. The commission gave this responsibility to the division because the

advisory panel that was to continue the education effort was not yet ready to administer the program. The Near Term Effort program was to bridge the gap between a similar education program that concluded in May 1998, and another that was not ready to begin until early 1999. The commission required the utilities—Pacific Gas and Electric, San Diego Gas and Electric, Southern California Water Company, and Southern California Edison—to provide the almost \$6 million needed to fund the Near Term Effort program from amounts that remained from the program that concluded in May 1998. The division selected three contractors to carry out the program.

The Commission Did Not Maintain Adequate Control Over the Contracts for the Near Term Effort Program

Although the division developed the scopes of work, selected the contractors, and reviewed and approved invoices for the Near Term Effort program contracts, the actual contracts were between the consultants and the utilities and thus did not undergo the reviews and approvals involved in the normal state contracting process. In addition, payments were not made through the commission's accounting system. Rather, the division approved the invoices and forwarded them to the utilities, which in turn paid the consultants. Figure 2 depicts the differences between the Near Term Effort program and the programs administered by advisory panels.

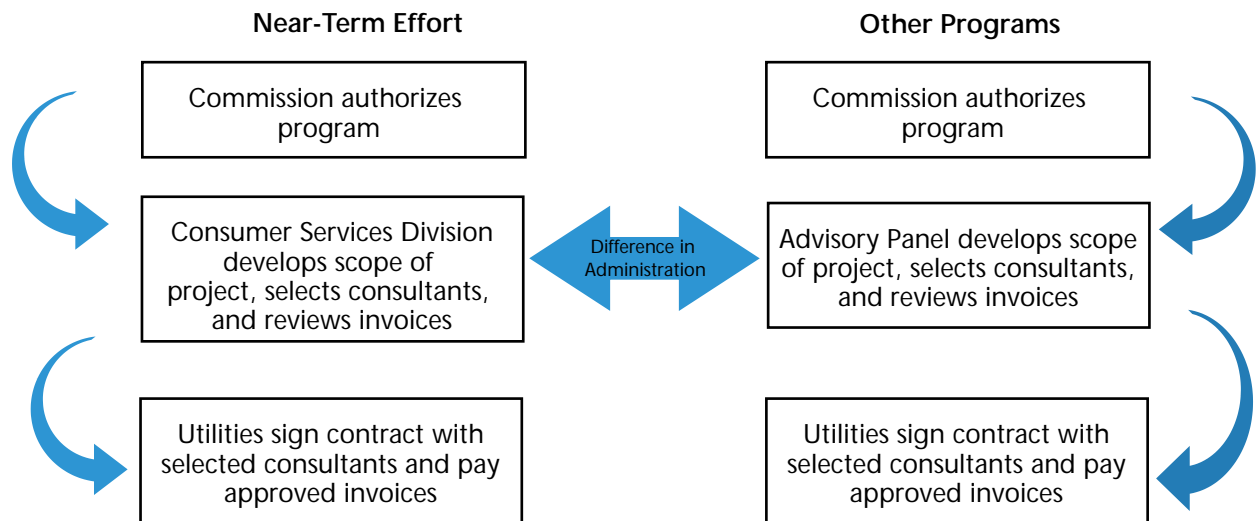
The division's administration of these contracts created an environment in which abuses could easily go undetected. For example, a commission employee could have created and approved an invoice payable to him- or herself and forwarded it to the utilities for payment. Lacking any administrative function in the program, and seeing that the employee had approved the payment, the utilities would likely have paid the invoice. Moreover, because of the commission's broad powers over the utilities, the utilities may have been reluctant to question the employee's approval of the payment.

The commission authorized a \$2 million payment to one consultant without a valid contract.

Although we did not find such fraudulent activity, we did find instances in which the division approved unearned payments. For example, in December 1998, the division authorized—and the utilities paid—an invoice for almost \$2 million to one consultant, even though the consultant had not yet incurred the costs being billed. In fact, the contract had not yet been signed when the division approved the payment. In addition, the division approved—and the utilities paid—a contractor's fee

FIGURE 2

Differences Between the Administration of the Near Term Effort Program and Programs Administered by Advisory Panels



totaling \$233,000 for work performed before the commissioners had approved the Near Term Effort plan. One reason these payments were allowed might have been that the division delegated the detailed review of invoices and supporting documentation to one consultant with whom it had contracted for the project. Because the division itself did not review the supporting documents, it was not able to ascertain whether the invoices it approved were adequately supported. Had these contracts and payments been made within the State’s normal system of controls, the improper payments might have been caught before they were made. More importantly, the contracts would have been exposed to a set of internal controls that would be more likely to detect any improper activities.

THE COMMISSION’S INTERNAL AUDIT OF ITS CONTRACTING PRACTICES FOUND WEAKNESSES SIMILAR TO THOSE WE HAVE IDENTIFIED

In response to our May 1999 report, the commission undertook an internal audit of its consultant contracting process. In its report issued in September 1999, the commission identified issues similar to several of those we discuss earlier in this report.

For example, it found that the commission had inadequate controls for selecting consultants in contracts that are exempt from competitive bidding requirements, did not always promptly identify selection criteria, and did not clearly identify commission staff responsible for monitoring consultant travel expenses. The commission characterized most of its auditors' recommendations as either issues that could be addressed by applying existing procedures more consistently or issues that it must address by developing new procedures. The appendix presents a list of the 27 recommendations contained in the internal audit report and how the commission plans to implement them.

The commission says it will implement all of the recommendations contained in its internal audit report.

The commission's executive director stated that the commission would implement all the recommendations contained in its internal audit report. As shown in the appendix, the commission is implementing most of the recommendations by developing a contracting policy and procedures manual. According to the commission, it will provide this manual to all management and staff involved in the procurement of consulting contracts. Other recommendations, such as making legal counsel available to the contracts officer and training contract managers, are being addressed by other commission actions.

The internal audit reported that one cause of the weaknesses in the commission's contracting practices is the inexperience and lack of training of its contract managers. The commission's auditors found that none of the managers of the 13 contracts they reviewed had any formal contract management training, and half had no contract management experience. Another reason given for the weaknesses was the lack of established authority of the commission's contracts officer, who is responsible for ensuring that the commission follows state contracting guidelines. The auditors noted that if a contract manager did not agree with the contracts officer on a contracting issue, the contracts officer would defer to the contract manager and process the contract anyway because there was no recourse.

Although the commission's initial response to the recommendations appears adequate, many of its actions are not yet complete. For example, the contracting policy and procedures manual has not yet been finalized and distributed, and not all of the contract managers and other staff involved in the commission's contracting process have received training in managing contracts. The commission should continue its efforts to strengthen

its contracting practices and ensure that it fully addresses the concerns raised in the internal audit.

RECOMMENDATIONS

To ensure that it properly develops and manages its contracts, the commission should take these actions:

- Include reasonably detailed budgets and progress schedules in its contracts.
- Solicit competitive bids for contracts whenever possible.
- Establish a policy requiring a minimum level of detail for consultant invoices prior to payment.
- Require contract managers to review charges and expenses contained in consultant invoices to ensure that only proper payments are made.

The commission should determine whether it has overpaid consultants who did not provide adequate supporting information for amounts invoiced to and paid by the commission and recover any overpayments.

The commission should reanalyze the invoices submitted by the consultant that investigated the 1998 San Francisco power outage and recover amounts that were inappropriately paid to the consultant.

The commission should provide all contractors with state travel guidelines and require its consultants to prepare expense claims on the standard state forms, following state guidelines, so that it can quickly determine if claimed costs are allowable.

The commission should use the State's contracting process for all contracts that it develops or manages, including contracts for consumer education programs.

The commission should continue to implement the recommendations contained in the internal audit report on its consultant contracting process.

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,

A handwritten signature in black ink that reads "Mary P. Noble". The signature is written in a cursive, slightly slanted style.

MARY P. NOBLE
Acting State Auditor

Date: March 16, 2000

Staff: Ann K. Campbell, CFE, Audit Principal
David E. Biggs, CPA
Bryan Beyer
Peter A. Foggiato, III
Ryan Storm

APPENDIX

How the Commission Is Implementing Recommendations From Its Own Internal Audit of Its Contracting Practices

Recommendation	Implementation
1. Clarify and strengthen contracts officer's role.	Included in draft policy and procedures manual (PPM).
2. Establish an internal dispute resolution process.	Included in PPM.
3. Assign legal counsel to contracts officer.	Legal staff made available.
4. Establish a process to determine type of contract to use.	Included in PPM.
5. Develop standard forms.	Included in PPM.
6. Develop procedures for contracts exempt from competitive bidding.	Included in PPM.*
7. Interview at least five consultants for contracts exempt from bidding.	Included in PPM.
8. Include member from outside division in selection panels.	Included in PPM.*
9. Get commission authorization for contracts exempt from bidding prior to start.	Included in PPM.
10. Provide contract managers with training in contract management.	Training in progress.
11. Select an experienced contract manager to assist others in each division.	Included in PPM.*
12. Develop a contract manager handbook.	Included in PPM.
13. Obtain guidance on how best to estimate contract prices.	Included in PPM.*
14. Ensure that clear selection criteria are provided to potential consultants.	Included in PPM.
15. Have contract managers complete evaluations of consultants.	Included in PPM.
16. Check for negative evaluations prior to selecting consultant.	Included in PPM.*

* These items were not addressed in the initial version of the policy and procedures manual that the commission provided to us. The commission subsequently advised us that it has added these items to the manual.

Recommendation	Implementation
17. Implement records management requirements from State Contracts Manual.	Included in PPM.*
18. Ensure that work plans are developed at beginning of contract.	Included in PPM.
19. Develop records retention policies.	Included in PPM.*
20. Clarify level of detail that consultant invoices must contain.	Still developing response.
21. Provide state travel guidelines to consultants.	Included in PPM.*
22. Provide utilities with detailed invoices for reimbursement.	Included in PPM.
23. Determine need for extension prior to end of contract.	Included in PPM.
24. Notify contract manager before disencumbering funds.	Included in PPM.*
25. Train commissioners and administrative law judges (ALJs) in contracting time requirements.	PPMs will be provided to commissioners and ALJs.
26. Perform cost-benefit analysis of hiring staff rather than contracting.	Directors will do this as part of the planning process.
27. Have legal division determine legality of requiring a utility to enter into a contract on behalf of the commission.	Commission will determine on a case-by-case basis.

* These items were not addressed in the initial version of the policy and procedures manual that the commission provided to us. The commission subsequently advised us that it has added these items to the manual.

Agency's comments provided as text only.

Public Utilities Commission
505 Van Ness Avenue
San Francisco, CA 94102-3298

March 7, 2000

Mary P. Noble
Acting State Auditor
Bureau of State Audits
555 Capitol Mall, Suite 300
Sacramento, CA 95814

Dear Ms. Noble:

Thank you for the opportunity to respond to the draft report, "California Public Utilities Commission: Weaknesses in its Contracting Process Have Resulted in Questionable Payments", received on March 1, 2000. While the limited comment period does not allow for a formal Commission response, in general, I do not dispute the criticisms contained in your draft. I appreciate that you recognize we are working toward improving our contracting process. I concur with your recommendations.

Based on our exit interviews with your staff, a large part of the problem appears to be with insufficiently supported work products as opposed to unsupported work products. Going forward, Contract Development and Management training will be mandatory for Contract Managers and will be designed to capture all of the recommendations of the State Auditor's concerns. We are working with the Department of General Services to put on several sessions of training before the end of March 2000.

In addition, we are implementing your recommendations as detailed below:

Recommendation 1:

"To ensure that it properly develops and manages its contracts, the commission should take these actions:

- Include reasonable budgets and progress schedules in its contracts.
- Solicit competitive bids for contracts whenever possible.
- Establish a policy requiring a minimum level of detail for consultant invoices prior to payment.
- Ensure that contract managers review charges and expenses contained in consultant invoices to ensure that only proper payments are made."

We implemented this recommendation for all new contract proposals. Our draft Policy and Procedures Manual (PPM) addresses each element of this recommendation. For contracts in progress, each Contract Manager will ensure that the budget, progress schedules and invoices comply with this recommendation. Contract managers must use the competitive bid process; exceptions will require approval of the Executive Director.

Recommendation 2:

“The commission should determine whether it has overpaid those consultants that did not provide adequate supporting information for amounts invoiced to and paid by the commission and, if so, should recover the overpayments.”

We are reviewing all current contracts in progress. Where consultants have been overpaid, we are requesting reimbursements from them. Where contractors have not provided sufficient supporting information, we are requesting it and will review it to justify payments. We will recover any overpayments to contractors.

Recommendation 3:

“The commission should reanalyze the invoices submitted by the consultant that investigated the 1998 San Francisco Power outage and recover amounts that were inappropriately paid to the consultant.”

The San Francisco power contract is currently being reviewed by the Executive Director, including all invoices already submitted. We will recover any amounts not justified, including travel expense claims. The Commission’s General Counsel will assume the role of contract manager for this consulting contract and all future invoices will be approved by the Executive Director.

Recommendation 4:

“The commission should provide all contractors with state travel guidelines and require its consultants to prepare expense claims on the standard state forms, following state guidelines, so that it can quickly determine if claimed costs are allowable.”

The Commission has provided all current contractors with state travel guidelines and now requires contractors to utilize the state guidelines and forms for expense recovery.

Recommendation 5:

“The commission should use the State’s contracting process for all contracts that it develops or manages, including contracts for consumer education programs.”

The Commission will use the State’s contracting process for all contracts it develops or manages, including contracts for consumer education programs. In addition, the Commission will review its policies and options for strengthening contract oversight for advisory boards and committees.

Recommendation 6:

“The Commission should continue to implement the recommendations contained in its own internal audit report on its consultant contracting process.”

The Commission will continue to implement the recommendations of its own internal audit, including the distribution of a Contracts Policies and Procedures Manual. A second draft of this manual has been completed and will be finalized for distribution on March 15, 2000.

Thank you for this opportunity to provide a written response to your draft, to be included in your final report.

Very truly yours,

(Signed by: Wesley M. Franklin)

Wesley M. Franklin
Executive Director

cc: **Members of the Legislature**
Office of the Lieutenant Governor
Milton Marks Commission on California State
Government Organization and Economy
Department of Finance
Attorney General
State Controller
State Treasurer
Legislative Analyst
Senate Office of Research
California Research Bureau
Capitol Press