

O L A

OFFICE OF THE LEGISLATIVE AUDITOR
STATE OF MINNESOTA

Financial Audit Division Report

Public Utilities Commission
July 1, 2002, through June 30, 2005



July 14, 2006

06-19

Financial Audit Division

The Office of the Legislative Auditor (OLA) is a professional, nonpartisan office in the legislative branch of Minnesota state government. Its principal responsibility is to audit and evaluate the agencies and programs of state government (the State Auditor audits local governments).

OLA's Financial Audit Division annually audits the state's financial statements and, on a rotating schedule, audits agencies in the executive and judicial branches of state government, three metropolitan agencies, and several "semi-state" organizations. The division also investigates allegations that state resources have been used inappropriately.

The division has a staff of approximately forty auditors, most of whom are CPAs. The division conducts audits in accordance with standards established by the American Institute of Certified Public Accountants and the Comptroller General of the United States.

Consistent with OLA's mission, the Financial Audit Division works to:

- Promote Accountability,
- Strengthen Legislative Oversight, and
- Support Good Financial Management.

Through its Program Evaluation Division, OLA conducts several evaluations each year.

OLA is under the direction of the Legislative Auditor, who is appointed for a six-year term by the Legislative Audit Commission (LAC). The LAC is a bipartisan commission of representatives and senators. It annually selects topics for the Program Evaluation Division, but is generally not involved in scheduling financial audits.

All findings, conclusions, and recommendations in reports issued by the Office of the Legislative Auditor are solely the responsibility of the office and may not reflect the views of the LAC, its individual members, or other members of the Minnesota Legislature.

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OFFICE OF THE LEGISLATIVE AUDITOR

State of Minnesota • James Nobles, Legislative Auditor

Senator Ann H. Rest, Chair
Legislative Audit Commission

Members of the Legislative Audit Commission

Mr. Burl Haar, Executive Secretary
Public Utilities Commission

We conducted an audit of the Public Utilities Commission for the period July 1, 2002, through June 30, 2005. Our audit scope included fines, assessments to utility and telecommunications companies, payroll and administrative expenditures, and the Telephone Assistance Plan revenues and expenditures. Our objectives focused on a review of the commission's internal controls over these financial activities and its compliance with applicable legal provisions.

At the time of our audit, the conduct of a former commissioner of the Public Utilities Commission was under investigation for potential conflict of interest arising from alleged employment negotiations with a regulated company and ex parte communications with an employee of another regulated company while serving as a commissioner. Due to the ongoing nature of the investigation and appeals process, we did not specifically address these issues during the scope of our audit.

The Report Summary highlights our overall audit conclusions. The specific audit objectives and conclusions for each area are contained in the individual chapters of this report.

We would like to thank the staff from the Public Utility Commission for their cooperation during this audit.

/s/ James R. Nobles

James R. Nobles
Legislative Auditor

/s/ Cecile M. Ferkul

Cecile M. Ferkul, CPA
Deputy Legislative Auditor

End of Fieldwork: April 14, 2006

Report Signed On: July 11, 2006

Public Utilities Commission

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Audit Participation

The following members of the Office of the Legislative Auditor prepared this report:

Cecile Ferkul, CPA, CISA	Deputy Legislative Auditor
Jim Riebe, CPA	Audit Manager
Susan Kachelmeyer, CPA, CISA	Auditor-in-Charge
David Westlund	Auditor

Exit Conference

We discussed the results of the audit with the following representatives of the Public Utilities Commission at an exit conference on June 26, 2006:

Burl Haar	Executive Secretary
Pat Gutwein	Accounting Officer
Mary Jo Jasicki	Administrative Manager

Report Summary

Overall Conclusion:

In general, the commission accurately recorded its revenues and expenditures in the state's accounting system and adequately safeguarded its fine and assessment revenues. However, we identified several concerns that need to be addressed by the commission.

Key Findings:

- The commission did not resolve a prior audit finding regarding the excess accumulation of funds in the Telephone Assistance Plan. The program's fund balance has grown to over \$4 million. (Finding 3, page 14)
- The commission needs to improve oversight of Telephone Assistance Plan eligibility determinations and ensure the accuracy of related revenues and expenditures. (Finding 4, page 15)
- Three commission employees violated the state's frequent flyer statutory provisions. (Finding 2, page 11)

The report contained four findings related to internal control and legal compliance. The findings include one prior audit finding.

Audit Scope:

Audit Period:

July 1, 2002, through June 30, 2005

Programs Audited:

- Fines and Assessments
- Administrative Expenditures
- Telephone Assistance Plan Revenues and Expenditures

Agency Background:

The Public Utilities Commission is a regulatory agency with jurisdiction over electric, natural gas, and telecommunications utilities in Minnesota. Revenues and expenditures totaled \$6.1 million and \$5.6 million, respectively, for fiscal year 2005.

Public Utilities Commission

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Chapter 1. Introduction

The Public Utilities Commission is a regulatory agency with jurisdiction over electric, natural gas, and telecommunications utilities in Minnesota. The Governor appoints five commissioners to six-year staggered terms, with no more than three members appointed from any given political party. Burl Haar has served as the commission's executive secretary since 1993.

The commission is responsible for maintaining fair and reasonable utility service rates, prescribing rules, and issuing orders with respect to the control and conduct of the utility companies within its jurisdiction. The commission derives its authority from *Minnesota Statutes* 2005, 216A, 216B, and 237.

The Public Utilities Commission has five main divisions, each with specific responsibilities:

- The **Energy Unit** reviews electrical and natural gas utility rates, energy resource planning, mergers and acquisitions, service areas, and construction of power plants throughout the state. The unit also handles formal complaints against the state's electrical and natural gas companies.
- The **Telecommunications Unit** reviews telecommunication utility rates, service areas, and the state's Telephone Assistance Plan. The unit also handles formal complaints against the state's telecommunications companies.
- The **Legal Unit** provides legal services to the commission in connection with its regulatory functions.
- The **Consumer Affairs Office** answers questions and provides dispute resolution assistance to consumers in connection with energy and telecommunications utilities.
- The **Administrative Management Unit** safeguards commission assets, processes revenues and expenditures, and performs other administrative functions required by the commission.

The Public Utilities Commission receives the majority of its funding from state appropriations. The commission assesses utility companies for services it provides and deposits these receipts into the state's General Fund as nondedicated revenues, meaning the money is not available to support department operations. Other significant sources of revenue include telephone surcharges paid by consumers for the Telephone Assistance Plan and billings to utility companies for the services of the Office of Administrative Hearings. The commission pays the costs associated with administrative hearings of contested public utility cases and invoices the utility companies associated with each case to recover its costs.

Public Utilities Commission

Table 1-1 shows the financial activity of the agency for fiscal year 2005.

	General Fund	Telephone Assistance Plan Special Revenue Fund ^(Note 1)
Sources of Funds:		
Appropriations	\$4,163,000	\$ 0
Dedicated Receipts	0	1,796,724
Balance Forward In	<u>247,489</u>	<u>3,608,251</u>
Total Sources	<u>\$4,410,489</u>	<u>\$5,404,795</u>
Uses of Funds:		
Payroll	\$3,289,001	\$14,658
Grants	0	1,201,922
Other Expenditures	<u>936,984</u>	<u>12,222</u>
Subtotal Expenditures	\$4,225,985	\$1,228,802
Balance Forward Out	<u>184,504</u>	<u>4,176,173</u>
Total Uses	<u>\$4,410,489</u>	<u>\$5,404,795</u>

Note 1: In addition to the Telephone Assistance Plan, the commission also used a special revenue fund account for the revenues and expenditures related to administrative hearings and extended area services, which totaled about \$132,000 for fiscal year 2005. This financial activity is not included in this table.

Source: Minnesota Accounting and Procurement System (MAPS) for fiscal year 2005, as of December 31, 2005.

The Office of the Legislative Auditor selected the Public Utilities Commission for audit based on an annual assessment of state agencies and programs. We used various criteria to determine the entities to audit, including the size and type of each agency's financial operations, length of time since the last audit, changes in organizational structure and key personnel, and available audit resources.

Audit Approach

Our audit was conducted in accordance with *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we obtain an understanding of the commission's internal controls relevant to the audit objectives. We used the guidance contained in *Internal Control-Integrated Framework*, published by the Committee of Sponsoring Organizations of the Treadway Commission,¹ as our criteria to evaluate agency controls. The standards also require that we plan the audit to provide reasonable assurance that the commission complied with financial-related legal provisions that are significant to the audit. In determining the commission's compliance with legal provisions, we considered requirements of laws, regulations, contracts, and grant agreements.

¹ The Treadway Commission (formerly known as the National Commission on Fraudulent Financial reporting) and its Committee of Sponsoring Organizations (COSO) were established in the mid-1980s by the major national associations of accountants. One of their primary tasks was to identify the components of "internal control" that organizations should have in place to prevent inappropriate financial activity.

Public Utilities Commission

To meet the audit objectives, we gained an understanding of the Public Utilities Commission's financial policies and procedures. We considered the risk of errors in the accounting records and noncompliance with relevant legal provisions. We analyzed accounting data to identify unusual trends or significant changes in financial operations and examined documents supporting the agency's internal controls and compliance with laws, regulations, contracts, and grant provisions.

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Chapter 2. Fines and Assessments

Chapter Conclusions

The Public Utilities Commission's internal controls provided reasonable assurance that it adequately safeguarded fine and assessment revenues, accurately recorded them in the state's accounting system, and effectively managed accounts receivable. For the items tested, the commission accurately determined and collected fines and fees from the state's utility companies, as required by state statutes.

Audit Objectives

The primary objectives of our review of fines and assessments for utility companies were to answer the following questions:

- Did the commission adequately safeguard fine and assessment receipts and effectively managed accounts receivable?
- Did the commission properly record fine and assessment activity in the accounting records?
- Did the commission comply with significant finance-related legal provisions in its administration of fines and assessments, including the statutory requirement to recover costs?

Background

*Minnesota Statutes*² authorize the commission to recover its direct and indirect costs of regulating energy and telecommunications companies operating in Minnesota. On a semiannual basis, the commission invoices companies for the direct costs of specific projects. The commission invoices companies on a quarterly basis for its estimated indirect costs not associated with specific projects. The commission allocates the indirect costs based on the proportion of each company's revenue to the total revenues of all regulated companies in its industry. In the subsequent fiscal year, the commission adjusts the billings to compensate for the difference between the estimated indirect costs assessed and the actual indirect costs incurred.

The commission partners with the Department of Commerce to bill and collect energy and telecommunications assessments. Commerce maintains the assessment computer system for

² *Minnesota Statutes* 2005, 216B and 237

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both agencies, tracks receivables, and generates invoices. The commission is responsible for collecting, depositing, and recording assessment receipts for both agencies.

Table 2-1 shows the commission's energy and telecommunications assessment of direct and indirect costs by type for fiscal years 2003 to 2005.

Table 2-1
Assessment Revenues by Type
By Fiscal Year

<u>Assessment Type</u>	<u>2003</u>	<u>2004</u>	<u>2005</u>
Energy Direct	\$1,029,257	\$1,056,621	\$1,160,131
Energy Indirect	1,011,453	1,157,145	1,207,613
Telecommunications Direct	1,447,565	1,158,863	1,095,522
Telecommunications Indirect	<u>1,073,950</u>	<u>759,456</u>	<u>825,249</u>
Total	<u>\$4,562,225</u>	<u>\$4,132,085</u>	<u>\$4,288,515</u>

Source: Minnesota Accounting and Procurement System (MAPS) from July 1, 2002 through December 31, 2005.

The commission deposited its assessment receipts into the General Fund as nondedicated receipts, with the exception of administrative law judge hearing assessments. Those assessments, totaling about \$387,000, \$173,000, and \$104,000 for fiscal years 2003, 2004, and 2005, respectively, were deposited into a special revenue fund. During fiscal year 2004, the commission also collected \$568,000 in fines imposed on one telecommunications company due to poor service quality in 1998.

There were no findings in this area.

Chapter 3. Administrative Expenditures

Chapter Conclusions

The Public Utilities Commission's internal controls provided reasonable assurance that it accurately compensated employees and properly paid vendors for goods and services received. The commission accurately recorded payroll and administrative expenditures in the accounting records and adequately safeguarded supplies and equipment.

For the items tested, the commission processed and paid payroll and the majority of its administrative expenditures in compliance with significant finance-related legal provisions. However, the commission let its local purchasing authority lapse in fiscal year 2004 and exceeded its authorized purchasing limit on several occasions. In addition, certain employees accrued frequent flier miles to their personal benefit, in violation of state statutes.

Audit Objectives

The primary objectives of our review of payroll and administrative expenditures were to answer the following questions:

- Did the commission's internal controls provide assurance that payroll and administrative expenditures were administered in accordance with financial legal provisions and properly recorded in the accounting records?
- Did the commission adequately safeguard supplies and equipment?
- Did the commission manage its payroll and administrative expenditures in accordance with management's authorization and in compliance with significant finance-related legal provisions contained in policies, contracts, collective bargaining unit agreements, and statutes?

Background

The Public Utilities Commission incurs various administrative expenditures in conducting its business. Table 3-1 shows the commission's administrative expenditures for budget fiscal years 2003 to 2005.

Public Utilities Commission

Table 3-1
Administrative Expenditures
By Fiscal Year

<u>Expenditures</u>	<u>2003</u>	<u>2004</u>	<u>2005</u>
Payroll	\$3,392,292	\$3,243,896	\$3,303,660
Purchased Services (Note 1)	557,772	252,088	339,252
Rent	417,886	467,920	501,510
Supplies and Equipment	137,109	137,703	132,401
Other	71,698	72,796	101,980
Total	<u>\$4,576,757</u>	<u>\$4,174,403</u>	<u>\$4,378,803</u>

Note 1: The administrative law judge assessments included in purchased services were \$407,000, \$134,000, and \$132,000, for fiscal years 2003, 2004, and 2005, respectively. These amounts fluctuate based on the volume of cases in a given year.

Source: Minnesota Accounting and Procurement System for budgetary fiscal years 2003, 2004, and 2005, as of December 31, 2005.

Payroll/personnel expenditures are the commission's largest administrative costs. The commission has a high employee retention rate with very little turnover. Currently the commission employs about 45 employees who are represented by several different unions including MAPE³ and AFSCME.⁴ The commissioners and staff keep current with developments in the utilities industry by maintaining memberships in industry associations and attending conferences and meetings. The commission established travel budgets for each commissioner for airline travel, hotel rooms, car rental, and other travel expenses. The commission spent \$39,000 on travel in fiscal year 2005.

The commission spent \$1.15 million on professional/technical and other purchased services during the three-year audit period. Fifty-nine percent of these expenditures were for services of the Office of Administrative Hearings. The commission invoiced the utilities directly involved in the hearings and fully recovered its costs. The costs of the hearings were based on the amount of activity in a fiscal year and fluctuated significantly as shown in Note 1 of Table 3-1.

The commission has rented space in the Metro Square Building since 1992. The commission rents an office suite, storage space, and several surface parking lot spaces. In addition, the commission rents monthly parking spaces for agency and employee needs in a nearby parking ramp. Commission employees reimburse the agency for a portion of their parking.

The commission used the state procurement system for most of its purchases, including the use of state contracts and local purchasing authority.

³ Minnesota Association of Professional Employees

⁴ American Federation of State, County and Municipal Employees

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Current Findings and Recommendations

1. The commission did not comply with certain state purchasing policies.

The commission did not have delegated authority from the Department of Administration since September 2003 to purchase supplies and equipment. At that time, the local purchasing authority that Administration granted to the commission employee responsible for purchasing lapsed. In addition, the commission did not seek approval from the Department of Administration for purchases over \$5,000 in five instances. The total amount spent on the five transactions that exceeded the \$5,000 limit was \$45,000 during the three-year audit period.

The Department of Administration requires that purchasing employees obtain training in purchasing policies and procedures and be recertified every three years. A properly trained, certified purchaser communicates state purchasing laws, rules, policies, and procedures to department staff and checks transactions for compliance. By allowing the purchasing employee's local purchasing authority to lapse, the commission increased the risk that its purchases would not comply with applicable legal requirements. Also, delays and inefficiencies in the commission's purchasing procedures could have resulted if the Department of Administration had exercised its authority and prohibited the commission from directly entering into purchasing transactions.

Recommendation

- *The commission should maintain its local purchasing authority in compliance with statutes.*

2. Three employees violated statutes governing frequent flyer miles.

Three department employees violated the state's frequent flyer legal provisions. One commissioner closed a commission account and transferred 52,000 miles to a personal account. A second commissioner stopped using the commission account in order to accrue and use the 46,000 miles in a personal account. We also found that one staff member accrued a nominal number of frequent flyer miles to a personal account while on state business where a third party paid the travel expenses. The commission estimated the value of each frequent flyer mile at about \$0.03 per mile (or \$1,560 in the first case, \$1,380 in the second case, and \$66 in the third case) based on an analysis of current fares to typical commission travel destinations.

Minnesota Statutes 2005, 15.435 requires that whenever public funds are used to pay for airline travel by a public employee, any credits or other benefits issued by any airline must accrue to the benefit of the public body providing the funding. In situations where a third party reimburses travel costs for conferences and meetings, *Minnesota Statutes* 2005, 43A.38 applies as it prohibits employees in the executive branch from receiving benefits attained while on state business.

Public Utilities Commission

The commission required employees who travel to set up business frequent flyer accounts with a local airline. In addition, commission employees certify that they have not claimed frequent flier mileage for personal use when submitting travel reimbursement requests. However, the commission did not have adequate procedures in place to ensure that frequent flyer miles earned by commission employees traveling on state business accrued to the benefit of the state.

Recommendations

- *The commission should monitor agency employees' frequent flyer business miles to ensure compliance with travel-related statutes.*
- *The commission should recover the frequent flyer miles or the value of the miles from the three employees.*

Chapter 4. Telephone Assistance Plan

Chapter Conclusions

The commission did not reduce the Telephone Assistance Plan's fund balance to prevent an unreasonable accumulation of surcharge revenues. Also, the commission needs to improve oversight of Telephone Assistance Plan eligibility determinations and ensure the accuracy of related revenues and expenditures.

The Public Utilities Commission ensured it properly recorded the Telephone Assistance Plan's financial activity in the accounting records.

Audit Objectives

Our review of the Public Utilities Commission's Telephone Assistance Plan focused on the following questions:

- Did the commission ensure the adequacy of its internal controls over the Telephone Assistance Plan's financial activity and the proper recording of its financial activity in the accounting records?
- Did the commission disburse the Telephone Assistance Plan's monies in compliance with significant finance-related legal provisions?

Background

The Minnesota Legislature created the Telephone Assistance Plan in 1987⁵. The Telephone Assistance Plan is one of three state programs where telecommunications companies collect monthly access line surcharges from their customers. The other two programs are Minnesota Statewide 911, administered by the Department of Public Safety, and the Telecommunications Access Minnesota Program administered by the Department of Commerce. Telecommunications companies remit all three surcharges to the Department of Public Safety, whose staff allocate and deposit the monies into separate special revenue funds to support program costs.

The Telephone Assistance Plan originally provided monthly credits to the telephone bills for low-income customers who were at least 65 years old or disabled. The plan changed in August 2003, when the Legislature allowed it to adopt the eligibility requirements of a similar federal telephone assistance program. The new requirements provided monthly credits to subscribers whose income is at or below 135 percent of federal poverty guidelines or who are enrolled in qualifying federal assistance programs such as Medical Assistance, Food Stamps, or Temporary Assistance for Needy Families. Currently the credit is \$8.63, of which the Telephone Assistance Plan is \$1.75.

⁵ *Minnesota Statutes* 2005, 237.69-237.711 and *Minnesota Rules* 2005, 7817 govern the plan.

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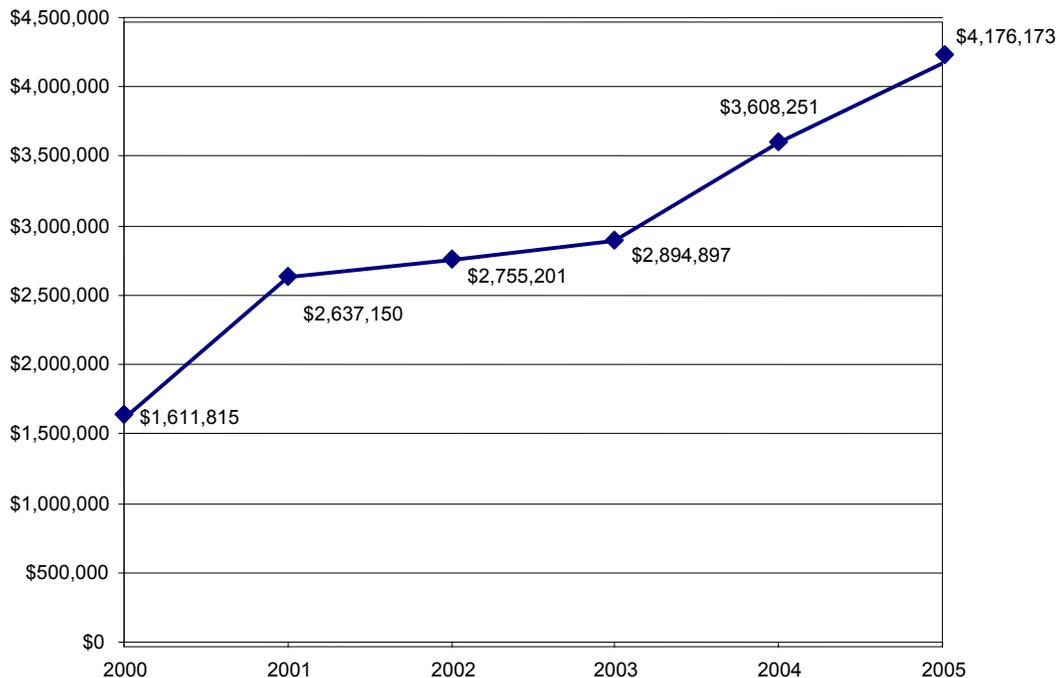
The state finances the Telephone Assistance Plan through dedicated receipts from telephone customers; currently the surcharge is five cents per telephone access line.⁶ The plan's revenues and expenditures for fiscal year 2005 totaled \$1.7 million and \$1.2 million, respectively.

Current Findings and Recommendations

3. PRIOR FINDING NOT RESOLVED: The commission did not resolve the excess accumulation of Telephone Assistance Plan funds.

In the last audit,⁷ we noted that the Telephone Assistance Plan had a significant fund balance. As shown in Figure 4-1, the fund balance at June 30, 2002, was \$2.8 million. The balance grew to \$4.2 million as of June 30, 2005.

Figure 4-1
Telephone Assistance Plan Fund Balance
By Fiscal Year



Source: Minnesota Accounting and Procurement System for budgetary fiscal years 2001, 2002, 2003, 2004, 2005, and 2006.

Minnesota Statutes 2005, 237.70, subd. 7(d) (5) authorizes the commission to establish the plan's monthly credits and surcharges at a level that will prevent an unreasonable accumulation of revenues. After we issued our audit report in July 2003, the commission met periodically to discuss the issue but did not take any substantive action to address the excess accumulation of

⁶ *Minnesota Rules* 2005, 7817.0100, Subpart 2 defines access lines.

⁷ Legislative Audit Report 03-37

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funds. The commission did not increase credits or reduce surcharges because of the uncertainty surrounding the expanded eligibility criteria and other changes to the program.

Recommendation

- *The commission needs to reduce the Telephone Assistance Plan's fund balance to prevent an unreasonable accumulation of surcharge revenues.*

4. The commission did not provide sufficient oversight of Telephone Assistance Plan eligibility determinations and ensure the accuracy of related program revenues and expenditures.

The commission has not verified the eligibility of the Telephone Assistance Plan's participants since 2003, when administrative changes to the program occurred, and did not ensure that telecommunications companies remitted the proper amounts of telephone customer surcharges that fund the program. Although the statutes permit an audit of the program, the commission has not implemented any procedures to verify program surcharges (revenues) or credits (expenditures) since the changes to the program took place.

Before August 2003, the Department of Human Services (DHS) provided some level of assurance by verifying the eligibility of program participants. DHS provided the commission with the number of participants eligible for the program and any questions about participant eligibility that came to its attention as a result of its verification procedures. However, there has been no verification or monitoring since 2003 when the telecommunications companies assumed full responsibility for determining program eligibility.

Currently, the telecommunications companies determine telephone assistance credits based on the subscriber's self-certification of eligibility, as provided for in the Federal Communications Commission's program guidelines. An applicant provides his or her social security number and certifies income and enrollment in eligible federal assistance programs. If an applicant is not in an eligible program, the applicant needs to provide income documentation such as pay-stubs or a tax return to the telecommunications company.

The telecommunications companies are not required to retain documentation supporting eligibility determinations, and the commission does not monitor the eligibility determination process. Federal guidelines permit reliance on initial self-certifications of program-based eligibility but require certification of income-based eligibility and verification of continued eligibility under both types of eligibility. The commission could develop methods to enhance oversight of the program's expenditures by obtaining the applicants' social security numbers and matching them to the Department of Human Services public assistance program database or the Department of Revenue's income tax system database.

The commission has not verified the accuracy of the plan's surcharge amounts collected by the telecommunications companies and remitted to the commission since 2004. Before December 2005, telecommunications companies filed calendar year reports with the Department of

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Commerce that included the number of access lines. The commission compared the annual access line information in the reports to the accumulated monthly remittance forms to provide some assurance that telecommunications companies were accurately reporting their activity. However, the state no longer requires the telecommunications companies to report access line information, increasing the risk that the commission does not receive the correct amount of revenue. The process to determine Telephone Assistance Plan surcharges is similar to Minnesota Statewide 911, Telecommunications Access Minnesota; therefore, the commission could partner with the departments of Public Safety and Commerce to determine a method of strengthening oversight of the telephone surcharge revenues.

Recommendation

- *The commission should establish procedures to verify the accuracy of Telephone Assistance Plan eligibility determinations and surcharge revenues.*

**Status of Prior Audit Issues
As of April 14, 2006**

Most Current Financial-Related Audit

Legislative Audit Report 03-37, issued in July 2003, covered the three fiscal years ending June 30, 2002. The audit scope included utility assessment receipts; Telephone Assistance Plan and administrative hearing judges' revenues and expenditures; and payroll, rent, and other administrative expenditures. The report contained two audit findings. One of the findings about weaknesses in internal controls over expenditures was resolved. The other finding concerned the excessive accumulation of funds related to the Telephone Assistance Plan and is repeated as Finding 3 in this report.

State of Minnesota Audit Follow-Up Process

The Department of Finance, on behalf of the Governor, maintains a quarterly process for following up on issues cited in financial audit reports issued by the Legislative Auditor. The process consists of an exchange of written correspondence that documents the status of audit findings. The follow-up process continues until Finance is satisfied that the issues have been resolved. It covers entities headed by gubernatorial appointees, including most state agencies, boards, commissions, and Minnesota state colleges and universities. It is not applied to audits of the University of Minnesota, any quasi-state organizations, such as metropolitan agencies or the State Agricultural Society, the state constitutional officers, or the judicial branch.

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Report Summary

Overall Conclusion:

In general, the commission accurately recorded its revenues and expenditures in the state's accounting system and adequately safeguarded its fine and assessment revenues. However, we identified several concerns that need to be addressed by the commission.

Key Findings:

- The commission did not resolve a prior audit finding regarding the excess accumulation of funds in the Telephone Assistance Plan. The program's fund balance has grown to over \$4 million. (Finding 3, page 14)
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Public Utilities Commission

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Audit Approach

Our audit was conducted in accordance with *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we obtain an understanding of the commission's internal controls relevant to the audit objectives. We used the guidance contained in *Internal Control-Integrated Framework*, published by the Committee of Sponsoring Organizations of the Treadway Commission,¹ as our criteria to evaluate agency controls. The standards also require that we plan the audit to provide reasonable assurance that the commission complied with financial-related legal provisions that are significant to the audit. In determining the commission's compliance with legal provisions, we considered requirements of laws, regulations, contracts, and grant agreements.

¹ The Treadway Commission (formerly known as the National Commission on Fraudulent Financial reporting) and its Committee of Sponsoring Organizations (COSO) were established in the mid-1980s by the major national associations of accountants. One of their primary tasks was to identify the components of "internal control" that organizations should have in place to prevent inappropriate financial activity.

Public Utilities Commission

To meet the audit objectives, we gained an understanding of the Public Utilities Commission's financial policies and procedures. We considered the risk of errors in the accounting records and noncompliance with relevant legal provisions. We analyzed accounting data to identify unusual trends or significant changes in financial operations and examined documents supporting the agency's internal controls and compliance with laws, regulations, contracts, and grant provisions.

Public Utilities Commission

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Chapter 2. Fines and Assessments

Chapter Conclusions

The Public Utilities Commission's internal controls provided reasonable assurance that it adequately safeguarded fine and assessment revenues, accurately recorded them in the state's accounting system, and effectively managed accounts receivable. For the items tested, the commission accurately determined and collected fines and fees from the state's utility companies, as required by state statutes.

Audit Objectives

The primary objectives of our review of fines and assessments for utility companies were to answer the following questions:

- Did the commission adequately safeguard fine and assessment receipts and effectively managed accounts receivable?
- Did the commission properly record fine and assessment activity in the accounting records?
- Did the commission comply with significant finance-related legal provisions in its administration of fines and assessments, including the statutory requirement to recover costs?

Background

*Minnesota Statutes*² authorize the commission to recover its direct and indirect costs of regulating energy and telecommunications companies operating in Minnesota. On a semiannual basis, the commission invoices companies for the direct costs of specific projects. The commission invoices companies on a quarterly basis for its estimated indirect costs not associated with specific projects. The commission allocates the indirect costs based on the proportion of each company's revenue to the total revenues of all regulated companies in its industry. In the subsequent fiscal year, the commission adjusts the billings to compensate for the difference between the estimated indirect costs assessed and the actual indirect costs incurred.

The commission partners with the Department of Commerce to bill and collect energy and telecommunications assessments. Commerce maintains the assessment computer system for

² *Minnesota Statutes* 2005, 216B and 237

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both agencies, tracks receivables, and generates invoices. The commission is responsible for collecting, depositing, and recording assessment receipts for both agencies.

Table 2-1 shows the commission's energy and telecommunications assessment of direct and indirect costs by type for fiscal years 2003 to 2005.

Table 2-1
Assessment Revenues by Type
By Fiscal Year

<u>Assessment Type</u>	<u>2003</u>	<u>2004</u>	<u>2005</u>
Energy Direct	\$1,029,257	\$1,056,621	\$1,160,131
Energy Indirect	1,011,453	1,157,145	1,207,613
Telecommunications Direct	1,447,565	1,158,863	1,095,522
Telecommunications Indirect	<u>1,073,950</u>	<u>759,456</u>	<u>825,249</u>
Total	<u>\$4,562,225</u>	<u>\$4,132,085</u>	<u>\$4,288,515</u>

Source: Minnesota Accounting and Procurement System (MAPS) from July 1, 2002 through December 31, 2005.

The commission deposited its assessment receipts into the General Fund as nondedicated receipts, with the exception of administrative law judge hearing assessments. Those assessments, totaling about \$387,000, \$173,000, and \$104,000 for fiscal years 2003, 2004, and 2005, respectively, were deposited into a special revenue fund. During fiscal year 2004, the commission also collected \$568,000 in fines imposed on one telecommunications company due to poor service quality in 1998.

There were no findings in this area.

Chapter 3. Administrative Expenditures

Chapter Conclusions

The Public Utilities Commission's internal controls provided reasonable assurance that it accurately compensated employees and properly paid vendors for goods and services received. The commission accurately recorded payroll and administrative expenditures in the accounting records and adequately safeguarded supplies and equipment.

For the items tested, the commission processed and paid payroll and the majority of its administrative expenditures in compliance with significant finance-related legal provisions. However, the commission let its local purchasing authority lapse in fiscal year 2004 and exceeded its authorized purchasing limit on several occasions. In addition, certain employees accrued frequent flier miles to their personal benefit, in violation of state statutes.

Audit Objectives

The primary objectives of our review of payroll and administrative expenditures were to answer the following questions:

- Did the commission's internal controls provide assurance that payroll and administrative expenditures were administered in accordance with financial legal provisions and properly recorded in the accounting records?
- Did the commission adequately safeguard supplies and equipment?
- Did the commission manage its payroll and administrative expenditures in accordance with management's authorization and in compliance with significant finance-related legal provisions contained in policies, contracts, collective bargaining unit agreements, and statutes?

Background

The Public Utilities Commission incurs various administrative expenditures in conducting its business. Table 3-1 shows the commission's administrative expenditures for budget fiscal years 2003 to 2005.

Public Utilities Commission

Table 3-1
Administrative Expenditures
By Fiscal Year

<u>Expenditures</u>	<u>2003</u>	<u>2004</u>	<u>2005</u>
Payroll	\$3,392,292	\$3,243,896	\$3,303,660
Purchased Services (Note 1)	557,772	252,088	339,252
Rent	417,886	467,920	501,510
Supplies and Equipment	137,109	137,703	132,401
Other	71,698	72,796	101,980
Total	<u>\$4,576,757</u>	<u>\$4,174,403</u>	<u>\$4,378,803</u>

Note 1: The administrative law judge assessments included in purchased services were \$407,000, \$134,000, and \$132,000, for fiscal years 2003, 2004, and 2005, respectively. These amounts fluctuate based on the volume of cases in a given year.

Source: Minnesota Accounting and Procurement System for budgetary fiscal years 2003, 2004, and 2005, as of December 31, 2005.

Payroll/personnel expenditures are the commission's largest administrative costs. The commission has a high employee retention rate with very little turnover. Currently the commission employs about 45 employees who are represented by several different unions including MAPE³ and AFSCME.⁴ The commissioners and staff keep current with developments in the utilities industry by maintaining memberships in industry associations and attending conferences and meetings. The commission established travel budgets for each commissioner for airline travel, hotel rooms, car rental, and other travel expenses. The commission spent \$39,000 on travel in fiscal year 2005.

The commission spent \$1.15 million on professional/technical and other purchased services during the three-year audit period. Fifty-nine percent of these expenditures were for services of the Office of Administrative Hearings. The commission invoiced the utilities directly involved in the hearings and fully recovered its costs. The costs of the hearings were based on the amount of activity in a fiscal year and fluctuated significantly as shown in Note 1 of Table 3-1.

The commission has rented space in the Metro Square Building since 1992. The commission rents an office suite, storage space, and several surface parking lot spaces. In addition, the commission rents monthly parking spaces for agency and employee needs in a nearby parking ramp. Commission employees reimburse the agency for a portion of their parking.

The commission used the state procurement system for most of its purchases, including the use of state contracts and local purchasing authority.

³ Minnesota Association of Professional Employees

⁴ American Federation of State, County and Municipal Employees

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Current Findings and Recommendations

1. The commission did not comply with certain state purchasing policies.

The commission did not have delegated authority from the Department of Administration since September 2003 to purchase supplies and equipment. At that time, the local purchasing authority that Administration granted to the commission employee responsible for purchasing lapsed. In addition, the commission did not seek approval from the Department of Administration for purchases over \$5,000 in five instances. The total amount spent on the five transactions that exceeded the \$5,000 limit was \$45,000 during the three-year audit period.

The Department of Administration requires that purchasing employees obtain training in purchasing policies and procedures and be recertified every three years. A properly trained, certified purchaser communicates state purchasing laws, rules, policies, and procedures to department staff and checks transactions for compliance. By allowing the purchasing employee's local purchasing authority to lapse, the commission increased the risk that its purchases would not comply with applicable legal requirements. Also, delays and inefficiencies in the commission's purchasing procedures could have resulted if the Department of Administration had exercised its authority and prohibited the commission from directly entering into purchasing transactions.

Recommendation

- *The commission should maintain its local purchasing authority in compliance with statutes.*

2. Three employees violated statutes governing frequent flyer miles.

Three department employees violated the state's frequent flyer legal provisions. One commissioner closed a commission account and transferred 52,000 miles to a personal account. A second commissioner stopped using the commission account in order to accrue and use the 46,000 miles in a personal account. We also found that one staff member accrued a nominal number of frequent flyer miles to a personal account while on state business where a third party paid the travel expenses. The commission estimated the value of each frequent flyer mile at about \$0.03 per mile (or \$1,560 in the first case, \$1,380 in the second case, and \$66 in the third case) based on an analysis of current fares to typical commission travel destinations.

Minnesota Statutes 2005, 15.435 requires that whenever public funds are used to pay for airline travel by a public employee, any credits or other benefits issued by any airline must accrue to the benefit of the public body providing the funding. In situations where a third party reimburses travel costs for conferences and meetings, *Minnesota Statutes* 2005, 43A.38 applies as it prohibits employees in the executive branch from receiving benefits attained while on state business.

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The commission required employees who travel to set up business frequent flyer accounts with a local airline. In addition, commission employees certify that they have not claimed frequent flier mileage for personal use when submitting travel reimbursement requests. However, the commission did not have adequate procedures in place to ensure that frequent flyer miles earned by commission employees traveling on state business accrued to the benefit of the state.

Recommendations

- *The commission should monitor agency employees' frequent flyer business miles to ensure compliance with travel-related statutes.*
- *The commission should recover the frequent flyer miles or the value of the miles from the three employees.*

Chapter 4. Telephone Assistance Plan

Chapter Conclusions

The commission did not reduce the Telephone Assistance Plan’s fund balance to prevent an unreasonable accumulation of surcharge revenues. Also, the commission needs to improve oversight of Telephone Assistance Plan eligibility determinations and ensure the accuracy of related revenues and expenditures.

The Public Utilities Commission ensured it properly recorded the Telephone Assistance Plan’s financial activity in the accounting records.

Audit Objectives

Our review of the Public Utilities Commission’s Telephone Assistance Plan focused on the following questions:

- Did the commission ensure the adequacy of its internal controls over the Telephone Assistance Plan’s financial activity and the proper recording of its financial activity in the accounting records?
- Did the commission disburse the Telephone Assistance Plan’s monies in compliance with significant finance-related legal provisions?

Background

The Minnesota Legislature created the Telephone Assistance Plan in 1987⁵. The Telephone Assistance Plan is one of three state programs where telecommunications companies collect monthly access line surcharges from their customers. The other two programs are Minnesota Statewide 911, administered by the Department of Public Safety, and the Telecommunications Access Minnesota Program administered by the Department of Commerce. Telecommunications companies remit all three surcharges to the Department of Public Safety, whose staff allocate and deposit the monies into separate special revenue funds to support program costs.

The Telephone Assistance Plan originally provided monthly credits to the telephone bills for low-income customers who were at least 65 years old or disabled. The plan changed in August 2003, when the Legislature allowed it to adopt the eligibility requirements of a similar federal telephone assistance program. The new requirements provided monthly credits to subscribers whose income is at or below 135 percent of federal poverty guidelines or who are enrolled in qualifying federal assistance programs such as Medical Assistance, Food Stamps, or Temporary Assistance for Needy Families. Currently the credit is \$8.63, of which the Telephone Assistance Plan is \$1.75.

⁵ *Minnesota Statutes* 2005, 237.69-237.711 and *Minnesota Rules* 2005, 7817 govern the plan.

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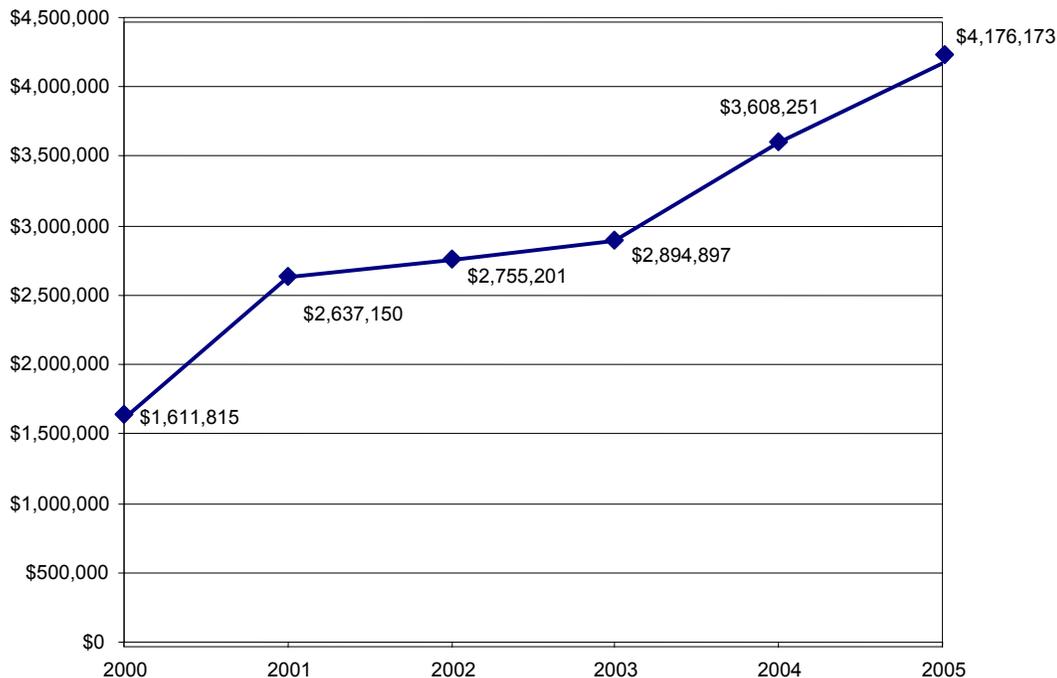
The state finances the Telephone Assistance Plan through dedicated receipts from telephone customers; currently the surcharge is five cents per telephone access line.⁶ The plan's revenues and expenditures for fiscal year 2005 totaled \$1.7 million and \$1.2 million, respectively.

Current Findings and Recommendations

3. PRIOR FINDING NOT RESOLVED: The commission did not resolve the excess accumulation of Telephone Assistance Plan funds.

In the last audit,⁷ we noted that the Telephone Assistance Plan had a significant fund balance. As shown in Figure 4-1, the fund balance at June 30, 2002, was \$2.8 million. The balance grew to \$4.2 million as of June 30, 2005.

Figure 4-1
Telephone Assistance Plan Fund Balance
By Fiscal Year



Source: Minnesota Accounting and Procurement System for budgetary fiscal years 2001, 2002, 2003, 2004, 2005, and 2006.

Minnesota Statutes 2005, 237.70, subd. 7(d) (5) authorizes the commission to establish the plan's monthly credits and surcharges at a level that will prevent an unreasonable accumulation of revenues. After we issued our audit report in July 2003, the commission met periodically to discuss the issue but did not take any substantive action to address the excess accumulation of

⁶ *Minnesota Rules* 2005, 7817.0100, Subpart 2 defines access lines.

⁷ Legislative Audit Report 03-37

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funds. The commission did not increase credits or reduce surcharges because of the uncertainty surrounding the expanded eligibility criteria and other changes to the program.

Recommendation

- *The commission needs to reduce the Telephone Assistance Plan's fund balance to prevent an unreasonable accumulation of surcharge revenues.*

4. The commission did not provide sufficient oversight of Telephone Assistance Plan eligibility determinations and ensure the accuracy of related program revenues and expenditures.

The commission has not verified the eligibility of the Telephone Assistance Plan's participants since 2003, when administrative changes to the program occurred, and did not ensure that telecommunications companies remitted the proper amounts of telephone customer surcharges that fund the program. Although the statutes permit an audit of the program, the commission has not implemented any procedures to verify program surcharges (revenues) or credits (expenditures) since the changes to the program took place.

Before August 2003, the Department of Human Services (DHS) provided some level of assurance by verifying the eligibility of program participants. DHS provided the commission with the number of participants eligible for the program and any questions about participant eligibility that came to its attention as a result of its verification procedures. However, there has been no verification or monitoring since 2003 when the telecommunications companies assumed full responsibility for determining program eligibility.

Currently, the telecommunications companies determine telephone assistance credits based on the subscriber's self-certification of eligibility, as provided for in the Federal Communications Commission's program guidelines. An applicant provides his or her social security number and certifies income and enrollment in eligible federal assistance programs. If an applicant is not in an eligible program, the applicant needs to provide income documentation such as pay-stubs or a tax return to the telecommunications company.

The telecommunications companies are not required to retain documentation supporting eligibility determinations, and the commission does not monitor the eligibility determination process. Federal guidelines permit reliance on initial self-certifications of program-based eligibility but require certification of income-based eligibility and verification of continued eligibility under both types of eligibility. The commission could develop methods to enhance oversight of the program's expenditures by obtaining the applicants' social security numbers and matching them to the Department of Human Services public assistance program database or the Department of Revenue's income tax system database.

The commission has not verified the accuracy of the plan's surcharge amounts collected by the telecommunications companies and remitted to the commission since 2004. Before December 2005, telecommunications companies filed calendar year reports with the Department of

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Commerce that included the number of access lines. The commission compared the annual access line information in the reports to the accumulated monthly remittance forms to provide some assurance that telecommunications companies were accurately reporting their activity. However, the state no longer requires the telecommunications companies to report access line information, increasing the risk that the commission does not receive the correct amount of revenue. The process to determine Telephone Assistance Plan surcharges is similar to Minnesota Statewide 911, Telecommunications Access Minnesota; therefore, the commission could partner with the departments of Public Safety and Commerce to determine a method of strengthening oversight of the telephone surcharge revenues.

Recommendation

- *The commission should establish procedures to verify the accuracy of Telephone Assistance Plan eligibility determinations and surcharge revenues.*

**Status of Prior Audit Issues
As of April 14, 2006**

Most Current Financial-Related Audit

Legislative Audit Report 03-37, issued in July 2003, covered the three fiscal years ending June 30, 2002. The audit scope included utility assessment receipts; Telephone Assistance Plan and administrative hearing judges' revenues and expenditures; and payroll, rent, and other administrative expenditures. The report contained two audit findings. One of the findings about weaknesses in internal controls over expenditures was resolved. The other finding concerned the excessive accumulation of funds related to the Telephone Assistance Plan and is repeated as Finding 3 in this report.

State of Minnesota Audit Follow-Up Process

The Department of Finance, on behalf of the Governor, maintains a quarterly process for following up on issues cited in financial audit reports issued by the Legislative Auditor. The process consists of an exchange of written correspondence that documents the status of audit findings. The follow-up process continues until Finance is satisfied that the issues have been resolved. It covers entities headed by gubernatorial appointees, including most state agencies, boards, commissions, and Minnesota state colleges and universities. It is not applied to audits of the University of Minnesota, any quasi-state organizations, such as metropolitan agencies or the State Agricultural Society, the state constitutional officers, or the judicial branch.

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STATE OF MINNESOTA PUBLIC UTILITIES COMMISSION

June 28, 2006

Mr. James R. Nobles
Legislative Auditor
Room 140, Centennial Building
658 Cedar Street
St. Paul, Minnesota 55155-1603

Re: Legislative Audit Report for July 1, 2002 through June 30, 2005.

Dear Mr. Nobles:

This letter is a response to the audit report of the Office of Legislative Auditor (OLA) concerning the Minnesota Public Utilities Commission (Commission) for the period July 1, 2002 through June 30, 2005. The letter will explain the steps the Commission will take to address the three findings noted in your report.

Finding: The Commission did not comply with certain state purchasing policies.

In September 2003, the Commission failed to renew its authority from the Department of Administration (DOA) to purchase supplies and equipments. In other words, for about half of the review period, the Commission did not have adequate purchasing authority from DOA. In addition, the Commission did not seek approval from DOA for purchases over \$5,000 in five transactions which involved \$45,000.

The OLA recommends that the Commission maintain its local purchasing authority.

On April 5, 2006, the Commission hired an Accounting Officer with the requisite DOA authorization for purchasing. The Commission will comply with purchasing authority requirements of the DOA in the future.

Finding: Three employees violated statutes governing frequent flyer miles.

Three employees accrued frequent flyer credits resulting from Commission-related travel to their personal frequent flyer accounts. The total value of these credits is estimated at \$3,006.

The OLA recommends that the Commission should monitor agency employees' frequent flyer business miles to ensure compliance with travel-related statutes. The OLA also recommends that the Commission should recover the frequent flyer miles or the value of the miles from the three employees.

The Commission will require documentation showing the frequent flyer account credited with any Commission-related air travel by employees to ensure that all credits due the State accrue to the State. The Executive Secretary will remind commissioners and staff of their obligation to comply with the State's frequent flyer policy and the need to produce supporting documentation, particularly when air travel involves frequent flyer credits.

The three employees have taken measures to compensate the Commission for the value of the frequent flyer credits in question.

Finding: The Commission did not resolve the excess accumulation of Telephone Assistance Plan funds.

In its audit for July 1, 1999 through June 30, 2002, the OLA found that the Commission needs better financial tools and data sources to forecast planned finances and allow it to reduce the TAP fund balance. Since that period, the balance of the Telephone Assistance Plan (TAP) fund has continued to increase. As noted in the OLA Report, at the conclusion of the audit period the fund's balance was \$4,176,173.

The OLA recommends that the Commission reduce the TAP fund balance to prevent an unreasonable accumulation of surcharge revenues. The OLA's Report and verbal comments to staff suggest that it believes the TAP fund has reached an unreasonably large balance.

Minnesota Statutes Section 237.70, Subdivision 7(d) (5) *requires* the Commission to reduce the TAP credit in the event revenues produced by the maximum permissible surcharge (i.e., 10 cents per month per access line) are not adequate to fund the program. Alternatively, Subdivision 7 (d) (5) *permits* the Commission to increase the TAP credit or reduce the surcharge to prevent an unreasonable over collection of surcharge revenues.

Since OLA's audit of June, 2002, the Commission has met three times to consider potential changes in TAP surcharges and credits, with the most recent on April 20, 2006. At the meetings, the Commission heard from interested parties; i.e., primarily, the Department of Commerce, the Office of the Attorney General, and the Legal Services Advocacy Project. In addition, the Commission has been apprised of the OLA's concerns about the fund balance.

The Commission's review of the TAP program issues has identified important facts that have had a bearing on the Commission's handling of the TAP program

benefits and surcharge. Due to changes in the state eligibility criteria for the TAP program, TAP participation has increased more than 80% between 2002 and 2005, and is expected to continue to increase in the future. There are also a decreasing number of access lines from which the surcharge can be collected. Furthermore, projections indicate that program collections will not exceed annual expenditures, thus depleting the fund balance over time. Based on these factors, the Commission has decided not to change the surcharge and credit levels at this time. The Commission has taken the position that decreasing the fund is its goal while ensuring stability of program benefits and surcharge levels.

The TAP program and its funding will continue to be brought before the Commission on a regular basis. To ensure that fund balance issues continue to be adequately monitored, the Commission staff will bring the TAP issue before the Commission at least annually.

Finding: The Commission did not provide sufficient oversight of Telephone Assistance Plan eligibility determinations and ensure the accuracy of related program revenues and expenditures.

Since 2003, independent verification of household eligibility for the TAP program by a state agency has not been done. Prior to that time, the Department of Human Services (DHS) provided some level of assurance of eligibility. To fund this service, DHS had received \$314,000 from the TAP fund. However, DHS found the \$314,000 was significantly less than the costs it incurred to provide the service. Subsequently, DHS was successful in obtaining legislation that discontinued its role in this process and eliminated its appropriation from the TAP fund. The legislation which was adopted defaulted to the self-certification system described in the Report.

The OLA suggests that the Commission take responsibility for assuring eligibility by obtaining applicants' social security numbers and matching them to the DHS public assistance program database or the Department of Revenues income tax system database.

Another factor affecting TAP fund revenues relates to telephone company access lines. The TAP surcharge is assessed per access line and has been set at 5 cents per line per month (i.e., half of the maximum permitted level) for many years. As noted in the Report, telephone companies are no longer required to annually report access lines. This change is the result of Legislative action. The Report correctly points out that lack of access line information makes it more difficult to know if the State is receiving the correct amount of revenue for the program. The Report notes that the Minnesota Statewide 911 program in the Department of Public Safety (DPS) and the Telecommunications Access Minnesota program in the Department of Commerce (DOC) also rely on surcharges on telephone access lines to fund their programs. Since these agencies also rely on access line counts

to verify the accuracy of revenues, the discontinuance of regular line count reports presumably is also an issue for those two agencies.

The OLA recommends that the Commission partner with the DPS and DOC to determine a method of strengthening oversight of the telephone surcharge revenues.

Verification of households' eligibility as well as telephone company access line counts on an on-going basis as recommended by OLA would require substantial attention by a staff person, preferably a person with accounting training. The Commission does not have the resources available to take on these additional tasks at this time. However, as OLA suggests, perhaps there is an opportunity for the three effected agencies to share such a function within one of the agencies. The Commission will raise this issue with the Department of Commerce and the Department of Public Safety. Obtaining the necessary staff resources to address the issue with a joint agency effort will very likely require an appropriation from some or all of the various funds involved. Providing the oversight for the TAP program as suggested by OLA would, by itself, require a significant share of one FTE. Minnesota Statutes Section 237.701, Subdivision 1 (2) currently limits the Commission to no more than \$25,000 annually from the TAP fund for expenses associated with administering the fund.

Any steps to address the audit findings not already taken will be implemented immediately and will be on-going. I am the person responsible for implementation. I believe these measures will adequately address the issues raised by the audit report. I would be very interested in any comments you or your staff might have with respect to these measures. If you would like any further status reports or other information on these matters, please contact me directly (651.201.2222)

Sincerely,



Burl W. Haar
Executive Secretary

Cc: LeRoy Koppendraye, Chair
Phyllis Reha, Vice Chair
Marshall Johnson, Commissioner
Kenneth Nickolai, Commissioner
Thomas Pugh, Commissioner
Mary Jo Jasicki, Administrative Management Director