

PUBLIC SERVICE COMMISSION

**FOR THE YEARS ENDED
JUNE 30, 1996, AND JUNE 30, 1995**

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September 18, 1996

The Honorable Don Sundquist, Governor
and
Members of the General Assembly
State Capitol
Nashville, Tennessee 37243
and

The Honorable Lynn Greer, Chairman
The Honorable Sara Kyle, Director
The Honorable Melvin Malone, Director
Tennessee Regulatory Authority
460 James Robertson Parkway
Nashville, Tennessee 37243-0505

Ladies and Gentlemen:

Transmitted herewith is the compliance audit of the Public Service Commission for the years ended June 30, 1996, and June 30, 1995.

Consideration of the internal control structure and tests of compliance disclosed certain deficiencies, which are detailed in the Results of the Audit section of this report. The administration of the Tennessee Regulatory Authority, successor to the Public Service Commission, has responded to the audit findings; the responses are included following each finding. The Division of State Audit will follow up the audit to examine the application of the procedures instituted because of the audit findings.

Very truly yours,

W. R. Snodgrass
Comptroller of the Treasury

WRS/tp
96/123

State of Tennessee

Audit Highlights

Comptroller of the Treasury

Division of State Audit

Compliance Audit
Public Service Commission
For the Years Ended June 30, 1996, and June 30, 1995

AUDIT OBJECTIVES

The objectives of the audit were to consider the commission's internal control structure; to test compliance with certain laws, regulations, contracts, or grants; and to recommend appropriate actions to correct any deficiencies.

BACKGROUND

The 99th General Assembly, in the Public Acts of 1995, Chapter 305, replaced the Public Service Commission with the Tennessee Regulatory Authority (TRA) and transferred some of its responsibilities to other state agencies. These changes occurred on or before July 1, 1996. The new management of the TRA responded that all issues addressed in the findings that were carried over to the new agency would be corrected.

INTERNAL CONTROL FINDING

Controls Over Cash Receipts Were Not Adequate*

Cash-receipting functions were not centralized; written receipts or a control list of money received was not always prepared upon receipt of money; photocopies of checks received were not compared with deposit records; and segregation of duties was not adequate for reconciliations (page 8).

COMPLIANCE FINDING

The Commission Did Not Comply With the Financial Integrity Act

Reports documenting the commission's evaluation of its system of internal accounting and administrative control have not been completed or submitted for the years ended December 31, 1995, and December 31, 1994 (page 9).

* This finding is repeated from two prior audits.

"Audit Highlights" is a summary of the audit report. To obtain the complete audit report which contains all findings, recommendations, and management comments, please contact

Comptroller of the Treasury, Division of State Audit
1500 James K. Polk Building, Nashville, TN 37243-0264
(615) 741-3697

AUDIT REPORT
PUBLIC SERVICE COMMISSION
FOR THE YEARS ENDED JUNE 30, 1996, AND JUNE 30, 1995

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PUBLIC SERVICE COMMISSION
FOR THE YEARS ENDED JUNE 30, 1996, AND JUNE 30, 1995

INTRODUCTION

POST-AUDIT AUTHORITY

This is a report on the compliance audit of the Public Service Commission. The audit was conducted pursuant to Section 4-3-304, *Tennessee Code Annotated*, which authorizes the Department of Audit to “perform currently a post-audit of all accounts and other financial records of the state government, and of any department, institution, office, or agency thereof in accordance with generally accepted auditing standards and in accordance with such procedures as may be established by the comptroller.”

Section 8-4-109, *Tennessee Code Annotated*, authorizes the Comptroller of the Treasury to audit any books and records of any governmental entity that handles public funds when the Comptroller considers an audit to be necessary or appropriate.

OBJECTIVES OF THE AUDIT

The objectives of the audit were

1. to consider the commission’s internal control structure to determine auditing procedures for the purpose of testing compliance with certain laws, regulations, contracts, or grants;
2. to test compliance with certain laws, regulations, contracts, or grants; and
3. to recommend appropriate actions to correct any deficiencies.

SCOPE OF THE AUDIT

The audit is limited to the period July 1, 1994, through June 30, 1996, and was conducted in accordance with generally accepted government auditing standards.

BACKGROUND AND ORGANIZATION

LEGISLATIVE HISTORY

The Public Service Commission dates to 1897 when a special session of the legislature passed an act to create a railroad commission. The commission was assigned general supervision and regulation of the services and rates of all railroads or common carriers operating in the state and was empowered to assess railroad, telegraph, and telephone companies.

The Public Utilities Act, passed in 1919, changed the name of the commission to the Railroad and Public Utilities Commission. The commission then became responsible for the general supervision and regulation of all public utilities operating in the state. The commission also was directed to evaluate, for tax purposes, all properties of utilities in Tennessee.

In 1921, *Tennessee Code Annotated* defined “public utilities” as all common carriers, express, gas, electric light, heat, power, water, telephone, telegraph, or any other like system, plant, or equipment affected by or dedicated to public use. A department of motor transportation was organized within the commission in 1928, and the Motor Vehicle Regulatory Act was enacted in 1929. This act provided that the commission was to regulate, supervise, and control the operation of motor vehicles as common carriers.

The 79th General Assembly, in the Public Acts of 1955, Chapter 69, changed the name of the commission to the Public Service Commission.

The 99th General Assembly, in the Public Acts of 1995, Chapter 305, replaced the Public Service Commission with the Tennessee Regulatory Authority and transferred some of its responsibilities to other state agencies. These changes occurred on or before July 1, 1996.

ORGANIZATION

The Public Service Commission consisted of three elected members. The three commissioners were each elected to a six-year term. One member was elected biennially in a state-wide election to succeed the commissioner whose term expired next. By statute, each grand division of the State of Tennessee had a representative member of the commission; the commissioners elected a chairman biennially from among themselves.

The Public Service Commission regulated and supervised the rates and services of the utilities, motor carriers, and railroads under the commission’s jurisdiction and assessed the properties of these companies for *ad valorem* tax purposes. The three commissioners and a staff consisting of an executive director, an administrative officer, administrative law judges, and directors of the eight operating divisions performed these duties.

An organization chart of the Public Service Commission is on the following page.

The commission was part of the special revenue fund of the State of Tennessee and was responsible for the following division and allotment code: Public Service Commission-311.00.

PRIOR AUDIT FINDINGS

Section 8-4-109, *Tennessee Code Annotated*, requires that each state department, agency, or institution report to the Comptroller of the Treasury the action taken to implement the recommendations in the prior audit report. The Public Service Commission filed its report with the Department of Audit on May 29, 1996. A follow-up of all prior audit findings was conducted as part of the current audit.

RESOLVED AUDIT FINDINGS

The current audit disclosed that the commission has corrected previous audit findings concerning controls over equipment, controls over citations, and controls over wire permits.

REPEATED AUDIT FINDING

The prior audit report also contained a finding concerning controls over cash receipts. This finding has not been resolved and is repeated in this report.

OBSERVATIONS AND COMMENTS

Tennessee Code Annotated, Section 4-21-901, requires each state governmental entity subject to the requirements of Title VI of the Civil Rights Act of 1964 to submit an annual Title VI compliance report and implementation plan to the Department of Audit by June 30, 1994, and each June 30 thereafter. The Public Service Commission filed its compliance report and implementation plan due on June 30, 1996, on July 24, 1996, and the report due on June 30, 1995, on June 30, 1995.

Title VI of the Civil Rights Act of 1964 is a federal law. The act requires all state agencies receiving federal money to develop and implement plans to ensure that no person shall, on the ground of race, color, or national origin, be excluded from participation in, be denied the benefits of, or be subjected to discrimination under any program or activity receiving federal funds.

The State Planning Office in the Executive Department was assigned the responsibility of serving as the monitoring agency for the Title VI compliance and copies of the required reports were filed with the State Planning Office for evaluation and comment. However, the State Planning Office has been abolished. The Office of the Governor is currently evaluating which office in the Executive Branch will be the new monitoring agency.

A summary of the dates state agencies filed their annual Title VI compliance reports and implementation plans is presented in the special report, *Submission of Title VI Implementation Plans*, issued annually by the Comptroller of the Treasury.

RESULTS OF THE AUDIT

AUDIT CONCLUSIONS

Internal Control Structure

We considered the internal control structure to determine auditing procedures for the purpose of testing compliance with certain laws, regulations, contracts, or grants. The report on the internal control structure is on the following pages. A deficiency, along with the recommendation and management's response, is detailed in the findings and recommendations, which follow the report on the internal control structure.

Compliance with Laws and Regulations

The commission complied with the provisions of certain laws, regulations, contracts, or grants except for an instance of noncompliance included in the findings and recommendations. The compliance report follows the findings and recommendations.

Report on the Internal Control Structure

July 9, 1996

The Honorable W. R. Snodgrass
Comptroller of the Treasury
State Capitol
Nashville, Tennessee 37243

Dear Mr. Snodgrass:

We have applied procedures to test the Public Service Commission's compliance with the provisions of certain laws, regulations, contracts, or grants for the years ended June 30, 1996, and June 30, 1995, and have issued our report thereon dated July 9, 1996. We performed the procedures in accordance with generally accepted government auditing standards. The 99th General Assembly, in the Public Acts of 1995, Chapter 305, replaced the Public Service Commission with the Tennessee Regulatory Authority and transferred some of its responsibilities to other state agencies. These changes occurred on or before July 1, 1996.

We considered the commission's internal control structure in order to determine our procedures for the purpose of testing the commission's compliance with certain laws, regulations, contracts, or grants and not to provide assurance on the internal control structure.

The Public Service Commission's management is responsible for establishing and maintaining an internal control structure. In fulfilling this responsibility, estimates and judgments by management are required to assess the expected benefits and related costs of internal control structure policies and procedures. The objectives of an internal control structure are to provide management with reasonable, but not absolute, assurance that assets are safeguarded against loss from unauthorized use or disposition, and that transactions are executed in accordance with management's authorization and recorded properly. Because of inherent limitations in any internal control structure, errors or irregularities may nevertheless occur and not be de-

The Honorable W. R. Snodgrass
July 9, 1996
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tected. Also, projection of any evaluation of the structure to future periods is subject to the risk that procedures may become inadequate because of changes in conditions or that the effectiveness of the design and operation of policies and procedures may deteriorate.

Our consideration of the internal control structure would not necessarily disclose all matters in the internal control structure that might be deficiencies in the design or operation of the internal control structure that, in our judgment, could adversely affect the commission's ability to comply with laws, regulations, contracts, or grants. However, we did note the following deficiency:

- Controls over cash receipts were not adequate.

This deficiency is described in the Findings and Recommendations section of this report.

We also noted certain matters involving the internal control structure and its operation that we have reported to the commission's management in a separate letter.

This report is intended for the information of the General Assembly of the State of Tennessee and management. However, this report is a matter of public record, and its distribution is not limited.

Sincerely,

Arthur A. Hayes, Jr., CPA, Director
Division of State Audit

AAH/tp

FINDINGS AND RECOMMENDATIONS

CONTROLS OVER CASH RECEIPTS WERE NOT ADEQUATE

1. FINDING:

As stated in the two prior audits, the Public Service Commission did not establish adequate controls over cash receipts. Management concurred with the prior audit finding and stated that “the audit team pointed out several areas where cash-receipting could be improved, and we have modified most processes to conform with their recommendations.” However, some of the areas addressed in the prior audit have not improved, and one additional weakness was noted.

- a. Cash-receipting functions were not centralized. Centralization allows for better segregation of duties and improved controls over the cash-receipting function.
- b. Written receipts or control lists of money received through the mail were not always prepared when the mail was opened away from the mail room. Thus, staff could not reconcile money deposited with money received in areas other than the mail room, and the timeliness of deposits could not be determined. Of eight checks included in a cash count on May 1, 1996, three (37.5%) were not supported by an agency-prepared record of receipt.
- c. All checks received through the mail room were photocopied, and the photocopies were dated to document when the funds were received. However, the photocopies were not compared with deposit records. Therefore, management had no assurance that all revenue received in the mail room was deposited to the commission’s account.
- d. Checks received in the mail by the Transportation Division for Certificates of Trailer Inspection and by other individuals were not always restrictively endorsed upon receipt.
- e. No person independent of receipt and deposit duties compared the cash receipt records with the deposit records. If duties are not adequately segregated, errors and irregularities may not be detected.

RECOMMENDATION:

The Tennessee Regulatory Authority, successor to the Public Service Commission, should consider the following recommendations to improve their controls over cash receipts. Receipting of funds should be centralized, and funds should be receipted

immediately. Checks should be restrictively endorsed by the first person to handle them. Mail room staff should list funds received rather than incur the expense of copying. The list should be compared with the deposit records by someone independent of the mail room. Reconciliations should be performed or reviewed by someone independent of cash-receipting and depositing functions.

MANAGEMENT'S COMMENT:

We concur with the finding and have taken initial steps to implement the recommendation. The PSC converted to a check log system during the course of the audit. This system has also been centralized and is being performed by our Administrative Section. In addition, the Tennessee Regulatory Authority has assembled a new internal audit team consisting of experienced Certified Public Accountants who will make additional recommendations to the agency directors on additional improvements in this area.

THE COMMISSION DID NOT COMPLY WITH THE
FINANCIAL INTEGRITY ACT

2. FINDING:

The Public Service Commission did not comply with the Financial Integrity Act. Although a report documenting the commission's evaluation of its system of internal accounting and administrative control was filed for the year ended December 31, 1993, the commission did not complete a review or submit a report for the years ended December 31, 1995, and December 31, 1994.

Section 9-18-102, *Tennessee Code Annotated*, stipulates:

Each agency of state government shall establish internal accounting and administrative controls which shall provide reasonable assurance that:

- (1) Obligations and costs are in compliance with applicable law;
- (2) Funds, property and other assets are safeguarded against waste, loss, unauthorized use or misappropriation; and

- (3) Revenues and expenditures applicable to agency operations are properly recorded and accounted for to permit the preparation of accounts and reliable financial and statistical reports and to maintain accountability over the assets.

Section 9-18-104 stipulates:

- (a) By December 31 of each year, the head of each executive agency shall, on the basis of an evaluation conducted in accordance with guidelines prescribed under the preceding section, prepare and transmit to the commissioner of finance and administration and the comptroller of the treasury a report which states that:
 - (1) The agency's systems of internal accounting and administrative control fully comply with the requirements specified in this chapter; or
 - (2) The agency's systems of internal accounting and administrative control do not fully comply with such requirements.
- (b) In the event that the agency's systems do not fully comply with such requirements, the report shall include and identify any material weaknesses in the agency's systems of internal accounting and administrative control and the plans and schedule for correcting such weaknesses.

The Department of Finance and Administration has established guidelines for agencies to follow in evaluating their systems' compliance with the above requirements. An annual evaluation of internal accounting and administrative controls is needed to provide reasonable assurance that obligations and costs are in compliance with applicable laws, assets are safeguarded, and revenues and expenditures are properly recorded and accounted for.

RECOMMENDATION:

The Tennessee Regulatory Authority, successor to the Public Service Commission, should assign someone to evaluate its systems of internal accounting and administrative control as required by Section 9-18-102, *Tennessee Code Annotated*. A report detailing the results of the examination should be submitted to the Commissioner of Finance and Administration and the Comptroller of the Treasury.

MANAGEMENT'S COMMENT:

We concur. Due to an initial severing of rate and accounting staff in fiscal year 1995 to the Consumer Advocate's Office, the PSC became short staffed and was unable to assign personnel to perform the various procedures necessary to comply with the Act. The decision to sunset the PSC compounded the staffing problem with uncertainty about filling vacant positions. The Tennessee Regulatory Authority has moved quickly to fill vacant positions in these areas and has assigned the task to a new internal audit team headed by a Utility Rate Manager who will utilize some full-time and part-time staff CPAs to accomplish the tasks.

Compliance Report

July 9, 1996

The Honorable W. R. Snodgrass
Comptroller of the Treasury
State Capitol
Nashville, Tennessee 37243

Dear Mr. Snodgrass:

We have applied procedures to test the Public Service Commission's compliance with the provisions of certain laws, regulations, contracts, or grants for the years ended June 30, 1996, and June 30, 1995. We performed the procedures in accordance with generally accepted government auditing standards. The 99th General Assembly, in the Public Acts of 1995, Chapter 305, replaced the Public Service Commission with the Tennessee Regulatory Authority and transferred certain of its responsibilities to other state agencies. These changes occurred on or before July 1, 1996.

Compliance with laws, regulations, contracts, or grants applicable to the Public Service Commission is the responsibility of the commission's management. Our objective was not to provide an opinion on overall compliance with such provisions. Accordingly, we do not express such an opinion.

The results of our tests indicate that the Public Service Commission complied with the provisions referred to in the preceding paragraph, except for one instance of noncompliance included in the Findings and Recommendations section of this report. We also noted other less significant instances of noncompliance that we have reported to the commission's management in a separate letter.

The Honorable W. R. Snodgrass
July 9, 1996
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This report is intended for the information of the General Assembly of the State of Tennessee and management. However, this report is a matter of public record and its distribution is not limited.

Sincerely,

Arthur A. Hayes, Jr., CPA, Director
Division of State Audit

AAH/tp