Audit Report

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# Public Service Commission

January 2021

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**OFFICE OF LEGISLATIVE AUDITS**
DEPARTMENT OF LEGISLATIVE SERVICES
MARYLAND GENERAL ASSEMBLY

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DEPARTMENT OF LEGISLATIVE SERVICES
OFFICE OF LEGISLATIVE AUDITS
MARYLAND GENERAL ASSEMBLY

Victoria L. Gruber
Executive Director

Gregory A. Hook, CPA
Legislative Auditor

January 15, 2021

Senator Clarence K. Lam, M.D., Senate Chair, Joint Audit and Evaluation Committee
Delegate Carol L. Krimm, House Chair, Joint Audit and Evaluation Committee
Members of Joint Audit and Evaluation Committee
Annapolis, Maryland

Ladies and Gentlemen:

We have conducted a fiscal compliance audit of the Public Service Commission (PSC) for the period beginning February 9, 2016 and ending March 11, 2020. PSC regulates public utilities (such as gas, electric, water, and telephone companies) operating within the State. PSC also regulates common carriers engaged in the public transportation of passengers in the State.

Our audit disclosed that PSC did not have an adequate process in place to ensure that utility companies complied with all requirements of PSC orders approving merger transactions. PSC includes these requirements to ensure the merger transactions benefit utility customers in the State. While PSC acknowledged that State law provides it with broad authority to enforce merger orders, it believes that this authority also provides discretion to not actively monitor compliance with individual requirements within the orders.

Our audit also disclosed that PSC had not obtained control agency approval for certain sole source procurements and lacked adequate controls over cash receipts and accounts receivable functions.

PSC's response to this audit is included as an appendix to this report. In accordance with State law, we have reviewed the response, and we identified certain instances in which statements in the response conflict with or disagree with the report findings. In each instance, we reviewed and reassessed our audit documentation, and reaffirmed the validity of our finding. Specifically, in

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response to Finding 1, PSC refuses to monitor compliance with the terms and conditions of its merger agreement, yet we are unaware of any statutory impediment to PSC implementing such monitoring. In fact, due to PSC's failure to assume such a role, at present there is no other entity or individual in a position to perform this critical task. In addition, PSC's disagreement with Finding 2 is equally troubling, as PSC seems unwilling to seek a resolution with appropriate parties to an apparent conflict in procurement authority.

In accordance with generally accepted government auditing standards, we have included "auditor comments" within PSC's response to further explain our position. We will advise the Joint Audit and Evaluation Committee of any outstanding issues that we cannot resolve with PSC. Additionally, in accordance with our policy, we have edited PSC's response to remove the name of a certain individual.

We wish to acknowledge the cooperation extended to us during the audit by PSC.

Respectfully submitted,

Gregory A. Hook, CPA
Legislative Auditor

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# Background Information

## Agency Responsibilities

The Public Service Commission (PSC), which functions under the provisions of the Public Utilities Article of the Annotated Code of Maryland, regulates public utilities (such as gas, electric, water, and telephone companies) operating within the State. PSC also regulates common carriers engaged in the public transportation of passengers in the State and has jurisdiction over taxicabs operating in Baltimore City, Baltimore County, Charles County, Cumberland, and Hagerstown, as well as transportation network companies throughout the State. PSC consists of five members who are appointed by the Governor, with the advice and consent of the Senate.

In accordance with State law, the operating expenses of PSC are paid for by annual assessments which are calculated and issued by PSC to regulated companies. These annual assessments also pay the operating expenses of the Office of People's Counsel (OPC). OPC, which we audit separately, is responsible for protecting the interests of residential and non-commercial users of these regulated services relating to matters and proceedings before PSC and the courts. According to State records, during fiscal year 2019, the operating expenses of PSC and OPC totaled $17.9 million and $4.1 million, respectively.

# Findings and Recommendations

## Utility Company Mergers

**Finding 1**
**The Public Service Commission (PSC) did not have an adequate process to ensure that utility companies complied with certain requirements of merger orders.**

**Analysis**
The Public Service Commission (PSC) did not have an adequate process to ensure that utility companies complied with certain requirements of merger orders. PSC reviews and authorizes merger applications for utility companies that operate in Maryland. State law authorizes PSC to impose requirements on the utility company as a condition of the merger, such as, credits to customers or donations to charities. These requirements (referred to as "conditions") are included in the written PSC merger orders, and are based on extensive testimony from all affected parties including the Office of People's Counsel (OPC). State law further provides that failure to comply with the conditions may result in PSC suspending or revoking the utility company's license and/or issuing civil penalties.

However, PSC did not have an adequate process to ensure that utility companies complied with all conditions set forth in the merger orders. Our review of 142 conditions relating to three merger orders that were in effect during our audit period disclosed that for 64 conditions, PSC did not ensure that utility companies complied with the conditions. PSC also did not formally document that the remaining 78 conditions were met. We found that PSC could have confirmed compliance with those conditions with information received from independent third parties in accordance with the monitoring provisions in the merger order(s) or information that was generally available to the public.

For example, one condition included in the orders for all three mergers required the utility companies to fund a one-time rate credit for customers within the utilities' respective service areas. The credits ranged from $50 to $100 per customer and were estimated to total approximately $208.5 million. Another condition required a utility company to provide an average of $7 million annually to charity and communal support within the State for a ten-year period. PSC did not establish procedures to ensure the utilities complied with these conditions. Instead, PSC relied on customer complaints and/or utility company self-reporting to ensure compliance. Further, in cases of self-reporting, we found that PSC did

not have a process in place to review that information to verify compliance, but accepted the representations of the utility companies without corroboration.

We were advised by PSC management that the Public Utilities Article of the Annotated Code of Maryland and relevant case law affords the PSC broad discretion as to how to establish, monitor, and enforce compliance with merger conditions. PSC further stated that in its capacity as a quasi-judicial agency, it functions most appropriately when it allows parties, such as OPC[1], to raise their own rights, rather than asserting the interests of the parties before it. PSC did not have a formal policy on when to include a provision requiring the monitoring of the conditions in the merger orders resulting in the inconsistencies and conditions noted above (including customer credits valued in the millions of dollars). In addition, PSC merger orders did not include any reporting requirements related to merger conditions by the companies to the OPC or any other party. Consequently, we continue to believe that since PSC was authorized to establish the conditions and to take corrective action for noncompliance, it is incumbent on PSC to ensure that its established conditions are met.

**Recommendation 1**
**We recommend that PSC establish a formal process to ensure that utility companies comply with all merger order conditions, including those noted above.**

## Procurement

**Finding 2**
**PSC did not obtain required control agency approval for three sole source contracts for consulting services totaling approximately $605,000.**

**Analysis**
PSC obtained consulting services from three vendors totaling approximately $605,000 using the sole source procurement method without approval from the Board of Public Works (BPW) or the Department of Budget and Management (DBM)[2] as required by State procurement regulations. Our review of all three sole source contracts awarded by PSC during the audit period disclosed that these

[1] We contacted OPC and were informed that its responsibility is limited to conditions that directly impact residential customers; any other conditions (such as the charitable donations noted previously) would not be subject to OPC involvement. In addition, OPC management advised that it does not have a formal process or practice to actively monitor compliance with PSC conditions.
[2] Effective October 1, 2019, procurement control authority was transferred from the Department of Budget and Management to the Department of General Services.

contracts were not submitted to the appropriate control agency for review and approval. Specifically, one contract totaling approximately $501,000 procured in June 2017 was not submitted to BPW for approval and two other contracts procured in June 2016 and June 2017 totaling approximately $104,000 were not submitted to DBM for approval.

State procurement law/regulations allow agencies to use the sole source procurement method when there is threatened or pending litigation (which applied to all three contracts) with the approval of the Office of the Attorney General (OAG) and BPW for contracts greater than $100,000 and from DBM for contracts $100,000 or less. While PSC obtained the OAG's approval, it did not obtain BPW or DBM approval, as required.

We were advised by PSC management that these procurements were exempt from control agency approval, other than by OAG, due to the confidential nature of the services provided by these contracts; citing an OAG opinion (from 1989). However, this interpretation appears to conflict with established BPW/DBM procurement authority, and BPW staff advised us that State procurement law/regulations related to confidential services do not preclude control agency approval.

**Recommendation 2**
**We recommend that PSC consult with the OAG and BPW to resolve the apparent contradiction on control agency approvals. Based on the advice obtained from these entities**

**a. ensure that sole source procurements are approved by the appropriate control agency; and**
**b. seek retroactive approval from the appropriate control agency for the aforementioned contracts, as necessary.**

## Cash Receipts and Accounts Receivables

**Finding 3**
**PSC did not establish adequate controls over cash receipts and accounts receivable.**

**Analysis**
PSC did not establish adequate controls over cash receipts and accounts receivable. PSC received cash and check payments through the mail and in person for assessments, permits, and other fees owed by regulated entities.

According to State records, during fiscal year 2020, check and cash collections totaled approximately $15.6 million.

- PSC had not properly segregated cash handling duties from accounts receivable and deposit verification functions. Specifically, the employee who prepared the deposit adjusted the related accounts receivable records and another employee who performed the deposit verification had access to the safe where the collections were stored prior to deposit.

- Five employees with access to the accounts receivable records could post payments and credits, and three could edit the charges and delete accounts without any independent review and approval. PSC maintains its accounts receivable records using a database that did not have the ability for online approval of transactions. PSC historically relied on a control account to monitor the accounts receivable transactions, but the control account was not independent and was discontinued in December 2019. Consequently, errors or other discrepancies could occur without timely detection.

The Comptroller of Maryland's *Accounting Procedures Manual* requires the segregation of the cash receipts handling duties from the accounts receivable record keeping and reconciliation functions. In addition, the *Manual* requires an accounts receivable control account and that the aggregate balance of the detail records be periodically reconciled to the control account balance. We were advised by PSC management that the inadequate segregation of duties was the result of employee turnover.

**Recommendation 3**
**We recommend that PSC**
**a. ensure proper segregation of duties over cash receipts, accounts receivable, and deposit verification functions;**
**b. ensure all accounts receivable transactions are subject to independent review and approval; and**
**c. maintain an independent control account and periodically reconcile it to the detailed records.**

**We advised PSC on accomplishing the necessary separation of duties using existing personnel.**

# Audit Scope, Objectives, and Methodology

We have conducted a fiscal compliance audit of the Public Service Commission (PSC), for the period beginning February 9, 2016 and ending March 11, 2020. The audit was conducted in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

As prescribed by the State Government Article, Section 2-1221 of the Annotated Code of Maryland, the objectives of this audit were to examine PSC's financial transactions, records, and internal control, and to evaluate its compliance with applicable State laws, rules, and regulations.

In planning and conducting our audit, we focused on the major financial-related areas of operations based on assessments of significance and risk. The areas addressed by the audit included procurements and disbursements, payroll, cash receipts, accounts receivable, assessments charged to regulated utilities, and PSC's role in certain trust funds established by law. We also reviewed PSC's oversight of certain provisions of several mergers.

Our assessment of internal controls was based on agency procedures and controls in place at the time of our fieldwork. Our tests of transactions and other auditing procedures were generally focused on the transactions occurring during our audit period of February 9, 2016 to March 11, 2020, but may include transactions before or after this period as we considered necessary to achieve our audit objectives.

To accomplish our audit objectives, our audit procedures included inquiries of appropriate personnel, inspections of documents and records, tests of transactions, and to the extent practicable, observations of PSC's operations. Generally, transactions were selected for testing based on auditor judgment, which primarily considers risk. Unless otherwise specifically indicated, neither statistical nor non-statistical audit sampling was used to select the transactions tested. Therefore, the results of the tests cannot be used to project those results to the entire population from which the test items were selected.

We also performed various data extracts of pertinent information from the State's Financial Management Information System (such as revenue and expenditure data) and the State's Central Payroll Bureau (payroll data) as well as from the

contractor administering the State's Corporate Purchasing Card Program (credit card activity). The extracts are performed as part of ongoing internal processes established by the Office of Legislative Audits and were subject to various tests to determine data reliability. We determined that the data extracted from these sources were sufficiently reliable for the purposes the data were used during this audit. Finally, we performed other auditing procedures that we considered necessary to achieve our audit objectives. The reliability of data used in this report for background or informational purposes was not assessed.

PSC's management is responsible for establishing and maintaining effective internal control. Internal control is a process designed to provide reasonable assurance that objectives pertaining to the reliability of financial records; effectiveness and efficiency of operations, including safeguarding of assets; and compliance with applicable laws, rules, and regulations are achieved. As provided in *Government Auditing Standards*, there are five components of internal control: control environment, risk assessment, control activities, information and communication, and monitoring. Each of the five components, when significant to the audit objectives, and as applicable to the PSC, were considered by us during the course of this audit.

Because of inherent limitations in internal control, errors or fraud may nevertheless occur and not be detected. Also, projections of any evaluation of internal control to future periods are subject to the risk that conditions may change or compliance with policies and procedures may deteriorate.

Our reports are designed to assist the Maryland General Assembly in exercising its legislative oversight function and to provide constructive recommendations for improving State operations. As a result, our reports generally do not address activities we reviewed that are functioning properly.

This report includes findings relating to conditions that we consider to be significant deficiencies in the design or operation of internal control that could adversely affect PSC's ability to maintain reliable financial records, operate effectively and efficiently, and/or comply with applicable laws, rules, and regulations. Our report also includes findings regarding significant instances of noncompliance with applicable laws, rules, or regulations. Other less significant findings were communicated to PSC that did not warrant inclusion in this report.

PSC's response to our findings and recommendations is included as an appendix to this report. As prescribed in the State Government Article, Section 2-1224 of the Annotated Code of Maryland, we will advise PSC regarding the results of our review of its response.

# APPENDIX

COMMISSIONERS

JASON M. STANEK
CHAIRMAN

MICHAEL T. RICHARD
ANTHONY J. O'DONNELL
ODOGWU OBI LINTON
MINDY L. HERMAN

STATE OF MARYLAND

PUBLIC SERVICE COMMISSION

January 5, 2021

Gregory A. Hook, CPA
Legislative Auditor
Department of Legislative Services
Office of Legislative Audits
Maryland General Assembly
301 West Preston Street
Room 1202
Baltimore, MD 21201

***RE: Public Service Commission Draft Audit – Period February 2016 – March 11, 2020***

Dear Mr. Hook:

Thank you for providing the Public Service Commission Draft Audit Report dated December 7, 2020.

Please find the Commission's response enclosed.

Sincerely,

Jason M. Stanek
Chairman

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## Public Service Commission

## Agency Response Form

# Utility Company Mergers

| **Finding 1**<br>**The Public Service Commission (PSC) did not have an adequate process to ensure that utility companies complied with certain requirements of merger orders.** |
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**We recommend that PSC establish a formal process to ensure that utility companies comply with all merger order conditions, including those noted above.**

<table>
<tr><th colspan="4">Agency Response</th></tr>
<tr><td>Analysis</td><td colspan="3"></td></tr>
<tr><td>Please provide additional comments as deemed necessary.</td><td colspan="3"></td></tr>
<tr><td>Recommendation 1</td><td>Disagree</td><td>Estimated Completion Date:</td><td>N/A</td></tr>
<tr><td>Please provide details of corrective action or explain disagreement.</td><td colspan="3">The Public Service Commission disagrees with this finding. As the Office of Legislative Audits (OLA) acknowledges, the Public Utilities Article of the Maryland Code (PUA) vests the Commission with broad discretion regarding how to enforce its orders, rather than mandating a particular protocol, as recommended by OLA. PUA § 2-113 provides the Commission with the authority to “supervise and regulate the public service companies,” to “ensure their operation in the interest of the public,” and to “enforce compliance with the requirements of law.” Regarding utility mergers and acquisitions specifically, the PUA provides expansively that the Commission “may condition an order authorizing the acquisition on the applicant's satisfactory performance or adherence to specific requirements.” PUA § 6-105(g)(3)(ii). Nowhere, however, does the PUA mandate that the Commission enforce its orders, including its merger conditions, in a particular manner. See, People's Counsel v. Pub. Serv. Comm'n, 52 Md. App. 715, 722, (1982) (holding that “[a] great deal of discretion is necessarily vested in the Commission in order that it may properly discharge its important and complex duties;” and Accokeek, Mattawoman, Piscataway Creeks Cmtys. Council, Inc. v. Md. PSC, 227 Md. App. 265, 288 (2014) (rejecting the argument that “the Commission employ a particular formula or method” in matters “the General Assembly entrusted to the Commission’s discretion.”).[1]</td></tr>
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[1] Inasmuch as the legislature gave the Commission discretion over whether to attach conditions, it is axiomatic that the Commission has discretion over how to enforce them.

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| | Historically, the Commission has included an extensive range of conditions in its merger approval orders. Those conditions benefit Maryland ratepayers and related State interests and protect the public and the State's public service companies from any potentially adverse consequences of the mergers. The Commission regularly receives compliance filings from its regulated utilities (as required by the merger orders), responds to petitions filed by stakeholders related to the conditions, and in some cases holds further proceedings to address merger conditions. For example, with regard to the Exelon-Pepco Holdings, Inc. merger in Case No. 9361, the Commission still reviews periodic compliance filings, even though the merger was approved over five years ago. Most recently, Pepco filed a notice of stock dividend payment on December 11, 2020, which relates to the Commission's condition that Pepco maintain a certain debt-equity ratio.[2] In 2020, the Commission also received merger compliance reports in that case related to cyber security and safety performance; charitable contributions and local community support; inter-utility comparisons; shared-service costs; utility ring-fencing; financial benefits related to low and moderate income customers; and annual economic benefits to all ratepayers.<br><br>In criticizing the Commission's enforcement practices, OLA misapprehends the nature of the Commission's role in contested adjudicative proceedings such as merger cases. Namely, the Commission sits in merger cases in a quasi-judicial capacity, where it issues orders in response to utility and stakeholder petitions. If a utility fails to comply with a Commission condition, affected stakeholders, such as the Office of People's Counsel (OPC), will move for an order to enforce. OPC is statutorily required to "evaluate each matter pending before the Commission" in conjunction with its duty to "to protect the interests of residential and noncommercial users." PUA § 2-204. Commission Staff performs a similar duty with regard to all ratepayers. The Commission does not, however, actively police its orders any more than a court would actively monitor the parties against whom it issued an injunction.[3] Instead, the court would depend on parties to the proceeding to file a motion to enforce if the injunction were violated. The Commission acts similarly.<br><br>In any event, the manner in which the Commission enforces its merger |

[2] Condition 30 of Order No. 86990 requires Pepco to file with the Commission within five business days after the payment of a dividend its calculations that demonstrate that the utility's common equity ratio did not fall below 48%.
[3] OLA acknowledges that it has not previously made any findings or recommendations concerning the monitoring of orders made by a judicial or quasi-judicial agency within Maryland.

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| | orders is within its discretion and not properly the subject of OLA's audit. State Government Article § 2-1221 provides that a fiscal / compliance audit entails the examination of financial transactions, records, and internal controls as well as evaluating compliance with applicable laws and regulations. The merger conditions at issue do not involve the spending of any State funds that could arguably be the subject of a fiscal / compliance audit. Instead, the merger conditions require the purchasing company (Exelon in the example above) to invest its shareholder money to benefit Maryland ratepayers, including through ratepayer credits and charitable contributions. No State financial transactions are at stake. Nor has OLA alleged any Commission violation of laws or regulations in its enforcement practices.[4] Additionally, the Commission's merger order practice is of long-standing duration and was not challenged by OLA in either of its two previous fiscal / compliance audits of the Commission.[5] Finally, the Commission observes that were it to police each merger condition as advised by OLA, it would require significantly more employment or third-party resources than the Commission currently possesses.<br><br>In sum, OLA's finding is an operational criticism, not a fiscal compliance issue. As the General Assembly is aware given its creation of the Commission's enabling statute, the Commission has conducted contested proceedings like a court of law for more than a century. The Commission has utilized its broad discretion under the PUA to create and enforce merger conditions, including by requiring utility compliance filings, responding to the objections of Commission staff and parties, and docketing investigations where warranted. Despite that history, OLA's finding is that the Commission's core method of functioning as a quasi-judicial agency is inadequate in the context of merger proceedings, and that it is "incumbent" that the Commission employ a different method of ensuring compliance with merger orders. In response, the Commission observes that when the General Assembly wants the Commission to take specific acts, the PUA is prescriptive.[6] Had the General Assembly intended for the Commission to establish a specific process to create and enforce merger conditions, including the |

[4] The Commission does not interpret the assertion that it could have operated differently to be an allegation that it has violated the law.

[5] In its February 17, 2012 Audit Report, OLA discussed the Commission's approval of the Exelon – Constellation merger in Case No. 9271, which included similar merger conditions to Case No. 9361, and found no violations or deficiencies.

[6] The PUA vests the Commission with a wide variety of specific responsibilities relative to ratemaking, mergers, and the supervision of transportation companies. *See*, e.g., PUA § 7-505(b)(2): "The Commission shall order a universal service program, to be made available on a statewide basis, to benefit low-income customers, in accordance with § 7-512.1 of this subtitle."

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| | prescriptive ones promoted by OLA, it would have made that intention clear in the statute.<br><br>OLA's finding is also contrary to the Commission's practice in merger proceedings of adopting conditions based on the recommendations of the parties, including the terms of their enforcement.[7] As in any court case, parties are fully entitled, and naturally predisposed, to see that those terms are met. Moreover, a wide array of parties maintain an interest in merger conditions, regardless of whether the conditions apply to them specifically, such as the Maryland Energy Administration, counties and municipalities, trade associations, federal agencies, nonprofit organizations, consumer advocacy groups, labor unions, OPC, and environmental groups. The conditions that attach to mergers are frequently established at a party's request or in response to concerns they raised during the hearing, and parties may request verification of a condition's fulfillment – from a utility or the Commission – at any time.[8] The Commission sits as a neutral party in determining whether the utility is in compliance with the merger conditions and any applicable regulations or PUA provisions as well as any resulting penalties.<br><br>If it is determined that enhanced scrutiny of merger conditions is warranted, such as through the hiring of a third-party entity to audit compliance, the Commission would caution that the costs of such a requirement would ultimately fall on ratepayers. Inasmuch as OLA has not provided any examples of a utility failing to comply with the conditions of a merger order (or a single complaint about such a failure), the Commission is concerned that requiring augmented scrutiny of merger condition compliance, such as through a third-party auditor, would be inconsistent with the Commission's statutory duty to consider |

[7] The Commission is not aware of any parties that have raised concerns with the enforcement of Commission merger orders, or of any instance in which the Commission has denied – or a party has requested – more specific requirements for determining compliance with such orders. Neither has any party sought judicial review in Maryland courts based on such a concern.

[8] In its Audit Report, OLA references charitable contributions and residential ratepayer credits as examples of areas where the Commission should have established specific procedures to ensure utility compliance. Nevertheless, utility compliance filings demonstrate full adherence to the requirements of the merger order regarding those categories. For example, in Case No. 9361, Pepco docketed letters of charitable contributions and local community support (*see* Item Nos. 346, 379 ,441, and 475) as well as its annual economic benefits reports (*see* Item Nos. 352, 392, 446, and 480.) Regarding residential ratepayer credits, they are the subject of wide media and public scrutiny, are announced through utility bill messages, pass through Commission rate proceedings, and are reflected on customer billing statements reviewed by Commission personnel. Defending ratepayer rights is also the responsibility of OPC, a separate party that appears before the Commission. If a credit is not received by one of the hundreds of thousands of ratepayers of a utility, the ratepayer need only contact the utility, OPC, or the Commission. In any event, the Commission has not received any complaint related to chartable contributions or rate credits to date.

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| | ratepayer resources and the economy of the State. |

**Auditor's Comment:** PSC's response disagreed with our recommendation to establish a formal process to ensure that utility companies comply with all merger conditions. PSC asserted that State law does not mandate that PSC enforce its merger conditions in a particular manner and, therefore, it relies on stakeholders to monitor compliance. PSC further asserted that it is a quasi-judicial entity and just like a judicial body would not "police its orders." Finally, PSC stated that the merger conditions are not within the scope of our audit because they did not involve the spending of any State funds and that OLA had not provided any examples of a utility failing to comply with the conditions of a merger order.

We evaluated the PSC response, and we maintain that our position is valid. In our opinion, the aforementioned arguments lack merit and appear to be an attempt by PSC to deflect its responsibilities for monitoring the merger conditions that it ordered with the utility companies. For example, as noted in our report, the assertion that the Office of People's Counsel (OPC) will help ensure compliance is not consistent with representations made by OPC to OLA that it did not have a formal policy or process to actively monitor compliance with utility company merger conditions established by PSC. Furthermore, the assertion that stakeholders can monitor compliance falsely assumes that the stakeholders are aware of the conditions contained in the agreements, and have ready access to needed information and the technical knowledge necessary to determine compliance. As evidence of the fallacy of this argument, during the course of our audit, certain information necessary to determine utility compliance with mergers we selected for review was not available at PSC, and PSC refused to request information from the parties necessary for OLA to determine whether the utilities complied with all the terms of the agreement. Under such circumstances, even if they had the desire, stakeholders, such as individual household ratepayers, could not be expected to monitor utility company compliance with PSC established merger terms and conditions.

**Public Service Commission**

**Agency Response Form**

## Procurement

| **Finding 2** |
|---|
| **PSC did not obtain required control agency approval for three sole source contracts for consulting services totaling approximately $605,000.** |

**We recommend that PSC consult with the OAG and BPW to resolve the apparent contradiction on control agency approvals. Based on the advice obtained from these entities**

**a. ensure that sole source procurements are approved by the appropriate control agency; and**

**b. seek retroactive approval from the appropriate control agency for the aforementioned contracts, as necessary.**

| **Agency Response** | | | |
|---|---|---|---|
| **Analysis** | | | |
| **Please provide additional comments as deemed necessary.** | | | |
| **Recommendation 2a** | Disagree | **Estimated Completion Date:** | N/A |
| **Please provide details of corrective action or explain disagreement.** | The Public Service Commission disagrees with this finding. OLA's recommendation that the Commission ensure that certain sole source procurements "are approved by the appropriate control agency" is predicated on the erroneous assumption that the Commission is required by law to obtain approval for these sole source procurements from the Board of Public Works (BPW) or the Department of Budget and Management (DBM). That recommendation is belied by the plain language of State Finance and Procurement Article (SF) § 13-107(b), which, unlike other sole source procurement provisions, contains no general requirement to obtain "any other approval required by law." Instead, SF § 13-107(b) contains only a specific requirement that the contracting unit obtain "the prior written approval of the Attorney General." The Maryland Attorney General issued an Opinion addressing this precise issue and found that "the award of a contract for expert witness or other consultant services under the 'sole source' procurement provisions of SF § 13-107(b) requires the approval of the Attorney General *only*."[9] (Emphasis added). | | |

[9] 74 Md. Op. Atty. Gen. 230 (1989), also available at 1989 Md. AG LEXIS 9.

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| | The Attorney General's Opinion was based on the fact that SF § 13-107 establishes two distinct classes of sole source procurement. The first, contained in SF § 13-107(a)(1), applies to cases in which the agency's procurement officer "determines that there is only one available source for the subject of a procurement contract." Under those circumstances, an attempt to obtain multiple prospective contractors would represent "an empty gesture."[10] Accordingly, SF § 13-107(a) permits the agency to "award the procurement contract without competition to that source," in lieu of pursuing the formality of public advertising and solicitation of bids or proposals that are not in fact available. Nevertheless, SF § 13-107(a) provides that a sole source contract awarded under its provisions requires prior approval by the head of the contracting unit and "any other approval required by law," including BPW. That is because procurement contracts that fall under this provision are unique only in that there exists just one available source, such that "no special considerations require that those contracts be subject to a review and approval process different from that applicable to contracts formed under other provisions of the Procurement Law."[11]<br><br>The second class of sole source procurement – and the one that is at issue in OLA's audit – is set forth in SF § 13-107(b)(1). Under that provision, "a unit may enter into a sole source procurement contract to obtain the services of a contractor in connection with . . . threatened or pending litigation . . . appraisal of real property for acquisition by the State; or . . . collective bargaining." In order for this type of sole source procurement to apply, "the nature of the services to be performed requires confidentiality." SF § 13-107(b)(2). Unlike the first type of sole source procurement, procurements under SF § 13-107(b) contain no general requirement of approvals "required by law," but only a specific requirement that the contracting unit obtain "the prior written approval of the Attorney General." In its Opinion, the Attorney General found that "this difference between the wording of the approval provisions evidences a legislative intent to establish substantively different approval procedures."[12]<br><br>The Opinion notes that had the General Assembly intended to require that contracts awarded under SF § 13-107(b) be subject to the same procurement approvals applicable to contracts awarded under the other procedures, it would have utilized the same general language that it used in those other provisions, including the sole source authorization |

[10] *Id*. at 231.
[11] *Id*. at 232.
[12] *Id*.

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| | articulated within the very same section in SF § 13-107(a). "This contrasting language indicates that the only approval required for the award of those contracts under SF § 13-107(b) is the approval of the Attorney General."[13] The Opinion further observed that SF § 13-107(b) applies only to contracts that relate to pending or threatened litigation, the acquisition of real property, or collective bargaining – all matters that are adversarial in character and that require confidentiality. As the Attorney General advised: "The public nature of the usual procurement process would breach the confidentiality of the contracts to which SF § 13-107(b) applies."[14] Required publications, for example, could reveal the State's legal theory, strategy, and contemplated actions. In particular, "the litigation-related contracts described in SF § 13-107(b)(1)(i) implicate the Attorney General's constitutional responsibility to serve as the lawyer for the State."[15] For all of these reasons, the Attorney General found that it was the intent of the General Assembly that sole source procurements awarded under SF § 13-107(b) be subject to "special review and approval process," including exemption from the normal requirements of BPW/DBM review, and "approval of the Attorney General only."[16]<br><br>Because the sole source procurements identified by OLA uniformly relate to the exceptions contained in SF § 13-107(b)(1), which the General Assembly has indicated should only be approved by the Attorney General, OLA's recommendation to seek BPW/DBM approval is legally unfounded. In that regard, the OLA auditors acknowledged they did not seek their legal counsel's opinion on this issue, which clearly involves a legal analysis that has been fully addressed by the Maryland Attorney General. Absent a court ruling or other legal precedent inconsistent with the Attorney General's Opinion, the Commission should continue to follow the clear language of the statute.<br><br>Although OLA alludes generally to the premise that "State procurement law/regulations" require consultation with DBM or BPW, it did not cite any specific Code of Maryland Regulation (COMAR) to support that assertion. Nevertheless, the Commission observes that COMAR 21.05.05.02C(1) authorizes a procurement agency "with the prior written approval of the Office of the Attorney General [to] enter into a sole source contract to retain the confidential services of a contractor ... in connection with threatened or pending litigation." The regulation does |

[13] *Id*.
[14] *Id*. at 233.
[15] *Id*.
[16] *Id*

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| | not state that the approval of DBM or BPW is also required.<br><br>Finally, over the course of the Commission's dialogue with OLA on this issue, OLA has softened its position. It now argues that "State procurement law/regulations related to confidential services do not preclude control agency approval." Ostensibly, OLA is now arguing that nothing in the Maryland Code or COMAR precludes the Commission from seeking the approval of DBM or BPW after the Attorney General has already approved the sole source contract. If DBM and BPW have a concern with this issue, the Commission is available to discuss it; however, the Maryland Code and applicable procurement regulations clearly provide that the Commission is following the appropriate procedures with regard to sole source contracts relating to pending litigation, as confirmed by the Attorney General Opinion on this issue. Indeed, the Attorney General concluded that the sole source' procurements subject to SF § 13-107(b) require "the approval of the Attorney General *alone*."[17] (Emphasis added). That finding is based on the adversarial nature of litigation, which requires confidentiality, and the Attorney General's unique role as "the lawyer for the State."[18] The Attorney General's Opinion was also confirmed in the April 20, 2011 correspondence from the Office of the Attorney General to the Commission General Counsel, which further noted that this practice has been followed between the Commission and the Attorney General since at least 2008. | | |
| **Recommendation 2b** | Disagree | **Estimated Completion Date:** | N/A |
| **Please provide details of corrective action or explain disagreement.** | See response to Recommendation a. | | |

**Auditor's Comment**: PSC's response disagreed with our recommendations because of a 1989 Opinion of the Attorney General that these types of procurements did not require control agency approval. We were aware of the Opinion, which is referenced in our finding. However, as noted in the finding, the OAG Opinion appears to contradict established BPW/DBM procurement authority and the advice that we received from BPW procurement staff. Therefore, we continue to believe that PSC should consult with the OAG and BPW to resolve the contradiction and comply with the related conclusions.

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[17] *Id*. at 233.

[18] The Commission additionally notes that OLA has never raised this issue in previous Commission audits, despite the fact that sole source contracts based on pending litigation were part of those audits. In the Commission's 2016 Audit OLA was fully aware of two sole-source confidential contracts, but OLA did not raise the issue that the Commission only sought approval from the Attorney General and not the additional approval of DBM or BPW.

## Public Service Commission

## Agency Response Form

### Cash Receipts and Accounts Receivables

| **Finding 3** |
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| **PSC did not establish adequate controls over cash receipts and accounts receivable.** |

**We recommend that PSC**

a. **ensure proper segregation of duties over cash receipts, accounts receivable, and deposit verification functions;**
b. **ensure all accounts receivable transactions are subject to independent review and approval; and**
c. **maintain an independent control account and periodically reconcile it to the detailed records.**

**We advised PSC on accomplishing the necessary separation of duties using existing personnel.**

| **Agency Response** | | | |
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| **Analysis** | | | |
| **Please provide additional comments as deemed necessary.** | | | |
| **Recommendation 3a** | Agree | **Estimated Completion Date:** | Completed |
| **Please provide details of corrective action or explain disagreement.** | The Public Service Commission (PSC) was extremely surprised to learn of the overall draft finding by the audit team that the PSC did not establish adequate controls over cash receipts and accounts receivables. This is surprising, considering the same processes, personnel, job functions, and resulting segregation of duties within the Fiscal Department have been in place at the Commission during the two previous legislative audits - with no mention of such issues either as a recommendation or as a finding in either of those Fiscal audits.<br><br>The person who prepares the deposit does make adjustments to related accounts receivable records; however, these adjustments are performed well after the initial deposit is performed with sufficient documentation that properly authorizes all adjustments. Currently, the individual who performs the deposit verification does have access to the safe where the collections are stored prior to deposit but deposits are verified after the monies are removed from the safe by the person who prepared the | | |

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| | deposit; therefore, monies can not be removed from safe before a deposit is prepared.<br><br>However, after discussion with the audit team, it was confirmed that the audit team's concern rests with the fact that the individual preparing the deposit as well as the individual(s) performing the deposit verification also have access to the safe where collections are stored, in addition to the Fiscal personnel that handle the cash receipts on a daily basis. In order to alleviate any concerns regarding segregation of cash handling duties from accounts receivable and deposit verification functions, the Commission has removed safe access (and therefore access to cash) to those personnel performing accounts receivable and deposit verification functions. | | |
| **Recommendation 3b** | Agree | **Estimated Completion Date:** | 1/15/21 |
| **Please provide details of corrective action or explain disagreement.** | The audit team indicated in its analysis that Fiscal personnel with access to accounts receivable records could post payments and credits, and three could edit charges and delete accounts without any independent review and approval. Personnel performing the database postings are verified independently in conjunction with the control account. See response to Recommendation c below. | | |
| **Recommendation 3c** | Agree | **Estimated Completion Date:** | 1/15/21 |
| **Please provide details of corrective action or explain disagreement.** | The control account was not eliminated in 2019. As of January 1, 2020, the Commission was in the process of completing its migration of its receivable records to a new receivables database and two Fiscal personnel retired from State service effective January 1, 2020. The Commission does acknowledge that it did not perform the necessary control account reconciliation/monitoring only initially during 2020 due to these two events. Although the two vacant positions were filled by March 2020, one of the newly hired employees abruptly left the Commission in September 2020. The Commission is currently recruiting for that position. In the interim, the Fiscal Director and/or the Deputy Executive Secretary are performing the required duties of this individual as necessary. Furthermore, the new receivables database has been implemented, albeit later than originally expected. As a result, the detailed accounts receivable records and a control account are being created and the aggregate balance of the detail records will be periodically reconciled to the control account balance. Fiscal is currently working with the Accounts Receivable Database vendor to ensure that the control account is being correctly implemented in the new system. | | |

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