

CALIFORNIA PUBLIC UTILITIES COMMISSION

Report of Review

FINES AND RESTITUTION ACCOUNTING AND COLLECTION



JOHN CHIANG
California State Controller

August 2007



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California State Controller

August 21, 2007

Paul Clanon
Executive Director
Public Utilities Commission
505 Van Ness Avenue, Room 5223
San Francisco, CA 94102-3298

Dear Mr. Clanon

This report presents the results of the State Controller's Office (SCO) review of the California Public Utilities Commission's (CPUC) practices and procedures for accounting and collecting fines and restitution imposed against the companies it regulates. Our review was initiated to address concerns raised that the CPUC failed to collect millions of dollars in fines and restitution, some outstanding since 1999, by not vigorously pursuing collection efforts.

The CPUC's response to a draft version of this report is included as an attachment.

If you have any questions, please contact John Chen at (916) 322-2460.

Sincerely,

Original signed by

JEFFREY V. BROWNFIELD
Chief, Division of Audits

JVB:wm

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Executive Summary

This report presents the results of the State Controller's Office (SCO) review of the California Public Utilities Commission's (CPUC) practices and procedures for accounting and collecting fines and restitution imposed against the companies it regulates. Our review was initiated to address concerns that the CPUC failed to collect millions of dollars in fines and restitution, some outstanding since 1999, by not vigorously pursuing collection efforts.

According to its records, since 1999, the CPUC has imposed approximately \$300 million in fines and restitution against utility companies. The records also show that \$105.9 million of the \$126.2 million (84%) in fines have been collected and \$130.5 million of the \$173.8 million (75%) in restitution have been paid. The CPUC has deemed uncollectible approximately \$31.8 million in fines and restitution against utility companies. (see the Appendix).

Decisions against transportation companies represent the next highest category of fines and restitution among CPUC programs. Excluding fines imposed and collected through the informal citation process, the CPUC records show that it has collected \$72,505 of \$515,421 (14%) in fines and restitution. Almost all of the remaining \$440,000 has been deemed uncollectible (see the Appendix).

Other CPUC divisions (i.e., the Energy Division and the Water Division) can issue citations to impose fines for late filings or minor administrative violations. These fines typically do not involve significant amounts and thus were excluded from the scope of our review.

Our review found that, in many cases, it was inherently difficult for the CPUC to collect, as the companies that engaged in fraudulent or inappropriate practices either ceased to operate or filed for bankruptcy shortly after the CPUC launched investigations or imposed fines. In addition, when a company refuses to pay a fine, the CPUC has to obtain a court judgment; this can be a lengthy process and further compromises the CPUC's ability to collect. However, the CPUC's collection difficulties are further compounded by the following processing shortcomings and control deficiencies:

- The CPUC does not adequately review the background and financial viability of applicants for licenses to operate as telecommunications providers. Of the \$32.2 million in fines and restitution that have been deemed uncollectible, \$29.2 million is from such companies. An applicant for a license only had to provide minimal information on an application form and pay a nominal application fee of \$75 to register as a telecommunication provider. In many cases, unscrupulous individuals or companies began billing consumers for millions of dollars in unauthorized charges shortly after being registered by the CPUC.

- The CPUC sometimes took years to render a decision imposing fines and restitution. In one case, after a CPUC administrative law judge made a recommendation about disposition, the CPUC did not render a decision to impose a \$1.5 million fine until 21 months later. In the meantime, the company filed for bankruptcy protection.
- The CPUC has not developed formal guidelines, processes, and procedures to ensure uniformity and consistency in its collection efforts. This is a significant concern because the CPUC's collection efforts are fragmented among various divisions. Collection efforts appeared to be inconsistent, even for similar cases within the same division. In a document dated March 14, 2007, a CPUC staff member prepared draft "standard operating procedures" for collection of fines, penalties and restitution. The procedures specified in this draft document appear to address many issues identified in this report. As the document was not provided to the SCO auditors until after the end of the fieldwork phase of our review, we did not evaluate the CPUC's progress in implementing the procedures delineated in this document.
- Responsibility for collection is not clearly assigned, as the CPUC does not have a centralized collection unit. We noted many cases in which the CPUC apparently made no effort to collect, even after it had obtained court judgments at considerable effort and expense. In the aforementioned standard operating procedure, currently in draft form, collection responsibility has been delineated among the various CPUC divisions and units.
- The CPUC made little effort to refer companies or individuals that apparently engaged in fraudulent activities to law enforcement agencies for prosecution. Nothing in the case files indicated why no referral was made. Some of these companies, or their principals, were prosecuted by law enforcement agencies in other states for engaging in activities similar to those in California.

Consequently, some unscrupulous companies or individuals were able to defraud California consumers for tens of millions dollars and then essentially disappear without suffering any fiscal or legal consequences.

In addition, our review found the following conditions:

- The CPUC has no means of ensuring the accuracy and completeness of the amount of fines imposed or collected, as such transactions are not recorded or reflected in its formal accounting records. We found that the CPUC has no procedures in place to ensure that its accounting office is notified of fines when they are imposed. Approximately \$126.5 million in fines imposed by the CPUC since 1999 has never been entered into the CPUC's accounting records. We also identified various accounting errors during our review. The lack of appropriate checks and balances in the CPUC's collection functions could lead to irregularities and errors.

- The CPUC has not undergone a comprehensive audit of its fiscal operations and internal control processes and procedures in many years. Available records disclosed that the last comprehensive audit was performed by the Department of Finance in 1992. It should be of significant concern to the CPUC's management that the conditions identified in our review of the collection system may exist in other areas of the CPUC's fiscal operations.

Review Report

Introduction

The State Controller's Office (SCO) conducted a review of the California Public Utilities Commission's (CPUC) practices and procedures for accounting and collecting fines and restitution imposed against the companies it regulates. Our review was initiated to address concerns raised that the CPUC failed to collect millions of dollars in fines and restitution, some outstanding since 1999, by not vigorously pursuing collection efforts. The SCO review was conducted pursuant to Government Code section 12418, which stipulates that the State Controller shall direct and superintend the collection of all money due the State.

Background of the California Public Utilities Commission (CPUC)

The CPUC consists of five commissioners appointed by the governor, with Senate approval, to six-year terms. The CPUC has broad powers to regulate investor-owned and operated natural gas, electric, telephone, water, sewer, steam, and certain transportation companies in California. The CPUC has jurisdiction over more than 5,000 utilities and carriers. The CPUC's regulatory activities—such as establishing operating authority, overseeing service standards, authorizing rate changes, and monitoring safety—benefit consumers by offering them more choices among new and upgraded utility products and services, and by protecting them in ways that competition between companies does not or can not.

CPUC's Authority to Improve Fines and Restitution

As a part of its regulatory responsibilities, the CPUC reviews and investigates complaints and allegations of wrongdoing to ensure that the entities it regulates are operating safely and legally, and that they are necessary for the public interest. When such a review or investigation determines that an entity has failed to comply with laws or has engaged in inappropriate practices, the CPUC may impose a fine payable to the State and/or order the entity to repay consumers in the form of restitution. Typically, a CPUC administrative law judge hears and reviews the case before presenting it to the CPUC commissioners for a decision. Public Utilities Code section 2104 provides that the CPUC may file an action to recover a penalty in Superior Court. In an opinion issued in 2006, the Court of Appeal found that while the CPUC can impose a fine, Section 2104 requires the CPUC to go to the Superior Court to enforce collection of the fines if those fines are not paid voluntarily. When an entity is ordered to make restitution, the CPUC can either direct the entity to pay consumers directly or do so through a third-party payer.

Fines and Restitution

The Appendix provides a schedule of fines and restitution imposed and amounts collected by the CPUC since 1999 through its Consumer Protection and Safety Division (CPSD). The SCO prepared this schedule based on data provided by CPSD staff. Decisions against utility companies, including telecommunication companies, totaled approximately \$300 million and constitute the overwhelming portion of fines and restitution. The \$300 million includes \$126.2 million in fines and \$173.8 million in restitution. Decisions against transportation companies, which typically include moving companies and passenger

carriers such as limousine and airport shuttles, totaled \$515,421 during this period; the total includes \$412,058 in fines and \$103,363 in restitution. These totals exclude fines imposed and collected through the informal citation process.

The CPSD's records also show that, of the \$126.2 million in fines against utility companies, the department has collected a total of \$105.9 million (84%) as of May 30, 2007. With respect to the \$173.8 million in restitution payments, the utilities have collectively paid a total of \$130.5 million (75%). A significant portion of the unpaid restitution consists of recent cases in which the companies are not scheduled to make payments until later. For example, one utility company was ordered by the CPUC to make approximately \$5.7 million in restitution payments, in installments, starting in 2009.

Of the \$412,058 in fines against transportation companies, the CPUC collected a total of \$59,900 (15%) as of May 30, 2007. Of \$103,363 in restitution payments, the transportation companies collectively paid \$12,505 (12%).

In addition to fines and restitution that are imposed through formal hearings, some CPUC divisions (i.e., the Consumer Protection and Safety Division, the Energy Division, and the Water Division) can issue citations to impose fines for late filings or minor administrative violations. These fines typically do not involve significant amounts.

Scope and Methodology

The scope of our audit includes a review of CPUC policies, processes, procedures, and practices relative to its accounting for and collection of fines and restitution against utility companies and transportation companies through the formal hearing process. We did not review the CPUC's practices and procedures relative to its informal process of issuing citations, as the amounts involved do not appear to be material. Similarly, the scope of our audit did not include evaluation of the CPUC's decisions with respect to the reasonableness of the amount of fines or restitution imposed because such decisions are within the purview of the CPUC commissioners.

We performed the following procedures:

- Reviewed pertinent statutes, regulations, and written policies and procedures regarding the CPUC as it relates to the accounting and collection of fines and restitution.
- Reviewed and analyzed relevant audit reports issued by the Bureau of State Audits (BSA) and the Department of Finance (DOF).
- Reviewed and assessed the CPUC's system of internal controls as they pertain to the accounting, tracking, and collection of fines and restitution.
- Reviewed and analyzed the amounts of fines and restitution imposed, recorded, and collected from Fiscal Year 1998-99 to Fiscal Year 2006-07.

- Interviewed responsible officials at CPUC headquarters, including staff at the Information and Management Services Division and Fiscal Office, as well as staff from the Consumer Protection Safety Division's Utilities Enforcement Branch and Transportation Branch and staff from the Administrative Law Division.
- Performed tests of transactions to assess the effectiveness of controls relating to the recording and collection of fines and restitution.
- Selected a sample of imposed fines to evaluate the accuracy and reliability of reported revenue and the balances reported as accounts receivables, and to determine if proper recording had occurred.

Findings and Recommendations

Finding 1—
The CPUC’s collection effort is ineffective against certain companies that ceased to operate and/or filed for bankruptcy when fines were imposed.

According to its records, the CPUC was unable to collect \$20.7 million in fines and \$11.1 million in restitution that were imposed against utility companies since 1999. The total of \$31.8 million in uncollected fines and restitution represents approximately 10.6% of the \$300 million in fines and penalties against utility companies since 1999.

Even though the amounts of fines and penalties imposed against transportation companies are considerably less, the CPUC has had significantly more difficulty collecting from such companies. Excluding informal citations, the CPUC records show that, over the years, it was able to collect only \$59,900 of \$412,058 in fines (15%) and \$12,505 of \$103,363 (12%) in restitution that were imposed against transportation companies.

Our review found that it is inherently difficult for the CPUC to collect in many cases, due to the following factors:

- The companies that engaged in fraudulent or inappropriate practices ceased to operate shortly after the CPUC launched investigations of issues that were brought to its attention or shortly after the CPUC imposed fines. When a company is no longer in operation, the CPUC has little leverage to collect. For example, in April 2001, the CPUC ordered Coral Communications Inc. (Coral) to pay \$5.1 million in fines and \$4.6 million in restitution for billing customers for services they did not authorize or did not realize they had agreed to accept during 1997 and 1998. The CPUC’s files show that the former owner of Coral shut down the business approximately 60 days after the CPUC issued an “Order Instituting Investigation” of Coral in August 1998. Thus, when the fines and restitution were eventually imposed more than two years later, in 2001, CPUC staff could not locate any assets that belonged to Coral; the company had been shut down for years and its former owner had reportedly moved to another country.
- The companies filed for bankruptcy before fines or restitution were imposed. For example, In July 2002, the CPUC fined Accutel Communications Inc. (Accutel) \$1.5 million for switching customers’ long-distance carriers without consent and charging for unauthorized services. When initiating efforts to collect, the CPUC staff found that Accutel had already filed for bankruptcy protection in September 2001 and the bankruptcy was discharged in October 2001.
- Delays in obtaining court orders to compel companies to pay CPUC-imposed fines make it more difficult for the CPUC to collect. Although the CPUC has the legal authority to impose fines and restitution, it must file a collection case with the Superior Court and obtain a judgment to enforce collection when a company refuses to pay the fines. The process can be quite lengthy and thus further compromises the CPUC’s ability to collect. For example, the CPUC fined the USP and C Corporation (USPC) \$1.75 million in April 2001 for engaging in various improper practices. After appeals, the CPUC did not obtain a Superior Court judgment until May 2004. USPC then

appealed the Superior Court decision; the Court of Appeal denied the appeal in March 2005, almost four years from the date on which the fine was initially imposed. Generally, it is more difficult to collect as time passes and often, after a lengthy and costly process of obtaining a judgment, the CPUC finds that the company has no assets to collect.

The CPUC's collection difficulties are compounded by other processing shortcomings and control deficiencies. Specifically, we found the following problems:

- The CPUC does not adequately review background and financial viability of applicants for licenses to operate as telecommunications providers. Approximately \$29.2 million of the \$31.8 million in fines and restitution against utility companies that are deemed uncollectible are from these companies. In June 1997, the CPUC—apparently in an effort to promote competition and to expand access—decided to streamline and simplify the application process for these companies. An applicant only had to provide minimal information on an application form and pay a nominal application fee of \$75 in order to register as a telecommunication provider. Much of the information requested consisted of self-certifications, such as a statement that none of the principals had filed for bankruptcy or had been found criminally or civilly liable for action involving misrepresentation to the consumers. In many instances, unscrupulous individuals or companies who had not been sufficiently scrutinized by the CPUC for background or financial viability began billing consumers for millions of dollars in unauthorized charges shortly after being registered by the CPUC. For example, after receiving its Certificate of Public Convenience and Necessity to operate as a reseller of long distance telephone service within California in May 1997, Accutel Communications billed approximately 40,000 consumers \$4.95 in unauthorized monthly charges in 1998. By February 25, 1999, Accutel was in receivership. The owner of Accutel eventually was convicted of various fraudulent activities in 2004 as a result of prosecution effort by the United States Attorney's Office in Miami, Florida.
- The CPUC sometimes took years to render a decision imposing fines and restitution. For example, in the aforementioned case against Accutel, the CPUC launched an investigation in early 1999 and was made aware that the company was in receivership when a Stipulation for Appointment of a Receiver was entered in the Superior Court for the County of San Diego on February 25, 1999. Despite the obvious sign of fiscal insolvency and the fact that a CPUC administrative law judge heard the case and made a recommendation about disposition on October 25, 2000, the CPUC did not render a decision to impose the \$1.5 million fine until 21 months later, in July 2002, and did not suspend Accutel's license until December 2002. In the meantime, Accutel filed for bankruptcy protection in September 2001. In another example, when aforementioned USPC filed an application for rehearing of the CPUC's order to impose a \$1.75 million fine in April 2001, the CPUC did not reject the application for rehearing until two years later, in April 2003.

- The CPUC did not develop formal guidelines, processes, and procedures to ensure uniformity and consistency in its collection efforts. This is especially important because the CPUC's collection efforts are fragmented among various divisions. We noted many instances in which collection efforts appeared to be inconsistent, even for similar cases within the same division. For example, in a case against All State Moving and Storage, Inc. in which the CPUC imposed a \$40,000 fine, the CPUC attempted to obtain a judgment from the Superior Court (dismissed for procedural reasons) and sent out two collection letters to the company seeking payment. In a case against Ace of Bace Moving Company that also resulted in a \$40,000 fine, nothing in the case file suggests that the CPUC made any effort to collect after its decision to impose the fine. Neither company paid the fine. An attorney from the CPUC's Legal Division told the auditors that on many occasions he observed CPUC staff members in possession of, and not knowing what to do with, checks from companies for as much \$300,000. On November 21, 2002, staff in the Consumer Protection and Safety Division received a \$25,000 check from a telecommunication company for fine payment, but the check was not submitted to the CPUC fiscal office until April 14, 2003. By then, the check had become stale and had to be returned to the company and the company had to issue a new check.

In a document dated March 14, 2007, a CPUC staff member prepared "standard operating procedures" for collection of fines, penalties, and restitution. The document, still in draft form, appears to address many issues identified in this report. According to the CPUC, the draft manual is currently being reviewed and tested prior to formal adoption. As the draft document was not provided to the SCO auditors until after the completion of the fieldwork phase of our review, we did not evaluate the CPUC's progress in implementing the prescribed procedures.

- Responsibility for collection is not clearly assigned, as the CPUC does not have a centralized collection unit. We found that collection responsibility at the CPUC is fragmented among the staff in the Legal Division, the Consumer Protection and Safety Division (CPSD), and other operating units such as the Energy Division, the Transportation Branch, and the Water Division. Meanwhile, the Information Management and Services Division, which is responsible for the fiscal activities of the department, has had virtually no involvement in the collection function. When interviewed, investigators at the CSPD said that collection efforts were the responsibility of the Legal Division. The investigators further stated that they do not believe the Legal Division staff made a determined effort to pursue collection, due to its inadequate staff resources and lack of expertise. This was especially true in cases where the companies appeared to have little assets. An attorney from the Legal Division told us that he did not believe that it was his job to be in the business of collection.
- The CPUC made little effort to refer companies or individuals that apparently engaged in fraudulent activities to law enforcement agencies for prosecution. We reviewed case files of 10 telecommunication companies and one electric service provider that

may have been engaged in fraudulent or inappropriate activities and then ceased to operate when the CPUC initiated investigative or administrative action; we found only two cases in which CPUC staff interacted with law enforcement agencies concerning possible prosecution. For the other nine companies, nothing in the case files indicated why the CPUC made no effort to refer the case to law enforcement agencies. Some of these companies, or their principals, were apparently successfully prosecuted by law enforcement agencies in other states for engaging in activities similar to those in California.

As a result of the factors listed above, some unscrupulous companies or individuals were able to defraud California consumers for tens of millions of dollars by billing for unauthorized services, or for services that were not provided, and then essentially disappearing without suffering any fiscal or legal consequences.

Finding 2—
The CPUC has no means of ensuring the accuracy and completeness of the amount of fines imposed or collected, as such transactions are not recorded or reflected in its formal accounting records.

When a fine is imposed, the CPUC accounting office should be notified so that it can set up an accounts receivable to record and track the transaction in the accounting records. We found that the CPUC has no procedures in place to ensure that its accounting office is notified of fines when they are imposed. Instead, staff in the Consumer Protection and Safety Division (CPSD) records and tracks fines (and restitution) using spreadsheets. Approximately \$126.5 million in fines imposed by the CPUC since 1999 has never been entered into the department's accounting records as accounts receivable. Moreover, although the payments are eventually reflected in the accounting records when the checks from the companies are turned over to the accounting office for deposit, there is no procedure requiring periodic reconciliation of the payments received between the CPSD's spreadsheet and the accounting records. Our review of the records disclosed the following conditions.

- The amounts of fines and restitution imposed and collected as shown in the CPSD spreadsheet and accounting records are not accurate or reliable. We found instances in which CPSD staff did not revise the spreadsheet figures after the CPUC rendered a decision to revise the fine and restitution amounts. Examples include:
 - The CPSD spreadsheet shows \$25 million in fines imposed and collected from Pacific Bell. In actuality, only \$15,225,000 was collected because the CPUC made a decision to modify the fine amount.
 - The CPSD spreadsheet shows \$378,000 in fines imposed and collected from Pacific Fiber Link. The actual amount of the original fine was \$275,000. Moreover, only \$25,000 had actually been collected because the CPUC amended the fine amount.
 - The CPSD spreadsheet shows \$1.2 million in fines imposed and collected from San Diego Gas and Electric. In actuality, in lieu of a fine, \$200,000 of the amount was to be spent for an education program to be administered by the utility. CPUC staff could not provide any evidence showing how or when the amount had been spent on education.

- The completeness of data in the CPSD spreadsheet is questionable. Without reconciliation with information in the department's accounting records or other control mechanisms to ensure the completeness of transactions, there is no way of knowing whether fines or restitution were intentionally or inadvertently excluded from the CPSD spreadsheet. As the CPSD spreadsheet is the CPUC's sole source of information for tracking fines, such incomplete data could result in outstanding fines remaining uncollected.
- Collection duties are inadequately segregated. The CPSD, in essence, has access to all aspects of the collection process, including making recommendations to impose fines, collection of fines, and recording and tracking the amounts of fines imposed and collected by the department. This lack of duty segregation represents a serious internal control weakness, as it does not provide the adequate checks and balances that would prevent errors and irregularities.

The procedures prescribed in the aforementioned "standard operating procedures" for collection of fines, penalties, and restitution, dated March 14, 2007, and currently in draft form, appear to address the issues identified in this finding.

Finding 3—
The CPUC has not undergone a comprehensive audit of its fiscal operations and internal control processes and procedures in many years.

Based on the conditions found in our review of its collection system, we believe the CPUC could significantly benefit from a comprehensive audit of its fiscal operations and related internal control processes and procedures. Available records disclosed that the last such audit was performed by the Department of Finance (DOF) in 1992. In July 2001, the DOF auditors issued another report of a "preliminary survey" of the CPUC's organizational and internal control structure. This survey report did not constitute an audit in accordance with the Financial Integrity and State Manager's Accountability Act (FISMA). Both the 1992 audit and the 2001 preliminary survey disclosed significant internal control deficiencies, including shortcomings in the department's collection system, processes, and procedures.

We believe that some of the issues raised in this report may have been mitigated to some extent had the CPUC fully and adequately addressed the previous audit findings and recommendations. Some examples of the issues noted in the 2001 DOF report include:

- "Receivables are not collected in a timely manner and an aging of the receivables outstanding is not performed."
- "No procedures are established to collect delinquent receivables and to ensure that receivable write-offs are properly approved and subsequently accounted for. For example, as of March 2001, over \$1.9 million receivables were outstanding from 1998 and over \$196,800, or 10%, were dated from 1990 through 1994."
- "Inadequate separation of duties over accounts receivable."

It should be of significant concern to the CPUC's management that the conditions identified in our review of the collection system may exist in other areas of the CPUC's fiscal operations. Under FISMA, the head of each state agency and department is required to submit to the Department of Finance on a biannual basis a certification as to the adequacy of its internal control system. In light of the conditions noted in this report, the CPUC should undergo a comprehensive audit of its internal control system to afford its management a reasonable basis for making the FISMA-required certification.

Recommendations

1. The CPUC should conduct more stringent background and financial viability reviews of individuals or companies applying for licenses to operate as telecommunications providers.
2. The CPUC should consider incorporating into the application approval process a requirement that companies post a performance bond before registering as telecommunications providers.
3. The CPUC should consider sponsoring legislation to:
 - Preclude transportation companies from re-registering or transferring title of company-owned vehicles carrying unpaid CPUC-imposed fines with the Department of Motor Vehicles.
 - Allow the CPUC to pursue collection action without a Superior Court judgment if the CPUC's order to impose fines or restitution is not appealed within a specified timeframe.
4. The CPUC should immediately clearly assign collection responsibility to the various divisions. In addition, the CPUC should consider establishing a centralized collection unit. The CPUC could staff the collection unit through redirection of existing resources from other divisions and/or requesting additional resources through the budget process.
5. The CPUC should formally adopt the procedures delineated in the draft "Standard Operating Procedures" for collection of fines, penalties, and restitution as soon as feasible. After adoption, the CPUC should periodically review and evaluate the effectiveness of the procedures and make appropriate modifications.
6. The CPUC should develop criteria for referring companies that have apparently engaged in fraudulent practices to law enforcement agencies for possible legal action. The referrals or final case disposition should be fully documented and explained in the case files.
7. The CPUC should again review and analyze the cases involving fines that are deemed uncollectible to determine whether there are other avenues for collection. If the CPUC determines that collection is no longer possible or feasible, the CPUC should fully document the rationale and basis for such determination and submit a request to the SCO for discharge of accountability in accordance with

Government Code section 13940-13944 and the State Administrative Manual section 8776. To provide for a proper audit trail, the fines should be reflected in the CPUC's accounting records as accounts receivable before the request for discharge of accountability is filed with the SCO.

8. The CPUC should arrange for a comprehensive audit of its internal control system, processes, and procedures in accordance with the Fiscal Integrity and State Manager's Accountability Act.

**Appendix—
California Public Utilities Commission
Consumer Protection and Safety Division (CPSD)
Summary of Fines and Restitution Imposed Since 1999**

	<u>Amount Imposed</u>	<u>Amount Paid</u>	<u>Percentage Paid/Collected</u>
<u>Utilities Enforcement Branch</u>			
Fines payable to the State	\$ 126,245,550	\$ 105,920,200	84%
Restitution	<u>173,818,219</u>	<u>130,527,447</u>	75%
Total	<u>\$ 300,063,769</u> ¹	<u>\$ 236,447,647</u>	79%
<u>Transportation Enforcement Branch</u>			
Fines	\$ 412,058	\$ 59,900	15%
Restitution	<u>103,363</u>	<u>12,505</u>	12%
Total	<u>\$ 515,421</u> ¹	<u>\$ 72,405</u>	14%

Source: Prepared based on data provided by CPSD Enforcement Branch staff.

¹ Includes approximately \$32.2 million in fines and restitution (\$31.8 million from utility companies and \$440,000 from transportation companies) deemed uncollectible by the California Public Utilities Commission.

**Attachment—
CPUC’s Response to Draft Report
Findings and Recommendations**

PUBLIC UTILITIES COMMISSION

505 VAN NESS AVENUE
SAN FRANCISCO, CA 94102-3298



August 2, 2007

Jeffrey V. Brownfield
Chief, Division of Audits
State Controller's Office
300 Capitol Mall, Suite 518
Sacramento, CA 95814

Dear Mr. Brownfield:

Thank you for the opportunity to respond to the draft audit report "Report of Review, Fines and Restitutions, Accounting and Collections". We agree with many of the findings and believe that our fine and collection process and related accounting procedures will be improved and strengthened as we are able to implement your recommendations. We have attached our comments on each of your findings and recommendations contained in the report.

In summary, we are currently implementing revised operating procedures for our fines and collections process on a test basis and plan to incorporate some of the report recommendations into our test procedures prior to a Commission wide implementation. We are reviewing our accounting procedures and will contact the Department of Finance, Office of State Audits and Evaluations to request a comprehensive audit of our internal controls and fiscal operations.

Please contact me directly if you should have any questions about our responses to the draft audit report and our ongoing effort to implement the revised operating procedures for our fine and collection process.

Sincerely,

A handwritten signature in cursive script that reads "Paul Clanon".

Paul Clanon
Executive Director

Attachment

California Public Utilities Commission Response to Audit Findings and Recommendations

Finding 1 – The CPUC's collection effort is ineffective against certain companies that ceased to operate and/or filed for bankruptcy when fines were imposed.

CPUC Response: Collection of fines or restitution from companies that no longer are operating is very difficult if the company does not have significant assets which may be liquidated to pay off accrued fines and other debts. If a company does have some assets, a bankruptcy petition may be filed which makes the collection of any fines or restitution subject to an approved plan of reorganization. Staff believes that for those entities that do not have significant assets, fines and restitution could be levied against not only the company but key officers to increase the potential for collection. Without personal liability of the principals, staff does not believe that collection efforts can be significantly improved against entities that cease operation and/or file for bankruptcy. With respect to past fines that have not been collected, staff has asked several law firms that specialize in debt collection to review these cases. These firms after review of our cases advised that the likelihood of collection was very low.

The Commission would also like to comment on the following State Controller's Office recommendations:

Recommendation 1 – The CPUC should conduct more stringent background and financial viability reviews of individuals or companies applying for licenses to operate as telecommunications providers.

CPUC Response: The Communications Division processes license applications submitted under the simplified registration process established by PU Code 1013 and Commission Decision 97-06-107. At present, the Communications Division only reviews applications to determine that all applicants have the minimum financial resources (\$25,000 for resale service, \$100,000 for facilities based service) and that no applicant has admitted to:

- a) bankruptcy
- b) misdemeanor violation or pending investigation for violation of Business & Professions Code 17000 et seq.
- c) FCC or other state regulatory sanctions

If any interested party protests a registration application, the Communications Division converts the filing to a formal application for a certificate of public convenience and necessity (CPC&N), and the matter is assigned to an Administrative Law Judge who will hold a hearing to determine an applicant's fitness.

In the future the Communications Division can work with the Commission's Legal Division and the Consumer Protection and Safety Division (CPSD) to:

- a) search financial databases for bankruptcy petitions filed by principals for applicants
- b) perform criminal background checks on principals for potential telecommunications carrier applicants (similar to criminal background checks currently performed by CPSD for transportation carrier permit applicants)
- c) search FCC and other state regulatory databases for evidence of regulatory sanctions involving principals for applicants

Recommendation 2 – The CPUC should consider incorporating into the application approval process a requirement that companies post a performance bond before registering as telecommunications providers.

CPUC Response: Public Utilities Code 1013 provides the Commission some discretion to adopt a performance bond as a precondition of registration to cover taxes or fees collected from customers and held for remittance. In Decision No. 97-06-107, the Commission found that existing fee collection rules were sufficient to ensure payment of these taxes or fees, and ruled that a performance bond was not necessary to collect taxes or fees.

The Communications Division will work with the Commission's Administrative Law Judge Division to initiate a Rulemaking to modify Decision 97-06-107 to consider requirements for a performance bond to ensure payment of fines to the Commission and restitution to customers.

In addition, the Legislature passed AB 2987, the Digital Infrastructure and Video Competition Act, in 2006, allowing the Commission to require applicants for state-issued video franchises to post bonds to provide adequate assurance that the applicants possess the financial, legal, and technical qualifications necessary to construct and operate the proposed systems. In Decision No. 07-03-014, adopted March 1, 2007, the Commission instituted such a bond requirement in the amount of \$100,000 per 20,000 households in a proposed video service area, with a required \$100,000 minimum and \$500,000 maximum per state video franchise holder.

Recommendation 3 – The CPUC should consider sponsoring legislation to:

- *Preclude transportation companies from re-registering or transferring title of company-owned vehicles carrying unpaid CPUC-imposed fines with the Department of Motor Vehicles.*

- *Allow the CPUC to pursue collection action without a Superior Court judgment if the CPUC's order to impose fines or restitution is not appealed within a specified timeframe.*

CPUC Response: The Commission believes that legislation should be enacted to prevent transportation companies from changing title of company-owned vehicles and to allow the Commission to collect fines and penalties without obtaining a certification of the Commission's decision in Superior Court. The Commission will explore legislation during the 2007-2008 fiscal year.

Recommendation 6 – The CPUC should develop criteria for referring companies that have apparently engaged in fraudulent practices to law enforcement agencies for possible legal action. The referrals or final case disposition should be fully documented and explained in the case files.

CPUC Response: In conjunction with the Consumer Protection and Safety Division, the Legal Division will develop a set of criteria for determining when an enforcement proceeding should be submitted to outside law enforcement agencies for additional prosecution.

Finding 2 – The CPUC has no means of ensuring the accuracy and completeness of the amount of fines imposed or collected, as such transactions are not recorded or recorded or reflected in its formal accounting records.

CPUC Response: The Commission agrees with the State Controller's Office recommendations to formally adopt the draft operating procedures for fines and collections, which the Commission is currently implementing on a test basis. The draft operating procedures assign collection responsibilities to the various Commission divisions and include accounting controls to ensure that all fines imposed and collected are accurately reflected in the formal accounting records.

Finding 3 – The CPUC has not undergone a comprehensive audit of its fiscal operations and internal control processes and procedures for many years.

CPUC Response: The Commission agrees with the State Controller's Office recommendation that a comprehensive internal control audit is necessary. The Commission will be contacting the Department of Finance, Office of State Audits and Evaluations to request an audit in accordance with the Financial Integrity and State Manager's Accountability Act (FISMA). The Commission will forward a copy of the FISMA audit report to the State Controller's Office, Division of Audits, upon completion.

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