An Audit Report on

The Public Utility Commission of Texas's Administration of the System Benefit Fund

July 2004

Report No. 04-043

State Auditor's Office

Lawrence F. Alwin, CPA
State Auditor

An Audit Report on the Public Utility Commission of Texas's

Administration of the System Benefit Fund

SAO Report No. 04-043
July 2004

Overall Conclusion

While the majority of funds from the System Benefit Fund (SBF) were distributed correctly, we identified instances where the Public Utility Commission of Texas (Commission) did not administer the SBF in accordance with laws and regulations. Specifically:

> **System Benefit Fund**
>
> The SBF is an account in the General Revenue Fund that was designed to provide assistance to low-income electric customers, provide consumer education on electric choice, and reimburse certain agencies for administrative expenditures. The SBF is funded through a fee collected from all electricity consumers in competitive markets.

- Because the Commission failed to include contract provisions requiring the low-income discount administrator (LIDA) to verify the eligibility of participants who enroll themselves in the Low-Income Discount Program, up to 11 percent of self-enrolled participants may not be eligible. This represents as much as $2.1 million in discounts, out of a total of $239 million in discounts given from September 2002 to February 2004. There are approximately 790,000 participants in the program, and 8 percent of them are self-enrolled. We also noted contract management issues relating to the LIDA contract and other contracts funded with the SBF: the Commission made payments without adequate support and entered into contracts that do not contain provisions to protect the State's interests.

- We identified matching and data accuracy weaknesses in the automatic enrollment process that was in use during fiscal year 2003. This process automatically enrolls electric customers who may be participating in other state assistance programs into the Low-Income Discount Program. In March 2004, during our fieldwork, the Commission began using a new LIDA and a significantly changed automatic enrollment process. It needs to ensure that the new process addresses the weaknesses identified in the prior process.

For fiscal year 2004, the Commission projects expenditures for the Low-Income Discount Program to decrease 24 percent from fiscal year 2003 expenditures. The Commission cites several reasons for the decrease, such as changes in Commission rules and a reduction in the Low-Income Discount rate from 17 percent in fiscal year 2003 to 10 percent in fiscal year 2004. These changes are also expected to result in a significant increase in fund balance, which is projected to increase from the August 31, 2003, balance of $10 million to approximately $94 million by August 31, 2005.

Summary of Information Technology Review

The information technology portion of the audit was designed to test the e-government automatic enrollment process and to determine whether the data used was reliable. Data control weaknesses identified at the LIDA indicated that some of its data may not be reliable. Problems identified in the LIDA's matching process may allow inaccurate information to be passed on to the electric companies.

State Auditor's Office
Lawrence F. Alwin, CPA
State Auditor

This audit was conducted in accordance with Government Code, Section 321.0132.

For more information regarding this report, please contact Nick Villalpando, Audit Manager, at (512) 936-9500.

In general, the e-government process automatically enrolls participants from other state assistance programs administered by the Department of Human Services (DHS) into programs funded by the SBF. The LIDA matches information in DHS's eligibility database with information in the electric customer database and provides the eligible participant data to the electric companies.

Detailed Results

Chapter 1

Between 5 and 11 Percent of Self-Enrolled Participants in the Low-Income Discount Program May Not Be Eligible Due to Weaknesses in the Commission's Management of the LIDA Contract

The Public Utility Commission of Texas (Commission) did not ensure that funds from the System Benefit Fund (SBF) for the Low-Income Discount Program, which provides discounted electric services to eligible participants, were distributed to self-enrolled customers in accordance with laws and regulations.

Our audit testing determined that between 5 and 11 percent[1] (2,000 to 4,800 customers) of the self-enrolled customers who received the discount from September 2002 through February 2004 may not have been eligible to participate. This represents between $965,000 and $2.1 million given in discounts to potentially ineligible participants out of a total of $239 million in program expenditures. The Low-Income Discount Program has approximately 790,000 customers receiving discounts each month, with 63,600 (8 percent) being self-enrolled.

The Texas Administrative Code, Section 25.454(e)(2)(G), states that the "LIDA may, at its discretion, verify the self-certification applicant's income by requesting copies of tax returns, pay stubs, or letters from employers." Because the rule is permissive, the only way the Commission could ensure that eligibility was properly determined was to include a clause in its contract with the LIDA to require it. However, the contract did not require that the LIDA verify self-enrolled customers' eligibility.

Furthermore, the LIDA did not collect all the information needed to determine self-enrolled customers' eligibility. As a result, we estimate that approximately $14.4 million (out of a total of $177 million in expenditures) was spent between January 2002 and August 2003 on the self-enrolled customers whose eligibility was never determined. The application for self-certification used in fiscal years 2002 and 2003 did not ask for the number of people in the household. This information is needed to determine whether applicants meet the requirements of the Public Utilities Regulatory Act, one of which is a household income of not more than 125 percent of the federal poverty guidelines.

In addition to not requiring the LIDA to verify self-enrolled customers' eligibility and not ensuring that the LIDA collected sufficient eligibility information, the Commission has further deficiencies in its management of its contract with the LIDA. Specifically:

- The contract lacked (1) provisions that required the LIDA to meet specific performance standards, (2) clear statements on how the LIDA's performance would be evaluated, and (3) sanctions for poor performance.

[1] This error rate may be higher because we could not determine the actual number of people in a household. Therefore, errors were conservatively based on one income source for a household.

- The Commission's process for monitoring payments to the LIDA did not ensure that expenditures were properly supported. Thirty-one percent of appropriation year 2003 expenditures ($533,805) lacked bills and other documentation to support the LIDA's invoices. However, the payments appeared to be allowable under the contract, and the process ensured that the LIDA calculated its invoices correctly. Payments to the LIDA totaled $1,701,727. Additionally, while there was evidence that the Commission worked with the LIDA to resolve issues as they arose, monitoring performed by the Commission was not sufficient to ensure that eligible customers were obtaining discounts.

While the contracting issues discussed above pertain to the Commission's contract with its prior LIDA, we identified similar issues in the management of other contracts that the Commission funds through the SBF:

- The Commission did not always obtain adequate support for expenditures from the SBF to contractors. Five percent ($374,486 out of a total of $7.9 million) of appropriation year 2003 expenditures to the consumer education contractor lacked sufficient support. Therefore, the Commission cannot ensure that the contractor's performance was in accordance with contract requirements. The expenditures mainly lacked signed affidavits stating that advertisements were actually aired. While an outside contractor concluded that the consumer education campaign met it goals because consumers were aware of the possibilities of electric choice, this does not ensure that the consumer education contractor performed in accordance with the contract requirements.

- Three of the six contracts tested had some combination of the following errors: a lack of provisions for requiring reimbursement for unallowable expenditures, payment methodologies that were not clearly defined, and a lack of audit clauses allowing the Commission or its designated party the right to audit.

Before our audit began, the Commission identified some self-enrolled participants who were not eligible and began making changes to improve the self-enrollment process. During audit fieldwork, the Commission sent letters to all self-enrolled customers that required them to send proof of their eligibility to continue to be in the program. Anyone who did not return the proof of eligibility was dropped from the program. In addition, the Commission has obtained a new LIDA and has changed the method used to enroll customers in the discount program. The Commission now requires self-enrolled customers to provide proof of eligibility when they apply for the program.

Recommendations

The Commission should continue to require self-enrolled customers to provide proof of eligibility at the time of enrollment into the program.

The Commission should address contract administration weaknesses by:

- Reviewing contracts to ensure that they contain all necessary provisions to hold contractors accountable for performance.

- Monitoring contractors' performance to ensure that only eligible participants are enrolled in the program.
- Obtaining adequate documentation before making expenditures.

Management's Response

In Fiscal Year 2003 the Commission recognized the need for verification of eligibility, and began taking steps to change the self-enrollment process.

- *In early Fiscal Year 2004, the PUC decided to review the eligibility of all self enrolled customers by requiring a complete re-enrollment into the program. All self-enrolled customers were sent new enrollment forms and were provided postage paid business reply envelopes. A Certified Public Accounting firm was retained to process the applications independently and report the findings to the Commission. In addition, the CPA firm forwarded the data to the new LIDA to update its database for the eligible customers, so that effective April 2004 every self-enrolled customer was verified as eligible.*
- *The Commission made significant changes to the self-enrollment application form by requiring submission of one of the following proofs of eligibility: evidence of enrollment in other qualifying federal or state programs; or completion of an income based eligibility worksheet, including information about the number of individuals in the household, and submission of at least one of five acceptable forms of income verification, e.g., pay stub, W-2, income tax return, or letter from employer.*
- *In March 2004, the Commission contracted with a new LIDA. The new contract required the LIDA to review every application for completion, signature, and proper evidence of eligibility. In addition, the LIDA is responsible for putting in place an internal audit process to ensure that its staff is properly reviewing the applications.*
- *The Commission amended 16 T.A.C. §25.454, and developed a Low Income Discount Operating Handbook to define more clearly the role and responsibility of all parties involved in the program.*
- *The Commission has created a new Compliance Auditor position that, among other duties, will conduct a sampled independent review of the work of the LIDA.*

The Commission has, and will continue to make improvements in contract design, management, and administration.

- *The new LIDA contract, effective March 1, 2004, corrected weaknesses the SAO identified in the previous contract.*
- *The Commission recognizes the need for better contract monitoring, and has created a new position of Contract Administrator. Creation of this position will consolidate the contract administration function in one area of the agency to improve accountability. The Contract Administrator will be responsible for assisting in drafting requests for proposal, assisting in developing the*

performance standards and deliverables to be included in the contract, being the main point of contact with the contractor on any contract issue, and ensure that all areas of the contract, reports monitoring, and invoice review is in conformity to the contract and state rules and guidelines. The commission will fill this position within the next thirty days.

- *Changes have been made in the invoice and expenditure monitoring process. Checklists currently in place are being enhanced, and a collaborative process with the Contract Administrator, Director of General Law, and Chief Financial Officer will take place in developing the support and documentation to support deliverables, and payments to the contractor.*

Chapter 2

The Commission Should Ensure that Its New Automatic Enrollment Process Addresses Weaknesses Identified in Its Prior Process

In March 2004, during our fieldwork, the Commission began using a new LIDA and a new process to automatically enroll those participating in state assistance programs administered by the Department of Human Services (DHS) into the Low-Income Discount Program. We reviewed the automatic enrollment process that was in place during fiscal year 2003. We identified matching and data accuracy issues that the Commission needs to ensure are resolved in the new process.

> **Automatic Enrollment Process**
>
> The automatic enrollment process is an e-government process that is transparent to participants who apply for services with DHS, and if they are eligible for those services, they also receive discounts on electric bills.

At least once per month, the electric companies downloaded from the prior LIDA the list of qualifying customers in a secure fashion. To create this list, the LIDA compared a list of the electric companies' customers supplied by the Electric Reliability Council of Texas with a list of individuals receiving services from DHS.

While the transmittal of data worked reasonably well under the prior LIDA for the sample tested, we identified two issues with its process for creating the list of qualifying customers. In addition, an external public accounting firm identified additional issues regarding the prior LIDA's list. Specifically:

- Inadequate data delayed discounts for customers who live in apartments or who have different mailing and residential addresses. The LIDA database did not have a standard field to capture apartment numbers. Therefore, customers living in apartments may not have received the discount unless they knew to call the LIDA and ensure that their particular apartments received a discount. Additionally, the LIDA used the mailing address provided by DHS when matching customers rather than the residential address provided. This caused problems because the discount had to be based on a residential address.

- Because customers were matched by address and not by name, households could have received the low-income discount on their electric bills solely because a child in the household received services from DHS. The Public Utilities Code, Chapter 39, Section 30.903, states that a "low-income electric customer" is an actual electric customer, and children are not typically electric customers. Our analysis revealed that approximately 20 percent of the clients on the DHS list were children who did not have a parent in the same household receiving a DHS benefit. Further analysis would be required to determine whether these children live in deregulated areas and whether the households actually received the discount.

- An external public accounting firm identified that the LIDA could not recalculate or provide documentation to support the number of customers receiving the discount. The analysis was conducted at the request of the Commission, and the report was issued in November 2003. The accounting firm also found that when customers moved, the LIDA did not remove their old addresses from the system, which could allow the new occupants to receive the discount. Controls are not adequate for data entry, which will allow errors, and controls set up by the LIDA for quality control were not performed by the LIDA. For example, the report indicated that the process of verifying the accuracy of data entries by randomly selecting and testing entries was being performed on a significantly smaller number of transactions than the LIDA stated needed to be tested in its procedures.

Recommendation

The Commission should work with the new LIDA to ensure that it provides accurate lists of eligible customers to the electric companies. Specifically, it should ensure that the new LIDA:

- Has a computer system capable of capturing apartment numbers.
- Has a process for updating its computer system when program participants move.
- Has quality control standards that it follows to ensure the accuracy of its data.

Management's Response

The PUC agrees that it is important to assure that all customers enrolled in the low income discount program are eligible based on the statutory criteria. To the Commission's knowledge, the statutory requirement for automatic enrollment of program participants based on participation in another agency's programs is unique in Texas, and perhaps in the country. Developing the automatic enrollment feature using existing data and computer systems that were not designed for this purpose was extremely challenging, and it has taken time to optimize the accuracy of the matches. The Commission has implemented many improvements to the automatic enrollment process, and continues to work with the LIDA to improve the accuracy of the matching to ensure that only eligible customers are enrolled, and that as many eligible customers as possible are enrolled through automatic enrollment.

The database initially used to identify electric customers was derived from the Electric Reliability Council of Texas (ERCOT), the entity that oversees the electric grid in Texas, as it had information about all electric customers. However, the Commission determined early in the program's implementation that differences between the ERCOT database and the TDHS database dictated that another method must be used, and began the process of making the changes.

Additionally;

- *A new LIDA with newly designed computer software began performing the matching process in March 2004.*
- *The Commission amended its rules to provide for use of data that would lead to more accurate matching.*

The Commission requires the utility companies to provide information about their customers to the LIDA monthly, including names, addresses, apartment numbers, social security numbers, and other information to support more accurate matching.

Electric Companies Provided the Appropriate Discount

Most retail electric companies provided low-income discount customers the appropriate discount. The Low-Income Discount Program has 790,000 participants receiving the discount each month. Testing of 60 percent of the discounts funded through the program showed that the majority of the total customers of the electric providers tested received discounts that were calculated correctly.

Most of the errors identified were related to one retail electric company that provides discounts to 3 percent of the total number of customers who receive the discount per month. We project that 25 percent (6,000) of its discount customers received the wrong discount each month. Some discounts were for more than they should have been, some were for less, and others were given without complete information. The SBF did not reimburse this company for more than the actual amount of discounts that the company provided.

Recommendation

The Commission should work with the above electric company to help ensure that its discounts are:

- Calculated using the appropriate, Commission-approved discount rate.
- Given to the correct customers in the correct months.

Management's Response

Prior to the beginning of the SAO audit, the Commission recognized, through the monthly utility reporting, the need to review, audit, and assist the retail electric providers (REP's), in calculating and applying the discount. The following processes have been, or will be, effectuated;

- *A team of individuals in the Financial Review Division of the agency developed and put into place an audit plan. The initial audits began in early 2004 and some of them had been completed and reports issued when the SAO audit began, while others were still in process. The Commission recognized, reported to, and assisted the REP's in developing safeguards and refining their billing processes, and is continuing that effort.*
- *The Commission has established a new position, as stated earlier in this report, Compliance Auditor that will be developing additional audit and review process to ensure accurate calculation of the discount.*
- *As part of its audit, the SAO verified whether the REPs were providing the discount rate in effect. Based on its discussion with the SAO, the Commission will establish a process to receive electronic database information from the REPs, and on a routine basis, either quarterly or semiannually, will review the rates and calculations used by the REP's.*

Chapter 4

The Commission Estimates an Increase in the Balance of the System Benefit Fund

The SBF had revenues of more than $181 million and expenditures of more than $221 million in fiscal year 2003. The fund is receiving all revenues that are due to it. For fiscal year 2004, the Commission projects expenditures for the Low-Income Discount Program to decrease 24 percent from fiscal year 2003 expenditures. The Commission cites several reasons for the decrease, which is also expected to result in an increase in fund balance (see Table 1):

Table 1

Fund Balance as of August 31	
2002	$50 million
2003	$10 million
2004[a]	$45 million
2005[a]	$94 million

[a] Estimated

Source: Self-reported data from the Commission

- The Commission adopted a new rule stating that self-enrolled customers can participate for only seven months, and customers who are enrolled automatically through DHS can participate for only as long as they participate in DHS programs. Prior to these rule changes, all enrolled customers received the discount for 13 months.
- The Commission changed the Low-Income Discount rate from 17 percent in fiscal year 2003 to 10 percent in fiscal year 2004.
- The Commission implemented a new matching methodology and stated that this methodology should reduce the number of ineligible participants.
- As reported in Chapter 1, the Commission reduced the number of self-enrolled customers by dropping any who did not respond to the Commission's request that they prove their eligibility.

Other Information

Objective, Scope, and Methodology

Objective

Our audit objective was to determine whether the Public Utility Commission of Texas administered the System Benefit Fund (SBF) in accordance with applicable laws and regulations.

Scope

We reviewed program participants' eligibility from January 2002 through August 2003. We also reviewed self-enrolled participants' eligibility from September 2002 through February 2004. We reviewed the discounts provided by the electric providers, contracting expenditures, and the low-income discount administrator (LIDA) database and matching process for fiscal year 2003.

Methodology

To assess eligibility and the matching processes, we obtained data from the LIDA, the Department of Human Services, the Texas Workforce Commission, and various electric providers. We performed numerous analytical procedures to determine whether the program participants were eligible to receive the discount by comparing database information. We also performed checks on several processes used to develop and distribute the list of program participants to the electric providers.

To assess discounts given to eligible customers, we used the LIDA data and the data provided by various electric providers to recalculate the appropriate discount. This number was compared with the discount given to determine whether the discount received by the customer was correct.

We also reviewed revenues and other expenditures from the SBF, and we analyzed them to determine whether the expenditures were appropriate and the revenues were received.

Project Information

Our fieldwork was conducted from November 2003 to April 2004. This audit was conducted in accordance with generally accepted government auditing standards. The following members of the State Auditor's staff conducted the audit:

- Verma L. Elliott, MBA (Project Manager)
- Anthony Patrick, MBA (Assistant Project Manager)
- Catherine K. Fallon, MPAff
- Tressie Landry, CIA

- Troy Neisen
- Erinn Smith
- J. Scott Killingsworth, CIA, CGFM (Quality Control Reviewer)
- Nick Villalpando, CPA (Audit Manager)
- Frank N. Vito, CPA (Director)

Distribution Information

Legislative Audit Committee

The Honorable David Dewhurst, Lieutenant Governor, Joint Chair
The Honorable Tom Craddick, Speaker of the House, Joint Chair
The Honorable Steve Ogden, Senate Finance Committee
The Honorable Thomas "Tommy" Williams, Member, Texas Senate
The Honorable Talmadge Heflin, House Appropriations Committee
The Honorable Brian McCall, House Ways and Means Committee

Office of the Governor

The Honorable Rick Perry, Governor

Public Utility Commission of Texas

Mr. Paul Hudson, Chairman
Ms. Julie Parsley, Member
Mr. Barry Smitherman, Member
Mr. W. Lane Lanford, Executive Director