



MICHIGAN

OFFICE OF THE AUDITOR GENERAL

AUDIT REPORT



THOMAS H. MCTAVISH, C.P.A.
AUDITOR GENERAL

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Michigan
Office of the Auditor General
REPORT SUMMARY

Performance Audit

Report Number:
 641-0425-06L

Utility Consumer Participation Board

Department of Labor and Economic Growth

Released:
 May 2007

The Utility Consumer Participation Board was created by Act 304, P.A. 1982, (Section 460.6l of the Michigan Compiled Laws). The five-member Board provides grants to qualified applicants that represent the interests of Michigan's residential energy (gas, electric, and other fuel) utility customers at residential energy proceedings before the Michigan Public Service Commission. Funding is generated through annual assessments of certain regulated utility companies.

Audit Objective:

To assess the effectiveness of the Board's efforts to award grants to qualified applicants in accordance with applicable statutes and administrative rules.

Audit Conclusion:

We concluded that the Board was effective in its efforts to award grants to qualified applicants in accordance with applicable statutes and administrative rules. However, we noted one reportable condition (Finding 1).

Reportable Condition:

The Board awarded a grant and disbursed funds to an applicant not statutorily qualified to receive funding (Finding 1).

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Audit Objective:

To assess the effectiveness of the Board's efforts to verify that grantees provided equitable representation of residential utility customers' interests at proceedings before the Michigan Public Service Commission.

Audit Conclusion:

We concluded that the Board was moderately effective in its efforts to verify that grantees provided equitable representation of residential utility customers' interests at proceedings before the Michigan Public Service Commission. We noted two reportable conditions (Findings 2 and 3).

Reportable Conditions:

The Board did not coordinate the representation efforts of its grantees with the representation efforts of the Department of Attorney General at residential energy proceedings before the Michigan Public Service Commission (Finding 2).

The Board did not validate the annual cost savings to Michigan's residential energy utility customers reported in its annual reports (Finding 3).

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Audit Objective:

To assess the Board's compliance with its enabling legislation.

Audit Conclusion:

We concluded that the Board was generally in compliance with its enabling legislation. However, we noted one reportable condition (Finding 4).

Reportable Condition:

The Board needs to improve its compliance with its enabling legislation regarding bimonthly meetings and public service announcements (Finding 4).

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Agency Response:

Our audit report contains 4 findings and 4 corresponding recommendations. The Board's preliminary responses indicate that the Board agrees with 2 recommendations and partially agrees with 2 recommendations.

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A copy of the full report can be obtained by calling 517.334.8050 or by visiting our Web site at: <http://audgen.michigan.gov>



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May 15, 2007

Dr. Harry M. Trebing, Chairman
Utility Consumer Participation Board
and
Mr. Keith W. Cooley, Director
Department of Labor and Economic Growth
Ottawa Building
Lansing, Michigan

Dear Dr. Trebing and Mr. Cooley:

This is our report on the performance audit of the Utility Consumer Participation Board, Department of Labor and Economic Growth.

This report contains our report summary; description of agency; audit objectives, scope, and methodology and agency responses; comments, findings, recommendations, and agency preliminary responses; and a glossary of acronyms and terms.

Our comments, findings, and recommendations are organized by audit objective. The agency preliminary responses were taken from the agency's responses subsequent to our audit fieldwork. The *Michigan Compiled Laws* and administrative procedures require that the audited agency develop a formal response within 60 days after release of the audit report.

We appreciate the courtesy and cooperation extended to us during this audit.

AUDITOR GENERAL

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Description of Agency

The Utility Consumer Participation Board was created by Act 304, P.A. 1982 (Section 460.6l of the *Michigan Compiled Laws*). The Board consists of five members, each appointed by the Governor, who administer the Utility Consumer Representation Fund. The Fund derives its revenues from annual assessments of certain regulated utility companies. The Board disburses funds through transfers to the Department of Attorney General and through grants to applicants who desire to represent residential energy utility customers.

The Department of Attorney General and the grantees represent the interests of Michigan's residential energy (gas, electric, and other fuel) utility customers at supply and cost review proceedings and at cost reconciliation proceedings before the Michigan Public Service Commission. Disbursements from the Utility Consumer Representation Fund may be used only to advocate the interests of energy utility customers or classes of energy utility customers.

Section 460.6a(2) of the *Michigan Compiled Laws* prohibits regulated utilities from using automatic adjustment clauses to recover increases in the cost of purchased energy. To recover cost increases, regulated utility companies must file energy cost recovery plans with the Michigan Public Service Commission. The cost recovery plans describe the utility companies' expected sources and quantities of energy as well as the changes in costs anticipated over a 12-month period.

Once a cost recovery plan has been filed, the Michigan Public Service Commission conducts proceedings to evaluate the reasonableness and prudence of the plan and to establish energy recovery factors. These are generally contested cases, in which Commission staff, the Department of Attorney General's Special Litigation Division, grantees, and others may participate through legal counsel.

For fiscal years 2005-06 and 2004-05, the Utility Consumer Representation Fund's revenues totaled \$1,200,435 and \$1,096,358, respectively, and expenditures totaled \$1,201,247 and \$776,481, respectively. As of September 30, 2006 and September 30, 2005, the fund balances were \$3,370,092 and \$3,373,411, respectively.

During fiscal years 2005-06 and 2004-05, the Board transferred to the Department of Attorney General \$513,000 and \$381,445, respectively. During fiscal years 2005-06 and 2004-05, the Board awarded grants totaling \$500,000 to five nonprofit organizations and \$522,500 to four nonprofit organizations, respectively.

Audit Objectives, Scope, and Methodology and Agency Responses

Audit Objectives

Our performance audit* of the Utility Consumer Participation Board, Department of Labor and Economic Growth (DLEG), had the following objectives:

1. To assess the effectiveness* of the Board's efforts to award grants to qualified applicants in accordance with applicable statutes and administrative rules.
2. To assess the effectiveness of the Board's efforts to verify that grantees provided equitable representation of residential utility customers' interests at proceedings before the Michigan Public Service Commission.
3. To assess the Board's compliance with its enabling legislation.

Audit Scope

Our audit scope was to examine the program and other records of the Utility Consumer Participation Board. Our audit was conducted in accordance with *Government Auditing Standards* issued by the Comptroller General of the United States and, accordingly, included such tests of the records and such other auditing procedures as we considered necessary in the circumstances. Our audit procedures, conducted from April through July 2006, generally covered the period October 1, 2002 through July 28, 2006.

Audit Methodology

To establish our audit objectives, we conducted a preliminary review of the Board's operations that included discussions with Board members regarding their functions and responsibilities, a review of the Board's program and financial records, and a review of the applicable laws and regulations.

To accomplish our audit objectives, we met with Board members and reviewed grant applicant records to evaluate Board efforts in awarding grants. Also, we obtained and analyzed electronic residential energy proceedings case file information from the Michigan Public Service Commission. In addition, we reviewed reports that the Board

* See glossary at end of report for definition.

uses to verify that grantees provided equitable representation of residential utility customers' interests at proceedings before the Michigan Public Service Commission. Further, we reviewed the Board's meeting minutes and financial information to verify the Board's compliance with its enabling legislation.

Agency Responses

Our audit report contains 4 findings and 4 corresponding recommendations. The Board's preliminary responses indicate that the Board agrees with 2 recommendations and partially agrees with 2 recommendations.

The agency preliminary response that follows each recommendation in our report was taken from the Board's written comments subsequent to our audit fieldwork. Section 18.1462 of the *Michigan Compiled Laws* and Department of Management and Budget Administrative Guide procedure 1280.02 require the Board to develop a formal response to our audit findings and recommendations within 60 days after release of the audit report.

COMMENTS, FINDINGS, RECOMMENDATIONS,
AND AGENCY PRELIMINARY RESPONSES

EFFECTIVENESS OF EFFORTS TO AWARD GRANTS TO QUALIFIED APPLICANTS

COMMENT

Audit Objective: To assess the effectiveness of the Utility Consumer Participation Board's efforts to award grants to qualified applicants in accordance with applicable statutes and administrative rules.

Conclusion: We concluded that the Board was effective in its efforts to award grants to qualified applicants in accordance with applicable statutes and administrative rules. However, our assessment disclosed a reportable condition* related to the awarding of grants (Finding 1).

FINDING

1. Awarding of Grants

The Board awarded a grant and disbursed funds to an applicant not statutorily qualified to receive funding. As a result, \$83,933 was not available to award to eligible nonprofit organizations and local units of government.

Section 460.6m(12) of the *Michigan Compiled Laws* states that the Board shall grant funds only to nonprofit organizations or local units of government within Michigan. This Section also states that applicants must represent the interests of residential energy utility customers through proceedings conducted under Act 304, P.A. 1982 (Sections 460.6h - 460.6k). In addition, the Department of Attorney General issued a memorandum of advice to the Board in 1991 stating that, based on the statutes, the Board lacked authority to make grants to nonprofit organizations located outside the State of Michigan.

On August 31, 2005, the Board awarded a fiscal year 2005-06 grant of \$83,933 to a nonprofit organization located in Boston, Massachusetts, for intervention efforts on behalf of consumers' gas costs.

RECOMMENDATION

We recommend that the Board award grants and disburse funds only to applicants statutorily qualified to receive funding.

* See glossary at end of report for definition.

AGENCY PRELIMINARY RESPONSE

DLEG stated:

DLEG agrees in part. It should be noted that this finding does not address key issues associated with the grant awarded to PAYS America, Inc. to conduct a pilot project for introducing conservation practices into the natural gas industry. The initial proposal called for a cooperative effort between SEMCO (a natural gas utility) and PAYS America to conduct a conservation study. The UCPB Board performed its due diligence during the grant application process by considering the applicant's professional qualifications and legal standing. At the time that the initial grant was being considered, no claims were made during the period allotted for public comment that would have dissuaded the Board from its action. The question of standing appears to have emerged later, when SEMCO demonstrated an unwillingness to work cooperatively with PAYS America, resulting in an adversarial litigation posture. The administrative law judge's decision regarding PAYS America's standing was essentially an interim action awaiting final Michigan Public Service Commission action.

In its decision in Case No. U-14718 (September 26, 2006), the Commission praised PAYS America's work in the area of conservation. It noted, "The Commission has looked favorably on the PAYS program in the past Proceedings before the Commission as described in Case No. U14701." However, the Commission stated that it was ". . . not persuaded that a GCR is the proper form for addressing the significant issues raised by PAYS in its petition to intervene".

The subsequent complexity of this case could not have been fully anticipated at the time the initial grant was made; thus, the Board did not act capriciously in awarding the grant. On its own initiative, the Board has attempted to prevent a similar problem in the future by modifying the reporting requirements in the application form for Act 304 grants. Each grant recipient will now be required to detail its qualifications and identify issues that could arise if the grant were to be approved. The Board took this initiative in the spring of 2006.

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The language of Section 460.6m of the *Michigan Compiled Laws*, as affirmed by the Attorney General, prohibits the Board from awarding grants to nonprofit organizations located outside the State of Michigan. The Board violated this Section when it awarded \$83,933 to a Massachusetts nonprofit organization. The fact that the Board believes the nonprofit organization's efforts are worthy of praise or that no one questioned the award prior to the audit did not release the Board of its responsibility to comply with its statutory requirements to award grants only to eligible organizations.

EFFECTIVENESS OF EFFORTS TO PROVIDE EQUITABLE REPRESENTATION

COMMENT

Audit Objective: To assess the effectiveness of the Board's efforts to verify that grantees provided equitable representation of residential utility customers' interests at proceedings before the Michigan Public Service Commission.

Conclusion: We concluded that the Board was moderately effective in its efforts to verify that grantees provided equitable representation of residential utility customers' interests at proceedings before the Michigan Public Service Commission. Our assessment disclosed reportable conditions related to coordination of representation efforts and validation of annual report cost savings (Findings 2 and 3).

FINDING

2. Coordination of Representation Efforts

The Board did not coordinate the representation efforts of its grantees with the representation efforts of the Department of Attorney General at residential energy proceedings before the Michigan Public Service Commission. As a result, duplication of representation efforts existed between grantees and the Department of Attorney General. Coordination of representation efforts would help avoid duplication, supplement efforts, maximize the number of hearings and proceedings with consumer representation, and enhance the efficient use of resources.

Section 460.6m(18) of the *Michigan Compiled Laws* requires the Board to coordinate the funded activities of grant recipients with those of the Department of

Attorney General to avoid duplication of effort, to promote supplementation of effort, and to maximize the number of hearings and proceedings with consumer representation.

It is the Board's stated goal to issue grants to qualified applicants to ensure equitable representation of the interests of residential utility customers or classes of residential utility customers at energy supply and cost review proceedings and energy cost reconciliation proceedings.

Our review of 46 residential energy proceedings held during September 27, 2002 through July 17, 2006 disclosed that 40 (87%) of the proceedings received duplicate representation by the Department of Attorney General and the grantees. Also, 3 (7%) of the proceedings had no representation.

RECOMMENDATION

We recommend that the Board coordinate the representation efforts of its grantees with the representation efforts of the Department of Attorney General at residential energy proceedings before the Michigan Public Service Commission.

AGENCY PRELIMINARY RESPONSE

DLEG stated:

DLEG agrees in part. It is important to note that (the controlling statute) MCL 460.6m(18)(c) provides: "The Board shall coordinate the funded activities of grant recipients with those of the attorney general to avoid duplication of effort, to promote supplementation of effort, and to maximize the number of hearings and proceedings with intervenor participation."

It must be emphasized that both the Attorney General (AG) and the Board's grant programs focus on the need to protect residential and small business customers. The AG and the grant recipients hire different attorneys and different expert witnesses. A typical case involves a wide range of issues so there is ample opportunity for specialization by intervenors. The Board is fully aware of the need to address potential duplication between its grantees and the AG's activities. Duplication is addressed in the grant proposal review and approval process. This

point is further discussed in on-going review and monitoring of UCRF funded activities.

Attention must also be directed to a special problem associated with any effort to require a grant applicant to set forth with great specificity how that applicant will pursue a strategy in a proceeding before the Commission or before a court. If this detail were set forth in an open meeting, then other parties involved in a pending proceeding would have an excellent insight into what the intervenor intends to accomplish. It would also give these parties a motive to deny making data available on the grounds that it was non-existent or that it would violate proprietary considerations, while in reality it would be a strategy to destroy the effectiveness of the grantee's participation in the proceedings. Further, the Board would have great difficulty coordinating this type of information with the strategies that the AG's office would plan in a forthcoming case. It is important to keep in mind that issues involved in Act 304 planning and reconciliation cases are so broad that they can only benefit from concurrent involvement by different parties seeking to protect residential and small business customers. The need for this protection is evident when there are few, if any, competitive entrants willing to serve residential energy markets.

OFFICE OF THE AUDITOR GENERAL EPILOGUE

In its response, the Board asserts that within a typical case there is "ample opportunity for specialization by intervenors." However, there was no evidence that the Board attempted to ensure that duplication of effort did not exist. In addition, the Board's response indicates that it would have great difficulty in coordinating this type of information. Notwithstanding, it is the Board's responsibility, as mandated by Section 460.6m of the *Michigan Compiled Laws*, to coordinate the funded activities of grant recipients with those of the Department of Attorney General to avoid duplication of effort.

FINDING

3. Validation of Annual Report Cost Savings

The Board did not validate the annual cost savings to Michigan's residential energy utility customers reported in its annual reports. As a result, the Board overstated

calendar year 2004 and 2003 annual cost savings by \$77,620,783 and \$76,529,000, respectively.

Section 460.6m(22) of the *Michigan Compiled Laws* states that on or before July 1 of each calendar year, the Board shall submit a detailed report to the Legislature regarding the discharge of duties and responsibilities during the preceding calendar year. Such reporting justifies the Board's existence to the Legislature and the public.

In its annual reports, the Board repeated cost savings projected from cases closed during other reporting periods and included cost savings for a case that had not been closed. This occurred because the Board relied solely on the grantees to self-report any cost savings. The Board included the grantee-reported cost savings in its annual reports without independently validating the accuracy of the amounts. Such validation efforts would help ensure that the Board's annual reports accurately reflect cost savings to Michigan's residential energy utility customers.

Our review of the Board's calendar year 2004 and 2003 annual reports disclosed:

- a. The Board reported cost savings of \$50,000,000 in both the 2004 and 2003 annual reports that related to a case that was closed by the Michigan Public Service Commission on October 11, 2001.
- b. The Board reported cost savings of \$26,500,000 and \$26,529,000 in its 2004 and 2003 annual reports, respectively, that related to a case not closed by the Michigan Public Service Commission until April 28, 2005.
- c. The Board reported cost savings of \$1,120,783 in the 2004 annual report that related to a case settled on July 23, 2003. These cost savings were previously reported in the 2003 annual report.

RECOMMENDATION

We recommend that the Board validate the annual cost savings to Michigan's residential energy utility customers reported in its annual reports.

AGENCY PRELIMINARY RESPONSE

DLEG stated:

DLEG agrees. It is important to note that prior to the hiring of a (part-time) special assistant in 2006, the Board had no staff assistance with expertise in the field of public utility regulation. As a result, estimates of cost savings were largely dependant upon the collaborative effort between DLEG personnel and the grant recipients. Board members did review the each year's findings. However, measuring net cost savings was not an easy task because benefit and cost estimates often cut across industry lines and time periods. This does not mean that past efforts in measuring net cost savings were erroneous or deliberately distorted. In fact, the Board's broad overview of past performance strongly suggests that residential consumers did receive benefits in excess of the cost associated with the grant programs.

With the employment of the special assistant, the Board expects to introduce standard reporting requirements for measuring future cost savings that can be applied to grantees funded by the Board. It also hopes that the creation of a new set of standards will provide a better insight into net savings associated with grantee intervention, Commission staff intervention, and AG intervention. The Board is committed to working with the AG's office in achieving a coordination of efforts.

COMPLIANCE WITH ENABLING LEGISLATION

COMMENT

Audit Objective: To assess the Board's compliance with its enabling legislation.

Conclusion: **We concluded that the Board was generally in compliance with its enabling legislation.** However, our assessment disclosed a reportable condition related to bimonthly meetings and public service announcements (Finding 4).

FINDING

4. **Bimonthly Meetings and Public Service Announcements**

The Board needs to improve its compliance with its enabling legislation regarding bimonthly meetings and public service announcements.

Our review of the Board's meeting minutes and financial information disclosed:

- a. The Board did not hold bimonthly meetings in accordance with statutory provisions.

Our review of the Board's minutes for fiscal years 2002-03, 2003-04, and 2004-05 disclosed that the Board held 11 (61%) of the required 18 meetings. Also, the Board had not developed and distributed a schedule of established times and dates for upcoming meetings.

Holding regularly scheduled meetings provides public assurance that the Board is fulfilling its required responsibilities. Distributing a schedule of upcoming Board meetings provides the public, the Department of Attorney General, and grantees sufficient time to attend and have meaningful input at the meetings.

Section 460.6l(8) of the *Michigan Compiled Laws* states that the Board shall hold bimonthly meetings and additional meetings as necessary.

- b. The Board did not produce and air public service announcements that informed residential utility customers, nonprofit organizations, and local units of government of the availability and purpose of the Utility Consumer Representation Fund.

Public service announcements regarding the Board's purpose could encourage other nonprofit organizations or local units of government within Michigan to participate in residential energy proceedings.

Section 322, Act 156, P.A. 2005, and Section 322, Act 354, P.A. 2004, require the Board to produce and air public service announcements that inform utility customers of the availability and purpose of the Utility Consumer Representation Fund. Also, the Board is statutorily required to report to the

subcommittees, fiscal agencies, and the Office of the State Budget its efforts regarding such announcements, including the amount of expenditures made for this purpose.

Funding was available for the production of such announcements as the Board did not use \$42,414 and \$44,063 of its annual administrative allocation available for fiscal years 2004-05 and 2003-04, respectively.

RECOMMENDATION

We recommend that the Board comply with its enabling legislation regarding bimonthly meetings and public service announcements.

AGENCY PRELIMINARY RESPONSE

DLEG stated:

DLEG agrees. It should be noted that the Board voted on its own initiative to hold bi-monthly meetings. Accordingly, this finding has already been implemented. Nevertheless, it is still important to note that the Board's annual schedule must focus primarily on the grant cycle. There are typically a series of meetings when grants are awarded for the upcoming cycle. Afterwards, Board members are kept informed by progress reports required of each grant recipient. In addition, the Board will meet in a special session when a problem arises that requires Board action. This may involve questions pertaining to the transfer of funds between accounts for a grant recipient arising from a change in the Commission's agenda, or from an appeal of cases to the courts. These special problems are handled on an ad hoc basis.

It should be noted that some members of the Board have been strong proponents of enlisting the participation of local units of government in the grants program. This would promote active participation on the part of local governments in Commission proceedings. It would also tend to attract a greater number of consultants into this field and improve the Board's options for making grants. In the past, the Board formed an ad hoc committee to study the problem of recruiting local government participation, but only had limited success. In 2006, before receipt of the Draft Report, DLEG and the Board collaborated to make a large mailing to local units of government

describing the UCPB grants program. The limited response indicated the need for a more targeted announcement and follow-up workshop for interested parties. It is hoped that the Board's special assistant will now be able to devote some time to the preparation of a new announcement that will have greater appeal at the local level.

GLOSSARY

Glossary of Acronyms and Terms

AG	Attorney General.
DLEG	Department of Labor and Economic Growth.
effectiveness	Program success in achieving mission and goals.
GCR	gas cost reconciliation.
MCL	<i>Michigan Compiled Laws.</i>
performance audit	An economy and efficiency audit or a program audit that is designed to provide an independent assessment of the performance of a governmental entity, program, activity, or function to improve public accountability and to facilitate decision making by parties responsible for overseeing or initiating corrective action.
reportable condition	A matter that, in the auditor's judgment, represents either an opportunity for improvement or a significant deficiency in management's ability to operate a program in an effective and efficient manner.
UCPB	Utility Consumer Participation Board.
UCRF	Utility Consumer Representation Fund.

