



MICHIGAN

OFFICE OF THE AUDITOR GENERAL

AUDIT REPORT

PERFORMANCE AUDIT
OF THE

MICHIGAN PUBLIC SERVICE COMMISSION

DEPARTMENT OF LICENSING AND REGULATORY AFFAIRS

March 2014



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

The auditor general shall conduct post audits of financial transactions and accounts of the state and of all branches, departments, offices, boards, commissions, agencies, authorities and institutions of the state established by this constitution or by law, and performance post audits thereof.

– Article IV, Section 53 of the Michigan Constitution

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Michigan
Office of the Auditor General
REPORT SUMMARY

Performance Audit

Report Number:
641-0170-13

Michigan Public Service Commission

*Department of Licensing and Regulatory
Affairs*

Released:
March 2014

The mission of the Michigan Public Service Commission (MPSC) is to grow Michigan's economy and enhance the quality of life of its communities by ensuring safe and reliable energy, telecommunications, and transportation services at reasonable rates. MPSC is composed of three commissioners appointed by the Governor, with the advice and consent of the Senate, for staggered six-year terms.

Audit Objective:

To assess the effectiveness of MPSC's efforts to achieve its mission and goals.

Audit Conclusion:

We could not conclude on the effectiveness of MPSC's efforts to achieve its mission and goals because its goals were mainly aspirational in nature, did not provide a measurable basis for determining specific performance, and could not be objectively measured. We noted one material condition (Finding 1).

Material Condition:

MPSC had not established a comprehensive process to evaluate and improve the effectiveness of its operations (Finding 1). Without a comprehensive process to evaluate effectiveness and identify potentially needed program changes, MPSC's ability to effectively grow Michigan's economy and enhance the quality of life of its communities was significantly reduced.

Audit Objective:

To assess the effectiveness and efficiency of MPSC's efforts to license and regulate motor carrier operators.

Audit Conclusion:

We concluded that MPSC's efforts to license and regulate motor carrier operators were moderately effective but were not efficient. We noted one material condition (Finding 2).

Material Condition:

MPSC did not timely process motor carriers' applications to operate in Michigan. Also, MPSC had not sought amendatory legislation to incorporate available technological practices (Finding 2). As a result, MPSC's process, which took nearly three times longer than the federal process for granting interstate authority, prevented motor carriers from timely and legally operating their businesses in Michigan.

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Audit Objective:

To assess the effectiveness of MPSC's efforts to ensure that the customers of Michigan's regulated utilities received appropriate and timely responses to their complaints.

Audit Conclusion:

We concluded that MPSC's efforts to ensure that the customers of Michigan's regulated utilities received appropriate and timely responses to their complaints were effective. Our audit report does not include any reportable conditions related to this audit objective.

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Agency Response:

Our audit report contains 2 findings and 3 corresponding recommendations. MPSC's preliminary response indicates that it agrees with all 3 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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March 25, 2014

Mr. John D. Quackenbush, Chairman
Michigan Public Service Commission
4300 West Saginaw Highway
Lansing, Michigan
and
Mr. Steve Arwood, Director
Department of Licensing and Regulatory Affairs
Ottawa Building
Lansing, Michigan

Dear Mr. Quackenbush and Mr. Arwood:

This is our report on the performance audit of the Michigan Public Service Commission, Department of Licensing and Regulatory Affairs.

This report contains our report summary; a description of agency; our audit objectives, scope, and methodology and agency responses and prior audit follow-up; comments, findings, recommendations, and agency preliminary responses; an organizational chart, presented as supplemental information; and a glossary of abbreviations and terms.

Our comments, findings, and recommendations are organized by audit objective. The agency preliminary responses were taken from the agency's response at the end of our audit fieldwork. The *Michigan Compiled Laws* and administrative procedures require that the audited agency develop a plan to comply with the audit recommendations and submit it within 60 days after release of the audit report to the Office of Internal Audit Services, State Budget Office. Within 30 days of receipt, the Office of Internal Audit Services is required to review the plan and either accept the plan as final or contact the agency to take additional steps to finalize the plan.

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

Sincerely,

A handwritten signature in black ink that reads "Thomas H. McTavish".

Thomas H. McTavish, C.P.A.
Auditor General

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Description of Agency

The Michigan Public Service Commission (MPSC), Department of Licensing and Regulatory Affairs, is composed of three commissioners appointed by the Governor, with the advice and consent of the Senate, for staggered six-year terms. No more than two of the three members can be of the same political party. One commissioner is designated as chairman by the Governor.

The mission of MPSC is to grow Michigan's economy and enhance the quality of life of its communities by ensuring safe and reliable energy, telecommunications, and transportation services at reasonable rates.

MPSC oversees Michigan's regulated electric, gas, and telephone utilities and provides for the registration, safety, and insurance regulation of the intrastate for-hire motor carriers*. MPSC is empowered in varying degrees to regulate rates, services, rules, condition of services, and other matters relating to the operations of public utilities to help ensure safe, adequate, and reliable energy supplies.

Municipally owned utilities are not included in MPSC's jurisdiction.

For the fiscal years ended September 30, 2012 and September 30, 2011, MPSC expended \$24.4 million and \$21.6 million, respectively. Federal and State restricted funding sources were used to fund these expenditures. As of June 30, 2013, MPSC had 178 full-time equated employees.

* See glossary at end of report for definition.

Audit Objectives, Scope, and Methodology and Agency Responses and Prior Audit Follow-Up

Audit Objectives

Our performance audit* of the Michigan Public Service Commission (MPSC), Department of Licensing and Regulatory Affairs, had the following objectives:

1. To assess the effectiveness* of MPSC's efforts to achieve its mission* and goals*.
2. To assess the effectiveness and efficiency* of MPSC's efforts to license and regulate motor carrier operators.
3. To assess the effectiveness of MPSC's efforts to ensure that the customers of Michigan's regulated utilities* received appropriate and timely responses to their complaints.

Audit Scope

Our audit scope was to examine the program and other records related to the Michigan Public Service Commission. We conducted this performance audit in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives. Our audit procedures, which included a preliminary survey, audit fieldwork, report preparation, analysis of agency responses, and quality assurance, generally covered the period October 1, 2010 through June 30, 2013.

MPSC's organizational chart was provided to us by MPSC and is presented as supplemental information. Our audit was not directed toward expressing a conclusion on this supplemental information and, accordingly, we express no conclusion on it.

* See glossary at end of report for definition.

Audit Methodology

To establish our audit objectives, we conducted a preliminary survey of MPSC's operations. We interviewed various MPSC management and staff members regarding their functions and responsibilities; reviewed MPSC meeting minutes and applicable policies, procedures, laws, and regulations; analyzed and conducted limited testing of MPSC records; and reviewed MPSC's internal control*.

To accomplish our first objective, in addition to the procedures conducted in our preliminary survey, we met with MPSC management regarding MPSC's mission and goals and its relationship with MPSC's eight divisions. We gained an understanding of each division's purpose.

To accomplish our second objective, we interviewed MPSC management and staff to obtain an understanding of the licensing process of intrastate and interstate motor carrier operators. We obtained and reviewed electronic data of intrastate motor carriers that applied for operating authority during our audit period. We calculated the length of time to process all applications requesting intrastate operating authority. We selected a sample of intrastate motor carrier applications and reviewed them to determine if safety and insurance requirements were met.

To accomplish our third objective, we interviewed MPSC management and staff to obtain an understanding of the process used to receive and process customer complaints regarding regulated utilities. We obtained and analyzed customer complaints received by MPSC during our audit period. We reviewed and evaluated a sample of complaints to assess whether MPSC appropriately addressed the complaints.

When selecting activities or programs for audit, we use an approach based on assessment of risk and opportunity for improvement. Accordingly, we focus our audit efforts on activities or programs having the greatest probability for needing improvement as identified through a preliminary survey. Our limited audit resources are used, by design, to identify where and how improvements can be made. Consequently, we prepare our performance audits reports on an exception basis.

* See glossary at end of report for definition.

Agency Responses and Prior Audit Follow-Up

Our audit report contains 2 findings and 3 corresponding recommendations. MPSC's preliminary response indicates that it agrees with all 3 recommendations.

The agency preliminary response that follows each recommendation in our report was taken from the agency's written comments and oral discussion at the end of our audit fieldwork. Section 18.1462 of the *Michigan Compiled Laws* and the State of Michigan Financial Management Guide (Part VII, Chapter 4, Section 100) require MPSC to develop a plan to comply with the audit recommendations and submit it within 60 days after release of the audit report to the Office of Internal Audit Services, State Budget Office. Within 30 days of receipt, the Office of Internal Audit Services is required to review the plan and either accept the plan as final or contact the agency to take additional steps to finalize the plan.

We released our prior performance audit of the Michigan Public Service Commission, Department of Consumer and Industry Services (63-170-99), in July 2000. Within the scope of this audit, we followed up 4 of the 6 prior audit recommendations. MPSC complied with 3 prior audit recommendations. We rewrote the other prior audit recommendation for inclusion in Finding 1 of this audit report.

COMMENTS, FINDINGS, RECOMMENDATIONS,
AND AGENCY PRELIMINARY RESPONSES

MPSC'S EFFORTS TO ACHIEVE ITS MISSION AND GOALS

COMMENT

Background: The Michigan Public Service Commission (MPSC) developed the following goals: establish fair and reasonable rates for regulated services and adopt and administer fair terms and conditions of service for the State's utility customers; ensure adequate and reliable supplies of regulated services to all Michigan customers and the safe and efficient production, distribution, and use of the State's energy, telecommunications, and transportation services; promote the State's economic growth and enhance the quality of life of its communities through adoption of new technologies like broadband telecommunications and efficient renewable energy resources; and provide regulatory oversight in a prudent and efficient manner while implementing legislative and constitutional requirements. We reviewed and evaluated these goals as they related to MPSC's mission.

Audit Objective: To assess the effectiveness of MPSC's efforts to achieve its mission and goals.

Audit Conclusion: **We could not conclude on the effectiveness of MPSC's efforts to achieve its mission and goals because its goals were mainly aspirational in nature, did not provide a measurable basis for determining specific performance, and could not be objectively measured.**

Our determination was based on our audit efforts as described in the audit scope and audit methodology sections and the resulting material condition* noted in the comments, findings, recommendations, and agency preliminary responses section.

We noted one finding related to this audit objective. In our professional judgment, this matter represents a material condition because it was severe enough that it could impair the ability of management to operate the program in an effective and efficient manner. MPSC had not established a comprehensive process to evaluate and improve the effectiveness of its operations (Finding 1).

* See glossary at end of report for definition.

In reaching our determination, we considered the material condition and that our evaluation of MPSC's mission and goals determined its goals to be not quantified and mainly aspirational in nature. We believe that the results of our audit efforts provide a reasonable basis for our audit conclusion for this audit objective.

FINDING

1. Performance Monitoring

MPSC had not established a comprehensive process to evaluate and improve the effectiveness of its operations. Without a comprehensive process to evaluate effectiveness and identify potentially needed program changes, MPSC's ability to effectively grow Michigan's economy and enhance the quality of life of its communities was significantly reduced.

Program effectiveness can often be evaluated and improved by having an effective continuous quality improvement (CQI) process. Such a process should include performance measures* for measuring outputs* and outcomes*; performance standards* or goals that describe the desired level of outputs and outcomes based on management's expectations, peer group performance, and/or historical performance; a management information system to accurately gather relevant output and outcome data on a timely basis; a comparison of the actual data to desired outputs and outcomes; a reporting of the comparison results to management; and recommendations to improve effectiveness and efficiency or change the desired performance standards or goals.

Although MPSC had established a mission statement, its goals, which were not quantified, were mainly aspirational in nature, did not provide a measurable basis for determining specific performance, and could not be objectively verified. Also, MPSC had not used various components of a CQI process to evaluate the effectiveness of its regulatory and oversight activities. MPSC had neither established performance standards and goals that described the desired level of outputs and outcomes nor identified what outputs and outcomes to measure. The broad range of MPSC's responsibilities makes it imperative that MPSC establish such a CQI process for evaluating its efforts. MPSC's responsibilities include the assurance of safe, adequate, and reliable energy supplies; implementation of the State's renewable energy policies; ratemaking for electric and natural gas utilities;

* See glossary at end of report for definition.

regulation of telecommunications services and regulation and licensing of motor carriers; administration of electric and gas customer choice programs; and assistance to utility customers.

We noted a similar condition in our prior audit. MPSC indicated that it agreed with our prior audit recommendation and that it constantly reviewed and refined its quality improvement processes and the performance measures used to evaluate, improve, and report such processes. However, because the MPSC evaluation process lacked several vital components of a CQI process, MPSC had not comprehensively evaluated the effectiveness of its operations.

RECOMMENDATION

We recommend that MPSC establish a comprehensive process to evaluate and improve the effectiveness of its operations.

AGENCY PRELIMINARY RESPONSE

MPSC agrees that its mission statement provided nonquantifiable goals and that those aspirational goals did not constitute a comprehensive CQI process to evaluate the effectiveness of MPSC programs. MPSC informed us that it believes that it is critical to distinguish between the aspirational goals of its mission statement and objectively verifiable measurements used to chart its day-to-day activities.

MPSC informed us that, in response to the Governor's directive on reinventing Michigan's regulatory environment through the use of metrics to verify program efforts, MPSC undertook a CQI effort early in 2013 to revise the existing MPSC score card by evaluating and identifying a list of objectively verifiable measures of MPSC operations. MPSC also informed us that, during this process, MPSC staff developed new metrics to better reflect the combined scope of the day-to-day work performed by MPSC's eight divisions.

MPSC stated that the new objectively verifiable metrics, which were developed between January 16, 2013 and September 5, 2013, are outcome driven and focus on measurable work outputs that MPSC staff can impact. According to MPSC, examples include the percentage of MPSC orders issued within statutory deadlines; the percentage of electricity generated from renewable energy; electric

distribution reliability; the percentage of customers with access to broadband services; the average retail price of electric and gas services; the percentage of the State covered by 2-1-1 calling plans; the meeting of federal standards for gas safety pipeline inspections; the processing of intrastate motor carrier applications, and timely resolution of customer complaints against regulated utilities.

Although MPSC informed us that these metrics will be subject to constant review and evaluation to ensure that they properly reflect and measure MPSC's ongoing work, MPSC stated that it will continue its development and implementation of all elements of an effective CQI process to allow for evaluation and improvement of MPSC's operations.

MPSC'S EFFORTS TO LICENSE AND REGULATE MOTOR CARRIER OPERATORS

COMMENT

Audit Objective: To assess the effectiveness and efficiency of MPSC's efforts to license and regulate motor carrier operators.

Audit Conclusion: **We concluded that MPSC's efforts to license and regulate motor carrier operators were moderately effective but were not efficient.**

Our audit conclusion was based on our audit efforts as described in the audit scope and audit methodology sections and the resulting material condition noted in the comments, findings, recommendations, and agency preliminary responses section.

We noted one finding related to this audit objective. In our professional judgment, this matter represents a material condition because it was severe enough that it could impair the ability of management to operate the program in an effective and efficient manner. MPSC did not timely process motor carriers' applications to operate in Michigan. Also, MPSC had not sought amendatory legislation to incorporate available technological practices (Finding 2).

Our evaluation of all 1,088 applications approved during our audit period disclosed that MPSC's processing of motor carriers' applications for intrastate authority took nearly

three times longer than the federal process for interstate authority. Also, such delays affected the motor carriers' ability to conduct commerce within the State, which negatively impacted State tax revenue generated by such activities.

In reaching our conclusion, we considered the material condition and the impacts of the elongated approval process. We also considered the results of our audit procedures regarding MPSC's oversight of selected safety and insurance requirements. We believe that the results of our audit efforts provide a reasonable basis for our audit conclusion for this audit objective.

FINDING

2. Intrastate Authority Registration

MPSC did not timely process motor carriers' applications to operate in Michigan. Also, MPSC had not sought amendatory legislation to incorporate available technological practices. As a result, MPSC's process, which took nearly three times longer than the federal process for granting interstate authority, prevented motor carriers from timely and legally operating their businesses in Michigan.

Section 476.1(1) of the *Michigan Compiled Laws* requires that all motor carriers of property obtain certificates of authority for all vehicles from MPSC before operating on Michigan highways. Although the statute does not prescribe timeliness standards, the Federal Motor Carrier Safety Administration of the U.S. Department of Transportation reported that it takes from 28 to 42 calendar days to issue full operating authority to interstate motor carriers that operate in Michigan and other states.

During our audit period, MPSC received 1,305 applications from motor carriers seeking authority to initiate operations within the State of Michigan. MPSC approved 1,088 (83%) of these applications and denied 144 (11%) applications. The remaining 73 (6%) applications were still pending at the end of our audit period.

Our analysis of MPSC's application approval process disclosed that MPSC averaged 125 calendar days to process the 1,088 applications for authority to operate in Michigan. The number of days to process the 1,088 applications ranged as follows:

<u>Range of Days From Receipt of Application to Approval of Application</u>	<u>Number of Applications</u>	<u>Percent of Total Applications</u>
0 - 42 days	12	1%
43 - 90 days	434	40%
91 - 150 days	381	35%
151 - 300 days	222	20%
301 days or more	39	4%
Total applications	1,088	100%

MPSC management informed us that its DOS-based information technology system was not user-friendly, was cumbersome, and significantly contributed to the excessive number of days to process applications. This impaired MPSC's ability to license and regulate motor carrier operators effectively.

MPSC management stated that outdated legislation contributed to the excessive processing time. For example, current legislation requires waiting periods related to protests and the commencement of operations and requires publishing a biweekly bulletin. These mandatory waiting periods can add up to 30 days to MPSC's processing period. In addition, Sections 476.3 and 477.4 of the *Michigan Compiled Laws* require that all applications be in writing and be verified by affidavits. This hard copy application format caused processing delays when motor carriers did not initially submit all required documentation. An on-line submission process could increase efficiency.

RECOMMENDATIONS

We recommend that MPSC timely process motor carriers' applications to operate in Michigan.

We also recommend that MPSC seek amendatory legislation to incorporate available technological practices.

AGENCY PRELIMINARY RESPONSE

MPSC agrees that, for the period covered by the audit, its processing of for-hire motor carrier applications for intrastate authority to operate in Michigan was not timely. MPSC informed us that the current intrastate carrier application process has been largely unchanged for over 50 years. MPSC stated that, given the outdated application process and in response to the Governor's directive on reinventing Michigan by streamlining processes, MPSC undertook a CQI effort that began in February 2013 and was completed at the agency level in July 2013.

MPSC informed us that it expects implementation of a new streamlined process during 2014. According to MPSC, the new process will eliminate 64 burdensome work steps and will feature a new Web-based information technology platform to allow the State's 24,300 motor carriers to complete and submit permit applications and attachments on-line. MPSC stated that it expects these changes to reduce the application processing time to less than 25 days (up to 67% faster) and make the State application processing time shorter than the 28- to 42-day processing time that the U.S. Department of Transportation takes to issue operating authority to interstate carriers. MPSC informed us that the process improvement proposal calls for statutory amendments to Act 254, P.A. 1933, to address the burdensome statutory waiting periods and further enhance the changes recommended by MPSC's process improvement effort. MPSC stated that, with the completion of these tasks in 2014, the delay associated with processing intrastate applications will be greatly resolved.

MPSC'S EFFORTS TO ADDRESS CUSTOMER COMPLAINTS

COMMENT

Audit Objective: To assess the effectiveness of MPSC's efforts to ensure that the customers of Michigan's regulated utilities received appropriate and timely responses to their complaints.

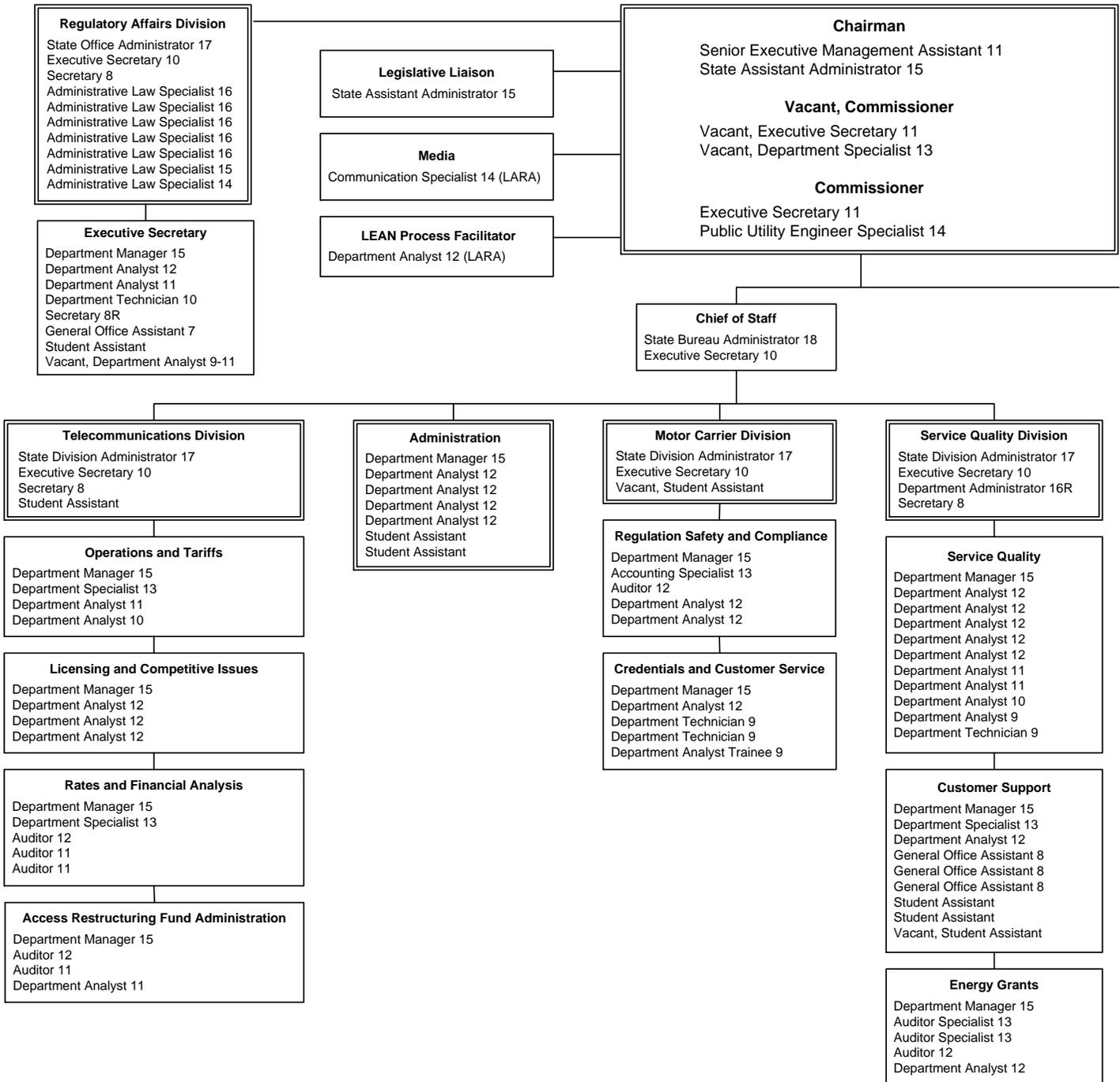
Audit Conclusion: We concluded that MPSC's efforts to ensure that the customers of Michigan's regulated utilities received appropriate and timely responses to their complaints were effective.

Our audit conclusion was based on our audit efforts as described in the audit scope and audit methodology sections. Our audit report does not include any reportable conditions* related to this audit objective. We believe that the results of our audit efforts provide a reasonable basis for our audit conclusion for this audit objective.

* See glossary at end of report for definition.

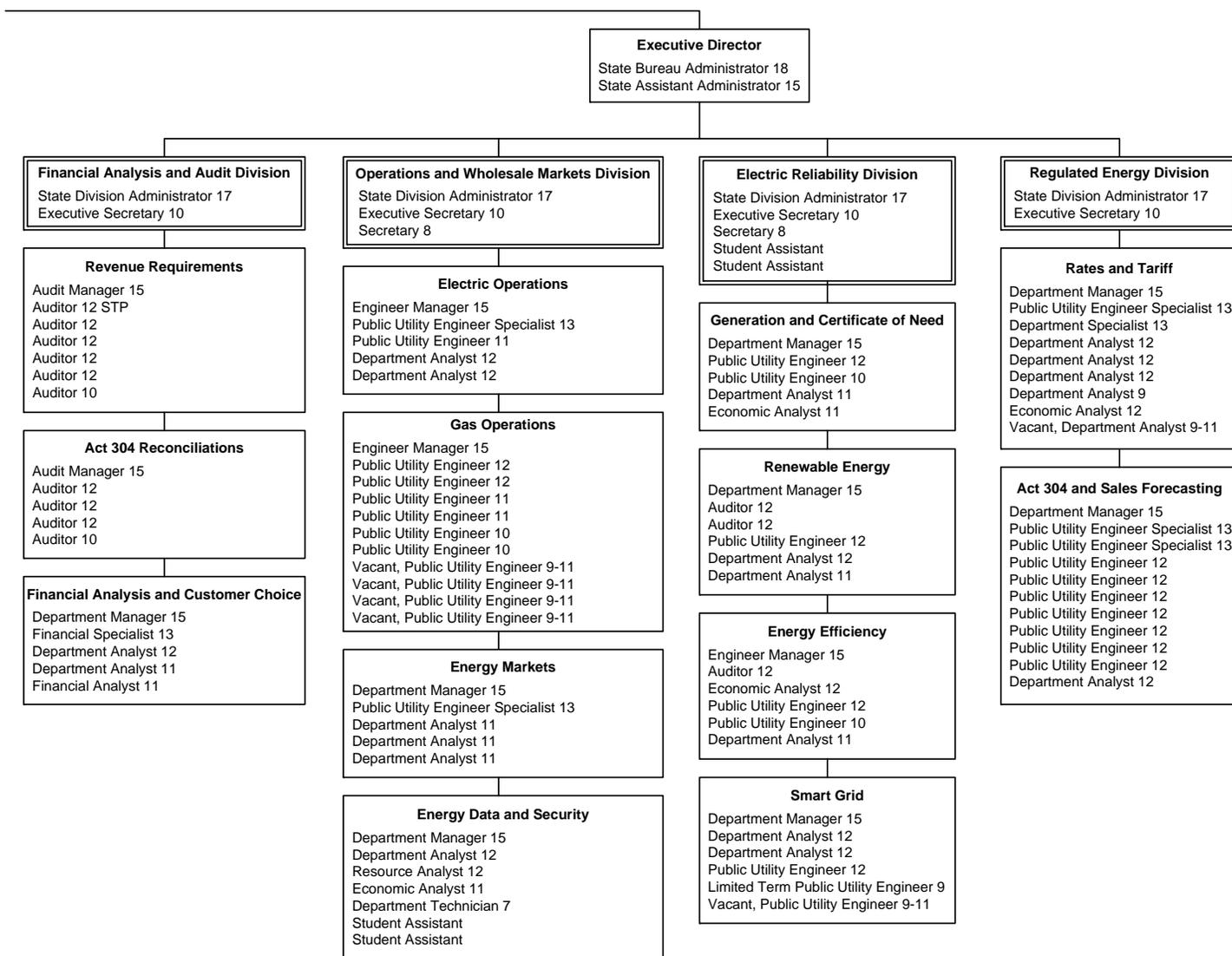
SUPPLEMENTAL INFORMATION

MICHIGAN PUBLIC SERVICE COMMISSION
 Department of Licensing and Regulatory Affairs (LARA)
 Organizational Chart
 As of June 30, 2013



Organizational chart continued on next page.

Source: Michigan Public Service Commission.



GLOSSARY

Glossary of Abbreviations and Terms

CQI	continuous quality improvement.
effectiveness	Success in achieving mission and goals.
efficiency	Achieving the most outputs and the most outcomes practical with the minimum amount of resources.
goal	An intended outcome of a program or an entity to accomplish its mission.
internal control	The plan, policies, methods, and procedures adopted by management to meet its mission, goals, and objectives. Internal control includes the processes for planning, organizing, directing, and controlling program operations. It also includes the systems for measuring, reporting, and monitoring program performance. Internal control serves as a defense in safeguarding assets and in preventing and detecting errors; fraud; violations of laws, regulations, and provisions of contracts and grant agreements; or abuse.
material condition	A matter that, in the auditor's judgment, is more severe than a reportable condition and could impair the ability of management to operate a program in an effective and efficient manner and/or could adversely affect the judgment of an interested person concerning the effectiveness and efficiency of the program.
mission	The main purpose of a program or an entity or the reason that the program or the entity was established.
motor carriers	A carrier of passengers or property in a commercial motor vehicle, which includes a person who owns or leases a commercial motor vehicle or who assigns employees to

operate the vehicle. Motor carrier includes a motor carrier's agents, officers, and representatives as well as employees responsible for hiring, supervising, training, assigning, or dispatching drivers and employees concerned with the installation, inspection, and maintenance of motor vehicle equipment and accessories.

MPSC	Michigan Public Service Commission.
outcome	An actual impact of a program or an entity.
output	A product or a service produced by a program or an entity.
performance audit	An audit that provides findings or conclusions based on an evaluation of sufficient, appropriate evidence against criteria. Performance audits provide objective analysis to assist management and those charged with governance and oversight in using the information to improve program performance and operations, reduce costs, facilitate decision making by parties with responsibility to oversee or initiate corrective action, and contribute to public accountability.
performance measure	A composite of key indicators of a program's or an activity's inputs, outputs, outcomes, productivity, timeliness, and/or quality. Performance measures are a means of evaluating policies and programs by measuring results against agreed upon program goals or standards.
performance standard	A desired level of output or outcome.
regulated utility	An electric, a gas, or a telephone company that provides services that are subject to the jurisdiction of MPSC.
reportable condition	A matter that, in the auditor's judgment, is less severe than a material condition and falls within any of the following categories: an opportunity for improvement within the

context of the audit objectives; a deficiency in internal control that is significant within the context of the audit objectives; all instances of fraud; illegal acts unless they are inconsequential within the context of the audit objectives; significant violations of provisions of contracts or grant agreements; and significant abuse that has occurred or is likely to have occurred.

