COMPLIANCE AND CONTROL AUDIT REPORT

Kansas Corporation Commission

A Report to the Legislative Post Audit Committee
By the Legislative Division of Post Audit
State of Kansas
October 1997

98-A

Legislative Post Audit Committee

Legislative Division of Post Audit

The Legislative Post Audit Committee and its audit agency, the Legislative Division of Post Audit, are the audit arm of Kansas government. The programs and activities of State government now cost about $8 billion a year. As legislators and administrators try increasingly to allocate tax dollars effectively and make government work more efficiently, they need information to evaluate the work of government agencies. The audit work performed by Legislative Post Audit helps provide that information.

We conduct our audit work in accordance with applicable government auditing standards set forth by the U. S. General Accounting Office. These standards pertain to the auditor's professional qualifications, the quality of the audit work, and the characteristics of professional and meaningful reports. These audit standards have been endorsed by the American Institute of Certified Public Accountants and adopted by the Legislative Post Audit Committee.

The Legislative Post Audit Committee is a bipartisan committee comprising five senators and five representatives. Of the Senate members, three are appointed by the President of the Senate and two are appointed by the Senate Minority Leader. Of the representatives, three are appointed by the Speaker of the House and two are appointed by the House Minority Leader.

As part of its audit responsibilities, the Division is charged with meeting the requirements of the Legislative Post Audit Act which address audits of financial matters. Those requirements call for two major types of audit work.

First, the Act requires an annual audit of the State's financial statements. Those statements, prepared by the Department of Administration's Division of Accounts and Reports, are audited by a certified public accounting firm under contract with the Legislative Division of Post Audit. The firm is selected by the Contract Audit Committee, which comprises three members of the Legislative Post Audit Committee (including the Chairman and Vice-Chairman), the Secretary of Administration, and the Legislative Post Auditor. This audit work also meets the State's audit responsibilities under the federal Single Audit Act.

Second, the Act provides for a regular audit presence in every State agency by requiring that audit work be conducted at each agency at least once every three years. Audit work done in addition to the annual financial statement audit focuses on compliance with legal and procedural requirements and on the adequacy of the audited agency's internal control procedures. These compliance and control audits are conducted by the Division's staff under the direction of the Legislative Post Audit Committee.

LEGISLATIVE POST AUDIT COMMITTEE

Representative Eugene Shore, Chair
Representative Richard Alldritt
Representative Doug Mays
Representative Ed McKechnie
Representative Dennis Wilson

Senator Lana Oleen, Vice-Chair
Senator Anthony Hensley
Senator Pat Ranson
Senator Chris Steineger
Senator Ben Vidricksen

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September 30, 1997

To: Members, Legislative Post Audit Committee

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This report contains the findings and conclusions from our completed compliance and control audit of the Corporation Commission.

The Commission generally ensures that its own spending adheres to applicable restrictions. Further, the Commission generally ensures that grantees appropriately spend moneys received from the Commission. Nevertheless, some improvements are needed in the Commission's oversight of local spending.

We would be happy to discuss these recommendations or any other items in the report with any legislative committees, individual legislators, or other State officials.

Barbara J. Hinton

Barbara J. Hinton
Legislative Post Auditor

EXECUTIVE SUMMARY

LEGISLATIVE DIVISION OF POST AUDIT

Question 1: Did the Corporation Commission's Financial-Management Practices Ensure That it Complied With State and Federal Spending Restrictions?

The Commission generally has established adequate procedures to ensure that it complies with spending restrictions. *These practices identify restrictions on the use of moneys, account for each type of restricted moneys separately, and provide supervisory oversight to ensure proper spending. Further, our tests showed the Commission effectively applied these procedures during fiscal year 1997.* .... page 2

Question 2: Did the Corporation Commission's Procedures Ensure That Local Agencies Spent Moneys Appropriately?

The Commission's oversight practices generally are adequate to ensure that local agencies spend grant moneys appropriately, but some improvements are necessary. *The Commission has established monitoring procedures, but some of them - such as on-site monitoring and receipt of local agency audits - aren't being followed. Further, the Commission needs to establish a procedure ensuring that salary reimbursements to local agencies are for employees who are working only on grant activities.* .... page 4

Recommendation .... page 6

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This audit was conducted by Jerry Fair. If you need any additional information about the audit's findings, please contact Ms. Fair at the Division's offices. Our address is: Legislative Division of Post Audit, 800 SW Jackson Street, Suite 1200, Topeka, Kansas 66612. You also may call (785) 296-3792, or contact us via the Internet at: **LPA@mail.ksleg.state.ks.us.**

CORPORATION COMMISSION

The Legislative Division of Post Audit has conducted compliance and control audit work at the Kansas Corporation Commission covering fiscal year 1997. Compliance and control audits identify noncompliance with applicable requirements and poor financial-management practices. The resulting audit findings often identify needed improvements that can help minimize the risk of potential future loss or misuse of State resources.

At the direction of the Legislative Post Audit Committee, this audit focused on how the Corporation Commission ensures that restricted moneys are properly used, and on its oversight of grants to local agencies. The audit addresses the following specific questions:

1. **Did the Corporation Commission's financial-management practices ensure that it complied with State and federal spending restrictions?**

2. **Did the Corporation Commission's procedures ensure that local agencies spent moneys appropriately?**

To answer these questions, we identified applicable legal spending restrictions and standard financial-management practices that would help the Corporation Commission ensure that it spends its own restricted moneys properly, and provides adequate oversight of subrecipients spending. We reviewed the Corporation Commission's written procedures, interviewed appropriate Commission personnel, and reviewed a sample of grants to local agencies to see if the Commission's procedures were consistent with those practices. In conducting this audit work, we followed all applicable government auditing standards set forth by the U.S. General Accounting Office.

Our findings are discussed on the following pages.

Did the Corporation Commission's Financial-Management Practices Ensure That It Complied with State and Federal Spending Restrictions?

The Corporation Commission's financial-management practices generally are well designed, and the way they're being applied is likely to ensure that restricted State and federal funds aren't misspent. Among other practices, the Commission has established both a method to allocate costs shared by different programs or funds in a logical and consistent manner and a system of review by various staff.

The Corporation Commission Generally Has Established Adequate Procedures to Ensure that It Complies with State and Federal Spending Restrictions

During fiscal year 1997, the Corporation Commission received a federal grant of approximately $471,000 from the U.S. Department of Energy for State-administered programs. The Commission also spent approximately $1.1 million in abandoned oil well funds, and $3.7 million from the Conservation Fee Fund.

To comply with applicable restrictions and to limit the State's potential future financial liability for misspending any federal funds, the Commission should take steps to ensure that these restricted moneys are spent properly. To do this, the Commission should have put in place certain financial-management practices, including the following:

- identifying any restrictions on the use of its moneys, particularly those restrictions imposed by law or regulation
- accounting for each type of restricted money separately from other moneys, so that the Commission knows how each type of restricted money is spent
- requiring supervisory oversight to ensure that costs charged to a program actually were incurred by that program
- requiring business office review of expenditure documents to ensure that supervisory oversight has taken place
- checking for consistency between program costs and the funds from which those costs are paid, to identify programs whose costs shouldn't be paid from certain funds
- allocating joint costs shared by several programs or funds on a logical, consistent basis, so that each program or fund pays only its proper share of those costs.

To find out the Commission's practices in this area, we interviewed Commission officials, reviewed written procedures, and examined a sample of applicable documents. We found that the Commission's practices generally were well designed and consistent with the "good practices" outlined above.

Did the Corporation Commission's Procedures Ensure That Local Agencies Spent Moneys Appropriately?

Federal regulations require the Corporation Commission, when awarding and administering a subgrant, to ensure that the subgrantee is aware of requirements imposed on it by federal laws and regulations. They also require the Commission to monitor each subgrant-supported program, function, or activity to ensure compliance with applicable federal requirements. Although the Commission has established practices regarding the oversight of subgrant expenditures, we found that some required practices either aren't in place, or aren't being applied in a manner likely to ensure that federal funds aren't misspent.

The Commission's Oversight Practices Generally Are Adequate To Ensure That Local Agencies Spend Grant Moneys Appropriately, But Some Improvements Are Necessary

During fiscal year 1997, the Corporation Commission transferred about $725,000 in federal moneys to local entities, such as school districts, hospitals, and nonprofit agencies. About 80% of this amount was Petroleum Violation Escrow funds–moneys the federal government collects from oil companies as a result of winning a lawsuit against those companies for overcharging consumers. These moneys are then distributed to the various states, including Kansas. Although the Escrow funds are considered State funding for subrecipients, federal guidelines apply as to which costs can be charged to those funds. The remaining 20% of the moneys transferred to local entities was received by the Commission from the U.S. Department of Energy.

The Commission uses a portion of the above moneys to make Institutional Conservation Program grants, which can be used to install energy-efficient heating, cooling, and lighting systems. The Commission makes other grants to support energy-saving activities such as recycling, ridesharing, and relevant education. The amounts of the grants ranged from $5,000 to $100,000.

The Commission is responsible for ensuring that local entities properly use the moneys they receive. To do so, the Commission should have put in place certain oversight practices. Those practices would include the following, as applicable:

- reviewing and approving local spending plans
- reimbursing local expenditures, rather than providing moneys in advance, and reviewing supporting documentation for the local expenditures to be reimbursed

- conducting periodic on-site reviews to determine how the local agencies are using moneys they get from the Department

- requiring the local agencies to obtain periodic independent audits

- following up on and resolving any discrepancies noted by the reviews and audits

To find out the Commission practices in this area, we interviewed appropriate agency officials, reviewed written procedures, and examined a sample of applicable documents. Our review focused on whether oversight procedures existed, and their likely effectiveness in revealing any misspending.

Generally, the Commission has established adequate practices to ensure that State and local moneys are spent appropriately. However, it is not consistently applying these practices and some additional procedures are needed.

The Commission didn't follow some practices that are required, or that would better ensure that moneys are spent properly at the local level. If local spending is inappropriate and federal grant moneys are involved, the federal granting agency will hold the Commission responsible for that inappropriate local spending. Thus, strong Commission oversight of local spending not only helps ensure that local spending is appropriate, but it also reduces the risk of financial liability on the part of the State. Those areas where the Commission needs improvement are as follows:

- Although Commission staff closely reviewed subrecipient expenditures for proper documentation, they didn't compare actual expenditures to the original local grant budget to ensure that local spending was consistent with the approved plan. Also, the approved monitoring plan for grant subrecipients allows only a 10% variance for each budget line. If this variance is exceeded, the cost must either be disallowed or the budget amended and reapproved. A comparison would ensure that the allowed variance was not exceeded and that expenditures were appropriate.

- Commission staff didn't conduct formal on-site reviews of local activities, even though it agreed to do such reviews in its application for federal grant moneys and has an established on-site review procedure. The Commission did some informal monitoring of local programs, but that monitoring didn't meet the requirement for formal on-site reviews. Formal on-site reviews would help ensure that local programs funded by the Commission are operated properly and would reduce the risk of inappropriate activities being conducted.

- Except for local agencies which received funding under the Institutional Conservation Program, the Commission didn't have a way to ensure that it received required audit reports from local agencies. Such audits, required by the federal Single Audit Act, identify problems such as questionable spending. When the Commission did receive audit reports from local agencies, grant management staff didn't know how to review those reports for adverse findings and questioned costs. Both these situations result in a risk that the Commission may be unaware of inappropriate local spending, even if it's identified by the local agencies' auditors. If inappropriate spending involves federal moneys received through the Commission, the federal granting agency will hold the Commission responsible for that problem.

- When local agencies requested reimbursement of salaries by the Commission, the Commission didn't always obtain documentation for the time spent. This situation existed primarily when the salary was for a person assumed to be working full time on the grant project or when a maximum percentage allocation had been set. As a result, the Commission had no assurance that the salaries reimbursed were for time spent on allowable activities. This results in a risk that the Commission is reimbursing inappropriate local spending.

Recommendation

1. To provide for adequate oversight of federal funds it distributes to local agencies, the Corporation Commission should do the following:

    a. institute a procedure for comparing subgrantee's budgeted and actual costs and either authorizing or disapproving expenditures that aren't part of the approved grant or that exceed the allowed variance

    b. improve on-going monitoring of local spending by using the established formal procedure for on-site reviews and keeping records of informal discussions

    c. institute a method of ensuring receipt of audits since they are required for federal subrecipients and are part of the State contracts with subrecipients

    d. institute a method of ensuring both review of audits received and follow-up on applicable audit findings

    e. require local agencies to document actual time spent on grant work when the agency submits a request for salary reimbursement.

APPENDIX A

Agency Response

On September 12, 1997, we provided a copy of the draft audit report to the Corporation Commission. The Commission's response is included as this Appendix.

Kansas Corporation Commission

Bill Graves, Governor   Timothy E. McKee, Chair   Susan M. Seltsam, Commissioner   John Wine, Commissioner
Judith McConnell, Executive Director   David J. Heinemann, General Counsel

September 18, 1997

RECEIVED
SEP 22 1997
LEGISLATIVE POST AUDIT

Barbara J. Hinton, Legislative Post Auditor
Division of Legislative Post Audit
Mercantile Bank Tower
800 SW Jackson, Suite 1200
Topeka, Kansas 66612-2212

Dear Ms. Hinton:

The Kansas Corporation Commission appreciates the opportunity to respond to the draft copy of the Division of Legislative Post Audit's compliance and control audit of the Commission.

The Commission has reviewed the draft report and we are in agreement with the recommendations for improvement contained in the report. The recommendations affect the Commission's energy programs. These programs have been the responsibility of the Commission since 1983 and have evolved largely in response to federal changes and declining federal funding levels.

The audit gave us an opportunity to step back and scrutinize these programs with a degree of thoroughness often not achieved when meeting the day-to-day demands of program management. Additionally, the Commission greatly benefitted from the objectivity and professional advice of the auditors. Most of the auditor's recommendations for improvement can, and will, be implemented immediately. We have been asked to respond to each audit recommendation addressed in the report; our response is attached as Exhibit A.

Finally, we look forward to visiting with the auditors in the future about the suggestions they have made and what we can do to continue to implement improvement in our financial management practices.

Sincerely,

JOHN WINE
Chair

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Exhibit A - Revised

Kansas Corporation Commission Response to Compliance and Control Audit Conducted by the Legislative Division of Post Audit

September 22, 1997

Item 1a: Procedural Recommendation Regarding Expenditure Comparisons. The Commission believes that it has sufficient internal controls to ensure that subgrantees are expending federal grant monies in accordance with budgeted expenditure categories and that such expenditures are consistent with and meet applicable federal requirements. The vast majority of the Commission's subgrantees do in fact take the initiative to request advance approval to move money from one budgeted expenditure category to another. Energy program managers as well as several fiscal staff accountants review invoices prior to payment authorization. Each review is discretely different and complements the review of others. These reviews ensure that all state and federal legal, contractual, and fiscal obligations are met. The degree of thoroughness that this review process lends itself to, meets (and often exceeds) federal requirements and has been so noted as part of previous DOE audits of Commission accounting procedures and federal subgrantee expenditures. Commission experience with the administration of DOE grants leads us to conclude that DOE objective focus primarily on the mutual establishment of program goals and the attainment of these goals. The DOE has granted increased flexibility to the states with respect to the internal management of such funds if managed within total approved budgets and with a demonstrated record of achievement of overall program goals and objectives.

Item 1b: Monitoring of Local Spending. The official State Energy Program (SEP) Plan submitted and approved by the U.S. Department of Energy will be modified to reflect that an onsite monitoring visit will occur for a minimum of 50% of SEP subgrantees and 5% of Institutional Conservation Program (ICP) subgrantees. Other routine desk audits (including telephone and informal personal contact and written correspondence) will continue with as much documentation as is practical.

Item 1c: Audits of Subrecipients. A "checklist" for each subgrantee file will be established to assure the proper audit(s) have been received and reviewed; implementation of this procedure should provide assurance that follow-up contact will be accomplished if required audit(s) are not received. This procedure may encompass a two or three year period due to overlapping fiscal years versus calendar years.

Item 1d: Review of Audits and Appropriate Follow-Up. In conjunction with the checklist mentioned in 1c above, more aggressive efforts will be taken with respect to follow-up on applicable audit findings. In cases where technical staff needs assistance interpreting complex audits, fiscal office accountants, certified public accountants employed in the Commission's Utilities Division, and/or legal staff will be consulted and this type of follow-up action will be documented on the checklist.

Item 1e: Documentation of Time Spent on Grant Work. The Commission presently requires documentation of actual time spent on grant work; however, the degree of compliance varies. The Commission staff will increase its level of effort in this regard in order to achieve a better compliance record. This particular audit finding might provide the KCC with some added leverage in its ongoing efforts to achieve compliance.