A REPORT
TO THE
MONTANA
LEGISLATURE

FINANCIAL-COMPLIANCE AUDIT

Department of Public Service Regulation

For the Two Fiscal Years Ended June 30, 2018

MAY 2019

LEGISLATIVE AUDIT DIVISION

18-26

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Financial-Compliance Audits

Financial-compliance audits are conducted by the Legislative Audit Division to determine if an agency's financial operations are properly conducted, the financial reports are presented fairly, and the agency has complied with applicable laws and regulations. In performing the audit work, the audit staff uses standards set forth by the American Institute of Certified Public Accountants and the United States Government Accountability Office. Financial-compliance audit staff members hold degrees with an emphasis in accounting. Most staff members hold Certified Public Accountant (CPA) certificates.

The Single Audit Act Amendments of 1996 and the Uniform Administrative Requirements, Cost Principles, and Audit Requirements for Federal Awards require the auditor to issue certain financial, internal control, and compliance reports in addition to those reports required by *Government Auditing Standards*. This individual agency audit report is not intended to comply with these reporting requirements and is therefore not intended for distribution to federal grantor agencies. The Legislative Audit Division issues a statewide biennial Single Audit Report which complies with the above reporting requirements. The Single Audit Report for the two fiscal years ended June 30, 2017, was issued March 23, 2018. The Single Audit Report for the two fiscal years ended June 30, 2019, will be issued by March 31, 2020.

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LEGISLATIVE AUDIT DIVISION

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May 2019

The Legislative Audit Committee
of the Montana State Legislature:

This is our financial-compliance audit report on the Department of Public Service Regulation for the two fiscal years ended June 30, 2018. Included in this report are six recommendations related to accounting errors, compliance with state laws and policies, and internal controls. We qualified our opinion on the Schedule of Changes in Fund Equity for fiscal year 2017, because the Prior Year Expenditures & Transfers-Out and the Budgeted Expenditures & Transfers-Out were misleading in the State Special and Federal Special Revenue Funds. Our opinion on the Schedule of Total Revenues & Transfers-In in fiscal year 2018 was adverse because the accounting errors were material and pervasive on the schedule in fiscal year 2018. An adverse opinion means you cannot rely on the information presented on the Schedule of Total Revenues & Transfers-In for fiscal year 2018. A qualified opinion means you should use caution when using the Schedule of Changes in Fund Equity for fiscal year 2017.

We thank the Commissioners and their staff for their cooperation and assistance throughout the audit. The department's response to the recommendations is on page C-1.

Respectfully submitted,

/s/ Angus Maciver

Angus Maciver
Legislative Auditor

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Elected and Administrative Officials

		Term Expires
Public Service Commission	Brad Johnson, Chair	January 2023
	Bob Lake, Vice Chair	January 2021
	Randy Pinocci	January 2023
	Roger Koopman	January 2021
	Tony O'Donnell	January 2021

Administrative Officials

Mandi Hinman, Administrator, Centralized Services Division

Justin Kraske, Administrator, Legal and Consumer Division

Will Rosquist, Administrator, Regulatory Division

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Montana Legislative Audit Division

Financial-Compliance Audit
Department of Public Service Regulation
For the Two Fiscal Years Ended June 30, 2018

May 2019 18-26 Report Summary

Under the direction of the Public Service Commission, the Department of Public Service Regulation is responsible for assuring the public receives safe, sufficient, and economical utility and transportation services at reasonable rates. Our audit identified three material weaknesses and one significant deficiency in internal controls. We issued an adverse opinion on the department's Schedule of Total Revenues & Transfers-In in fiscal year 2018, meaning a reader cannot rely on the information presented. We issued a qualified opinion on the Schedule of Changes in Fund Equity for fiscal year 2017, meaning a reader should use caution when using the schedule.

Context

The Department of Public Service Regulation (department) is charged with assuring the public receives safe and satisfactory utility and transportation services at reasonable rates. The department is responsible for regulating certain public utilities, motor carriers, railroads, and pipelines within the state, and performs safety inspections of regulated activities under the direction of the Public Service Commission.

The department's 35 full-time equivalent (FTE) positions (as of June 30, 2018) consist of five commissioners, a Communications Director, and staff in the Regulatory Division, Centralized Services Division, and Legal and Consumer Division. Commissioners are elected by district and serve four-year terms.

Most department funding comes from a tax on the gross operating revenue of regulated companies collected by the Montana Department of Revenue. In fiscal years 2017 and 2018, the tax generated over $4 million annually. The tax is presented as a Direct Entry to Fund Equity on the Schedules of Changes in Fund Equity. The department also received federal grant funding for the National Gas Pipeline Safety Program.

Results

We audited fiscal years 2017 and 2018 financial schedules and tested compliance with state laws. We reviewed federal revenues and expenditures, expenditures disbursed for personal services, other services expenditures in the State Special Revenue Fund, direct entries to fund equity, budget authority, and revenue estimates. We also considered the implementation of the prior audit recommendations. Our audit identified three material weaknesses and one significant deficiency in internal controls. Our audit resulted in six recommendations to the department. We recommended the department develop and implement internal controls over revenue estimates, Note Disclosures, and Direct Entries to Fund Equity. Federal revenues, expenditures, and receivables were not correctly recorded in

(continued on back)

fiscal years 2017 or 2018. We recommended the department strengthen controls over requests for federal reimbursement, and record federal financial activity correctly. Finally, we recommended the department comply with state law over the hiring of consultants.

Recommendation Concurrence	
Concur	6
Partially Concur	0
Do Not Concur	0

Source: Agency audit response included in final report.

For a complete copy of the report (18-26) or for further information, contact the Legislative Audit Division at 406-444-3122; e-mail to **lad@mt.gov**; or check the web site at **https://leg.mt.gov/lad/audit-reports**
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Chapter I – Introduction

Introduction

We performed a financial-compliance audit of the Department of Public Service Regulation (department) for the two fiscal years ended June 30, 2018. The objectives of the audit were to:

1. Obtain an understanding of the department's internal controls to the extent necessary to support our audit of the department's financial schedules and, if appropriate, make recommendations for improvements in management and internal controls of the department.
2. Determine whether the department complied with selected state laws and regulations.
3. Determine whether the department's financial schedules present fairly the results of operations and changes in fund equity for each of the two fiscal years ended June 30, 2018.
4. Determine implementation status of prior audit recommendations.

Background Information

The department operates under the direction of the Public Service Commission (commission). The commission consists of five voting members who are elected on a district basis and serve a term of four years. After each general election, commissioners elect a chairman and vice chairman to serve until the next general election. The chairman exercises authority on behalf of the commission. The department's responsibility is to assure the public receives safe and adequate utility and transportation services at reasonable rates. The department is responsible for the regulation of certain public utilities, motor carriers, railroads, and pipelines within the state, and performs safety inspections of regulated activities under the direction of the commission.

The department's 35 full-time equivalent (FTE) positions (as of June 30, 2018) consist of five commissioners, Communications Director, and staff of the following three divisions:

- **The Regulatory Division** (16 FTE) advises the commission on the activities of the regulated public utilities, including rate determination and safety standards. The division also exercises general supervisory control over the activities of motor carriers and railroads.
- **The Centralized Services Division** (6 FTE) provides financial, human resources, information technology, and administrative support to the department.

- **The Legal and Consumer Division** (7 FTE) advises the commission on matters requiring a legal interpretation or opinion, represents the commission in legal proceedings, and assists with customer complaints and issues.

The aggregate of the department's expenditure activity is shown in the Public Service Regulation Program on pages A-7 and A-8. The department is primarily funded by a fee levied on regulated companies to fund amounts appropriated by the legislature for a specific fiscal year as required by §69-1-402, MCA. The fee is based upon a percentage of the gross operating revenue of all activities regulated by the commission for each calendar quarter of operation.

Prior Audit Recommendations

The prior audit had three recommendations. Prior audit Recommendation #1 was for the department to comply with state policy by accruing federal revenue at fiscal year-end. The department partially implemented the prior audit recommendation as described in Recommendation #5 starting on page 10 of this report.

Prior audit Recommendation #2 recommended the department develop and implement internal controls to ensure the completeness and accuracy of the fee charged by Department of Revenue on the department's behalf. The department has not implemented the recommendation, and the current report includes an updated recommendation starting on page 7.

Prior audit Recommendation #3 was related to compliance with state policy requirements for uncollected receivables. We recommended the department: A) Implement procedures to collect tax identification numbers from regulated companies who have proceedings before the commission, and B) Comply with state policy and transfer receivables to the Department of Revenue (DOR) or an outside collection agency after all reasonable attempts to collect the receivable. The department began collecting the tax IDs from transportation companies during the current audit period, but was not yet able to collect tax IDs from utility companies. Therefore, part A is partially implemented. We recommended part B because the department had written off accounts receivable without first transferring them to DOR as required by state law. They did not transfer receivables to the DOR or an outside collection agency during the current audit period, because they have not yet completed all reasonable attempts to collect the receivable. The department also kept the receivable on their books and did not write them off. They still have a chance to collect on the receivables in the future. As such, we considered part B partially implemented as well. We are not making a further recommendation at this time, because the department did not write off accounts receivable without attempting to collect them. We will assess the status of the recommendation in the next audit.

Chapter II – Findings and Recommendations

One of the objectives of our audit is to express an opinion on the Department of Public Service Regulation (department) financial schedules. An unmodified opinion means the schedules present fairly the results of operations and changes in fund equity. We issued an adverse opinion on the department Schedule of Total Revenues & Transfers-In for the fiscal year ended June 30, 2018. This means information in the schedule cannot be relied upon. We also issued a qualified opinion on the Schedule of Changes in Fund Equity for fiscal year 2017. This means readers should use caution when using the schedule. Table 1 and Table 2 below summarize the errors in the financial schedules giving rise to our opinion modifications.

In fiscal year 2017, personnel reclassified six months of the Gas Pipeline Safety Program expenditures via a Prior Year Expenditure & Transfers-Out Adjustment between the State Special Revenue Fund (SSRF) and the Federal Special Revenue Fund (FSRF) on the Schedule of Changes in Fund Equity, causing the department's Schedule of Changes in Fund Equity to be misleading as summarized below. Recommendation #5 further describes the issue.

Table 1

Errors in the Schedule of Changes in Fund Equity for the Fiscal Year Ended June 30, 2017

	State Special Revenue Fund			Federal Special Revenue Fund		
	Amount Reported	Over(Under) Statement	Correct Amount	Amount Reported	Over(Under) Statement	Correct Amount
Budgeted Expenditures & Transfers-Out	$3,677,129	$77,566	$3,599,563	$69,960	$(77,566)	$147,526
Prior Year Expenditures & Transfers-Out Adjustments	$(77,566)	$(77,566)	-	$77,566	$77,566	-

Source: Compiled by the Legislative Audit Division from the Statewide Accounting, Budgeting, and Human Resources System (SABHRS).

In fiscal year 2018, the errors on the Schedule of Total Revenues & Transfers-In were material and pervasive as summarized below.

- The department did not record Charges for Services Revenues in the SSRF as required by state law. Recommendation #6 further describes the issue.
- Federal Revenue was not recorded correctly, as explained in Recommendation #5.

- The department doubled its revenue estimates in the FSRF, as explained in Recommendation #1.
- The department recorded SSRF revenue estimates for revenues not collected by the department as explained in Recommendation #1.

Table 2

Errors in the Schedule of Total Revenues & Transfers-In for Fiscal Year 2018

	State Special Revenue Fund			Federal Special Revenue Fund		
	Amount Reported	Over(Under) Statement	Correct Amount	Amount Reported	Over(Under) Statement	Correct Amount
Charges for Services	$22,348	($10,388)	$32,736			
Federal				$174,062	$19,000	$155,062
Total Revenues & Transfers-In	$39,553	($10,388)	$49,941	$174,214	$19,000	$155,214
Actual Budgeted Revenues & Transfers-In	$39,501	($10,388)	$49,889	$174,062	$19,000	$155,062
Estimated Revenues & Transfers-In	$4,541,881	$4,491,881	$50,000	$418,000	$200,000	$218,000
Budgeted Revenues & Transfers-In Over (Under) Estimate	($4,502,380)	($4,502,269)	($111)	($243,938)	($181,000)	($62,938)
BUDGETED REVENUES & TRANSFERS-IN OVER (UNDER) ESTIMATED BY CLASS						
Charges for Services	($4,504,585)	($4,502,269)	($2,316)			
Federal				($243,938)	($181,000)	($62,938)

SOURCE: Compiled by the Legislative Audit Division, from the Statewide Accounting, Budgeting, and Human Resources System (SABHRS).

As discussed in the following four report sections, the department has room to improve its internal controls over accounting and financial reporting.

Internal Controls

State policy requires management to establish and maintain agency internal controls. Part of that responsibility involves establishing policies and procedures designed to safeguard agency assets, check the accuracy and reliability of financial data, promote operational efficiency, and encourage adherence to prescribed managerial policies and compliance with applicable laws and regulations. During the audit of the department, we identified multiple deficiencies in internal controls.

Auditing standards require us to consider whether control deficiencies identified during an audit rise to the level of significant deficiencies or material weaknesses. A material weakness is a deficiency in internal control, such that there is a reasonable possibility that a material misstatement of the entity's financial schedules will not be prevented, or detected and corrected, on a timely basis. A significant deficiency is a deficiency, or a combination of deficiencies, in internal control that is less severe than a material weakness yet important enough to merit attention by those charged with governance. Some of the identified control deficiencies were material weaknesses or significant deficiencies as described below.

The department is a small state agency, so it is difficult for staff to develop the expertise necessary to enter and review complex accounting entries in the state's accounting system, and to draft and review the financial schedule notes. Traditionally, Centralized Services personnel have taken all accounting processes on themselves. However, as the department implements the recommendations described below, management should consider whether other department resources can be reallocated to strengthen internal controls. Management should also use state accounting training and resources when creating new controls over complex accounting processes. Accounting decisions require research of state laws, policies, and accounting standards. State accounting staff are also available to answer questions if a decision cannot be made through research alone.

An Absence of Internal Controls Led to Misstated Revenue Estimates

Revenue estimates are materially misstated for both fund types in fiscal year 2018, and controls over revenue estimates are missing.

The Department of Revenue (DOR) collects fees on behalf of the department. In this role, the DOR records both a revenue estimate and deposits the collected fees into a State Special Revenue Fund account shared with the department. The department records expenditures in this shared fund throughout the fiscal year. During the fiscal year-end closing process completed by the Department of Administration, the cash collected and deposited into the shared fund by DOR is moved to the department via a direct entry to fund equity. The activity is not presented on the department's Schedule of Revenues &Transfers-In. Accordingly, the department should not record a revenue estimate for the fees. However, department staff erroneously entered revenue estimates in the state's accounting records for this activity in fiscal year 2018. Consequently, in fiscal year 2018, the reported Estimated Revenues & Transfers-In in the State Special Revenue Fund column of the department's Schedule of Total Revenues & Transfers-In is overstated by over $4,500,000.

In addition, in fiscal year 2018, department personnel inadvertently recorded a $200,000 revenue estimate twice in the Federal Special Revenue Fund. As a result, revenue estimates in that fund type were nearly doubled. The reported Estimated Revenues & Transfers-In in the Federal Special Revenue Fund column of the department's Schedule of Total Revenues & Transfers-In are overstated by $200,000 for fiscal year 2018.

The department did not have documented controls over revenue estimates to prevent and detect material misstatements during the audit period, and the resulting errors contributed to our adverse opinion on the Schedule of Total Revenues & Transfers-In for fiscal year 2018. Because it led to material misstatements, we consider the control deficiency a material weakness, as is reported in our Report on Internal Control Over Financial Reporting and on Compliance and Other Matters Based on an Audit of Financial Schedules Performed in Accordance with *Government Auditing Standards* on page B-1. To ensure the department's financial schedules present reasonable revenue estimate amounts, the department should develop internal controls. For example, the department can run reports in the state's accounting system to review revenue estimates prior to fiscal year-end.

Recommendation #1

We recommend the Department of Public Service Regulation develop and implement internal controls to ensure revenue estimates are accurate.

Note Disclosures

Controls should be strengthened to prevent misleading note disclosures.

The Notes presented on page A-11 give the reader more detail on the department's financial information. They are written by department personnel and audited by our audit staff. To comply with state policy requirements, the department should have appropriate internal controls in place to ensure the notes provided as part of the audit are free from material misstatement prior to the audit process.

We reviewed the notes provided by the department during the audit, communicated identified misstatements, and requested the department correct the notes. During the audit, the department's original note disclosures contained misleading or inaccurate information, such as a discussion of General Fund activity when there is no General Fund presented on the financial schedules in either fiscal years 2017 or 2018.

The department's second set of note disclosures contained more errors, such as a title of 'revenue collected' with no discussion of revenue collected and a discussion of compliance issues unrelated to the financial schedules. The errors considered in total, made the disclosures materially misleading to a reader. We communicated these items, and the department corrected them.

While the errors were ultimately corrected, they are indication of a weakness in internal controls over preparation of the note disclosures. The current process involves two people writing the notes together without a review by personnel not involved in the note drafting process. Controls should be strengthened to include a review by knowledgeable personnel prior to the audit process. We consider the deficiency in internal controls to be a material weakness, given the department's procedures did not prevent, or detect and correct, material misstatements in the note disclosures. This material weakness is reported in our Report on Internal Control Over Financial Reporting and on Compliance and Other Matters Based on an Audit of Financial Schedules Performed in Accordance with *Government Auditing Standards* on page B-1.

Recommendation #2

We recommend the Department of Public Service Regulation develop and implement internal controls over note disclosure development.

Controls Over Direct Entries to Fund Equity

The department has not developed internal controls over the fee calculated and collected on its behalf by the Department of Revenue, as recommended in the prior audit.

The department is primarily funded by a quarterly fee levied on all regulated companies within the state. This fee is based on the percentage of gross operating revenue of all activities regulated by the Public Service Commission and calculated and collected by the Department of Revenue (DOR) on behalf of the department. DOR deposits the collected fee into a State Special Revenue Fund (SSRF) account shared with the department. The department records expenditures in this shared fund throughout the fiscal year. During the fiscal year-end closing process completed by the Department of Administration, the cash collected and deposited into the shared fund by DOR is moved to the department via a direct entry to fund equity. The direct entries were over $4 million in both fiscal years 2017 and 2018.

Our prior audit determined the department did not have controls in place to ensure the fee calculated and collected by DOR, and the corresponding direct entry to fund equity, were accurate. The department has traditionally relied on DOR to have controls in place to collect the fee correctly and deposit all the money into the shared SSRF. During our current audit, department personnel indicated they have not developed any new controls over the fee collected by DOR, because they did not understand why controls are necessary in both agencies. Without such internal controls, department personnel do not know whether the department is receiving all the funds to which it is entitled, and their financial schedules could be materially misstated. As a result, we reviewed DOR's internal controls and questioned DOR personnel about the direct entries during the audit, because department personnel did not know if the direct entry amounts were reasonable. Department management must take responsibility for implementing internal controls and reviewing financial information affecting their financial schedules. They cannot rely on DOR's internal controls or the work of external auditors to make sure their financial information is complete and accurate. The audit process would be more efficient if the department had considered the accuracy and completeness of the cash recorded to the fund during the fiscal years being tested. Because of the risk of material misstatement, the control deficiency rises to the level of a material weakness and is reported as such in the Report on Internal Control Over Financial Reporting and on Compliance and Other Matters Based on an Audit of Financial Schedules Performed in Accordance with *Government Auditing Standards* on page B-1.

Department personnel indicated they have begun discussing this issue with DOR personnel, and anticipate the department will have an internal policy in place by before the next calculation takes place in September of 2019. To ensure the accuracy and completeness of the fiscal year 2019 direct entry, however, the department should implement internal controls prior to fiscal year-end 2019.

Recommendation #3

We recommend the Department of Public Service Regulation develop and implement internal controls to ensure the completeness and accuracy of the rate charged and collected on the department's behalf.

Reimbursement Requests

The department did not draw federal funds as quickly as allowed, because internal controls over federal reimbursement requests were not working as designed.

The department received federal funds under the Gas Pipeline Safety Grant. The department is required to request reimbursement for the grant at least yearly, but has the option to request reimbursement for the first six months of the calendar year. The department has opted to request this early reimbursement. During the audit, we noted department personnel were not using the control over the reimbursement requests as designed, because they did not understand the relationship between total program expenses and the reimbursement calculated by the federal government.

The control is a spreadsheet summarizing the Gas Pipeline Safety expenditures incurred to date, to which the expected federal reimbursement rate is applied. During our testing of the associated federal revenues under this grant, we discovered Gas Pipeline Safety program personnel were unintentionally entering only the expenditures expected to be federally reimbursed, not total expenditures, into the spreadsheet. Therefore, the department's requests for federal reimbursement were at a lower amount than they could have been on these optional reimbursement requests, so the department was not getting the full reimbursement for the first six months of the calendar year.

The department was completing the end of year request correctly and getting the full reimbursement for the calendar year. However, receiving cash as soon as possible makes it easier to run the program without using state resources. In addition, the uneven payment made it difficult for accounting staff to estimate the amount of federal revenue to accrue at fiscal year-end, as described further in Recommendation #5.

The control deficiency merits the attention of those charged with governance, but is not likely to lead to material misstatement given the final grant payment is requested correctly. Accordingly, we have classified it as a significant deficiency on the Report on

Internal Control Over Financial Reporting and on Compliance and Other Matters Based on an Audit of Financial Schedules Performed in Accordance with *Government Auditing Standards* on page B-1. A significant deficiency means the commission should ensure controls over federal revenue are in place and working as intended.

Recommendation #4

We recommend the Department of Public Service Regulation use controls as intended, to ensure timely reimbursement from the federal government.

Misstatements Related to the Activity in the Federal Special Revenue Fund

The schedules do not present federal revenue and expenses correctly.

The department receives a federal grant each calendar year related to pipeline safety. The Gas Pipeline Safety Grant program has been in effect since 1970 and enables the department to develop, issue, and enforce pipeline safety regulations by conducting compliance audits in conjunction with other regulatory agencies, enforcing standards, providing training, and investigating incidents. The department seeks and receives federal reimbursement for a percent of its expenditures for this program every six months. Traditionally, the department recorded all expenditures for this program in the SSRF at the time they were incurred, and moved the federal expenditures to the Federal Special Revenue Fund (FSRF) when the reimbursements were received. As described in the prior audit report, this accounting treatment is incorrect, and we issued a recommendation to the department to record activity in accordance with state accounting policy.

State accounting policy requires revenue to be recognized when it is realizable, measurable, earned, and available. The Gas Pipeline Safety Grant reimbursements are realizable, measurable, and earned at the time expenditures are incurred, given the reimbursement is based on known costs incurred by the department during the fiscal year and a generally predictable reimbursement rate. Further, the reimbursements are considered available as the department has an irrevocable agreement with the federal government for the reimbursement of a portion of the program's costs. Additionally, the FSRF should be used to account for all expenditures funded from federal revenue sources. Therefore, at fiscal year-end, the department should record the expenditures incurred and expected to be reimbursed by the federal government as expenditures in the FSRF. The department should also accrue revenue in the amount due from the federal government, along with a corresponding accounts receivable. These entries would result in the department recognizing the federal revenue and expense in the correct fiscal year.

In an attempt to implement the prior audit recommendation, the department personnel recorded various journal entries in both fiscal years 2017 and 2018. We reviewed these entries and noted they resulted in inaccuracies, as detailed below.

- In fiscal year 2017, personnel reclassified six months of the Gas Pipeline Safety Program expenditures via a Prior Year Expenditure & Transfers-Out Adjustment between the SSRF and the FSRF on the Schedule of Changes in Fund Equity, causing the department's Schedule of Changes in Fund Equity to be misleading. Total federal activity in fiscal year 2016 was not misstated by over $77,000, as the entry implies. In the prior audit report, we estimated fiscal year 2016's activity was only misstated by $2,500. In addition, the schedule presents $77,000 fewer Budgeted Expenditure & Transfer-Outs in both the SSRF and FSRF columns than should be reported. The department did not have the appropriate budget authority to record to expenditures as budgeted, but they should have requested enough budget authority in the FSRF to run the federal program.
- In fiscal year 2017, the department did not accrue any federal revenue when earned as recommended, instead they recorded revenue when they received the final cash payment in fiscal year 2018. The department also recorded the first payment received for fiscal year 2018 when cash was received and accrued federal revenue up to the remaining budget authority in the FSRF instead of estimating federal revenue earned in fiscal year 2018. The combination of the accrual, the fiscal year 2017 revenue recorded in fiscal year 2018, and the fiscal year 2018 payment recorded resulted in an overstatement of federal revenues for fiscal year 2018. In total, we estimate revenues were overstated by $19,000.

In the prior audit response, department personnel explained they do not accrue revenue at fiscal year-end as they do not know the amount they will be reimbursed, and department personnel explained they did not have sufficient budget authority in the FSRF. During our current audit, we determined this uncertainty of reimbursement was due, in part, to the significant deficiency in internal controls explained in Recommendation #4. Because of this deficiency, there were uneven payments from the federal government, which made it difficult to estimate federal revenue and related federal expense. Regarding budget authority in the current audit, department personnel noted they obtained additional appropriation in fiscal year 2018 in the FSRF to record the expenditures in the fiscal year they occur.

In fiscal year 2017 and 2018, the department should have used the total Gas Pipeline Safety Grant expenditures for the current fiscal year to estimate the total expenditures belonging in the FSRF and the related federal revenue earned. The estimated federal expenditures should have been recorded in the FSRF prior to fiscal year-end and federal revenue earned, but not received, should be recorded as federal revenue with a related receivable in the FSRF prior to fiscal year-end.

Recommendation #5

We recommend the Department of Public Service Regulation comply with state accounting policy by recording federal revenue, expenditures, and receivables in the fiscal year when the revenue is earned and expenditures are incurred.

Compliance

The department did not comply with state law when hiring a consultant.

Section 69-8-421 (10), MCA, allows the commission to engage independent engineering, financial, and management consultants or advisory services to evaluate a public utility's electricity supply resource procurement plans and proposed electricity supply resources. This law also requires the commission to charge a fee to the public utility to pay for the costs of consultants or advisory services. Section 69-1-114 (3), MCA, requires the revenue associated with the fee to be recorded in the SSRF.

In fiscal year 2018, a consultant was hired by the commission as allowed, but the contract written by the commission required a utility to pay the consultant directly, contrary to state law. Neither the revenue nor expenditures associated with this contract were recorded in the state's accounting system. We estimate total revenues and expenditures in fiscal year 2018 are understated by approximately $10,000. This led, in part, to an adverse opinion on the Schedule of Total Revenues & Transfers-In for fiscal year 2018. Additionally, the department was not in compliance with §§69-8-421 (10), MCA, and 69-1-114 (3), MCA.

Per department personnel, consultants hired under §69-8-421 (10), MCA, are rare, and this was the only one hired during the audit period. Additionally, personnel noted no fees were collected by the department because the commission wanted the consultant to be involved at the beginning of the utility's planning process, and having the money flow through the state's accounting system would have slowed the process down. We attribute this timing concern partially to the department's budget authority in the

SSRF. During the audit, we noted there was very little budget authority in the SSRF at the end of fiscal year 2018, and the department may have needed to submit a budget change document to increase spending authority to record the expense of paying the consultant. While this situation existed, compliance with state law is required. The department should also record all financial activity in the state's accounting system to give the users of their financial schedules the full picture of the department's activity.

Recommendation #6

We recommend the Department of Public Service Regulation comply with state law when contracting with consultants hired to evaluate a public utility's electric supply resource procurement plans and proposed electricity supply resources by:

A. *Charging the utility a fee as required, and*

B. *Recording the related revenues and expenditure in the State Special Revenue Fund.*

Independent Auditor's Report and Department Financial Schedules

LEGISLATIVE AUDIT DIVISION

Angus Maciver, Legislative Auditor
Deborah F. Butler, Legal Counsel

Deputy Legislative Auditors:
Cindy Jorgenson
Joe Murray

Independent Auditor's Report

The Legislative Audit Committee
of the Montana State Legislature:

Introduction
We have audited the accompanying Schedules of Changes in Fund Equity, Schedules of Total Revenues & Transfers-In, and Schedules of Total Expenditures & Transfers-Out of the Department of Public Service Regulation for each of the fiscal years ended June 30, 2018, and 2017, and the related notes to the financial schedules.

Management's Responsibility for the Financial Schedules
Management is responsible for the preparation and fair presentation of these financial schedules in accordance with the regulatory format prescribed by the Legislative Audit Committee, based on the transactions posted to the state's accounting system without adjustment; this responsibility includes recording transactions in accordance with state accounting policy; and designing, implementing, and maintaining internal controls relevant to the preparation and fair presentation of the financial schedules that are free from material misstatement, whether due to fraud or error.

Auditor's Responsibility
Our responsibility is to express opinions on these financial schedules based on our audit. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial schedules are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial schedules. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial schedules, whether due to fraud or error. In making those risk assessments, the auditor considers internal controls relevant to the department's preparation and fair presentation of the financial schedules in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the department's internal control, and accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as the overall presentation of the financial schedules.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinions and modified opinion units.

Basis for Adverse Opinions on U.S. Generally Accepted Accounting Principles
As described in Note 1, the financial schedules are prepared from the transactions posted to the state's primary accounting system without adjustment, in the regulatory format prescribed by the Legislative Audit Committee. This is a basis of accounting other than accounting principles generally accepted in the United States of America. The financial schedules are not intended to, and do not, report assets and liabilities.

The effects on the financial schedules of the variances between the regulatory basis of accounting described in Note 1 and accounting principles generally accepted in the United States of America, although not reasonably determinable, are presumed to be material.

Adverse Opinions on U.S. Generally Accepted Accounting Principles
In our opinion, because of the significance of the matter discussed in the "Basis for Adverse Opinions on U.S. Generally Accepted Accounting Principles" paragraph, the financial schedules referred to above do not present fairly, in accordance with accounting principles generally accepted in the United States of America, the financial position of the department as of June 30, 2018, and June 30, 2017, or changes in financial position for the years then ended.

Basis for Adverse Opinion on Regulatory Basis of Accounting
In fiscal year 2018, the department recorded several types of revenue-related activity incorrectly, including those outlined below:

- The department did not record Charges for Services Revenues in the State Special Revenue Fund (SSRF), as required by §§69-8-421 (10) and 69-1-114 (3), MCA. As a result, those revenues are understated by $10,388, with corresponding errors in SSRF total revenues and budgeted revenues.
- The department did not correctly record Federal Revenues in the Federal Special Revenue Fund (FSRF). As a result, those revenues are overstated by $19,000, with corresponding errors in the FSRF total revenues and budgeted revenues.
- The department doubled its revenue estimates in the FSRF. As a result, FSRF revenue estimates are overstated by $200,000, with corresponding errors in the FSRF budgeted revenues over (under) estimate.
- The department recorded SSRF revenue estimates for revenues not collected by the department. As a result, SSRF revenue estimates are overstated by $4,491,881, with corresponding errors in the SSRF budgeted revenues over (under) estimate.

See the table below for a summary of the errors in each of the SSRF and FSRF columns of the Schedule of Total Revenues & Transfers-In for the fiscal year ended June 30, 2018. The errors also impact the reported amounts in the total column of the schedule.

	State Special Revenue Fund			Federal Special Revenue Fund		
	Amount Reported	Over(Under) Statement	Correct Amount	Amount Reported	Over(Under) Statement	Correct Amount
Charges for Services	$22,348	($10,388)	$32,736			
Federal				$174,062	$19,000	$155,062
Total Revenues & Transfers-In	$39,553	($10,388)	$49,941	$174,214	$19,000	$155,214
Actual Budgeted Revenues & Transfers-In	$39,501	($10,388)	$49,889	$174,062	$19,000	$155,062
Estimated Revenues & Transfers-In	$4,541,881	$4,491,881	$50,000	$418,000	$200,000	$218,000
Budgeted Revenues & Transfers-In Over (Under) Estimate	($4,502,380)	($4,502,269)	($111)	($243,938)	($181,000)	($62,938)
BUDGETED REVENUES & TRANSFERS-IN OVER (UNDER) ESTIMATED BY CLASS						
Charges for Services	($4,504,585)	($4,502,269)	($2,316)			
Federal				($243,938)	($181,000)	($62,938)

Adverse Opinion on Regulatory Basis of Accounting

In our opinion, because of the significance of the matters discussed in the "Basis for Adverse Opinion" paragraph, the Schedule of Total Revenues & Transfers-In for the fiscal year ended June 30, 2018, does not present fairly the results of operations of the Department of the Public Service Regulation, in conformity with the basis of accounting described in Note 1.

Basis for Qualified Opinion on Regulatory Basis of Accounting

In fiscal year 2017, the department incorrectly reclassified budgeted State Special Revenue Fund expenditures as prior-year expenditures & transfers-out adjustments in the Federal Special Revenue Fund. As a result, the Schedule of Changes in Fund Equity for the fiscal year ended June 30, 2017, contains errors, as outlined in the table on page A-4.

	State Special Revenue Fund			Federal Special Revenue Fund		
	Amount Reported	Over(Under) Statement	Correct Amount	Amount Reported	Over(Under) Statement	Correct Amount
Budgeted Expenditures & Transfers-Out	$3,677,129	$77,566	$3,599,563	$69,960	$(77,566)	$147,526
Prior Year Expenditures & Transfers-Out Adjustments	$(77,566)	$(77,566)	-	$77,566	$77,566	-

Qualified Opinion on Regulatory Basis of Accounting

In our opinion, except for the effects of the matter described in the "Basis for Qualified Opinion" paragraph, the Schedule of Changes in Fund Equity for the fiscal year ended June 30, 2017, present fairly, in all material respects, the results of operations and changes in fund equity of the Department of the Public Service Regulation in conformity with the basis of accounting described in Note 1.

Unmodified Opinions on Regulatory Basis of Accounting

In our opinion, the Schedule of Changes in Fund Equity presents fairly, in all material respects, the results of operations and changes in fund equity of the Department of the Public Service Regulation for the fiscal year ended June 30, 2018; and the Schedule of Total Revenues & Transfers-In for the fiscal year ended June 30, 2017, and the Schedules of Total Expenditures and Transfers-Out for each of the two fiscal years ending June 30, 2018, and 2017, present fairly, in all material respects, the results of operations of the Department of Public Service Regulation for each of the fiscal years noted above in conformity with the basis of accounting described in Note 1.

Other Reporting Required by Government Auditing Standards

In accordance with *Government Auditing Standards*, we have also issued our report dated March 26, 2019, on our consideration of the Department of Public Service Regulation's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the department's internal control over financial reporting and compliance.

Respectfully submitted,

/s/ Cindy Jorgenson

Cindy Jorgenson, CPA
Deputy Legislative Auditor
Helena, MT

March 26, 2019

PUBLIC SERVICE REGULATION
SCHEDULE OF CHANGES IN FUND EQUITY
FOR THE FISCAL YEAR ENDED JUNE 30, 2018

	State Special Revenue Fund	Federal Special Revenue Fund
FUND EQUITY: July 1, 2017	$ 1,136,783	$ 0
ADDITIONS		
Budgeted Revenues & Transfers-In	39,501	174,062
Nonbudgeted Revenues & Transfers-In	52	152
Direct Entries to Fund Equity	4,238,166	
Total Additions	4,277,719	174,214
REDUCTIONS		
Budgeted Expenditures & Transfers-Out	4,032,272	174,214
Nonbudgeted Expenditures & Transfers-Out	271,102	
Prior Year Expenditures & Transfers-Out Adjustments	3,407	
Total Reductions	4,306,782	174,214
FUND EQUITY: June 30, 2018	$ 1,107,720	$ 0

This schedule is prepared from the Statewide Accounting, Budgeting, and Human Resources System (SABHRS) without adjustment. Additional information is provided in the notes to the financial schedules beginning on page A-11.

PUBLIC SERVICE REGULATION
SCHEDULE OF CHANGES IN FUND EQUITY
FOR THE FISCAL YEAR ENDED JUNE 30, 2017

	State Special Revenue Fund	Federal Special Revenue Fund
FUND EQUITY: July 1, 2016	$ 423,204	$ 0
ADDITIONS		
Budgeted Revenues & Transfers-In	37,062	147,490
Nonbudgeted Revenues & Transfers-In	114	36
Direct Entries to Fund Equity	4,272,331	
Total Additions	4,309,508	147,526
REDUCTIONS		
Budgeted Expenditures & Transfers-Out	3,677,129	69,960
Nonbudgeted Expenditures & Transfers-Out	(3,634)	
Prior Year Expenditures & Transfers-Out Adjustments	(77,566)	77,566
Total Reductions	3,595,930	147,526
FUND EQUITY: June 30, 2017	$ 1,136,783	$ 0

This schedule is prepared from the Statewide Accounting, Budgeting, and Human Resources System (SABHRS) without adjustment.
Additional information is provided in the notes to the financial schedules beginning on page A-11.

PUBLIC SERVICE REGULATION
SCHEDULE OF TOTAL REVENUES & TRANSFERS-IN
FOR THE FISCAL YEAR ENDED JUNE 30, 2018

	State Special Revenue Fund	Federal Special Revenue Fund	Total
TOTAL REVENUES & TRANSFERS-IN BY CLASS			
Licenses and Permits	$ 17,205		$ 17,205
Taxes		$ 152	152
Charges for Services	22,348		22,348
Federal		174,062	174,062
Total Revenues & Transfers-In	39,553	174,214	213,767
Less: Nonbudgeted Revenues & Transfers-In	52	152	204
Prior Year Revenues & Transfers-In Adjustments			0
Actual Budgeted Revenues & Transfers-In	39,501	174,062	213,563
Estimated Revenues & Transfers-In	4,541,881	418,000	4,959,881
Budgeted Revenues & Transfers-In Over (Under) Estimated	$ (4,502,380)	$ (243,938)	$ (4,746,318)
BUDGETED REVENUES & TRANSFERS-IN OVER (UNDER) ESTIMATED BY CLASS			
Licenses and Permits	$ 2,205		$ 2,205
Charges for Services	(4,504,585)		(4,504,585)
Federal		$ (243,938)	(243,938)
Budgeted Revenues & Transfers-In Over (Under) Estimated	$ (4,502,380)	$ (243,938)	$ (4,746,318)

This schedule is prepared from the Statewide Accounting, Budgeting, and Human Resources System (SABHRS) without adjustment.
Additional information is provided in the notes to the financial schedules beginning on page A-11.

PUBLIC SERVICE REGULATION
SCHEDULE OF TOTAL REVENUES & TRANSFERS-IN
FOR THE FISCAL YEAR ENDED JUNE 30, 2017

	State Special Revenue Fund	Federal Special Revenue Fund	Total
TOTAL REVENUES & TRANSFERS-IN BY CLASS			
Licenses and Permits	$ 10,400		$ 10,400
Taxes		$ 36	36
Charges for Services	26,777		26,777
Federal		147,490	147,490
Total Revenues & Transfers-In	37,177	147,526	184,702
Less: Nonbudgeted Revenues & Transfers-In	114	36	150
Prior Year Revenues & Transfers-In Adjustments			0
Actual Budgeted Revenues & Transfers-In	37,062	147,490	184,552
Estimated Revenues & Transfers-In	50,002	218,001	268,003
Budgeted Revenues & Transfers-In Over (Under) Estimated	$ (12,940)	$ (70,511)	$ (83,451)
BUDGETED REVENUES & TRANSFERS-IN OVER (UNDER) ESTIMATED BY CLASS			
Licenses and Permits	$ (4,601)		$ (4,601)
Charges for Services	(8,339)		(8,339)
Federal		$ (70,511)	(70,511)
Budgeted Revenues & Transfers-In Over (Under) Estimated	$ (12,940)	$ (70,511)	$ (83,451)

This schedule is prepared from the Statewide Accounting, Budgeting, and Human Resources System (SABHRS) without adjustment.
Additional information is provided in the notes to the financial schedules beginning on page A-11.

PUBLIC SERVICE REGULATION
SCHEDULE OF TOTAL EXPENDITURES & TRANSFERS-OUT
FOR THE FISCAL YEAR ENDED JUNE 30, 2018

	Public Srevice Regultion Program	Total
PROGRAM (ORG) EXPENDITURES & TRANSFERS-OUT		
Personal Services		
Salaries	$ 2,367,788	$ 2,367,788
Employee Benefits	741,324	741,324
Total	3,109,112	3,109,112
Operating Expenses		
Other Services	556,161	556,161
Supplies & Materials	36,692	36,692
Communications	61,075	61,075
Travel	118,413	118,413
Rent	239,733	239,733
Repair & Maintenance	1,616	1,616
Other Expenses	81,228	81,228
Total	1,094,919	1,094,919
Transfers-out		
Fund transfers	276,964	276,964
Total	276,964	276,964
Total Expenditures & Transfers-Out	$ 4,480,996	$ 4,480,996
EXPENDITURES & TRANSFERS-OUT BY FUND		
State Special Revenue Fund	$ 4,306,782	$ 4,306,782
Federal Special Revenue Fund	174,214	174,214
Total Expenditures & Transfers-Out	4,480,996	4,480,996
Less: Nonbudgeted Expenditures & Transfers-Out	271,102	271,102
Prior Year Expenditures & Transfers-Out Adjustments	3,407	3,407
Actual Budgeted Expenditures & Transfers-Out	4,206,486	4,206,486
Budget Authority	4,232,896	4,232,896
Unspent Budget Authority	$ 26,410	$ 26,410
UNSPENT BUDGET AUTHORITY BY FUND		
State Special Revenue Fund	$ 26,410	$ 26,410
Unspent Budget Authority	$ 26,410	$ 26,410

This schedule is prepared from the Statewide Accounting, Budgeting, and Human Resources System (SABHRS) without adjustment. Additional information is provided in the notes to the financial schedules beginning on page A-11.

PUBLIC SERVICE REGULATION
SCHEDULE OF TOTAL EXPENDITURES & TRANSFERS-OUT
FOR THE FISCAL YEAR ENDED JUNE 30, 2017

	Public Service Regulation Program	Total
PROGRAM (ORG) EXPENDITURES & TRANSFERS-OUT		
Personal Services		
Salaries	$ 2,203,562	$ 2,203,562
Employee Benefits	757,854	757,854
Total	2,961,415	2,961,415
Operating Expenses		
Other Services	192,188	192,188
Supplies & Materials	81,501	81,501
Communications	63,145	63,145
Travel	112,798	112,798
Rent	236,891	236,891
Repair & Maintenance	3,197	3,197
Other Expenses	80,033	80,033
Total	769,752	769,752
Equipment & Intangible Assets		
Equipment	12,288	12,288
Total	12,288	12,288
Total Expenditures & Transfers-Out	$ 3,743,456	$ 3,743,456
EXPENDITURES & TRANSFERS-OUT BY FUND		
State Special Revenue Fund	$ 3,595,930	$ 3,595,930
Federal Special Revenue Fund	147,526	147,526
Total Expenditures & Transfers-Out	3,743,456	3,743,456
Less: Nonbudgeted Expenditures & Transfers-Out	(3,634)	(3,634)
Prior Year Expenditures & Transfers-Out Adjustments		
Actual Budgeted Expenditures & Transfers-Out	3,747,089	3,747,089
Budget Authority	4,295,161	4,295,161
Unspent Budget Authority	$ 548,071	$ 548,071
UNSPENT BUDGET AUTHORITY BY FUND		
State Special Revenue Fund	$ 544,696	$ 544,696
Federal Special Revenue Fund	3,376	3,376
Unspent Budget Authority	$ 548,071	$ 548,071

This schedule is prepared from the Statewide Accounting, Budgeting, and Human Resources System (SABHRS) without adjustment. Additional information is provided in the notes to the financial schedules beginning on page A-11.

Montana Department of Public Service Regulation
Notes to the Financial Schedules
For the Two Fiscal Years Ended June 30, 2018

1. Summary of Significant Accounting Policies

Basis of Accounting

The department uses the modified accrual basis of accounting, as defined by state accounting policy, for its Governmental fund category (State Special Revenue and Federal Special Revenue). In applying the modified accrual basis, the department records:

- Revenues when it receives cash or when receipts are realizable, measurable, earned, and available to pay current period liabilities.
- Expenditures for valid obligations when the department incurs the related liability and it is measurable, with the exception of the cost of employees' annual and sick leave. State accounting policy requires the department to record the cost of employees' annual and sick leave when used or paid.

Expenditures and expenses may include: entire budgeted service contracts even though the department receives the services in a subsequent fiscal year; goods ordered with a purchase order before fiscal year-end, but not received as of fiscal year-end; and equipment ordered with a purchase order before fiscal year-end.

Basis of Presentation

The financial schedule format was adopted by the Legislative Audit Committee. The financial schedules are prepared from the transactions posted to the state's accounting system without adjustment.

The department uses the following funds:

- **State Special Revenue Fund** – to account for proceeds of specific revenue sources that are legally restricted to expenditures for specific state program purposes. Department State Special Revenue Funds include a fund to account for general operating revenues and expenditures and a fund to account for Qwest performance monitoring.
- **Federal Special Revenue Fund** – to account for activities funded from federal revenue sources. Department Federal Special Revenue Funds account for the Federal Natural Gas Safety Program.

2. Direct Entries to Fund Equity

Direct entries to fund equity in the Special Revenue fund includes entries generated by SABHRS to reflect the flow of resources within individual funds shared by separate agencies.

3. Revenue Estimates

Department revenue estimates are based on our history of revenue estimates and how much revenue we anticipate receiving through the tax on gross operating revenues of the utilities (State Special Revenue) and the amount of the grant that we will be receiving to fund our Pipeline Program (Federal Special Revenue).

The revenue estimates in the department federal fund were entered twice/doubled in FY 2018 by $200,000. The related Budgeted Revenue and Transfer-In Over (Under) estimated is also overstated $200,000.

PSR entered a revenue estimate under our business unit in FY 2018. The revenue collected on behalf of PSR by the Department of Revenue is presented on the PSR schedules as a direct entry. The revenue estimate in the State Special Revenue Fund is overstated by $4,491,881. The related Budgeted Revenue over estimated is also overstated by $4,491,881 for FY 2018.

4. Unspent Budget Authority

The department unspent budget authority is the result of unspent IT related authority and FY2016 carry forward in FY 2017. In FY 2018, basically all authority was utilized.

5. Fees

A contract with a consultant required a utility to pay the consultant directly, rather than the activity being recorded in the state special revenue fund as required by Section 69-1-114, MCA.

Total revenues and total expenses are understated by $10,388 (1 month of the contracted payments) in FY 2018.

6. Cash Transfer

HB 6 from the 11/2017 Special Legislative Session stated that "By December 15, 2017, the state treasurer shall transfer $276,964 from the Public Service Commission state special revenue account into the general fund…."

The transfer of $ 276,964 cash did take place in FY 2018.

Report on Internal Control and Compliance

LEGISLATIVE AUDIT DIVISION

Angus Maciver, Legislative Auditor
Deborah F. Butler, Legal Counsel

Deputy Legislative Auditors:
Cindy Jorgenson
Joe Murray

Report on Internal Control Over Financial Reporting and on Compliance and Other Matters Based on an Audit of Financial Schedules Performed in Accordance with *Government Auditing Standards*

The Legislative Audit Committee
of the Montana State Legislature:

We have audited, in accordance with the auditing standards generally accepted in the United States of America and the standards applicable to the financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States, the Schedules of Changes in Fund Equity, Schedules of Total Revenues & Transfers-In, and Schedules of Total Expenditures & Transfers-Out of the Department of Public Service Regulation for each of the fiscal years ended June 30, 2018, and 2017, and the related notes to the financial schedules, and have issued our report thereon dated March 26, 2019. Our report includes a qualified opinion on the Schedule of Changes in Fund Equity for the fiscal year ended June 30, 2017, and an adverse opinion on the Schedule of Total Revenues & Transfers-In for the fiscal year ended June 30, 2018.

Internal Control Over Financial Reporting

In planning and performing our audit of the financial schedules, we considered the department's internal control over financial reporting to determine the audit procedures that are appropriate in the circumstances for the purpose of expressing our opinions on the financial schedules, but not for the purpose of expressing an opinion on the effectiveness of the department's internal control. Accordingly, we do not express an opinion on the effectiveness of the department's internal control.

Our consideration of internal control was for the limited purpose described in the preceding paragraph and was not designed to identify all deficiencies in internal control that might be material weaknesses or significant deficiencies and therefore, material weaknesses or significant deficiencies may exist that were not identified. However, as described below, we identified certain deficiencies in internal control that we consider to be material weaknesses and significant deficiencies.

A *deficiency* in internal control exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct, misstatements on a timely basis. A *material weakness* is a deficiency, or a combination of deficiencies, in internal control such that there is a reasonable possibility that a material misstatement of the entity's financial schedules will not be prevented, or detected and corrected on a timely basis. We consider the deficiencies described in the accompanying table to be material weaknesses.

Subject	Type of Deficiency	Page in 18-26 Report
Internal controls over revenue estimates	Material Weakness	Page 5
Internal controls over the drafting of the Notes to the Financial Schedules	Material Weakness	Page 6
Internal controls over the reasonableness of Direct Entries to Fund Equity	Material Weakness	Page 7

A *significant deficiency* is a deficiency, or a combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance. We consider the deficiency described in the accompanying table to be a significant deficiency.

Subject	Type of Deficiency	Page in 18-26 Report
Internal controls over requesting reimbursement for the Gas Pipeline Safety Grant	Significant Deficiency	Page 9

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the department's financial schedules are free from material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial schedule amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such an opinion. The results of our tests disclosed instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards* as described in the table below.

Subject	Page in 18-26 Report
Compliance with state law requiring the department to charge utilities a fee for consultants hired, and to record the fee in the State Special Revenue Fund.	Page 12

Department of Public Service Regulation

The department's response to the findings identified in our audit are described on page C-1 of this report. The department's response was not subjected to the auditing procedures applied in the audit of the financial schedules and, accordingly, we express no opinion on it.

Purpose of this Report

The purpose of this report is solely to describe the scope of our testing of internal control and compliance and the results of that testing, and not to provide an opinion on the effectiveness of the department's internal control or on compliance. This report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the department's internal control and compliance. Accordingly, this communication is not suitable for any other purpose.

Respectfully submitted,

/s/ Cindy Jorgenson

Cindy Jorgenson, CPA
Deputy Legislative Auditor
Helena, MT

March 26, 2019

Department of Public Service Regulation

Department Response

Montana Public Service Commission

May 14, 2019

Angus Maciver
Legislative Auditor
State Capitol Building
Room 160
P.O. Box 201705
Helena, MT 59620-1705

RECEIVED
MAY 15 2019
LEGISLATIVE AUDIT DIV.

Dear Mr. Maciver:

Please find enclosed the responses of the Montana Public Service Commission to the 2017-2018 Financial Audit. Please do not hesitate to contact us if you have questions or require further information.

Sincerely,

Brad Johnson, Chairman
Montana Public Service Commission

1701 Prospect Avenue • P.O. Box 202601 • Helena, Montana 59620-2601• Web: http://psc.mt.gov
Phone: 406-444-6199 • Consumer Assistance: 800-646-6150 • Fax: 406-444-7618 • Email: psc_webmaster@mt.gov

Recommendation #1 - We recommend the Department of Public Service Regulation develop and implement internal controls to ensure revenue estimates are accurate.

Agency Response: Concur

Corrective Action Plan: Errors that took place during the budget implementation phase have been identified. Steps have been taken to correct the revenue estimates for FY 2019 and to prevent these errors in future years.

Recommendation #2 - We recommend the Department of Public Service Regulation develop and implement internal controls over note disclosure development.

Agency Response: Concur

Corrective Action Plan: The Department of Public Service Regulation has a CPA on staff, and will utilize this staff member's expertise in developing note disclosures for all future financial compliance audits.

Recommendation #3 - We recommend the Department of Public Service Regulation develop and implement internal controls to ensure the completeness and accuracy of the rate charged and collected on the department's behalf.

Agency Response: Concur

Corrective Action Plan: The PSC has met with the staff from the DOR and a plan has been agreed upon to allow the department to independently determine the completeness and accuracy of the fee charged and collected on behalf of the department. This process will take place each quarter leading up to the next year's calculation, which takes place in September of each year.

Recommendation #4: We recommend the Department of Public Service Regulation use controls as intended, to ensure timely reimbursement from the federal government.

Agency Response: Concur

Corrective Action Plan: This error has been identified, and will not happen during future requests.

Recommendation #5 - We recommended the Department of Public Service Regulation comply with state accounting policy by recording federal revenue, expenditures, and receivables in the fiscal year when the revenue is earned and expenditures are incurred.

Agency Response: Concur

Corrective Action Plan: Steps have been taken since the last audit to ensure that the necessary appropriation and cash are available to record expenditures in the fiscal year when the expenditures are incurred.

<u>Recommendation #6 - We recommended the Department of Public Service Regulation comply with state law when contracting with consultants hired to evaluate a public utility's electric supply resource procurement plans and proposed electricity supply resources by:</u>

A. **Charging the utility a fee as required, and**
B. **Recording the related revenues and expenditure in the State Special Revenue Fund.**

<u>Agency Response:</u> Concur

<u>Corrective Action Plan:</u> All future situations in which this item is to occur, the department will comply with A and B above.