



DEPARTMENT OF  
**FINANCE**

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January 30, 2009

Ms. Melissa Jones, Executive Director  
California Energy Commission  
1516 Ninth Street  
Sacramento, CA 95814

Dear Ms. Jones:

**Final Report—California Energy Commission, Public Interest Energy Research Program Audit**

The Department of Finance, Office of State Audits and Evaluations, has completed its programmatic audit of the California Energy Commission's (Commission) Public Interest Energy Research Program as of November 25, 2008.

The enclosed report is for your information and use. The Commission's response to the report observations and our evaluation of the response are incorporated into this final report.

We appreciate the assistance and cooperation of the Commission. If you have any questions regarding this report, please contact Mary Kelly, Manager, or Cheryl Lyon, Supervisor, at (916) 322-2985.

Sincerely,

Original signed by:

David Botelho, CPA  
Chief, Office of State Audits and Evaluations

Enclosure

cc: Ms. Claudia Chandler, Chief Deputy Director, California Energy Commission  
Mr. Thom Kelly, Division Deputy Director, Energy Research and Development Division,  
California Energy Commission  
Ms. Martha Krebs PhD, PIER Program Director, California Energy Commission  
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Mr. Allan Ward, Staff Counsel, California Energy Commission  
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Ms. Jackalyne Pfannenstiel, Chairman, California Energy Commission

PROGRAMMATIC AUDIT

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California Energy Commission  
Public Interest Energy Research Program

Prepared By:  
Office of State Audits and Evaluations  
Department of Finance

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November 2008

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Final reports are available on our website at <http://www.dof.ca.gov>

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## EXECUTIVE SUMMARY

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The Public Resources Code (PRC) authorizes the California Energy Commission (Commission) to implement and administer the Public Interest Energy Research (PIER) electricity program. The impetus of the PIER program is to improve the quality of California citizens' lives by providing environmentally sound, safe, reliable, and affordable energy services and products; by facilitating public interest energy research, development, and demonstration projects; and by advancing energy science or technologies of value to California citizens.

The Commission requested the Department of Finance, Office of State Audits and Evaluations (Finance), to conduct a programmatic audit of the PIER program. Our audit, determined that, in most instances, the Commission is operating the PIER program in compliance with the PRC, state laws and regulations, and budget requirements. However, our audit disclosed several instances where performance deviated. Instances include the Commission's:

- Failure to monitor and collect intellectual property payments.
- Reclassification of authorized positions that were necessary for program activities.
- Inadequate policies and procedures to administer contracts and work authorizations.
- Lack of documentation to support compliance with Personnel Management Liaison Memos.

We recommend the following improvements to Commission practices to strengthen the administration, management, and operations of the PIER program and prevent future instances of non-compliance:

- Revise PIER program contracting policies and practices to ensure an open and competitive contracting process that promotes accountability, fairness, and efficiency while limiting the risk of fraud, waste, and abuse.
- Develop and document PIER program policies, procedures, and best practices.

Non-compliance with the PRC, state laws and regulations, and budget requirements, as well as administrative weaknesses, increases the risk that the Commission will not achieve the goals of the PIER program. These conditions also increase the risk of inefficient use of funds; and reduced research, development, and demonstration activities. By implementing corrective actions, the Commission's administrative oversight will produce an efficient operational program that achieves its goal of providing electricity related advancements to the citizens of California.

# BACKGROUND, SCOPE, AND METHODOLOGY

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## BACKGROUND

The Public Interest Energy Research (PIER) electricity program was established by Chapter 854 of the Statutes of 1996 (AB 1890), which was incorporated into the Public Resources Code (PRC). The PIER program was created to improve the quality of California citizens' lives by providing environmentally sound, safe, reliable, and affordable energy services and products; undertaking public interest energy research, development, and demonstration projects that are not provided for by competitive and regulated energy markets; and advancing energy science or technologies of value to California citizens.

The PRC authorizes the California Energy Commission (Commission) to implement and administer the PIER program. The Commission's Research, Development, and Demonstration Division (Division) manages the PIER program in its three offices and seven sub-offices<sup>1</sup>.

The PIER program was reauthorized by Chapter 512 of the Statutes of 2006 (SB 1250). The bill revised certain sections of the PRC, including goals of the program, and extended the program through 2011. The goal of the PIER electricity program is to develop, and help bring to market, energy technologies that provide increased environmental benefits, greater system reliability, and lower system costs. The technologies aim to provide tangible benefits to electric utility customers through investments in transportation, building efficiency, and advanced electricity generation and technologies.

The PIER program is funded through fees collected from the ratepayers of Investor Owned Utilities' (IOU). Three IOUs—Pacific Gas and Electric Company, San Diego Gas and Electric Company, and Southern California Edison—are required by the Public Utilities Code<sup>2</sup> (PUC) to collect the fees by means of a surcharge to the electric customer. Funds collected are deposited into the Public Interest Energy Research, Development, and Demonstration Fund (Fund). As of June 30, 2007, there was a balance of \$233 million in the Fund<sup>3</sup>.

Funds are appropriated to the Commission for administration of the PIER program. The program annually receives \$62.5 million for research, development, and demonstration (RD&D) activities; \$1.573 million for technical support contracts; and from \$5 million to \$7 million for Commission internal operations. The PUC<sup>4</sup> states that any appropriations from the Fund shall have an encumbrance period of not longer than two years, and a liquidation period of not longer than four years.

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<sup>1</sup> See Appendix A for PIER program organization chart

<sup>2</sup> PUC section 399.8 (d) (1)

<sup>3</sup> State of California, Budgetary/Legal Basis Annual Report, Balance Sheet as of June 30, 2007. The Annual Report as of June 30, 2008 has not been released.

<sup>4</sup> PUC section 384

The Division creates annual RD&D budget plans in support of the PIER program goals. The offices develop “roadmaps” that identify how the annual allocation should be distributed. The roadmaps identify the specific research within the focus area, priority of completion, and goals. The Commission’s Research and Development Committee (Committee) reviews and approves the annual plan and roadmaps.

Upon approval of the plan and roadmaps, the Commission awards funds for the planning, implementation, and administration of projects or programs. The awards, issued through several types of funding mechanisms<sup>5</sup>, are reviewed and approved by the Committee and the Commissioners. The Commission managed approximately 8 prime contracts, 229 work authorizations, 191 contracts, and 267 grants (24 managed by PIER staff and 243 managed through the San Diego State University Foundation contract) in October 2008.

The Commission is required to report on the PIER program progress and accomplishments. The PRC<sup>6</sup> requires the Commission to deliver an annual report to the Legislature documenting the projects funded for the calendar year, projects completed during the time period, and current research in progress. The PRC<sup>7</sup> also requires the Commission to prepare an Integrated Energy Policy Report on or before November 1 every two years. The report assesses major energy trends and issues facing the state’s electricity, natural gas, and transportation sectors. In addition, the Commission includes policy recommendations aimed at conserving resources, protecting the environment, ensuring energy reliability, enhancing the state’s economy, and protecting public health and safety.

## **SCOPE**

The Commission requested the Department of Finance, Office of State Audits and Evaluations (Finance), to conduct a programmatic audit of the PIER program. The request included 11 specific objectives<sup>8</sup> and can be summarized into the following categories:

- Determine if the PIER program is operating in accordance with the PRC.
- Determine if the PIER program is complying with state laws and regulations regarding project awards, monitoring, and invoicing.
- Determine if the PIER program is operating within budget.
- Issue a report on deficiencies observed and provide recommendations for corrective action.

The audit period is from July 1, 2005 through November 25, 2008, with an emphasis placed on current practices.

The audit did not include an assessment of the efficiency or effectiveness of the PIER program or the accomplishment of its goals. Further limitations to this audit were as follows:

- Commission selected two of three contracts tested for compliance with state contracting policies.
- Accuracy of the California State Accounting and Reporting System (Calstars) and PIER Information Management System (PIMS) data was not tested.
- Contractor performance was not tested.
- Sub-contractor performance was not tested.

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<sup>5</sup> See Appendix B for funding mechanisms

<sup>6</sup> PRC section 25620.8

<sup>7</sup> PRC section 25302

<sup>8</sup> See Appendix F for a listing of detailed objectives and summary of results

- Revenues and receipts from the IOU's were not tested.
- PIER natural gas program was not included.

## METHODOLOGY

To audit the program, interviews were conducted with the following: Division Deputy Executive Director; PIER Program Director; Commission accounting, contracts, and grants staff; PIER program staff; Department of General Services, Office of Legal Services staff; and select contractor staff. Topics discussed included:

- Roles and responsibilities
- Implementation of the PRC
- Operational processes and policies

We also conducted a survey of PIER program staff, and received a response rate of 45 percent. The information provided assisted with the development of our observations and recommendations.

The following steps were also performed to meet the audit's objectives:

- Review and analysis of PRC, State Contractors Manual, Public Contract Code, Government Code, and Federal Regulations.
- Research for best practices.
- Review and analysis of financial reports from Calstars and PIMS.
- Substantive testing of contracts, work authorizations, grants, and invoices.

Recommendations were developed based on the evaluation of data, documentation obtained, and discussions with Commission staff.

Except as noted, the audit was conducted in accordance with *Government Auditing Standards*, issued by the Comptroller General of the United States. In connection with this audit, Finance is not independent of the Commission, as both are part of the State of California's Executive Branch. As required by various statutes within the California Government Code, Finance performs certain management and accounting functions. These activities impair independence. However, sufficient safeguards exist for readers of this report to rely on the information contained herein.

Further, the audit departed from *Government Auditing Standards* with respect to *Communicating with Management, Those Charged with Governance, and Others*. We did not communicate an overview of the objectives, scope, methodology, timing, and planned reporting of the audit with those charged with governance—Commissioners—at the inception or during the performance of the audit. However, we included the Commission Chairman in the distribution of our final report documenting audit results and recommendations.

The audit was performed during the period June 1, 2008 through November 25, 2008.

Our programmatic audit found that, in most instances, the California Energy Commission (Commission) is operating the Public Interest Energy Research (PIER) program in compliance with the Public Resources Code (PRC), state laws, regulations, and policies, and the Budget Act. However, we noted several deviations from applicable requirements and identified practices that can be improved to enhance the administration, management, and operations of the PIER program and further the Commission's efforts at meeting the program's goals.

During fieldwork, we consistently communicated the progress of our audit and observations identified with Commission management. In some instances, Commission management has already implemented corrective action to remedy the observation. We commend the Commission on its prompt response and encourage continued action in addressing all observations noted in our report.

Our report on deficiencies is organized into the following sections:

- Compliance
- Administration
- Management
- Operations

## **COMPLIANCE**

As administrator of the PIER program, the Commission has the responsibility of ensuring the program is operating within the parameters of the PRC, state laws, regulations, and policies, and the Budget Act. The following deviations were identified.

### **Observation 1: Inapplicable Policy**

The contracting/sub-contracting policy created for the PIER program is no longer applicable to its current practices and includes weaknesses that foster an environment of high risk to the state and the PIER funds. The following instances were observed:

#### ***Non-compliance with Organizational Structure***

The contracting/sub-contracting policy was developed in 2000-01 and has not been updated since. The models outlined do not reflect the PIER program's current organizational structure. During 2007, the Commission defined tasks to distinguish between research, development, and demonstration (RD&D) and program support funding. By doing such, the entire composition of contracts was changed as many became both program support and RD&D models. Because of the change, the contracts became non-compliant with the policy. The Regents of the University of California, Office of the President (UC)—Basic Ordering Agreement (BOA) is an example. The contract began as a program support model (i.e. technical support), but RD&D activities were added through an amendment. The contract's sub-contracting policy was never revised to include the two model types. Further, none of the work authorizations issued for RD&D activities are subject to the Commission's

Research and Development Committee or the Commissioners' approval as are other RD&D contracts.

Other contracts simply do not fall within any of the models—standard or otherwise. Three contracts were evaluated for applicability with the policy. Neither we nor Commission legal staff were able to link the UC—Master Research Agreement (MRA) contract to any of the policy models. Because of this, we cannot be certain that the required sub-contracting terms and conditions are appropriately presented. Periodically reviewing and updating policies ensures that Commission activities are reflective of current and appropriate practices.

### ***Lack of Transparent Contracting Environment***

Transparency in the contracting process is a key element to ensure responsible expenditure of funds for the benefit of California's citizens. The policy developed by the Commission includes exemptions from state contracting rules that diminish the transparency of an open and competitive contracting environment. Additionally, the policy provides for contractors to use their own procurement methods, and select and award funds without the oversight or control of the Commission. An effective contracting/sub-contracting policy that deviates from standard state regulations should have controls in place to provide for transparency of government, accountability, and protection of state funds.

### ***Confusing Policy***

The contracting/sub-contracting policy in its current form is difficult to interpret and apply. It outlines four contracting models and policy applicable to each, which included exemptions from state contracting rules. However, since contract models such as RD&D with a contractor who performs the research itself are not included, standard state contracting rules apply. The policy acknowledges that many PIER contracts may be a blend and consequently multiple types of policy may be applicable to one contract. Additionally, legal analysis and justification is interspersed throughout the policy. We also noted a lack of definition for key concepts and terms used. To the average user, the policy lacks clarity and is not readily comprehensible. As such, its applicability and usage by Commission staff is questionable.

### ***Lack of Formal Approval by the Department of General Services (DGS)***

The Commission did not receive formal written approval from DGS regarding the proposed policy. We contacted DGS to confirm approval and appropriateness of use. DGS did not have a record of the approval, but stated that nothing in its file indicated the policy was not approved. DGS acknowledged that it had approved PIER contracts under this policy; and explanations received from the Commission justified the policy for those specific contracts. The DGS currently accepts the Commission's use of the policy, on a case by case basis, and has had no objections to its use. Ensuring proper approvals are received and retained are good business practices and help avoid confusion amongst users of the information.

### **Recommendations:**

- A. Re-evaluate and revise the contracting/sub-contracting policy to address the weaknesses identified. Ensure appropriate controls are included to provide for an open and competitive contracting process that promotes accountability and fairness, and limits the risk of fraud, waste, and abuse.
- B. Cooperate with DGS to develop a policy that ensures flexibility and expedient award issuance. Ensure written approval of the policy is obtained and retained.

## **Observation 2: Non-Compliant Contracts and Work Authorizations**

Two contracts were selected by Commission staff and we selected one program support contract for testing compliance with state contracting laws, regulations, and policies. Two of the three contracts were found to not fully comply with the requirements. Additionally, six work authorizations were tested for compliance with the prime contract, with four instances of non-compliance identified.<sup>9</sup>

Violations of state contracting laws, regulations, and policies, and non-compliance with prime contract requirements increases the liability risk to the state and the susceptibility of inappropriate use of funds. Further, non-compliance instances enhances areas of weaknesses with Commission internal controls.

The Commission has recently implemented a practice whereby the Legal Office reviews/approves all work authorizations. We encourage the Commission to continue this practice and possibly implement review/approval by the Contracts Office to ensure work authorization agreements comply with the prime contract.

### **Recommendations:**

- A. Ensure contract terms and conditions are consistent, non-contradictory, and clearly presented.
- B. Document and ensure procedures are in compliance with state requirements and consistently followed during amendment processing. Ensure supporting documentation is properly retained in the contract file.
- C. Ensure all work authorizations provide detailed tasks, deliverables, timelines, and a budget. Work authorizations should directly link to the prime contract. Flexibility can be granted on a case by case basis, and exceptions should be justified and documented. Allowable instances for exceptions should be outlined and documented in the work authorization processing policy to ensure consistent staff implementation.
- D. Review and strengthen controls over the contract/work authorization awarding process. Procedures should specify requirements for review and include second level reviews to ensure accuracy. Exceptions and deviations should be based on dollar amounts and/or risk levels. Consider enhancing the Commission's Checklist of New and Amended Contract Packages or creating a supplemental checklist to include the verification of required provisions.

## **Observation 3: Failure to Monitor and Collect Intellectual Property Payments**

The Commission does not have established procedures for staff to monitor project results and product sales to ensure that projects are adequately tracked, results reported, and revenues collected. The PRC<sup>10</sup> requires that an equitable share of rights in the intellectual property or in the benefits derived therefrom shall accrue to the state.

In our survey, program staff were asked whether they monitored projects for royalty payments. The results indicated that projects were not tracked or monitored. By not ensuring its share of rights, the state is potentially forgoing benefits which could be used to enhance the PIER program. Further, without monitoring projects through the technology transfer and market adoption phases, the Commission cannot effectively determine if the PIER program is successfully meeting its performance goals.

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<sup>9</sup> See Appendix C for instances of non-compliance

<sup>10</sup> PRC section 25620.4 (a)

**Recommendations:**

- A. Create and document a consistent process for contract managers or designated staff to monitor completed projects to ensure that the state's equitable share of rights in the intellectual property is realized.
- B. Enhance the contract closure process to include a review of the project for potential royalties and follow up. The PIER Management Information System (PIMS) can be programmed to periodically notify staff to follow up on project status. The follow up dates and notes can be retained in PIMS so information is readily accessible by all program staff.

**Observation 4: Reclassification of Authorized Positions**

Four of eleven positions were not performing the duties authorized in the respective Budget Change Proposals (BCP). Specifically, four contract manager positions authorized for engineers were immediately reclassified for other purposes. The reclassifications included an executive office assistant to provide office support; staff programmer analyst to provide PIMS maintenance; automotive equipment engineer to define and develop research initiatives and projects; and a supervisor to oversee program staff.

During our audit, PIER program staff and management commented on the lack of staff to perform contract and project management duties. Also, we observed the Commission utilizing its contracting authority to contract out for services that could have been completed by PIER staff. Because the PIER program reclassified positions that were necessary for the administration of the program, the number of staff available to perform daily tasks was diminished.

**Recommendations:**

- A. Seek positions for duties that are required to assist the Commission with administering the PIER program.
- B. Periodically review and reconcile staff duties with BCP authorizations. Variances should be researched and justified.
- C. Implement policy where position reclassifications are only performed if the position authorized is no longer needed or required by the program; and the reclassification will not create deficiencies where staff are needed.
- D. Contact a Department of Finance budget analyst for guidance on reclassifications, if deemed necessary.

**Observation 5: Non-Compliance with Personnel Management Liaison Memos**

The Commission did not provide documentation supporting its compliance with Personnel Management Liaison Memos<sup>11</sup> (PML) issued by the Department of Personnel. The memos specify that state agencies are to provide union representatives information regarding contracts to be let for services, if they call for services found in the bargaining unit.

**Recommendation:**

- A. Develop a system whereby contracts are reviewed for applicability with the PMLs. Send required information to the designated union representatives and retain documentation of compliance.

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<sup>11</sup> PML 2004-021 and 2004-059

## ADMINISTRATION

The Commission's management establishes the tone of an operation and provides guidance through the development, communication, and implementation of policies and procedures. While Commission-wide policies and procedures exist for certain processes, the Commission's Research, Development, and Demonstration Division (Division) has not provided effective guidance to the PIER program. We identified instances of non-existent program specific policies and procedures, inadequate policies and procedures, and weaknesses in methodologies used by Division management.

### **Observation 6: Lack of PIER Program Written Policies and Procedures**

The Commission has not sufficiently developed and documented policies and procedures directing the PIER program. While some Commission-wide policies and procedures<sup>12</sup> are documented, specifics related to the PIER program were found to be insufficient, disorganized, or not documented. Examples include:

- PIER program annual planning process is not documented.
- Definitions for RD&D and program support activities are not adequately documented.
- Definitions, requirements, and evaluation criteria for non-competitive bid requirement waivers using "best interest of the state" or "cost is reasonable to the state" are not documented.
- Guidance on program/project management is not documented.
- Guidance on reasonableness of costs evaluation is not documented.
- Intellectual property payment monitoring process is not documented.
- Work authorization procedures including circumstances for use are not documented.
- Contracting/sub-contracting policy is not adequately documented.

The PRC<sup>13</sup> requires the Commission to ensure the efficient implementation and administration of the PIER program and to ensure efficient program management. Failure to adequately document, maintain, and distribute current practices, policies, and procedures increases the risk of operational inconsistencies and errors. The risk of non-conformity with applicable state laws and regulations, liability to the state, and inappropriate use of PIER funds is heightened. Further, the Commission's training effectiveness and operational continuity should PIER program staff turnover occur is diminished.

### **Recommendations:**

- A. Create PIER program written policies, procedures, and best practices that provide consistency among all PIER focus areas, are easily accessible, and are communicated to all staff<sup>14</sup>. Policies and procedures should augment the Commission-wide policies and procedures.
- B. Maintain the policies and procedures in a centralized location and periodically review and revise as necessary.
- C. Utilize internal staff expertise to develop best practices for program staff to follow when developing and evaluating non-competitively bid agreement budgets, tasks, and timelines.

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<sup>12</sup> See Appendix D for analysis of Commission-wide policies and procedures

<sup>13</sup> PRC section 25620.2 (a)

<sup>14</sup> See Appendix E for potential resources

- D. Convene a multi-disciplinary team to assist with developing and implementing written policies and procedures. The exercise should focus on identifying the program risk areas and developing procedures and controls to mitigate the risk. Through this process, institutional knowledge will be captured; and practices in place, areas for improvement, and areas requiring development will be identified. Staff acceptance and implementation will increase by including all program staff levels in the process.
- E. Consider revising and building upon information already documented in the PIMS PIER Commission Project Manager Handbook to create a comprehensive and complete PIER program manual.
- F. Periodically review and revise Commission-wide policies and procedures to ensure correct references and other applicable information is adequately presented.

**Observation 7: Inadequate Program Support Contracting Methodology**

Interviews with Division management disclosed that the project’s length is the primary determinant for deciding whether to contract for program support. Generally, if a project is greater than one year but less than three, the project will be contracted out. This methodology does not promote cost savings; and is not an efficient or effective means of contracting out for services. Further, we observed instances where contracts appeared to be awarded for services the Commission had the staff and expertise to perform. Examples include:

- Developing policies and procedures for the PIER Sparky Team
- Serving as Executive Secretary/Office Assistant for the PIER Program
- Maintaining PIMS

Division management stated they were reducing the number of on-site contractors and scrutinizing services before contracting out. Our audit disclosed a 79 percent decrease in on-site contractors during fiscal year 2007-08. However, we note the revised methodology has not yet been documented.

**Recommendations:**

- A. The Government Code<sup>15</sup> provides standards for the use of personal services contracts. While the PIER program may be exempt from the Government Code, adopting certain provisions would strengthen its program support contracting methodologies and policy. Such as:
  - Use state civil service staff unless the proposed contract will result in an overall cost savings to the state.
  - Allow contracts for services that are not available within civil service; cannot be performed satisfactorily by civil service employees; or are of such a highly specialized or technical nature that the necessary expert knowledge, experience, and ability are not available through the civil service system.
- B. Maintain and utilize a log of all PIER program staff skills and abilities to reference when determining A.
- C. Create and maintain a tracking spreadsheet outlining the workload of each contract/project manager and reference this schedule when determining A. Establish policy as to an acceptable work load for contract/program managers. Use this as a guide when determining if the task can be accommodated in-house.

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<sup>15</sup> Government Code section 19130

- D. Document and support contracting decisions for future inquiries and to provide consistency among decisions.

**Observation 8: Grant Terms and Conditions Weaknesses**

Weaknesses with grant terms and conditions were identified. Specifically, during 2007, the Commission updated the terms to include funding sources—either electricity or natural gas. The terms and conditions require the solicitation preparer to select the correct opening paragraph; however, we found both paragraphs were included in each of the last two proposals reviewed and it was unclear if both funding sources were applicable.

Additionally, because the terms and conditions were revised to no longer contain a copy of or reference to the suggested invoice and final report formats, inconsistent and incomplete information may be submitted.

**Recommendations:**

- A. Revise policy to require the grant manager to select the funding source paragraph to be used in all grant documents. Include an optional paragraph that references multiple funding sources, should the need arise.
- B. Revise the grant terms and conditions to require grantees to submit invoices, progress reports, and final reports following a standardized format. Flexibility can be granted on a case by case basis, and exceptions should be justified and documented. Allowable instances for exceptions should be outlined and documented in the grants processing policy to ensure consistent staff implementation.

**MANAGEMENT**

Program management comprises the centralized coordinated efforts to achieve program goals in an efficient and effective manner. The Division’s management of the PIER program includes inefficiencies and questionable practices that do not necessarily promote the most cost efficient or effective use of PIER funds.

**Observation 9: Questionable Prime Contracts**

Instances of questionable prime contracts were observed, and prime contracts and work authorizations may be used to avoid an open and competitive bidding process. We do not question activities that the prime contractor requires assistance in completing, as long as a majority of the work is completed by the prime contractor. However, if the prime contractor cannot perform or complete the activity, then the public should be able to compete for performance of the activity.

For example, we identified instances where work authorizations were used as a sub-contracting mechanism to distribute funds to a third party and thereby bypassing the competitive bidding process. Under the UC—BOA and UC—MRA prime contracts—which were non-competitively bid because UC is a governmental entity—the intent was to create a mechanism whereby RD&D and program support activities could be assigned to the UC group on an as needed basis. However, we found that activities were assigned to third parties outside the UC group. Specifically, we reviewed work authorizations initiated between 2005 and 2008 under the BOA and MRA contracts. We identified approximately 40 work authorizations totaling \$7.4 million that were issued to third parties; eight totaling approximately \$3 million which were issued during 2007-2008. None of the tasks assigned were competitively bid.

Additionally, a competitively bid program support prime contract stipulated that sub-contracts were allowable and specifically identified the entities that would be used. We found 15 instances totaling \$627,648 where activities were assigned directly to sub-contractors through work authorizations issued by the Commission. Again, none of the sub-contractor activities appeared to be competitively bid.

Further, in our interviews and survey, staff consistently stated that the contracting/sub-contracting policy and the UC—MRA and UC—BOA contracts were ways to circumvent standard practices. Specifically, staff stated that the BOA and MRA are convenient tools to bypass the standard process. Under the BOA, funds can be issued as quickly as six weeks versus six months following standard procedures. If a contract/project manager has a project they want funded more expediently, they will initiate a work authorization through either the BOA or MRA rather than initiate a contract directly with the party. Because the manner with which the policy and prime agreements are written, this is an allowable practice.

The Commission's application of its policy is questionable because it gives the impression that competitive bidding requirements and state contracting policies are being circumvented, and increases the risk of fraud and bias. Further, excessive administrative costs are being created.

Although PIER program management indicated that the practice of issuing work authorizations to third parties was no longer occurring, the policy has not been documented, nor have the prime contracts been amended to prevent this practice.

#### **Recommendations:**

- A. Re-evaluate the use of prime contracts and work authorizations, and non-competitive bid practices. Encourage the use of competitively bid contracts and direct contracting with parties. Implement policy to require the practice as the norm, rather than the exception.
- B. Develop and implement management controls to provide for an open and competitive contracting process that promotes accountability and fairness, and limits the risk of fraud, waste, and abuse.

#### **Observation 10: Excessive Administration Costs**

The Commission's management of the PIER program has resulted in excessive administration costs; reducing the funds expended on research, development, and demonstration activities. We identified the following examples:

- Using prime contracts to award funds. Although this practice is allowed by the PRC<sup>16</sup>, it has resulted in excessive administration costs. For example, a work authorization issued under the UC—MRA was awarded by the Commission to the UC's California Institute for Energy and Environment (CIEE), who then awarded the funds to Lawrence Berkeley Laboratories (LBL), who in turn awarded the funds to three sub-contractors. In this example, the Commission oversees the MRA work authorization with CIEE, CIEE oversees the contract with LBL, LBL oversees the contracts with the three sub-contractors. This creates, at a minimum, three layers of administration which reduces the amount of funds being expended on research. A similar situation was identified with the San Diego State University (SDSU) grants program contract. The Commission contracted with the California State University Trustees who in turn contracted

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<sup>16</sup> PRC sections 25620.3 and 25620.7

with the SDSU Foundation to administer the program; adding an extra layer of administrative costs.

- Duplicate functions between PIER program staff and CIEE exist. The Commission contracts with the CIEE to perform administrative program activities under the UC—MRA contract. The terms of the CIEE work authorization require the CIEE to administer and manage the work authorizations issued under the prime contract. This includes monitoring the progress of each project, ensuring compliance with the terms and conditions of the agreement, and reviewing invoices. The CIEE then forwards the invoice and progress reports to the Commission. Upon receipt, the PIER program staff duplicate the responsibilities assigned to CIEE by also reviewing the progress of the projects in detail and reviewing and approving invoices for payment.

**Recommendations:**

- A. Re-evaluate the use and structure of prime contracts. Ensure the use and structure of awarding funds provides the most cost efficient means of accomplishing program goals.
- B. Issue contracts directly with parties when possible. Should the Commission require program support contracts for assistance with its administration, all means should be taken to ensure the most efficient expenditure of funds.
- C. Cancel or amend the work authorization with the CIEE; or revise Commission program staff duties to eliminate duplicated tasks performed.
- D. Review other prime agreements and ensure program administration tasks are not duplicated.

**Observation 11: Two Functionally Equivalent Prime Contracts with One Vendor**

Two functionally equivalent prime contracts were identified with one vendor—the UC: UC—MRA and UC—BOA. Although the contracts were initially established for different purposes, contract amendments have resulted in both contracts allowing RD&D and program support activities. However, two primary differences exist. First, work authorizations issued under the MRA are required to be reviewed and approved by the Commission’s Research and Development Committee and Commissioners. BOA work authorizations are authorized by the PIER contract manager and Division Deputy Executive Director, and are not subject to the Committee or Commissioners’ approval. As such, the BOA has less restrictive oversight. Second, the CIEE is reimbursed both for the actual costs incurred for managing the MRA agreements and a service fee based on a percentage of the work authorization dollars for management of BOA agreements. Maintaining two functionally equivalent contracts with the same organization is not sound business practice. Additionally, because of the UC—BOA structure, Commission controls can be circumvented, thus increasing the risk of inappropriate use of funds.

**Recommendation:**

- A. Establish and maintain one prime contract with the UC, if deemed necessary. The contract can encompass both RD&D and program support activities. Two contracts may be maintained as long as each is functionally different.

**OPERATIONS**

Program operations are a set of coordinated tasks and activities, conducted by both people and equipment, which will lead to accomplishing a specific programmatic goal. PIER program operating processes include inconsistent and flawed practices that reduce the assurance that projects are adequately managed and state assets are protected from inappropriate use.

## **Observation 12: Inconsistent Project Management Practices**

Although oversight of projects is exercised, we identified inconsistent practices and areas where the Commission could strengthen its PIER program contract management process.

### ***Inconsistent Authorization Process***

The authorization process for all aspects of the PIER program are not documented. The results of our survey showed inconsistencies and uncertainties with respect to invoice, progress report, contracts, work authorizations, and grants processing approvals. We observed that most invoices, contracts, and work authorizations, regardless of the amount, were receiving the same review and authorization process, which creates an inefficient and lengthy process. Approvals and authorizations should be established based on the type and dollar amount of the document and/or risk levels.

Additionally, approvals authorizing payment of invoices by program staff are not documented. Accounting staff seek informal approvals and do not require program staff to authorize by signature or another manner of certification. Should a discrepancy or error occur, accountability would not be apparent.

### ***Inconsistent Evaluation Process***

Inconsistent and inadequate review practices were found amongst contract and project managers. Although a majority of survey respondents indicated performing a detailed comparison of progress reports and invoices to the contract terms and conditions, a few respondents stated they follow other methodologies. Further, the process followed when analyzing projects for work authorization awards varied among the thirteen respondents as did the methodology followed to determine if the tasks, timelines, and budgets are reasonable. For example, one contract manager reported arbitrarily doubling the requested overhead rate—in this instance, the rate was increased to 98 percent.

### ***Inconsistent Progress Report Monitoring***

Although all survey respondents monitor contractors to ensure progress reports and invoices are submitted regularly, the methods followed if a contractor does not varied. All respondents would contact the contractor via phone call or email. Subsequent to the initial communication, the process varied. Several stated they would refuse payment of invoices until progress reports are submitted; while some stated they would request a Critical Review Committee meeting.

### ***Contractor Site-Visit Variances***

Respondents to our survey indicated variances with respect to conducting site visits. Visits ranged from one to more than five per year. For those projects that lend themselves to site visits for proper management, guidance as to the amount or timing should be provided by PIER management.

### ***Caseload Reporting Variances***

Caseload reporting variances exist within the PIER program offices<sup>17</sup>. We found that staff level, manner, and frequency varied. Consistent reporting among focus groups and PIER management would ensure that project progress is being adequately monitored and instills accountability upon the contract/project managers.

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<sup>17</sup> See Appendix A for PIER program organization chart

**Recommendations:**

- A. Utilize internal staff expertise to develop best practices for program staff to follow when evaluating and monitoring projects<sup>18</sup>.
- B. Ensure all projects require development and reporting of detailed tasks, deliverables, timelines, and budget/expenditures. Flexibility can be granted on a case by case basis, and exceptions should be justified and documented. Allowable instances for exceptions should be outlined and documented in the work authorization processing policy to ensure consistent staff implementation.
- C. Require the same review process for all invoices. Allowances and deviations should be based on dollar amounts and/or risk levels; not by program and/or Commission Division.
- D. Require all PIER program staff to use the CEC 103 form to provide documentation of review and approval of progress reports, and authorization to pay invoices.
- E. Consider requiring contractors/sub-contractors to provide supporting information regarding budget calculations and estimates for use during evaluations.

**Observation 13: Flawed Invoice Process**

The streamlined invoice process does not provide adequate assurance that actual and appropriate costs are reimbursed. Under the streamlined process, contractors are not required to submit documentation supporting the costs claimed for reimbursement. Requiring supporting receipts would increase the contractors' accountability and reduce the risk of inappropriate costs being claimed and reimbursed.

Additionally, a standard invoice format is not required amongst contractors. A suggested invoice template is available on the Commission's website, but its use is optional. During testing of the invoice process, we observed three different invoice formats used by contractors; two of which prohibited the contract manager from effectively reviewing the invoice. Those two invoice types provided summary level information rather than detailed costs by task. Thus the contract manager had no basis for reviewing the invoice in comparison with the terms of the agreement or progress of the project.

Further, because large dollar invoices do not require a second level of review, a single individual has the responsibility of determining if the costs claimed are reasonable, appropriate, and in compliance with the terms of the agreement. A second review and authorization for large dollar invoices is a good management practice and reduces the risk of inappropriate or unallowable costs being reimbursed.

Although the Commission has attempted to negate some of the streamlined invoice processing risk by contracting with the State Controllers Office (SCO) to perform audits; the audits are not performed regularly and work authorizations issued under prime contracts are not included in the audit population. As of June 2007, the SCO has completed 113 audits of 219 completed contracts (52 percent). The SCO identified \$180,000 in unallowable costs claimed by the contractors.

**Recommendations:**

- A. Standardize the invoice format by requiring all contractors to use the "suggested format" invoice maintained on the Commission's web-site. Flexibility can be granted on a case by case basis, but exceptions should be justified and documented. Allowable instances for exceptions should be outlined and documented in the invoice processing policy to ensure consistent staff implementation.

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<sup>18</sup> See Appendix E for potential resources

- B. Require supporting documentation be submitted with all invoices. To decrease processing time, the Commission may elect to review supporting documentation on a sample basis.
- C. Require a second review and authorization for large dollar invoices. The Commission, at its discretion, can determine the level of risk to assume in determining the review dollar and authorization levels.
- D. Increase the frequency and number of audits. All agreement types should be included in the population and subject to audit.

**Observation 14: Lack of Reconciliation between Calstars and PIMS**

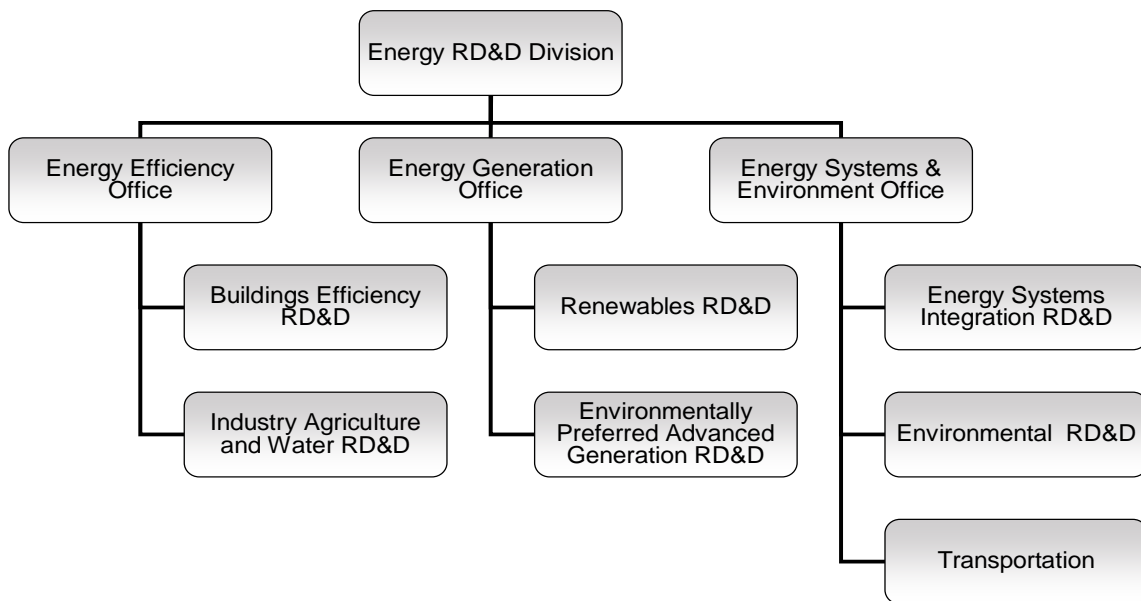
The Commission does not perform a system reconciliation between the two accounting systems it uses to account for the fiscal operations of the PIER program, specifically California State Accounting and Reporting System (Calstars) and PIMS.

Calstars and PIMS do not interface; information must be entered into each system separately. Because a reconciliation of information between the two systems is not performed, the Commission cannot be assured that the summary (Calstars) is accurate or supported by the details (PIMS). For example, liquidation of a 2007-08 encumbrance in PIMS may have been recorded as a liquidation of a 2004-05 encumbrance in Calstars. Reconciliations between the systems will enhance the reliability of information and will allow Commission management to use the systems in conjunction to promote effective program management.

**Recommendation:**

- A. Perform and document a reconciliation between Calstars and PIMS, at least quarterly. Variances identified should be researched and resolved.

## PIER Program Organization Chart



Source: California Energy Commission, June 30, 2008

## AWARDING MECHANISMS

The Public Resources Code Sections 25620.1 (d), 25620.3, and 25620.5 authorize the Commission to use several mechanisms to award PIER funds. Those mechanisms include:

### **Prime Contracts**

Prime contracts are broad in scope and are issued for a lump sum dollar amount. Work authorizations are initiated for specific tasks and dollar amounts, under the scope of the prime contract. Prime contracts may be issued through a competitive or non-competitive process.

### **Contracts**

Contracts are entered into with entities for specified tasks and dollar amounts. Contracts may be issued through a competitive or non-competitive process.

### **Grants**

Grants are entered into with entities for specified tasks and dollar amounts. Grants are normally issued through a competitive process.

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## NON-COMPLIANT CONTRACTS AND WORK AUTHORIZATIONS

Two contracts and four work authorizations were found to be non-compliant with applicable requirements. Instances are as follows:

### **Contract 500-02-004: UC—MRA**

- Inconsistent and contradictory terms and conditions. The Commission included interagency standard terms and conditions in the MRA that were inconsistent with or contradicted other terms and conditions in the same contract. This, in addition to the use of a form normally not used for interagency agreements<sup>19</sup>, resulted in a confusing contract with terms that may not be enforceable if a dispute occurred.

### **Contract 500-06-013: Technical (i.e. Program) Support Contract with Private Entity**

- Evaluation criteria for consultant services was not included<sup>20</sup>.
- Contract was not amended in compliance with the SCM. Specifically, a competitively bid contract cannot be amended or modified unless it qualifies for an exception as provided by the SCM<sup>21</sup>. We did not identify an exception that applied, nor was the required justification form included in the contract file.

### **Work Authorizations**

- One (013-P-06) provided inconsistent guidance on travel and per diem reimbursements, circumvented the state procurement process by authorizing the contractor to enter into a contract with a hotel on behalf of the state, and included an unreasonable surcharge (26 percent totaling \$15,488) on conference hotel charges.
- One (008-P-06) did not provide measurable deliverables.
- One (BOA 135-P-05) did not detail tasks, deliverables, or timelines, as required.
- One (BOA 131-P-05) was issued directly to a third party and did not include supporting information on the sub-contractor method of selection. Because the prime contract did not include allowable sub-contractors, we were unable to determine if the contractor was approved by the Commission.

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<sup>19</sup> When the contract was initiated, two forms were allowable by the SCM: Standard Agreement (STD 213) and Interagency Agreement (STD 13). Although the UC-MRA was an interagency agreement, the Commission used the STD 213 form.

<sup>20</sup> PCC 10371(c)

<sup>21</sup> SCM sections 3.09 and 5.80

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## ANALYSIS OF COMMISSION-WIDE MANUALS

The primary resources PIER program staff reported using for contract and grant guidance were the Commission-wide Contract Manual and Project Managers Manual. As such, we reviewed the manuals for consistency with the PRC, state contracting laws, regulations, and policies, internal policies, and best practices.

Weaknesses were observed with both manuals. As such, appropriate guidance to PIER program staff was not being provided. The following weaknesses were observed:

### Commission Contract Manual

- Did not incorporate PRC guidance defining conditions for selecting an award solicitation method and convening award proposal scoring teams.
- Did not define or require documentation supporting "fair and reasonable" pricing.
- Did not incorporate PIER program contract/sub-contract policy.
- Did not include requirements specific to contractor selection such as requiring the review of existing contractor evaluations on file at DGS prior to issuing awards in excess of \$5,000; or the requirement that each contractor participant attach its resume to the contract.
- Did not describe the authorization levels applicable to contract amendments.
- Did not provide guidance regarding staff conflict of interest requirements.
- Did not require a post evaluation of contractor performance.
- Did not require that non-competitively bid documentation be retained in the contract file.

### Project Managers Manual

- Manual described two solicitation methods for grant awards, while the PRC<sup>22</sup> authorizes six.
- Manual identified program manager as performing the application evaluation while best practices dictate evaluations should be conducted by a committee.
- Manual provided that the program manager should conduct a solicitation workshop, but does not provide guidelines for conducting the workshop.
- Manual stated that each Commission Division is responsible for establishing authorization requirements; however such requirements have not been documented for the PIER program.
- Manual lacked guidance regarding non-compliance with reporting requirements aside from notifying the Grants and Loans Office regarding any administrative issues; but language does not define an administrative issue. Further, action to be taken by the Grants and Loans Office is not specified.

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<sup>22</sup> PRC section 25620.5 (a)

- Manual provides that the accounting office, not program staff, is responsible for reviewing payment requests for attributes such as verifying expenditure consistency with the project scope. However, because PIER projects may be technical, this task is performed by PIER program staff and the manual should note the exception.
- Manual exempted the PIER program from submitting invoices/progress reports to the Grants and Loans Office for review. As such, the PIER program staff are not required to complete the CEC 103 form.
- Manual did not describe the requirements for termination of a contract beyond stating that award terminations may be granted by breach or convenience. While the PIER program has a Critical Review Committee (CRC) meeting process, the factors for consideration of termination are not documented.

**RESOURCES**

Resources to assist with development of best practices and policies and procedures include:

- Federal Acquisition Regulation Section 31.201-3 *Determining Reasonableness of Costs*, [www.acqnet.gov/Far](http://www.acqnet.gov/Far)
- PIMS PIER CPM Handbook, *Earned Value Analysis*
- Office of Management and Budget Circular A-21, *Cost Principles Applicable to Grants, Contracts, and Other Agreements with Institutions of Higher Education*, [www.whitehouse.gov/omb](http://www.whitehouse.gov/omb)
- Office of Management and Budget, *Best Practices for Multiple Award Task and Delivery Order Contracting*, [www.whitehouse.gov/omb](http://www.whitehouse.gov/omb)
- Domestic Working Group, *Guide to Opportunities for Improving Grant Accountability*, [www.epa.gov/oig/dwg/reports](http://www.epa.gov/oig/dwg/reports)
- United States Government Accountability Office, *Grants Management September 2006*, GAO-06-1046, [www.gao.gov](http://www.gao.gov)
- National Science Foundations, *Grant Policy Manual, July 2005*, [www.nsf.gov](http://www.nsf.gov)

**TABLE OF AUDIT OBJECTIVES AND RESULTS**

The Commission's request for audit included 11 specific objectives. The following table is a listing of the specific objectives, summarizing the results, and referencing to the observations reported in the Results section of our report.

Objective	Description	Summarized Results	Corresponding Observations
1	PIER program operating in compliance with PRC.	Instances of non-compliance were observed.	1, 2, 3, 4, 5
2	PIER program operating in budget.	PIER program is operating within encumbrance and liquidation <sup>23</sup> requirements, Budget Act appropriations, and PIER program budget allocations. However, instances of non-compliance with Budget Change Proposals were identified.	4, 14
3	PIER program's contracting policies comply with state contracting laws and policies. Review will focus on UC-MRA, UC-BOA, and one technical support contract.	Non-compliance instances were observed with two of the three contracts tested. Additionally, instances of non-compliance with the Commission's Contract Manual were observed.	1, 2, 6
4	PIER program sub-contracting terms and internal policies comply with state contracting law and policies.	Policy developed for the PIER program includes exemptions from state contracting rules. DGS did not specifically confirm approval of this policy. Policy fosters an environment of high risk to the state and PIER funds. Weaknesses and questionable practices were identified.	1, 6
5	Use of PIER program contractors, sub-contractors, and interjurisdictional exchanges are in compliance with state laws and policies.	Instances of questionable practices were observed, but do not necessarily constitute non-compliance.	7, 9, 10, 11
6	PIER contract and project managers are adequately managing projects to ensure work is performed consistent with the contract terms, work statement, and budget.	Inconsistent management practices were identified thus reducing the assurance that adequate project management is occurring.	6, 12
7	Proper procedures exist and are being followed for evaluating the reasonableness of costs when developing contract and/or work authorization budgets.	Procedures have not been developed or documented.	6, 12
8	PIER work authorization procedures ensure work and costs are budgeted, expended, and billed in accordance with contract terms and state laws and policies. Also determine if work authorizations are consistent with the prime contract.	Inconsistent management practices were identified thus reducing the assurance that adequate project management is occurring. Instances of non-compliance with the prime contract were identified with four of six work authorizations tested.	2, 6
9	PIER streamlined invoicing process provides adequate assurance that actual and appropriate costs are being reimbursed.	Streamlined invoice process does not provide adequate assurance that actual and appropriate costs are being reimbursed.	13
10	Proper procedures exist and are being followed to ensure PIER project results and product sales that result from PIER funded projects are adequately tracked, results are reported, and revenues are collected in accordance with the royalty payment terms of the contract or grant and PRC.	Procedures have not been developed or documented.	3, 6
11	PIER grants issuance is in compliance with state laws and policies for issuing grants, and good business practices.	PRC authorizes the Commission to award PIER funds using grants. Instances of non-compliance with the PRC and best practices were observed with the Project Managers Manual and weaknesses observed with the grant terms and conditions.	6, 8, 12

<sup>23</sup> Because the liquidation period had not expired for our audit period, we were unable to determine if the Commission complied with the liquidation requirement. However, we analyzed expenditures as of June 30, 2008 and determined the liquidations to date were within program budgeted amounts and Budget Act appropriation amounts.

# COMMISSION RESPONSE

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## CALIFORNIA ENERGY COMMISSION

1516 NINTH STREET  
SACRAMENTO, CA 95814-5512  
www.energy.ca.gov



January 20, 2009

Mr. David Botelho, Chief of  
State Audits and Evaluations  
915 L Street  
Sacramento, CA 95814

Dear Mr. Botelho:

Thank you for the opportunity to respond to the program audit report, "California Energy Commission, Public Interest Energy Research Program, Programmatic Audit." The California Energy Commission requested this audit because it wanted an unbiased, external assessment of the Public Interest Energy Research (PIER) Program's contracting practices. The audit report will assist the Energy Commission in improving our operation and oversight of this important program, as well as other Energy Commission programs.

The Energy Commission has already taken steps to improve administrative oversight and operations; the audit recommendations will be an important part of our ongoing process. I am pleased that the audit recognizes and validates many of the improvements that we have made to date.

The Energy Commission wishes to acknowledge your staff for their hard work, professionalism, and the detailed recommendations provided in the report.

Thank you for this opportunity to provide a written response to the audit report.

Sincerely,

Original signed by:

MELISSA JONES  
Executive Director

Enclosure

**SPECIFIC RESPONSES TO THE DOF AUDIT REPORT OF THE PIER PROGRAM**  
**January 20, 2009**

The Energy Commission is taking two primary actions to address issues raised in the Department of Finance audit report. First, we will work with the Department of General Services to update the Public Interest Energy Research (PIER) program policies and contracting procedures. Second, the Energy Commission will develop a comprehensive PIER Policy and Procedures Contract Manual and implement contract manager training on the new manual.

**Observation 1: PIER Subcontracting Policy**

Response: The audit report noted that the PIER contracting/sub-contracting policy is no longer applicable to current practices. While state contracting policies have generally been developed to procure services, goods, and construction, the need for the policy stemmed from the unique role of PIER contracts within state contracting. The Energy Commission recognizes that changes in PIER contracts have occurred since the policy's inception.

Action: The Energy Commission will work with DGS to develop and implement policies and an improved contracting process that is consistent with state procurement regulations and meets the Energy Commission's unique programmatic contracting needs. The Energy Commission will also develop a PIER contract manual and institute a new round of training for PIER contract managers using the new manual.

**Observation 2: Contracts and Work Authorizations**

Response: The audit report identified concerns about the streamlined invoice management process that was set up under prior Energy Commission management. As stated in the report, the current Executive Director has eliminated the streamlined invoice process in August 2008 and directed the Commission's Legal Office to review all work authorizations.

Action: Completed

**Observation 3: Collect Intellectual Property Payments**

Response: The audit report states that the Energy Commission does not have established procedures for staff to monitor project results and product sales to ensure that projects are adequately tracked, results reported, and revenues collected. PRC Section 25620.4(a) requires that an equitable share of rights in the intellectual property or in the benefits derived from projects shall accrue to the state. Currently, the Energy Commission's Contracts Office has procedures to identify contracts with the potential to generate intellectual property payments as part of their closeout procedures; however, we agree that more should be done to ensure repayment.

Action: The Energy Commission will expand current procedures to closely monitor project results and product sales to ensure that revenues are collected. The process for monitoring completed projects for intellectual property development will be included in the PIER contract manual. The Energy Commission will also re-evaluate the equitable share of rights accruing to the state from PIER projects.

#### **Observation 4: Reclassification of Authorized Positions**

Response: The audit report identified positions that were not performing the duties authorized in the original Budget Change Proposals. The Energy Commission concurs with this observation. In certain instances, the Energy Commission reclassified positions to lower levels after an extensive unsuccessful recruitment to fill the position. The reclassified positions are performing duties in direct support of the PIER program in keeping with the report's recommendation.

Action: The Energy Commission is reviewing its reclassification policy to ensure that staff have clear guidelines and we are establishing a tracking system for BCP positions.

#### **Observation 5: Personnel Management Liaison Memos**

Response: The Energy Commission concurs that there has been inconsistency in providing union representatives with appropriate contract documents. The Contracts Office, in consultation with the Energy Commission's labor relations officer, has implemented and documented a formal process to ensure union representatives receive the appropriate contract documents when using bargaining unit services.

Action: Completed

#### **Observation 6: Written Policies and Procedures**

Response: The audit report recommends developing a policy and procedures manual specific to the PIER program. The Energy Commission agrees that while much information is contained in the Energy Commission's contract manual and other management memos, such as definitions for RD&D and program support activities, the Energy Commission should develop a contracting manual specifically for the PIER program.

Action: The Energy Commission will develop a PIER contract manual and provide training for PIER contract managers on the manual.

#### **Observation 7: Program Support Contracting Methodology**

Response: The audit report identifies concerns with the criteria for contracting with outside consultants. The Energy Commission's policy is that both the Legal Office and the Contracts Office must review and approve PIER contracts to ensure that the Energy Commission properly hires and uses contractors. The contracts office staff and attorneys ensure compliance with Government Code section 19130. The decision to enter into a support contract does not rest with staff or solely hinge on the timeframe of the work.

Action: Legal Office attorneys ensure compliance with Government Code section 19130 for all PIER contracts. Staff are being trained on the current approval process for program support contractors and information on GCS 19130 will be included in the PIER contract manual.

#### **Observation 8: Grant Terms and Conditions**

Response: The audit report states that funding sources for grants are unclear and may cause confusion for the PIER program grants manager. The Energy Commission Grants and Loan Office ensures the funding source for each grant by listing it in the grant application manual of each solicitation, on the cover page of each individual grant agreement and on an internal form that became effective July 1, 2008.

Action: Based upon the report's recommendation, the Energy Commission is evaluating a standard grant invoice form.

#### **Observation 9: Prime Contracts**

Response: The audit report notes that in the past, the prime contracts with the University of California (UC) were used to obtain the services of non-UC entities. The Energy Commission ended this practice in 2007, as acknowledged in writing by UC and since that time the Energy Commission's Legal Office has reviewed all work authorizations. PIER staff are receiving training.

Action: Energy Commission Legal Office attorneys reviews all work authorizations. Current contracting practices and the approval process will be addressed in the PIER contract manual and staff training on the contract manual will be implemented.

#### **Observation 10: Administration Costs**

Response: The audit report notes that having too many layers of contractors and subcontractors creates unnecessary overhead. The Energy Commission takes fiscal oversight very seriously. The Energy Commission has negotiated a lower overhead rate for all of its PIER agreements with the University of California (UC). In September 2007, the Energy Commission stopped issuing work authorizations to non-UC entities and issues direct agreements to reduce overhead to both UC and non-UC entities. The audit report also indicates that UC

and PIER staff perform duplicative administrative activities under the Master Research Agreements (MRA). Although the duties have similar descriptions, they are in fact distinct. California Institute for Energy and the Environment (CIEE) coordinates the UC's work to ensure that it complies with contract responsibilities. PIER staff are responsible for ensuring that the Energy Commission contract is properly administered, including the review and approval of invoices and deliverables.

Action: Lower overhead rates have been negotiated and the practice of issuing work authorization to non-UC entities has stopped. The Energy Commission is training staff to better identify and prevent situations of multiple overheads in PIER agreements. The Energy Commission will also clearly identify in any new UC master agreement which administrative duties are the responsibility of the UC.

#### **Observation 11: Prime Contracts**

Response: The audit report identifies and the Energy Commission concurs with the observation that the Energy Commission requires only one prime contract with UC. When the Energy Commission and UC first executed the MRA and Basic Ordering Agreement (BOA), there were good reasons for two agreements. However, because of changes to the two agreements, these reasons have eroded over time.

Action: The Energy Commission is currently negotiating terms for a new prime contract with UC. When executed, the new contract will combine the functions of the current MRA and BOA into one agreement.

#### **Observation 12: Project Management Practices**

Response: The audit report noted inconsistencies with the oversight of projects. The report recommends, and the Energy Commission agrees, that there are areas where the program contract management process can be strengthened, including project-related authorizations, evaluations, progress report monitoring, contractor site visits, and caseload reporting.

Action: The Energy Commission will develop a PIER contract manual that includes the contract management processes identified in the report and will provide training for PIER contract managers. (See Observation 1 and 6).

**Observation 13: Invoice Process**

Response: The Energy Commission concurs with the audit report observation that PIER's streamlined invoice process did not provide adequate assurance that actual and appropriate costs are reimbursed.

Action: In January 2008, the Energy Commission began the effort of assessing the invoice review process and effective August 2008; the Energy Commission discontinued the previous streamline invoice process. (See Observation 2)

**Observation 14: Reconciliation between Calstars and PIMS**

Response: The audit report noted that Energy Commission does not reconcile the two accounting systems. The Energy Commission concurs with this observation.

Action: The Energy Commission will develop and implement a plan to automate information reconciliation regularly between Calstars and PIMS.

## EVALUATION OF RESPONSE

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We are in receipt of the California Energy Commission's (Commission) response, dated January 20, 2009, to our draft report on the Commission's Public Interest Energy Research Program (PIER), Programmatic Audit. The Commission's response, along with our evaluation, is incorporated into the body of this report. In evaluating the Commission's response, we provide the following comments.

We commend the Commission on its prompt action to improve the administrative oversight and operations of the PIER program and acknowledge the implementation of corrective actions to resolve certain observations noted in our report. We encourage the Commission to continue its efforts to develop and implement corrective actions that address the remaining observations.

As noted in the Commission's response, two primary actions will be taken: (1) Work with the Department of General Services (DGS) to update the PIER program policies and contracting procedures and (2) Develop a comprehensive PIER Policy and Procedures Contract Manual and implement contract manager training on the new manual. While both efforts will address a majority of the reported observations, we note that further action may be necessary to fully address Observation 6, Lack of PIER Program Written Policies and Procedures.

While contracting is a primary function of the PIER program operations, our observation/recommendations address the need to develop and document written policies and procedures directing the entire PIER program. Development of an all-encompassing manual will help ensure efficient program management and operational consistency. As such, we encourage the Commission to expand its corrective actions to include the development of a comprehensive PIER program manual.