

Memorandum



Date: October 31, 2013
To: Paul Clanon, Executive Director
California Public Utilities Commission (Commission)

From: Public Utilities Commission—
San Francisco
Kayode Kajopaiye
Division of Water and Audits

A handwritten signature in black ink, appearing to read "Kajopaiye", written over the typed name.

Subject: General Order (GO) 156 Reporting Compliance Examination
Pacific Gas and Electric Company

Enclosed is a copy of UAFCB's report on the results of our compliance examination of Pacific Gas and Electric Company's (PG&E) Supplier Diversity 2011 Annual Report. PG&E did not demonstrate compliance, in all material respects, with the Commission's directives when reporting its 2011 Supplier Diversity Program. With respect to the sampled transactions of \$249 million that UAFCB examined, PG&E's Supplier Diversity 2011 Annual Report is materially misstated by at least \$25.3 million or 10.1%. In addition, PG&E did not maintain proper documentation for over three percent or \$8.4 million of the sample UAFCB examined.

Among other things, UAFCB is recommending that: (1) PG&E correct its 2011 report and improve its internal controls; (2) file the corrected version and a copy of its revised internal control by November 27, 2013; and (3) PG&E's internal audit department audit its revised report, with oversight from UAFCB.

In Decision 11-05-019, the Commission states, among other things, that beginning in 2012, UAFCB is to conduct a minimum one random audit every two years of a GO 156 annual report and promptly report its findings by letter to the Executive Director. UAFCB is required to segregate reporting companies by industry beginning with energy companies, followed by telecommunications and water in subsequent two-year periods, verify the accuracy of reported diversity procurement. UAFCB randomly selected PG&E, an energy company, to be the first utility to have its GO 156 report audited.

If you have any questions, please contact me at 3-2279.



California Public Utilities Commission
Division of Water and Audits

General Order 156

Reporting Compliance

Pacific Gas and Electric Company
U 39 E

For the Supplier Diversity 2011 Report filed March 1, 2012

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October 31, 2013



Edited by Donna Wagoner

General Order 156 Reporting Compliance
Pacific Gas and Electric Company
U 39 E

For the Supplier Diversity 2011 Report filed March 1, 2012

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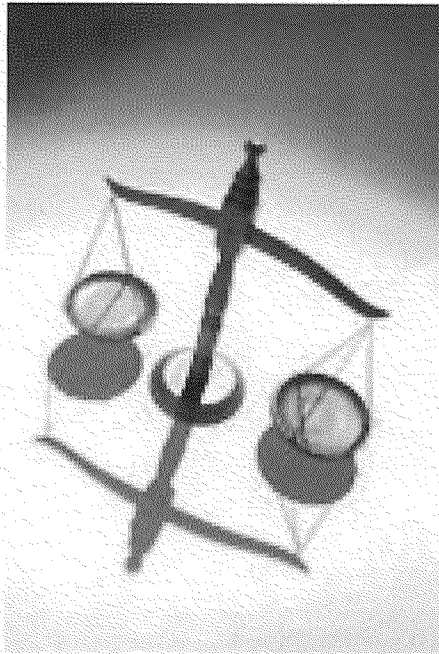
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General Order 156 Reporting Compliance
Pacific Gas and Electric Company (U 39 E)
For the Supplier Diversity 2011 Report filed March 1, 2012

Independent Accountant's Report

Pursuant to Public Utilities Code (PUC) § 314 and Commission Decision (D.) 11-05-019, Ordering Paragraph (OP) 3, the Utility Audit, Finance and Compliance Branch (UAFCB), of the Commission's Division of Water and Audits, performed a regulatory compliance examination or audit of Pacific Gas and Electric Company's (PG&E) reporting on its 2011 Supplier Diversity Program.

PG&E's management is, among other things, responsible for compliance with the requirements of: (1) the PUC; (2) General Order (GO) 28, which sets forth the Commission's rules on the preservation of utility records; (3) D. 11-05-019, in which the Commission amended General Order (GO) 156; and (4) GO 156, which sets forth the Commission's reporting requirements governing the development of programs to increase the participation of diverse suppliers in the utilities' procurement.

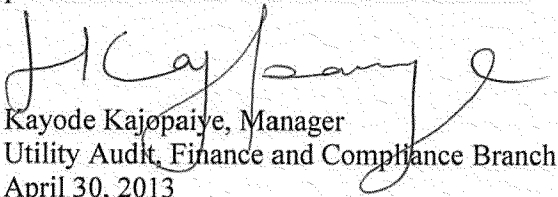
The responsibility of UAFCB is to express an opinion on PG&E's compliance with the aforementioned regulations based on UAFCB's examination of PG&E's records. UAFCB conducted its reporting compliance examination in accordance with attestation standards established by the American Institute of Certified Public Accountants (AICPA) and, accordingly, included examining, on a test basis, evidence concerning PG&E's compliance with the reporting requirements noted above and performing any other procedures as we considered necessary in the circumstances. UAFCB believes that its examination provides a reasonable basis for an examination opinion. UAFCB's opinion does not provide a legal determination on PG&E's compliance with the specified requirements. This report is not intended to and does not address any aspects of GO 156 other than its reporting obligations.

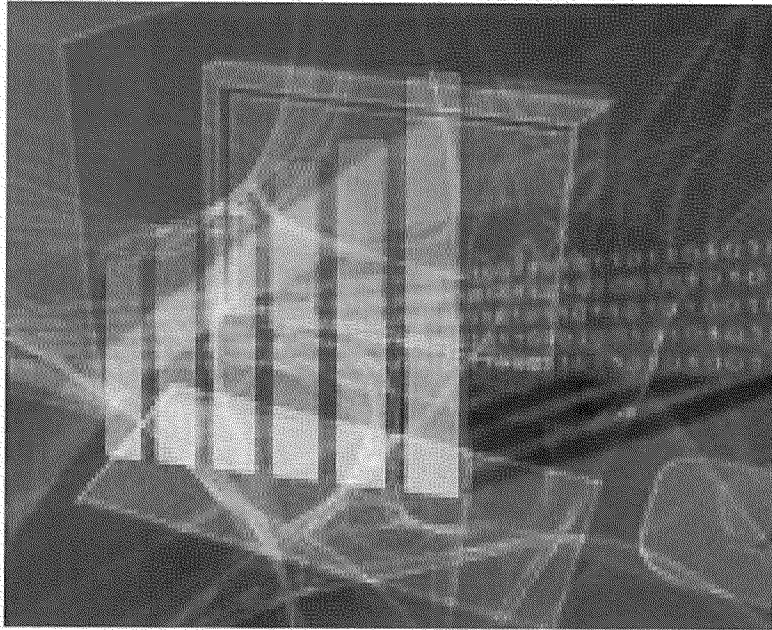
Based on the sampled transactions, UAFCB found the following material reporting and record keeping noncompliance by PG&E:

1. PG&E significantly overstated its direct disabled veteran-owned business enterprise (DVBE) procurement by including \$15.6 million of women and minority-owned business enterprises who were not also DVBE in its reported DVBE procurement. In addition, PG&E included \$1.0 million of transactions with a supplier who did not have a verifiable DVBE certificate.
2. PG&E significantly overstated its diverse procurement by not deducting almost \$2.7 million of discounts, markups, voided transactions, and moneys retained by itself and its prime non-diverse suppliers before paying for its diverse procurement.
3. PG&E significantly overstated its diverse spend by including \$4.2 million of 2012 procurement.
4. PG&E did not maintain adequate documentation to support \$8.3 million of its reported diverse procurement. Based on the limited information PG&E provided, UAFCB determined that PG&E should not have reported \$4.7 million of this amount as diverse procurement.

Because of the significant effects of the aforementioned noncompliance by PG&E, PG&E did not demonstrate compliance, in all material respects, with the aforementioned requirements with respect to the record keeping and reporting of its 2011 Supplier Diversity Program. The errors disclosed by the sampled transactions show that PG&E possibly materially misstated its report and did not maintain adequate documentation to substantiate its diverse procurement.

UAFCB cannot express an opinion with regards to the accuracy of \$3.6 million of supplier diversity procurement that PG&E did not substantiate.


Kayode Kajopaiye, Manager
Utility Audit, Finance and Compliance Branch
April 30, 2013



General Order 156 Reporting Compliance

Pacific Gas and Electric Company

U 39 E

For the Supplier Diversity 2011 Report filed March 1, 2012

I. EXECUTIVE SUMMARY¹

This report presents the results of an examination conducted by the Utility Audit, Finance and Compliance Branch (UAFCB) of Division of Water and Audits. The purpose of the examination or audit was to determine whether Pacific Gas and Electric Company (PG&E) complied with General Order (GO) 156's reporting requirements when reporting its 2011 diverse procurement. UAFCB conducted the examination pursuant to Decision (D.) 11-05-019.²

Due to the deficiencies described in this report, PG&E did not fully demonstrate reasonable compliance with Commission directives with respect to the reporting of its 2011 Supplier Diversity Program in the areas that UAFCB examined. Given the sampled transactions, PG&E materially misstated its Supplier Diversity 2011 Annual Report by at least \$23.5 million for the transactions that UAFCB reviewed.³ In addition, PG&E did not maintain adequate documentation for over 29.1% percent or \$8.3 million of the sample that UAFCB examined in these areas. PG&E's lack of documentation prevents UAFCB from expressing an opinion on \$3.6 million of this \$8.3 million of diverse procurement.⁴ Since UAFCB could not verify that \$3.6 million of procurement, UAFCB requests that the \$3.6 million be excluded from PG&E's diverse procurement in its report.

During the audit, UAFCB discussed the types of reporting errors it was observing with PG&E. After discussing one of the types of errors, PG&E's failure to net out unpaid discounts afforded by its prime suppliers, PG&E acknowledged that its reported amounts for its total and diverse procurement did not account for early payment discounts. PG&E provided UAFCB with revised amounts for its total and diverse procurement. However, UAFCB deemed these revised amounts as unreliable because of other types of reporting errors PG&E made and the revisions that PG&E submitted did not account for those other errors.

PG&E did not provide its substantiation to UAFCB in a timely manner. PG&E did not begin to provide UAFCB with its data for UAFCB to conduct its field work until December 11, 2012, nearly five months later than when it was originally due. Even then, some of the data provided was incorrect, and PG&E needed to resupply it after UAFCB discovered the errors, and PG&E failed to provide other data until well into 2013. When UAFCB was in the field, it found that PG&E had not even requested many of its prime contractors to provide the subcontracting data UAFCB requested months before. As a result, UAFCB's field work was

¹ Appendix A describes the abbreviations and acronyms used in this report.

² See D. 11-05-019, page 33 and Ordering Paragraph 3.

³ See PG&E's report entitled "Supplier Diversity 2011 Annual Report-2012 Annual Plan," dated March 1, 2012.

⁴ UAFCB determined that PG&E overstated \$4.8 million of the transactions that lacked proper documentation.

substantially delayed and prolonged. In addition, because PG&E did not provide UAFCB with all the requested documentation at one time and sometimes provided wrong data, the overall examination costs to the Commission were increased and UAFCB's audit staff was unavailable to begin other projects.

The areas that UAFCB examined included the accuracy of amounts PG&E reported it spent in 2011 on procurement with women (WBE), minority (MBE), collectively known as WMBE, and disabled veteran-owned (DVBE) business enterprises, collectively referred to as WMDVBE.⁵ The reporting directives that UAFCB used to test compliance included, but were not limited to, D. 11-05-019 and GO 156.

Due to the limited scope of UAFCB's examination, UAFCB cannot provide complete assurance to the reasonableness of the diverse procurement amounts that PG&E reported in its Supplier Diversity 2011 Annual Report.

Directly below is a summary of UAFCB's recommendations resulting from its examination. Among the recommendations, UAFCB recommends that PG&E correct and re-file page 47 of its 2011 report by November 27, 2013 and that PG&E's internal audit department conduct an audit to verify the accuracy of the revised 2011 and 2012 pages 47, subject to UAFCB's review and approval of the scope, work plan and work papers. Once the audit is complete, PG&E should submit a full revised GO 156 report for each of the audited years. If PG&E does not begin the audit by March 1, 2014, the audit should also include page 47 of its 2013 report in the audit. At the latest, PG&E's internal audit report needs to be submitted to UAFCB on or before December 31, 2014. UAFCB is concerned that PG&E may have made the same types of errors when it compiled and submitted its 2012 report. Consequently, UAFCB recommends that PG&E also correct and re-file its 2012 report and that the 2012 corrected report be audited with the 2011 report. In addition, PG&E should not use the costs of the internal audit as historical costs in its next general rate case.

The numbering of the recommendations below corresponds to the numbering of the related observations.

II. RECOMMENDATIONS

Recommendation 1: PG&E needs to ensure that it reports only direct DVBE suppliers as direct DVBE. When it revises its 2011 report, it should only move the portion, if any, of \$15.6 million DVBE prime overstatement for which it can correct all of the deficiencies, No. 1-6 listed in Observation 1.

Recommendation 2: PG&E needs to ensure that it only reports DVBE that have valid certificates for the entire reporting period and exclude any contract amounts paid when a contractor does not have a valid certificate. Among other things, PG&E needs to maintain a copy of proof of certification in its files when it contracts or subcontracts with a vendor and each time the vendor is recertified. PG&E needs to remove \$1,035,523.03 in DVBE subcontracting from its 2011 report.

⁵ See page 47 of PG&E's report entitled "Supplier Diversity 2011 Annual Report-2012 Annual Plan," dated March 1, 2012. For convenience, a copy of PG&E's page 47 is included in Section III. of this report.

Recommendation 3: PG&E needs to train its diversity staff that compile the data for its procurement report to ensure the staff can properly and correctly reconcile its procurement data. When reporting its diverse procurement, PG&E needs to ensure that it excludes early payment discounts deducted before making payment to its direct or prime vendors and canceled transactions.

Recommendation 4: PG&E needs to improve its contracting practices to ensure it receives correct information from its contractors. PG&E needs to ensure that it only reports the payments that its diverse subcontractors actually receive.

Recommendation 5: PG&E needs to ensure that all of its diverse procurement data is reported to the Commission using the cash basis of accounting. At a minimum, PG&E needs to remove \$4,196,871 from its diverse subcontracting per the table in Observation 5 before submitting its revised 2011 report. PG&E should go through its prime contractor invoices and compile the correct data in this area when revising its 2011 report.

Recommendation 6: PG&E needs to ensure that it retains sufficient documentation associated with its procurement to facilitate verification of the accuracy of all transactions associated with its procurement data reported to the Commission. PG&E needs to remove \$3,618,612 from its diverse subcontracting per the table in Observation 6 before submitting its revised 2011 report, unless it can provide UAFCB with the invoices and purchase orders.

Recommendation 7: PG&E needs to ensure that the percentage of purchases from DVBE is correctly represented in the procurement data that it reports to the Commission.

Recommendation 8: PG&E should train its reporting staff to use the correct procurement data when compiling the data for the procurement reports and utilize a sufficient review process of the information before submitting its reports to the Commission. PG&E needs to ensure that it uses correct data when compiling information for and when reporting on its diverse procurement.

Recommendation 9: PG&E should amend its contracting processes and its contracts to specify how much of the payments the prime contractors can keep and require its contractors to accurately report information about their subcontracting. PG&E should require its prime contractors to report enough data so that PG&E can correctly report on a cash basis, net of any voided transactions, estimates, early payment discounts, markups, etc. PG&E should also require its contractors allow PG&E to conduct periodic audits of its diverse contracting and subcontracting. In addition, PG&E should require its vendors to keep, for at least three years and provide when requested, adequate documentation to fully substantiate the diverse subcontracting transactions. This should not be an onerous requirement as its direct and subcontractors need to keep such documentation for tax and/or financial reporting purposes.

Recommendation 10: By November 27, 2013, PG&E should add, implement and enforce new internal controls for its supplier diversity reporting to prevent future misclassification of PG&E purchases from its diverse procurement. PG&E should correct page 47 of its 2011 and 2012 reports and re-file the corrected versions by November 27, 2013. PG&E's internal audit department should conduct an audit to verify the accuracy of the revised page 47 for 2011 and page 47 of its 2012 report, subject to UAFCB's review and approval of the scope, work plan and work papers. Once the audit is complete, PG&E will need to submit a full revised GO 156 report for each of the audited years. If PG&E does not begin the audit by March 1, 2014,

the audit should also include page 47 of its 2013 report. At the latest, PG&E's internal audit report needs to be submitted to UAFCB on or before December 31, 2014. In addition, PG&E should not use the costs of the internal audit as historical costs in its next general rate case.

Recommendation 11: PG&E should ensure that it maintains all supporting documents associated with its Supplier Diversity Program in such a manner that UAFCB may readily examine them at its convenience.

III. BACKGROUND

In 1986, the California Legislature enacted Public Utilities Code (PUC) §§ 8281-8285 in which it made findings about the economic benefits of full and free participation by WMDVBE in utility procurement. The Legislators also found that promoting utility procurement with WMDVBE would encourage the number of potential suppliers, competition, growth and economic efficiencies and would result in benefits to the state, those businesses, the utilities, and ratepayers.

The Legislature mandated that the Commission require each electrical, gas, water and telephone corporation with gross annual revenues exceeding \$25 million (utilities) and their Commission-regulated affiliates and subsidiaries to submit annual plans for increasing WMDVBE participation in their procurement and to submit annual reports on the implementation of their plans in an effort to enhance transparency.

A. General Order 156

Pursuant to §§ 8281-8284, the Commission developed and adopted GO 156 in 1986 to, among other things, establish criteria for determining the eligibility of WMDVBE for utility procurement and authorized utility outreach programs to inform and recruit WMDVBE to apply for procurement contracts. Since 1986, GO 156 has been modified through a number of subsequent Commission decisions to respond to the concerns of interested parties, market considerations, and other circumstances.

B. GO 156 Amendments

The latest modifications to GO 156 were initiated in 2009 and culminated in the Commission issuing D. 11-05-019. In D.11-05-019, the Commission, among other things, reaffirmed its support of the policy goals of GO 156 and made several changes and amendments to GO 156. These amendments provide for, among other things:

- (1) Electronic filing of the GO 156 annual reports;
- (2) Posting of the reports on the Commission's website;
- (3) Separate reporting of electric procurement spending;
- (4) Reporting of the total number of WMDVBE that received direct spend in a reporting period;
- (5) Reporting of amounts spent by utilities on technical assistance; and
- (6) Periodic random audits of the GO 156 reports.

C. Reporting Requirements

GO 156 directs the utilities to file an annual report on their diverse procurement for the previous year by March 1st. GO 156 prescribes the minimum elements that must be included each year in the utilities' annual reports.

D. PG&E's 2011 Supplier Diversity Results

In its 2011 Supplier Diversity Annual Report filed with the Commission, PG&E reported \$1.6 billion of WMDVBE purchases for 2011, out of \$4.4 billion in total procurement. In the following table, UAFCB shows the Supplier Diversity Annual Results by Ethnicity as reported by PG&E on page 47 of its 2011 annual report.

Table 1
Diversity Results As Reported by PG&E

Supplier Diversity Annual Results by Ethnicity

| Line No. | | 2011 | | | | |
|----------|---|----------------------|---------------|-------------|---------------|--------|
| | | Direct \$ | Sub \$ | Total \$ | % | |
| 1 | Minority | Asian-Pacific | 103,020,528 | 25,244,751 | 128,265,279 | 2.91% |
| 2 | Men | Black | 170,839,790 | 9,280,925 | 180,120,715 | 4.09% |
| 3 | | Hispanic | 160,014,472 | 203,242,033 | 363,256,505 | 8.25% |
| 4 | | Native-American | 26,684,624 | 35,844,452 | 62,529,076 | 1.42% |
| 5 | | Total Minority Men | 460,559,413 | 273,612,161 | 734,171,574 | 16.67% |
| 6 | Minority | Asian-Pacific | 47,395,509 | 43,008,105 | 90,403,615 | 2.05% |
| 7 | Women | Black | 75,839,637 | 9,920,226 | 85,759,863 | 1.95% |
| 8 | | Hispanic | 11,744,559 | 34,250,188 | 45,994,747 | 1.04% |
| 9 | | Native-American | 48,359,496 | 11,673,678 | 60,033,174 | 1.36% |
| 11 | | Total Minority Women | 183,339,201 | 98,852,197 | 282,191,399 | 6.41% |
| 12 | Total Minority Business Enterprise (MBE) | | 643,898,614 | 372,464,359 | 1,016,362,973 | 23.07% |
| 13 | Women Business Enterprise (WBE) | | 413,934,104 | 100,272,069 | 514,206,173 | 11.67% |
| 14 | Subtotal Women, Minority Business Enterprise (MWBE) | | 1,057,832,719 | 472,736,428 | 1,530,569,147 | 34.74% |
| 15 | Service Disabled Veteran Business Enterprise (DVBE) | | 54,833,325 | 25,329,350 | 80,162,675 | 1.82% |
| 16 | TOTAL DBE | | 1,112,666,043 | 498,065,778 | 1,610,731,822 | 36.56% |
| 17 | Gross Procurement | | 4,405,275,958 | | | |
| 18 | Exclusions | | | | | |
| 19 | Net Procurement | | 4,405,275,958 | | | |

*Totals may not add due to rounding.

IV. LIMITED SCOPE REPORTING EXAMINATION

As discussed below, UAFCB limited the scope of its examination to examining the accuracy of amounts PG&E reported on page 47 of its 2011 Supplier Diversity Annual Report. UAFCB initiated this examination by sending an engagement letter, dated April 5, 2012, to PG&E. UAFCB representatives visited PG&E's office in San Francisco, California on several occasions, met with PG&E's management and staff, and during the field work, among other things, reviewed PG&E's original supporting documentation. UAFCB completed its fieldwork on April 19, 2013. UAFCB discussed its preliminary findings with PG&E on April 19, 2013.

On August 30, 2013, UAFCB provided PG&E a copy of its draft report and requested that PG&E provide its comments on UAFCB's draft report. On September 24, 2013, PG&E provided a UAFCB its comments. UAFCB provides a summary of PG&E's comments in the following sections and PG&E's comments in their entirety as a separate attachment. On October 10, 2013, PG&E met with UAFCB to discuss their concerns with some of UAFCB's observations and on October 21, 2013 PG&E provided UAFCB with additional data. UAFCB also provides a summary of that conversation and data in the following sections. After receiving PG&E's comments, UAFCB contacted the Department of General Services (DGS) about UAFCB's Observation 2 to independently evaluate conflicting data. UAFCB provides a summary of the results of its discussions with DGS in UAFCB's summary of Observation 2.

A. Authority

In D. 11-05-019, the Commission requires, among other things, that beginning in 2012, UAFCB conduct a minimum of one random audit every two years of a GO 156 annual report from the most recently filed annual reports.⁶ UAFCB is authorized to determine the random selection process and audit methodology. The Commission requires UAFCB to segregate reporting companies by industry and, beginning with energy companies in 2012, followed by telecommunications and water in subsequent two-year periods, determine the random selection process and audit methodology to be used to verify the accuracy of WMDVBE reporting. UAFCB is to promptly report its findings to the Commission by letter to the Executive Director.

UAFCB randomly selected PG&E, an energy company, to be the first utility to have one of its annual GO 156 reports audited. Accordingly, UAFCB conducted a GO 156 reporting compliance examination of PG&E's Supplier Diversity 2011 Annual Report, which at the time UAFCB began its examination was the most recently filed PG&E supplier diversity report.

B. Goal

UAFCB conducted this examination to verify whether PG&E complied with the Commission's GO 156 reporting directives when PG&E submitted its Supplier Diversity 2011 Annual Report.

⁶ See D. 11-05-019, page 33 and Ordering Paragraph 3.

C. Standards

UAFCB conducted its examination in accordance with attestation standards established by the American Institute of Certified Public Accountants and, accordingly, included examining, on a test basis, evidence concerning PG&E's compliance with the reporting requirements noted above and performing any other procedures as we considered necessary in the circumstances. UAFCB believes that its examination provides a reasonable basis for an opinion. Our examination does not provide a legal determination on PG&E's compliance with the specified reporting requirements. The report is not intended to and does not address any aspects of GO 156 other than reporting.

D. Scope

UAFCB limited the scope of its examination. Based on consultation with and concurrence by the Business and Community Outreach of the Commission's Executive Division, UAFCB's examination primarily focused on evaluating the accuracy of the diversity procurement amounts PG&E reported on page 47 of its 2011 Supplier Diversity Annual Report.⁷ On page 47 of its annual report, PG&E summarizes its procurement by ethnicity, including whether by prime or subcontractor, and the relationship of the subtotals by ethnicity to its gross procurement. In addition, UAFCB tested the adequacy of PG&E's internal accounting controls for its Supplier Diversity Program.

E. Objectives

UAFCB's overall objectives were to determine whether:

1. PG&E complied with the GO 156 and D. 11-05-019 reporting requirements;
2. PG&E's accounting for and the reporting of its procurement with WMDVBE was accurate;
3. PG&E's supplier diversity procurement expenses were accountable and substantiated; and
4. PG&E complied with its data reporting guidelines and internal accounting control policies and procedures with respect to its GO 156 reporting.

F. Materiality

In an examination of an entity's compliance with specified requirements, the consideration of materiality differs from that of an audit of financial statements in accordance with Generally Accepted Auditing Standards or GAAS. When conducting an examination of a utility's compliance with specified reporting requirements, UAFCB's consideration of materiality is affected by (a) the nature of the reporting compliance requirements, which may or may not be quantifiable in monetary terms, (b) the nature and frequency of noncompliance identified with appropriate consideration of sampling risk, and (c) qualitative considerations, including the needs and expectations of the report's users. When conducting reporting compliance examinations, UAFCB's assessment of materiality addresses items that individually or in aggregate could signal whether a utility is in compliance.

⁷ See PG&E's report entitled "Supplier Diversity 2011 Annual Report-2012 Annual Plan," dated March 1, 2012.

V. EXAMINATION OBSERVATIONS

UAFCB detected material errors when it sampled and tested PG&E's procurement data associated with the total amounts shown spent in 2011 for WBE, MBE and DVBE procurement on page 47 of PG&E's 2011 Supplier Diversity Annual Report.⁸ Due to the materiality of the errors and lack of documentation relative to the sample, as described in the following observations, UAFCB deems PG&E's procurement data as reported in its 2011 Supplier Diversity Annual Report inaccurate and unreliable. In the following table, UAFCB presents a summary of its exceptions by Observation Number (Ob. No.).

Table 2
Summary of Observations

| Ob. No. | Description | Examination Adjustments | Comments |
|---------|--|-------------------------------|--------------|
| 1 | WMBE Contract Counted as DVBE | \$15,570,795.87 | |
| 2 | Suppliers Counted as DVBE Without Valid Certificate | 1,035,523.03 | |
| 3 | Direct Suppliers Overstated | 359,974.69 | |
| 4 | Sub Suppliers Overstated | 2,367,230.48 | |
| 5 | Included 2012 Payments | 4,196,871.06 | |
| 6 | DVBE Percentage Overstated by 0.42% | -- | [x] |
| 7 | Lack of Documentation, Not Addressed in Other Observations | 3,618,611.91 | Total \$8.3m |
| 8 | PG&E Provided Revised Base – Deemed Unreliable | -- | [x] |
| 9 | Lack of Proper Contracting Procedures | -- | [x] |
| 10 | Internal Control Weaknesses | -- | [x] |
| 11 | Books and Records Not Readily Available; Unreliable Data | -- | [x] |
| | Total | <u>\$27,149,007.04</u> | |

[x] The dollar amount associated with these observations was already included in another adjustment or represent non-compliance with Commission directives.

In the following table, UAFCB shows its adjustments by ethnicity and type, and whether a sub or prime contractor.

Table 3
Adjustments by Ethnicity and Type

| Ethnicity | Total Reported in 2011 | Sample | % of Total | Total Exception per Sample | Exception % of Sample |
|--------------|-------------------------------|--------------------------------|--------------|-------------------------------|-----------------------|
| DVBE (Prime) | \$ 54,833,325 | \$29,683,521.93 | 54.13% | \$15,570,795.87 | 52.46% |
| DVBE (Subs) | 25,329,350 | 17,675,407.91 | 32.23% | 3,569,568.58 | 20.20% |
| MBE (Prime) | 643,898,614 | 7,899,140.09 | 1.23% | 130,316,88 | 1.65% |
| MBE (Subs) | 372,464,359 | 133,665,157.48 | 35.89% | 7,451,510.75 | 5.57% |
| WBE (Prime) | 413,934,104 | 56,215,275.04 | 13.58% | 295,035.65 | 0.52% |
| WBE (Subs) | <u>100,272,069</u> | <u>4,212,207.03</u> | <u>4.20%</u> | <u>131,779.31</u> | 3.13% |
| Total | <u>\$1,610,731,822</u> | <u>\$249,350,709.48</u> | | <u>\$28,815,888.51</u> | |

A. Observations

Observation 1: PG&E did not fully demonstrate compliance with the reporting and record keeping requirements of General Order (GO) 156 §§ 4.2 and 8.2 and Public

⁸ UAFCB considers its observations material because of the (a) small size of UAFCB's sample, (b) that PG&E didn't provide adequate substantiation for three percent of UAFCB's total sample and 26.6% of the specific sample, and (c) the frequency and multiple types of errors.

Utilities Code (PUC) §§ 581 and 584. PG&E counted \$15.6 million of contracts with WMBE Direct Suppliers as DVBE Direct Suppliers.

Criteria: GO 156 § 4.2 provides that “in order to qualify as a DVBE, businesses...must present a current certificate from the California State Department of General Services verifying that such criteria have been met.” Section 8.2 permits utilities to count WMBE contracts toward either the MBE goal or the WBE goal, but not both. Similarly, transactions with DVBE may be counted toward either DVBE or the appropriate WBE or MBE goal. PUC § 581 requires that “... Every public utility receiving from the commission any blanks with directions to fill them shall answer fully and correctly ...” Section 584 requires utilities to provide reports to the Commission as specified by the Commission.

Condition: For the sample that UAFCB reviewed, PG&E reported \$15.6 million of WMBE direct suppliers, that were not also DVBE, as DVBE. The overstatement represents 52.4% of UAFCB’s sample of \$29.7 million and 28.4 % of PG&E’s reported prime DVBE contractor spend of \$54.8 million. In the following table, UAFCB shows the direct WMBE suppliers that PG&E reported as DVBE.

**Table 4
 WMBE Counted as DVBE**

| WMBE Suppliers | Amount Reported as DVBE |
|----------------|-------------------------------|
| WBE | \$ 8,202,815.22 |
| MBE | <u>7,367,980.65</u> |
| Total | <u>\$15,570,795.87</u> |

While GO 156 § 8.2 permits the utilities to report suppliers that are both a WMBE and a DVBE in either category, it does not permit the utilities to report WMBE that are not also DVBE as DVBE.

Cause: PG&E stated that GO 156 permitted it to report direct WBE or MBE as direct DVBE.

Effect: On page 47 of its report, PG&E overstated its total direct DVBE spend by almost \$15.6 million.

PG&E Comments: PG&E asserts that it mistakenly placed \$15.6 million of DVBE subcontracting in the direct spend column. On October 21, 2013, PG&E provided UAFCB with what it purported was documentation showing that it incorrectly reported \$15,570,795.87 of DVBE subcontracting as DVBE prime procurement.

Rebuttal: The information that PG&E provided on October 21, 2013 did not demonstrate what PG&E claimed:

1. The three subcontractors that PG&E provided data for were not on PG&E’s approved subcontractor list. PG&E’s contracts with the two PG&E diverse prime contractors that paid these subcontractors require that subcontractors must be pre-approved by PG&E before work can be done.
2. The data PG&E provided did not add up to the \$15.6 million as PG&E claimed. The data PG&E provided only added up to \$14.7 million.

3. The \$14.7 million of data improperly included \$1.7 million of payments made in 2012.
4. PG&E did not include proof of payment for \$872,024 of the invoices submitted by the subcontractors to the prime contractors, making it impossible, among other things, to determine what year the payments were made to the subcontractors or if the payments were made at all.
5. The data PG&E provided show that payments were made by the prime contractors to the subcontractors but did not demonstrate that the amounts PG&E's prime contractors paid to these subcontractors was work done for PG&E.
6. The data conflicts with data independently provided by one of the prime contractors.

If PG&E intended to move this \$15.6 million to its DVBE subcontracting when it revises and resubmits its 2011 report, the data PG&E submitted to UAFCB is insufficient to support reporting this \$15.6 million as DVBE subcontracting.

Recommendation: PG&E needs to ensure that it reports only direct DVBE suppliers as direct DVBE. When it revises its 2011 report, it should only move the portion, if any, of \$15.6 million DVBE prime overstatement for which it can correct all of the deficiencies, No. 1-6 listed in Observation 1.

Observation 2: PG&E did not fully demonstrate compliance with certification and accuracy requirements of GO 156 § 4.2 and PUC §§ 581 and 584. PG&E reported \$1.0 million of transactions with a subcontractor suppliers as DVBE that did not have a verifiable certificate from the California State Department of General Services verifying that the DVBE criteria were met.

Criteria: GO 156 § 4.2 provides that “in order to qualify as a DVBE, businesses ... must present a current certificate from the California State Department of General Services verifying that such criteria have been met.” PUC § 581 requires that “... Every public utility receiving from the commission any blanks with directions to fill them shall answer fully and correctly ...” Section 584 requires utilities to provide reports to the Commission as specified by the Commission.

Condition: PG&E relied on screenshots from the DGS website for documentation during the examination. Based on that information that UAFCB received during the field work, two of PG&E's reported DVBE subcontractors, included in UAFCB's sample, did not have a valid DVBE certificate for the entire reporting period.

After reviewing data submitted by PG&E when it submitted its comments on UAFCB's draft report and discussions with DGS, UAFCB received sufficient information to demonstrate that information on DGS' website during the examination was incorrect with respect to one of the two contractors.

Because UAFCB received conflicting information from PG&E and DGS, UAFCB independently contacted DGS to evaluate the screenshot changes. While DGS provided a copy of the certification letter sent to one of the two vendors originally in

question, it continued to provide UAFCB with conflicting information for the other vendor. DGS said it made a mistake on its website about the term of the certification and asserts it certified the vendor in May 2013 and also corrected its website in May 2013 for this vendor. DGS indicated that it didn't have a copy of the certification letter sent to the second vendor in question. UAFCB questions how DGS knows the information on its website originally for the second vendor was in error when it stated that it doesn't have a copy of the certification letter sent to the vendor. Consequently, the transactions related to the second vendor remain as an exception.

PG&E should not report the transactions conducted during periods when contractors do not have valid certificates. In the following table, UAFCB shows the amounts PG&E should have excluded.

Table 5
Suppliers Counted as DVBE without a Valid Certificate

| Subcontractors | Amount of Exception | Reason |
|---------------------------------|------------------------------|--|
| During Field Work: | | |
| Contractor A | \$1,035,523.03 | Transactions 1/1 – 3/31/11; Certificate valid 11/1/11. |
| Contractor B ^(a) | <u>1,666,881.47</u> | Transactions 7/6 - 12/31/11; Certificate revoked 7/6/11. |
| Original Total | 2,702,404.50 | |
| Resolved After Draft Rpt | <u>1,666,881.47</u> | |
| Outstanding | <u>\$1,035,523.03</u> | |

Notes:

(a) Resolved after PG&E submitted its comments on UAFCB's report and discussion with DGS after PG&E submitted its comments.

The overstatement of \$1.0 million represents 5.9% of UAFCB's sample of \$17.7 million and 4.0% of PG&E's reported DVBE spend for DVBE subcontractors.

PG&E should always maintain, among other things, a copy of the certificate and any recertifications for the contract period. Such documentation is required to be maintained under the USOA and GO 28.

Cause: PG&E originally asserted that one contractor's transactions between July 6 and December 31, 2011 should be considered valid DVBE transactions because the contractor's owner died in April 2012. However, UAFCB does not see the correlation between the death of the contractor's owner in 2012 and the revocation of the contractor's DVBE certificate in 2011. When actually, PG&E did not maintain a copy of the certification and/or recertification for the contract period. DGS provided a copy of the certification letter it provided to the vendor in July of 2011. For the other vendor, PG&E did not maintain a copy of the certification and/or recertification during the contract period and DGS did not maintain a copy of the certification letter to the vendor. DGS indicated that it certified the second vendor for 2011 in May of 2013.

Effect: PG&E overstated the amount it spent on DVBE subcontractors by at least \$1.0 million.

PG&E Comments: PG&E asserts that DGS confirmed that both of these vendors were certified during the relevant reporting period. PG&E provided snap shots of DGS website screens with its comments.

Rebuttal: Neither PG&E nor DGS could provide substantiation that one of the vendors had a valid certificate during the report period. Without adequate substantiation that this vendor had a valid certificate during the report period, PG&E should not have included these transactions in its report as DVBE procurement.

Recommendation: PG&E needs to ensure that all DVBE that it reports have valid certificates for the entire reporting period and exclude any contract amounts paid when a DVBE does not have a valid certificate. Among other things, PG&E needs to maintain a copy of proof of certification in its files when it contracts or subcontracts with a vendor and each time the vendor is recertified. PG&E needs to remove \$1,035,523.03 in DVBE subcontracting from its 2011 report.

Observation 3: PG&E did not fully demonstrate compliance with PUC §§ 581 and 584. Of the sample UAFCB reviewed, PG&E overstated its diverse procurement with its WMBE prime or direct contractors by \$359,975 because it did not report its procurement amounts net of early payment discounts it deducted before making payments to its vendors.

Criteria: PUC § 581 requires that "... Every public utility receiving from the commission any blanks with directions to fill them shall answer fully and correctly ...". Section 584 requires utilities to provide reports to the Commission as specified by the Commission.

Condition: PG&E's recorded data did not agree with the data it reported to the Commission. PG&E was allowed early payment discounts on its invoices resulting in (1) some payments made to suppliers were the same as the invoice amounts and (2) some payments made to suppliers were less than the invoice amounts.

For some of the transactions that UAFCB reviewed from its sample, PG&E reported the full invoice amounts in its annual report to the Commission and did not reflect the discounts it deducted before making payments.

Originally, based on documentation provided by PG&E, UAFCB found that PG&E reported a voided invoice of \$55,600 as paid. When it submitted its comments on UAFCB's draft report, PG&E provided sufficient documentation to show it canceled and then reissued the invoice so that the payment was proper.

In the following table, UAFCB shows a summary of the payments for which PG&E reported the discounts. UAFCB deleted the amount related to the canceled invoice.

Table 6
Diverse Direct Suppliers Overstated

| Direct Suppliers | Amount Reported by PG&E (1) | Amount Paid by PG&E | Amount Over- Stated | % Over |
|-------------------|-------------------------------|-------------------------------|----------------------------|--------|
| MBE | \$ 283,782.60 | \$ 276,820.79 | \$ 6,961.81 | 2.5% |
| MBE | 371,628.28 | 364,577.91 | 7,050.37 | 1.9% |
| MBE | 171,019.18 | 168,453.87 | 2,565.31 | 1.5% |
| MBE | 409,443.00 | 401,246.14 | 8,196.86 | 2.0% |
| MBE | 2,883,493.16 | 2,824,719.22 | 58,773.94 | 2.0% |
| MBE | \$10,114.00 | \$9,903.61 | 210.39 | 2.0% |
| MBE | 163,305.64 | 160,039.81 | 3,265.83 | 2.0% |
| MBE | 3,103,072.96 | 3,069,986.72 | 33,086.24 | 1.0% |
| MBE | 294,610.00 | 288,577.30 | 6,032.70 | 2.0% |
| MBE | <u>208,671.27</u> | <u>204,497.84</u> | <u>4,173.43</u> | 2.0% |
| Total MBE | <u>7,899,140.09</u> | <u>7,768,823.21</u> | <u>130,316.88</u> | 1.7% |
| WBE | 9,540,196.57 | 9,345,638.63 | 194,557.94 | 2.0% |
| WBE | 1,480,636.72 | 1,447,564.85 | 33,071.87 | 2.2% |
| WBE | <u>123,900.00</u> | <u>121,872.00</u> | <u>2,028.00</u> | 1.6% |
| Total WBE | <u>11,144,733.29</u> | <u>10,915,075.48</u> | <u>229,657.81</u> | 2.0% |
| Total WMBE | <u>\$19,099,473.38</u> | <u>\$18,683,898.69</u> | <u>\$359,974.69</u> | 1.9% |

Notes:

(1) Not net of early payment discounts exercised.

The overstatement totaling \$359,975 represents 1.9% of the sample of \$19.1 million that UAFGB examined and UAFGB's sample is 1.8% of PG&E's reported prime WMBE direct spend of \$1.1 billion.

Cause: PG&E asserts that its diversity team in charge of the final reconciliation of PG&E's diverse procurement data did not realize that the procurement data it used was neither net of early payment discounts.

Effect: With respect to reporting on the amount of its diverse procurement with its WMBE prime or direct contractors, PG&E's 2011 report to the Commission was incorrect and unreliable. PG&E overstated the amounts it paid to its direct WMBE contractors by almost \$359,975.

PG&E Comments: PG&E asserts that since the examiner alerted it about the early payment discounts, as of 2012, all PG&E reporting will not include early payment discounts.

Rebuttal: None.

Recommendation: PG&E needs to train its diversity staff that compile its procurement report to ensure that its staff can accurately reconcile its procurement data. PG&E needs to ensure that it excludes early payment discounts deducted before making payment to its vendors and canceled transactions from the procurement data that it reports to the Commission.

Observation 4: PG&E did not fully demonstrate compliance with PUC §§ 581 and 584. PG&E overstated its diverse procurement by \$2.4 million because it did not report its procurement net of amounts that were unpaid to its diverse subcontractors.

Criteria: PUC § 581 requires that "... Every public utility receiving from the commission any blanks with directions to fill them shall answer fully and correctly ..." Section 584 requires utilities to provide reports to the Commission as specified by the Commission.

Condition: PG&E overstated payments made by its non-diverse suppliers to its diverse subcontractor suppliers. Several of PG&E's suppliers that UAFCB had conversations with confirmed that reduced amounts were paid to the subcontractors and indicated that PG&E knew that they held back some of the payments for themselves. PG&E's subcontractors received less payment than PG&E reported for various reasons:

- a) The non-diverse direct supplier was allowed early payment discounts which it exercised sometimes, paying the subcontractor less than the full invoice amount.
- b) The non-diverse direct supplier kept a two-percent markup for itself before paying the diverse subcontractor the net amount.
- c) PG&E reported estimated amounts rather than the actual amounts that were paid to the diverse subcontractors.
- d) PG&E reported amounts paid to a third-party non-diverse subcontractor.
- e) PG&E reported amounts that were greater than the amounts paid to the diverse subcontractors, and UAFCB was unable to determine what the overstated amount represented.
- f) PG&E reported a transaction that had been voided or canceled.

With respect to some transactions in the sample that UAFCB reviewed, UAFCB was able to determine that the overstatement was related to a markup kept by the prime contractor, a voided or estimated transaction, an early payment discount or another specific circumstance that PG&E did not account for when it reported its diverse procurement. However, in certain instances, UAFCB was unable to determine why the payments to the diverse vendors were less than the reported amounts and PG&E's contracts with these suppliers do not indicate that these prime contractors are entitled to hold back some of the funds for themselves.

In the following table, UAFCB shows the incidences in the sample it reviewed where PG&E overstated the amounts that the diverse subcontractors received from subcontracting with PG&E. The letters in the last column entitled "Form" correspond to the reasons for the exceptions defined in a) through f) above.

Table 7
Overstated Amounts for Subcontractors

| Type | Amount Reported by PG&E | Amount Paid by Non Diverse Suppliers | Amount Over-Reported | % Overstated | Form |
|-----------------------------|-------------------------|--------------------------------------|-----------------------|--------------|------|
| DVBE | \$ 379,051.00 | \$ 371,619.09 | \$ 7,431.91 | 2% | b) |
| Total DVBE | 379,051.00 | 371,619.09 | 7,431.91 | 2% | |
| MBE (1) | 1,813,877.08 | 725,503.80 | 10,587.51 | 1% | a) |
| | // | // | 1,077,785.77 | 59% | d) |
| MBE | 10,002.01 | 9,805.00 | 197.01 | 2% | b) |
| MBE | 474,174.99 | 464,877.92 | 9,297.07 | 2% | b) |
| MBE | 102,823.98 | 100,807.87 | 2,016.11 | 2% | b) |
| MBE | 13,295.70 | 13,035.00 | 260.70 | 2% | b) |
| MBE | 4,695.41 | 4,603.34 | 92.07 | 2% | b) |
| MBE | 126,211.02 | 73,663.64 | 52,547.38 | 42% | c) |
| MBE | 1,118,215.19 | 1,047,903.09 | 70,312.10 | 6% | e) |
| MBE | 22,858.09 | 20,475.81 | 2,382.28 | 10% | e) |
| MBE | 383,088.18 | 283,191.13 | 99,897.05 | 26% | e) |
| MBE | 56,706.96 | 48,117.50 | 8,589.46 | 15% | e) |
| MBE | 870,407.96 | 802,752.47 | 67,655.49 | 8% | e) |
| MBE | 231,642.01 | 172,583.40 | 59,058.61 | 25% | e) |
| MBE | 4,926,346.57 | 4,873,136.56 | 53,210.01 | 1% | e) |
| MBE | 110,345,989.00 | 109,626,491.98 | 719,497.02 | 1% | e) |
| MBE | 1,563,430.02 | 1,544,369.95 | 19,060.07 | 1% | e) |
| MBE | 5,999.00 | 0 | 5,999.00 | 100% | f) |
| Total MBE | 122,448,414.17 | 120,182,937.55 | 2,258,044.71 | 2% | |
| WBE | 84,975.01 | 83,308.33 | 1,666.68 | 2% | b) |
| WBE | 38,445.00 | 37,691.00 | 754.00 | 2% | b) |
| WBE | 106,323.92 | 97,369.01 | 8,954.91 | 8% | e) |
| WBE | 11,915.03 | 10,793.90 | 1,121.13 | 9% | e) |
| WBE | 773,273.06 | 684,015.92 | 89,257.14 | 12% | e) |
| Total WBE | 1,014,932.02 | 913,178.16 | 101,753.86 | 10% | |
| Total Subcontractors | \$123,842,397.19 | \$121,467,734.80 | \$2,367,230.48 | 2% | |

Notes:

(1) The invoice related to the payment to this contractor before netting out the early payment discount was \$736,091.31. The remainder, or \$1,077,786, was paid to a non-diverse third party.

The overstated amount of \$2.4 million was 2% of UAFCB's sample of \$123.8 million and UAFCB's sample was 25.0% of PG&E's reported subcontractor WMDVBE procurement of \$498.1 million.

UAFCB did not see evidence of an accounting adjustment for the voided or the estimated transactions so that UAFCB is unaware of whether or not PG&E properly accounted for these invoices.

Cause: PG&E claims that it did not realize that the amounts it reported as paid by some of its non-diverse suppliers to some of its diverse subcontractors were overstated. In addition, PG&E asserts that it does not control the amount its non-diverse suppliers report as paid to its diverse subcontractors because it does not interfere with its prime suppliers' transactions with the diverse subcontractors.

Effect: With respect to reporting on the amount of its diverse procurement with diverse subcontractors, PG&E reported incorrect and unreliable data to the Commission. PG&E overstated the amount that its non-diverse suppliers paid its subcontractor by almost \$2.4 million.

PG&E Comments: PG&E agrees with the examiner that some of its prime suppliers may not be following its subcontracting reporting guidelines rigorously. PG&E agrees to incorporate these key learnings in its prime supplier training and will continue to work with its consultant to review the accuracy of subcontracting reporting. PG&E indicated that it will adjust its 2011 results by removing the \$2.4 million in over-reported diverse subcontracting.

Rebuttal: In addition to training its prime suppliers, PG&E needs to enforce its reporting requirements with its prime contractors and conduct random testing to verify the accuracy of the information reported by its prime suppliers.

Recommendation: PG&E needs to improve its contracting practices to ensure proper reporting.⁹ PG&E needs to ensure that it only reports the payments that its diverse subcontractors actually receive.

Observation 5: PG&E did not fully demonstrate compliance with PUC §§ 581 and 584. PG&E overstated its non-diverse prime suppliers' payments made to diverse subcontractors by representing \$4.2 million of invoices paid in 2012 as part of its 2011 diverse procurement. PG&E uses the cash basis of accounting when reporting its diverse procurement and should not have included amounts paid in 2012.

Criteria: PUC § 581 requires that "... Every public utility receiving from the commission any blanks with directions to fill them shall answer fully and correctly ..." Section 584 requires utilities to provide reports to the Commission as specified by the Commission.

Condition: The Commission requires the utilities to conduct their accounting on an accrual basis.¹⁰ In most cases, the Commission requires the utilities to use the accrual method of accounting when submitting reports to the Commission. Under the accrual method, transactions are counted when the order is made, the item is delivered, or the services occur, regardless of when the money for them is actually received or paid.

However, UAFCB understands that for the GO 156 reports, in 1986, Commission staff and the utilities agreed that the utilities' procurement should be reported on the cash basis. Under the cash basis of reporting for GO 156, procurement is not reported unless the diverse supplier has received payment for the goods and services. Consequently, goods and services can be received in one year while the payments made for these goods and services may not be received until the next year when the procurement is reported.

For example, a supplier could have provided PG&E with services in 2010 but did not receive payment until 2011. Under this scenario, using the cash basis of accounting,

⁹ See Observation 9.

¹⁰ See the Uniform System of Accounts.

PG&E should have reported this procurement as occurring in 2011. Likewise, for goods and services provided to PG&E in 2011 for which the diverse supplier did not receive payment until 2012, under the cash basis of accounting, PG&E should not report this procurement as occurring in 2011.

UAFCB corroborated PG&E's assertions that it reported on a cash basis for certain transactions of its diverse procurement, as shown in the following table. For the transactions shown in the following table, PG&E included transactions accrued in 2010 but the subcontractor did not receive payment for them until 2011.

Table 8
Transactions Accrued in 2010 and Payment Received in 2011

| Non Diverse Suppliers | 2011 Invoice Amounts | 2010 Invoice Amounts | Amount Reported by PG&E |
|-----------------------|------------------------------|----------------------------|------------------------------|
| MBE | \$ 367,444.58 | \$ 97,433.34 | \$ 464,877.92 |
| MBE | 308,867.94 | 67,673.06 | 376,541.00 |
| MBE | 790,369.18 | 70,816.82 | 861,186.00 |
| MBE (1) | 70,666.35 | 2,995.29 | 73,663.64 |
| Total MBE | <u>1,537,348.05</u> | <u>238,918.51</u> | <u>1,776,268.56</u> |
| WBE | 46,736.41 | 60,394.60 | 107,131.01 |
| Total WBE | <u>46,736.41</u> | <u>60,394.60</u> | <u>107,131.01</u> |
| Total WMBE | <u>\$1,584,084.46</u> | <u>\$299,313.11</u> | <u>\$1,883,399.57</u> |

Notes:

(1) The total amount reported by PG&E was actually \$126,211.02. However, PG&E's reported amount was also overstated by \$52,547 because PG&E had used an estimate rather than the actual amount of payment. See Observation 5. ($\$126,211.02 - \$52,547.38 = \$73,663.64$) To avoid counting the estimated amount twice as an exception, UAFCB netted it out in this table.

However, UAFCB found instances where PG&E's diverse suppliers did not receive payment until 2012, and PG&E should not have included these amounts in its 2011 GO 156 report. PG&E cannot use a mixture of cash and accrual accounting for its diverse procurement. PG&E overstated payments of \$4.2 million made by its non-diverse suppliers to its diverse subcontractor suppliers by using invoices paid in 2012. In the following table, UAFCB shows a summary of the transactions that PG&E reported as part of its 2011 subcontractor procurement data when the subcontractors did not receive payment until 2012.

Table 9
Overstated Diverse Subs by Using 2012 Payments

| Type | Reported | 2011 Payments | 2012 Payments/ Overstated | % of Reported |
|-------------------|-------------------------------|-------------------------------|------------------------------|----------------------|
| DVBE | \$11,343,191.98 | \$ 9,188,197.43 | \$2,154,994.55 | 19.00% |
| DVBE | 379,051.00 | 7,431.91 | 371,619.09 | 98.04% |
| Total DVBE | <u>11,722,242.98</u> | <u>9,195,629.34</u> | <u>2,526,613.64</u> | <u>21.55%</u> |
| MBE | 2,949,699.01 | 2,688,789.20 | 260,909.81 | 8.85% |
| MBE | \$102,823.98 | 2,016.11 | 100,807.87 | 98.04% |
| MBE | <u>1,563,430.02</u> | <u>284,915.73</u> | <u>1,278,514.29</u> | <u>81.78%</u> |
| Total MBE | <u>4,615,953.01</u> | <u>2,975,721.04</u> | <u>1,640,231.97</u> | <u>35.53%</u> |
| WBE | <u>84,975.01</u> | <u>54,949.56</u> | <u>30,025.45</u> | <u>35.33%</u> |
| Total WBE | <u>84,975.01</u> | <u>54,949.56</u> | <u>30,025.45</u> | <u>35.33%</u> |
| | <u>\$16,423,171.00</u> | <u>\$12,226,299.94</u> | <u>\$4,196,871.06</u> | <u>25.55%</u> |

The overstated amount of \$4.2 million represents 26% of the sample of \$16.4 million that UAFCB examined and UAFCB's sample is 2.3% of all the diverse subcontracting reported by PG&E of \$498.1 million.

Cause: PG&E stated that ideally all suppliers should report diverse payments using the cash basis of accounting. However, PG&E stated that it accepts payments reported as paid to subcontractors by its prime suppliers who use the accrual method of accounting. PG&E asserts that it may be too demanding of its prime suppliers to convert payments from the accrual basis to the cash basis of accounting before reporting the payments to PG&E.

Effect: PG&E overstated payments to diverse subcontractors by at least \$4,196,871 by using invoices paid in 2012 for its reporting.

PG&E Comments: PG&E acknowledged that this area presents a challenge for its prime suppliers to report and recommends further discussion with the Commission and the other utilities to determine the appropriate methodology to report subcontracting. PG&E said that it wouldn't include this adjustment in its revised table.

Rebuttal: Since UAFCB confirmed that at least \$4,196,871 of the amounts reported by PG&E for its diverse subcontracting was for 2012 payments, PG&E needs to remove these amounts from its revised 2011 report before submitting it. When revising its 2011 reporting and compiling information for future reports, PG&E does not need to discuss this issue with the Commission and the other utilities. PG&E has the ability to compile the information on its own. On the prime contractor invoices UAFCB reviewed, the payment dates and amounts that the prime paid the subcontractors were always listed. Consequently, PG&E may already be receiving all the data it needs to report on the cash basis for the subcontracting. If all of its prime contractors do not report this information to PG&E on their invoices, a simple solution for the future is for PG&E to require the prime contractor to report its payments to the subcontractors, including the date and amount of payments, along with the name of subcontractors on its invoices to PG&E.

Recommendation: PG&E needs to ensure that all of its diverse procurement data is reported to the Commission using the cash basis of accounting. At a minimum, PG&E needs to remove \$4,196,871 from its diverse subcontracting per the table in Observation 5 before submitting its revised 2011 report. PG&E should go through its prime contractor invoices and compile the correct data in this area when revising its 2011 report.

Observation 6: PG&E did not fully demonstrate compliance with the Uniform System of Accounts (USOA), GO 28 and PUC §§ 451, 581 and 584. PG&E did not provide all of the documentation requested and required to be maintained for \$8.3 million of UAFCB's sample. Because of the lack of substantiation, UAFCB could not attest to \$3.6 million of PG&E's supplier diversity.

Criteria: The USOA and GO 28 require that the utilities preserve all records, memoranda, and papers supporting each and every entry so that this Commission may readily examine the same at its convenience. PUC § 451 requires just and reasonable rates. Section 581 requires that "... Every public utility receiving from the commission any blanks with directions to fill them shall answer fully and correctly ..." Section 584 requires utilities to provide reports to the Commission as specified by the Commission.

Condition: In the following table are transactions for which PG&E did not provide substantiation and that were not part of any of the previous exceptions. Originally, based on data provided by PG&E, UAFCB found that PG&E did not provide adequate documentation for an additional \$18,132.39. With its comments on UAFCB's draft report, PG&E provided UAFCB with adequate documentation to substantiate the \$18,132.39. UAFCB excludes that amount from the following table.

Table 10
Lack of Documentation for Transactions Not Included in Other Observations

| Type | Sample Amounts | Invoice Amounts Without Adequate Documentation | Year | Documents Requested and Not Available for Review |
|-------------------------|-------------------------------|--|------|--|
| MBE | \$ 642,763.95 | \$ 642,763.95 | 2011 | No POs or invoices (only list) |
| MBE | 30,595.00 | 30,595.00 | 2011 | No POs or invoices (only list) |
| MBE | 191,085.92 | 191,085.92 | 2011 | No POs or invoices |
| MBE | <u>2,949,699.01</u> | <u>2,688,789.20</u> | 2011 | No POs or invoices |
| Total MBE Subs | <u>3,814,143.88</u> | <u>3,553,234.07</u> | | |
| WBE | 19,926,538.00 | 6,551.80 | 2010 | No bank statement for ACH debit |
| WBE | // | 58,826.04 | 2010 | No bank statement for ACH debit |
| Total WBE Direct | <u>19,926,538.00</u> | <u>65,377.84</u> | | |
| Total | <u>\$23,740,681.88</u> | <u>\$3,618,611.91</u> | | |

The overstated amount of \$3.6 million represents 15.2% of the sample that UAFCB examined and UAFCB's sample represents 1.0% of PG&E's reported contracting with WMBE subcontractors of \$472.7 million.

In addition, PG&E did not provide all documentation requested associated with some of the transactions that UAFCB included in other observations. In the following table,

UAFCB summarizes the transactions for which PG&E did not maintain sufficient documentation but were the subject of other observations. In its draft report, UAFCB included a transaction totaling \$55,600 in the following table because PG&E did not provide UAFCB with the invoice. With its comments on UAFCB's draft report, PG&E provided adequate substantiation for this transaction and UAFCB does not include it in the following table.

Table 11
Lack of Documentation for Transactions Included in Other Observations

| Type | Sample Amounts | Invoice Amounts Without Adequate Documentation | Year | Documents Requested and Not Available for Review |
|--------------|------------------------------|--|------|--|
| MBE | \$2,949,699.01 | \$ 260,909.81 | 2011 | No POs or invoices |
| MBE | 126,211.00 | 2,846.82 | 2010 | No POs or invoices (only list provided) |
| MBE | // | 123,364.18 | 2011 | No POs or invoices (only list provided) |
| MBE | 2,531,468.00 | 2,531,468.00 | 2011 | POs, invoices/payment unavailable |
| MBE | 1,813,877.08 | 725,504.00 | 2011 | No POs or invoices available for review |
| MBE | // | <u>1,077,785.77</u> | 2011 | No proof of payment to Petros Energy |
| Total | <u>\$7,421,255.09</u> | <u>\$4,721,878.58</u> | | |

The \$4.7 million of UAFCB's sample for which PG&E did not provide adequate substantiation represents 63.6% of the sample that UAFCB examined and UAFCB's sample is 2.0% of PG&E's reported 2011 procurement with all MBE contractors of \$372.5 million.

In total, PG&E reported \$8.3 million of diverse procurement for which it did not provide UAFCB with adequate substantiation.¹¹ For some of these transactions, \$4.7 million, UAFCB uncovered some inaccuracies in PG&E's reporting. Had PG&E provided all the necessary substantiation for all of the \$8.3 million of the unsubstantiated transactions, UAFCB would have been able to determine if there were other reporting improprieties or if the \$3.6 million of transactions were reported fairly. Without complete and adequate documentation, all of these \$8.3 million of reported transactions could not be fully vetted for accuracy.

The \$8.3 million of UAFCB's sample for which PG&E did not provide sufficient documentation represents 29.1% of the sample that UAFCB examined in this area and UAFCB's sample of \$31.2 million is 2.0% of PG&E's reported 2011 procurement with all WMBE contractors of \$1.5 billion.

Cause: Some of PG&E's prime suppliers stated that they did not maintain purchase orders and/or invoices substantiating payments to subcontractors. They appeared to be under the impression that proof of payment to the subcontractors was the most important document to maintain. PG&E's diverse contracting processes were not robust.

Effect: Not requiring or retaining supporting documentation associated with payments to diverse suppliers may put PG&E at risk of paying its vendors for services

¹¹ \$8,340,491 = \$3,618,612 + \$4,721,879.

that have not been properly reviewed and accounted for. Without all the evidence to support the transactions, UAFCB cannot verify whether PG&E correctly reported the transactions.

PG&E's Comments: PG&E asserts that the purchase orders and invoices do not have any impact on payment. PG&E claims that the \$3.6 million was paid to diverse suppliers. PG&E indicated that it doesn't intend to reduce its diverse procurement by the \$3.6 million since it asserts that it paid these amounts.

Rebuttal: Without the purchase orders and invoices, UAFCB was unable to ascertain if proper approvals were obtained to initiate the transactions and whether discounts were taken, etc. Proof of payment alone does not demonstrate the proper accounting and support for economic transactions. Without UAFCB being able to ascertain whether these transactions were correct, PG&E should not report them.

Recommendation: PG&E needs to ensure that it retains sufficient documentation associated with its procurement data to facilitate the verification of the accuracy of all transactions associated with its procurement data reported to the Commission. PG&E needs to remove \$3,618,612 from its diverse subcontracting per the table in Observation 6 before submitting its revised 2011 report, unless it can provide UAFCB with the invoices and purchase orders.

Observation 7: PG&E did not fully demonstrate compliance with PUC §§ 581 and 584. After the above examination adjustments, PG&E's purchases from DVBE vendors fell to 1.39% or 0.43% below the 1.82% that PG&E reported it spent on DVBE in its 2011 Annual Report.

Criteria: PUC § 581 requires that "... Every public utility receiving from the commission any blanks with directions to fill them shall answer fully and correctly ..." Section 584 requires utilities to provide reports to the Commission as specified by the Commission.

Condition: \$15.6 million or 52% of the \$29.7 million that UAFCB sampled from PG&E's reported direct DVBE represents an overstatement of PG&E's direct DVBE. \$1.0 million or 5.9% of the \$17.7 million that UAFCB sampled from PG&E's reported DVBE subcontractors represents an overstatement of its DVBE subcontracting due to lack of certification. \$2.5 million or 21.6% of the \$16.4 million that UAFCB sampled from PG&E's reported DVBE subcontractors represents an overstatement of its DVBE subcontracting due to PG&E incorrectly including 2012 amounts.

In the following table, taking into account UAFCB's revised adjustments, UAFCB shows the new percentage of PG&E's DVBE procurement using PG&E's reported base and a base PG&E provided during the examination, which UAFCB deems unreliable.¹²

¹² For information on PG&E's reported and discounted bases, see Observation 8 discussed in this report.

Table 12
DVBE Percentage After Adjustment¹³

| Base or Denominator | Total Procurement used as Base | Adjusted Total Direct DVBE | Adjusted DVBE Sub | New Total DVBE | New DVBE % |
|---------------------|--------------------------------|----------------------------|-------------------|----------------|------------|
| Reported base | \$4,405,275,958 | \$39,262,529 | \$22,626,946 | 61,889,475 | 1.39% |
| Discounted base | \$4,373,870,543 | \$39,262,529 | \$22,626,946 | 61,889,475 | 1.40% |

Cause: On page 47 of its annual report, PG&E overstated its DVBE by almost \$18.3 million.¹⁴ Consequently, PG&E's procurement from DVBE vendors falls 0.43% below the 1.82% that PG&E reported. While GO 156 does not require a specific amount of DVBE spend, all utilities must accurately report their diverse procurement.

Effect: PG&E's reported DVBE spend data to the Commission was incorrect and unreliable.

PG&E's Comments: PG&E asserts that its DVBE percentage remains at 1.8% because it claims that 1) the \$15.6 million it reported as prime DVBE spend was DVBE subcontracting and 2) all of its DVBE contractors that it reported had valid certification from DGS during the examination period. See also the summary of PG&E's comments in Observations 1 and 2.

UAFCB Rebuttal: See UAFCB's rebuttal in Observation 1 and 2.

Recommendation: PG&E needs to ensure that purchases from DVBE are correctly represented in the procurement data that it reports to the Commission.

Observation 8: PG&E did not fully demonstrate compliance with Public Utilities Code §§ 581 and 584. PG&E admitted that it overstated its diverse procurement because it did not report its procurement net of early payment discounts deducted before making payments to its diverse suppliers.

Criteria: PUC § 584 requires utilities to provide reports to the Commission as specified by the Commission and § 581 requires that "... Every public utility receiving from the commission any blanks with directions to fill them shall answer fully and correctly ..."

Condition: As UAFCB found and described in Observation 3 above, PG&E's recorded data did not agree with the data it reported to the Commission. PG&E was allowed early payment discounts on its invoices resulting in (1) some payments made to suppliers were the same as the invoice amounts and (2) some payments made to suppliers were less than invoice amounts. PG&E reported the full invoice amounts in its annual report to the Commission and did not reflect the discounts it deducted before making payments.

PG&E's Admissions: After UAFCB discussed with PG&E the discount discrepancy between some of the amounts reported compared to the actual amounts paid in the

¹³ UAFCB revised this calculation from its draft report to reflect changes from the draft report.

¹⁴ \$18,272,201 = \$15,570,796 + \$2,702,405.

transactions that UAFCB sampled, PG&E confirmed that the total procurement amounts represented on page 47 of its annual report were incorrect. Although UAFCB did not request that PG&E recast its total and net procurement, PG&E represented that the total procurement amounts included in the following table were the actual amounts paid in 2011. However, the discounts shown in the following table do not include discounts that the non-diverse prime contractors subtracted before making payments to the diverse subcontractors.

Table 13
Summary of PG&E's Admissions

| Year 2011 | Total Net Procurement | Total Diversity Procurement |
|----------------------|-------------------------------|------------------------------------|
| Originally Reported | \$4,405,275,958 | \$1,610,731,822 |
| Discounts Taken | <u>(31,405,415)</u> | <u>(7,377,652)</u> |
| Actual Amount | <u>\$4,373,870,543</u> | <u>\$1,603,354,170</u> |

Since UAFCB did not test PG&E's revised total net procurement of \$4.37 billion, which would include PG&E's revised total diversity procurement of \$1.6 billion, UAFCB cannot confirm PG&E's new representation.

In addition, as noted in the observations above, PG&E used (1) the cash basis method of accounting to track its Direct Suppliers procurement expenses (expenses recognized only when invoices are paid) and (2) a combination of the accrual method (expenses recognized when occurred) and the cash method to track its subcontracting procurement expenses; and (3) reported more than it paid its diverse suppliers in some instances that were unrelated to an early payment discount. PG&E did not correct its procurement data for these deficiencies. Consequently, PG&E's reported total Net Procurement is unreliable due to the inconsistent use of accounting methods.

Based on these observations, UAFCB deems PG&E's new procurement data unreliable.

Cause: PG&E claims it was not aware that it was reporting its procurement without netting out early payment discounts.

Effect: After discussion with UAFCB, PG&E acknowledged that it reported its procurement without netting out early payment discounts. With respect to the amounts PG&E reported without netting out the early payment discounts, PG&E reported incorrect and unreliable data to the Commission.

PG&E's Comments: PG&E indicated that it has implemented updated processes to address early payment discounts. In addition, see the summary of PG&E's comments in Observation 3.

PG&E's Rebuttal: None.

Recommendation: PG&E should train its reporting staff to use the correct procurement data when compiling the data for the procurement reports and utilize a sufficient review process of the information before submitting its reports to the

Commission. PG&E needs to ensure that it uses correct data when compiling information for and when reporting on its diverse procurement.

Observation 9: PG&E did not fully demonstrate compliance with the USOA, GO 28 and PUC §§ 451, 581 and 584. Based on the previous observations in this report, PG&E does not employ sufficiently stringent contracting practices.

Criteria: The USOA and GO 28 require that the utilities preserve all records, memoranda, and papers supporting each and every entry so that this Commission may readily examine the same at its convenience. PUC § 451 requires just and reasonable rates. Section 581 requires that "... Every public utility receiving from the commission any blanks with directions to fill them shall answer fully and correctly ..." Section 584 requires utilities to provide reports to the Commission as specified by the Commission. Accounting best practices dictate the use of effective internal controls.

Condition: It is appropriate for PG&E to ensure that it captures all diverse procurement to include in its report. However, it is not appropriate to overstate its diverse procurement.

Many of the reporting errors UAFCB found may stem from deficiencies in PG&E's contracting processes. By its own admission, PG&E has not ensured accurate reporting from its prime or direct contractors nor has it required the maintenance and provision of proper substantiation from all of its prime or direct contractors.¹⁵ The majority of transactions with missing substantiation from UAFCB's sample, \$8.3 million or 98%, were for transactions with diverse subcontractors.¹⁶

In its draft report before PG&E provided additional information, some of which UAFCB deemed as adequate substantiation, it found that the total subcontracting reporting errors, not including lack of substantiation were \$9,273,937. UAFCB revised its calculation to take into account the amounts UAFCB removed from other observations and in the following table, UAFCB shows the total amount of errors associated with subcontractor data:

**Table 14
 Subcontracting Reporting Errors Not Including Lack of Substantiation**

| Ob. No. | Summary of Observation | Amount of Error |
|----------------|---|------------------------------|
| 2 | Suppliers Counted as DVBE W/O Valid Certificate | \$1,035,523.03 |
| 4 | Differences Between Reported And Paid Amounts | 2,374,662.39 |
| 5 | Not Netting Out Payments Received in 2012 | 4,196,871.06 |
| | Total | <u>\$7,607,056.48</u> |

PG&E asserts that it performed audits of its 2008, 2009, 2010, and 2011 diverse subcontracting as reported in its GO 156 reports. UAFCB requested and received two

¹⁵ For example, PG&E asserts that it would be too onerous to require its prime contractors who perform their accounting on an accrual basis to convert to a cash basis for reporting on the subcontracting. See Observation 5.

¹⁶ See Observation 6.

of the resulting reports. The 2011 and 2012 brief studies were not audits. They were very limited reviews of summary reports completed by the vendor. For 2011 and 2012, according to the resulting reports provided by PG&E to UAFCB, PG&E hired a minority-woman-owned consulting firm (Consultant) to assist PG&E.¹⁷

Neither of the two reports provided by PG&E contained an opinion signed by Consultant and/or PG&E's staff and neither contained the standards used to conduct what PG&E and Consultant refer to as an audit. According to the reports, PG&E deemed any variances less than 10% as immaterial. Instead of diligently pursuing responses from six out of the 63 prime suppliers who did not respond to PG&E's requests for information, PG&E deemed their lack of response as immaterial because of the combined subcontracting dollar amount of \$425,520 that was related to those six prime suppliers. Other findings maintained that variances due to differing billing cycles was acceptable even though PG&E reports on a cash basis and using differing billing cycles could result in misstated subcontracting amounts. PG&E did not use the process to evaluate its processes or to provide recommendations on how its reporting could be improved.

Among other things, PG&E selected the sample of 63 prime suppliers, facilitated the project, and reviewed the information submitted by the sampled suppliers. Consultant compared invoice summary amounts certified by the sampled contractors to PG&E's supplier diversity spend reports and reviewed system payment reports, also certified as accurate by the sampled contractors. It appears that neither PG&E nor Consultant reviewed any original documentation and instead relied on the summary reports provided by the suppliers, the same suppliers that provided the information for PG&E's Supplier Diversity 2011 Annual Report. If the prime suppliers misunderstood what should be compiled or were not diligent in compiling the information, their certification would not remedy that.

PG&E has not implemented nor maintained an effective monitoring system by requiring and implementing meaningful periodic audits of the information or data provided by its prime or direct contractors with respect to its diverse contracting and subcontracting and reporting.

PG&E could modify its tracking to require additional information from its direct contractors about its subcontracting. Useful information that PG&E could add to its tracking that could help it recast the information from its prime contractors into the cash basis it needs for reporting include, but are not limited to the date the subcontractors are paid, a field for any discounts, markups, canceled transactions, etc.

In conjunction with requiring the maintenance of adequate substantiation and effective monitoring and auditing of data supplied by its diverse contractors, PG&E should implement and enforce penalties for prime contractors who fail to provide accurate data or to maintain or provide adequate documentation to support its subcontracting

¹⁷ PG&E provided UAFCB with two reports, one dated July 12, 2012 and one dated August 14, 2012. The reports each contained a logo from PG&E and Consultant at the top of the pages.

when requested. Doing so should reduce reporting errors related to PG&E's diverse subcontracting.

Cause: PG&E asserts that including more requirements in its diverse contracting processes could undermine its diverse procurement efforts.

Effect: Without proper contracting processes and effectively monitoring and auditing, PG&E cannot ensure that its diverse reporting will be accurate.

PG&E Comments: PG&E indicated that it agrees that additional prime supplier training is necessary.

UAFCB Rebuttal: Additional training would be only a step in the right direction and will not fully address the deficiencies in PG&E's contracting and reporting processes. PG&E needs to take additional actions to ensure its GO 156 reporting is correct.

Recommendation: PG&E should amend its contracting processes and its contracts to specify how much of the payments the prime contractors can keep and require its contractors accurately report information about the subcontracting. PG&E should require its prime contractors to report enough data so that PG&E can correctly report on a cash basis, net of any voided transactions, estimates, early payment discounts, markups, etc. PG&E should also require that it be allowed to conduct periodic audits of its diverse contracting and subcontracting. In addition, PG&E should require its vendors to keep, for at least three years and provide when requested, adequate documentation to fully substantiate the diverse subcontracting transactions. This should not be an onerous requirement as its direct and subcontractors need to keep such documentation for tax and/or financial reporting purposes.

Observation 10: As shown throughout this report, PG&E did not fully demonstrate compliance with the GO 156 §§ 4.2 and 8.2 reporting requirements, the USOA, GO 28, PUC §§ 451, 581 and 584 and accounting best practices. Based on the previous observations, PG&E does not adequately control its data for GO 156 reporting and record keeping.

Criteria: GO 156 § 4.2 requires that "in order to qualify as a DVBE, businesses...must present a current certificate from the California State Department of General Services verifying that such criteria have been met." Section 8.2 permits utilities to count WMBE contracts toward either the MBE goal or the WBE enterprise goal, but not both. Similarly, DVBE's contracts may be counted toward either DVBE or the appropriate women or minority business enterprise goal. The USOA and GO 28 require that the utilities preserve all records, memoranda and papers supporting each and every entry so that this Commission may readily examine the same at its convenience. PUC § 451 requires just and reasonable rates. Section 581 requires that "... Every public utility receiving from the commission any blanks with directions to fill them shall answer fully and correctly ..." Section 584 requires utilities to provide reports to the Commission as specified by the Commission. Accounting best practices dictate the use of effective internal controls.

Condition: Given the small sample tested by UAFCB during its examination and in view of the different kinds and the magnitude of the reporting and record keeping errors in relation to the sample, PG&E clearly need to improve its reporting and record keeping processes.

Internal controls are used to provide a company's management reasonable assurance about:

1. Effectiveness and efficiency of operations;
2. Reliability of financial reporting; and
3. Compliance with applicable laws and regulations.

Internal controls are put into place in these types of situations to prevent and identify accounting and reporting errors and the violation of laws and regulatory requirements.

The Committee of Sponsoring Organizations (COSO) is a nationally recognized group that provides thought leadership through the development of comprehensive frameworks and guidance on risk management, internal control and fraud deterrence.¹⁸ COSO indicates that internal controls consist of five interrelated components:

- **Control Environment:** Includes the integrity, ethical values and competence of the entity's people; and management's philosophy and operative style.
- **Risk Assessment:** The identification and analysis of relevant risks to the achievement of objectives and forms the basis of how the risks should be managed.
- **Control Activities:** Policies and procedures that help ensure management directives are carried out.
- **Information and Communication:** Pertinent information must be identified, captured and communicated, including, but not limited to, external parties such as regulators.
- **Monitoring:** Internal controls need to be monitored to assess the system's performance over time.

A first step in improving PG&E's supplier diversity reporting processes should be for PG&E to implement, monitor and enforce adequate internal controls for its supplier diversity reporting, including but not limited to, requiring audits of its own reporting processes and the reporting and processes of its diverse prime contractors and diverse subcontracting. When designing and implementing its new supplier diversity internal controls, PG&E should consider all of the factors discussed above.

Because of the widespread and magnitude of errors UAFCB found in the 2011 report, UAFCB is concerned that PG&E might have made the same types of errors when it compiled and submitted its 2012 report.

¹⁸ COSO was organized in 1985 to sponsor the National Commission of Fraudulent Financial Reporting, an independent private-sector initiative that studies the causal factors that can lead to fraudulent financial reporting. It also developed recommendations for public companies and their independent auditors, for the SEC and other regulators, and for educational institutions.

Cause: PG&E has not effectively implemented adequate internal controls with respect to its supplier diversity reporting.

Effect: Without adequate internal controls that are effectively implemented and monitored, PG&E's reporting errors are likely to continue.

PG&E's Comments: PG&E agrees and indicated that it will review and reinforce its internal reporting practices and upgrade its prime supplier training to educate its prime contractors on subcontracting reporting.

Rebuttal: Reviewing and reinforcing its current controls is only a first step. With effective internal controls in place, PG&E would not have made so many errors in its report. To improve its reporting, PG&E needs to add new controls to ensure the accuracy of its reports.

Recommendation: By November 27, 2013, PG&E should add, implement and enforce new internal controls for its supplier diversity reporting to prevent future misclassification of PG&E purchases from its diverse procurement. PG&E should submit a summary of these changes to UAFCB by November 27, 2013. PG&E should correct page 47 of its 2011 report and re-file the corrected versions by November 27, 2013. PG&E's internal audit department should conduct an audit to verify the accuracy of the revised page 47 for 2011 and page 47 of its 2012 report, subject to UAFCB's review and approval of the scope, work plan and work papers. Once the audit is complete, PG&E will need to submit a full revised GO 156 report for each of the audited years. If PG&E does not begin the audit by March 1, 2014, the audit should also include page 47 of its 2013 report. At the latest, PG&E's internal audit report needs to be submitted to UAFCB on or before December 31, 2014. In addition, PG&E should not use the costs of the internal audit as historical costs in its next general rate case.

Observation 11: PG&E did not fully demonstrate that it was in compliance with the USOA, GO 28 and PUC §§ 313 through 314. During the audit, requested records were not readily available to be examined. Consequently, the Commission could not examine the records associated with PG&E's 2011 Procurements at its convenience.

Criteria: The USOA and GO 28 require that the utilities preserve all records, memoranda, and papers supporting each and every entry so that this Commission may readily examine the same at its convenience. PUC § 313 requires the production of any books, accounts, papers, or records kept by the public utility so that an examination thereof may be made by the commission or under its direction. Section 314 requires that each officer and person employed by the commission may, at any time, inspect the accounts, books, papers, and documents of any public utility.

Condition: PG&E's records were not readily available for review during the examination. UAFCB waited from several months to five and six months to get the data it requested from PG&E. In some cases, months after the data was due, UAFCB found that PG&E had not even asked its suppliers for the documentation that UAFCB requested. Instead of compiling the requested data from its accounting system and

from its suppliers, it continuously tried to convince UAFCB to accept documentation for a sample of PG&E's choosing, the documentation it already amassed for its internal audit. In addition, PG&E had to resubmit some data provided asserting that the data was incorrect due to a corruption of PG&E's system.

On July 11, 2012, UAFCB selected its first sample: 14 direct suppliers with transactions totaling \$72.3 million and 12 sub-contractors with transactions totaling \$6.2 million. The sample data was due from PG&E on July 21, 2012.

On October 29, 2012 when UAFCB selected its second sample, PG&E had only submitted information for \$4.2 million out of the \$72.3 million of total invoices that UAFCB requested on July 11th, representing only 5.83% from the first sample. The second sample data set was due on November 14, 2012.

After PG&E received the second sample request sent in October, PG&E indicated that the sample UAFCB requested fell outside the scope of its internal audit, meaning that the vendors that UAFCB requested documentation for were different from the ones it had selected and compiled data for when it conducted its internal audit. PG&E requested six to eight weeks from November 14th to provide documents from suppliers falling outside the sample it already had drawn data for during its own internal review, regardless of the size of the transaction amount associated with the suppliers.

On November 6, 2012, PG&E stated that some documents requested from the first sample set were available for review on November 8, 2012. On November 8th, UAFCB arrived at PG&E and noticed that the documentation available for review was incomplete. The documentation requested in UAFCB's data request, that PG&E asserted was available, actually was not available, because it did not include cancelled checks or proof of payment and the purchase orders or invoices.

UAFCB returned to its office and requested that PG&E request the required documentation from its prime suppliers. PG&E made arrangements for UAFCB to return to PG&E on December 11, 2012 to begin reviewing the documents. As the field work continued, UAFCB had to return to its offices from time-to-time because PG&E needed additional time to get the documentation requested that was due July 21, 2012 and November 14, 2012. Consequently, UAFCB could not complete its field work until April 19, 2013.

Trying to review incomplete and/or inaccurate data and documentation increases the overall time to complete an examination. Instead of passing or failing a transaction when reviewing all the available documentation together, UAFCB would need to return to the data for each transaction possibly multiple times as the data came in, creating an unnecessary drain on UAFCB and state resources. UAFCB was unable to review PG&E's documentation at its convenience, as required by the USOA and GO 28.

For example, when reviewing the data related to one of the contractors, in the first set of data provided, the data did not match the number of transactions in the selected sample. PG&E later resubmitted a second set of data claiming that its SAP system was corrupted. Additionally, after UAFCB reviewed PG&E's prime supplier data and

noted that the early payment discount exception, UAFCB requested that PG&E email it the same data it reviewed to include in the examination work papers. The data that PG&E provided contained a different amount of early payment discount. Once UAFCB pointed out the discrepancy to PG&E, PG&E apologized for the error and stated that the discrepancy was likely caused by data corruption during the file merge.

Cause: For invoices associated with its prime suppliers, PG&E stated that missing documents associated with payments to its prime suppliers was due to the way its SAP is programmed. Its SAP for some reason could not locate some documents affecting its 2010 transactions or voided invoices. For documents associated with its subcontractors, PG&E's prime suppliers stated that they did not maintain purchase orders and/or invoices substantiating payments to PG&E's subcontractors.

Effect: The time PG&E took to obtain and submit the requested data, along with corrupt data being provided on occasion, created a substantial delay in the examination process and increased the GO 156 audit costs for the Commission. In addition, UAFCB was unable to verify certain transactions that lacked substantiation.

PG&E Comments: PG&E claims it makes every effort to maintain supporting documentation for diverse suppliers. PG&E asserts that retrieving data from various systems was complex and it worked diligently to meet the examiner's requirements in the most expeditious way possible. PG&E indicated that obtaining subcontracting data from prime suppliers was often a challenge. PG&E asserts that it deployed three internal and four external staff for finding, matching and printing tens of thousands of documents that were not easily obtainable. PG&E claims that it responded to the data requests as quickly as possible.

Rebuttal: As indicated above, for months, instead of compiling the requested data from its accounting system and from its suppliers, it continuously tried to convince UAFCB to decrease its sample size and also to accept documentation for a sample of PG&E's choosing, the documentation it already amassed for a very limited review it hired a consultant to conduct. When in the field beginning in January 2013, UAFCB found that PG&E had not even requested data from many of its suppliers, many months after UAFCB had requested the information. In addition, PG&E had to resubmit some data provided that was incorrect, asserting that the data was incorrect due to a corruption of PG&E's system.

PG&E asserted that it printed tens of thousands of documents. In fact, PG&E only printed a few documents for the examiner, only several hundred. Even in terms of finding and matching the documents, PG&E's claim that it found and matched tens of thousands of documents is an exaggeration. The documentation PG&E provided to support UAFCB's sample was not that extensive and most of it was supplied on electronic medium.

Recommendation: PG&E should ensure all supporting documents associated with its Supplier Diversity Program are maintained in such a manner that UAFCB may readily examine them at its convenience.

B. Summary of Observations by Supplier Type

In the following table, UAFCB summarizes its observations by supplier type, as appropriate.

Table 15
DVBE Prime or Direct

| Ob. | Description | Amount of Exception | Percent of Sample |
|----------------------------|--|------------------------------|-------------------|
| DVBE Direct | | | |
| 1 | WMBE Counted as DVBE | \$ <u>15,570,795.87</u> | 52.4% |
| DVBE Subcontractors | | | |
| 2 | Lacking a Valid Certificate | \$1,035,523.03 | 5.9% |
| 4 | Overstated Amounts Paid | 7,431.91 | 2% |
| 5 | Reported 2012 Amounts | <u>2,526,613.64</u> | 21.6% |
| | Total DVBE Sub | <u>\$5,236,450.05</u> | |
| MBE Direct | | | |
| 3 | Overstated Amounts Paid | <u>\$130,316.88</u> | 1.7% |
| | Total MBE Direct | <u>\$130,316.88</u> | |
| MBE Subcontractors | | | |
| 4 | Overstated Amounts | \$2,258,044.71 | 2% |
| 5 | Reported 2012 Amounts | 1,640,231.97 | 35.5% |
| 6 | Lack of Documentation Not Included in Other Observations | <u>3,553,234.07</u> | 87.7% |
| | Total MBE Sub | <u>\$7,451,510.75</u> | |
| WBE Direct | | | |
| 3 | Overstated Amounts Paid | \$229,657.81 | 2.0% |
| 6 | Lack of Documentation Not Included in Other Observations | <u>65,377.84</u> | 3.3% |
| | Total WBE Direct | <u>\$295,035.65</u> | |
| WBE Subcontractors | | | |
| 4 | Overstated Amounts Paid | \$101,753.86 | 10% |
| 5 | Reported 2012 Amounts | <u>30,025.45</u> | 35.3% |
| | Total WBE Sub | <u>\$131,779.31</u> | |

VI. CONCLUSION

In the samples that UAFCB reviewed, PG&E made multiple types of reporting and record keeping errors. PG&E materially misstated its diverse 2011 procurement by at least \$23.5 million, maintained lax contracting and reporting controls, and failed to maintain sufficient documentation for at least \$8.3 million of its diverse procurement. PG&E did not provide UAFCB with its documentation in a timely fashion causing substantial delays in conducting the field work and prolonging the time needed to conduct the examination. On several occasions, PG&E submitted wrong data, also delaying and prolonging the examination. Consequently, PG&E needs to improve its GO 156 contracting and reporting processes, and needs to maintain sufficient documentation. PG&E should train its staff on GO 156 reporting

requirements and on how data is maintained in their accounting systems. PG&E needs to fully comply with UAFCB's examination data requests within two weeks of receiving them. PG&E was aware of this examination as early as April 2012 and should have been ready to respond with its documentation for the examination when UAFCB submitted its data requests.

The official date of UAFCB's draft report was August 30, 2013. All 90-day deadlines contained in the draft report were 90 days from August 30, 2013, or November 27, 2013.

APPENDIX A
ABBREVIATIONS AND ACRONYMS

| | |
|--------|---|
| AICPA | American Institute of Public Accountants |
| COSO | Committee of Sponsoring Organizations |
| D. | Decision |
| DVBE | Disabled Veteran-Owned Business Enterprise |
| GO | General Order |
| MBE | Minority-Owned Business Enterprise |
| OP | Ordering Paragraph |
| PG&E | Pacific Gas and Electric Company |
| PUC | Public Utilities Code |
| SAP | Systems, Applications Products |
| UAFCB | Utility Audit, Finance and Compliance Branch |
| USOA | Uniform System of Accounts |
| WBE | Woman-Owned Business Enterprise |
| WMBE | Woman or Minority-Owned Business Enterprise |
| WMDVBE | Woman, Minority or Disabled Veteran-Owned Business Enterprise |