

California Department of Toxic Substances Control

Its Lack of Diligence in Cost Recovery Has Contributed
to Millions in Unbilled and Uncollected Costs

Report 2013-122

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August 7, 2014

2013-122

The Governor of California
President pro Tempore of the Senate
Speaker of the Assembly
State Capitol
Sacramento, California 95814

Dear Governor and Legislative Leaders:

As requested by the Joint Legislative Audit Committee, the California State Auditor (state auditor) presents this audit report concerning whether the California Department of Toxic Substances Control (department) has an effective process for recovering costs from responsible parties for cleanup and oversight actions the department takes in response to hazardous waste and substance contamination.

This report concludes that long-standing shortcomings with the department's recovery of costs have resulted in millions of dollars in unbilled and billed but uncollected cleanup costs (outstanding costs) dating back to 1987. Specifically, the department has acknowledged problems with inadequate procedures, incomplete documentation, and misclassification of certain sites in its database. These issues are so pervasive that the department has not yet determined the exact amount it may be able to recover. The department's spreadsheet for tracking projects with outstanding costs as of March 2014 shows that it has over 1,600 projects totaling almost \$194 million in outstanding costs, of which nearly \$142 million was unbilled and almost \$52 million was billed but uncollected. The department has created a work plan to conduct a comprehensive evaluation of its outstanding costs and has made progress in resolving the accuracy of the information related to its outstanding costs. However, according to a senior staff counsel, the department is currently evaluating whether to revise its work plan to extend the target completion dates for some of its evaluative tasks until June 2016. Furthermore, the department may not be able to recover all of its outstanding costs due to several factors, such as when the federal and state statutes of limitations (statute of limitations) for cost recovery have expired on projects. The department's preliminary determinations indicated that the statute of limitations has expired for 76 projects with a total of \$13.4 million in outstanding costs, which the department may not recover.

In November 2013 the department established updated cost recovery procedures in accordance with its work plan goals. However, we found several areas in which the department could better maximize its cost recovery efforts. Specifically, the department still lacks processes for tracking and monitoring the statute of limitations on contaminated sites and for tracking the progress and resolution of its settlement agreements.

Further, the department uses various methods to facilitate its recovery of cleanup costs associated with contaminated sites, such as entering into payment plans with the responsible parties or working with the California Office of the Attorney General to pursue litigation. However, the department has not consistently used some of these methods to ensure that it maximizes the recovery of costs from responsible parties. For example, the department has not always consistently issued collection letters to responsible parties that are delinquent in their payments or recorded liens on the properties of responsible parties.

Respectfully submitted,



ELAINE M. HOWLE, CPA
State Auditor

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Summary

Results in Brief

The California Legislature required the California Department of Toxic Substances Control (department), within the California Environmental Protection Agency, to have general administrative responsibility for overseeing the State's responses to spills or releases of hazardous substances, and for hazardous waste disposal sites that pose a threat to public health or the environment. The department generally conducts this work under the authority of the Carpenter-Presley-Tanner Hazardous Substance Account Act and the Hazardous Waste Control Act. State law provides the department with the authority, procedures, and standards to investigate, remove, and remediate contamination at sites; to issue and enforce a removal or remedial action order to any responsible party; and to impose administrative or civil penalties for noncompliance with an order. Federal and state law also authorizes the department to recover costs and expenses it incurs in carrying out these activities.

Long-standing shortcomings with the department's recovery of costs have resulted in millions of dollars in unbilled and billed but uncollected cleanup costs (outstanding costs) dating back to 1987. Specifically, the department has acknowledged problems with inadequate procedures, incomplete documentation, and misclassification of certain sites in its database. These issues are so pervasive that the department has not yet determined the exact amount it may be able to recover. As of March 2014 the department's spreadsheet for tracking projects with outstanding costs shows that it has 1,661 projects totaling almost \$194 million in outstanding costs, of which nearly \$142 million was unbilled and almost \$52 million was billed but uncollected.¹ These outstanding costs were incurred between July 1987 and December 2013.

The department has created a work plan to conduct a comprehensive evaluation of its outstanding costs. Specifically, the department grouped its outstanding costs into various categories for evaluation to determine the extent to which it could collect those costs. As a result of these efforts, the department has made progress in resolving its outstanding costs. The accuracy of the information related to projects with outstanding costs will continue to improve as the department evaluates the projects and adjusts

¹ The department's tracking spreadsheet contained 80 duplicate project entries due to instances where it included a separate record for projects that had both unbilled and billed but uncollected costs. Some of these duplicate entries crossed over into different project categories. Because we were unable to determine which duplicate entries to remove in certain instances, we elected to leave them in both project categories.

Audit Highlights . . .

Our audit of the California Department of Toxic Substances Control (department) highlighted the following:

- » *Long-standing shortcomings with the department's recovery of costs have resulted in unbilled and billed but uncollected cleanup costs (outstanding costs)—as of March 2014 the department has 1,661 projects totaling almost \$194 million in outstanding costs.*
 - *Nearly \$142 million was unbilled and almost \$52 million was billed but uncollected.*
 - *These outstanding costs were incurred between July 1987 and December 2013.*
- » *The department has made progress in resolving the accuracy of information related to projects with outstanding costs. However, it may extend the target completion dates for some tasks until June 2016.*
- » *The department may not be able to recover all of its outstanding costs due to several factors—preliminary determinations indicated that the federal and state statutes of limitations have expired for 76 projects with a total of \$13.4 million in outstanding costs.*
- » *Despite updating its cost recovery procedures, we found several areas in which the department could better maximize its cost recovery efforts.*
- » *The department has not consistently used some of its methods—such as issuing collection letters or recording liens on the properties of responsible parties to ensure that it maximizes cost recovery.*

outstanding costs in its Cost Recovery Billing System (billing system) or initiates cost recovery efforts in accordance with its work plan procedures. However, according to a senior staff counsel, the department is currently evaluating whether to revise its work plan to extend the target completion dates for some of its evaluative tasks until June 2016, to correspond with the expiration of the two-year terms of the 14 new cost recovery positions approved in the fiscal year 2014–15 budget.

The department may not be able to recover all of its outstanding costs due to several factors, such as when the federal and state statutes of limitations (statute of limitations) for cost recovery have expired on projects. The department's preliminary determinations indicated that the statute of limitations has expired for 76 projects with a total of \$13.4 million in outstanding costs, which the department may not recover. The outstanding costs also include \$73 million for projects involving litigation and bankruptcy. For these projects, the department will not know how much, if any, it could recover of the \$73 million in outstanding costs until the legal process concludes for each of the project sites.

In November 2013 the department established updated cost recovery procedures, and it conducted trainings in February and March 2014 with department staff in accordance with its work plan goals. The updated procedures we reviewed contain additional controls that, if followed, could prevent another buildup of outstanding costs. However, we found several areas in which the department could better maximize its cost recovery efforts. Specifically, the department still lacks processes for tracking and monitoring the statute of limitations on contaminated sites and for tracking the progress and resolution of its settlement agreements to ensure that department staff can verify they have updated information. Additionally, it did not always properly implement its new procedures related to responsible party searches. Although the number of instances we tested was limited because few projects had been processed using the new procedures as of May 2014, our review found that the department complied with three other updated procedures.

Further, the department uses various methods to facilitate its recovery of cleanup costs associated with contaminated sites, such as entering into payment plans with the responsible parties or working with the California Office of the Attorney General to pursue litigation. However, the department has not consistently used some of these methods to ensure that it maximizes the recovery of costs from responsible parties. Specifically, the department has not always consistently issued collection letters to responsible parties that are delinquent in their payments or recorded liens on the properties of responsible parties. Additionally,

increasing the interest rate charged on billed but delinquent unpaid amounts may improve the timeliness of collections from responsible parties. State law requires the department to charge interest for invoices not paid within 60 days at a rate equal to the rate of return earned on investments in the State's Surplus Money Investment Fund (SMIF). However, the SMIF interest rate is substantially lower than the interest rate charged for late payments by other state entities, such as the California State Board of Equalization (BOE). For example, for the quarter ending June 30, 2013, the SMIF interest rate was 0.246 percent, while the BOE interest rate was 6 percent for the same period. As long as the SMIF interest rate remains low, there is less incentive for responsible parties to make payments on time.

Although the financial planning and business manager stated that the department is planning to rely on the Financial Information System for California (FI\$Cal) to replace its current billing system, there are uncertainties about whether the department will have accurate data to load into the new system by the July 2015 implementation date. The department is still in the process of evaluating projects with outstanding costs in its billing system, and according to a senior staff counsel, the department is currently evaluating whether to revise its work plan to extend target completion dates for some of its evaluative tasks until June 2016. Until the department determines when it will finish evaluating these projects, it cannot ensure that it will be able to load accurate information into FI\$Cal.

Recommendations

To ensure that it maximizes opportunities to recover its costs, by January 2015, the department should develop a reporting function in its project management database to track and monitor the statute of limitations expiration dates for its projects.

To improve the accuracy of the outstanding costs in its billing system, by January 2015, the department should establish a process to track its settlement agreements to ensure that department staff can verify they have updated information.

To ensure that it maximizes the recovery of its costs from responsible parties, by October 2014, the department should do the following:

- Develop written procedures for updating and monitoring its collection letter process.
- Update policies and procedures for using liens.

To improve the department's efforts to promptly recover its costs, the Legislature should revise state law to allow the department to use a higher interest rate assessed on late payments. For example, the department could be allowed to use an interest rate similar to that used by the BOE.

To ensure that it loads only accurate billing data into FI\$Cal, the department should continue evaluating projects with outstanding costs in its billing system to meet the July 2015 implementation date.

Agency Comments

The department concurred with the audit findings and plans to implement the recommendations.

Introduction

Background

The potential public health and environmental harm that can be caused by various hazardous substances used in industrial, manufacturing, and other processes has drawn widespread national attention. Information provided by the U.S. Environmental Protection Agency (U.S. EPA) advises that over the next several decades, federal, state, and local governments and private industry will commit billions of dollars annually to clean up sites contaminated with hazardous waste and petroleum products from a variety of industrial sources. A U.S. EPA report projects that as many as 355,000 contaminated sites will require cleanup over the next 30 years and that the cost of this cleanup may amount to as much as \$250 billion.

Hazardous substance is a broad term that includes many chemicals and materials that present an imminent and substantial danger to public health or welfare. Improper use and disposal of these products can result in *hazardous waste*. According to the U.S. EPA, hazardous wastes or substances are potentially hazardous to human health or the environment when they are improperly managed. They possess at least one of following characteristics: ignitability, corrosivity, reactivity, or toxicity, or they appear on special U.S. EPA lists.

The California Legislature required the California Department of Toxic Substances Control (department), within the California Environmental Protection Agency, to have general administrative responsibility for overseeing the State's response to spills or releases of hazardous substances, and for hazardous waste disposal sites that pose a threat to public health or the environment. The department generally conducts this work under the authority of the Carpenter-Presley-Tanner Hazardous Substance Account Act (act) and the Hazardous Waste Control Act. The act is intended to provide compensation for out-of-pocket medical expenses and lost wages or business incomes resulting from injuries caused by exposure to hazardous substances, and to make available adequate funding to meet federal requirements that California pay 10 percent of cleanup costs for federal Superfund sites and 100 percent of the operation and maintenance costs after cleanup is complete. State law authorizes the department to conduct investigations, to remove and remediate hazardous waste spills, and to recover the costs it incurs in undertaking these activities from the parties responsible for the contamination.

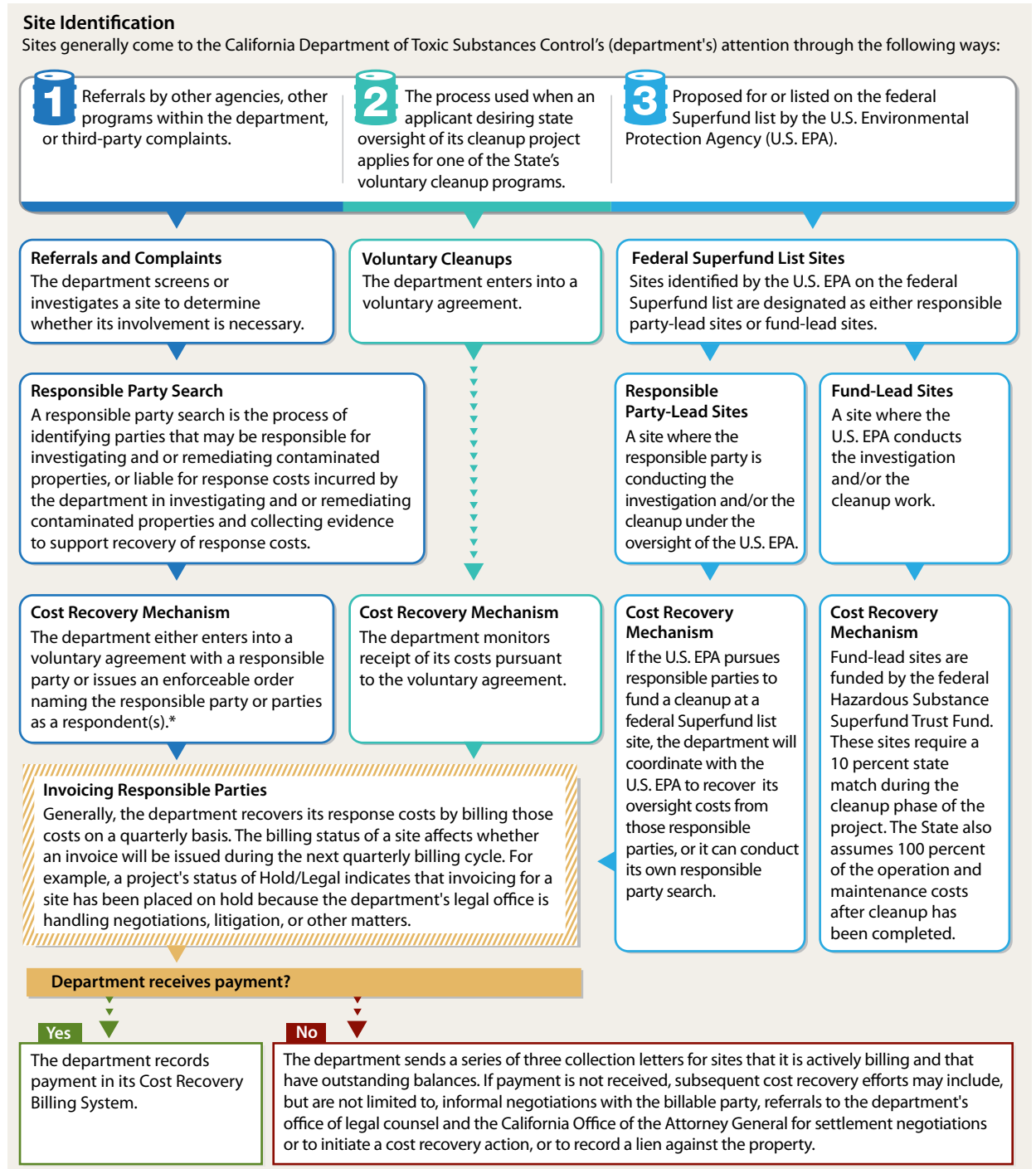
To achieve these goals, state law outlines steps to ensure the timely and cost-effective cleanup of hazardous substance release sites. Further, state law provides the department with the authority, procedures, and standards to carry out the investigation, removal, and remediation of contaminated sites; to issue and enforce a removal or remedial action order to any responsible party; and to impose administrative or civil penalties for noncompliance with an order. Federal and state law also authorizes the department to recover costs and expenses it incurs in carrying out these activities.

At the federal level, the Comprehensive Environmental Response, Compensation, and Liability Act of 1980 (CERCLA, sometimes called the federal “Superfund” law) gives the federal government and the department the authority to identify and investigate sites that need cleanup, to clean up contaminated sites or direct responsible parties to do the cleanup themselves, and to impose liability on responsible parties by requiring them to pay for the cost of cleanup. CERCLA defines liable parties as current owners and operators of a facility, former owners and operators of a facility at the time of disposal, persons who arranged for treatment or disposal of hazardous substances, and transporters of hazardous substances who selected the disposal site. A person who falls within the definition of one of these classes may be held liable under CERCLA. The department provided a summary of cost figures showing it had spent \$1.8 billion between 1987 and March 2013 overseeing or actively cleaning up contaminated properties throughout California.

The Department’s Cost Recovery Process

The department can recover its costs through various means, depending on how the site was brought to its attention. For example, other agencies refer sites to the department, which then screens and investigates the site. If necessary, the department determines which parties are responsible for the contamination and either enters into a voluntary agreement or issues an enforcement order naming the responsible party or parties as respondents. The Figure presents a general overview of the department’s cost recovery process as of November 2013.

Figure
General Overview of the California Department of Toxic Substances Control's Cost Recovery Process as of November 2013



Sources: The department's procedures issued in November 2013 and a cost recovery flow chart provided by the department.

* The department may use site remediation account funds, also referred to by the department as state orphan funds, at various points in the cleanup process. State law authorizes the department to use these funds if the director determines removal or remedial action is necessary because an imminent and substantial endangerment to public health or the environment exists, or the department, after reasonable effort, is unable to identify responsible parties, or a responsible party fails to comply with an enforceable order issued by the department.

The department incurs costs while overseeing the investigation and cleanup of contaminated sites, and may also incur costs when performing these tasks itself. The department's program staff are responsible for some of these activities, such as screening potentially hazardous substance release sites for possible future cleanup by responsible parties or the department, overseeing the investigation or remediation of sites, and conducting searches for parties responsible for contaminating the sites. The department is authorized to recover its costs from responsible parties and has several units that have a role in the recovery of its costs for cleaning up contaminated sites. For example, the cost recovery billing unit is responsible for sending invoices to parties on a quarterly basis and for recording payments in the Cost Recovery Billing System. The department also has a collections and resolutions unit that is responsible for working to resolve invoice disputes with responsible parties. The department's office of legal counsel is involved in its collection efforts through activities such as negotiating settlements with responsible parties, assisting department staff in placing liens on properties, and determining whether a site should be referred to the California Office of the Attorney General to file a cost recovery action against responsible parties for the department's response costs. Although the department investigates contaminated sites and identifies potentially responsible parties, a court may ultimately determine who the responsible parties are if liability is in dispute.

The department receives the majority of its funding from four main sources; it uses this funding to protect the people of California and the environment from the effects of toxic substances. First, for fiscal year 2014–15, the January 2014 Governor's Proposed Budget (Governor's Budget) allocated nearly \$55.7 million from the Hazardous Waste Control Account. The funding from this account comes from fees collected by the department from entities that dispose of, receive, generate, or transport hazardous wastes. These fees pay for the department's costs in administering the rules and regulations for the disposal of hazardous wastes. Second, the Governor's Budget allocated \$44 million to the department from the Toxic Substances Control Account. This funding is from fines and penalties received from responsible parties for the department to use in remedial or removal actions at specific sites and fees from organizations that generate, store, or conduct activities related to hazardous materials, including hazardous waste. The department can use these funds to respond to releases of hazardous substances, including spills and hazardous waste disposal sites posing a threat to public health or the environment. The department may also use the funds to pay for costs to contract for the cleanup of sites for which no viable party is responsible for the contamination and the cleanup of federal Superfund sites. Third, the Governor's Budget shows allocations to the department of \$35 million from federal funds and fourth, \$21 million from the State's General Fund for state operations and local assistance.

The Department's Estimate of Unbilled and Billed but Uncollected Costs

In its May 2013 follow-up to its 2011 review of internal controls, the department reported that its unbilled and billed but not collected cleanup costs (outstanding costs) totaled \$185 million for the period of July 1987 through December 2012. Nearly a year later, in March 2014, the department provided us with an updated spreadsheet that it uses for tracking its projects with outstanding costs. The updated spreadsheet, which added projects with outstanding costs incurred through December 2013, showed that the costs had grown to almost \$194 million.

The May 2013 follow-up also noted that the department has developed a work plan to create and implement a cost recovery policy and procedures to maximize recovery of past, present, and future oversight costs. The plan indicates that the department will provide staff training on the updated cost recovery procedures and will develop performance metrics, among other actions. The department has also developed another work plan outlining a comprehensive evaluation of outstanding costs, with the goal of initiating collection efforts to the maximum extent possible. We discuss these work plans in more detail in the Audit Results section.

It is also worth noting that the department tracks costs separately for one project site—referred to as the Stringfellow hazardous waste site—for which the State is the sole party responsible for cleanup. Appropriately, the department does not include these costs—\$423 million as of March 2013—in its tracking spreadsheet of outstanding costs, because there are no other responsible parties to bill. The Stringfellow site is located in Riverside County, and it operated as a waste disposal site from 1955 to 1972. In 1998 a federal district court found the State 100 percent liable for the site cleanup because of its negligence in investigating the site, its failure to design and supervise construction of the site, and its delay in undertaking cleanup activities, among other reasons. The State, through the department, is implementing all cleanup work at the site as well as its ongoing maintenance and monitoring.

Scope and Methodology

The Joint Legislative Audit Committee (audit committee) directed the California State Auditor to perform an audit of the department to determine whether it has an effective process for recovering costs from responsible parties for cleanup and oversight actions the department takes in response to hazardous waste and substance contamination. We list the objectives and the methods we used to address them in Table 1 beginning on the following page.

Table 1
Audit Objectives and the Methods Used to Address Them

AUDIT OBJECTIVE	METHOD
1 Review and evaluate the laws, rules, and regulations significant to the audit objectives.	Reviewed relevant state and federal laws and regulations.
2 For the five-year period beginning in fiscal year 2007–08, related to cost recovery under the Carpenter-Presley-Tanner Hazardous Substance Account Act, perform the following:	
a. Determine whether the California Department of Toxic Substances Control's (department) cost recovery process is adequate and complies with applicable law.	<ul style="list-style-type: none"> • Reviewed selected cost recovery procedures updated in November 2013 and determined whether they comply with state and federal law related to cost recovery. • Assessed the selected procedures' adequacy in addressing problems contributing to the backlog of unbilled and billed but uncollected cleanup costs (outstanding costs). • Reviewed judgmentally selected projects to determine whether staff had implemented the new procedures correctly.
b. Verify the amount billed but uncollected related to costs incurred in performing oversight and response actions, and determine the reasons for the inability to achieve cost recovery.	<ul style="list-style-type: none"> • Because the department is still in the process of reviewing projects to determine the accuracy of its amount of billed but uncollected costs, the best information available is the department's tracking spreadsheet updated as of March 2014. The exact amount of billed but uncollected costs changes on a daily basis depending upon several factors, including whether collection efforts have been initiated, payments have been received, and adjustments have been made. • Interviewed department staff to determine the reasons for projects with billed but uncollected costs. • Obtained documentation from department staff and project files to verify the reasons why billed costs have not been collected.
c. Verify that the department's assessment of interest on billed but uncollected costs complies with statute, regulation, and/or policy, as appropriate.	Reviewed selection of 10 invoices that had not been paid within 60 days and determined whether the department applied the correct interest amount to past-due payments in accordance with state law.
d. Verify the amount incurred by the department for oversight and response, but not billed, and determine the reasons these costs were not billed.	<ul style="list-style-type: none"> • Because the department is still in the process of reviewing projects to determine the accuracy of its amount of unbilled costs, the best information available is the department's tracking spreadsheet updated as of March 2014. The exact unbilled amount changes on a daily basis depending upon several factors, including whether the costs have been billed or otherwise reduced from the current unbilled total. • Interviewed department staff to determine the reasons for projects with unbilled costs. • Obtained documentation from department staff and project files to verify the reasons why projects have unbilled costs.
e. Identify, to the extent possible, the entities that have substantial unbilled or unpaid costs associated with oversight or response actions.	<ul style="list-style-type: none"> • Reviewed the spreadsheet used by the department to track projects with outstanding costs and identified the 15 projects with the greatest amounts of unbilled costs. • Also identified the 15 projects with the greatest billed but uncollected costs and obtained the corresponding invoices from department staff.
3 Review the five-phase action plan that the department has developed to increase its cost recovery and complete the following:	
a. Assess whether the plan complies with statute and regulations.	Reviewed selected cost recovery procedures established in November 2013 and compared them to relevant laws and regulations.
b. Recommend necessary changes or improvements to the plan.	<ul style="list-style-type: none"> • Judgmentally selected and reviewed 25 projects with outstanding costs to identify issues not addressed in the department's work plan. • Reviewed these projects to ascertain whether the department was taking steps to evaluate projects with outstanding costs in accordance with its work plan.

AUDIT OBJECTIVE	METHOD
c. Identify any other actions beyond those in its five-phase plan that the department is taking to increase cost recovery.	<ul style="list-style-type: none"> Reviewed the department's work plans. Interviewed department staff to identify other actions beyond those in its five-phase plan that it is taking to increase cost recovery. Requested and reviewed documentation related to other actions identified.
d. Identify statutory or other impediments that may hinder the department's effectiveness at cost recovery.	Interviewed department staff and reviewed relevant state laws to identify any impediments that might hinder or adversely affect the department's ability to effectively recover costs.
4 Review and assess any other issues that are significant to the department's effectiveness at cost recovery for hazardous waste cleanup projects.	We did not identify any other issues that are significant to the department's effectiveness at cost recovery.

Sources: California State Auditor's analysis of Joint Legislative Audit Committee audit request number 2013-122, and information and documentation identified in the table column titled *Method*.

Data Reliability Assessment

The U.S. Government Accountability Office (GAO), whose standards we are statutorily required to follow, requires us to assess the sufficiency and appropriateness of computer-processed information that we use to support our findings, conclusions, or recommendations. Table 2 shows the results of this analysis for data obtained from the department.

Table 2
Methods Used to Assess Data Reliability

INFORMATION SYSTEM	PURPOSE	METHODS AND RESULTS	CONCLUSION
California Department of Toxic Substances Control (department) Cost Recovery Billing System (billing system) Data as of March 2014	To determine the amount of unbilled and billed but uncollected cleanup costs (outstanding costs) for projects in the billing system.	<ul style="list-style-type: none"> We performed data-set verification procedures and electronic testing of key data elements and did not identify any issues. The department acknowledges the unreliability of the data contained in its billing system, and has little confidence that the billing statuses of its outstanding costs are correct. 	Not sufficiently reliable for the purposes of the audit. We present these data despite the problems noted because they represent the best available electronic source of this information.
Department EnviroStor (project management database) Data used to support EnviroStor summary reports between November 2013 and May 2014	To determine whether the department is consistently uploading documents used in the cost recovery process.	<ul style="list-style-type: none"> To test the accuracy of the project management database, we traced a judgmental selection of 29 transactions to the supporting documents and found no errors. We did not perform completeness testing because the procedures requiring the department staff to upload cost recovery documents into the project management database were established in November 2013, and as we discuss in the Audit Results, there were few projects processed using the new procedures between November 2013 and May 2014. 	Undetermined reliability for the purposes of this audit.

continued on next page...

INFORMATION SYSTEM	PURPOSE	METHODS AND RESULTS	CONCLUSION
Department Federal and state statutes of limitations (statute of limitations) tracking spreadsheet Data as of January 2014	To determine the number of projects where the department is unlikely to recover unbilled and billed but uncollected costs based on its preliminary review of statutes of limitations expiration dates.	<ul style="list-style-type: none"> • We performed data-set verification procedures and did not identify any issues. • To test the accuracy of the statute of limitations tracking spreadsheet, we traced a haphazard selection of 29 records to the supporting documentation and found no errors. • To test completeness, we traced a haphazard selection of 29 worksheets to the tracking spreadsheet and found no errors. 	Sufficiently reliable for the purposes of the audit.

Sources: California State Auditor's analysis of various documents, interviews, and data obtained from the department.

Audit Results

The California Department of Toxic Substances Control Is Still Determining How Much of the \$194 Million in Outstanding Cleanup Costs It Can Recover

Long-standing problems with the California Department of Toxic Substances Control's (department) recovery of its costs incurred under the Carpenter-Presley-Tanner Hazardous Substance Account Act and Hazardous Waste Control Act have resulted in millions of dollars in unbilled and billed but uncollected cleanup costs (outstanding costs) dating back to 1987. Specifically, the department has acknowledged problems with inadequate procedures, incomplete documentation, and misclassification of certain sites in its database. These issues are so pervasive that the department has not yet determined the exact amount it may be able to recover.

Our review of the department's spreadsheet for tracking projects with outstanding costs (tracking spreadsheet) found that, as of March 2014, it had not evaluated 1,661 projects with almost \$194 million in outstanding costs, of which nearly \$142 million was unbilled and almost \$52 million was billed but uncollected.² The department incurred these outstanding costs from July 1987 through December 2013. As shown in Table 3 on the following page, 15 projects account for more than \$31 million, or 60 percent, of the total billed but uncollected costs. Table 4 on page 15 shows that the 15 projects with the largest unbilled costs (excluding the Stringfellow hazardous waste site³) total nearly \$90 million, or 63 percent of the unbilled costs.

According to a senior staff counsel, the department is committed to maximizing recovery of its costs and is implementing a work plan to do so. However, she acknowledged that even with the department's efforts, it will likely not be able to recover all of its outstanding costs. The department created the work plan to conduct a comprehensive evaluation of its outstanding costs. Specifically, the department grouped its outstanding costs into various categories for evaluation to determine the extent to which it could collect those costs. As of March 2014 the department's tracking spreadsheet showed that 1,661 projects remained to be evaluated of the more than 2,700 projects the department had identified for evaluation.

² The department's tracking spreadsheet contained 80 duplicate project entries due to instances where it included a separate record for projects that had both unbilled and billed but uncollected costs. Some of these duplicate entries crossed over into different project categories. Because we were unable to determine which duplicate entry to remove in certain instances, we elected to leave them in both project categories.

³ As described in the Introduction, the State is the sole party responsible for cleanup of the Stringfellow hazardous waste site, located in Riverside, California. The department does not include \$423 million in costs incurred as of March 2013 for this project in its tracking spreadsheet because there are no other responsible parties to bill.

Table 3
Top 15 Projects With Billed but Uncollected Costs as of March 2014

	PROJECT NAME	PARTIES LISTED ON INVOICE*	BILLED BUT UNCOLLECTED COSTS†
1	J & S Chrome/Bell Gardens	James Mancuso and Helen Mancuso Kenfield Development LLC	\$7,087,457
2	Frontier Fertilizer	Orphan‡	3,398,684
3	Cameo California Metal	Porcelain Metals Corporation	2,391,871
4	Caltech Metal Finishing	James Park 31 LLC Pas Development LLC Arsalan Darmal & Mir W. Sharq Eleanor Richard Astro 1 Corp. Inc. Hector Sagastumes	2,329,317
5	Wickes Forest Industries, Solano	David Van Over Jim Dobbas Inc.	2,256,266
6	Former Lane Metal Finishers	James Chung	1,960,337
7	Brown & Bryant, Inc - Shafter Facility	Burlington Northern & Santa Fe Railway Hercules Inc.	1,713,485
8	Fresno Battery Exchange	Vang Khamdee Yang	1,576,587
9	Peter Pan Cleaners	Reverend Hertman & Mrs. Mary Jane Casablanca Myung Choy Van Nguyen Jerry U. and Kay H. Pak	1,515,725
10	K & L Plating	William Bowers	1,232,796
11	Gardena Sumps	Thomas Cooper	1,223,938
12	Technichem Inc.	Mario & Virginia Pelligrini Trust Technichem Inc.	1,187,357
13	Talley Brothers	Talley Brothers	1,180,820
14	Fieldstone Residential Area	Hearthside Residential Corporation	1,072,644
15	Renu Plating Co. Inc.	Mario Pinzon Eric Lichtbach David Lichtbach William D. Morrison	1,066,887
	Total		\$31,194,171

Sources: California Department of Toxic Substances Control's (department) tracking spreadsheet of unbilled and billed but uncollected costs (unaudited) from its Cost Recovery Billing System and related invoices.

* The parties displayed in this table are billable parties that have been billed by the department for its response costs and appear on invoices sent by the department. According to a senior staff counsel, the term billable party is used by the department to broadly identify persons to whom the department issues an invoice for response costs, including project proponents, potentially responsible parties, and responsible parties. The term *project proponent* is used by the department to describe those persons that enter into voluntary agreements with the department. *Potentially responsible parties* is generally used to describe persons that fall within the four categories of responsible parties or liable persons under the federal Comprehensive Environmental Response, Compensation, and Liability Act (CERCLA) or the State's Hazardous Substance Account Act, but have not been determined to be liable by a court of law. Finally, the term *responsible party* is generally used to describe those persons that have been adjudicated as liable by a court of law. Unless otherwise noted, for purposes of this report, "responsible parties" includes responsible parties and potentially responsible parties.

† According to our legal counsel, when the department engages in cost recovery, it seeks recovery pursuant to CERCLA. Liability under CERCLA is typically joint and several, which means that the department may recover all of its incurred costs from any responsible party. Accordingly, the department sends an invoice to each party for the entire amount of outstanding costs associated with a site. As a result, the parties listed individually in this table may appear to owe more than they actually do. The department will recover each cost associated with a particular site only once.

‡ In May 2014 the department designated the site as an orphan, indicating that there are no remaining viable responsible parties.

Table 4
Top 15 Projects With Unbilled Costs as of March 2014

PROJECT NAME	TOTAL UNBILLED COSTS*
BKK Sanitary Landfill	\$39,049,761
Chemical and Pigment Company	9,550,100
McColl Superfund Site	5,011,353
Charles Caine Company, Inc.	4,567,236
Selma Treating Company	4,491,300
City of Cudahy Park	4,289,008
Whittier Narrows (San Gabriel Valley Superfund Site)	3,536,846
Casmalia Resources	3,269,045
Orchard Supply Company	3,197,393
Alco Pacific	2,733,731
Chicago Musical Group (Former)	2,722,741
Carlson Property	2,322,317
K & D Salvage	1,772,644
Cudahy Residential Area	1,695,489
Central Valley Fertilizer Company, Inc.	1,669,184
Total	\$89,878,148

Sources: California Department of Toxic Substances Control's tracking spreadsheet of unbilled and billed but uncollected costs (unaudited) from its Cost Recovery Billing System for 1987 through March 10, 2014, and its project management database.

* Costs related to the Stringfellow project have been excluded from this table because the State is the sole responsible party for cleanup of the site.

The department has made progress in resolving the accuracy of the information related to projects with outstanding costs and will continue to improve as the department evaluates the projects and adjusts costs in its Cost Recovery Billing System (billing system) or initiates cost recovery efforts in accordance with its work plan procedures. However, according to a senior staff counsel, the department is currently evaluating whether to revise its work plan to extend the target completion dates for some of its evaluative tasks until June 2016, to correspond with the expiration of the two-year terms of the 14 cost recovery positions approved in the fiscal year 2014–15 budget.

The Department Is Unlikely to Collect Millions in Outstanding Costs

The department will be unable to recover all of the outstanding costs due to several factors, such as that the federal and state statutes of limitations (statute of limitations) for recovering costs on some projects have already expired. Further, concerns with the accuracy of project billing statuses require department staff to manually review more than 200 projects. Until they evaluate these projects, the department will not know how much it can potentially recover. Other outstanding costs that are unlikely

Although the department is taking steps to review those projects for which the statute of limitations has not yet expired, it may have already missed the opportunity to potentially recover millions in outstanding costs for other projects on which the statute of limitations has expired.

to be fully collected and therefore overstate the balance in the billing system include instances where the department is involved in ongoing litigation or has negotiated settlements, a party has filed for bankruptcy, or instances where state agencies are responsible for some of the contamination.

Federal and State Statutes of Limitations May Have Expired on Some Sites, Making Collection Highly Unlikely

Although the department is taking steps to review those projects for which the statute of limitations has not yet expired, it may have already missed the opportunity to potentially recover millions in outstanding costs for other projects on which the statute of limitations has expired. Under federal law, an initial action to recover costs from responsible parties must commence within three years of completing removal activities, or within six years of beginning the implementation of remedial activities.⁴ Similarly, state law requires the initiation of a cost recovery action within three years of the department certifying the completion of a cleanup activity. According to a department attorney, for the purposes of recovering costs, the department can file an action against a responsible party under federal law, state law, or upon a provision in a contract. Therefore, she explained, if the statute of limitations has expired for one, the department may still pursue cost recovery under the other two if they have not expired.

As part of the department's work plan to resolve its outstanding costs, program staff completed statute of limitations worksheets (worksheets) for certain projects to provide information needed to establish when the statute of limitations expired or will expire. As of March 2014 the department's program staff had completed worksheets for 615 projects. Specifically, program staff prepared worksheets for projects with unbilled costs of \$5,000 or more, projects with historical costs that the department is currently billing, and projects that make up 90 percent of the total uncollected costs. Using these worksheets, program staff referred some to the department's office of legal counsel to make a preliminary determination as to whether the statute of limitations has expired, while others were referred to the administrative unit for resolution. The department's tracking spreadsheet for these worksheets shows that the office of legal counsel has made preliminary determinations of whether the statute of limitations has expired for 249 of these project sites. The preliminary determinations indicate that the statute of limitations has expired for 76 of the projects, totaling approximately \$13.4 million in cleanup costs.⁵ According to the work plan, every project with a worksheet

⁴ According to a senior staff counsel, the term *responsible parties* is generally used to describe those persons that have been adjudicated as liable by a court of law. The term *potentially responsible parties* is generally used to describe persons that fall within the four categories of responsible parties or liable persons under the federal Comprehensive Environmental Response, Compensation, and Liability Act (CERCLA), or the State's Hazardous Substance Account Act, but have not been determined to be liable in a court of law. Unless otherwise noted, for purposes of this report, responsible parties includes both terms.

⁵ For another 10 projects, totaling \$2.6 million, for which the statutes of limitations may have expired, the department still may be able to pursue cost recovery under a contract agreement.

referred to the office of legal counsel for further evaluation will be evaluated for cost recovery potential. A senior staff counsel stated that evaluation may include a more detailed statute of limitations analysis. However, she acknowledged that the department may not be able to recover costs for projects for which the office of legal counsel's preliminary review determined that the statute of limitations has expired.

When we asked the department why it allowed the statute of limitations to expire for these sites, a senior staff counsel replied that the department is unable to provide a primary, department-wide explanation. She indicated that the reasons may vary and could depend on project-specific circumstances. For example, she explained that the department may have been unable to identify all responsible parties prior to the lapse date, or it may have determined that the responsible party was not financially viable and thus that collection efforts would not be cost-effective, among other reasons. However, as we discuss later in this report, the department does not have a centralized mechanism for tracking and monitoring when the statute of limitations will expire. As a result, it might have missed, and may continue to miss, opportunities to collect millions in outstanding costs.

Due to Poor Documentation, the Department Cannot Verify the Billing Status of Many Projects With Outstanding Costs

Because of concerns regarding the accuracy of the billing statuses, the department is manually reviewing certain project files to determine the cost recovery potential and whether documentation is complete or needs to be supplemented to support the correct status. For example, a senior staff counsel stated that even though the department performed a search for a potentially responsible party (responsible party search), some project files lack documentation supporting the completed search. A responsible party search is the process of identifying the parties that may be responsible for investigating and/or remediating contaminated properties or are liable for the department's costs in investigating and/or remediating the contaminated site. As of March 2014 the department's tracking spreadsheet included 221 projects totaling \$50 million in outstanding costs that may require verification of responsible party search designations. As of March 2013 the department had designated 44 of these projects as having no viable responsible party to recover cleanup costs; these projects are known as orphan sites. However, a senior staff counsel told us that sufficient documentation did not always exist to support these designations. For example, one project with \$40,000 in unbilled costs was classified as an orphan in the billing system even though the documentation in the project files indicated that a responsible party had been identified. As part of its review to resolve outstanding costs, the department has reclassified this project in the billing system. In this case, the project should not have been classified as an orphan.

According to a senior staff counsel, the department believes it misclassified some projects as orphan sites because it lacked a clear definition and because staff misunderstood the requirements for classification as an orphan site. The department's work plan indicates that staff will evaluate projects with outstanding costs, such as those designated as orphan sites. This review is still ongoing, and the department is currently evaluating whether to extend the target completion dates for some of its evaluative tasks until June 2016. However, until it completes the evaluation of projects, the department will not know how much it can potentially recover.

Some Outstanding Amounts Were Never Reduced in the Billing System After the Department Entered Into a Settlement Agreement

Because until recently the department had no written procedures to inform the billing unit about settlement agreements it had reached, the outstanding amounts remaining after the department received settlement payments were sometimes never reduced in the billing system. The department sometimes settles with responsible parties to avoid prolonged and complicated litigation. According to a senior staff counsel, for projects with settlement agreements, the department may recover any remaining outstanding costs from other viable responsible parties, but if no other viable parties exist, it is unlikely to recover the remaining balance. The senior staff counsel confirmed that before November 2013 the department did not have a written procedure directing its office of legal counsel to send settlement agreements reached to the billing unit so that it could make adjustments to the billing system based on the settlement amounts. Thus, the billing unit may not have been aware of such settlements, resulting in outstanding costs remaining in the billing system that were never adjusted. For example, the department incurred more than \$62,000 in oversight and other administrative costs for one site and in 1992 settled with the responsible party for \$33,000. The remaining \$29,000 was recorded in the billing system as an unbilled cost until April 2013.

The department's tracking spreadsheet included four projects that referenced settlement agreements and indicated that the department had not identified any other parties to pay for the remaining costs of \$1.4 million.

The department's tracking spreadsheet as of March 2014 included four projects that referenced settlement agreements and indicated that the department had not identified any other parties to pay for the remaining costs. The outstanding costs for those four projects totaled \$1.4 million. A senior staff counsel indicated that as of May 2014 the department was still analyzing these projects to ensure that settlement funds had been applied to their accounts. Until the department completes this process, its outstanding costs will continue to be overstated. Later in this report we discuss the department's lack of a process for tracking settlement agreements to ensure that the remaining costs are reduced in the billing system.

Outstanding Costs Include Projects Tied Up in Litigation and Bankruptcy, Whose Recovery Is Uncertain

As shown in Table 5 the department has outstanding costs totaling nearly \$73 million for 61 project sites that involve litigation or bankruptcy. For these projects, the department will not know how much, if any, of the costs it could recover until the legal process concludes for each of the project sites. For example, in March 2014, the California Office of the Attorney General (attorney general’s office) filed a complaint against the potentially responsible parties for one project to recover more than \$2 million in costs the department had incurred for cleaning up a contaminated site. The complaint specifies that the defendants failed to comply with the department’s enforcement order issued in March 2011 to complete response actions, such as monitoring and remediating contamination at the site. Until this litigation is resolved, the amount of outstanding costs that the department is owed for this site is uncertain.

Table 5
California Department of Toxic Substances Control’s Projects With Unbilled and Billed but Uncollected Costs (Outstanding Costs) as of March 2014

PROJECT CATEGORY	NUMBER OF PROJECTS*	TOTAL UNBILLED COSTS	TOTAL BILLED BUT UNCOLLECTED COSTS	TOTAL OUTSTANDING COSTS†	PERCENT OF TOTAL NUMBER OF PROJECTS	PERCENT OF TOTAL OUTSTANDING COSTS
Projects with \$0–5,000 in total outstanding costs	722	\$1,082,613	\$114,852	\$1,197,465	43%	1%
Projects with billing issues‡	493	6,256,774	43,817,161	50,073,935	30	26
Closed projects with outstanding costs	95	7,294,288	80,474	7,374,762	6	4
Projects requiring verification of responsible party searches or orphan designations§	223	52,569,212	1,134,158	53,703,370	13	27
Projects with bankruptcies or ongoing litigation being handled by the California Department of Toxic Substances Control (department) office of legal counsel	61	69,529,706	3,267,715	72,797,421	4	38
Projects requiring verification of a No Further Cost Recovery Action (NFCRA) designation	67	5,014,183	3,407,834	8,422,017	4	4
Totals	1,661	\$141,746,776	\$51,822,194	\$193,568,970	100%	100%

Source: The department’s tracking spreadsheet of projects with outstanding costs from its Cost Recovery Billing System (billing system) from July 1987 through March 10, 2014.

* The department’s tracking spreadsheet contained 80 duplicate project entries due to instances where it included a separate record for projects that had both unbilled and billed but uncollected costs. Some of these duplicate entries crossed over into different project categories. Because we were unable to determine which duplicate entry to remove in certain instances, we elected to leave them in both project categories.

† Costs related to the Stringfellow project have been excluded from this table because the State is the sole responsible party for cleanup of the site.

‡ The department is evaluating the outstanding costs for these projects to correct past billing issues, such as timesheet errors or costs that the department never billed.

§ The department is in the process of determining whether it needs to document or supplement prior identification of the parties responsible for contamination of the project site. If the department cannot identify a viable responsible party, it will designate the project as an orphan site.

|| These projects are classified as NFCRA in the billing system indicating that the department determined it was not cost effective to pursue further cost recovery. However, according to the former cost recovery program manager, because of poor documentation in the project files, the department is verifying that this classification is accurate.

In another example, the department does not know how much of its outstanding costs it will recover because the responsible party filed for bankruptcy in April 2013. In October 2013 the department filed a claim for \$35,000 in unpaid cleanup costs and penalties, and according to a senior staff counsel, it will be paid on a pro rata basis along with other general unsecured creditors when the bankruptcy court or trustee makes the distribution.

Cost Recovery Can Be Complicated When State Agencies Are Potentially Responsible Parties

Outstanding costs are also associated with sites for which state agencies are potentially liable for some of the contamination because they possibly sent hazardous substances for disposal. Specifically, the department identified one project for which various state departments and agencies, along with private entities, are potentially responsible parties. According to a senior staff counsel, in general, the department tracks its costs for potential future recovery from responsible parties which can include, in appropriate instances, other state agencies. However, in some instances, it may not pursue formal cost recovery from state agencies.

The project, known as BKK, has \$39 million in unbilled costs. However, the department has not yet billed or otherwise pursued cost recovery from some other potentially responsible parties because their liabilities have not yet been determined.

The project, known as BKK, has \$39 million in unbilled costs. This project site is a closed landfill in West Covina for which the department is continuing to oversee cleanup. According to a senior staff counsel, the department has filed administrative and civil enforcement actions against many of the larger potentially responsible parties and, as a result, these potentially responsible parties are now conducting response actions at the site. The department, however, has not yet billed or otherwise pursued cost recovery from some other potentially responsible parties because their liabilities have not yet been determined. She also stated that preliminary estimates indicate that state agencies sent less than 10 percent of the total hazardous waste disposed at the landfill and that the cost for cleanup of the site may exceed \$800 million. According to state law, costs incurred by the department in response to a hazardous substance release at BKK that are traceable to hazardous substance contamination by another state agency are counted toward any state liability for those response costs. Therefore, according to a senior staff counsel, the department may not pursue formal cost recovery methods, such as sending invoices, for state agencies that are potential responsible parties.

The Department Has Made Progress, but It Is Still Lacking Procedures in Certain Areas

Although the department established updated cost recovery procedures in November 2013 and conducted trainings with staff in February and March 2014, it has just begun to implement some of them. Thus, while we generally found that the updated procedures we reviewed are adequate if followed, it is too early in the implementation to conclude whether department staff are using them consistently, because so few projects had been processed using the new procedures as of May 2014.

One of the department's cost recovery work plans acknowledges that in the past, its lack of updated cost recovery policies to clearly define the roles and responsibilities of all staff involved impeded its cost recovery efforts. In addition, gaps in the previous policies led to inconsistent handling of cost recovery issues. Further, the work plan states that communication between the various units involved in cost recovery could be improved, and the lack of clarity and communication led to a number of billing, collection, and data management problems that have plagued the department for years.

The department developed the new work plan to focus on creating procedures, policies, and performance metrics to ensure that these and similar problems do not recur. The department intends to develop performance metrics that provide information on cost recovery activities by the end of August 2014. The department also indicates that it will begin quarterly reporting on its progress in evaluating outstanding costs and initiating collection efforts by the end of September 2014.

In November 2013 the department established updated cost recovery procedures, and it conducted trainings in February and March 2014 with department staff in accordance with its work plan goals. The updated procedures we reviewed contain additional controls that, if followed, should prevent another buildup of outstanding costs. However, we found several areas in which the department could better maximize its cost recovery efforts. Specifically, the department still lacks processes for tracking and monitoring the statute of limitations on contaminated sites and tracking the progress and resolution of its settlement agreements. Additionally, it did not always properly implement its new procedures related to its responsible party searches. Although few projects had been processed using the new procedures as of May 2014, our review found that the department complied with three other procedures in the limited number of instances we were able to test.

The department still lacks processes for tracking and monitoring the statute of limitations on contaminated sites and tracking the progress and resolution of its settlement agreements.

The department's lack of a formal process for tracking and monitoring when the statute of limitations will expire may have contributed to at least some of the \$13.4 million in costs that it may not recover.

The Department Has Not Established Processes to Track and Monitor the Statute of Limitations or Settlement Agreements for Its Projects

The department does not have a formal process for tracking and monitoring when the statute of limitations will expire on its project sites. As previously discussed, the department's program staff completed statute of limitations worksheets for 615 projects and referred some to the office of legal counsel, who made preliminary determinations. These determinations indicated that the statute of limitations has expired for 76 projects, totaling \$13.4 million. The department's lack of a formal process for tracking and monitoring when the statute of limitations will expire may have contributed to at least some of the \$13.4 million in costs that it may not recover. At the end of June 2014 the department released a tool staff can use to enter the statute of limitations data into its project management database. However, the department's data systems unit chief stated that the department has not yet built a reporting function into the project management database and it has not established a time frame for doing so. Until the department implements a reporting function to monitor the expiration of the statute of limitations on its projects, it increases the risk that it will not take all actions necessary to maximize cost recovery before the statute of limitations expires.

In addition, the department's updated cost recovery procedures require program staff to provide documentation of settlement agreements reached to the billing unit so it can adjust outstanding costs appropriately. As discussed earlier, the billing unit may not have been aware of some settlements and, as a result, the outstanding costs related to these settlements remained in the billing system and were never adjusted. According to a department senior staff counsel, before November 2013, the department did not have a written procedure directing its legal office to send completed settlement agreements to the billing unit so it could make adjustments in the billing system based on settlement amounts. The department's new procedures address this issue by requiring cleanup program staff to complete settlement-related documentation in conjunction with the department's legal office and provide the documentation to the billing unit to assist it in processing payments received pursuant to a settlement agreement. Although the department entered into some settlement agreements from November 2013 through early June 2014, it is either still pursuing other responsible parties or has yet to receive settlement payments for those projects. Therefore, we were unable to review whether the department made adjustments in the billing system in accordance with the new procedures.

Although the department now has a procedure for sending settlement agreement information to the billing unit, it does not have a formal mechanism for tracking settlement agreements. A senior staff counsel explained that the department is in the process of developing and implementing a tool to track the progress and resolution of projects referred to the attorney general's office, which will include whether it reaches a settlement with the responsible parties. A department attorney estimated that the department will complete this tool by mid-August 2014. Until the department implements a process to track its settlements, the billing unit and others involved in cost recovery cannot verify that they have the latest information on settlement agreements.

Although the Department Recently Established Procedures for Documenting Searches for Responsible Parties, It Has Not Always Followed the Procedures

In November 2013 the department developed formal procedures for program staff to follow when documenting searches for responsible parties, but staff have not always followed the procedures. Applicable laws generally require the department to make reasonable efforts to identify parties responsible for contaminating sites. However, a division chief in the department's Brownfields and Environmental Restoration Program (division chief) stated that before November 2013 the department did not have a single source document describing when and how to conduct responsible party searches. In addition, a senior staff counsel stated that the department did not uniformly document its responsible party searches. As a result, as we discussed earlier, the department's tracking spreadsheet for projects with outstanding costs included 221 projects that the department is reviewing to determine whether they require verification of responsible party search designations.

The department provided training to its staff with responsibilities related to cost recovery in February and March 2014. The training covered the new procedures issued in November 2013, including responsible party searches. Using the department's project management database, we identified three responsible party searches completed by the department from November 2013 to late May 2014. We reviewed the three searches and found that the department failed to obtain and document one of the three required approvals for two of them. Although department staff did not fully comply with the new procedures, we found that, if followed, the procedures require staff to complete and retain adequate documentation to support responsible party searches. Specifically, program staff must now memorialize responsible party searches in a memorandum and have the memo approved by two managers and an attorney. The project manager must document the results

We reviewed the three searches and found that the department failed to obtain and document one of the three required approvals for two of them.

in the project files. However, until it ensures that staff follow the procedures for conducting and documenting responsible party searches, the department cannot demonstrate that it is maximizing its cost recovery opportunities.

The Department Has Implemented Some Additional New Procedures

In addition to its updated procedures for applying settlement agreement payments and documenting responsible party searches, the department has established many other procedures related to cost recovery. We reviewed three other procedures and found the department followed its processes for the items we reviewed. For example, as shown in Table 5 on page 19, the department's tracking spreadsheet included 95 closed projects that had outstanding costs totaling just under \$7.4 million. The department's procedures for closing projects in its billing system before November 2013 were inadequate and did not prohibit program staff from charging costs to closed projects. The new procedures for closing projects require program staff to complete a closure request form and require the billing unit staff to verify that all costs have been settled before changing the project's status to closed in the billing system. Based on our review of the procedures, we believe that, if followed, they are adequate to prevent future charges to closed projects. We reviewed two projects that the department closed after November 2013 and found that it had followed the new procedures for closing projects to prevent staff from charging additional costs to them.

We reviewed two projects that the department closed after November 2013 and found that it had followed the new procedures for closing projects to prevent staff from charging additional costs to them.

Another new procedure we reviewed relates to designating a project as an orphan site. It requires staff to assemble specific documentation needed to substantiate the orphan designation, such as a search for responsible parties or an analysis of the responsible parties' ability to pay cleanup costs. Further, the program supervisor, the branch chief, and the department's office of legal counsel must all approve the orphan designation before billing unit staff can enter or change the designation of a project in the billing system to an orphan site. We believe this procedure, if followed, is adequate to prevent the department from misclassifying orphan sites in the future. As part of its work plan to address the backlog of outstanding costs, the department is reviewing projects it previously classified as orphan sites. As of March 2014 the department's tracking spreadsheet included two projects with a final designation as an orphan site. Our review of the two finalized orphan designations found that staff followed the new procedures.

Finally, before November 2013, the department had a policy memo describing how to make a decision to pursue a No Further Cost Recovery Action (NFCRA) classification for a site and how to document the decision. A NFCRA determination is usually the

last step in the cost recovery process and pursued only when the department has considered and rejected all other reasonable cost recovery alternatives. However, according to the former cost recovery program manager, because of poor documentation in some of the project files classified as NFCRA, the department could not verify that staff had made the appropriate determination and obtained the required approvals. As shown in Table 5 on page 19, the department's tracking spreadsheet included 67 projects designated as NFCRA, with outstanding costs totaling more than \$8.4 million. Additionally, the policy memo did not include requirements for the billing unit to obtain documentation from program staff to support an approved change to a NFCRA status in the billing system, which, according to the accounting administrator II (accounting manager), would suspend billing of the responsible parties. Pursuant to its work plan to address past outstanding costs, the department is in the process of evaluating whether the projects designated as NFCRA have completed determinations or whether it can recover any costs.

We reviewed the department's updated procedures for making a NFCRA determination and found that, if followed, they are adequate to ensure that staff appropriately process, document, and obtain approvals for a NFCRA designation. Specifically, the updated procedures require multiple levels of review and approvals. They also require the billing unit to obtain and document the approved NFCRA memorandum in the billing system before making any adjustments to the way the responsible parties are billed. We reviewed four projects that the department identified as NFCRA under the new process and found that it documented and approved the NFCRA memorandums in compliance with the new procedures.

The Department Can Improve the Use of Its Cost Recovery Tools

The department uses various tools to facilitate cost recovery, such as entering into payment plans with the responsible parties or working with the attorney general's office to pursue litigation. However, the department has not consistently used some of its tools to ensure that it maximizes the recovery of costs from responsible parties. Specifically, the department has not always consistently issued collection letters to responsible parties that are delinquent in their payments or placed liens on their properties. Additionally, increasing the interest rate charged on billed but delinquent unpaid amounts may improve the timeliness of collections from responsible parties.

Although the department had written procedures requiring its cost recovery unit to notify legal staff to send collection letters to the responsible parties when two invoices go unpaid, the department did

The department has not consistently used some of its tools to ensure that it maximizes the recovery of costs from responsible parties.

There was an informal policy for program staff to undertake sending the collection letters, however, program staff were not sending collection letters consistently.

not always follow these procedures. Specifically, the department division chief stated that because of a lack of resources in the legal office, there was an informal policy for program staff to undertake sending the collection letters. However, according to the former cost recovery program manager, responses to an e-mail inquiry by the department to its regional offices in August 2012 indicated that program staff were not sending collection letters consistently. Further, according to a senior staff counsel, before approximately September 2012, the department did not have a centralized process to track whether collection letters were being sent on a timely basis for all sites with overdue costs. Therefore, the department was not aware that staff were not sending the collection letters, resulting in missed opportunities to maximize cost recovery.

In October 2012 the department began the practice of making the accounting unit responsible for issuing collection letters for past-due invoices, which it formalized in November 2013. The new procedures require the accounting unit's staff to send a sequence of three collection letters at 30-calendar-day intervals to parties whom the department has billed but whose amounts owed are more than 60 days past due.⁶ Although the new procedures centralize the process, the department has not always followed them. For two projects we reviewed related to this procedure, the department did not send the first collection letters within the specified time frame. Specifically, the new procedures require the department's accounting office to send the first collection letter within 70 calendar days after issuing the invoice that the billed party has not paid. However, in one instance the department's accounting unit issued the first collection letter on the 108th day, or 38 days late. For another project, it issued the first letter on the 77th day, or seven days late. The department's accounting manager stated that he could not provide a specific reason why the department did not send these collection letters within the required time frame, because the staff member in the accounting unit who sent the collection letters no longer works at the department.

In these two instances, we did note that the subsequent collection letters were sent within the required time frames or were stopped in compliance with the department's procedures. The accounting manager stated that the accounting unit has assigned two staff members, instead of one, the responsibility of issuing the collection letters and updating the collection letter log to help minimize future errors and delays in the manual process. The department uses the collection letter log to track letters it sends to billable parties. He also indicated that the department plans to automate the collection

⁶ The department has provided schools with a 180-day grace period and would send a sequence of three collection letters at 30-calendar-day intervals for invoices more than 180 days late. However, the procedures indicate that effective July 2014, the grace period will be eliminated.

letter process once the Financial Information System for California (FI\$Cal) is implemented. Until the department is able to automate this function, it should develop written procedures for updating and monitoring its collection letter log.

Another tool the department uses in its cost recovery efforts is liens recorded on real property. State law establishes a lien on a responsible party's real property for which the department incurred costs. However, to make the lien effective, the department must give the responsible party notice and an opportunity for a hearing, and must record the lien with the county. Although the department has procedures for placing liens, it has not consistently used liens as a cost recovery tool. According to a senior staff counsel, the department uses liens to secure recovery of its response costs in various situations, including when a responsible party cannot afford to pay. The senior staff counsel stated that the department staff have not shared a uniform view regarding the use of liens as a cost recovery tool. For example, she stated that sometimes staff use liens as a final tool for cost recovery without considering whether additional cost recovery tools were reasonable or appropriate.

The department updated its written procedures for lien placements in November 2013. However, the senior staff counsel explained that the recently issued procedures do not address certain issues that are the focus of the department's current efforts to update its existing lien placement policy. The department is working with the attorney general's office to update its lien placement policy, and according to a senior staff counsel, the department believes it will have an updated policy in place within six to eight months. Until the department revises its policy to fully implement its lien authority, it will not ensure that it is maximizing its recovery of costs from responsible parties.

A third tool that the department uses as part of its cost recovery efforts and that could be improved is the interest charged on late payments. According to a department senior staff counsel, because the interest rate that it can charge responsible parties for late payments is so low, the incentive to pay recovery costs promptly may also be low. State law requires the department to charge interest for invoices not paid within 60 days at a rate equal to the rate of return earned on investments in the State's Surplus Money Investment Fund (SMIF). However, the SMIF interest rate is substantially lower than the interest rate charged for late payments by other state entities, such as the California State Board of Equalization (BOE) interest rate. For example, for the quarter ending June 30, 2013, the SMIF interest rate was 0.246 percent, while the BOE interest rate was 6 percent for the same period. Increasing the interest rate could result in more timely payments. For example, a responsible party failed to pay invoices totaling

Until the department revises its policy to fully implement its lien authority, it will not ensure that it is maximizing its recovery of costs from responsible parties.

An increase in the interest rate may improve the timeliness of payments by responsible parties, thereby improving the department's cost recovery efforts.

more than \$856,000 for one quarter and was assessed \$654 using the SMIF interest rate. However, using the BOE interest rate, the same responsible party would incur \$10,842 in interest. The department's legislative director stated that the department is considering pursuing a legislative change to increase the interest rate it can charge for late payments, but it does not have a specific time frame for doing so. As long as the SMIF interest rate remains low, there is less incentive for responsible parties to make payments on time. An increase in the interest rate may improve the timeliness of payments by responsible parties, thereby improving the department's cost recovery efforts.

The department is also limited in its ability to recover costs effectively because it lacks the authority to require a potentially responsible party to provide information related to the financial ability to pay cleanup costs. Unlike the U.S. Environmental Protection Agency, the department does not have the authority to require that potentially responsible parties provide financial information when searching for responsible parties. Instead, the department can only request potentially responsible parties to provide financial information voluntarily. Having the authority to compel parties to submit pertinent financial information would allow the department to identify those potentially responsible parties who genuinely lack the ability to pay for cleanup and no longer require the department to first sue these parties to obtain financial information. According to a legislative manager, the department is evaluating whether to pursue a legislative proposal seeking this change. The ability to require this type of information could better inform the department's decision making about whether to file cost recovery actions because it could better differentiate between parties capable of paying for cleanup costs, thus increasing the department's ability to recover costs effectively.

The Department Has More to Do to Ensure the Viability of Its Data Systems and the Accuracy of Its Data

Although the department is taking some steps to improve the accuracy of the cost recovery data in its billing system, it still must address whether it will finish evaluating the project data in its billing system in time for implementation of FI\$Cal. It must also continue to reduce outstanding costs associated with federal grants for which the department already received payments, and complete its evaluation of projects with outstanding costs under \$5,000 to determine whether it can write off the balances or will need to pursue collection. Until the department resolves these issues, it cannot ensure that the amount of outstanding costs in its billing system is accurate.

The department indicated that its current billing system, developed in 2002, is no longer supported by the manufacturer, which stopped providing technical support for the software in 2008. According to the financial planning and business manager, the department is planning to rely on the State's new FI\$Cal system to replace its billing system. According to FI\$Cal's 2014 *Annual Report to the Legislature* (annual report), the system is intended to enable the State to combine accounting, budgeting, cash management, and procurement operations into a single financial management system. This will eliminate the need for independent legacy systems and department-specific applications that support the State's internal financial management operations. In May 2013 the department's agency, the California Environmental Protection Agency, requested and received approval from the FI\$Cal project team to move the department up to Wave 2 in the FI\$Cal implementation process. FI\$Cal's 2014 annual report shows implementation of Wave 2 occurring by July 2015.

Although the department is planning to rely on FI\$Cal to replace its current billing system, there are uncertainties about whether the department will have accurate data to load into the new system by the July 2015 implementation date. The department is still in the process of evaluating projects with outstanding costs in its billing system and, according to a senior staff counsel, the department is currently evaluating whether to revise its work plan to extend target completion dates for some of its evaluative tasks until June 2016. Until the department determines when it will finish evaluating these projects, it cannot ensure that it will be able to load accurate information into FI\$Cal.

Further, the department's outstanding costs were overstated because they included costs related to a state loan program for which the department received funding for its costs. This outstanding cost overstatement has since been corrected. An accounting manager explained that the department needed to remove costs from its billing system related to the State's Cleanup Loans and Environmental Assistance to Neighborhoods Loan Program (CLEAN loan program). This program provides low-interest loans to landowners, developers, local governments, and community organizations to finance environmental assessments and hazardous waste cleanups of sites with actual or perceived contamination and the potential for redevelopment or reuse. To correct these overstated costs, the department identified and removed \$1.1 million in CLEAN loan program costs from its billing system. However, he stated the department has not yet updated its written procedures to include the process for removing these costs in the future and plans to do so the next time it updates its procedures.

Although the department is planning to rely on FI\$Cal to replace its current billing system, there are uncertainties about whether the department will have accurate data to load into the new system by the July 2015 implementation date.

Although the department has removed some costs from its billing system for these federal grants and the state cleanup loan program, the accounting manager acknowledged that it has not adjusted all of the costs related to the two grants for which the federal funding received is considered payment in full, and it does not yet know how much more it still needs to remove from the system.

The department's unbilled costs were also overstated because they included costs related to some federal grants for which the department received funding. The department's accounting manager identified three federal grants for which the department needed to reduce costs in its billing system. Specifically, for one federal grant, which was to be used to treat contamination at California naval facilities, the department determined that the costs were duplicative because they were accounted for separately in another system and should not have been loaded into the billing system. The department identified and removed \$11.8 million in costs for this grant from the billing system.

For two other federal grants, the department determined that the costs in its billing system were nonreimbursable because the amounts it received from the federal government are considered payment in full of the costs incurred by the department.

Although the department has removed some costs from its billing system for these federal grants and the state cleanup loan program, the accounting manager acknowledged that it has not adjusted all of the costs related to the two grants for which the federal funding received is considered payment in full, and it does not yet know how much more it still needs to remove from the system. The department indicated that, as part of its actions taken to resolve outstanding costs, in January 2012 it removed \$19 million in duplicate costs from its billing system. However, the documentation provided to us by the department substantiated adjustments totaling only \$15.7 million. The department could not support the full \$19 million in adjustments because, according to the accounting manager, it was unable to re-create the former cost recovery manager's reported grant adjustments. The accounting manager stated that the department will make additional adjustments to the costs for the two federal grants considered paid in full through ongoing data cleanup efforts. Until the department completes its review of projects and data cleanup, the unbilled costs may continue to be overstated.

Finally, the department is evaluating whether it should pursue further collection efforts on projects with unbilled costs of less than \$5,000 as part of its work plan to resolve outstanding costs. As of March 2014 the department's updated tracking spreadsheet shows that roughly 720 project sites still have outstanding costs totaling almost \$1.2 million. This population also includes some projects with total outstanding costs over \$5,000 because some projects have incurred additional costs since the department initially categorized them. The department will need to remove projects that exceed \$5,000 before it takes further action on the remaining projects under the threshold. According to the department's special assistant for program review (special assistant), because the department believes it may not be cost-effective to try to recover costs for these projects, it is pursuing whether it can write off these costs. The department has completed

an analysis of how much it costs to perform various steps in the cost recovery process and determined it would cost between \$1,000 and \$8,800 depending on the project's complexity. The special assistant stated that the department plans to meet with the California Department of Finance in August 2014 to discuss the department's ability to write off costs of \$5,000 or less for unbilled and uncollected costs. Until the department resolves its questions about whether it has authority to write off these costs or whether it will need to pursue cost recovery efforts, its costs for these projects will be included in its outstanding costs.

Recommendations

To ensure that it maximizes opportunities to recover its costs, by January 2015, the department should develop a reporting function in its project management database to track and monitor the statute of limitations expiration dates for its projects.

To improve the accuracy of the outstanding costs in its billing system, by January 2015, the department should establish a process to track its settlement agreements to ensure that department staff can verify they have updated information for outstanding costs that reflects all adjustments made for settlements paid and reduced in the billing system.

To ensure that it maximizes the recovery of its costs from responsible parties, by October 2014, the department should do the following:

- Establish processes to monitor and verify that responsible party searches are properly reviewed and approved according to its procedures.
- Develop written procedures for updating and monitoring its collection letter log.
- Continue its plan to update policies and procedures for using liens whenever appropriate.

To improve the department's efforts to recover its costs promptly, the Legislature should revise state law to allow the department to use a higher interest rate for late payments. For example, the department could be allowed to use an interest rate similar to that used by the BOE.

To improve its ability to more effectively recover costs, the Legislature should give the department the authority to require financial information from potentially responsible parties.

To ensure it loads only accurate billing data into FI\$Cal, the department should continue evaluating projects with outstanding costs in its billing system to meet the July 2015 implementation date.

To improve the accuracy of its outstanding costs related to the CLEAN loan program and federal grants, the department should do the following:

- Follow through with its plan to update its written procedures to include the changes in billing procedures for the CLEAN loan program.
- Continue to identify and remove outstanding costs for the federal grants when it determines it has already received funding.

The department should continue to resolve its questions about its authority to write off outstanding costs under \$5,000. To the extent that it determines it cannot write off outstanding costs, it should pursue collecting the costs.

We conducted this audit under the authority vested in the California State Auditor by Section 8543 et seq. of the California Government Code and according to generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives specified in the scope section of the report. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

Respectfully submitted,



ELAINE M. HOWLE, CPA
State Auditor

Date: August 7, 2014

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For questions regarding the contents of this report, please contact Margarita Fernández, Chief of Public Affairs, at 916.445.0255.



CALIFORNIA ENVIRONMENTAL PROTECTION AGENCY



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EDMUND G. BROWN JR.
GOVERNOR

July 18, 2014

Elaine M. Howle, CPA*
California State Auditor
555 Capitol Mall, Suite 300
Sacramento, CA 95814

Dear Ms. Howle:

Thank you for the opportunity to respond to the draft report on cost recovery issues at the Department of Toxic Substance Control (DTSC). My staff and I have reviewed the report and concur in the Department's attached comments.

DTSC recognizes that timely cost recovery is a central part of its mission to protect human health and the environment. Over the course of the last year, DTSC has demonstrated its commitment to restore the public trust by aggressively working to strengthen its cost recovery process and pursue cost recovery from potentially responsible parties. I am pleased that your office has concluded that progress has been made in resolving these issues and agrees that DTSC's new procedures are adequate if consistently implemented.

Both CalEPA and DTSC, however, recognize that this work is not complete, and the draft report includes important findings and recommendations that DTSC will work to address.

I greatly appreciate your audit team's thoroughness and professionalism during this audit.

Sincerely,

Matthew Rodriguez
Secretary for Environmental Protection

AIR RESOURCES BOARD • DEPARTMENT OF PESTICIDE REGULATION • DEPARTMENT OF RESOURCES RECYCLING AND RECOVERY
DEPARTMENT OF TOXIC SUBSTANCES CONTROL • OFFICE OF ENVIRONMENTAL HEALTH HAZARD ASSESSMENT
STATE WATER RESOURCES CONTROL BOARD • REGIONAL WATER QUALITY CONTROL BOARDS

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* California State Auditor's comments appear on page 37.



Department of Toxic Substances Control



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Secretary for
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Edmund G. Brown Jr.
Governor

July 18, 2014

Elaine M. Howle, CPA
California State Auditor
555 Capitol Mall, Suite 300
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California State Auditor's Draft Report 2013-122 re Department of Toxic Substances Control

Dear Ms. Howle:

Thank you for the opportunity to review the California State Auditor's draft report, which documented the Department of Toxic Substances Control's (Department) ongoing progress in addressing its historical cost recovery issues. The Department concurs with the recommendations outlined in the audit findings and will reassess its reform efforts to ensure that your recommendations are fully implemented.

Since 1987, the Department has spent more than \$1.8 billion to clean contaminated sites and fulfill its mission to protect California's people and environment from the harmful effects of hazardous substances. Of that amount, the Department publicly disclosed on May 31, 2013, that \$184.5 million in costs incurred by the Department from July 1987 through December 2012 remained outstanding. The California State Auditor subsequently included 2013 data in its draft report, reflecting a new total of \$194 million in outstanding costs as a result of the Department's continued oversight and remediation of contaminated sites. Since March 2013, the Department has actively addressed its historical cost recovery issues by developing and implementing two comprehensive work plans. We are committed to the creation and adoption of a transparent cost recovery program that will earn the trust of California taxpayers.

The first work plan outlines the Department's plan to comprehensively evaluate its outstanding costs and initiate cost recovery efforts to the maximum extent feasible and practical. As your findings indicate, the Department has made progress in addressing its outstanding costs and has already been able to reduce the number of sites with outstanding costs from 2,700 to less than 1,661.

Although further Department investigation is necessary to determine how much of the \$194 million in outstanding costs the Department will be able to collect, the Department is working aggressively to evaluate the collection potential of the remaining sites and has referred numerous matters to the Office of the Attorney General. As noted in the audit report, nearly \$73 million in outstanding costs is the subject of litigation or bankruptcy. Moreover, additional outstanding costs will be resolved as the Department continues its data cleanup efforts, such as reconciling federal grant and CLEAN loan payments. The Department is continuing its cost recovery data cleanup efforts and will ensure that this issue will not delay or hinder the implementation of FiSCal in July 2015.

The second work plan guides the creation of comprehensive procedures and training to address present and future recovery of the Department's costs and ensure that past issues do not persist. As part of this work plan, the Department created a number of new procedures clearly setting out the cost recovery roles and responsibilities of its employees. The Department also conducted training regarding the procedures for more than 400 employees. The Department is further reviewing the procedures and is using staff feedback to create a comprehensive cost recovery policy that will underscore the importance of cost recovery for the Department. We are gratified by your conclusion that the Department's new procedures, if followed, will prevent another buildup of outstanding costs. ②

The Governor's Office and the Legislature have provided support for the Department's effort to resolve its historical cost recovery issues by approving our request for 14 two-year positions, starting July 14, 2014. With this additional support and the ongoing commitment by its employees, the Department is confident that it can institute the recommendations contained in the audit. We look forward to providing you and the public with updates regarding our progress as we continue to improve and build public trust through our comprehensive reform effort.

Sincerely,


Miriam Barcellona Ingenito
Acting Director

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Comments

CALIFORNIA STATE AUDITOR'S COMMENTS ON THE RESPONSE FROM THE CALIFORNIA ENVIRONMENTAL PROTECTION AGENCY, CALIFORNIA DEPARTMENT OF TOXIC SUBSTANCES CONTROL

To provide clarity and perspective, we are commenting on the response to our audit report from the California Environmental Protection Agency (CalEPA). The numbers below correspond to the numbers we have placed in the margin of CalEPA's response.

CalEPA's response somewhat overstates our conclusion about the California Department of Toxic Substances Control's (department) new procedures. As we state objective 2 in Table 1 on page 10, we assessed the adequacy of selected cost recovery procedures in addressing problems contributing to the backlog of unbilled and billed but uncollected costs (outstanding costs). We state on page 21 the updated procedures we reviewed contain additional controls that, if followed, should prevent another buildup of outstanding costs. Additionally, on page 21 we state that while we generally found that the updated procedures we reviewed are adequate if followed, it is too early in the implementation to conclude whether department staff are using them consistently because so few projects had been processed using the new procedures as of May 2014. Further, on pages 22 to 23 we describe the department's lack of processes for tracking and monitoring when the federal and state statutes of limitations will expire on its project sites and the absence of a process to track its settlement agreements.

①

The department's response misstates our conclusion about its new procedures. Our report does not conclude that the department's new procedures, if followed, will prevent another buildup of outstanding costs. Instead, we state on page 21 that the updated procedures we reviewed contain additional controls that, if followed, should prevent another buildup of outstanding costs. Additionally, on pages 22 to 23 we describe the department's lack of processes for tracking and monitoring when the federal and state statutes of limitations will expire on its project sites and the absence of a process to track its settlement agreements.

②