



February 22, 2010

Miles Burnett, Assistant Deputy Director  
California State Water Resources Control Board  
1001 I Street  
Sacramento, CA 95814

Dear Mr. Burnett:

Enclosed is our report entitled 'Underground Storage Tank Cleanup Fund (Fund) Performance Audit.' This report was prepared on behalf of the California State Water Resources Control Board by Sjoberg Evashenk Consulting and includes our analysis and recommendations. As it relates to the Fund, our report addresses the Board's compliance with statutes, regulations, policies, and procedures; efficiency and effectiveness of policies and procedures; and internal controls. A draft report was discussed with the Board's executive management in early February 2010 and management comments received were considered in drafting the final report.

Sjoberg Evashenk Consulting was pleased to work with the Board on this important project.

Respectfully submitted,

A handwritten signature in blue ink that reads "Lynda McCallum".

Lynda McCallum, Manager  
Sjoberg Evashenk Consulting, Inc.

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# California State Water Resources Control Board

## Underground Storage Tank Cleanup Fund Performance Audit

February 22, 2010



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## Executive Summary

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Sjoberg Evashenk Consulting, working on behalf of the State Water Resources Control Board (SWRCB), completed a performance audit of the Underground Storage Tank Cleanup Fund (USTCF). The objectives of the audit were to assess:

- The Board's compliance with statutes, regulations, policies, procedures, and processes at meeting program goals and objectives.
- Efficiency and effectiveness of the Board's policies, procedures, and processes at meeting program goals and objectives.
- Internal controls to prevent fraud and other activities incompatible with generally accepted accounting principles (GAAP), State Administrative Manual (SAM) guidelines, and sound fund management practices.

Overall, we found that because the program is premised on reimbursing participants for the cleanup costs that have already been incurred, the Fund's top priority is to reimburse claimants as quickly as possible. To do so, the Fund activated claimants with a goal to fully utilize resources in the short-term without sufficient data or cash flow estimates to project the full extent of funding needed to close out projects or to estimate unmet needs. Further, sound financial management practices and effective cost containment measures were not utilized such as requiring claimants expecting reimbursement from the Fund to provide Fund staff with project plans or cost estimates up front for review and approval prior to cleanup work beginning. Without needed data, Fund management is unable to successfully manage or estimate the demand on the Fund's limited resources—either related to current cash flow demands or more broadly related to future demand. As a result of this and other financial planning shortcomings, an unanticipated financial crisis erupted in 2008 as demand on the Fund outpaced resources and Fund cash balances and reserves were nearly depleted and millions of dollars in claimant reimbursement payments had to be placed on hold.

The issues associated with inadequate financial management practices were exacerbated by other fundamental problems, namely rapidly increasing project costs and lack of control functions and effective cost containment. During the last four years alone, the Fund's average total cost for cleanup projects to reach closure increased from about \$131,000 per project to more than \$250,000 and the average cost of currently active projects (i.e. not closed) is already about \$400,000. In fact, our projections reveal that if the rapid escalation of project costs continues, the Fund is likely to experience a significant revenue shortfall where between \$1.6 billion to \$1.8 billion in eligible claimants' cleanup costs will be left unfunded when the Fund sunsets in 2016. However, according to management, the program was never intended to have sufficient funding to cover all claimants' cleanup costs before the program sunsets.

Currently, the only uncompromising cost containment measure in place is the statutory reimbursement cap of \$1.5 million per claim. Other than a generally imperfect process of reviewing the costs and reasonableness of cleanup activities after they have been conducted, the program lacks effective and reliable measures that control costs or establish budgeted or projected costs for cleanup projects that the Fund could track costs against and view program

demands on a short and long-term basis. Information, such as project plans, budgets, or competitive bids, in order to effectively contain project costs is not provided to the Fund and individual costs are typically reviewed for the first time when reimbursement requests are submitted. As a result, Fund staff lack the ability to influence or control project costs before cleanup activities occur and reimbursement is sought. Moreover, excluding the Fund from the cleanup project lifecycle until the end leaves management and staff operating under a disjointed, “siloed” approach that focuses on whether or not individual costs submitted at any given time are eligible to be reimbursed irrespective of the project as a whole. Additionally, another significant cost containment issue outside of the Fund’s control is the fact that cleanup projects are staying open longer, thus incurring more costs; regulatory oversight agencies retain the authority and wide-discretion to determine when cases are ready for closure.

Exacerbating the cost containment issues facing the Fund are the unclear roles and responsibilities and conflicting objectives between regulatory oversight agencies responsible for overseeing and directing cleanup activities and Fund staff responsible for providing reimbursements for eligible costs. Regulatory agencies focus on remediation, the spill site, and have little incentive to encourage cost management or cost effective alternatives. While Fund resources were robust, there was little problem with this approach. While the Fund may determine a cost submitted for reimbursement does not meet “reasonableness and necessity” criteria, it is unclear whether the Fund or the regulator has the ultimate authority to make the determination. As a result, there is little communication and coordination between the regulators and the Fund, especially throughout the projects planning phases, that hampers their ability to reach collaborative decisions early in the cleanup project lifecycle; thus, avoiding disagreements later in the process. Furthermore, we found that costs associated with regulatory oversight are also increasing. In particular, oversight costs are paid with Fund resources but funding arrangements and contracting practices are outside the control of Fund management resulting in little motivation for effective and efficient operations or accountability and no incentive to push for timely and efficient progress toward project closure.

The Fund’s looming financial management and cost containment issues not only leave an incomplete financial picture of the likely demand that the hundreds of cleanup projects will place on the Fund’s limited resources, but impacts the ability to hold project decision makers accountable for incurring only those costs that are reasonable and necessary and ensuring cleanup projects efficiently move toward completion. In the end, without swift and significant changes, the Fund will be unable to sustain the demand of increasingly more expensive projects. While Fund management can and should take swift action to modify certain processes and procedures, the viability of the Fund depends on all USTCF stakeholders communicating and working in a collaborative fashion to ensure project costs are contained and projects move toward completion as quickly as possible.

While matters related to financial planning and cost containment represent the Fund’s most significant issues, we also noted several other areas where processes could be streamlined and controls could be strengthened, such as eliminating unnecessary compliance reviews related to eligibility determinations and incorporating independent quality control processes related to reimbursement payments.

# Introduction

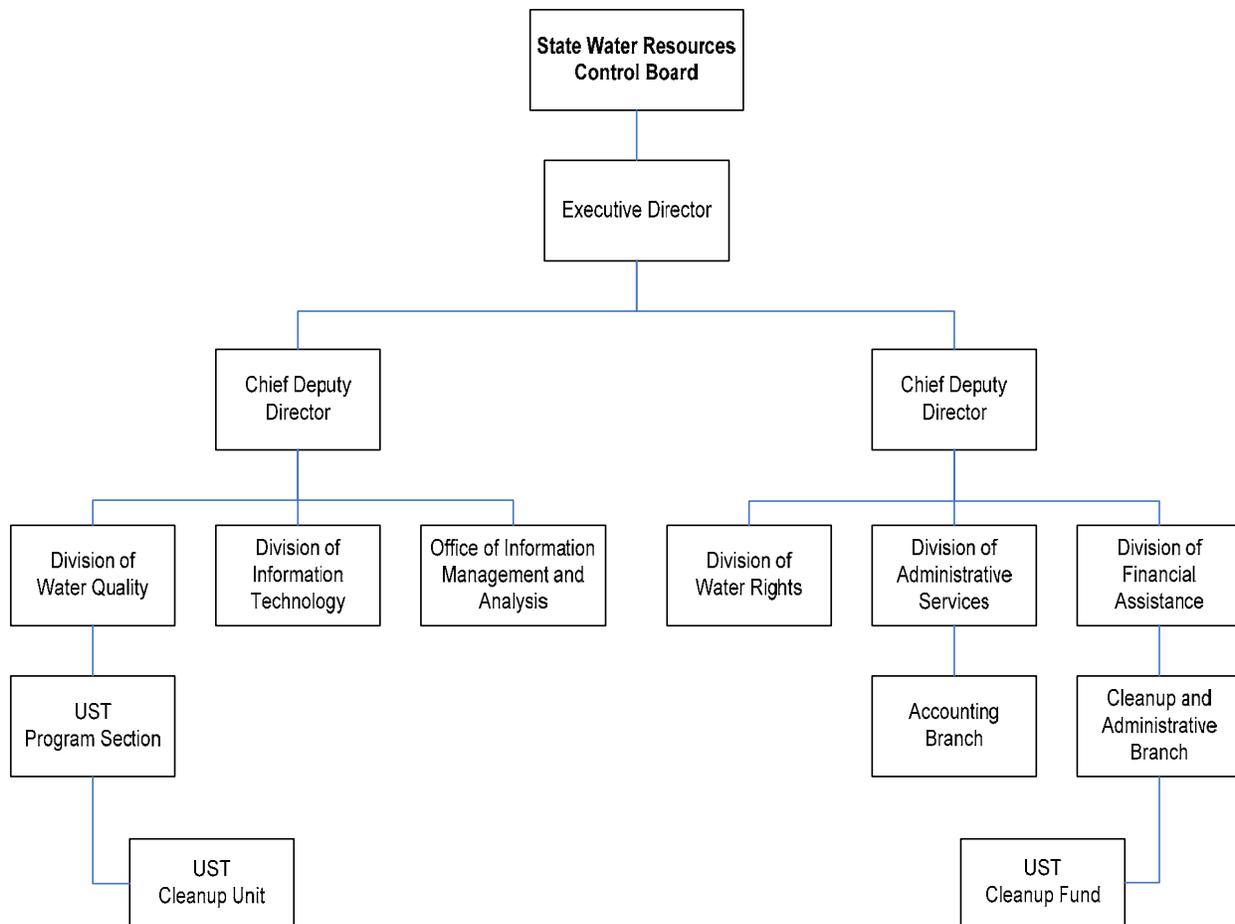
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California's Underground Storage Tank Cleanup Fund (Fund) program was established by the Barry Keene Underground Storage Tank Cleanup Fund Act of 1989 (Senate Bill 299) to:

- Provide a means for petroleum underground storage tanks (UST) owners and operators (claimants or responsible parties) to meet the federal and state financial responsibility requirements; and,
- Reimburse eligible owners for corrective action costs associated with the cleanup of contaminated soil and groundwater caused by an unauthorized release of petroleum from underground storage tanks.

The Fund, one of the largest state-funded cleanup programs in the nation, is administered by the California State Water Resources Control Board's (SWRCB) Cleanup and Administration Branch within the Division of Financial Assistance.

**Figure 1. SWRCB Organization Chart (abbreviated)**



## Cleanup Fund Process

Since the Fund's inception in 1991 through June 30, 2009, the Fund has received approximately 19,500 applications. To be deemed eligible to participate in the Fund, claimants must meet specific statutory and regulatory requirements, such as:

- Confirmed as the former or current owner or operator of the UST determined to have leaked a petroleum based or otherwise eligible substance;
- Received a directive from a regulatory agency to cleanup (take corrective action) the site;
- Complied with all UST permitting and corrective action requirements (regulatory cleanup orders);
- Paid all required UST storage maintenance fees to the Board of Equalization; and,
- Provided adequate financial responsibility coverage for the UST.

Of the approximate 15,500 that have been deemed eligible, about 4,000 claimants are active, 4,600 claimants are awaiting activation, and 6,900 claims have been closed. As part of its mandate, the Fund follows a "Priority System" to prioritize the funding of reimbursements to eligible claimants based on claimants' ability to pay:

- Priority A (residential tank owners);
- Priority B (small California businesses, including NPOs and some governmental entities);
- Priority C (certain California businesses, NPOs, and governmental entities not meeting the criteria for Priority B); and,
- Priority D (all other claimants, typically large corporations).

The following entities are integral to the Underground Storage Tank Cleanup Fund Program:

- State Water Resources Control Board—Five member oversight Board sets statewide water quality policy.
- Regional Boards—9 semi-autonomous Boards make regional water quality decisions.
- UST Program—Administers the following UST programs: Leak Prevention, Cleanup, and Tank Tester Licensing.
- USTCF Program (Fund)—Provides reimbursement to eligible responsible parties for corrective action costs associated with the cleanup of contaminated soil and groundwater caused by leaking or unauthorized release of petroleum from underground storage tanks.
- SWRCB's Office of Enforcement— Provides support activities related to both UST leak prevention and cleanup by investigating fraud and violations of the UST laws and regulations related to issues such as improper UST construction, failure to upgrade USTs, tampering with leak detection devices.
- Regulatory Agencies—Provides regulatory oversight of all UST cleanup projects, whether or not the responsible party is a claimant that participates in the Fund and is eligible to receive reimbursement for the cleanup activities. Most cleanup projects are overseen by regulators that are employed at either the Regional Boards or County Local

Oversight Programs, but a few projects are also overseen by City Local Implementing Agencies.

- Claimant (responsible party)—Owns or operates a leaking UST and meets specific eligibility requirements to participate in the Fund and receive reimbursement for cleanup activities. Not all responsible parties meet eligibility requirements or receive reimbursement for the cost of cleanup.
- BOE—Collects the UST maintenance fees from responsible parties that own or operate USTs in California that are the source of the Fund’s revenues.

## Objectives, Scope, and Methodology

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Sjoberg Evashenk Consulting was hired by the State Water Resources Control Board (SWRCB) to conduct a performance audit of the Underground Storage Tank Cleanup Fund (USTCF). The objectives of the audit were to assess:

- The Board's compliance with statutes, regulations, policies, procedures, and processes at meeting program goals and objectives;
- Efficiency and effectiveness of the Board's policies, procedures, and processes at meeting program goals and objectives; and,
- Internal controls to prevent fraud and other activities incompatible with generally accepted accounting principles (GAAP), State Administrative Manual (SAM) guidelines, and sound fund management practices.

The period of our audit is focused on fiscal years 2000 through 2009. To ensure we gathered the full context of information and environment that the Fund must operate within, where appropriate, we gathered pertinent information relative to Board of Equalization, an entity outside of the SWRCB, and information from the SWRCB's UST Program and Office of Enforcement, which are separate from the UST Cleanup Fund. We did not evaluate the processes of these entities as they were deemed not within the scope of this audit.

As part of the first phase of the audit, we conducted a preliminary review of the USTCF organizational and management processes and provided the SWRCB with a proposed project plan on September 14, 2009. In concert with the approved project plan and to answer audit questions and objectives, we specifically reviewed and relied upon the following as part of our work during this audit:

- Reviewed California Health and Safety Code, Water Code, Fund regulations, UST regulations, Legislative Annual Reports, Board decisions, and Fund policies and procedures.
- Interviewed management and staff of the Fund, UST program, and Division of Administrative Services' Accounting Office as well as Board of Equalization staff to gain an understanding of the Fund's overall environment;
- Analyzed financial data, including revenues, expenditures, fund balances and reserves, encumbrances, reimbursement payments, etc.
- Projected revenues and expenditures for the next seven years (through 2016);
- Obtained, reviewed, and analyzed SCUFIS system reports related to areas such as:
  - Applicant submissions,
  - Claimant eligibility determinations,
  - Active and Priority List claimant pools,
  - Closed claims,
  - Payment and claim backlogs, and,

- Timelines and trends associated with each category above.
- Obtained and reviewed Geotracker system statistical reports related to areas such as:
  - Active and closed UST cleanup projects,
  - Regulatory data submission rates, and
  - Regulatory performance data,
- Ascertained whether the project revenues are likely to be sufficient to support the Fund's potential demand;
- Conducted physical walk-throughs of the Fund's various processes and procedures;
- Performed research to identify national industry standards, best practices, and comparable statistics; and,
- Observed USTCF Task Force meetings and considered the audit recommendations prepared by the Task Force pursuant to SWRCB Resolution No. 2009-0042.

We conducted this performance audit in accordance with generally accepted government auditing standards (GAGAS). Those standards required 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. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

## Chapter I: Reduced Cash Balances, Diminished Reserves, and Inadequate Financial Management Strategies Challenge USTCF

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The Underground Storage Tank (UST) Cleanup Fund (Fund) program reimburses eligible owners for corrective action costs associated with the cleanup of contaminated soil and groundwater caused by leaking or unauthorized release of petroleum from underground storage tanks. Approximately 83 percent of California's UST cleanup projects are eligible to participate in the Fund and the remaining cleanup projects must be paid at the sole expense of the responsible party. California's eligibility rate is significantly higher than the national rate in which 46 percent of all UST cleanup projects are paid with public funds according to the Government Accountability Office.

The Fund generates revenue from UST maintenance fees paid by tank owners as well as some interest earnings. Those deemed eligible to participate in the reimbursement program are assigned to one of four rankings based on the claimant's ability to pay and are added to the Fund's "Priority List":

- Priority A (residential tank owners);
- Priority B (small California businesses, including NPOs and some governmental entities);
- Priority C (certain California businesses, NPOs, and governmental entities not meeting the criteria for Priority B); and,
- Priority D (all other claimants, typically large corporations and some governmental entities).

Because the program is a reimbursement program to participants that have already expended monies on cleanup activities, reimbursing claimants as quickly as possible has been the Fund's top priority—unfortunately at the expense of sound financial management practices. For example, the Fund's financial practices related to reimbursing cleanup activities have never required claimants provide project plans and budgets detailing the costs of proposed cleanup activities or the timeframes in which reimbursements would likely be sought. Thus, Fund management has not been able to successfully manage or estimate the demand on the Fund's limited resources—either related to current cash flow demands or more broadly related to future long-term demand. As a result of this and other financial management shortcomings, a financial crisis surfaced in 2008 as the Fund's cash balances and reserves were nearly depleted and millions in claimant reimbursement payments were placed on hold.

In fact, our projections reveal that if the rapid escalation of project costs continues, the Fund is likely to experience a significant revenue shortfall (even with the AB 1188 temporary UST maintenance fee increase) where between \$1.6 billion to nearly \$1.8 billion in eligible claimants' cleanup costs will be left unfunded when the Fund sunsets in 2016.

### **Cash Balances Built Up During the 1990s Depleted over the Last Decade**

According to a May 2008 comprehensive, statewide survey of underground storage tank cleanup funds conducted by the Vermont Department of Environmental Conservation (DEC),

California’s cleanup Fund is one of the largest state-administered funds in the nation. Specifically, with recent annual revenues of approximately \$250 million, only one other state, Florida, reported annual revenues of about \$225 million—all other states ranged from \$0.3 million to \$77 million annual revenues. The Fund’s substantial revenue generation enabled it to build sizable cash balances during the early years of the Fund. Unfortunately, the combination of large cash balances, management’s desire to maximize the utilization of resources, and a lack of information upon which to base its financial decisions led to the eventual depletion of those balances in 2008.

Since the inception of the Fund in 1991 through June 30, 2009, the Fund has generated approximately \$3.28 billion in total revenue. According to data provided by the Fund, just over \$2.52 billion, or nearly 77 percent of total revenue, was expended toward the Fund’s single largest expense category—“Priority System<sup>1</sup>” reimbursement payments, as shown in Table 1.

**Table 1. Cumulative Reimbursement Payments by Priority Class as of June 30, 2009**

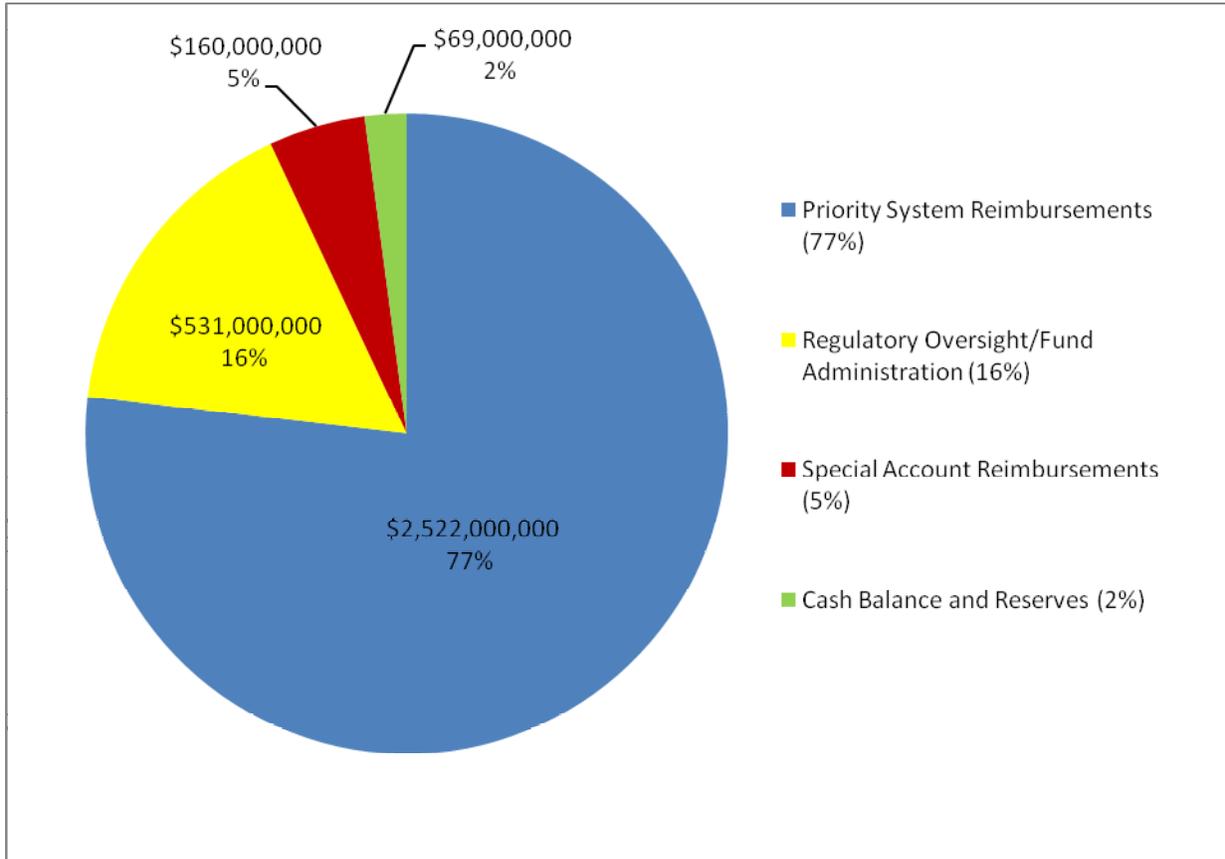
<b>Priority Class</b>	<b>Cumulative Priority System Reimbursement Payments<sup>2</sup></b>	<b>Share Percentage</b>
A	\$27,000,000	1%
B	\$1,043,000,000	41%
C	\$959,000,000	38%
D	\$493,000,000	20%
<b>Total (approx.)</b>	<b>\$2,522,000,000</b>	<b>100%</b>

The remaining 23 percent, or \$0.76 billion, of the Fund’s total revenues went toward the Fund’s administration and regulatory oversight (\$0.53 billion), reimbursements/transfers related to special account programs (\$0.16 billion), and ending cash balances and reserves (\$0.069 billion). The Fund’s use of resources since inception is illustrated in Figure 2.

<sup>1</sup> “Priority System” reimbursements refers to payments to claimants in one of the four Priority Classes and do not include payments to special account programs such as commingled plume, orphan, emergency and recalcitrant, etc.

<sup>2</sup> Figures approximated and rounded.

**Figure 2. Utilization of Fund Revenues—Inception through June 30, 2009**



The Fund has historically reserved approximately \$50 million of its cash balances (monies that are set aside and remain in the Fund, but are not available for reimbursement purposes or other expenses) for the following purposes:

- Emergency reserves—protection against economic uncertainties and assistance with daily cash flow. SWRCB executive management set the emergency reserve level at 10 percent of yearly revenue—approximately \$23.5 million.
- Clearing account—Established (in statute) by the California Department of Finance to coordinate the payment of SWRCB’s administrative expenses.<sup>3</sup> The clearing account receives monthly reimbursements from each of the SWRCB’s 34 funds. While the Fund’s monies are utilized to provide a continuous float (approximately \$26.5 million), the fact that the Fund acts as the SWRCB’s clearing account does not directly impact the number of claims that can be paid annually.

<sup>3</sup> Previously, the Water Board utilized its General Fund as the revolving Fund, but over the years the GF became too small and the Department of Finance authorized the use of the Water Board’s largest fund—USTCF—to serve as the Water Board’s revolving fund.

In addition to the \$50 million of the Fund's cash balances reserved for emergencies and remitted to the clearing account, the Fund also encumbered (set aside) some of its cash balances for portions of near-term cleanup project costs. The amount of the Fund's cash balances encumbered vary year to year depending how much of the money set aside was actually paid out or held and carried forward to the next fiscal year. Under Department of Finance provisions, monies can only be encumbered for three years and if unspent revert back to an unencumbered status once the time period has expired.

Since Fund inception in 1991, cash balances built up during the 1990s when the Fund experienced years with more UST maintenance fee revenue available to fund reimbursement requests than active, eligible claimants submitting reimbursement requests. By the end of Fiscal Year 2000-2001, the Fund's cash balances<sup>4</sup> grew to over \$185.6 million as cumulative revenues totaled nearly \$1.553 billion and cumulative expenditures totaled only about \$1.367 billion.

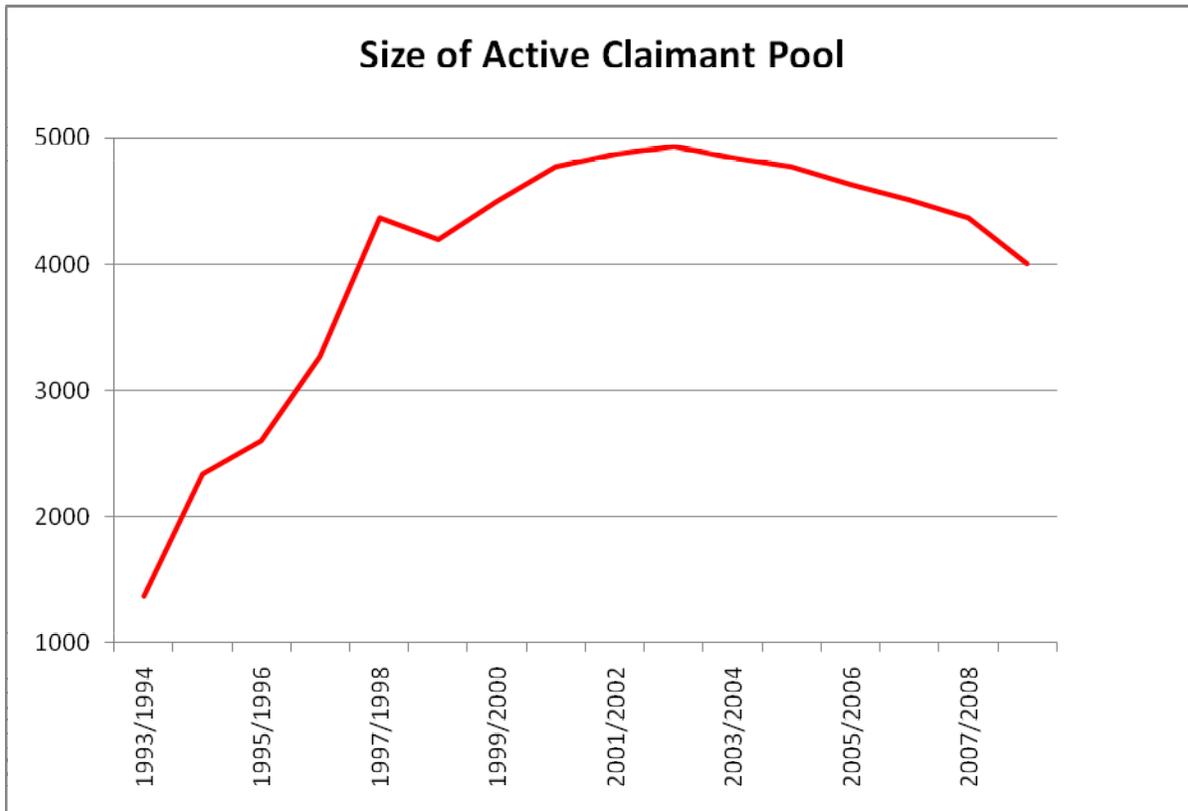
According to management staff, because the Fund's cash balances exceeded the amounts intended to be reserved during the 1990s, Fund resources were considered underutilized. Additionally, with this seemingly an endless "pot" of money the millions in reserves built during the early years of the Fund, an imprudent confidence developed. This confidence, bolstered by management's desire to increase utilization of, and demand for Fund resources, guided financial management decisions and strategies rather than more systematic plans based on project plans and unmet needs and the balancing of current and future demand with projected revenues. The need for concrete fiscal and management information proved particularly important in light of increasing costs associated with cleanup projects and reduced revenues due to a reduction in fuel consumption. Ultimately, these strategies led to Fund shortfalls.

As management financial strategies were focused on increasing the utilization of Fund resources, the Fund sought to increase the size of the pool of active claimants (those claimants able to submit reimbursement requests) during the late 1990s and early 2000s.

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<sup>4</sup> Cash balances include fund balance and amounts available and encumbered cash as well as cash reserved for emergencies and the SWRCB's clearing account.

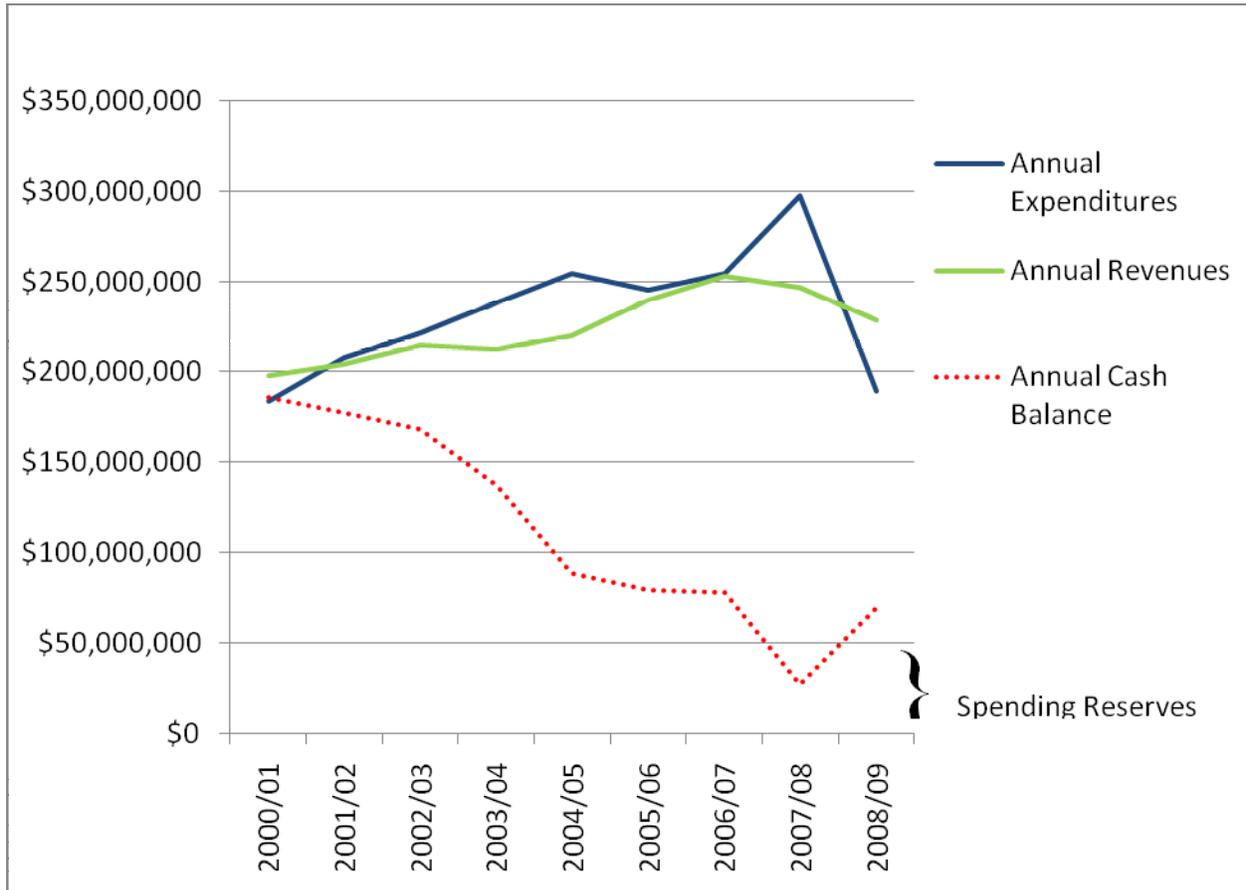
**Figure 3. Changes in the Size of the Fund’s Active Claimant Pool**



However, by the time the pool of active claimants began to level off and decrease around 2002-2003 as illustrated in Figure 3, the Fund was unable to meet the demand within its annual appropriation due to not only the larger active claimant pool but also rapidly increasing project costs. Although annual fee revenue generally continued to increase through much of the decade, until it dipped slightly in 2007-2008 due to a decrease in fuel consumption, revenues in the 2000s were insufficient to meet the increasing demands. In fact, in Fiscal Year 2001-2002, Fund expenditures exceeded revenues for the first time and the trend continued in each of the next six years, thus, necessitating dipping into the Fund’s cash balances to cover the shortfalls.

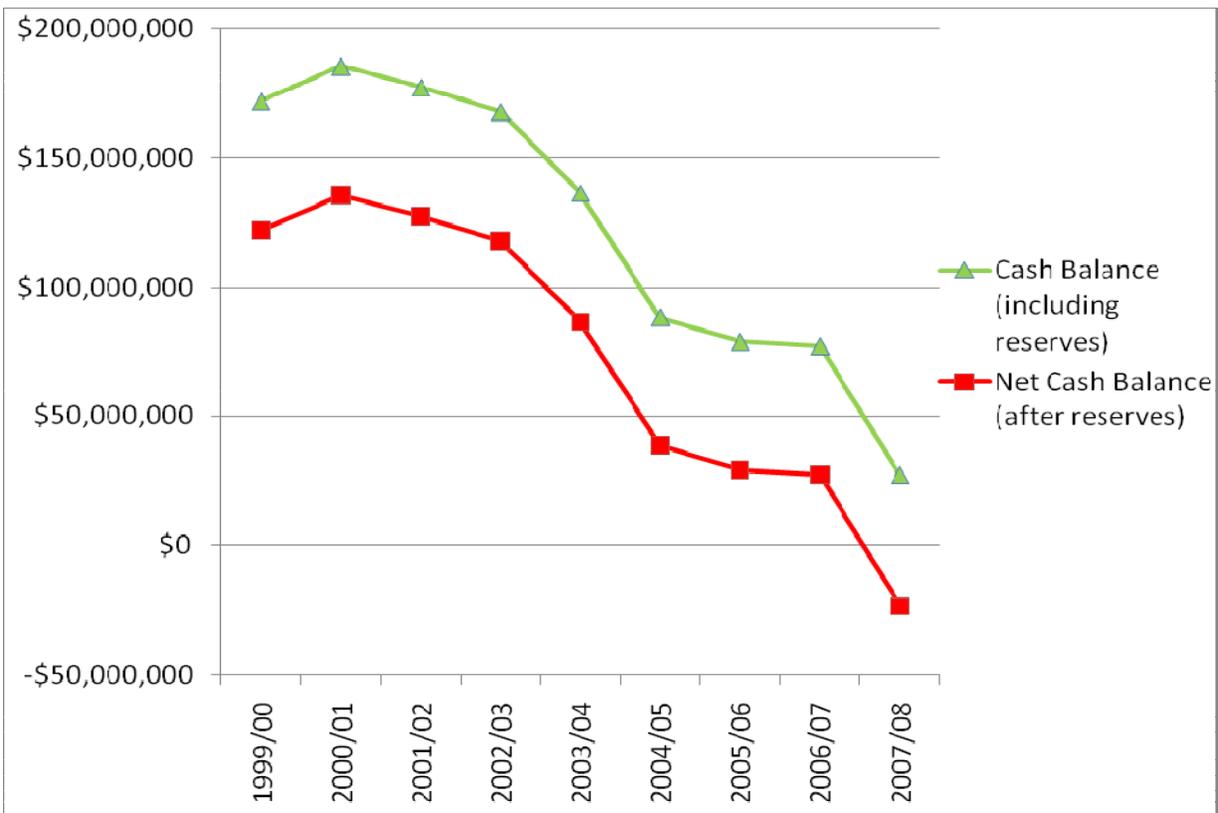
As shown in Figure 4, as expenditures continued to exceed revenues each subsequent year, the Fund’s cash balances and reserves were eventually depleted by Fiscal Year 2007-2008. The Fund’s cumulative revenues and expenditures during this time (Fiscal Year 2001-2002 through 2007-2008) totaled \$1.59 billion and \$1.72 billion, respectively, and the Fund’s cash balances were used to cover the difference of approximately \$125 million. During Fiscal Year 2007-2008 alone, expenditures exceeded revenues by more than \$50 million.

**Figure 4. Annual Expenditures, Revenues, and Cash Balance from Fiscal Year 2000-2001 through Fiscal Year 2008-2009.**



As a direct result, the Fund’s cash balances (including reserves) of nearly \$185.5 million as of the end of Fiscal Year 2000-2001, plummeted to just over \$27 million by Fiscal Year 2007-2008—more than a 85 percent drop in just seven years—which resulted in the Fund running out of available cash to reimburse eligible claimants and its \$50 million in reserve requirement to be short by nearly half, approximately \$23 million, as shown in Figure 5.

**Figure 5. Changes in the Fund’s Cash Balances**



Although early in the decade the Fund reflected a deficit position, annual expenditures continued to exceed annual revenue, in large part, because of management’s desire to utilize Fund resources and more of the Fund’s annual revenue each year to pay reimbursement requests. In fact, the percentage of annual revenue utilized to pay reimbursement requests has increased from 72 percent in 2000-2001 to 97 percent in 2007-2008—during this time, on average, 86 percent of annual revenue was used to pay reimbursement requests. The Fund had two especially high years recently when 97 percent of annual revenue was used to pay reimbursement requests in 2004-2005 and in 2007-2008.

When the vast majority of annual revenue is spent reimbursing claimants for costs associated with cleanups, little is left to cover the Fund’s other demands that include expenses associated with fund administration as well as expenditures that the Fund management has no control over related to special account programs and local regulatory oversight, which are controlled by legislation and the budget process as well as contract negotiations handled by a separate division within the SWRCB. Since 2000-2001 through 2007-2008, the demand these other expenditures placed on Fund resources reflected an upward trend and required, on average, approximately 20 percent of annual revenue. Additionally, these other costs also increased during these years—from \$41,062,042 in Fiscal Year 2000-2001 to \$58,498,938 in Fiscal Year 2007-2008 (\$17.4 million or 42.5 percent) and jumped 21.8 percent to more than \$71 million in Fiscal Year 2008-2009. The situation was further exacerbated by the fuel conservation trends—total revenues in recent years have dropped (as shown in Figure 4) due to declining gas consumption, while the

demands on Fund revenue increased due to project costs and the Fund's other expenditures trending upwards.

As a result, even though 20 percent of annual revenue, on average, was needed to pay for the Fund's other non-reimbursement request related expenditures, 86 percent of annual revenue, on average, over the last decade was spent reimbursing claimants. Thus, as these patterns of spending continued, with the amount of annual revenue insufficient to meet demands, Fund management had to utilize, and eventually nearly exhaust, cash reserves to cover the difference.

### **Certain Demands on Fund Resources Either Outside of Fund Management's Control or Lack Corresponding Revenue Source**

While the Fund's largest single category of expense relates to reimbursing priority system claimants for the cost of cleanup activities, Fund resources are required by statute to also support specific types of cleanup projects that do not have a corresponding revenue source in addition to funding regulatory oversight activities and public health research projects. These activities place additional demands on the Fund's limited resources; yet, several of these activities are outside of Fund management's control and are adjusted year-to-year through the annual budget process.

About five percent of total expenditures since the Fund's inception relate to funding provided to local governmental agencies and regulators to abate emergency situations or to cleanup abandoned sites posing a threat to human health, safety, and the environment, as a result of petroleum release from a UST. Specifically, the Fund supports certain special account programs that are governed by their own rules and regulations and include<sup>5</sup>:

- Emergency, Abandoned and Recalcitrant (EAR) Account Program<sup>6</sup>—Established in 1991 to provide funding to regulatory agencies to abate emergency situations or to cleanup abandoned or recalcitrant sites that pose a threat to human health, safety, and the environment, as a result of a petroleum release from a UST.
- Orphan Site Cleanup Account (OSCA) Program—Sunset on 1/1-2008, provided financial assistance to eligible applicants for the cleanup of Brownfield sites contaminated by leaking petroleum underground storage tanks where there is no financially responsible party.
- Orphan Site Cleanup Fund (OSCF) Program—Established in Fiscal Year 2009-2010 to replace the OSCA program and provides the same type of financial assistance.

Unlike the Priority System where claimants must have paid into the Fund via their quarterly UST maintenance fees paid to the Board of Equalization to be eligible to participate in the reimbursement program, expenditures from the Fund for these public programs do not have an

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<sup>5</sup> Commingled Plume, Fire Safety Agency, and School District Program Accounts are special account programs but are not included in the listing because claimants pay UST maintenance fees into the Fund.

<sup>6</sup> The EAR special account program can seek cost recovery for reimbursement expenditures. EAR expenditures are very small and account for less than one half of one percent of all Fund expenditures—approximately \$9.6 million funding cleanups at 114 EAR sites. The Fund has collected approximately \$112,000 and has filed 61 liens to date totaling approximately \$7 million. Due to the nature of property liens, cost recovery is rare.

independent revenue source although there is a cost recovery potential for funds utilized for EAR reimbursements.

Additionally, statute allows for some private tank owners to be eligible to receive reimbursements from the Fund even though they have paid little or nothing in UST maintenance fees, such as “home heating oil” owners. Additionally, cleanup costs incurred for leaks discovered between 1988 and when the Fund was established in 1991, also may be eligible to receive reimbursement for cleanup costs even though no related maintenance fees were paid into the Fund because it had not been established at the time the leak occurred and the tanks were removed. Although data is not readily available, Fund management believes that a sizable portion of the Fund’s claimants have never paid into the Fund.

Furthermore, the SWRCB’s Division of Financial Assistance (DFA) provides RUST grants and loans to assist small gas station owners and operators to comply with UST regulatory requirements through the replacement, removal, or upgrade of USTs. While Fund resources are utilized through legislatively-mandated transfers (approximately \$15 million as of June 30, 2008), this program is managed outside of the cleanup Fund.

Also, statute requires the Fund, upon request, to transfer up to \$5 million annually to the California Department of Public Health (CDPH) for the Drinking Water Treatment and Research Fund for research related to public drinking water wells contaminated by motor fuel. The annual transfer occurs, upon request of CDPH, when the unencumbered funds in the research account are less than \$2 million. As of Fiscal Year 2007-2008, a total of \$20 million has been transferred from the UST Fund to CDPH’s research account (Fiscal Years 2001-2002, 2002-2003, 2004-2005, and 2005-2006; no transfer occurred in Fiscal Years 2008-2009 or 2009-2010). This program will sunset January 1, 2010.

Lastly, as described in greater detail in Chapter 2 regarding cost containment, to comply with California Health and Safety Code and Budget act, the Fund provides the vast majority of funding required for the statewide regulatory oversight of the thousands of UST cleanup projects without regard to whether the responsible party is eligible to receive reimbursement from the Fund. These regulators oversee Fund-eligible cleanups and also spend time overseeing non-cleanup Fund sites. The Fund supports the regulatory oversight activities related to cleanup sites even where the responsible parties are not eligible for, and do not participate in the Fund. Management has not established processes to recoup Fund resources spent on regulatory activities related to ineligible sites. According to Fund management, there are few other sources of revenue that provide support to the local regulators and the local regulators are not required to differentiate or track their time separately between cleanup Fund claimants and non-cleanup Fund claimants.

Moreover, even though Fund resources support these regulatory oversight activities—approximately \$23.5 million in Fiscal Year 2008-2009—cleanup Fund management is not involved in funding arrangements and do not have the responsibility to ensure the regulatory agencies fulfill their oversight responsibilities effectively and efficiently. Specifically, the SWRCB’s UST program, within the Division of Water Quality, oversees the cleanup of all leaking USTs in California, including those not eligible to participate in the Fund—

approximately 17 percent. As part of its responsibilities, the UST program executes contracts and agreements with the State's 22 county regulatory agencies—referred to as local oversight programs (LOP)—as well as establishes funding amounts with the SWRCB's regulators at its nine regional boards.<sup>7</sup> Fund resources provide the related financial support for these agreements.

While the increase in demand for Fund resources related to Priority System claimant reimbursements is the primary reason for overspending and depleting Fund resources, it is also important to recognize the other required demands on these funds that do not contribute any corresponding revenue or are outside of Fund management's control.

### **Financial Position Unable to Support Continuing Reimbursement Demands**

Due to the cash flow crisis that surfaced in 2008 where cash balances and reserves were nearly depleted, the Fund was unable to continue supporting reimbursement demands. As a result, reimbursement payments were placed on hold and some claimants' ability to submit requests for reimbursement was suspended. To ease financial pressures, the Fund received a temporary two-year fee increase. However, once the temporary fee sunsets, unless significant changes are made to the program, it is likely that demands on resources will continue to exceed the Fund's annual appropriation.

As shown in Table 2, since the inception of the Fund in 1991 through June 30, 2009, the Fund has deemed approximately 15,500<sup>8</sup> claimants at least provisionally eligible. Of these, 26 percent are active and have been issued a letter of commitment, 30 percent are currently on the priority list waiting to be activated, and 44 percent have closed claims. Active claimants represent the current demand on Fund resources as this group of claimants have letters of commitment and are eligible to submit requests for reimbursement. Claimants on the priority list represent future demand on Fund resources as they are deemed preliminarily eligible and are waiting to be activated while claimants with closed claims are no longer active and place no demands on current or future Fund resources.

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<sup>7</sup> A few local city regulators also provide some limited oversight but these entities represent a small fraction of oversight activities and expenditures. Additionally, these entities direct bill their activities to claimants, who include the associated oversight costs with their reimbursement requests.

<sup>8</sup> The Fund has received approximately 19,500 eligibility applications. The difference between the numbers of applications received and deemed eligible are applications that have either been rejected or are still in process.

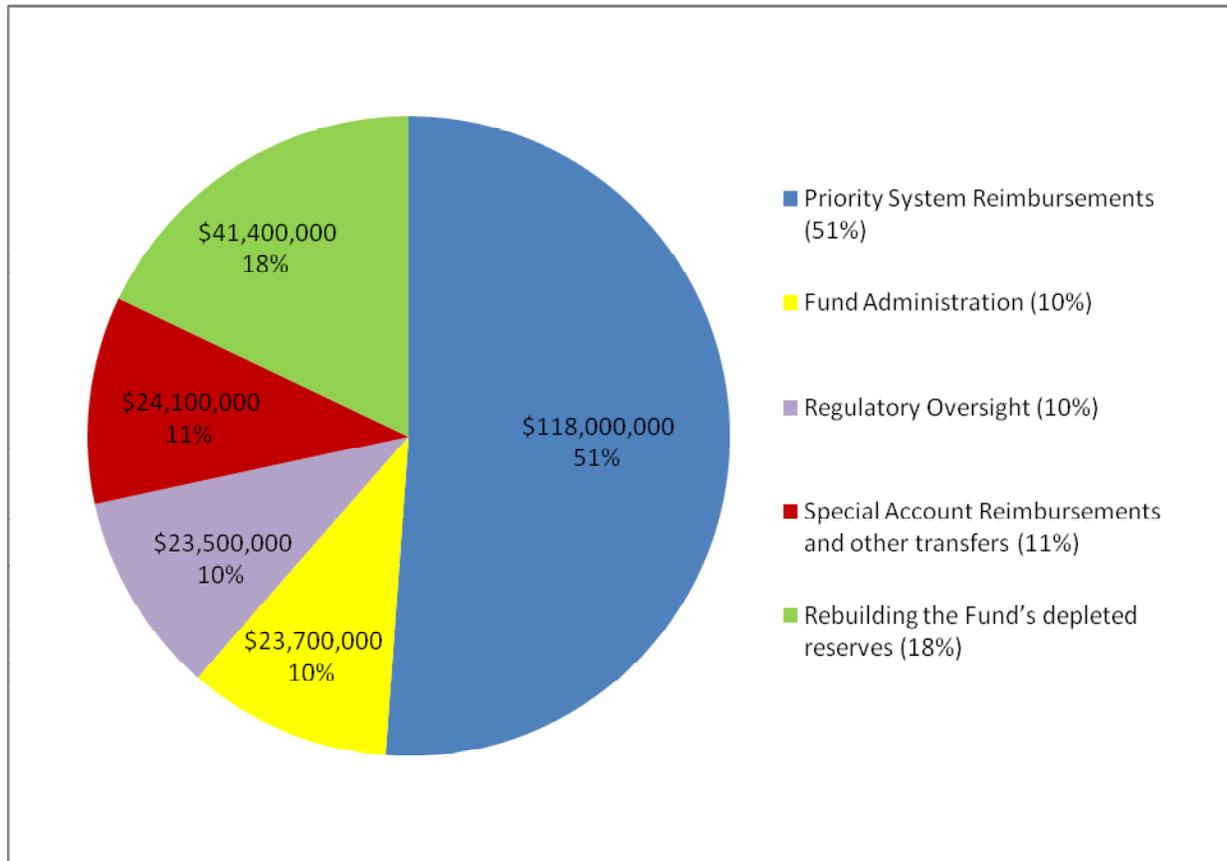
**Table 2. Claimant Status Breakdown by Priority Class—Inception through June 30, 2009**

<b>Priority Class</b>	<b>Total Deemed Eligible as of 6/30/2009</b>	<b>Claimants with Closed Claims as of 6/30/2009</b>	<b>Active Claimants as of 6/30/2009</b>	<b>Claimants on the Priority List as of 6/30/2009</b>
A	500	400	90	5
B	4,900	2,900	1,950	50
C	4,000	2,500	1,460	45
D	6,100	1,100	500	4,500
<b>Total (approx.)</b>	<b>15,500</b>	<b>6,900</b>	<b>4,000</b>	<b>4,600</b>

\*Some numbers do not total due to rounding.

By the end of Fiscal Year 2007-2008, the Fund’s depleted cash balances, shrinking UST maintenance fee revenue, and increasing cleanup project costs rendered it unable to meet the active claimants’ continuing demand for reimbursement requests ending the year with a deficit of \$23.5 million in available cash after accounting for required reserves, as shown in Figure 5. In the following year, the Fund generated approximately \$231 million in revenue from fee payments and interest income as well as a loan reimbursement. However, as shown in Figure 6, due to the Fund’s diminished cash position, only 51 percent (\$118 million) was made available to pay priority system reimbursement requests—significantly less than the average 86 percent that had typically been made available during most of the last decade. With only \$118 million available to fund \$240 million (as of March 2009) in demand for reimbursement, approximately \$122 million in unpaid (backlogged) claims carried into Fiscal Year 2009-2010. Additionally, management took action to replenish diminished cash reserve balances using 18 percent of revenues or \$41.4 million to bolster the Fund’s ending cash balance from \$27 million in Fiscal Year 2007-2008 to approximately \$69 million by June 30, 2009.

**Figure 6. Utilization of Fiscal Year 2008-2009 Revenue**



*Active Claimants Reimbursement Payments Placed on Hold*

During 2009, Fund management placed some active claimants' payments on hold because fee revenues and cash balances were insufficient to cover the demand. We understand that a first in/first out protocol was developed resulting in some active claimants having to wait extended periods for the Fund to receive revenue and make reimbursement payments in "Priority Order" (then date received order) as funds became available. Previously, reimbursement requests were typically paid once staff completed the review and approval of the reimbursement request—there was no lag due to available resources because the Fund had large cash balances to fall back on.

By the end of Fiscal Year 2008-2009, the Fund had approximately 4,000 active claimants approved to submit reimbursement requests with Priority classes B and C comprising the vast majority—of active claimants, 85 percent (combined), as shown in Table 3.

**Table 3. Active Claimants by Priority Class as of June 30, 2009**

<b>Priority Class</b>	<b>Approximate Number of Active Claimants</b>	<b>Share Percentage</b>
A	90	2%
B	1,950	48%
C	1,460	37%
D	500	13%
<b>Total (approx.)</b>	<b>4,000</b>	<b>100%</b>

The active claimants within Priority classes B and C (e.g. small and medium size businesses and some government entities) were most impacted by the payment backlog crisis. By August 2009, the payment backlog grew to more than \$173 million and Priority classes B and C made up a combined 87 percent of reimbursements on hold, as shown in Table 4.

**Table 4. Payment Backlog by Priority Class as of August 2009**

<b>Priority Class</b>	<b>Payment Backlog<sup>9</sup></b>	<b>Share Percentage</b>
A	\$548,000	Less than a percent
B	\$71,900,000	42%
C	\$78,500,000	45%
D	\$22,494,000	13%
<b>Total (approx.)</b>	<b>\$173,442,000</b>	<b>100%</b>

This funding crisis continues into the 2009-2010 fiscal year with Fund management projecting that only \$156 million of the estimated \$223 million in revenue would be available to fund reimbursement requests with the remaining \$67 million providing funding for administration costs, regulatory oversight, and other special account programs. Thus, the Fund anticipates that by the end of June 2010, approximately \$17.5 million of the previous backlog will remain unpaid along with other reimbursement requests submitted the current fiscal year. Fund management's current projections indicate that Priority B claimants may wait 6 to 18 months for sufficient funds to become available for reimbursement payments and Priority C claimants may wait as long as 30 months as the Fund tries to resolve the payment backlog crisis. Throughout this period, the Fund has worked diligently to keep claimants informed of payment status by posting updated information on the Fund's website related to which claimant payments will be released against the Fund's upcoming quarterly revenue receipts from the Board of Equalization.

These circumstances are not unique to California. According to the May 2008 Vermont DEC Annual State Fund Survey, nine states, including California, reported a greater liability related to

<sup>9</sup> Includes approximately \$75.3 million in payments on hold, \$14.2 million in payments in transit, and the remainder, approximately \$83.9 million, involves reimbursement requests received but processing has either not started or not complete.

outstanding claims (reimbursements submitted but not yet paid) than the amounts of their approximate fund balances.

### *Active Claimants Letters of Commitment Suspended*

In addition to placing active claimants' reimbursement payments on hold, Fund management determined that the letters of commitment of some of their active claimants would have to be suspended in order to slow the submission of reimbursement requests and reduce the corresponding demand on fund resources. Additionally, Fund management was concerned with exacerbating the Fund's inability to meet the statutory and regulatory requirements that claimants receive payment within 60 days of submitting a reimbursement request if all active claimants continued to submit reimbursement requests and the payment backlog continued to grow.

To determine how many letters of commitment to suspend, Fund management set out to estimate near-future cash needs. To do this, the Fund attempted to gather data to estimate the average dollar value of reimbursement requests that would be submitted in the near-term per each active claimant and project the resulting required resources against anticipated available funds—the amount of reimbursements projected above the anticipated available revenue would be equated to the number of letters of commitment to suspend.

Fund experience reflects that during the last decade, reimbursement requests generated payments averaging approximately \$40,500 annually—not the average total cost of the entire project/claim. However, the annual average amount per payment has steadily increased over the 10-year period with the average individual payment in Fiscal Year 2008-2009 about \$50,000. Based on this information, Fund management initially projected that the approximately \$150 million of Fiscal Year 2009-2010 revenue available to fund reimbursement requests could support issuing only about 3,000 payments (\$150 million at \$50,000 each) associated with a potential 4,450 reimbursement requests submitted by active claimants—leaving more than 1,400 reimbursement requests unpaid. Because there would be insufficient revenues to support issuing enough payments to cover the amount of reimbursement requests submitted, Fund management planned to suspend (or deactivate) the letters of commitment of about 1,000 active claimants to reduce the number of reimbursement requests submitted for reimbursement.

To have additional confirmation of the accuracy of their projections of near-term resources required, in October 2008, Fund management required its active claimants to submit budgets estimating project expenditures covering 18 months into the future from the period of January 2009 through June 2010. While approximately 3,000 (75 percent) of the Fund's active claimants' submitted budgets, unfortunately, Fund management found the information provided appeared flawed. Specifically, according to Fund management, expense estimated for the 3,000 claimants reflected, on average, \$150,000 would be requested for payment during Fiscal Year 2009-2010 totaling \$450,000,000 or more than 2.5 times the annual average of \$184,400,000—far exceeding the Fund's prior payment expenses. If this data were accurate, the Fund would be able to support payments to only 1,000 active claimants (\$150 million/\$150,000) versus making reimbursements to 3,000 claimants at \$50,000 per year. Because these amounts significantly exceeded Fund historical experience, Fund management determined that the claimants and consultants did not provide reasonable or accurate estimates; rather, they included a “wish list” of items in their projections.

Fund management choose to rely on their own projections and in November 2008 and January 2009 more than 1,350 (1229 Cs and 127 Ds) active claimants were notified that their letters of commitment were temporarily suspended (based on priority class and claim application received date) and any costs incurred after a specified date would not be paid. Priority C claimants accounted for the majority of letter of commitment suspensions along with some Priority D claimants; the Fund's highest priority claimants—A and B claimants were not subject to the letter of commitment suspension and the Fund continues to accept and process their reimbursement requests.

According to Fund management and UST Task Force members, the payment “holds” and letter of commitment suspensions have created significant hardships on Priority C claimants. Specifically, these claimants and their consultants continued to incur cleanup costs assuming the Fund would reimburse such costs all without prior knowledge that payments could or would be placed on hold. Some claimants halted cleanup activities because they rely on timely reimbursement payments from the Fund; as a result these claimants are being deemed out of compliance by regulatory agencies. Additionally, claimants rely on letter of commitment documents to provide support to obtain interim funding for cleanup activities as the letter of commitment demonstrates to lending institutions that a revenue source exists to repay loans.

#### *Temporary Funding Increase*

To ease financial pressures of the Fund and claimants, AB 1188 was signed into law on November 9, 2009 providing a two year temporary fee increase intended to generate additional revenue to begin resolving the payment backlog and allow the suspended Priority C claimants to be reactivated by January 1, 2010. The additional revenue is projected to generate approximately \$186 million between January 1, 2010 and December 31, 2011 and help the Fund reduce the payment backlog. As a result of the temporary UST fee maintenance increase, the Fund sent a letter on December 14, 2009 to Priority C claimants that the suspension of their letters of commitment was lifted and the Fund would begin accepting reimbursement request packages beginning January 1, 2010.

If historical reimbursement request amounts are reflective of the current environment, Fund management hopes that the AB 1188 fees will be sufficient to eliminate much of the payment backlog before the temporary fee sunsets. However, even if AB 1188 fees generate sufficient revenue to eliminate the payment backlog, once the temporary fee sunsets, unless a significant number of claims are closed, the number of active claimants decrease, and fuel consumption increases, it is likely that the active claimant pool's demands on Fund resources would exceed the annual funds available.

#### *Activating New Claimants from the Priority List on Hold*

By the end of Fiscal Year 2008-2009, there were approximately 4,600 claimants on the Fund's Priority List waiting to be issued a letter of commitment and thus be allowed to begin submitting reimbursement requests. In addition to the recent payment holds and letter of commitment suspensions, activating new claimants from the Priority List and issuing new letters of commitment is mostly on hold. Currently, the Fund is only activating priority A and B claimants and School District claimants (special group of Priority D claimants).

**Table 5. Priority List Breakdown by Priority Class as of June 30, 2009**

<b>Priority Class</b>	<b>Approximate Number of Claimants on the Priority List</b>	<b>Percentage</b>
A	5	~0%
B	50	1%
C	45	1%
D	4,500	98%
<b>Total (approx.)</b>	<b>4,600</b>	<b>100%</b>

\*Some numbers do not total due to rounding.

Although claimants on the Priority List represent the Fund's future demand on resources, the Fund's current payment backlog crisis is somewhat moderated because the vast majority of the Fund's Priority D claimants remain on the Fund's priority list awaiting letter of commitment activation. Because of the ranking process within the Fund's priority system, Priority D claimants, those of large corporations, have to wait for other priority claimants to be served before they are issued a letter of commitment and activated. As a result, most of the Fund's major oil corporation claimants are not placing demands on the Fund's resources and only account for a small portion of the Fund's active claimants (13 percent) and account for the same portion of the payment backlog (13 percent), as shown in Tables 3 and 4. However, Priority D claimants still represent a significant future resource demand for the Fund.

Unless there are significant changes made to the program's financial management planning strategies to improve management's ability to estimate and anticipate short-term demand, it is likely that demands on resources at any given time will continue to exceed the Fund's annual revenues.

### **Financial Projections Indicate Resources Not Sufficient to Cover Future Demand**

In addition to the Fund's current cash flow problems, our projections indicate that the future viability of the Fund is uncertain. Specifically, due to the rapid increase in project costs, the Fund will likely not have sufficient resources to cover its potential long-term demand before it is scheduled to sunset in 2016, even with the AB 1188 temporary fee increase.

#### *Estimates of Future Available Resources*

With the Fund's cash balances (including reserves) at only \$27 million by the close of Fiscal Year 2007-2008, the Fund utilized nearly \$41.4 million of Fiscal Year 2008-2009 revenue to build the Fund's cash balances back up to \$69.3 million by June 30, 2009. The Fund received approximately \$228.3 million in total revenue<sup>10</sup> during Fiscal Year 2008-2009 and Fund management estimated Fiscal Year 2009-2010 receipts of about \$223 million from the \$.014 per gallon UST maintenance fee. The Board of Equalization (BOE) projected a slightly steeper decline in fee revenue as they estimated \$220 million will be received during Fiscal Year 2009-2010. Additionally, Assembly Bill 1188 was signed into law on November 9, 2009 provides the

<sup>10</sup> Total revenue is mostly made up of UST fees but also includes some earned interest.

Fund with a temporary fee increase—an additional \$.006 per gallon fee starting January 1, 2010 through December 31, 2011. Management estimates, which may be overly optimistic if fuel consumption continues to decline, that the temporary fee increase will generate an additional \$186 million in resources before it sunsets.

Using Fund management’s Fiscal Year 2009-2010 revenue projections as a baseline and including the AB 1188 temporary fee increase, the Fund could receive an additional \$1.617 to 1.636 billion between Fiscal Years 2008-2009 and 2015-2016, as shown in the Table 6.

**Table 6. Revenue Projections through January 1, 2016**

	<b>Fiscal Year</b>	<b>Total Revenue using Fund Management Projections</b>	<b>Total Revenue using BOE Projections</b>
1	2009/2010	\$269,500,000	\$266,500,000
2	2010/2011	\$316,000,000	\$313,000,000
3	2011/2012	\$269,500,000	\$266,500,000
4	2012/2013	\$223,000,000	\$220,000,000
5	2013/2014	\$223,000,000	\$220,000,000
6	2014/2015	\$223,000,000	\$220,000,000
7	2015/2016	\$111,500,000 <sup>11</sup>	\$111,000,000
	<b>Total Estimated Future Revenue</b>	<b>\$1,635,500,000</b>	<b>\$1,617,000,000</b>

Adding the \$1.636 billion in future estimated revenue to the Fund’s cash balance of \$69,278,199 as of June 30, 2009, the Fund will have approximately \$1.705 billion in available cash from July 1, 2009 through its expected termination at January 1, 2016 to use for the following purposes:

- Priority system reimbursements;
- Special fund reimbursements and transfers;
- Fund administration; and,
- Regulatory oversight.

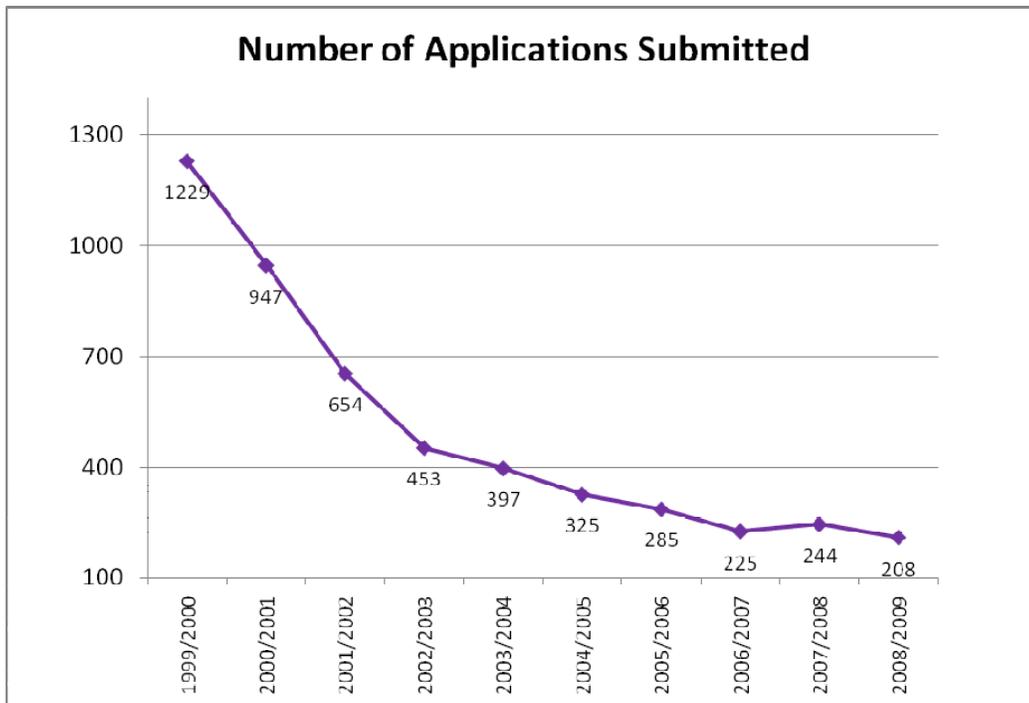
If special account programs reimbursements, fund administration, and local regulatory expenses continue to require approximately 31 percent (combined) of annual fund resources as they did during Fiscal Year 2008-2009 (as shown in Figure 6), those three categories will consume approximately \$528.6 million of the \$1.705 billion in available cash—leaving approximately \$1.176 billion available for priority system reimbursements between Fiscal Years 2009-2010 through the Fund’s sunset.

<sup>11</sup> Revenue for Fiscal Year 2015-2016 was reduced by half because the maintenance fee is slated to end January 1, 2016.

*Estimates of Future Demand on Fund Resources*

As shown in Figure 7, the number of new applications submitted has steadily decreased, on average, about 17 percent annually over the years as USTs are upgraded, monitoring is improved, and cleanups are completed. About 200 new applications were submitted during Fiscal Year 2008-2009 compared to more than 1,200 during Fiscal Year 1999-2000. Since inception, approximately 19,500 applications have been submitted and 15,500 have been accepted, representing about an 80 percent rate of acceptance into the Fund.

**Figure 7. Number of Applications Submitted—Fiscal Years 1999-2000 through 2008-2009**



Using the 80 percent acceptance figure, approximately 170 new claimants that submitted applications in Fiscal Year 2008-2009 would eventually be approved as meeting eligibility requirements and accepted into the Fund within the priority classes.

**Table 7. Projection of the Numbers of New Claimants through January 1, 2016**

			Scenario #1	Scenario #2
Priority Class	2008-2009 New Claimants	Percentage of new 2008-2009 Claimants Per Priority Class	New Claimants through 2016 <sup>12</sup> (170 per year)	New Claimants through 2016 <sup>3</sup> (17% fewer per year)
A	10	6.0 %	72	44
B	62	36.5%	438	266
C	20	11.5%	138	84
D	78	46.0%	552	336
<b>Total</b>	<b>170</b>	<b>100.0%</b>	<b>1,200</b>	<b>730</b>

As reflected on Table 7, to create a range of the potential number of new claimants, we utilized the Fiscal Year 2008-2009 of 170 new claimants accepted into the fund as an annual baseline for the next 7 years, which estimates that another 1,200 new claimants could add to the demand on Fund resources from 2009 through January 2016 (scenario #1). For the low-end of the range, we included an annual 17 percent decline in claimants accepted into the Fund as has been experienced over the last decade—this provides that 730 new claimants could add to the demand on Fund resources from 2009 through the Fund’s sunset (scenario #2).

Using either estimate of 730 or 1,200 new claimants to the 8,600 active claimants and those on the priority list as of June 30, 2009, the Fund could have a total of between 9,330 and 9,800 claimants demanding Fund resources at any given time between Fiscal Year 2008-2009 through January 2016, as shown on Table 8.

**Table 8. Projection of the Numbers of Total Claimants through January 1, 2016**

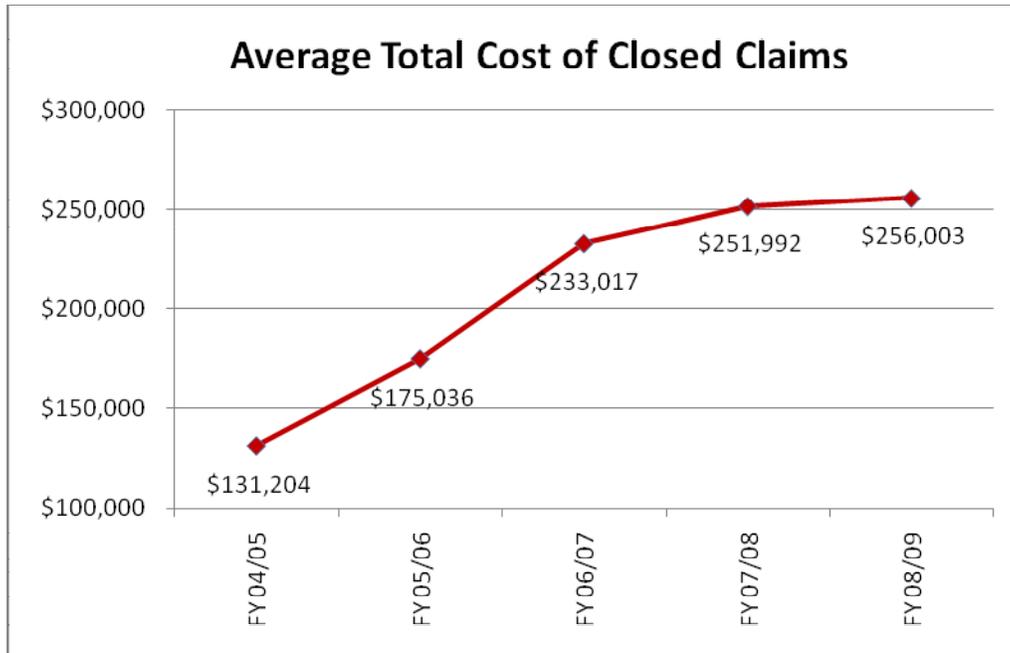
Priority Class	Current Claimants—Active (4,000) and Priority List (4,600)	Scenario #1		Scenario #2	
		New Claimants through 1/1/2016 (170 per year)	Total Claimants through 2016	New Claimants through 1/1/2016 (17% fewer per year)	Total Claimants through 2016
A	100	72	172	44	144
B	2,000	438	2,438	266	2,266
C	1,500	138	1,638	84	1,584
D	5,000	552	5,552	336	5,336
<b>Total (approx.)</b>	<b>8,600</b>	<b>1,200</b>	<b>9,800</b>	<b>730</b>	<b>9,330</b>

As shown in Figure 8, the average total cost of claims that closed between Fiscal Years 2004-2005 through 2008-2009 ranged from approximately \$130,000 to just over \$250,000, increasing an average of 19 percent per year over this period. However, figures reveal that the average project costs paid to Fund’s current 4,000 active claimants as of June 30, 2009 are already

<sup>12</sup> Utilizing the same percentage breakdown per priority class as 2008-2009.

approximately \$400,000 per claimant with variances between priority classes as shown on Table 9. As such, by the time the 4,000 active claimants projects are completed and closed, the average total cost of closed claims will likely be significantly higher than the \$250,000 average total cost of closed claims during Fiscal Year 2008-2009.

**Figure 8. Changes in Average Total Cost of Closed Claims**



**Table 9. Average Reimbursement Paid to the Fund’s Active Claimants as of June 30, 2009**

Priority Class	Average Reimbursements Paid to the Fund’s Current Active Claimants as of June 30, 2009
A	\$175,000
B	\$394,000
C	\$390,000
D	\$517,000
<b>Average Across all Priority Classes</b>	<b>\$400,000</b>

Thus, to calculate the Fund’s future demand, we:

- Used the average reimbursement amounts paid to the Fund’s currently active claimants from Table 9 as a baseline for total project cost figures. It is important to note that these average cost figures are based on amounts paid to claimants that are still active and thus, requesting additional reimbursements. We applied the cost figures reflected in Table 9 by priority class to the estimated 9,330 to 9,800 claimants from Table 8 to arrive at a

projection of the amount of reimbursements each of these claimants could demand between 2009 and January 1, 2016.

- Removed the amounts already paid to the Fund’s active claimants from the projected cost figures. Since the inception of the Fund through June 30, 2009, the Fund expended approximately \$2.5 billion on reimbursement requests, of which, approximately \$1 billion was paid to the approximate 6,900 claimants with closed cases as of June 30, 2009. Thus, the remainder, \$1.5 billion, has already been paid to the Fund’s 4,000 currently active claimants. As such, we reduced the \$1.5 billion from each scenario.

The Fund’s projected total future demand through January 1, 2016 is reflected on Table 10.

**Table 10. Estimates of Fund Demand through January 1, 2016**

<b>Priority Class</b>	<b>Average Reimbursements Paid to the Fund’s Current Active Claimants as of June 30, 2009</b>	<b>Total Claimants from 2008-2009 through 2016— Scenario 1</b>	<b>Total Demand— Scenario 1</b>	<b>Total Claimants from 2008-2009 through 2016— Scenario 2</b>	<b>Total Demand— Scenario 2</b>
A	\$175,000	172	\$30,100,000	144	\$25,200,000
B	\$394,000	2,438	\$960,572,000	2,266	\$892,804,000
C	\$390,000	1,638	\$638,820,000	1,584	\$617,760,000
D	\$517,000	5,552	\$2,870,384,000	5,336	\$2,758,712,000
<b>Sub-Total</b>		<b>9,800</b>	<b>\$4,499,876,000</b>	<b>9,330</b>	<b>\$4,294,476,000</b>
Amounts paid to active claimants			\$1,500,000,000		\$1,500,000,000
<b>Total Projected Demand</b>			<b>\$2,999,876,000</b>		<b>\$2,794,476,000</b>
<b>Total Projected Available Resources</b>			<b>\$1,175,000,000</b>		<b>\$1,175,000,000</b>
<b>Projected Shortfall</b>			<b>\$1,824,876,000</b>		<b>\$1,619,476,000</b>

Based on the data reflected in Table 10, the Fund likely will not generate sufficient revenue to cover its future demand under the current project management approach. Specifically, the Fund is projected to have approximately \$1.175 billion available through January 2016 to pay reimbursement requests and have projected demand of between \$2.8 billion and nearly \$3 billion from an estimated 9,330 to 9,800 claimants, the Fund shortfall can reach as much as \$1.6 billion to \$1.8 billion.

Although the Fund's current and most pressing problem stems from cash flow issues resulting from the pool of too many active claimants, given these estimates, even with the temporary fee increase, the Fund appears to be facing a larger structural issue of insufficient revenue to cover the likely total demand. However, according to management, the program was never intended to have sufficient funding to cover all claimants' cleanup costs before the program sunsets.

California is not alone in its struggles to ensure there is sufficient funding to support proving financial responsibility coverage. For example, Michigan's budget shortfall for their UST Fund was projected to be more than \$1.5 billion at the beginning of October 2009. Also, Texas experienced periods where backlogged reimbursement requests exceeded their annual income by as much as 300 percent. Furthermore, some states, such as Florida, Texas, and Wisconsin have implemented strategies to "phase out" their state-funded financial responsibility coverage due to depleted balances and increasing costs and switched to requiring claimants to secure private insurance coverage.

### **Administration of Fund Resources Based on Inadequate Financial Management Strategies**

Despite setting forth its financial strategies and objectives, management has not instituted adequate program management approaches that would maximize the resources of the Fund and exercise control over reimbursements. Management efforts have focused on accomplishing the following four objectives:

- Encumbering all appropriated funds each year;
- Activating as many claims as possible from Priority List;
- Reserving sufficient funds to carry active cases through the current fiscal year;
- Complying with statutory requirements regarding priority of claims (i.e., pay claims in priority order);<sup>13</sup> and
- Reviewing cleanup costs for reimbursement eligibility (but after work is already completed).

Critical components missing from these financial strategy objectives are data and analysis that would allow management to develop accurate estimates and projections of the demand on Fund resources and exercise an element of control over spending on cleanup costs. The fact that claimants are not required to submit project plans and budgets related to the cleanup project activities that they are seeking reimbursement from Fund resources has not only directly impacted the Fund's ability to anticipate demand on resources but, in turn, hampered its ability to successfully meet these four objectives. Instead of establishing project budgets, developing full-term estimates of total project costs, and forecasting the Fund's short and long-term cash needs and demand, Fund management has focused on short-term objectives by estimating upcoming active claimants demands based on reimbursements paid out in the previous year. While such

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<sup>13</sup> Exception: 14 percent of each year's appropriation must go to Priority C claimants and 14 percent to Priority D claimants.

calculations are important to consider, prior year reimbursements comprise just one aspect of a complete program management approach. The Fund's current cash crisis demonstrates the critical nature of adjusting, evaluating, and refining management strategies based on on-going analysis and monitoring of the Fund's cash position, unpaid but upcoming claims, and anticipation of unmet demands. Without discrete data on expected costs of projects and anticipated duration, the Fund cannot effectively develop long-term projections to manage cash flow and demand on resources through controlling the size of the active claimant pool.

#### *SWRCB's Accounting Expertise and Information Not Effectively Utilized*

Most of the Fund's senior managers are engineers or have technical backgrounds and may lack specific expertise in financial management. While these technical managers appropriately focus on facilitating cleanups and supporting regulatory activities, the management structure lacks the control elements and fiscal outlook to balance a financially-based program. Although the SWRCB's Division of Administrative Services (DAS) Accounting Office has the needed financial expertise on staff, the Accounting Office was not involved or sought out for advice in the Fund's financial decision-making processes. Rather, the technical managers made fiscal decisions impacting cash flow and resource consumption. As a result, the focus of management's efforts remained on paying reimbursements and activating letters of commitment and the erosion of the substantial fund balance was not recognized despite the continual drain over several consecutive years. It was not until the Accounting Manager alerted executive management to the Fund's cash crisis in February 2008 that the SWRCB's executive management recognized the need for accounting to become involved with the Fund's financial decisions.

Further, although DAS' accounting staff provided Fund managers with regular management reports that clearly reflected the negative changes in cash balances, this information was not used in planning by program management. In fact, Fund management stated that the Fund's diminished cash balances and reserves should have been recognized much sooner had management paid attention to this, and other, financial indicators.

#### *Management's Cash Utilization Philosophy and Resource Management Strategies Lack Project Plans and Budgets*

With the depletion of Fund resources and likelihood of not meeting future demands, one of the Fund's most pressing issues is its inability to efficiently manage the utilization of its resources—both long-term and short-term. In the past, project plans and cost estimates were not provided by claimants—letters of commitment were approved base on claimant eligibility requirements. Once activated, the claimant requested reimbursement on allowable costs. The only true limitation was the \$1.5 million ceiling on a single claim. Thus, Fund management had no data on the projected total demand of any claim—reimbursement requests were paid as received and approved. Without estimates of project costs and duration, reasonable projections on issues such as establishing how much of the Fund's resources would be needed for current and future expenditures related to existing projects or for determining how many new claimants Fund resources could support. In fact, the Fund's past efforts to encumber (set aside) resources for future project costs involved guesswork and was ultimately eliminated.

While it is acknowledged that cleanups require multiple years to complete and are open-ended on the long-term, annual budgets can be established and a budget revision process can be implemented. Without budgets or other project management plans, not only is management unable to determine its long-term demand, but the Fund's cash flow is also impacted as management does not know approximate timeframes in which to anticipate its active projects will submit requests demanding Fund resources or the approximate amounts that will be requested. Currently, the timeframes and project phases in which claimants request cost reimbursement vary greatly from project to project. While by nature of the program, it is almost impossible for the Fund to accurately predict the timing when active claimants will submit reimbursement requests not knowing the size of active projects, it is also difficult for the Fund to estimate the amount of revenue needed to cover demands within specific revenue-receipt periods or to gauge cash flow.

This lack of project specific data not only leaves Fund management without a complete financial picture of the likely demand the thousands of cleanup projects will place on resources, but management is also unable to measure the success of cleanup projects by monitoring claimants' budgets to actual expenditures and comparing the percentage of project costs incurred to-date against the amount of project costs remaining and activities completed. As a result, the Fund operates under a disjointed and "siloed" approach that focuses on whether or not the costs submitted at any given time by claimants are eligible for reimbursement and are supported with documentation without considering the cost and length of each project as a whole.

Moreover, due to the Fund's inability to anticipate demand on resources, the process to encumber (set aside) cash for project expenses evolved over the years. In the early 1990s, Fund management encumbered initial letters of commitment<sup>14</sup> for the amount of costs already incurred by the claimant as of the date of activation plus additional "seed" monies based on rough estimates of near-term expenditures. Not surprisingly, the amounts encumbered were often inaccurate as the Fund did not institute processes to gather project plans and more reliable budgets. Thus, the amounts set aside at activation were guesses of costs claimants would submit in the near term. Additionally, although Fund management stated that \$150,000 was about the cost of an average cleanup (in total), letters of commitment were encumbered for far less because Fund management did not want to restrict too many funds that might not be needed during a specific year. This process that inaccurately estimated project costs and under-obligated fund resources necessitated frequent "amended" letters of commitment through the life of a cleanup project as additional costs were incurred beyond the original amounts encumbered.

As time went on, even though the amounts encumbered were not sufficient to see claimants through to project completion, Fund management still believed the letters of commitment were padded with too much seed money and that this practice left too much money underutilized and needlessly tied up (encumbered) for several years that could have been spent activating new claimants. As a result, the encumbering strategy was changed to set aside enough resources to cover only the amount of costs already incurred when claimants were newly activated (the amount the Fund could expect to receive an invoice quickly) without adding seed money. Also, letters of commitment were amended when reimbursement requests were submitted and only for

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<sup>14</sup> Document promising a specific amount of funds at the time a claimant is activated off of the priority list.

the exact amount of the approved costs. According to Fund management, the revised strategy resulted in the following:

- Fund staff no longer attempted to guess at future project costs;
- Less money was encumbered, which allowed more claimants to be activated; and,
- Letter of commitment amendments were required for nearly all reimbursements.

With setting aside only those funds needed to cover new claimants' already incurred expenses at the time of letter of commitment activation and "amending" the plan with each current claim, management sought to utilize the uncommitted funds by activating more claimants. This process to essentially apply the program on a "pay as you go" basis critically and negatively impacted management's ability to ensure sufficient resources were available to support existing claimants before creating additional demand on resources by activating new claimants. Due to the Fund's current financial predicament, as of October 2009, letters of commitment are no longer used as an encumbering tool in any respect as all costs are paid when reimbursement requests are submitted and sufficient Fund resources are available (cash basis).

Moreover, while management has conducted some limited cash-flow projections, there appears to be an incomplete analysis of the relationships between the existing (and growing) demand on Fund resources related to active claimants and the additional demand created by the activation of new claimants. The incomplete analysis, coupled with management's specific desire to increase the utilization of Fund resources by activating new claimants, resulted in too large of a claimant pool demanding more monies than were available within the Fund's annual allocations.

Specifically, although project budgets are not utilized to estimate demand on the Fund's resources, as part of an effort to manage annual cash flow and determine the number of new claimants to activate, Fund management develops an annual "encumbrance plan." Specifically, encumbrance plans start with the Fund's anticipated available revenue and the amount of reimbursements paid during the previous fiscal year is applied—the difference between the revenue required to service existing claimants and the available revenue reflects the amount of revenue earmarked to activate new claimants from the Priority List. However, the number of claimants that will be activated is based only on the project costs new claimants indicated had already been incurred at the time they are placed on the Priority List—the number of new claimants activated does not consider how much on-going demand claimants will place going-forward on Fund resources and annual cash flow.

For example, during Fiscal Year 2007-2008, the Fund estimated that approximately \$200 million of the nearly \$207 million appropriation would be available for letter of commitment amendments and the rest, about \$6.6 million, would be used to activate 153 new claimants. The Fund activated claimants, in priority order, based on the amount of costs incurred at the time claimants were placed on the priority list until the \$6.6 million was exhausted. While for some claimants the amount indicated as already incurred at the time they are placed on the priority list may be the majority of their total project costs, for other claimants, the amount indicated as already incurred may only be a very small fraction of their project costs with the vast majority of expenditures to follow once activated.

Additionally, as shown in Table 11, over the last few years, the Fund’s estimates of annual demand on resources have indicated that the Fund would consume the majority of its resources paying the reimbursement requests of existing active claimants. In fact, Fiscal Year 2007-2008 projections indicated that reimbursement requests related to existing active claimants would require 97 percent of available appropriation funds. Even though there was little projected to activate new claimants, another 153 new claimants were slated to be activated without due consideration of the full demand these new claimants would place on Fund resources going forward or without leaving any cushion in case existing claimant letter of commitment amendments require more of the available appropriation than anticipated. Given all of this, it is not surprising that Fiscal Year 2007-2008 encumbrance plan underestimated the demand on Fund resources by indicating that approximately \$207 million appropriation slated for reimbursements would both service the demand of existing active claimants and activate some new claimants when approximately \$239 million was actually awarded. Unfortunately, because of the way accounting data is tracked, we were unable to determine if the nearly \$32 million difference was a result of more monies spent reimbursing existing claimants versus new claimants.

**Table 11. Fund Management Estimates of the Percentage Amendments Would Require of Annual Appropriations**

	<b>Appropriation for Priority Reimbursement Requests</b>	<b>Estimated Expenditures For Amendments</b>	<b>Estimated Expenditures for New Claimants</b>	<b>Percentage Amendments Require of the Appropriation</b>
07/08	\$206.6	\$200	\$6.6	97%
06/07	\$215.1	\$196	\$19.1	91%
05/06	\$221.1	\$190	\$31.1	86%
04/05	\$200.8	\$180	\$20.8	90%

Overall, the relationship between the demand of the current pool of active claimants and number of new claimants activated appears to not have been given sufficient consideration. As a result, the size of the Fund’s active claimant pool was allowed to increase to a point where the Fund is unable to meet the associated annual resource demand within its annual appropriation. To make up the difference, the Fund had to utilize its cash balances and once cash balances were depleted in Fiscal Year 2007-2008, payments to active claimants had to cease due to lack of funds.

**Other Issues Contributing to Management’s Challenges**

The SWRCB does not participate in any part of the UST Maintenance Fee collection process as it simply receives transfers directly into the Fund—the majority of funds are transferred quarterly but money is received and deposited daily throughout the year. Rather, the California Board of Equalization’s (BOE) Fuel Taxes Division handles all aspects of collecting UST Maintenance Fees that must be paid by owners and operators of USTs that store petroleum products placed

into underground storage tanks, including gasoline, jet fuel, diesel, heating oil and solvents. The historical fee rate per gallon is reflected on Table 12.

**Table 12. Historical UST Maintenance Fees**

<b>UST Maintenance Fees Assessed (per gallon)</b>	<b>Fee Collection Timeframe</b>
\$ 0.006	January 1, 1991–December 31, 1994
\$ 0.007	January 1, 1995–December 31, 1995
\$ 0.009	January 1, 1996–December 31, 1996
\$ 0.012	January 1, 1997–December 31, 2004
\$ 0.013	January 1, 2005–December 31, 2005
\$ 0.014 <sup>15</sup>	January 1, 2006–Present

Although we did not perform an audit of BOE’s processes, we noted that the BOE faces certain difficulties associated with collecting the UST maintenance fees that make it difficult to ensure that the proper amounts have been paid and collected.

One requirement of claimants to be eligible to participate in the Fund reimbursement program is that claimants must provide proof of paying all required UST maintenance fees through the BOE. If claimants owned and operated USTs since the inception of the Fund, they must show proof that they paid the UST maintenance fee back to 1991. However, according to regulations over BOE activities, there is an eight year statute of limitations in making an assessment of fees due when a claimant has not remitted fee returns. The disconnect in BOE’s eight year assessment limitation and the UST fund’s requirement that claimants must show proof that fees were paid as many as 18 years ago make it difficult for claimants to meet this eligibility requirement if claimants have not maintained their own personal records.

*Limited Data Related to the Number of Regulated USTs*

Remitting the UST maintenance fee starts with local regulators permitting the placement of the UST. Specifically, when an UST is placed underground, the owner or responsible party must obtain a permit from their local Certified Unified Program Agency (CUPA)<sup>16</sup>. There are approximately 100 CUPAs statewide, which are local regulatory agencies that are responsible for overseeing, monitoring, and regulating USTs. Because there is no requirement to provide permitting information to BOE when permits are issued by CUPAs, BOE does not have sufficient information to have a complete inventory of USTs.

Additionally, while CUPAs submit limited summary tank permitting information to SWRCB, this data simply indicates the number of total sites with USTs and number of total regulated tanks—there is no site-specific information. Unfortunately, the information that is provided does

<sup>15</sup> Amendment to AB 1188 was signed into law on November 9, 2009 providing a temporary increase of an additional \$.06 per gallon fee for a total \$.02 per gallon maintenance fee. The fee increase sunsets on 12/31/2011.

<sup>16</sup> CUPAs oversee USTs and LOPs oversee the cleanup of leaks caused by USTs.

not specify how many USTs at each site, which would be helpful assuming there is one responsible party per site. Moreover, there is no information as to the number of unregulated USTs in operation because the responsible parties do not report tank usage to the required entities, such as permitting agencies, BOE, and SWRCB. Thus, because of the lack of a central repository of such data, neither BOE nor the SWRCB has knowledge of the universe of regulated and permitted USTs, and cannot verify or fully validate the accuracy of self-reported fees remitted. According to California Environmental Protection Agency, a new system is currently being developed that will act as a central repository of regulated USTs. The system is expected to go online in 2013.

#### *BOE Account Registration Process*

To ensure all UST owners and responsible parties register with the BOE and submit their required UST maintenance fees, UST owners are required to self-register an account with the BOE during the permitting process. Unfortunately, this is not always enforced or UST owners are not informed of the requirement. In fact, most local regulators do not use the standard State of California UST permit application required by the new UST CCR Title 23 regulations. This standard application has a place for the UST owner to indicate the BOE account number, which would provide proof to the local regulator that the tank owner had already registered with the BOE. Rather than using the standard State of California UST permit application, most local regulators utilize their own permitting applications and are not required to check or ensure the tank owner has registered with BOE before issuing a permit.

Contributing to the lack of information as to the number of regulated USTs, under BOE regulations, registration of new UST maintenance fee BOE accounts is by owner rather than by site or tank. According to the BOE, there are currently approximately 7,500 registered UST maintenance fee account owners. However, how many USTs are covered by these owners is unclear as fees are paid based on fuel volume not by tank.

#### *Self-reporting Mechanism Used to Determine Amount of Fees Due*

For each account holder, BOE sends a “fee return” to registered account owners to prompt them to remit fees that are due. As BOE regulations require registered account owners to “self-report” the volume of petroleum fuel supplied to their USTs (in total, not by site or tank) and remit the corresponding UST maintenance fees either monthly, quarterly, or annually. Under current conditions, BOE lacks the information to determine the accuracy of the self reporting process but states that analytical reviews look for consistency between returns. For example, if there is a large increase or decrease in the self reported fee, it could be attributed to the registered account owner having bought additional tanks (i.e. was supplied more gas) or sold tanks (i.e. was supplied less gas). However, the analysis only looks at consistency and reasonableness in the amount of fee revenue collected.

To gauge the reasonableness of UST fees paid, BOE conducted a high-level comparison of taxable distributions of gallons of gas to UST fees collected. Their analysis indicates that UST maintenance fees have been consistently collected on approximately 93 percent of the gallons of gasoline that have been taxed—the remaining 7 percent is assumed to relate to distributions of gasoline to above ground storage tanks.

Further, according to the BOE, its resources are insufficient and only allow for a limited audit function in the UST area. While BOE states that routine audits are conducted as time permits to ensure fee payers are in compliance, due to limited resources the bulk of the audit function involves BOE close-out audits that occur when a UST tank is sold or removed. However, the BOE is not always notified when tanks are sold or removed. Nonetheless, during the close-out audit process, BOE staff compares the amount of prepaid sales tax paid on gasoline sold to the owner to the amount of self reported fees paid by the owner to determine if the amount of self reported fees paid is reasonable. The BOE also compares the size of the business to the amount reported for reasonableness. Additionally, related to gasoline sales tax paid by the major oil companies, BOE regularly (3 year cycle) compares the amount paid in sales tax to the self reported fees paid.

In the event, when an UST maintenance fee account holder fails to submit a quarterly fee return, according to the BOE, the compliance unit of its Fuel Taxes Division sends a delinquency letter. If the fees are still not submitted, a bill with penalties and interest is sent. BOE estimates that approximately 8 percent of its fee returns are delinquent each year and that as of November 2009, approximately \$8 million in fees were outstanding.

Overall, inadequate financial management practices have hampered the Fund's efforts to manage and estimate the demand on the Fund's limited resources resulting in a financial crisis that significantly impacted when claimants would be paid.

**Recommendations:**<sup>17</sup>

To improve the Fund's financial management practices and strategies in order to better manage and estimate demand on resources, the Board and Fund management should, in consultation with DAS' Accounting Office:

1. Seek out regular independent program assessments and evaluative processes to review and monitor the Fund's strategic and financial planning efforts.
2. Ensure the financial expertise within DAS' Accounting Office is appropriately relied upon and sought when developing new financial management strategies and practices and especially prior to making a financial decision that can impact either the Fund's cash balances or demand on cash balances.
3. Develop a regular and systematic reconciliation process between accounting records of claims paid and the Fund's records of claims approved for payment. Specifically, consider developing an electronic data management system or interface that will facilitate the automatic transfer of approved payment information to accounting, assist in the reconciliation between accounting and Fund records, and foster transparent sharing of data between the units.
4. As new management employees are hired within the Fund, consider dedicating a position to act as the Fund's Financial Manager or at a minimum, consider management candidates that have strong financial backgrounds.

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<sup>17</sup> Some recommendations may require legislative action and changes in budget authority to implement.

5. Base financial planning decisions and management strategies only on comprehensive and dependable data, such as management information/reports pertaining to the Fund's overall financial condition/position and well-developed, reasonable, and reliable project plans and budgets. Ensure approved budgets contain schedules or timelines when reimbursements will be sought. Additional recommendations related to project plans and budgets are provided at the end of Chapter 2.
6. Utilizing the well-developed and reliable project plans, budgets, and reimbursement schedules and histories, develop estimates and projections of the near, mid, and long-term demands on Fund resources, including the likely demand of existing claimants as well as the potential demand of future claimants.
7. Consider reincorporating processes to encumber Fund monies for project costs, but only in conjunction with approved project plans, budgets, and reimbursement schedules.
8. Work with the BOE to develop projections of future revenue from current through the Fund's sunset. Include multiple scenarios for any factors that could have a negative or positive impact on future revenue, such as declining gas consumption or increases in fees.
9. Compare projections of near-term demand and reimbursement schedules of existing claimants against future revenue anticipation to ensure cash flow needs will be met. Continually refine estimates and projections, particularly as new and pertinent information is provided.
10. Activate new claimants only when analysis (i.e. encumbrance plan process) of annual revenue indicates sufficient resources are available and not earmarked for existing claimants. Fund management and DAS Accounting Office should jointly determine what percentage of revenue must be available before new claimants are activated and also how many new claimants should be activated. A buffer should be incorporated to account for necessary budget or cost revisions submitted for approval by claimants.
11. Develop practices to regularly monitor changes in the Fund's cash balances and cash flow by comparing cash inflows against cash outflows to ensure that the Fund's available cash and reserve balances do not fall below required amounts.
12. Require Executive Director approval before utilizing any funds for project-related reimbursement purposes that are reserved for emergencies and clearing account.
13. Implement a process to compare estimates and projects with actual amounts. When unexpected variances occur, immediately understand the cause of the variance and determine any associated impact.
14. Regularly analyze projections of long-term demand and future revenue to monitor the Fund's overall financial viability.
15. On a regular basis, provide the Board with standard financial status reports developed jointly between Fund management and DAS accounting staff. Status reports should contain any critical financial information that could positively or negatively impact the Fund's financial situation and should include, at a minimum, the current and past statuses of, and any anticipated changes in, Fund cash balances and cash flow. Also, provide the Board with estimates/projections of future near and long-term revenues, expenditures, and reimbursement demand.

16. DAS Accounting Office should provide the Board with a regular and independent assessment of the Fund's current and future financial status.
17. Work with the California Environmental Protection Agency and the California CUPA forum to develop procedures that require and ensure all UST permitting agencies in the State to verify tank owners have established accounts with BOE for the purpose of remitting the required UST maintenance fee before approving or renewing UST permits.
18. Consider working with the BOE to:
  - a. Introduce legislation to bridge gaps in statutory requirements of the BOE and the Fund, such as the amount of time claimants must provide proof that all UST fees were paid versus the amount of time BOE maintains such information as well as modifying certain BOE processes so that the number of tanks each account holder owns and remits corresponding UST fees is known.
  - b. Once the EPA has established the system that is intended to act as a central repository of regulated USTs, ensure all required tank owners submit the required UST maintenance fee.
  - c. Develop a process where BOE would provide the Fund with a list of delinquent UST fee payers and the Fund would deactivate any corresponding claimants.

To address issues surrounding the Fund's long-term ability to continue providing the means for tank owners and operators to meet financial responsibility and to continue providing reimbursements for eligible cleanup costs, the Board and Fund management, in addition to the recommendations noted in each chapter of the report, should:

19. Work with Fund stakeholders and industry experts to conduct an in-depth analysis of the likelihood that the Fund will run out of resources before the demand for cleanup reimbursement is met and carefully weigh alternatives, such as the following:
  - a. Transitioning entirely from a state UST Cleanup Fund program to requiring all responsible parties to secure private insurance to meet federal responsibilities requirements.
  - b. Restricting the eligibility criteria to participate in a "downsized" state UST Cleanup Fund program and requiring all other responsible parties to secure private insurance to meet federal responsibility requirements.
  - c. Seeking additional fee increases.
  - d. Reducing the \$1.5 million maximum reimbursement dollar amount per claim.

## Chapter II: Fund Management Lacks Necessary Processes as well as Clear Responsibility and Authority Needed to Effectively Contain Costs

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The financial challenges discussed previously in Chapter 1 are worsened by the Fund's core and fundamental problems—namely rapidly increasing project costs and lack of management processes and control needed to effectively contain project-related costs. Standard management processes are not in place that require claimants to provide Fund management with critical information needed to effectively control project costs, such as project plans, budgets, or competitive bids. Although Fund staff review costs associated with cleanup activities that have already been performed, the only uncompromising cost control measure currently in place is the statutory reimbursement cap of \$1.5 million per claim. Additionally, cleanup projects are staying open longer, which increases the total cost of projects, and regulatory oversight agencies hold the authority and can exercise wide-discretion as to when cleanups are ready for closure.

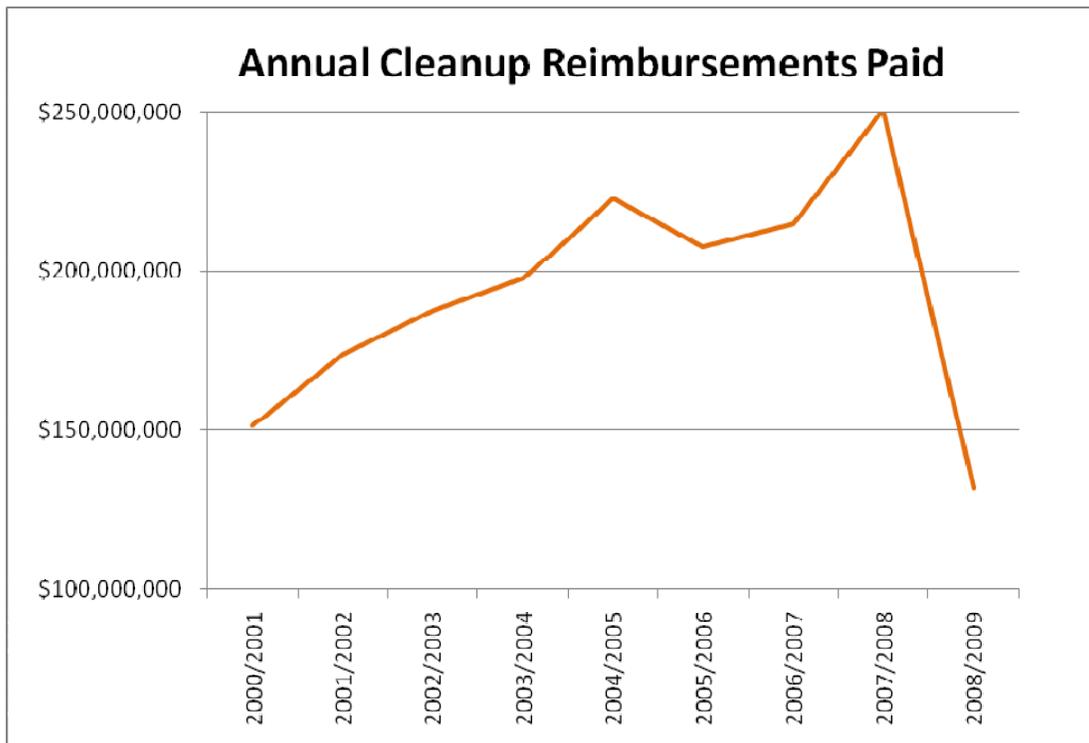
Exacerbating the cost containment issues facing the Fund are the unclear roles and responsibilities and conflicting objectives between regulatory oversight agencies responsible for overseeing and directing cleanup activities and Fund staff responsible for providing reimbursements for eligible costs. As a result, there is little communication and coordination between the regulators and the Fund, particularly in the project planning phases. Sharing project planning information could facilitate collaborative decisions early in the cleanup project lifecycle, avoiding disagreements later in the process but also allow Fund management essential planning tools.

In addition to increases in project-related expenses, costs associated with regulatory oversight are also increasing. Even though oversight costs are paid with Fund resources, funding arrangements and contracting practices are outside the control of Fund management and provide little incentive or accountability to ensure timely and efficient progress is made toward closure.

### **Project Expenses Associated with Claim Reimbursements Continue to Increase**

Since the inception of the Underground Storage Cleanup Fund (Fund) in 1991 through June 30, 2009, the Fund has expended \$3.28 billion with the costs associated with reimbursing Priority System claimants for the cost of cleanups accounting for the vast majority (77 percent) of the Fund's use of resources as shown in Figure 2 in Chapter I. The Fund's annual total expenditures have increased consistently over the last decade—averaging a nine percent increase in each year except during the Fiscal Year 2005-2006 and especially Fiscal Year 2008-2009 when expenditures dropped significantly because the Fund was unable to pay reimbursement requests due to its diminished cash balances. As shown in Figure 9, project reimbursements have significantly increased (except in 2008-2009 when reimbursement payments fell due to the funding crisis), but little has been done by Fund management to establish adequate cost controls so to optimize the use of the Fund's scarce and high-demand resources.

**Figure 9. Annual Cleanup Reimbursements—Fiscal Year 2000-2001 through 2008-2009**



\*Does not include statutorily required transfers/loans to and from other programs.

Under provisions of the program, once a claimant is determined to be eligible to participate in the Fund and is “activated” from the Priority List, the claimant may request repayment of eligible cleanup activities.<sup>18</sup> The Fund reimburses “reasonable and necessary” corrective action costs paid or incurred for work performed after January 1, 1988 that was the result of an unauthorized release of petroleum from an UST that caused contamination of soil and/or groundwater. Cleanup projects typically involve the following types of activities, but can vary greatly depending on the degree of cleanup required and directed by local regulatory agencies<sup>19</sup>:

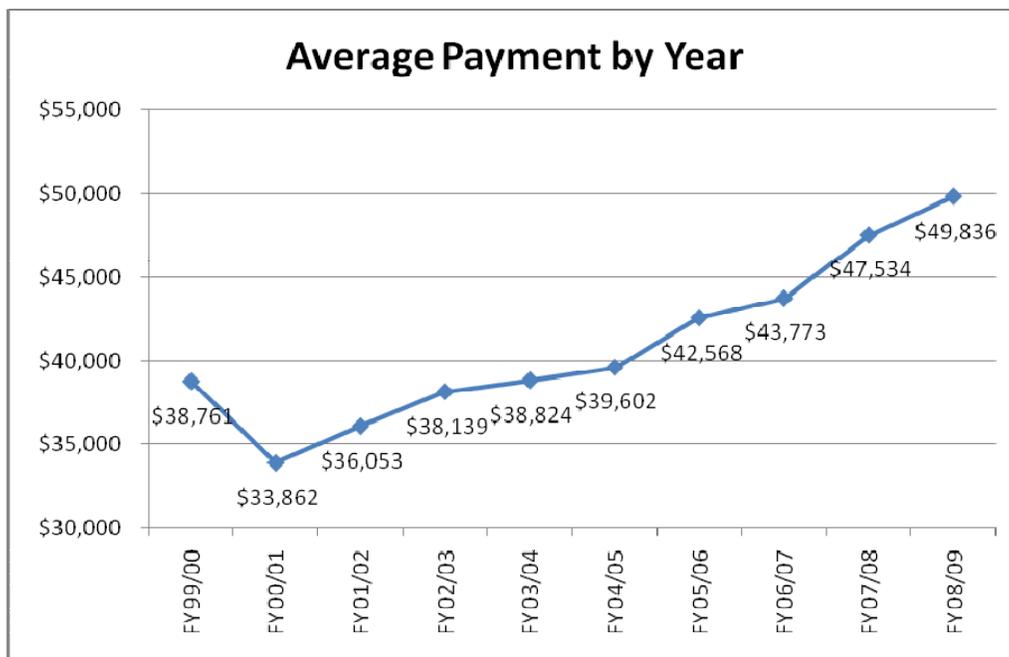
- Corrective and Remedial Action Plan Preparation
- Regulatory Report Preparation
- Site Investigation
- Groundwater Monitoring
- Soil Excavation and Remediation
- Waste Transportation and Disposal

<sup>18</sup> Once the responsible party has received direction to perform corrective action, they can apply for eligibility to participate in the Fund to help with the costs of the cleanup. The maximum reimbursement from the Fund a claimant can receive, per occurrence, is \$1.5 million, less the applicable deductible, which ranges from \$0 to \$40,000.

<sup>19</sup> The Fund does not cover the removal, repair, retrofit or installation of USTs and funds are disbursed only after costs are actually incurred.

While Fund management attributes the increase in reimbursements to the increased size of the pool of active claimants (those claimants able to submit reimbursement requests) particularly during the late 1990s and early 2000s when the Fund sought “full utilization” of Fund resources, statistics do not support that notion. While clearly the number of claimants sharply increased from the mid-1990s to the end of that decade, the size of pool of active claimants actually began to level off and then decrease around 2003-2004 as shown in Figure 3 in Chapter 1. What is notable, however, is that the average individual reimbursement payment dollar amount increased nearly 47 percent from 2000-2001 to 2008-2009 from \$33,862 to nearly \$50,000 at the end of that period. Therefore, even though fewer claimants (and projects) were active in the 2000s, those fewer claimants requested payments that were for larger dollars. As shown in Figure 10, costs continued to climb throughout the decade with annual payments to claimants over the 10 year period averaging \$40,561.

**Figure 10. Changes in Average Annual Payments to Claimants**



The Fund attributes these rising project costs to reasons such as normal inflationary pressures as well as costly changes in project cleanup requirements related to vapor intrusion as well as methyl tertiary butyl ether (MTBE) previously used in gasoline. According to the EPA, costs are also impacted based on the extent of contamination. As such, Texas and Florida, two states that had funds similar in size as California, converted to a risk-based approach where funds would be obligated first to pay for releases that pose the greatest threat to human health and the environment and by starting cleanups on higher risk sites sooner means that contaminations would be less extensive and the associated required cleanups less costly.

While these are valid reasons for some of the increases in project costs, escalating costs are also influenced by the following: little involvement of the Fund on project scope or cost decisions before work commences, lack of focus on project cost controls, conflicting roles and

responsibilities between Fund management and regulatory agencies, and allowing projects to stay open too long.

*Due to Lack of Budgets, Fund Has Little Insight into the Scope or Cost of Cleanup Activities Before Work Commences*

There is no mandate that project plans or budgets be developed and submitted to the Fund for review and approval prior to a claimant commencing cleanup activities. The determination of the need for approval and oversight resides with the regulatory agency. Even though the Fund must approve letters of commitment to activate a claimant, staff typically are provided little insight into the scope or cost of cleanup projects. Often, the only source of project information comes in the form of claimants' requests for reimbursement; thus, the Fund's analysis of the reasonableness of scope of work and cost decisions is after the fact, piecemeal, and often very late in the process. In fact, generally, work has already been approved by local regulatory agencies, activities already completed by the claimant, and the associated costs incurred before reimbursement requests are submitted to the Fund. According to Fund management, it is hard to control costs when the "horse is out of the barn."

While program provisions do not require budget and project information be submitted to the Fund for its preliminary review or approval, there are workplans and feasibility studies that claimants must prepare and submit to regulatory oversight agencies for their review and approval prior to work commencing on a cleanup project. Specifically, Health and Safety Code requires that workplans approved by regulatory agencies must detail the proposed scope of corrective action, describe the actions to be taken during the specified phase to remediate the leak, explain how the work will accomplish the cleanup goals, and include a schedule of completion of the proposed work—information that could be beneficial to the Fund. Additionally, UST regulations require that project workplans and related information be uploaded into the Geotracker system<sup>20</sup> by the responsible party—a system to which Fund staff have access.

While the information submitted to regulators and required to be uploaded into Geotracker may be helpful to the Fund, it provides only part of the data essential to the proactive management of Fund resources. Information uploaded into Geotracker is typically submitted after the work has been approved by the regulator, plans often do not include cost or budget information that would be key data for Fund staff, and Fund staff are not aware when information is uploaded into the system because of their limited involvement during the planning process. While budgets are subject to change as cleanup progresses, having a benchmark for project costs would go a long way to assisting in Fund management. Without such essential project data, it is nearly impossible to estimate the demand associated with active claims or manage the near as well as long-term demand on the Fund's resources. According to the Fund, working with claimants and consultants to develop project budgets and plans at the beginning of cleanup projects has not been made a priority due, largely in management's view, to a lack of resources and lack of coordination with key project partners—claimants, project consultants, and regulators.

Moreover, according to UST program management and Fund management, not all responsible parties are compliant with the Geotracker submittal requirement and not all regulators provide

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<sup>20</sup> SWRCB's database that provides online access to environmental data.

sufficient oversight to ensure the requirement is met. Currently, of all the active UST cleanup projects in California, about 22 percent have not been “claimed” by a responsible party, which must occur before data can be uploaded into Geotracker. Additionally, another 25 percent of all the active cases have either had no regulatory activity documented in Geotracker or had any regulatory activity documented in the last 5 years and 18 percent have had no regulatory data submitted in the last 12 months. The Fund can enforce compliance with Geotracker submission requirements during the standard regulatory compliance check that is performed before reimbursement requests are processed. If claimants have not complied with the submission requirements, their reimbursement request is placed on hold until compliance has been achieved.

#### *Feasibility Studies Submitted to Regulators Often Lack Required Cost-Effectiveness Analysis*

Another potential source of project cost information is associated with Health and Safety Code requirements for feasibility studies to be submitted to and approved by the local regulatory agency and be evaluated for cost-effectiveness. However, according to discussions with Fund management and the UST program managers as well as our high level review of example documents, feasibility studies generally do not delve into the costs associated with proposed cleanup activities. This is likely due to the fact that the documents are drafted for approval by local regulatory agencies—entities that are concerned with approving corrective action activities that are necessary to protect human health and the environment and are not always concerned with the associated costs. According to Fund management, regulators’ focus is to remediate environmental conditions to a specific level that complies with local water quality objectives regardless of cost. Additionally, we were told that some regulators may feel that they would be in violation of State law if they directed responsible parties to undertake specific cleanup activities due to cost considerations because of California Water Code Section 13360 which prohibits SWRCB and its regional boards from issuing orders that specify the design, location, type of construction or particular manner in which compliance may be had with a requirement, order or decree.

Moreover, the contracts in place between the SWRCB and County regulators to provide oversight of cleanup projects specify that the regulators shall oversee the preparation of feasibility studies that evaluate alternatives related to the following types of criteria: human health and safety risk, ground or surface water polluted, beneficial uses affected, etc. However, the contracts do not specify any requirements that cost-effectiveness must be included in the evaluation of various alternatives.

The consideration of these separate and distinct responsibilities, providing budget and cost information against which to allow the Fund to exercise its responsibilities to pay “reasonable and necessary” costs of cleanup are not contrary to law and regulation. In fact, having appropriate data is essential to the Fund providing its role in the process and for ensuring the integrity of the ratepayer monies.

#### *Limited Use of Cost Pre-Approvals*

The Fund’s use of cost “pre-approvals” has been limited since the inception of the fund and “greatly reduced” in 2003 due to the lack of resources. Although these processes do afford some cost information, it does not provide a level or completeness of cost data to be useful for Fund management. The utilization of cost pre-approvals is neither legislatively required nor does it

mitigate the lack of project plans; however, the pre-approval mechanism is intended to improve payment process efficiency as well as contain costs. Cost pre-approvals are used in cases where specific activities will likely require a substantial expenditures (and Fund reimbursement), such as an excavation, or installation of a soil vapor extraction system. The benefit of the pre-approval is that the Fund affords the claimant an opportunity to have the Fund's Technical Unit conduct a preliminary review of the proposed expenditures prior to the activity commencing so the claimant can be reasonably sure the associated costs will be approved for reimbursement by the Fund.

However, Fund management cited several issues with the preapprovals that were completed in the past that hamper the effectiveness of this tool:

- The pre-approval process occurred after the scope of the project had already been set.
- Preapprovals were cost by cost rather than all costs during a specific timeframe or phase.
- When preapproved costs were submitted for reimbursement, it was nearly impossible to tie preapproved amounts to amounts reflected on invoices because portions of various preapproved costs would be commingled and buried within other billed costs.
- The pre-approval process was intended to be used for large expenditures but owners and consultants wanted every cost preapproved no matter how minor.
- Consultants and claimants were not held to cost preapprovals.

Clearly, cost preapprovals can simplify the reimbursement process for claimants anticipating substantial costs. However, even if broadly applied, would not provide the comprehensive information needed by Fund management.

#### *Competitive Bid Processes Not Employed*

Another cost control tool required by Health and Safety Code Section 25299.57 (g) (3) stipulates that claimants must receive multiple bids with detailed cost estimates from qualified firms for cleanup work if they file a claim for reimbursement from the Fund. However, we found that this competitive bid requirement is not enforced and Board regulations Section 2812.1 (d) allows for waivers if the Fund finds the requirement is unnecessary, unreasonable, or impossible to comply with under the circumstances pertaining to a particular claim.

Fund management has not required competitive bids to be submitted because they believe the use of the three bid process is problematic in that consultants will "game" the system. For example, Fund managers contend that some consultants would take turns submitting unrealistic bids to ensure a specific consultant will submit the low bid and win the project. Additionally, consultants would also "low ball" a bid to get approval and then bill a higher amount later. Nonetheless, the Fund should implement a process to ensure competitive bids are utilized to contain costs as intended and where applicable. For example, rather than the lead consultant on the cleanup project submitting multiple bids directly to the Fund, a competitive process where qualified consultants submit sealed bids directly to the Fund would allow multiple consultants to independently bid on various cleanup projects. Cost and management controls should not be allowed to be compromised by collusion or price fixing. Fund engineers should have the expertise to spot such unethical activities and ban those contractors from future projects.

### *Special Funded Projects are Closely Monitored*

Unlike Priority System projects, cleanups that are supported by the Fund under the five “special account” programs are closely tracked and overseen. As previously discussed, the UST program has five special account programs, including the Emergency, Abandoned and Recalcitrant (EAR), Orphan Site Clean Account (OSCA), Orphan Site Clean Fund (OSCF), Commingled Plume (CP), and Replacement or Repair of Underground Storage Tank (RUST). Each of the special account programs, except CP, are treated as grant programs and are administered and overseen by two special account analysts. CP accounts are largely overseen by the Fund’s Technical Unit and treated the same as “Priority System” claimants.

The special account analysts accept applications, review and determine eligibility, generate the grant agreements<sup>21</sup>, and process reimbursement requests processes similar to that of the “Priority System.” However, unlike the “Priority System,” each special account analyst is assigned specific grants to administer. Claimants must submit project plans that include specific tasks, estimated costs for each task, and specific timelines. Claimants are held accountable to adhering to all of the terms of the agreements enabling Fund staff to contain costs by holding project decision makers to costs schedules, which also makes the reimbursement review process easier and reduces conflicts between the Fund and regulators because specific activities are already approved before work starts. Within these “grant” project efforts, cleanups progress quickly and claims are closed faster than the Priority System claims because funding is supplied for a limited time. It should be noted that grants may not cover an entire project and may only support specific, limited activities; thus, when claims are closed, it is likely the cleanup project itself may continue outside of the cleanup Fund program. Such an oversight process may not be possible for Priority System projects because of the regulatory responsibilities, however, the underlying controls of matching proposed project efforts and costs to reimbursements submitted could be applied and provide a cost containment element.

### *Cost Guidelines Out-of-Date and Not Utilized*

The primary tool that the Fund staff utilize to assess the reasonableness of costs for reimbursement approval is the Fund’s cost guidelines. Section 25299.57(h) of the California Health and Safety Code requires the Fund to “develop a summary of expected costs for common corrective action.” While the Fund developed a 106 page cost guideline in 1996, the guidelines are significantly out of date as the last major revision was completed in October 2001 even though the guidelines state that a continuous effort will be made to keep the guidelines current and responsive to industry, regulatory, and cost changes.

The primary purpose of the guidelines is to “provide guidance to claimants for evaluating proposed and incurred corrective action costs...” and “...understand how the Fund evaluates activities and costs.” The current version of the guidelines includes detailed unit and project costs related to the following technical areas:

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<sup>21</sup> Grant agreement assistance provided by the Technical Unit and approval is provided by the Offices of Chief Counsel and Chief Deputy Director of the Division of Administration)

- Personnel Labor Rates
- Analytical Tests (soil, water, and air samples) and Drilling
- Supplies and Equipment Costs
- Workplan, Status Report, and Regulatory Report Preparation
- Investigation, Monitoring, and Remediation Activities
- Premiums, Extra Costs, and Expense Markups
- Non-Reimbursable Costs

Further, although the guidelines list the specific types of costs that are not eligible, for the most part, determinations as to whether or not costs are reasonable are subjective and left to the judgment of reimbursement request reviewers. According to Fund staff, the cost guidelines are merely suggestions and Fund staff that review and approve reimbursement requests typically do not refer to the guidelines when analyzing the eligibility of reimbursement costs. Specifically, the Fund's technical reviewers (engineers) rely more heavily on their own technical expertise and personal experience to determine if costs are reasonable.

Of note, however, payment analysts—non-technical employees—are charged with the review and approval of about 80 percent of submitted reimbursement requests, payment analysts we spoke with typically do not utilize the cost guidelines when approving costs due to a lack of understanding and knowledge related to applying the intensely technical information contained in the guidelines to the associated cleanup activities reflected in the reimbursement requests. As described in more detail in Chapter 4 related to the internal control environment, payment analysts focus on ensuring that support is present, such as invoices and bills. Given that reimbursement request review is essentially the only control in place over expenses paid by the Fund, we see an increased risk that unnecessary or ineligible costs are paid with Fund resources.

Additionally, since 2001, the only update to the cost guidelines related to changes made in 2006 related to Personnel Labor Rates unit costs. Fund management acknowledges that the cost guidelines are out of date and should be revised, but indicated staff resources are currently required for other priorities. However, a working group has been formed to review needed changes related to equipment lease/rental versus purchase guidelines, but specific recommendations will not be submitted to the SWRCB before spring 2010.

Since the guidelines are out-of-date and not relied upon by analysts approving reimbursement requests, not only is an important cost control mechanism of utilizing standard benchmarks eliminated, but the primary purpose of the cost guidelines in providing claimants with guidance for evaluating corrective action costs is lost.

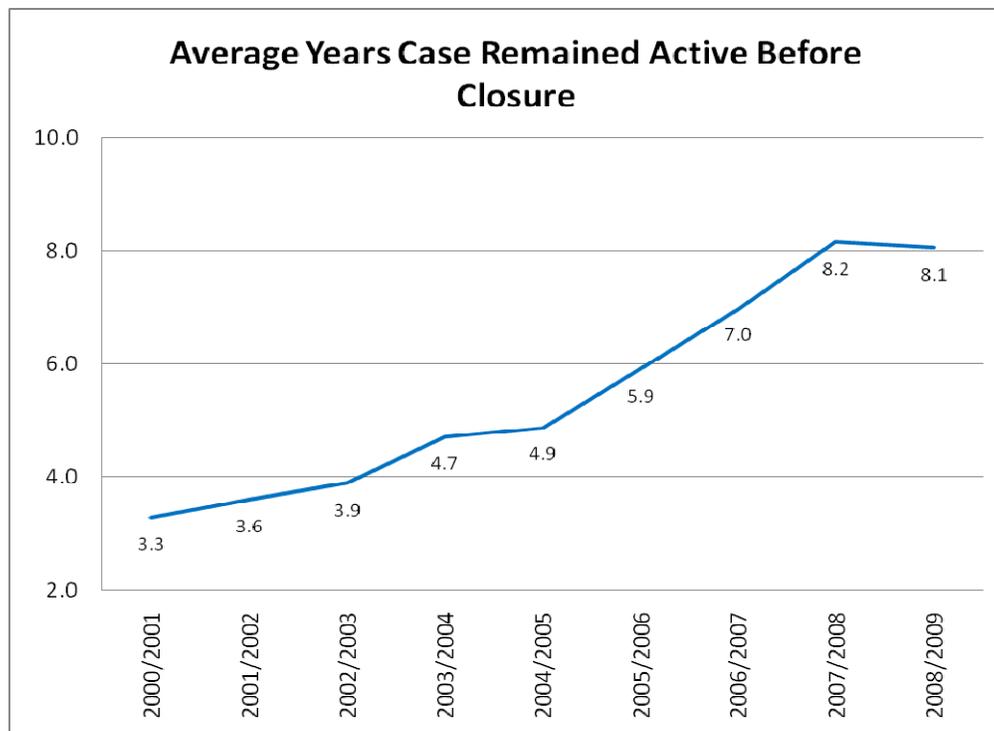
### **Cleanup Projects are Remaining Open Longer and Becoming More Expensive**

One struggle of Fund management that is widely acknowledged and discussed relates to ensuring cleanup projects are closed within an optimal time period. Actively moving to complete a cleanup and closing the project serves not only to reduce the number of active claims and potential demand on Fund resources, but also to expedite the accomplishment of health and

safety goals and to contain costs. We consistently heard through interviews that years can be spent on only monitoring activities with consultants requesting reimbursement for such monitoring services without any demonstrated effort or progress toward remediation or closure. The reality is that having projects stay active and ongoing increases project costs as well as the potential demand on Fund resources.

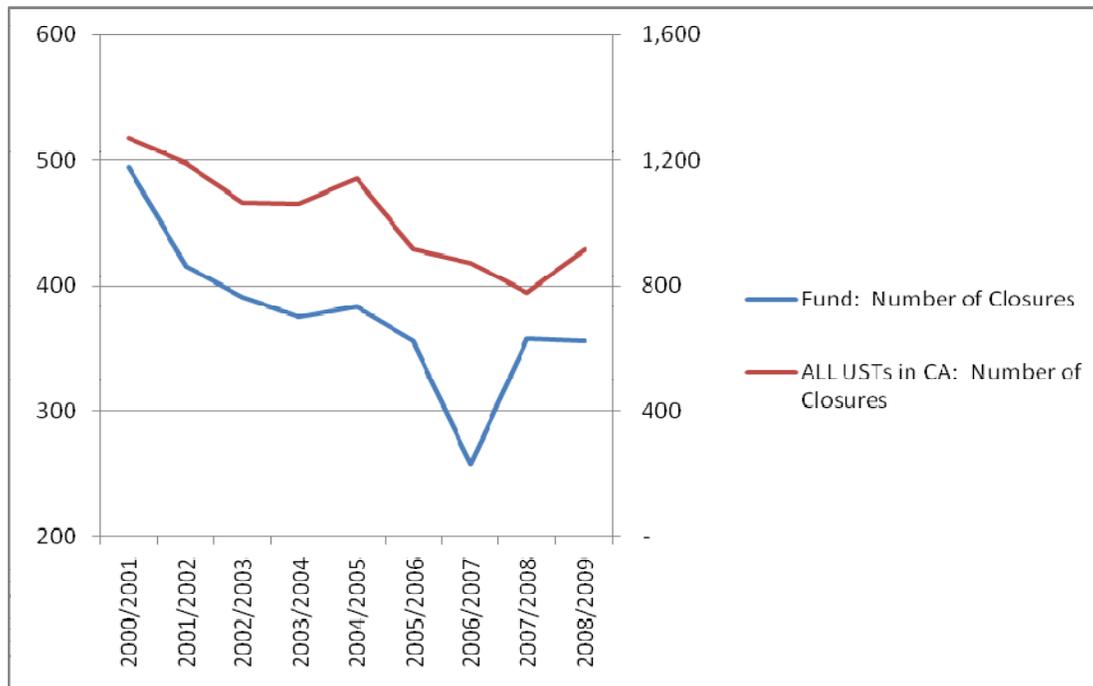
Active claims are closed either once the claimant reaches the maximum reimbursement amount of \$1.5 million or when the local regulatory agency determines that the cleanup is complete. For cleanup projects closed between Fiscal Years 2000-2001 and 2008-2009, the average years cleanup projects remained active increased from 3.3 to 8.1 years, as shown in Figure 11. During this same time period, the length of time projects remained active before closure ranged from 99 days to nearly 17 years.

**Figure 11. Average Number of Years Cleanup Cases Remain Active Before Closure**



Additionally, trends show that over the last decade, the number of cleanup cases closed annually, both within the Fund as well as USTs in California as a whole, have decreased, as shown in Figure 12.

**Figure 12. Number of Cleanup Cases Closed by the Fund Compared with all USTs Closed in California**



Furthermore, only 63 percent of the Fund’s approximate 11,000 claims that have been activated since inception have been closed as of November 2009—a statistic that is well below either the EPA’s 83 percent<sup>22</sup> national average or California’s average of 76 percent<sup>23</sup> for all UST cleanup projects, which include cleanup projects that do not participate in the Fund.

While 76 percent of all UST cleanup sites in California have been closed—the remaining 9,700 or so sites that continue to be active statewide have languished for years. For example, approximately 52 percent of the active cases are in the site assessment phase and the average age of those cases is 13 years. Furthermore, nearly 25 percent of all the active cases have never had any regulatory activity documented in Geotracker or haven’t had any regulatory activity documented in the last 5 years—however, it is unclear if work hasn’t been performed or if the required regulatory activity information simply wasn’t submitted into Geotracker.

Moreover, the EPA found that the decreasing rate in which cleanups are completed is not limited to California but the trend also applies nationally—from a high of 20,834 closures in Fiscal Year 1999-2000 to 12,768 in Fiscal Year 2007-2008. The EPA also found that 14 states are responsible for much of the decline: California, Florida, Illinois, Michigan, Montana, Nebraska, New Hampshire, New Jersey, New York, North Carolina, Pennsylvania, South Carolina, Texas, and Washington. The EPA is currently analyzing data to identify national challenges and state-specific strategies for completing cleanups.

<sup>22</sup> As of March 2009.

<sup>23</sup> As of November 2009.

Not only are claims staying open longer and fewer UST cleanups in California are closing each year, including those that participate in the Fund, the cost of an average total cleanup (calculated after a claim is closed) has also increased—\$131,000 in 2004-2005 to approximately \$256,000 in 2008-2009, as discussed earlier and shown in Figure 8 in Chapter 1. According to the May 2008 Vermont DEC Annual State Fund Survey, the average cost of cleanup sites still active (i.e. not closed) was \$128,023 nationally and the states with the five largest programs in terms of number of sites and cumulative amounts spent reimbursing cleanup expenses reported the following average costs of its active sites:

- Florida—\$380,000;
- California—\$300,000;
- Illinois—\$200,000;
- Wisconsin—\$134,053; and,
- Texas—\$73,580.

About a year and half later, as of November 2009, the average project cost of California’s Fund’s claims was already more than \$400,000.

The fiscal impact of these long-term projects is substantial—potentially allowing costs to be incurred and reimbursed with unrelated outcomes toward remediating the spill. Under current practices, Fund management lacks the authority to close claims and regulators lack incentives to ensure projects close timely.

#### *Fund Management Lack Authority and Regulators Lack Incentives to Ensure Projects Close Timely*

Fund staff do not have control over when cleanup projects are closed; rather, regulatory agencies charged with project oversight also make the final determination to close a cleanup site and declare that no further action is needed if the owner or operator has met all corrective action requirements. Regional boards establish the local water quality objectives and therefore the criteria used to close sites vary amongst regulators statewide. According to Fund management, some regulators are flexible in applying local rules and may allow the closure of low risk sites while other regulators apply rigid requirements even if the end result is an “island of clean in a sea of dirty.” Because of the diverse interpretation of rules and deliberative application, the duration that cleanup projects remain open and the associated project costs vary between regions. Data on the Fund’s approximate 6,900 closed claims as of June 30, 2009 suggests that, often, regions with the claims reflecting the fewest number of days open also have the lowest project costs and vice versa. For example:

- Region 2—San Francisco Bay area—is one of the regions with the highest number of active claims and also has the highest percentage of closed to active cases. Additionally, Region 2 cases remain open the fewest number of days and project costs are among the cheapest.
- Region 6—Lahontan area—is one of the regions with the fewest number of active claims and is in the middle in terms of percentage of closed to active cases. On average, Region

6 claims stay open the most number of days and related project costs are the most expensive.

However, the opposite is also true:

- Region 5—Central Valley area—has the most number of active claims and has among the lowest percentage of closed to active cases. Additionally, although Region 5 cases stay open among the most number of days, its claims are among the cheapest, on average.
- Region 7—Colorado River Basin area—has the fewest number of active claims and has among the lowest percentage of closed to active cases. While Region 7 cases stay open one of the longest number of days, its claims are among the cheapest.

Without determining differences in project size, local regulatory criteria and culture, we cannot assess the specific reasons for these differences. Fund management and UST program management indicated that projects stay open too long and become more costly because regulators lack incentive to monitor cleanup projects for closure readiness. Because the regulatory agencies are generally autonomous, historically, these entities have not answered to the SWRCB staff (within either UST program or USTCF program) regarding the progress or lack of progress of projects they are responsible for overseeing and monitoring. Funding support for these regulatory agencies is not linked to specific activities or outcomes. Additionally, regulators are not held accountable for ensuring cleanup projects they are responsible for overseeing demonstrates progress toward site closure through efficient remediation efforts. As a result, regulators lack incentives to ensure sites close timely and funds are expended prudently as regulators will continue to receive funding whether or not they produce positive results and for most projects, funds to reimburse claimants appear unlimited. In fact, it could be argued that under the current model there is a disincentive for regulators to actively close sites because the faster sites close, the sooner the Fund will discontinue supporting regulatory efforts. Because regulators are responsible for requiring cleanup, overseeing the progress, and determining when sites can close, regulators ultimately generate their own workload and funding.

Because of the increases in the length of time projects are remaining open, the SWRCB issued Board resolution No. 2009-0042 in May 2009 directing all local regulators to conduct reviews of their UST sites involved in the cleanup Fund and close those that are ready. According to a presentation by the UST program to the Board on November 17, 2009 detailing the preliminary results of this review process, UST program management indicated that 5,266 (59 percent) of the regional board and county regulatory agencies total active sites had been reviewed between May 19, 2009 and November 9, 2009, which includes both Fund and non-Fund sites. Of the 5,266 sites reviewed, 418 sites were closed during this nearly 6-month timeframe, which represents significantly more closures than the Fund, which accounts for 83 percent of all UST active sites, has experienced annually during the last few fiscal years. These closures can be attributed to a specific few regulatory agencies, some of which agreed to view their active cases with a new set of eyes and closed those cases that would not have an adverse impact to human health. A few of the notable examples of regulatory agencies taking action to close out projects are reflected on Table 13.

**Table 13. Example Comparisons of Case Closure Percentages Before and After Board Resolution**

	<b>Percent of Case Closures between 5/19/09 and 11/9/09 (after Board Resolution)</b>	<b>Percent of Case Closures 6-month average over the last 5 years (before Board Resolution)</b>
Ventura County Local Oversight Program	10 percent	7 percent
San Bernardino County Local Oversight Program	18 percent	8 percent
San Francisco Regional Board	19 percent	6 percent

Finally, another factor that can unnecessarily prolong case closure is monitoring costs that inefficiently utilize Fund resources in overseeing activities associated with sites that are allowed to remain open longer than necessary. Unfortunately, because the Fund does not track project costs by activity type, we were unable to analyze expenditure trends related to monitoring activities. However, data suggests that 11 percent of all of California’s active UST cases currently remain in the verification and monitoring phase and, on average, these cases have been active for 16 years. To begin addressing this concern, SWRCB resolution 2009-0042 directed regulatory agencies to reduce monitoring requirements unless specifically needed.

On a positive note, the UST program is in the process of revising the California LUFT Manual—a manual originally introduced in 1989 that provided technical guidance to all stakeholders on the investigation and remediation of leaking USTs in the State of California. The revised manual is intended to encourage consistency and will describe “best practices for the remediation process from discovery to closure, and why these practices should be used in site assessments; sampling and sample analysis; interim remedial measures; feasibility studies; remedial designs; remediation system instrumentation, data collection, and reporting; risk assessments (for human health and beneficial uses); monitoring; and site closures.” Revising the manual was a collaborative effort and included input from various stakeholders and is scheduled to be released for comment in late 2010.

*The Fund has Recently Begun Tracking Aged Projects*

Even though Fund staff do not have direct control over when cleanup projects are closed and can only provide recommendations, until recent years, the Fund has not proactively monitored the age of its active cleanup cases. As a result, legislation was passed in 2000 requiring the Fund to perform an initial review of all projects that had been open for five or more years and then perform annual reviews thereafter until aged claims were closed. Finally, in 2007, the Fund implemented a new five-year review process dedicated to reviewing the Fund’s active cleanup

projects that are five years or older. According to Fund management, this process was late getting started due to lack of resources.

The five year review process considers if cleanup projects are making progress toward remediation and completion or if the cleanup project should be closed because additional environmental benefit seems unlikely. After the review and analysis is complete, Fund staff prepare a recommendation report to the regulatory agency to close the site, continue with current remediation efforts, or complete additional remediation. After a recommendation to close a site, if the regulatory agency hasn't closed the site, the Fund can elevate the recommendations to the Regional Board's executive management, and if necessary, to the SWRCB. The Fund's approach is for its Technical Unit to work in collaboration with the regulators before taking corrective measures, such as going before the Board as it has the executive authority to close any cleanup sites. As of December 2009, only 7 cases have been elevated to the Board (January 2010). According to Fund management, as of July 2009, over 200 sites had been reviewed and closed through this process and an additional 529 sites had been recommended for closure—actions related to those recommendations are still pending.

Due to an historical lack of processes to monitor and proactively ensure projects are closed timely, projects have lingered and some active case files are decades old. While the Fund's five year review process has had positive results, the Fund still has a significant number of cases that are decades old. According to Fund management's March 2009 statistics related to its current active cleanup projects:

- 78 percent have been active 5 years or more
- 43 percent have been active 10 years or more
- 8 percent have been active 15 years or more

Clearly, taking steps to complete and close cleanup projects would have a positive impact on the fiscal demands of the Fund. Of greater import, however, is that California's trend to allow cleanups to extend over long periods appears to run contrary to the program goals of cleanup spills to protect water systems and the health and safety of the State's residents.

### **Little Coordination between the Roles and Responsibilities of Cleanup Fund Staff and Regulatory Agency Staff Make it Difficult to Balance Water Quality Objectives and Cost Containment Concerns**

Although regulatory oversight over UST cleanup projects is largely funded (85 percent) by Fund resources, regulators report to their own governing bodies. Specifically, regulators at each of the nine semi-autonomous Regional Boards report directly to their Board members, regulators at County LOPs report to their respective Board of Supervisors, and regulators at LIAs report to city officials. As such, SWRCB employees, particularly Fund staff, have little ability to influence the activities of these regulators. In practice, regulators and Fund staff often have conflicting objectives and operate under blurred roles and responsibilities—regulators' focus is to protect human health and water quality while Fund staff is tasked with ensuring the most efficient use of Fund resources. These competing objectives make it difficult to balance water quality objectives and cost containment concerns.

The Porter-Cologne Water Quality Control Act—California Water Code commencing with Section 13000—grants the State Water Resources Control Board and its Regional Boards the authority to implement and enforce water quality laws, regulations, and policies and plans to protect the ground water and surface waters within each region of the state. In conjunction with this, state and local regulatory agencies (Boards and county agencies that contract with the Boards) have the authority and responsibility to oversee corrective action related to unauthorized releases from underground storage tanks. Similarly, a key part of the cleanup Fund’s mission is to reimburse “eligible corrective action costs incurred in the cleanup of contamination resulting from the unauthorized release of petroleum from USTs.” Additionally, Health and Safety Code requires that claimants must comply with regulatory agency corrective action requirements and directives to be eligible for reimbursement from the Fund.

At first glance, legislation related to remediating UST leaks seems to position regulators with the sole authority to oversee and approve corrective actions while the Fund is charged with reimbursing eligible claimants for the costs associated with complying with regulatory direction. In fact, the segregation of responsibility can be associated with the concept of the “carrot and stick” to responsible parties to take the desired behavior—regulators requiring claimants to take remediation action and the Fund rewards claimants with repayment of associated costs. However, Health and Safety Code 25299 governing the Fund states that the Fund can only reimburse corrective action costs that are “reasonable and necessary” but does not specify which entity—regulator or Fund—has the authority to determine what is “reasonable and necessary.”

Under seemingly conflicting mandates, disagreements do occur between regulators and Fund staff as the authority to determine whether corrective actions taken and the associated costs are reasonable and necessary. These disagreements happen particularly when corrective actions approved and directed by regulators are later deemed unnecessary, and thus, ineligible for reimbursement, by the Fund’s technical staff. What exacerbates such a situation is the fact when the Fund denies costs, often the work has already been completed and the claimant incurred costs. Because the Fund does not receive project plans and budgets for prior review and approval, this situation is difficult to avoid.

Further, it appears that when the Fund attempts to exercise its discretion and oversight and deem certain reimbursement requests ineligible, not only does conflict arise between regulators and Fund staff, the situation often culminates with the claimant appealing the decision through the SWRCB. Fund management indicated that appeals related to denied reimbursements have a historically high rate of reversal due to claimants’ ability to appeal to multiple levels within the SWRCB and decisions tend to side in favor of claimants, particularly in light of the subjective nature of determining if costs are “reasonable or necessary” and the fact that the claimant was directed by the regulatory agency to perform the activities.

Due to the tension created, work involved processing appeals, and the likelihood that denied costs will be eventually over-turned, the Fund is less likely to exercise its statutory discretion and simply defer to the regulators decision. In one such example, the lead Regional Board gave approval to the Local Implementing Agency to connect an extensive redevelopment of a parcel of land to a parcel that required a small remediation caused by a petroleum leak. The claimant’s

project consultant requested that the regulatory agency reconsider its directive to allow linking the two projects because “there is no justification for additional excavation...” on the parcel because the additional work was not related to the initial petroleum leak and, thus, was not necessary. Despite the fact that the work related to the redevelopment parcel did not meet the provisions of the Health and Safety Code specifying that cleanup activities are only eligible for reimbursement from the Fund if the contamination of soil and/or groundwater was the result of an unauthorized release of petroleum from an UST, the regulatory agencies approved the additional work. When the Fund received the related reimbursement requests, its technical staff denied the non-UST leak work. Ultimately, Fund management allowed and justified the costs citing that because the local regulator’s soil cleanup standards were “extremely stringent and this led to a much more extensive excavation than is typically seen in other UST cases.” Fund management also noted that because “the Fund was unaware of the extensive over-excavation until it was well underway, the Fund had no chance to push for less conservative cleanup standards.” This one example involved more than \$1 million of Fund monies and serious disagreement amongst the Fund and regulatory agencies. The fact that, in practice, disallowed costs are reversed has a chilling effect on staff taking an oversight role in assuring funds are efficiently and effectively spent for intended purposes.

### **Fund Management in Process of Developing Project-related Cost Containment Measures**

Fund management recognizes that project-related expenditures have increased significantly over the past decade and that costs will continue to rise unless cost containment measures are adopted. According to the Vermont DEC Annual Fund Survey as of May 2008, the vast majority of other states have cost containment measures, such as budget and/or cost preapproval processes prior to the implementation of project plans and competitive bidding. Also, according to an Association of State and Territorial Solid Waste Management Officials publication in July 2008, the state of Louisiana went from reimbursing 350 sites and paying out \$24 million per year in 2003 to reimbursing 750 sites but paying out only \$16 million per year five years later. According to the report, “the dramatic decrease in reimbursements include a remediation oversight group in which senior scientists review remediation plans before the Fund agrees to pay for it. Also, Louisiana only commits to two years of remediation.”

On a go-forward basis, Fund management plans to be involved with developing and approving project work plans/scope and costs early in the project life cycle and is in the process of developing Multi Year Management Plans (MYMP). These plans are expected to:

- Focus on improving communication between local regulators, responsible parties, consultants, and the cleanup Fund.
- Allow the Fund to be part of the early project decisions related to scope to reduce the problems caused when the Fund questions scope decisions after work has been completed and costs are submitted.
- Reduce duplication of efforts between local regulators and the Fund in reviewing and questioning scope decisions.
- Build budgets to address work that will be performed over longer timeframes (i.e. 18 months) but also allow enough flexibility to revisit budgets when necessary.

- Improve the efficiency of reviewing reimbursement requests as the costs submitted for reimbursement should align with the preapproved plans and budgets.

As part of the development of the MYMP process, the Fund has established a pilot project that is scheduled to commence February 2010 and will include the participation of several regulatory agencies and about 30 claimants.

As Fund management implements the MYMP process to all Fund participants, they will have to account for the fact that the Fund's active claimants' projects are in various and different stages of cleanup. As mentioned in Chapter 1 and illustrated on Table 3, the Fund currently has approximately 4,000 active claimants consisting of 85 percent Priority B and C claimants, which includes small and medium sized businesses and some governmental entities. As these claimants have projects in various stages of completion, the MYMP will be implemented as new claimants are activated, but efforts will also include working with active claimants to develop plans and cost estimates that relate to the remaining life of the projects.

Of note, the Fund currently has 4,600 claimants on the Priority List waiting to be activated and eligible for project reimbursements. Because statute requires that major corporations be prioritized last, Priority Class D, which is made up of mostly major corporations, represents about 98 percent of the Priority List. Given the Fund's current financial situation, it could be years before any of the claimants on the Priority List are activated. Further, the fact that major corporations do not depend on Fund resources to support their ongoing cleanup activities, it is likely that many of the cleanups associated with the Priority List are already or will be complete before those class of claimants can submit reimbursement requests. Because many aspects of the MYMP, such as building budgets, will be irrelevant for these claimants, Fund management plans to focus the MYMP process on claimants not in Priority Class D, which are smaller businesses that are less likely than major corporations to have the sophisticated cost containment strategies and protocols.

### **Regulatory Oversight Activities Supported by the Fund Need Improvement**

As discussed earlier, activities of regulatory agencies is directed by local rules and regulation and essentially act independent of Fund or State oversight and direction. The Fund provides funding support to the SWRCB's Regional Boards and County Local Oversight Programs (LOP) to carry out the vast majority of the State's UST cleanup oversight, regardless if the responsible party is eligible to participate in the Fund. Over time, the contracts and agreements the SWRCB has executed with regulatory agencies have changed and under current form lack any performance measures or accountability for the substantial funding provided.

#### *Regulatory Oversight Costs Continue to Increase and Fund Resources Support Oversight Activities Related to Non-cleanup Fund Participating Sites*

While funding for regional boards and LOPs regulatory oversight activities is provided by the Fund, determining the annual amounts of funding is not the responsibility of Fund management. Rather, the SWRCB's UST program—that oversees leak prevention and cleanup related to all USTs—is responsible for negotiating and managing contracts with the LOPs. Since the regional boards are within the organization of the SWRCB, their funding is established through the SWRCB's budget office with some input from the cleanup Fund and the UST program.

Total expenses charged to the Fund by the Regional Boards and LOPs have increased 23 percent between Fiscal Years 2000-2001 and 2008-2009. While these costs are not stable year to year, on average, they have grown approximately 2.5 percent annually. Further, as shown in Table 14, during Fiscal Year 2008-2009, approximately \$27.6 million was expended by the Regional Boards and LOPs to perform regulatory oversight, of which \$23.5 million (85 percent) came from Fund resources. Also, Local Implementing Agencies (LIA) handle small cleanup projects that involve only soil contamination and those agencies are paid directly by claimants—costs that may be reimbursed by the Fund if deemed eligible.

**Table 14. Breakdown of Cleanups and Expenditures by Regulatory Agency Type and Funding Source**

Regulatory Agency	Number of Active Cleanup Projects (as of November 2009)	Percentage of Cleanup Projects Regulatory Agency Oversees	2008-2009 Expenditures by Funding Source for Oversight Activities for UST Cleanup Projects		
			USTCF	Federal Funds and SWRCB General Fund	Total
SWRCB—9 Regional Boards	4,735	46 percent	\$8,017,336	\$4,129,266	\$12,146,602
Local Oversight Programs (LOP)—22 County Agencies	4,397	42 percent	\$15,499,888	N/A	\$15,499,888
Local Implementing Agency (LIA)—100 (approx) City Agencies	1,261	12 percent	N/A <sup>24</sup>	N/A	N/A
<b>Total</b>	10,394	100 percent	\$23,517,224	\$4,129,266	\$27,646,490

Interestingly, the regulators at the Regional Boards, who are employees of the SWRCB, received approximately \$3.4 million less funding (from \$15.5 million down to \$12.1 million) in 2008-2009 to provide oversight to 4 percent more cleanup projects than those overseen by regulators employed by county LOPs. According to UST program management, one reason that County

<sup>24</sup> LIAs are not paid directly by SWRCB; rather, these costs are included on claimant submittals of reimbursement requests and the Fund does not track these costs separately.

LOPs receive a greater proportion of funding under contracts with the SWRCB is that County employees are generally paid more than state employees and associated costs would be greater.

Another element outside of Fund control is that the SWRCB's UST program manages all UST cleanup activities, whether or not the responsible party is eligible to participate in the Fund reimbursement program. While 83 percent of all active UST cleanup projects participate in the Fund, Fund resources also provide the vast majority of money required for regulatory entities to oversee cleanups associated with non-cleanup Fund sites. According to Fund management, statute allows Fund resources to support costs of regulatory oversight for all UST cleanups regardless whether it's part of the Fund program. Moreover, management stated that non-cleanup Fund sites represent only a small portion of UST cleanups and few alternate sources of revenue are available to support regulatory oversight of non-cleanup Fund sites. While statute allows Fund resources to cover the costs of regulatory oversight of all UST cleanups, provisions also stipulate the recovery of monies from responsible parties for costs incurred by the regulators for oversight activities. Specifically, Health and Safety Code Section 25297.1 (d) (4) states that the Board shall adopt "Protocols for assessing and recovering money from responsible parties for any reasonable and necessary costs incurred by the local agency..." While the Fund has the authority to pay for regulatory oversight on cleanup projects that participate in the Fund, according to management, there have been no attempts to recover costs associated with regulatory oversight of non-cleanup Fund sites. Furthermore, we are told that current practices do not require regulators—SWRCB employees or county staff—to differentiate or track their time separately between cleanup Fund claimants and non-cleanup Fund claimants.

#### *Contracting Practices with Regulators Lack Performance Accountability and Require Improvement*

Contracts executed by the SWRCB with regulatory agencies include standard language and discuss very high level types of general oversight activities the LOPs will perform within their defined region. Because the LOP related expenditures account for 66 percent of the \$23.5 million in regulatory oversight funding paid by the Fund and the fact that expenses related to LOPs increased nearly 20 percent from Fiscal Year 2006-2007 to Fiscal 2007-2008 alone, controls over costs and spending warrant review and contract revision.

The contracts with the LOPs set out a scope of work such as confirm unauthorized releases, identify/notify responsible parties, provide oversight related to site assessment, investigation, feasibility study, corrective action plan, and remediation, and update case plans and information into Geotracker. However, the contracts do not tie funding to specific projects or include performance measures or deliverables to make regulators accountable or to ensure the efficient and effective use of Fund resources. Rather, the agreed-upon funding reflected in the contracts is based largely on the cost of regulatory staff salaries. According to UST program managers, funding is not pinned to performance metrics because Health and Safety Code Section 25297.1 states that the LOP program is to receive "reasonable costs" to run the program. Additionally, in the past, management has relied on the honor system with LOPs in determining reasonable costs.

Nonetheless, beginning in Fiscal Year 2008-2009, the contracts include a new task within the scope of work directing the contractors to "Achieve Performance Measures." However, the cited performance measures simply suggest that regulators exert their best efforts to accomplish the

work that the entities “project” will occur; no meaningful criteria, benchmarks, or measures are included or indicators that would reveal the result of the funded efforts. Moreover, contract provisions still do not tie activities and results to funding or hold the regulators accountable for demonstrating the efficient use of Fund resources. Rather, to assess regulator activities, beginning with the 2008-2009 fiscal year, UST program staff extract data from Geotracker, such as the number of cases closed during the contract year and uses the information as discussion items with the regulators. However, because performance isn’t tied to funding, the UST program has no ability to hold regulators accountable to meeting goals or performing agreed-upon services efficiently. Also, because data related to performance is input into the system by responsible parties and regulators, the UST program’s ability to independently verify regulators are, in fact, achieving their projected goals is compromised. As a result, not only does the SWRCB lack the ability to ensure the regulators they contract with are performing regulatory oversight services efficiently, they are unable to know if these regulators are performing any services at all—a fact that UST program management readily acknowledges.

We selected four contracts in place between the SWRCB and LOPs during Fiscal Years 2006 through 2009 to understand the basis for the annual funding and to glean insight as to the reasons for the increased costs. The funding amounts reflected in one of the four contracts remained the same in total for each of the three fiscal years reviewed, while amounts reflected in the other three contracts increased without clear indication or justification for the increases. For example, the funding provided to the County of Orange remained the same for each fiscal year we reviewed—\$1,072,470 per year. Conversely, funding provided to the County of San Diego in 2006-2007 increased 35 percent the following year, from \$1,568,574 to \$2,114,217. According to UST program staff, the increase was due to San Diego previously not receiving sufficient funding to cover its regulatory oversight expenses which caused the regulator to begin also billing claimants directly to make up the difference. As a result, the SWRCB increased San Diego’s funding to eliminate their practice of billing claimants.

Another example of the lack of justification or support for certain costs, the indirect cost figures reflected in some of the contracts changed from one year to the next with no clear indication as to the reason while indirect cost figures reflected in other contracts remained the same. For example, the indirect cost calculation reflected in the contract with the County of Santa Clara remained at approximately 18 percent each year. Conversely, the 2006-2007 and 2007-2008 contracts with the County of Orange reflected an indirect cost calculation of 32.40 percent of salaries and benefits while the 2008-2009 contract reflected an indirect cost calculation of 17.61 percent. It appears that some of these changes relate to indirect cost rates to compensate increases in salaries so that the total funding remained the same. Moreover, the 32.13 percent indirect cost figure reflected in the Fiscal Year 2007-2008 contract with the County of Stanislaus increased to 51.88 percent the following year, seeming to keep the total contract funding the same between the two fiscal years even though salary and benefit costs went down.

According to UST program management, a process to regularly reassess amounts paid to local regulators to determine the reasonable cost for specific activities does not exist. Rather, counties submit proposed budgets each year—if the proposed amount is the same, it is approved without much discussion. If the proposed amounts are higher, there is some discussion between the LOP

and UST program to understand the justification for the increases, but the amounts are typically easily approved.

Before the SWRCB established contracts with LOPs, a different billing and payment process was in place related to regulatory oversight activities. Specifically, most regulators would create a bill for site-specific regulatory oversight costs that included some overhead costs, the Fund would notify the responsible party of the bill and collect the funds. Fund resources would be used to pay the regulator. However, some LOPs would send regulatory oversight bill directly to the responsible party for payment and the responsible party would pay the LOP. In return, the responsible party, even if not eligible to participate in the Fund, would submit a request for reimbursement from the Fund. The SWRCB stopped this process because of the complexity and difficulty for management. Moreover, it found that the Fund was ultimately paying all regulatory oversight costs regardless of payments from the responsible parties. However, while regulatory oversight costs were paid with Fund monies whether or not the responsible party was eligible to participate in the Fund, the previous billing system not only required regulators to provide site specific information regarding oversight activities performed, responsible parties were billed, which increased the opportunity for cost recovery, where appropriate. Due to data collection limitations, Fund management was unable to provide data comparing the historical regulatory oversight costs under the previous reimbursement model with costs under the current model. However, management indicated that their anecdotal information suggests that the regulatory oversight costs have increased under the new model.

Although costs associated with local regulators at the Regional Boards and LOPs account for a relatively small amount of Fund expenditures, the SWRCB has an obligation to ensure that resources are allocated based on careful analysis of the costs to provide services to cleanup projects rather than providing a lump sum of money that is not tied to measurable results. Additionally, contracts should be drafted with specific, quantifiable activities that are tied to funding arrangements and hold regulators accountable for demonstrating that they have met the SWRCB's performance expectations. Incentives must be established to ensure regulators provide efficient oversight and work toward ensuring projects progress toward completion as quickly and economically as possible without negatively impacting environmental concerns.

Based on discussions with UST program management, it appears that they agree that improvements are necessary to the current contracting practices to ensure monies provided to regulators are justifiable, tied to performance, and hold regulators accountable. Additionally, they have begun reviewing past performance indicators and funding to determine how improvements can be made to the process.

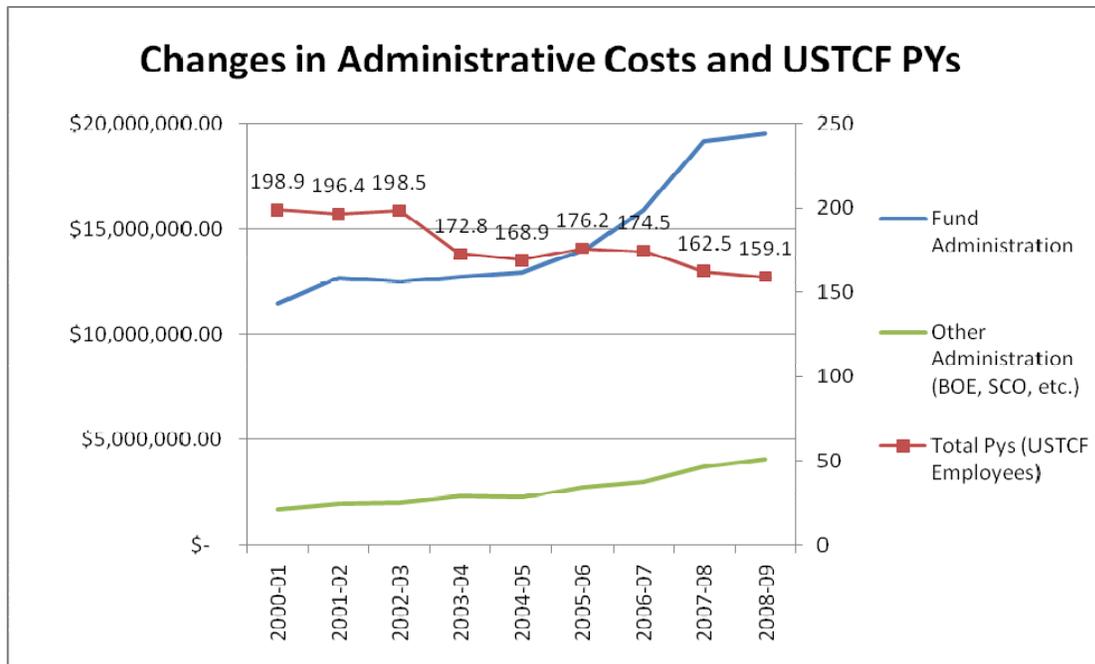
### **Fund Administration Expenses have Increased but Appear Reasonable**

In addition to regulatory oversight activities, there are costs associated with activities related to administering the cleanup program, such as determining the eligibility of claimants, reviewing reimbursement requests, processing payments, handling appeals, and recommending project closures.

Similar to other program costs, expenses related to Fund administration expenses have increased significantly over the last decade while the Fund's total number of employees has declined.

Conversely, other administrative costs related to the Board of Equalization, State Controller’s Office, etc., have only increased slightly.

**Figure 13. Changes in Administrative Costs and Staffing Levels**



Over the last four fiscal years, as shown in Figure 13, total Fund Administration costs have increased nearly 40 percent over the past four fiscal years, averaging about 12 percent annually. Fiscal Year 2007-2008 alone reflects an increase of nearly 21 percent. The three categories of costs shown on Table 15 account for the vast majority (97 percent) of total Fund Administration expenses and relate primarily to the salaries and benefits of Fund management and staff. Most of the administration costs are associated with three functional program activities; claims processing consumes the majority of administrative resources—about 48 percent in Fiscal Year 2008-2009 with program development and management comprising another approximate 42 percent of these costs.

**Table 15. Administrative Expenditures Major Cost Categories**

	<b>FY 2005-2006</b>	<b>FY 2006-2007</b>	<b>FY 2007-2008</b>	<b>FY 2008-2009</b>	<b>Average Annual Increase</b>
Compliance Checks	\$1,388,283	\$1,637,291	\$1,751,582	\$1,907,404	11 %
Program Development and Management	\$4,903,148	\$5,050,004	\$7,448,368	\$7,851,128	18%
Claims Processing	\$7,466,767	\$8,928,341	\$9,344,026	\$9,106,837	7%

Expenses in each of these areas relate almost entirely to salaries and benefits of Fund management and technical/administrative staff. According to Fund management, the noted average annual increase of 12 percent across the categories is largely the result of raises for State engineering staff negotiated by the Professional Engineers in California Government union to compete with the private sector. The raises began in 2005, continued through 2008, and ranged from 4 percent to more than 12 percent per represented employee. While not as significant, other expenditures related to activities performed by the BOE, the State Controller, and others have also increased due primarily to legislative adjustments to costs chargeable to client agencies by these State supported departments.

Unless significant changes are made to address the Fund's core issues, rapidly increasing project costs and lack of management processes and controls needed to effectively contain project-related costs, the long-term viability of the Fund is uncertain.

## **Recommendations:**<sup>25</sup>

In conjunction with continuing current efforts to establish a MYMP process, to improve the Fund's cost containment measures and practices and clarify roles and responsibilities amongst stakeholders, the Board should direct Fund management to:

20. For A, B, and C claimants<sup>26</sup>, create a uniform list of project management information claimants must submit covering the entire lifecycle of each cleanup project (or remaining life of project already underway), such as:
  - a. Project Plans
  - b. Project Schedules/Milestones
  - c. Cost Estimates/Budgets
  - d. Reimbursement Submission Schedules
21. Standardize the specific types of associated project management information (from recommendation #1 above) forms to be used to ensure data submitted by claimants is consistent.
22. Establish specific types of cost estimation methodologies that are acceptable to ensure the reliability and consistency of information submitted.
23. Incorporate competitive bidding processes into cost estimation methodologies, where appropriate.
24. Require A, B, and C claimants to submit the project management information using the specified submission processes, standardized forms, and established methodologies. Create consequences if the required information is not provided or is provided in an unacceptable format.<sup>26</sup>
25. As these processes are initially developed, establish initial submission protocols to ensure the Fund isn't inundated by an immediate and simultaneous inflow of new project management information.
26. Establish a project management information review and approval process that occurs before cleanup work commences and details all agreements reached related to project plans, cost estimates, budgets, work schedules/timelines, milestones, and overall project expectations.
27. Develop procedures to review and approve necessary project plan, cost estimate/budget revisions.
28. Continue efforts to revise and update standard cost guidelines. Ensure the guidelines are prepared in a way that is useful in claimants' independent evaluation of costs and also useful during the Fund's review/approval processes of initial and revised cost estimates and reimbursement requests.

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<sup>25</sup> Some recommendations may require legislative action and changes in budget authority to implement.

<sup>26</sup> As discussed in the chapter, pre-approving budgets may be irrelevant for D claimants as their cleanup projects will likely be completed before they are activated. Fund management plans to focus the MYMP process on A, B, and C claimants that are smaller businesses and are less likely than major corporations to have the sophisticated cost containment strategies and protocols. However, refer to recommendation #34 related to Priority D review processes.

29. Hold claimants responsible for adhering to approved project plans, budgets, estimates, schedules, etc. Develop consequences for non-compliance.
30. Develop a list of specific project phases and cost categories to be used by claimants when submitting reimbursement requests to ensure all activities/costs that are being invoiced link directly to predefined project phases and cost categories.
31. Utilizing reimbursement submission schedules approved during the planning phase of projects, ensure reimbursement requests submitted are only activities within a specific project phase that corresponds with the approved submission schedule. Ensure all costs invoiced apply only to activities conducted during a specific project phase and that all costs link directly and clearly to specific predefined cost categories.
32. Compare and link approved project management information (planned project activities, cost estimates, reimbursement submission schedules, etc.) to reimbursement request documentation submitted for approval and payment. When discrepancies occur, the reimbursement should be denied and the claimant required to resolve/clarify the differences.
33. Ensure Fund staff only approve costs that are reasonable and necessary. (Additional related recommendations are provided in Chapter IV related to Internal Controls.)
34. For situations where cleanup projects are already completed before claimants are activated off the Priority List and can submit reimbursement requests (i.e. Priority D claimants) and where preapproved budgets and plans are irrelevant, develop specific protocols to review reimbursement requests once these claimants are activated. Specifically, ensure appropriately trained staff with technical expertise review project activities performed and costs submitted for reimbursement are reasonable and necessary. Because these cleanup activities are conducted without the Fund's involvement during projects planning phases, these requests should undergo greater scrutiny for reasonableness and necessity compared to reimbursement requests that are associated with preapproved budgets and plans.
35. Determine the cost-effectiveness of recouping costs associated with providing regulatory oversight on non-cleanup Fund projects and if appropriate, develop associated processes to recoup the costs.
36. Develop processes to compare claimant provided cost estimates and actual expenditures. Determine causes for large discrepancies and adjust planning strategies if needed.
37. Track and trend expenditures by types of costs and phases of projects. Using this information, establish cost baselines and targets and compare against proposed costs provided during the planning phase.

Additionally, the Board should:

38. Clarify and define the specific roles and responsibilities that all stakeholders have in the cleanup Fund, including the Board, UST program staff, Fund staff, and regulators, including which entities have the authority and responsibility to make critical decisions—particularly related to the reasonableness and necessity of cleanup activities and costs.
39. Clarify the responsibility regulators have to consider costs when evaluating proposed cleanup activities.

40. Establish authority levels to be used when regulators and Fund staff—through newly established protocols aimed at improving collaboration—are unable to reach agreement on project plans, schedules, and milestones, etc.
41. Direct regulatory agencies overseeing cleanup Fund projects to work with the Fund to establish protocols aimed at facilitating collaborative decisions early in the process, such as working together at the beginning of cleanup work to discuss project management information submitted by claimants, including the reasonableness of proposed work and alternatives, work schedules/timelines, milestones, and overall project expectations.
42. Continue to direct regulators to review and close cleanup cases and exercise its executive authority to close cleanup cases, when appropriate.
43. Direct the UST program and regulators to work together to develop specific performance measures that hold regulators accountable for performing oversight efficiently and effectively.
44. Direct the UST program to improve contracting practices with regulatory agencies, such as linking meeting specific performance goals with funding levels to provide regulators with incentives to meet performance expectations, establishing funding levels based on workload (specific projects/activities) rather than only on staff salaries, appropriately reassessing/negotiating contracts annually, and verifying (independently) that oversight services that Fund resources support were actually provided.

## Chapter III: Efficiency Improvements Needed to Assist Fund in Meeting Mandated Processing Timelines

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Efficient and effective processes are key to government agencies because they not only ensure constituents are receiving the services and goods programs are intended to provide, but they also help ensure limited resources are spent to achieve the maximum benefit. When the Legislation created the Underground Storage Tank Cleanup Fund (Fund), it included requirements to ensure timely and efficient processing of key fund activities, including determining the eligibility of applicants to participate in the Fund and processing payments for reimbursement of eligible costs associated with cleanup activities. Our testing of these processing activities over several recent years revealed that Fund applicants did not always receive notice of eligibility and active claimants frequently did not receive reimbursement payments within statutorily mandated time frames. Further, we noted that other processes warrant improvement, such as limiting the detailed eligibility compliance review to a risk basis, implementing a standardized invoice process, and developing budgets and work schedules for Fund employees. Although we identified areas where the Fund could improve processes, these improvements alone may not be significant enough to ensure the Fund meets statutory time frames.

### **Fund Does Not Meet Mandated Claimant Eligibility Determination Timelines**

According to Health and Safety Code Section 25299.56, “The board shall determine an applicant's eligibility... within 60 days from the date of the receipt of the fund application.” However, during the last several years, the Fund has not met the 60-day statutory requirement when determining whether or not a claimant meets eligibility requirements to participate in the UST Fund. Annual Legislative Reports convey general compliance with mandated timeframes, however, we found that the Fund’s interpretation of the provisions could be at question.

To be deemed eligible to participate in the Fund, claimants must meet specific statutory and regulatory requirements, such as:

- Confirmed as the former or current owner or operator of the UST determined to have leaked a petroleum based or otherwise eligible substance;
- Received a directive from a regulatory agency to cleanup (take corrective action) the site;
- Complied with all UST permitting and corrective action requirements (regulatory cleanup orders);
- Paid all required UST storage maintenance fees to the Board of Equalization; and
- Provided adequate financial responsibility coverage for the UST.

The Fund’s process to determine eligibility occurs at the completion of either one or two key decision steps—cursory review and detailed compliance review:

- Cursory review consists of an in-house assessment to ensure the submitted application is complete and that the claimant appears to meet the eligibility requirements based on the information submitted. The outcome of the cursory review process is a determination that the claimant either does not meet eligibility requirements (rejected) or is

*preliminarily* deemed eligible and placed on the Fund’s Priority List pending the outcome of a detailed compliance review.

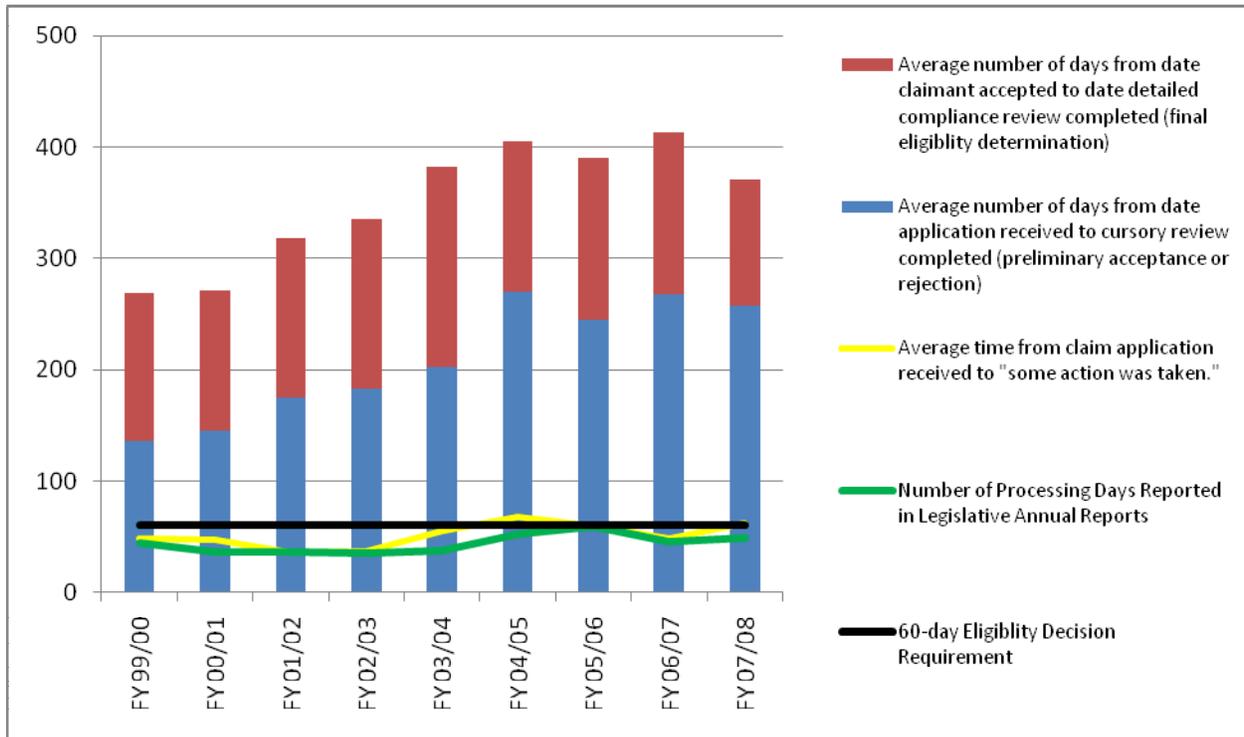
- Detailed compliance review process entails the Fund’s claim analysts traveling to the respective regional boards and to various city and county regulatory agencies where they review applicant files to ensure applicants have complied with all UST permitting requirements and regulatory directives. The outcome of the detailed compliance review process is a final decision whether or not claimants either do not meet eligibility requirements (rejected) or are fully eligible—a decision that must occur before the claimant can be issued a Letter of Commitment and allowed to submit reimbursement requests.

Approximately 80 percent of all applicants are deemed preliminarily eligible and undergo this detailed compliance review. Since the Fund’s inception, approximately 7 percent of claimants have been deemed ineligible as a result of the detailed compliance review process.

To determine the Fund’s compliance with the 60-day statutory requirement, we reviewed processing timelines between 1999 and 2008 and found that the average number of processing days from the date claim applications were received to the date claimants were preliminarily accepted or rejected consistently exceeded the 60-day requirement by a significant margin. The processing times generally increased year to year and ranged from taking 129 days in Fiscal Year 1999-2000 to 258 days in Fiscal Year 2007-2008, as shown in Figure 14.

When including the average number of days until a final eligibility determination decision is rendered after the detailed compliance review is completed for those claimants that were preliminarily accepted, the Fund’s processing timelines extend much farther beyond the 60-day requirement. According to claims staff, the actual detailed compliance review requires only a few days, however, scheduling and coordinating these field reviews accounts for most of the additional time required between completing the cursory review and finalizing the detailed compliance review. We calculated the number of days beyond the preliminary decision date to render a final eligibility decision consumed an additional 133 days in Fiscal Year 1999-2000 and 114 days in Fiscal Year 2007-2008.

**Figure 14. Claimant Eligibility Determination Timelines**



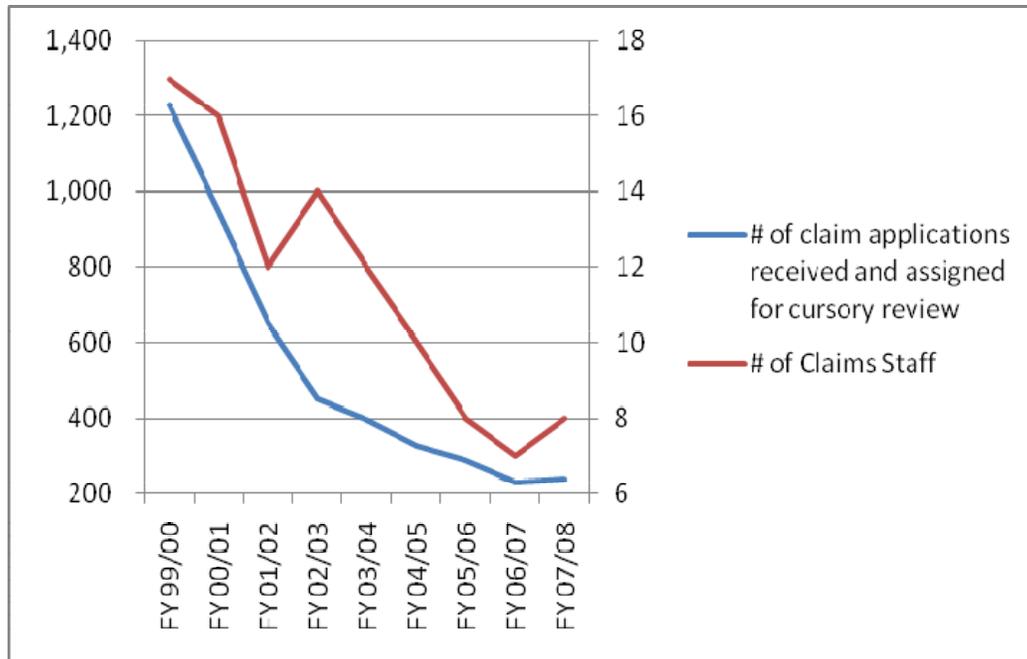
Annually, Fund-related performance data is included in an Annual Report to the California Legislature. Our review of these shows substantially different statistics. Specifically, the self-reported number of processing days reflected in the seven annual reports beginning Fiscal Year 2001-2002 indicates consistent compliance with the 60-day mandated processing timelines to determine an applicant's eligibility. These reported timelines are significantly different than the results of our review. It appears that the Fund measures compliance with the 60-day requirement beginning with the date an application is received to the date the Fund takes "some action." Most often, "taking some action" involves notifying applicants of missing application materials, but may also include determining whether or not a claimant is rejected or preliminarily accepted. While the Fund could reject the incomplete application and consider that action complete, a new "clock" could start once all the required materials are provided. However, even though applicants often submit incomplete application materials and Fund staff must request the additional information and the clock continues, the end-to-end processes clearly fall outside the parameters.

Furthermore, statute says that once a claimant is deemed as having met eligibility requirements, the Fund cannot reverse its decision and remove the claimant from Fund participation. Since preliminarily accepted claimants on the Fund's Priority List can be, and have been, rejected as a result of the outcome of the detailed compliance review process, it is clear that the final eligibility determination is not rendered until after the detailed compliance review is complete. Thus, to comply with statute, the Fund is required to render a final decision of eligibility within 60 days of receipt of the application. Viewing the processing timelines from preliminary

approval to final eligibility determination—all processes within the Fund’s control, the mandated timelines are not met and average more than three times the allowable period.

According to Fund management, processing timelines have been impacted by a significant decrease in the number of claim analysts over the years. However, it must be pointed out that the Fund also experienced a corresponding significant decrease in the number of applications received, as shown in Figure 15.

**Figure 15. Changes Number of Applications Received and Number of Claims Staff**



According to Fund management, even though there were fewer applications submitted, several additional factors affect the claim analysts workload and the Fund’s ability to meet the prescribed processing time frames, including:

- Legislative changes<sup>27</sup> affecting claimant eligibility, including allowing some previously ineligible claimants to be eligible and allowing claims to transfer between responsible parties, increased workload as claims had to be re-evaluated.
- Stringent claim eligibility requirements impact how long the review process takes, including verifying claimants have been in continuous compliance with permitting requirements as well as local oversight agency directives and all Board of Equalization fees have been paid and are current.
- Decreased staffing availability as staff have been redirected from reviewing claim applications to reviewing claim eligibility appeals as well as reassigned to special assignments such as developing new forms and updating policies and procedures. Additionally, the mandatory statewide furloughs have decreased the number of working days by three days each month.

<sup>27</sup> AB2481, AB1437, SB1161 and the Board’s Lake Order.

- Incomplete application information and/or documentation submitted by applicants. The Funds internal policy allows claimants 30 days to provide additional information, which may be extended by an additional 20 days upon request, for a total of 50 days to provide information and/or documentation. Although the Funds policy allots an additional 50 days, legislation is silent on the issue and does not account for additional time necessary to process an application because the application is incomplete.

Given the Fund’s inability to control circumstances outside the Fund’s authority, such as claimants submitting incomplete applications, and recent statewide furloughs reducing staff availability, it may not be reasonable to hold the Fund to the 60-day timeline. Nonetheless, if claim applications are submitted incomplete the Fund should either initially deny the application until all required documentation is submitted or if the Fund decides to continue its current process, the Fund should document dates information was requested and received so that it may demonstrate the causes for the delayed acceptance or denial.

### **Certain Processing and Administrative Activities are Inefficient and could be Streamlined**

Given the Fund’s challenges to meet statutory timeframes, we identified key processing activities where the Fund could streamline processes, which could not only improve the Fund’s ability to meet its legislatively mandated processing timelines, but could also reduce the burden on employees and improve cost containment practices.

Since the Fund’s inception, the claimant eligibility determination review process has become increasingly complex due to changing legislative requirements. Fund staff continuously review these processes to incorporate efficiencies, and as a result, the processes appear fairly streamlined given the complex nature of the information submitted by very a diverse group of potential claimants—ranging from major oil corporations to individual homeowners. However, our review identified one specific area where the Fund could streamline its processes to determine final claimant eligibility. Specifically, the Fund could reduce the number of detailed field compliance reviews by conducting preliminary risk assessments using easily available data and concentrate detailed field reviews on those few applicants indicating a problem.

The current detailed compliance review process accounts for a significant portion of the processing timeline to provide claimants with final determinations regarding their eligibility to participate in the Fund. As shown in Figure 14, the time from preliminary acceptance to rendering a final eligibility decision when incorporating a detailed compliance review required an average of 114 days in Fiscal Year 2007-2008. This is beyond the average 258 days consumed to render the preliminary eligibility decision. The bulk of the lengthy detailed compliance review timeline is spent by claim analysts scheduling, coordinating, and traveling for field site visits to respective regulatory agencies. Specifically, claim analysts travel to regulatory agencies to confirm applicant compliance with regulatory directives and UST permitting requirements and seek “sign-off” by the regulatory agencies acknowledging claimants have been in compliance with directives and requirements. This confirmation process entails the physical file review, at the local agency, of certain permits—the same permits that claimants are required to submit copies of in their application. Fund staff we spoke with also noted that during the field visits, claim analysts review documents in the claimants’ files to catch any pertinent information that may not have been disclosed on the application. Time is spent gathering detailed

information from the files, such as cleanup directives, even though this type of information is required to be uploaded into Geotracker—a system to which Fund staff have access. Although the information gathered is intended to also assist in the review of the claimant’s future reimbursement requests if they are eventually deemed eligible to participate in the Fund, our review of the reimbursement request process and interviews with staff revealed that the information gathered is not used by anyone.

Current protocols require these detailed compliance reviews on all preliminarily approved claimants before a final decision can be rendered—approximately 80 percent of all applicants are preliminarily accepted requiring detailed field reviews. Since inception of the Fund, approximately 12,500 applicants have been preliminarily accepted; most have undergone the detailed compliance review process, but many detailed reviews are still outstanding related to claimants that are currently on the Fund’s Priority List. Of the approximate 12,500 detailed compliance reviews conducted since the Fund’s inception through June 30, 2009, only about 7 percent have been denied after the detailed review process. According to management, the number of claimants denied eligibility during the detailed compliance review has probably even declined in recent years as a result of efforts to streamline the application process and collect more information at the time of application submission.

Management and staff acknowledged that performing a detailed eligibility review on every application was probably unnecessary not only due to the low percentage of claimants denied as a result of the process, but also since the vast majority of the critical information is either provided in the application or available electronically. In addition, claim analysts and Engineers in the Technical Unit that we spoke with believe they can easily identify high-risk applications with complex situations, such as commingled plumes that involve multiple claimants that would necessitate and justify a detailed eligibility review. As such, having claim analysts travel to perform detailed compliance reviews on every preliminarily accepted applicant is no longer necessary and likely an inefficient use of Fund resources.

Overall, not only do detailed field reviews hamper the Fund’s ability to render final eligibility decisions within the 60-day statutory requirement, these processes consume the Fund’s limited resources by covering all of the costs associated with travel and creating unnecessary workflow burdens. Management should consider incorporating a risk-based methodology whereby applicants that meet certain high-risk criteria are reviewed in-depth.

### **Fund Does Not Meet Required Reimbursement Processing Timelines and Could Improve its Processes**

According to Health and Safety Code Section 25299.57 (i), the Fund has 60 days from the date an invoice of expenditures is received to pay all of the eligible cleanup project costs. However, the Fund has continuously struggled to meet this 60-day payment processing time requirement. Moreover, reimbursement request processing could benefit by standardizing submission and invoicing requirements and activities.

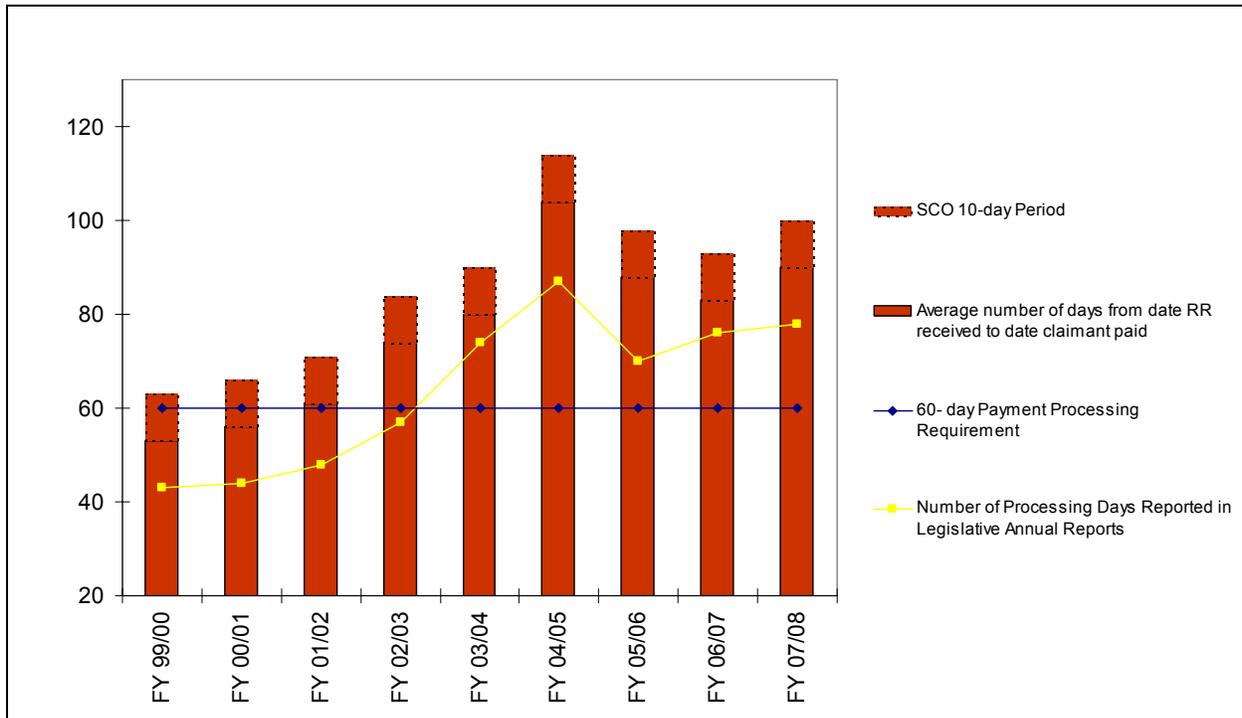
When a reimbursement request packet is received by the Fund, an initial “triage” is conducted where analysts verify claimants are in compliance with regulatory agencies directives so that Fund efforts are focused on processing claims that are in compliance and thus, eligible to be

reimbursed by the Fund. For those reimbursement request packets that are ready to be reviewed, payment analysts select packets from the Payment Unit's "holding" tables and begins the review and approval process, which involves:

- Examining information contained in SCUFHIS and the claimant's main file to ensure all required documents are present, technical reports have been uploaded into Geotracker, signature forms in the main file agrees to the signature appearing on the current reimbursement request, etc.
- Reviewing associated invoices and billing documentation to ensure amounts requested link to amounts reflected on supporting documentation, date parameters are in chronological order, and reimbursement packets do not contain duplicate invoices.
- Verifying claimants provided proof (i.e. cancelled checks) that previous reimbursement monies received were used to pay contractors as claimants are required to pay vendors within 30 days of receiving reimbursement monies from the Fund.
- Performing technical review (performed by either payment analysts or Technical Unit Engineers and Geologists based on specific criterion) to ensure requested reimbursement amounts and associated activities were reasonable and necessary.
- Approving the payment of eligible costs; documentation is forwarded to the DFA's Administrative Unit and the DAS' Accounting Office for additional processes before being submitted to the State Controller's Office for official payment.

To determine the Fund's compliance with the 60-day payment processing statutory requirement, we reviewed payment processing timelines for all reimbursements paid between 1999 and 2008 and found that the average number of processing days from the date a reimbursement request is received to the date claimants were paid consistently exceeded the 60-day requirement. The processing times generally increased year to year and ranged from taking 63 days in Fiscal Year 1999-2000 to 100 days in Fiscal Year 2007-2008, as shown in Figure 16.

**Figure 16. Reimbursement Request Processing Timelines**



Additionally, as shown in Figure 16, self-reported data reflected in Legislative Annual Reports over the last several years indicates that payment processing timelines have not met the 60-day requirement. Furthermore, the processing days statistics reported in the Legislative Annual Reports do not accurately represent the average number of days to pay claimants from. It appears that the Fund measures its compliance with the 60-day requirement from the date reimbursement requests are received to the date the Fund’s Payment Unit completes its review, approves the payment, and submits to the SWRCB’s Division of Administrative Services’ (DAS) Accounting Office; this timeframe does not include the processing time required by DAS’ Accounting Office or the State Controller’s Office to finalize the administration of the payments. Additional days required by each of these entities to process payments after the Fund’s Payment Unit is finished ranges from a single day to 2 weeks.

The Fund believes its approach is supported in law and noted that Health and Safety Code Section 25299.57(i) requires that the board “pay” costs within 60 days of receipt and further that Health and Safety Code Section 25299.62 requires that all reimbursement requests that are approved be forwarded to the Controller within 10 days of date of approval, thus, differentiating the actual payment approval as one step and that the Accounting and Controller functions as additional process outside the 60-day requirement. However, even allowing the 10-day process for the State Controller to cut the check for payment, the Fund exceeds the mandated period. Specifically, our interpretation of the law is the 60-day timeframe encompasses the period from when the reimbursement request is received by the Fund and the date the SWRCB submits the claim for payment. Even if statute indicated that the date from receipt of reimbursement requests to the completion of the Payment Unit’s processes alone was the appropriate measure to be used when determining compliance with the 60-day timeline requirement, the Payment Unit’s

reported average number of days required to complete just their analytical review and approval processes alone has not even occurred within 60-days for the last several years, as shown in Figure 16.

Because some payment processing activities are outside the control of the Fund, the current 60-day limit may be difficult for the Fund to achieve. In fact, according to the May 2008 Vermont DEC Annual Fund Survey, the national average to process reimbursement payments took approximately 3.5 months, which is in line with the approximate 100 days it took the Fund to pay claimants in Fiscal Year 2008-2009.

To understand some of the underlying causes for the missed timelines, we performed detailed testing of 68 reimbursement requests and found that 65 of the 68 reimbursement requests were not paid within the 60-day deadline. Additionally, as illustrated in Table 16, for the 58 reimbursement requests tested that were submitted between Fiscal Years 2005 and 2008, we found it took an average of 112 days to process payments from the date the Fund received reimbursement requests to the date claimants were paid. Our testing of the 10 reimbursement requests submitted during Fiscal Year 2008-2009 revealed that the average number of days to process payments was 137.

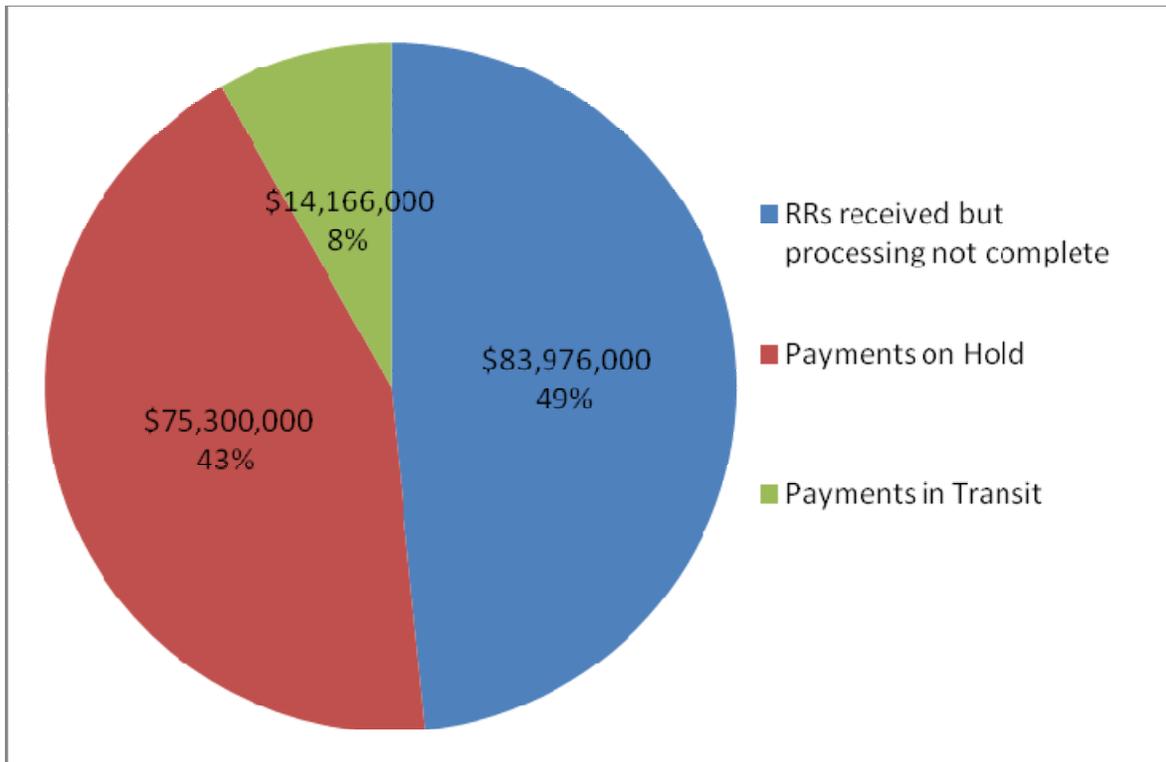
**Table 16. Test Results Breakdown of Reimbursement Request Processing Timelines**

	Average days in Payment Unit	Average days in Technical Unit	Average days in Administrative Unit	Average days in Accounting Office	Average Days at SCO	Average total days to from Date of Receipt to Date of Payment
58 reimbursement requests Submitted between FY 2004-2005 to FY 2007-2008	42	40	4	19	7	112
10 reimbursement requests Submitted during FY 2008-2009	89	6	11	21	10	137

While we noted some instances where the file that included notations that information provided was insufficient or lacking, for the most part, we were unable to determine the specific causes for the payment processing delays due to the fact that dates are often not associated with documentation that exists or explanations regarding delays were not present.

Moreover, associated with processing delays, as of August 2009, the Fund had a considerable number of reimbursement requests that were in various stages of completion, including approximately 1,662 reimbursement requests worth about \$84 million, that were received, but processing either had not started or was not complete and also a significant backlog of payments related to 1,508 reimbursement requests worth about \$75 million on hold due to the current financial crisis and waiting funding, as shown in Figure 17.

**Figure 17. Payment Backlog as of August 2009**



Clearly, in order to meet mandated timelines, the Fund must address issues that impact its ability to process payments timely. However, the largest roadblock to meeting the 60-day timeline currently is the lack of funds in which to pay claimants. Fund management's current projections indicate that some claimants may wait for payment anywhere from 6 to 30 months as the Fund tries to resolve the payment backlog crisis. As a result, AB 1188 was signed into law on November 9, 2009, to provide additional temporary funding as well as provide the Fund some flexibility by only requiring the Fund to meet the 60-day timeline requirement if funding is available.

Fund management widely acknowledges the increased processing times and reimbursement request backlog and attributes it to the following factors:

- Increases in the numbers of reimbursement requests submitted by claimants have increased workload. Our review found that in Fiscal Year 1999-2000, nearly 4,700 reimbursement requests were submitted for processing whereas in Fiscal Year 2008-2009, nearly 5,700 reimbursement requests were submitted.
- Some reductions in staff available to process reimbursement payments, while staffing has remained relatively flat over the years due to transferring three experienced payment analysts to the Fund's Claims Unit, there are fewer staff available to process reimbursement payments. In addition, staff availability has been impacted by mandatory statewide furloughs that have decreased the number of working days by three days each month.

- Payment staff redirected to other projects, such as assisting with preparing monthly fund status update reports and reports for the Underground Storage Tank Task Force; streamlining existing payment processes, such as creating new forms, procedure manuals; and developing new payment processes, such as a more detailed review of proof of payments.
- Transfer of most of the technical review aspect of payment processing to payment analysts from the Fund’s Technical Unit, which may have increased processing times in the short-term due to the learning curve involved.
- Portions of reimbursement request processing are out of the Fund’s control, such as the SWRCB’s Division of Financial Assistance (DFA) Administrative Unit and DAS’ Accounting Office. According to the Accounting Office, seven positions are designated to process payments for both the Fund and the SWRCB’s other programs, but only four positions are currently filled. Furthermore, payment processing is based on priority and other programs that require contract-related payments with late payment penalties receive first priority for processing. As a result, while the Accounting Office attempts to process all payments within two business weeks, some payments may take longer to process due to staffing limitations and workload.
- Incomplete reimbursement information and/or documentation submitted by claimants. According to payment review analysts, although the Fund communicates the required information for submitting a reimbursement request on the Fund’s website and in correspondence with claimants, reimbursement requests are often submitted lacking the necessary documentation.
- Little direct communication, such as phone calls, between claimants and Fund staff when reimbursement information and/or documentation is submitted incomplete to resolve matters quickly; rather, Fund staff typically sends notification by postal mail.

Clearly the Fund has near-term as well as long-term challenges it needs to address to comply with state law. Our review did reveal some areas that would improve reimbursement payment processing and assist the Fund in meeting statutory criteria.

### **Some Reimbursement Related Processes are Inefficient and Could be Improved**

Given the Fund’s challenges to meet statutory timeframes, we identified certain processing activities that could be streamlined, including standardizing reimbursement request documentation and invoices submission protocols, eliminating inefficient “wet” signature requirements, and developing budgets and work schedules for Fund employees.

#### *Reimbursement Request Submission Process Requires Standardization to Improve Efficiency*

Although claimants are required to submit a Fund-developed reimbursement request form, reimbursement request submission intervals as well as the level of documentation detail required to be submitted is not standard, which significantly increases processing complexity and, in turn, increases processing timelines.

Currently, apart from the Fund’s policy that claimants may submit only one invoice every 30 days and invoices must be at least \$10,000—with the exception of the final invoice—there are no

requirements that claimants submit invoices to the Fund at specific project intervals or phases. Instead, invoices are submitted to the Fund at any point during a project that a claimant decides to request reimbursement. In fact, a single invoice can cover all phases of an entire project, multiple unrelated phases of a project, or just a single expense, such as purchasing a piece of equipment. Additionally, the reimbursement request form, and often the submitted invoices, do not provide sufficient detail for Fund staff to link expenses to specific tasks or phases of a project, determine total costs incurred to date for project tasks or phases, or identify the completion status of the project. As a result, reimbursement requests submitted for approval range from just a couple of invoices to large stacks of invoices and volumes of supporting documentation with varying complexity and inconsistent detail. The inconsistent nature of the reimbursement request submission process makes it difficult for the Fund's analysts to track and evaluate submitted costs in the context of the status of the entire project for reasonability as well as hampers the Fund's ability to meet the mandated 60-day payment processing timeframe.

Fund staff and management are fully supportive of opportunities to improve the reimbursement request submission process and agree that requiring claimants to submit invoices tied to specific project phases or tasks would help Fund analysts process reimbursement requests more efficiently and effectively. To this end, as discussed earlier in Chapter 2, Fund management is currently implementing a new multi-year management plan (MYMP) process that will involve developing and approving project work plans/scope and costs early in the project life cycle. Additionally, the MYMP will also require claimants to submit reimbursement requests at time-intervals based on deliverables or completion of a specific task or phase with costs tied to the following eight categories:

- Project Management
- Site Assessment
- Groundwater Monitoring
- Interim Remedial Action
- Remedy Selection
- Remedial Implementation
- Remedial System O&M
- Closure

Other states, such as Florida and Texas have faced similar funding challenges and successfully implemented budget preapproval processes to help contain cleanup costs and manage fund resources. If implemented, these changes will enable the Fund to track and manage costs and forecast future costs, resulting in better management of fund resources as well as allow analysts to process reimbursement requests more efficiently and timely as the costs submitted for reimbursement should align with the preapproved plans and budgets. Additionally, the changes will allow key cost information beneficial to management to be tracked, such as the average costs of project phases or tasks.

*Processes Related to Issuing and Amending Letters of Commitment Create Inefficiencies but Provide Little Control*

Until recently, the Letter of Commitment (letter of commitment) processes has been the mechanism used by the Fund to encumber (set aside) funds for the projects of eligible claimants. However, certain administrative processes associated with letters of commitment were intended

to provide a control benefit but, in practice, merely decreased efficiencies and provided little, to no value.

Specifically, when letters of commitment were issued or amended, the Fund’s internal policy required five copies of each letter of commitment document, each with a “wet” (original) signature from a Fund Manager indicating the documents were reviewed and approved for accuracy and appropriateness. However, management and staff indicated that the process of individually signing each copy was very time consuming and delayed management from addressing the Fund’s higher priority needs. While this control was put in place to reduce the risk of a fraudulent letter of commitment being issued, due to the significant amount of time required to perform this process, management did not review the letters of commitment for reasonableness and appropriateness, but simply signed each document as presented; as a result, the wet signature process did not serve its intended purpose. Ultimately, the signing activity was transferred to DFA’s Administrative Unit (provides support to Fund staff) and required the full attention of one staff in the Administrative Unit for two hours each day.

As of October 2009, the Fund stopped amending and issuing letters of commitment for a dollar amount, rather claimants are now only initially notified that their claim has been accepted to the Fund and are sent a payment notice with each reimbursement. According to Fund management, because letters of commitment are no longer amended, the amount of time needed to perform the “wet” signature process should be greatly reduced as well as unnecessary accounting transactions eliminated.

#### *Appeal Processes Require Significant Staff Resources*

While appeals due process are an important aspect of the Fund, these processes consume significant staff resources, it appears that little can be done to improve the process itself. Rather, the implementation of other key processes, such as the Fund reviewing cost estimates early, may reduce the number of decisions appealed and will likely free staff resources that can be used elsewhere.

Regulations provide claimants with the ability to appeal most decisions made by the Fund—most often involving claim eligibility and reimbursement request cost eligibility decisions. The appeals process has three levels:

- Fund Manager Decision (first level)
- Final Division Decision (second level)
- SWRCB Decision (highest level)

If a claimant is unhappy with the SWRCB’s decision, the last step is to file a lawsuit.

According to the Fund, processing appeals is very time consuming on staff resources as the staff that rendered the initial decision must re-review the decision and prepare a response to the appeal. The response is reviewed and approved by management and an appeal decision letter is prepared—depending on the appeal level. While data isn’t readily available to indicate the amount of time Fund employees spend processing appeals, according to management, handling

appeals is a significant portion of staff time and encompasses nearly all of some of supervisory staff time, it takes time away from conducting daily activities.

Additionally, according to management, the most difficult appeals to handle relate to reimbursement request cost eligibility decisions due to the subjectivity involved in rendering those decisions. Alternatively, appeals related to eligibility to participate in the Fund, while still time-consuming, are generally more straight-forward because those decisions are based on specific statutory guidelines. Further, appeals related to denied reimbursements have a very high rate of reversal due to claimants' ability to appeal to multiple levels within the SWRCB organization that tends to be sympathetic in favor of claimants, particularly in light of the subjective nature of determining if costs are "reasonable or necessary" and the fact that claimants are directed by the regulatory agency to perform the activities. As stated earlier in the report, early involvement by the Fund in the project planning and budgeting process would afford the needed fiscal controls and likely reduce the numbers of appeals related to cost determinations.

### **Fund Lacks Processes to Monitor Staff Workload and Measure Performance Efficiency**

Finally, an essential aspect of the performance of the Fund relates to its staff. Our review of the Fund's current processes, available performance statistics, and quantitative data, found that the Fund collects only limited and anecdotal data that could be used to measure efficiency and effectiveness of the work performed by Fund staff. Tracking and analyzing performance statistics and quantitative data is essential for management to make program decisions to ensure resources are used efficiently and the program is operating effectively.

Currently, Fund management does not track or manage the workload of Fund staff or analyze information necessary to assess whether its employees are performing efficiently. Specifically, while the Fund utilizes data from the SCUFIS system (an automated claim management system) to compile some high-level output metrics (number of reimbursement requests received, number of claims reviewed, processing times, etc.), management does not formally track, monitor, or manage individual employee workload. For example, staff in the Payments Unit assign their own workload by simply picking-up work, such as reimbursement requests to process, at their own pace without management or supervisory input. Also, management does not track how many reimbursement requests employees are working on at a given time or determine how long employees take processing reimbursement requests. While management gathers some output metrics, it does not appear this information is used by management to analyze employee performance. Coupled with the fact that staff in all units, with the exception of management employees, is allowed to work from home twice a week, it is important for management to understand the composition of employee workload and measure the efficiency of processing activities.

Setting performance goals not only make staff more accountable, but also afford them opportunity to assess themselves and take ownership of their position. Moreover, in the telecommuting environment adopted by the Fund for the majority of its non-management employees, setting budgets and timelines for task completion allows managers to oversee and track staff not in the office and assist the staff in setting parameters for work completion and performance expectations.

## **Recommendations:**<sup>28</sup>

To improve the Fund's ability to meet mandated timelines and increase the efficiency and effectiveness of certain processing functions, Fund management should:

45. Reevaluate methodologies used to measure compliance with mandated processing timelines. Clearly report what measurement is used when reporting level of compliance in the Legislative Annual Reports and retain documentation/system reports that supports reported figures and statistics.
46. Utilize a risk-based approach to conducting detailed compliance reviews and identify what additional information that claimants could submit at the beginning of the application process to reduce Fund staff processing burden.
47. Consider rejecting applications that do not provide all required information and/or develop a tracking process to "stop the clock" when necessary information isn't received by the claimant. Date and keep all correspondence with claimants that supports rejecting applications and/or stopping the clock related to processing timelines.
48. Standardize invoicing requirements to ensure reimbursement request documentation and support is provided in a way that is consistent amongst claimants and easy to review by analysts. In conjunction with Chapter 2 recommendations, create reimbursement request submission schedules where claimants submit specific project work/activities by a certain date and by a specific project phase.
49. When feasible, contact claimants by telephone to obtain needed information or clarification rather than utilizing time consuming formal letters.
50. Eliminate unnecessary "wet" signature processes, such as those associated with the letters of commitment that do not provide controls, but increase inefficiencies.
51. Assign, track, monitor, and manage employee workload as well as set performance goals and regularly measure employee performance against goals.

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<sup>28</sup> Some recommendations may require legislative action and changes in budget authority to implement.

## Chapter IV: Fund Struggles Balancing Reimbursing Claimants Quickly and Maintaining a Strong Control Environment

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Government agencies are continuously discovering the need for increased internal controls to secure public funds against fraud, waste, and abuse as well as to ensure management's goals, objectives, and expectations are being carried out as intended. Meanwhile, there is a constant struggle to find a balance between operating efficiently and effectively while maintaining a strong internal control environment—one designed with sufficient procedures and activities intended to reduce or mitigate risks that are most likely to occur and would have a potentially significant impact on the agency's ability to carry out its mission.

In May 2009, the Fund began reviewing its internal controls and prepared an analysis of "Fraud, Waste and Abuse Prevention in the Underground Storage Tank Cleanup Fund" to assess the "likelihood of fraud in the Fund and make recommendations for change." While this was a step in the right direction and illustrates the Fund's efforts to identify areas of potential weakness and take corrective action, the review was fairly limited in scope and the controls identified will not sufficiently safeguard the Fund's assets. Moreover, as discussed in detail below, our review and testing of the Fund's processes found multiple areas where controls in place were either insufficient or could be improved to strengthen the Fund's control environment.

### **Lack of Second Review of Reimbursement Decisions Increases Risk of Inappropriate Payments and Internal Controls are Insufficient**

Currently, there is no quality control or independent analytical review process in place to ensure that reimbursement requests approved by staff are correct and appropriate. Without a supervisory review or other quality control processes, the Fund cannot be assured that associated payments generated go only to eligible projects and appropriate costs. Analysts in the Payment or Technical Units that process reimbursement requests can singly approve all reimbursement requests submitted and therefore, allow, intentionally or unintentionally, ineligible or inappropriate costs without any control in the system identifying or stopping an associated payment from being processed. Specifically, payment analysts are non-technical workers who review reimbursement requests looking for support of the charges to be paid and assessing the mathematical accuracy. Although some criteria exist that would trigger the reimbursement request to be forwarded to technical staff, the payment analysts are the only point of review and approval. Supervisors and managers of the unit conduct other activities and do not review or spot check the work done by staff.

Additionally, payment analysts are not assigned to specific claims to act as a "case worker" to handle all reimbursement requests on a particular project. Rather, payment analysts arbitrarily choose reimbursement requests that are ready to be reviewed from a holding area. Management states files are chosen by date order received but because of the vast number of files it can sometimes prove difficult to ensure files are always selected to be reviewed in this manner. Also, as described in Chapter 3, management does not assign, monitor, or manage staff workload, which increases the chance that reimbursement requests are not always selected for review in date order received.

Further, analysts do not routinely review the past documentation related to any previous reimbursement request submitted on their selected claim. The lack of case continuity potentially increases the amount of time analysts spend reviewing file information to become familiar with the particulars of a claimant file, but also makes it difficult for analysts to catch irregularities, such as consultants submitting duplicate invoices or charges previously denied by a different payment analyst.

The fact that reimbursement requests of a claimant are not always reviewed by the same analyst coupled with the lack of an independent review process, the lack of staff workload assignment/management, and the lack of standardization within the invoice submission requirements, the Fund is operating in an environment where inappropriate or ineligible costs approved on past reimbursement requests may not be detected. What is more, the lack of controls provides opportunity for claimants to take advantage of the system by double billing or repeatedly submitting previously denied costs hoping that a different analyst will eventually approve the costs.

According to management, there are several “independent” reviews that mitigate the lack of specific supervisory reviews or quality control processes. Specifically, one such review is performed by the DFA’s Administrative Unit prior to payments being made. However, this process does not involve an analytical review of the payment approval documentation, but is strictly administrative in nature as it simply checks for spelling and mathematical accuracy and verifies that certain claimant certifications on file are current. Another review point cited by Fund management is performed before a claim is closed by the Fund’s Closure Unit. The “closure review” is intended to act as an internal control to detect overpayments and inappropriate expenses that were paid during a claim’s life. The closure review process occurs when claimants submit a reimbursement request identified as the final request on a claim (i.e. cleanup is finished or the maximum \$1.5 million reimbursement limit has been reached) or when claimants are inactive for a six month period (i.e. fails to submit a reimbursement claim or an update notice). The closure review process verifies:

- Total payment amounts have not exceeded the \$1.5 million reimbursement limit;
- Claimants have provided proof that they have paid all contractors (i.e. proof of payment); and,
- Invoices submitted do not reflect overlapping invoice dates.

While staff indicated that the closure review process has identified a few overpayments in the past, we found that the process does not provide sufficient controls as it too is administrative in nature and limited in scope. Moreover, given that the average age of claims closed during Fiscal Year 2008-2009 was about 8 years and 43 percent of the Fund’s currently active claims are ten years or older, this process often occurs very late and leaves the Fund little ability to recover monies apart from withholding the final payment.

According to Fund management, another control in place relates to ensuring that claimants provide proof that all activities reimbursed by the Fund have been paid via the Proof of Payment (POP) process. In the past, claimants were required to submit copies of cancelled checks before they could receive payment on future reimbursement requests. The intent of this check ensures

the consultant—often the party responsible for preparing reimbursement requests, invoices, and supporting documentation—is reimbursed by the claimant. However, this process does not prevent the consultant from engaging in wasteful behavior, such as performing excessive and/or unreasonable tasks, charging excessive rates, or submitting false documentation. In December 2009, the Fund began allowing claimants to provide a POP affidavit signed by both the claimant and consultant that performed the work indicating the claimant paid the consultant. According to the Fund’s internal review of controls, the POP requirement “is a major element of the fraud, waste and abuse prevention program.” While it is a valuable step, this process does not prevent the consultant from engaging in wasteful behavior, such as performing excessive and/or unreasonable tasks, charging excessive rates or submitting ineligible expenses for payments.

Finally, in certain circumstances, the SWRCB’s Office of Enforcement may become involved in a case. The Office of Enforcement was created to support activities related to both UST leak prevention and cleanup by investigating fraud and violations of the UST laws and regulations related to issues such as improper UST construction, failure to upgrade USTs, tampering with leak detection devices. According to the Office of Enforcement, they typically receive about five complaints a year, mostly from Fund staff or from outside stakeholders. Since the Fund’s inception, only a few cases involved fraud (over billing and fraudulent invoices) and required being turned over to authorities.

Appropriate internal controls requires developing strong and deliberative processes to provide a set of checks and balances that will not only deter or detect single individuals from subverting the process, but also ensure quality of service, uniform treatment of clients, and staff development opportunities. A reasonable control environment will prevent inappropriate activities from occurring as well as prevent opportunities for someone to take advantage of weaknesses in the system. Adding a quality control component to the reimbursement request review and approval process, particularly in the form of supervisory review and work load control, will not only strengthen controls to protect Fund assets, but allow management to identify if reviews are conducted consistently and where additional training may be needed. Because the Fund expends hundreds of millions of dollars each year in reimbursement payments, it is imperative that the Fund has a process in place to identify and mitigate the risk of inappropriate, unreasonable cost being paid.

### **Recent Changes to Certain Processing Activities Increase the Risk of Inappropriate Payments**

In the past, the environmental engineers and geologists within the Fund’s Technical Unit, with the assistance of two seasoned payment analysts from the Payment Unit, perform a technical review of all reimbursement requests to evaluate whether or not the activities conducted and costs submitted were reasonable and necessary and approved all associated payments. Under these processes, the role of most payment analysts—either staff service analysts (SSA) or associate government program analysts (AGPA)—in reimbursement request processing was strictly administrative ensuring proof of payments were submitted related to previous reimbursement requests, certifications on file were current, and costs were supported by underlying invoices and documentation.

In 2008, in an effort to increase the efficiency of reimbursement request processing, the majority of the reimbursement request review and approval process was transferred to the payment analysts, including technical review responsibilities. According to management, the transfer of responsibility has allowed the Technical Unit to focus additional effort on conducting additional 5-year reviews and “triaging” reimbursement requests when they are initially submitted to ensure claimants are in compliance with regulatory directives. When the Fund transferred the responsibility for the reimbursement reviews to the payment analysts, management provided several training workshops; however, despite the training, due to the complexity of reimbursement requests and lack of technical experience, many payment analysts we interviewed indicated that they did not feel comfortable performing the technical evaluation.

As mentioned earlier, certain criteria were established that could trigger a reimbursement request being forwarded to the Technical Unit. Under the new process, payment analysts continue to forward the most complex reimbursement requests to the Technical Unit for specific reasons, including:

- First or final reimbursement request;
- Regulatory “Out of Compliance” issue;
- Requested reimbursement exceeds \$150,000 or cumulative requested reimbursement over a 12 month period exceeds \$150,000;
- Any requested reimbursement for costs associated with soil excavation, transportation, disposal, or treatment;
- Third party compensation costs, such as reimbursements from a legal settlement;
- Reimbursement request involves a commingled plume;
- Any requested reimbursement for costs associated with remediation of any non-petroleum contaminants; and,
- Reference to or documentation of Pre-Approved costs.

Nonetheless, the two seasoned payment analysts that assisted the Technical Unit with technical reviews prior to the transition are now responsible for “pre-screening” those reimbursement requests that the other payment analysts’ believe meet these criteria to determine if the issue can be resolved without involving the Technical Unit.

According to management in the Technical Unit, approximately 20 percent of reimbursement requests are sent to the Technical Unit for technical review and approval and the remainder are reviewed and approved solely by payment analysts. During interviews with staff, a common concern noted was the payment analysts lack of training and education (unlike Technical Unit staff, payment analysts do not have technical degrees and/or licenses); experience (unlike Technical Unit staff, payment analysts have not worked in the field); expertise (unlike technical staff, payment analysts are not engineers or geologists); and historical knowledge of a claimant to thoroughly analyze reimbursement requests. While the duty statements for these positions require AGPAs and SSAs working as payment analysts to assess the reasonableness and

necessity of costs, the State classifications for AGPAs and SSAs do not require specific technical expertise—only the ability to perform analytical work.

Additionally, staff we spoke with within both the Payment and Technical Units indicated management has been informed of concerns regarding payment analysts ability to perform an analytical review of reimbursement requests for reasonableness and appropriateness due to their lack of technical training and experience, particularly given the subjective nature of approving these costs. Yet, management continues to allow payment analysts review reimbursement requests without any independent review or quality control.

Our high-level review of reimbursement requests processed between Fiscal Year 2004-2005 and Fiscal Year 2008-2009 revealed that under the old review process, denial of costs were often based on technical reasons under the old review process, but currently most often based on administrative reasons, such as incomplete documentary support, since the transition. Thus, few reimbursement requests are rejected for technical reasons. For instance, for one reimbursement request, paid in October 2004, the Technical Unit denied \$13,650 in rental costs because the technical reviewer stated rental costs exceeded the purchase price. On another reimbursement request, paid in February 2005, the Technical Unit denied \$22,863 in expenses related to the operation of an ineligible treatment system and the fact that no effective remediation was performed. In more recent years, Fiscal Years 2007-2008 and 2008-2009, it appears the top reasons costs were either deemed ineligible or “pending” (meaning the cost was put on hold until further clarification) were lack of invoices supporting costs, \$3,000 RTAC limit was reached, claimant failed to provide POP from the previous reimbursement request, or the \$1.5 million reimbursement limit per claim was reached. As such, it appears that in the past, reimbursement requests were more thoroughly reviewed and technical and analytical analyses were performed to ensure costs were reasonable and appropriate.

Although the incentive for the current approach is to establish a process for more timely reimbursement requests processing, the risks may outweigh the benefits. In effect, where in the past all costs underwent a technical review to ensure reasonability and necessity, currently only 20 percent undergo a technical review and the vast majority are subject to only an administrative review. In an environment where there is a lack of standard reimbursement request submission and invoicing requirements, reimbursement requests processed without an analytical review or supervisory oversight increases the risk that inappropriate and unreasonable costs are paid.

### **Fund Controls over Data Could be Improved to Better Safeguard and Ensure Integrity of Claim Information**

As part of our review of internal controls, we performed a high level review of system access to the Fund’s claim management system, SCUFIS. DFA’s Administrative Unit is the single point of contact between various Fund units and the SCUFIS system consultant to coordinate the development of reports and system updates—requests for improvements and/or updates are initiated by Fund managers. According to management, SCUFIS is an antiquated system that was initially designed to manage active claims and later was updated to enable the tracking and managing of reimbursement requests. The system does not have the capability to run the types of reports necessary to ensure the integrity of data in the system and provide management assurance that access is restricted to only those functions necessary to perform daily duties. For

instance, the system cannot generate a system user access report or an exception report to identify when information has been changed or deleted in the system. Specifically, a user has the ability to delete a comment or “pop up notification” and there would be no evidence of the note in the history of the electronic file.

To assess system access, we initially requested user access reports; however, the system was unable to generate these reports. As a result, we worked with staff to perform a high level review of access by conducting a walk-through of system capabilities. In addition, during this system access tour, the Fund provided a description of access generally granted to users in each unit (i.e. payments, claims, administrative, and technical). According to the Fund and based on our high level tour of system access, key incompatible functions, such as creating a claim, inputting the initial reimbursement request information, and processing a request in the system are segregated amongst DFA’s Administrative Unit and the Fund’s Payment and Claims Units to mitigate the risk of inappropriate claim and reimbursement request being paid. However, because the Fund was not able to provide system generated user access reports and was unable to confirm when system access had last been reviewed, we were unable to reasonably ensure access was limited to the specified screens and fields reported and no information had been inappropriately deleted or modified.

In addition, while on-site, our review of claim and technical files found that files did not include an index of file contents and key information was not documented in the file. For instance, Fund staff does not always document correspondence with claimants and regulators, making it difficult to assess the reasons for longer claim and reimbursement request processing times. We also noted that Fund staff in the payments and claims units take files home twice a week when telecommuting, increasing the risk that documents may be lost, removed, or misplaced without managements knowledge. When coupled with the lack of controls over data in the claims management system, the Fund opens itself to the risk of claim data being inappropriately removed, deleted, or modified without an ability to easily identify these changes. Additionally, because the Fund does not always document requests and conversations with claimants and local oversight agencies; in instances where the Fund exceeded the Legislative processing time requirements, the Fund is unable to demonstrate the causes for the delays, such as a claimant failing to provide information necessary to process a claim application or reimbursement request.

### **Recommendations:**<sup>29</sup>

To improve the Fund’s internal control environment, Fund management should:

52. Ensure all staff involved in the review and approval process related to reimbursement requests as well as staff involved in determining the reasonableness and necessity of cleanup activities and costs have the necessary knowledge, skills and abilities, particularly technical skills and expertise where applicable.
53. Clarify which Fund employees (i.e. payment analysts, engineers and geologists in the Technical Unit, etc.) are responsible for performing “technical reviews” of the reimbursement requests versus “administrative review.” Specify clearly the type of analysis expected of each type of review.

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<sup>29</sup> Some recommendations may require legislative action and changes in budget authority to implement.

54. Protect the Fund's limited resources by developing processes that better ensure only costs that are reasonable and necessary are approved for payment, including:
  - a. Implementing an independent, secondary (supervisory) review process of approved reimbursement requests before payments are made.
  - b. Developing and implementing a quality control process led by the Fund's technical management to review already approved reimbursement requests and associated documentation to determine if staff appropriately reviewed and approved payments, using a "reasonable person" approach. This will allow the Fund to measure the ability of staff reviewing reimbursement requests and identify situations that require additional training or position changes.
55. Develop a process to compare costs submitted for reimbursement against previously reimbursed costs to eliminate the ability for consultants and claimants to have duplicate charges approved and the Fund pays for the same cost/activity multiple times.
56. Within the claimant main file, develop a tracking process to list all denied costs so future payment analysts can compare the costs submitted against a list of previously denied costs to eliminate the ability for consultants and claimants to submit previously denied costs for reimbursement in the future.
57. In conjunction with Chapter 3 recommendations, ensure staff workload is assigned and monitored and develop processes to ensure reimbursement requests are always reviewed in date order received.
58. Implement file indexing system for hard copy claim files that indicates what documents are located in the file, and require staff to document all correspondence with claimants and regulators in the claim files.
59. Develop a process to review user access on annual basis to ensure the level of access granted is appropriate and limited to only those functions necessary to perform daily duties.
60. Consider designing system user access and audit reports for SCUFIS that will enable the Fund to easily identify changes made within the system.

Appendix –  
State Water Resources Control Board's Response to the Audit

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Linda S. Adams  
Secretary for  
Environmental Protection

# State Water Resources Control Board

## Executive Office

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Arnold Schwarzenegger  
Governor

February 18, 2010

Ms. Lynda McCallum  
Sjoberg Evashenk Consulting, Inc.  
455 Capitol Mall, Suite 700  
Sacramento, California 95814

Dear Ms. McCallum:

### UNDERGROUND STORAGE TANK (UST) CLEANUP FUND PERFORMANCE AUDIT

We have reviewed the draft report for the above entitled audit and find it to be a thorough analysis of the program and accurate characterization of the causes leading to the recent program cash shortfall. We have also reviewed the 60 recommendations in the areas of financial management, cost containment, processing efficiency and internal controls, and find them to be well thought out and constructive. Implementation of the recommendations in general will require careful consideration and coordination to ensure that operations are not unnecessarily disrupted and that we achieve the desired result of a more efficient program. Also, as you note, implementation of some of the recommendations may require legislative or budgetary action. Following receipt and public posting of the final report, we will obtain input from our stakeholder group to help us develop an action plan to implement the recommendations, with consideration of priority, feasibility and authority.

Thank you for your work on this project, we believe this effort will be instrumental in restoring the UST Cleanup Fund to an effective funding program.

Sincerely,

Thomas Howard  
Chief Deputy Director

*California Environmental Protection Agency*