



*Matthew Rodriguez*  
Secretary for  
Environmental Protection



## Department of Toxic Substances Control

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*Edmund G. Brown Jr.*  
Governor

### MEMORANDUM

TO: Matt Rodriguez  
Secretary for Environmental Protection  
California Environmental Protection Agency

FROM: *Deborah O. Raphael*  
Deborah O. Raphael  
Director

DATE: December 23, 2011

SUBJECT: REVIEW OF INTERNAL CONTROL SYSTEMS

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In accordance with the Financial Integrity and State Managers' Accountability (FISMA) Act of 1983, the Department of Toxic Substances Control (DTSC) submits this report on the review of our systems of internal control for the biennial period ended December 31, 2011.

#### BACKGROUND

Working as part of the California Environmental Protection Agency, DTSC's three major program responsibilities are restoring the safety and health of communities and cleanup of sites contaminated by toxic substances from the legacy of California's industrial past; ensuring that hazardous waste generated in California's present industrial economy is managed safely and does not pose threats to people or the environment; and preventing pollution to ensure a safe and healthy future for California.

The mission of DTSC is to protect California's people and environment from harmful effects of toxic substances through the restoration of contaminated resources, enforcement, regulation, and pollution prevention. DTSC is committed to a vision that Californians enjoy a clean and healthy environment, and as a result of our efforts: 1) communities are confident that we protect them from toxic harm, 2) businesses are confident that we engage them with consistency and integrity, and 3) consumers are confident that we stimulate innovation in the development of safer products.

Through our vision, we have recently developed three new goals for DTSC:

- Protect California from toxic harm to improve the quality of life for communities, business, and consumers and preserve the environment.
- Restore land and water to protect human health and the environment, and to facilitate efficient reuse and redevelopment.
- Strengthen our effectiveness, efficiencies, and capabilities to better serve stakeholders.

## **RISK ASSESSMENT**

For the 2011 report, two methods of risk assessment were conducted involving all supervisors and managers, including Executive management.

The first method was the completion of a department-wide Strength, Weaknesses, Opportunities and Threat (SWOT) Analysis by all DTSC supervisors and managers. This analysis was conducted in April 2011 and the areas identified in both the weaknesses and threats categories were further analyzed by a FISMA Task Force team using a risk assessment scorecard.

The second method utilized the Department of Finance's "Control Environment Survey" which was distributed electronically to all Executive management including Deputy Directors, Assistant Deputy Directors and to branch managers where there was no Assistant Deputy Director for that program. The results were categorized by common areas and analyzed by the FISMA Task Force team using a risk assessment matrix.

The results from both methods resulted in several potential risks being identified by the Department. The Control Environmental Survey identified three significant risks to DTSC operations.

## EVALUATION OF RISKS AND CONTROLS

The 2011 FISMA Internal Control Review revealed the following three areas posing significant risk to DTSC:

- 1) One of the Department's support funds is projected to be in the "red" in 18 months.
- 2) Insufficient funding for Green Chemistry.
- 3) Millions of dollars in costs incurred that require further investigation before they can be invoiced.

See attachment for the details of each of the three significant risks.

## PREVIOUS AUDIT FINDINGS

Overall, DTSC has an effective system of internal control. Past reviews conducted by the Department of Finance's Office of State Audits and Evaluations found findings in six areas all considered moderate to low risk for the department. They included: fixed assets, accounts receivable, payroll, cash disbursements, purchasing, and information technology.

Below is the current status of the six moderate to low findings:

Area	Status
Cash disbursements	Resolved
Purchasing	Resolved
Information Technology	Resolved
Fixed Assets	Not Resolved
Receivable Collections	Not Resolved
Payroll	Not Resolved

## VACANT POSITIONS

As statutorily required, DTSC is in compliance with Government Code 12439. DTSC works with the State Controller's Office to re-establish any positions abolished in error and annually submits a justification to the Department of Finance requesting that abolished positions be re-established.

**CONCLUSION**

The three significant risk areas identified in this report are a high priority for the Director and Executive staff to resolve. The Department has begun implementing corrective actions as specified in the attachment, and will be reporting the progress of these actions in another six months.

In 2011, DTSC created a new Program Review and Audit Branch to conduct ongoing monitoring of the Department's internal and administrative controls, including the areas of fixed assets, receivable collections and payroll that are not yet fully resolved; and to review key program operations for effectiveness and efficiency. Furthermore, the moderate to low risk areas identified in the risk assessment process will be monitored on an ongoing basis until fully mitigated.

If you have any questions regarding this report, please contact Randy Fong, Chief of Program Review and Audit Branch at (916) 322-0468, or by e-mail at [rfong1@dtsc.ca.gov](mailto:rfong1@dtsc.ca.gov).

**Attachment**

cc:	Director of Finance	<a href="mailto:FISMAhotline@dof.ca.gov">FISMAhotline@dof.ca.gov</a>
	Legislature	<a href="mailto:Katarina.Tarr@asm.ca.gov">Katarina.Tarr@asm.ca.gov</a>
	State Auditor	<a href="mailto:MargaritaF@bsa.ca.gov">MargaritaF@bsa.ca.gov</a>
	Governor's Office	<a href="mailto:Adrian.Mata@gov.ca.gov">Adrian.Mata@gov.ca.gov</a>
	State Library	<a href="mailto:RFontaine@library.ca.gov">RFontaine@library.ca.gov</a>
	State Controller's Office	<a href="mailto:SCOaudFISMA@sco.ca.gov">SCOaudFISMA@sco.ca.gov</a>
	State Treasurer's Office	<a href="mailto:FISMA@Reports@treasurer.ca.gov">FISMA@Reports@treasurer.ca.gov</a>
	Attorney General	<a href="mailto:OPRA@doj.ca.gov">OPRA@doj.ca.gov</a>

## DTSC Risk Assessment Findings and Recommendations

For its Financial Integrity and State Manager's Accountability report for 2011, the Department of Toxic Substances Control (Department) conducted its department-wide risk assessment process involving all supervisors, managers and executive management. Areas that were identified as weaknesses, threats or areas needing improvements were further analyzed and ranked utilizing a 20-point risk assessment matrix. The risk assessment matrix revealed three critical areas that would be significant to the Department with a high likely loss of program continuity or funding unless immediate action is not taken timely.

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### **1. One of the Department of Toxic Substances Control's (DTSC) primary support funds will be in the "red" in 18 months.**

The Department is funded by the General Fund, hazardous waste fees, environmental taxes levied on businesses, grants from federal agencies, fines and penalties collected for violations of the hazardous waste control laws, reimbursement agreements, and cost recoveries from responsible parties.

The Toxic Substances Control Account (TSCA) a special fund that supports the Department's entire pollution prevention program and part of its clean-up program activities. The TSCA fund is supported by revenues primary consisting of environmental taxes paid by California businesses. TSCA currently has a fund balance of approximately \$35 million; however, there is also an estimated funding gap of \$33 million (excess expenditures over incoming revenues) if the expenditure trend continues. As a result of having more expenditures than current revenues, the TSCA fund will have a near-zero or negative fund balance entering the FY 2013-14 budget year, based on the current anticipated level of budget authority.

The Department's other support special fund, the Hazardous Waste Control Account (HWCA), derives its revenues primary from hazardous waste fees. These fees have declined annually 9% (\$4.7 million) from FY 2008-09 to FY 2010-11. The HWCA currently has a fund balance of \$19 million; and it is expected to have a negative fund balance of \$2 million by the end of FY 2014-15 unless changes are also made.

During the review, the Department had already developed a plan to begin to work with Cal/EPA and Department of Finance for immediate actions to resolve both funds' situations.

**Impact:** Because of the funding gap, TSCA and HWCA will not be able to support further increases for new programs or augmentations in existing programs. The current funding gap will significantly impact the Department's future ability to pay for program expenditures and employee salaries funded by TSCA and HWCA.

## DTSC Risk Assessment Findings and Recommendations

Recommendation: We concur with the Department's current action to develop and implement a plan that would reduce expenditures for the current and upcoming budget year and/or increase revenues to the TSCA and HWCA fund.

### Department Corrective Action Plan:

The Department has developed a plan which includes redirecting TSCA and HWCA resources to either Federal funded or cost recovery projects, proposing TSCA and HWCA program cuts, and exploring avenues of fee restructuring or increases.

### **2. Insufficient funding for recently enacted legislation (Green Chemistry – AB 1879) (Feuer, Chapter 559, Statutes of 2008) and SB 509 (Simitian, Chapter 560, Statutes of 2008).**

Enactment of these landmark laws laid the foundation for Green Chemistry in California by launching a new chemicals framework and a dramatic shift in environmental protection; however, a funding source to fund this initiative has not yet been identified. The Pollution Prevention Program is funded by TSCA; however, this fund would not be able to sustain this program without a fee increase or a decrease in other expenditures charged to this fund. To support this recently enacted legislation, the Department estimates that a fee increase of approximately thirty percent would be needed.

Impact: Without an earmarked revenue source to fund the Green Chemistry Program initiative expenditures, the Department must absorb the cost of this new initiative from the TSCA fund further accelerating when the TSCA fund balance will go into the red.

Recommendation: The Department needs to set priorities for the workload and charges being supported by TSCA. In conjunction with Finding #1 above, the Department should consider options of redirecting current resources or exploring the possibility of a legislative solution, in part, for the lack of corresponding funding to accompany this recent Green Chemistry legislative workload.

### Department Corrective Action Plan

The Department plans first to redirect existing staff to implement the Safer Consumer Product regulations, second to consider legislation to repeal other pollution prevention mandates, and finally to explore legislative solutions for a new funding source.

## DTSC Risk Assessment Findings and Recommendations

### **3. The Department has millions of dollars in costs incurred that require further investigation before they can be invoiced.**

Under the California Health and Safety Code Sections 25206.2 and 25360, the Department is able to recover its costs for services it provides for clean-up or compliance activities at project sites. To accomplish the recovery of costs, the Department maintains an automated billing system (updated in 2004) by project sites of recoverable costs associated with its activities. Employee time charges, along with travel and contract expenses, are recorded monthly in the billing system. The Department depends on its site project managers to timely identify parties to be invoiced. Generally, invoices are issued quarterly to parties unless other events (e.g., bankruptcy or litigation) have occurred.

An October 31, 2011 report from the Department's billing system showed \$70 million in potential recoverable costs not invoiced (also known as "billings on-hold") for the period 2004 to current. However, the Department believes this amount is much lower because each project's "billings on-hold" requires validation to ensure its accuracy. In addition, 60 percent of the aforementioned dollar value (approximately \$42 million) of unbilled costs represents clean-up sites that are considered "orphan" in which there has been no financially viable responsible party identified to invoice. Generally, orphan sites are clean-up sites in which the property owner or the parties responsible for the problem have walked away from the property or the parties have demonstrated that they are not financial viable and the property requires immediate remediation to protect the surrounding public and environment. For 2010, the annual cost for orphan site clean-up was \$12 million, a cost that the Department will likely be unable to collect even if invoiced.

The remaining "billings on-hold" balance of approximately \$28 million (\$70 million less \$42 million) represents potential recoverable costs from many individual project sites. Moreover, the Department must perform advance steps before it can invoice its incurred costs. Some of the key advance steps include defining the responsible parties; who have legal obligations to undertake the work; and identifying other financial "viable" responsible parties. The first is a legal bar that must be met. The Department must demonstrate the connection of the contamination to actions that these parties have undertaken. This is not a simple task and sometime results in court litigation. A second major step is evaluating the financial capabilities of the responsible party. This requires extensive evaluations of various financial documents.

## DTSC Risk Assessment Findings and Recommendations

Without the timely execution of these advance steps, the Department has not been able to invoice its cost that it is entitled to recover. Currently, the required advance steps are undertaken by project managers and the Department's legal staff with limited auditor support.

On an average quarter, the Department invoices about \$6.5 million in cost recoveries. During our review work in October 2011, the Department was able to invoice \$4 million of these "billings on-hold". To address the "billings on-hold", the Department will incur an increased workload in various units of the Department handling collections. The Department is on the right track to focus its current resources to begin resolving and invoicing its "billings on-hold".

Impact: The millions in "billings on-hold" for the last seven years (2004 to current) could represent future revenues to the Department once invoice issues are resolved for "unbilled" costs, including identifying responsible and financially viable parties.

### Recommendation:

- a) The Department reviews the data on the "billings on-hold" and identifies projects which can be immediately be invoiced and re-classify projects which are covered under grants or are "orphan" sites.
- b) The Department should establish formal written cost recovery policies and procedures to ensure that future new accounts/project sites are minimized from being considered "billings on-hold."
- c) The Department should define the necessary resources to conduct the "advance steps" necessary to invoice current and future costs incurred.
- d) The Department needs to establish updated procedures that notify the liable responsible parties of an upcoming invoice(s) for prior years' services performed.
- e) Lastly, the Department should make resolving its "billings on-hold" accounts a key performance indicator for monitoring its progress.

### Department Corrective Action Plan

The Department has formed a new Cost Recovery Team to improve the cost recovery process and address the "billings on hold". This team will develop a formal corrective action plan within 60 days and will report its progress in another six months.