Implementation of State Auditor's Recommendations

Audits Released in January 2003 Through December 2004

Special Report to

Assembly Budget Subcommittee #3—Resources

February 2005
Report No. 2005-406 A3

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CALIFORNIA STATE AUDITOR

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February 23, 2005 2005-406 A3

The Governor of California
Members of the Legislature
State Capitol
Sacramento, California 95814

Dear Governor and Legislative Leaders:

The Bureau of State Audits presents its special report for the Assembly Budget Subcommittee No. 3—Resources. This report summarizes the audits and investigations we issued during the previous two years that are within this subcommittee's purview. This report includes the major findings and recommendations, along with the corrective actions auditees reportedly have taken to implement our recommendations.

This information is also available in a special report that is organized by policy areas that generally correspond to the Assembly and Senate standing committees. This special policy area report includes appendices that summarize recommendations that warrant legislative consideration and monetary benefits that auditees could realize if they implemented our recommendations. This special policy area report is available on our Web site at www.bsa.ca.gov/bsa/reports/subcom2005-policy.html. Finally, we notify auditees of the release of these special reports.

Our audit efforts bring the greatest returns when the auditee acts upon our findings and recommendations. This report is one vehicle to ensure that the State's policy makers and managers are aware of the status of corrective action agencies and departments report they have taken. Further, we believe the State's budget process is a good opportunity for the Legislature to explore these issues and, to the extent necessary, reinforce the need for corrective action.

Respectfully Submitted,

Elaine M. Howle

ELAINE M. HOWLE
State Auditor

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INTRODUCTION

This report summarizes the major findings and recommendations from audit and investigative reports we issued from January 2003 through December 2004, that relate to agencies and departments under the purview of the Assembly Budget Subcommittee No. 3—Resources. The purpose of this report is to identify what actions, if any, these auditees have taken in response to our findings and recommendations. We have placed this symbol ➲ in the left-hand margin of the auditee action to identify areas of concern or issues that we believe an auditee has not adequately addressed.

For this report, we have relied upon periodic written responses prepared by auditees to determine whether corrective action has been taken. The Bureau of State Audits' (bureau) policy requests that auditees provide a written response to the audit findings and recommendations before the audit report is initially issued publicly. As a follow-up, we request the auditee to respond at least three times subsequently: at 60 days, six months, and one year after the public release of the audit report. However, we may request an auditee provide a response beyond one year or initiate a follow-up audit if deemed necessary.

We report all instances of substantiated improper governmental activities resulting from our investigative activities to the cognizant state department for corrective action. These departments are required to report the status of their corrective actions every 30 days until all such actions are complete.

Unless otherwise noted, we have not performed any type of review or validation of the corrective actions reported by the auditees. All corrective actions noted in this report were based on responses received by our office as of February 7, 2005.

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WATER QUALITY CONTROL BOARDS

Could Improve Their Administration of Water Quality Improvement Projects Funded by Enforcement Actions

REPORT NUMBER 2003-102, DECEMBER 2003

California Environmental Protection Agency response as of January 2005

Audit Highlights . . .

Our review of the State Water Resources Control Board's (state board) and Regional Water Quality Control Boards' (regional boards) collection of fines and subsequent expenditure of those funds under the Porter-Cologne Water Quality Control Act (State water quality act) revealed the following:

- ☑ *As allowed by law, there is no correlation between the amount of fines collected by a given regional board and the amount the regional board receives from the state board for water quality projects.*
- ☑ *From fiscal years 1998–99 through 2002–03, the regional boards collected about $26 million in fines and the state board committed $24.9 million for water quality projects throughout the State.*
- ☑ *The state board received almost $21 million from a legal settlement between the State and Atlantic Richfield Company and Prestige Stations, Inc., and shortly after committed $19.2 million of those funds for water quality projects throughout the State.*

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The Joint Legislative Audit Committee (audit committee) asked the Bureau of State Audits (bureau) to provide information to the Legislature and others to clarify how money designated to improve the State's water quality is distributed throughout the State. Specifically, the audit committee wanted the bureau to provide information related to the State Water Resources Control Board (state board) and a sample of Regional Water Quality Control Boards (regional boards), including how they assess and collect fines, whether they spend the fines in accordance with the Porter-Cologne Water Quality Control Act (State water quality act), and whether they spend the money they collect in or near the areas from which they collect it. The state board reports to the California Environmental Protection Agency (Cal EPA), which was created in 1991. The audit committee also asked us to identify any new funds available in the state board's operating budget and examine the ways those funds have been used. Additionally, the audit committee wanted to know the number and amount of fines the regional boards collected, the public or private entities or individuals who violate the State water quality act (polluters) most commonly, and the changes in the amount of fines assessed and collected over the last five years.

As allowed by law, there is no correlation between the amount of the fines collected by a given regional board and the amount the regional board receives from the state board. When allocating funds to regional boards, the state board attempts to determine how best to use available funds to meet the State's most urgent water quality needs. It appears reasonable that the state board would base its fund commitments not on where fines are generated but what represents the highest and best use

☑ *Despite appearing to focus on the main goal of ensuring that public and private entities comply with the State water quality act, regional boards sometimes fail to follow through on enforcement actions.*

of those funds. From fiscal years 1998–99 through 2002–03, the regional boards collected about $26 million in Administrative Civil Liabilities (ACL) and either spent or committed to spend $24.9 million in water quality improvement projects.

Finding #1: Regional boards can retain some benefits from their enforcement actions by approving supplemental environmental projects.

Although the regional boards do not keep the money associated with the ACLs they impose locally, they can recover at least a portion of the money or otherwise retain the benefits of their enforcement actions. First, a regional board can endorse a water quality improvement project within its region and forward it for approval to the state board, which then can allocate funds to projects it considers worthy. However, not all regional boards take advantage of this option, and they may miss opportunities to realize some benefits from their enforcement actions.

Second, regional boards might benefit from their enforcement actions, in accordance with state board procedures, by seeking partial reimbursement for staff costs they incurred in enforcing the State water quality act. However, over the last five fiscal years, only five of the nine regional boards used this option to submit a total of roughly $670,000 in claims. Also, the state board could do a better job of clearly communicating how and when regional boards may submit claims and how they can use those funds once they receive reimbursement.

Third, a regional board can retain the benefits of some of the ACLs it assesses within its region by allowing a polluter to perform or fund a supplemental environmental project (SEP) in lieu of paying a portion of an ACL. Of the four regional boards we visited, one retained benefits in lieu of almost $3.5 million and another retained benefits in lieu of more than $2.2 million of the ACLs they assessed in their respective regions. The four regions we visited retained more than $6.5 million total for SEPs.

We recommended the state board encourage and assist the regional boards in taking the following steps to ensure that the regional boards receive all the funding they are entitled to under the State water quality act:

- Identify any needed water quality improvement projects in their regions and submit the appropriate funding requests to the state board.

- Collect and compile staff costs associated with enforcing the State water quality act and submit periodic claims for these costs from the account, as the State water quality act allows.

- Evaluate strategies that other regional boards use to maximize water improvement activities in their respective regions.

We also recommended the state board take steps to communicate the intent of the practice to reimburse regional boards for staff costs and the proper way to claim and use such funds to ensure that regional boards are aware of and understand how to use and subsequently spend those funds.

State Board Action: Corrective action taken.

A revision to the Administrative Procedures Manual has been approved by the executive director and posted on the state board's internet and intranet sites. It includes specific direction for requesting funding for projects and reimbursement for staff costs. Copies have been routed to each state board organization for inclusion in their manuals. State board staff and management continue to meet and routinely discuss utilization of the Cleanup and Abatement Account (CAA), as appropriate.

Finding #2: Regional boards do not always ensure that polluters complete supplemental environmental projects or pay fines.

Despite appearing to focus on the main goal of ensuring that public and private entities comply with the State water quality act, regional boards sometimes fail to follow through on enforcement actions. For example, the Santa Ana and San Francisco Bay regional boards often approved SEPs for their enforcement actions but did not always ensure that the SEPs were completed. Further, all four regional boards we visited had, as state board policy allowed, suspended portions of or entire ACLs for polluters that agreed to clean up the pollution or to stop violations. However, the San Francisco Bay regional board did not always follow up to determine that polluters either came into compliance with the State water quality act in accordance with the ACL suspension agreements or paid the ACLs.

Additionally, although all the regional boards appear to collect the mandatory minimum penalties (MMPs) that they initially assessed against polluters, the San Francisco Bay and Santa Ana regional boards could assess fines more promptly when polluters

continue to commit violations subject to MMPs. Regional boards that do not assess and collect fines appropriately and ensure completion of SEPs limit their ability to protect the public health and the environment and do not ensure that violators of the State water quality act do not gain a competitive advantage over those that comply with it.

We recommended the state board require the regional boards to monitor and report on the progress and completion of these projects to ensure that the state water system receives the maximum benefit from SEPs the regional boards approve.

We also recommended the state board require the regional boards to promptly issue and collect all ACLs to ensure that the regional boards effectively use enforcement actions to discourage violations of the State water quality act.

State Board Action: Partial corrective action taken.

The System for Water Information Management Compliance Module is now able to track the successful completion of milestones, including requirements related to the successful completion of SEPs. The state board has been working with each regional board to ensure that staff understands the data entry requirements. The Office of Statewide Initiatives monitors data entry of SEP requirements and prepares a quarterly report on the status of all SEPs approved by the regional boards since January 1, 2004. The current report is posted on the state board's internet site (www.swrcb.ca.gov).

Efforts are ongoing to issue and collect outstanding MMPs. Competing priorities for resources remains a significant issue. Steps taken to address this include:

- The state board has focused efforts on implementation of electronic submittal and review of discharger self-monitoring reports (e-SMR). This is scheduled to phase in dischargers starting in July 2005. e-SMR will replace the current manual review of reports and will lead to semi-automated or automated issuance of mandatory penalties, thus assuring prompt issuance.
- Tracking of report submittal has been dramatically improved. Information about late and missing reports is now reliable for most facilities.

- New templates and process streamlining for MMPs are under development.
- A pilot project for MMP process streamlining and other improvements are planned for the Los Angeles Regional Board in winter 2004–05.
- Increased use of student help for report review and violation tracking until e-SMR is under consideration if resources can be identified.
- Improved prioritization for addressing our enforcement workload is being internally debated. Improved effectiveness with existing resources through MMPs and other enforcement authorities is the goal

Finding #3: Because the state board does not always obtain adequate information on all water quality project proposals, it cannot ensure that it funds the most meritorious projects.

The state board's Division of Financial Assistance (division) does not consistently obtain written information regarding proposed water quality improvement projects before submitting them to the state board for review. One reason it has not consistently obtained the information is inadequate direction from the state board. Specifically, we found that in fiscal year 2002–03, for 20 water quality projects costing $17.9 million (64 percent of the $27.9 million funded that required state board approval), although the division followed procedures it has informally established for reviewing water quality projects, it did not follow these procedures in two cases, failing to obtain documentation on two projects worth a total of $10 million from funds the state board received from a legal settlement. By not gathering all the necessary written information, it is not clear whether the division analyzed the merits of the two projects before submitting them for the state board to consider along with other water quality projects; thus, the state board could not make a fully informed decision regarding which water quality projects were the best use of funds. One factor limiting the division's ability to evaluate and analyze requests for water quality projects is that the state board has not formally adopted a policy to guide the division in fulfilling this responsibility. Instead, the division has its own set of informal procedures that, lacking the authority of the state board behind them, the division is under no obligation to follow.

We recommended the members of the state board establish and approve a policy to guide division staff in processing project requests to ensure that division staff consistently review funding requests for water quality improvement projects. Further, to ensure that the state board has the information necessary to decide which of these water quality projects to fund, the division should follow the established policy in all instances.

State Board Action: Corrective action taken.

Administrative Procedures Manual for accessing the CAA has been revised as suggested. The division intends to follow the approved guidance for requests to access the CAA.

CALIFORNIA ENVIRONMENTAL PROTECTION AGENCY

Insufficient Data Exists on the Number of Abandoned, Idled, or Underused Contaminated Properties, and Liability Concerns and Funding Constraints Can Impede Their Cleanup and Redevelopment

Audit Highlights . . .

Our review of the entities under the California Environmental Protection Agency (Cal/EPA) that oversee the cleanup of contaminated sites, the Department of Toxic Substances Control (Toxics) and the State Water Resources Control Board (State Water Board), found the following:

- ☑ *State law does not require Toxics or the State Water Board to capture information on brownfields, such as the number of sites and their potential reuses.*
- ☑ *Toxics anticipates needing between $124 million and $146 million for the remediation of 45 existing orphan sites and $2.4 million in fiscal year 2003–04 for orphan shares.*
- ☑ *The State Water Board's unaudited data indicate that it has seven orphan sites to which it has committed $1.4 million in state resources for cleanup.*

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REPORT NUMBER 2002-121, JULY 2003

California Environmental Protection Agency, the Department of Toxic Substances Control, and the State Water Resources Control Board combined response as of October 2004

The Joint Legislative Audit Committee requested that the Bureau of State Audits conduct an audit of the California Environmental Protection Agency (Cal/EPA) and its entities involved in the cleanup of properties contaminated by hazardous material and waste, the Department of Toxic Substances Control (Toxics) and the State Water Resources Control Board (State Water Board). We were asked to provide information on how many orphan sites and sites with orphan shares exist in the State, as well as how much funding is needed and how much is directly available to clean up those sites.

Finding #1: California lacks a comprehensive inventory of brownfields.

California does not have a uniform definition for brownfields. Further, state law does not require Toxics or the State Water Board to maintain databases to capture information on brownfields, such as the number of sites and their potential reuse. On May 30, 2003, Toxics did submit an application to the United States Environmental Protection Agency (U.S. EPA) to receive a state response grant. Toxics intends to use a portion of the grant to work with the State Water Board and the regional water quality control boards (regional water boards) to maintain and display accurate geographical information on brownfield sites and other properties that pose environmental concerns.

☑ *The reuse of brownfields faces challenges, such as the liability provisions the federal Superfund law imposes and limited funding opportunities.*

Toxics and the State Water Board have yet to apply for certain federal grants available to assist with the State's assessment and cleanup costs for certain sites, such as mine-scarred lands.

We recommended that if Toxics does not receive funding from the U.S. EPA, Cal/EPA should seek guidance from the Legislature to determine if it desires a database to track the State's efforts to promote the reuse of properties with contamination. If the Legislature approves the development or upgrade of a statewide database that includes relevant data to identify brownfields sites and their planned and actual uses, Cal/EPA should establish a uniform brownfield definition to ensure consistency.

Cal/EPA Action: Partial corrective action taken.

Cal/EPA told us that Toxics was awarded funds from the U.S. EPA under the Small Business Liability Relief and Brownfields Revitalization Act for fiscal years 2003–04 and 2004–05. In conjunction with the award of these funds, Toxics and the State Water Board plan to continue efforts to operate and enhance their site information databases. The grant also calls for a survey and inventory of brownfields in the State. To accomplish this task, Cal/EPA informally surveyed other state brownfield programs for information about the challenges, features, and operating costs of their inventories. Cal/EPA also intends to hold a series of discussions with various stakeholders and will use the information to proceed with its inventory efforts.

Finding #2: Existing databases do not provide a comprehensive reporting of orphan sites and sites with orphan shares.

Toxics maintains a database to track the number of contaminated sites in the State. Although this database currently reports the number of orphan sites under its jurisdiction, the database is not able to track the number of sites with orphan shares. Additionally, due to incomplete data relating to responsible parties in the State Water Board's database, we were unable to identify the number of orphan sites under its jurisdiction. The State Water Board told us that orphan shares do not exist since the nine regional water boards apportion liability for cleanup using a strict application of joint and several liability. Under a strict application of joint and several liability there are no orphan shares because even though some share of the cleanup costs is not attributable to a responsible party, each must assume full responsibility for those costs.

We recommended that to obtain a comprehensive listing of the number of orphan sites and sites with orphan shares, the Legislature should consider requiring Cal/EPA and its entities to capture necessary data in their existing or new databases.

Legislative Action: Legislation passed.

Chapter 705, Statutes of 2004 (Assembly Bill 389) directs Toxics to install improvements to its database systems to maintain and display information that includes the number of brownfield sites, each brownfield site's location, acreage, response action, site assessments, and the number of orphan sites where the department is overseeing the response action.

Finding #3: Toxics and the State Water Board have yet to apply for all available federal grants.

The Small Business Liability Relief and Brownfields Revitalization Act (revitalization act) provides grants and loans to states, local governments, and other eligible participants to inventory, characterize, assess, conduct planning, and remediate brownfields. However, Toxics and the State Water Board have not applied for all available monies under the revitalization act to assist with the State's assessment and cleanup costs for certain sites.

We recommended that to reduce the State's brownfield assessment and cleanup costs, Cal/EPA should ensure that Toxics and the State Water Board apply for all available funding under the revitalization act.

Cal/EPA Action: Pending.

Cal/EPA stated that Toxics applied for and was awarded grant funds from the U.S. EPA for a variety of brownfield activities, including targeted site investigations, program coordination with the State Water Board, public outreach activities, Web site improvements, and assisting local jurisdictions. Additionally, Cal/EPA stated that Toxics and the State Water Board are actively pursuing other available competitive brownfield funds.

CALIFORNIA INTEGRATED WASTE MANAGEMENT BOARD

Its New Regulations Establish Rules for Oversight of Construction and Demolition Debris Sites, but Good Communication and Enforcement Are Also Needed to Help Prevent Threats to Public Health and Safety

REPORT NUMBER 2003-113, DECEMBER 2003

Responses of the California Integrated Waste Management Board, the County and the City of Fresno, and the County and the City of Sacramento as of December 2004

Audit Highlights . . .

Our review of the California Integrated Waste Management Board (board) and local agencies' oversight of solid waste facilities found:

- ☑ *The board had not finalized regulations for construction and demolition debris sites when a large fire broke out at the Archie Crippen Excavation Site (Crippen Site), which accepted construction and demolition waste in Fresno.*
- ☑ *The board's interim directions did not provide the local enforcement agencies (LEAs) with clear guidance on how to handle construction and demolition debris sites.*
- ☑ *Representatives of several agencies visiting the Crippen Site before the fire failed to cite and remediate conditions that ultimately made the fire difficult to suppress, raising concerns about public health.*
- ☑ *The board does not track "excluded" solid waste sites because regulations do not require it to do so.*

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Each year Californians generate an estimated 66 million tons of solid waste, which must be properly handled to prevent health and environmental threats. In 1976 Congress enacted the Resource Conservation and Recovery Act of 1976, which expanded the federal government's role in regulating the disposal of solid wastes and required that all solid waste landfills comply with certain minimum criteria adopted by the U.S. Environmental Protection Agency. In that same year, when cities and counties became responsible for enforcing these standards, each local government, with the California Integrated Waste Management Board's (board) approval, designated a local enforcement agency (LEA) to enforce state minimum standards and solid waste facility permits.

Our audit concluded that, although the board has established regulations for many types of solid waste streams, it could have improved its interim guidance in its LEA Advisory #12 (advisory) for areas pending regulation. While the board was preparing regulations for construction and demolition debris waste sites, a serious fire broke out at the Archie Crippen Excavation Site (Crippen Site), which accepted construction and demolition debris, in Fresno, resulting in a threat to public health and suppression and cleanup costs of over $6 million. Further, the board has established a system for reviewing LEAs' performance that meets statutory requirements for scope, but not for frequency.

- ☑ *The board does not complete a review of each LEA every three years, as required by law.*
- ☑ *Through legal challenges to enforcement actions, solid waste facility operators can delay correction of identified problems.*

Finding #1: Until recently, the board had only an advisory statement in place of regulations for construction and demolition debris sites.

While working on regulations for construction and demolition debris sites during the last six years, the board advised the LEAs to follow its advisory for permitting of "nontraditional" facilities, including construction and demolition debris waste sites. The advisory's purpose is to guide LEAs and board staff on the permitting of nontraditional facilities with activities not yet covered by regulations. "Nontraditional facilities" are those facilities other than landfills, transfer stations, and composting facilities that handle or process solid waste. Although not precluding LEAs from accepting applications for solid waste facility permits at these sites, the advisory strongly encourages LEAs not to accept applications for solid waste facility permits for materials and handling methods that are under evaluation. However, the advisory also states that should an LEA consider a facility proposal that appears to fall into the nontraditional facility category, but not be certain whether the advisory's interim policy applies to the particular facility, the LEA can contact the board's permitting branch representative for assistance.

In August 2003, after many draft proposals and public comments, the first phase of the regulations became effective, covering the transfer and processing of construction and demolition debris. At that time, work was also progressing on the second phase, dealing with the disposal of construction and demolition debris. The board has indicated it adopted regulations for construction and demolition debris disposal in September 2003, and they are scheduled to become effective in January 2004.

We recommended that to meet the goals of the California Integrated Waste Management Act of 1989 (Waste Act) and improve regulation of solid waste, the board should complete and implement as promptly as possible its work on the second phase of regulations for construction and demolition debris sites, covering the disposal of the waste materials.

Board Action: Corrective action taken.

The board stated that on September 17, 2003, it adopted the second phase of regulations for construction and demolition debris sites. On November 10, 2003, the regulations were submitted to the Office of Administrative Law (OAL) for approval. OAL filed the regulations with the secretary of state on December 26, 2003. The regulations became effective on

February 24, 2004. The board also stated that it is working with the local enforcement agencies and operators through training and ongoing assistance to effect prompt implementation of the regulations.

Finding #2: Concerns about the Crippen Site were not addressed.

In the two years before the Crippen Site fire, staff of the city of Fresno Code Enforcement Division, the city of Fresno Fire Department, the Fresno LEA, and the board visited the site. According to the city of Fresno's Planning Commission resolution to revoke the Crippen Site's conditional use permit after the fire, the Crippen Site had accumulated material in type and quantity that violated the terms of the conditional use permit, and the debris pile had existed for at least seven years before the fire. Thus, staff of each of these agencies observed the conditions at the Crippen Site. However, because of questions about the board's written direction in its advisory and verbal directions to the LEA at the time of the board staff's visit to the Crippen site, lack of communication between some of these agencies, and failure to cite the conditions, the problems at the Crippen Site were not remediated.

We recommended that to ensure sites are adequately monitored, the board should clarify the intent of the advisory for currently known or newly identified nontraditional sites for which regulations are not yet in place. For example, the board should resolve the ambiguity between the advisory's statement that LEAs are strongly encouraged not to accept applications for solid waste facility permits for materials and handling methods under evaluation, on the one hand, and its statement that it is ultimately the responsibility of the LEAs to determine whether to require solid waste facility permits for such sites, on the other hand. In addition, when it determines that an LEA has inappropriately classified a site—for example, treating a composting site as a construction and demolition debris site—the board should work with the LEA to correct the classification.

Board Action: Corrective action taken.

The board stated that on January 22, 2004, it sent a notice to all LEAs rescinding the advisory. With the adoption of the Construction and Demolition Waste and Inert Disposal regulations, the board's regulations provide a comprehensive regulatory permitting structure. In addition, existing regulations now address the permitting

requirements for any solid waste facility; therefore, the advisory is no longer necessary. Further, the board stated that it will continue to assist LEAs in determining what activities require a permit and where the activities fit in the existing tiered regulatory structure. Also, the board has posted detailed responses to questions from LEAs regarding the compostable materials and construction and demolition debris regulations on its Web site.

Finding #3: Questions arose about the city of Fresno's handling of the Crippen Site fire.

During a hearing of a Senate select committee on air quality in the Central Valley, questions arose about the city of Fresno's preparedness for the Crippen Site fire, its fire-fighting techniques, and its timing of requests for expert assistance. In April 2003 a city of Fresno task force made up of concerned citizens, representatives of various interest groups, city and county officials and staff, and current and former members of the City Council issued its report on the events associated with the Crippen Site fire and made 24 recommendations for addressing identified problems. Areas the recommendations covered included, but were not limited to, issuing of permits, monitoring sites with conditional use permits, setting staffing levels and providing training, determining the adequacy of policies and procedures for code enforcement, establishing adequate means for communicating warnings about health hazards, and assessing the adequacy of the emergency response plan. As of late October 2003 the city's status report on its implementation of the recommendations indicated that only seven recommendations remained outstanding.

We recommended that to ensure it appropriately permits, monitors, and enforces compliance with the terms of its conditional use permits and has an adequate system in place to deal with emergencies, such as the Crippen Site fire, the city of Fresno should continue to implement the remaining recommendations from its task force report on the response to the Crippen Site fire. In particular, it should ensure the proper training of staff to ensure they identify existing problems at sites with conditional use permits and effectively enforce compliance with regulations and the terms of conditional use permits, and Code Enforcement should continue implementing its proactive, risk-based monitoring of conditional use permits. It should also take steps to ensure its response to emergencies is effective and prompt.

Board Action: Corrective action taken.

As of January 18, 2005, the city of Fresno reported that it had implemented all 24 recommendations.

Finding #4: New regulations address the lack of oversight of construction and demolition debris sites, but certain operations still lack adequate regulation.

The board's new requirements for processing construction and demolition debris now provide regulatory guidance for oversight of facilities and operations. However, some construction and demolition operations and facilities may fit into the excluded tier of the board's regulatory system. The board's regulations do not require operators in the excluded tier to notify the LEA of their intent to operate, and such operators who increase their activity enough to require a permit are merely "honor bound" to notify the LEA of any changes that modify their current operations. If the LEA is not aware that an excluded tier activity is taking place, the LEA is unable to monitor the activity. Relying on operators to self-report or the industry to self-monitor is insufficient to ensure that all excluded tier activities are accounted for, tracked, and monitored to ensure that materials on site are stable and will not harm public health and safety.

Regulations specify that the LEA or the board can inspect an excluded tier activity to verify that the activity continues to qualify as an excluded tier activity and can take any appropriate enforcement action. However, our survey of LEAs indicated that 26 of 48 responding LEAs, including the two LEAs we reviewed, monitor excluded tier activities only by responding to complaints or reports from other entities. None of these LEAs stated that it performs periodic on-site visits or inspections outside of receiving a complaint.

Of the 48 LEAs responding to our survey, 43 told us that they track the existence of excluded tier activities when they are notified that a local government is considering a conditional use permit or when another entity or department files a complaint with the LEA. However, regulations do not require this tracking, and our visit to one LEA identified that after initially confirming that an activity falls in the excluded tier, the LEA does not track or perform any further monitoring of that activity to determine whether the operator has maintained or changed its activity level. Also, local governments may not forward all conditional use permits to their LEAs for review, so some operations may remain unknown to the LEAs.

We recommended that to ensure the enforcement community is aware of excluded operations that could potentially grow into a public health, safety, or environmental concern, the board should require, pursuant to the Public Resources Code, Section 43209(c), LEAs to compile and track information on operations in the excluded tier. To track this information, each LEA should work with its related cities and counties to develop a system to communicate information to the LEA about existing and proposed operations in the excluded tier with the potential to grow and cause problems for public health, safety, and the environment. For example, cities and counties might forward to LEAs information about requests for conditional use permits, revisions to current conditional use permits, or requests for new business licenses. We are not suggesting that the LEA track all operations in the excluded tier—for example, backyard composting or disposal bins located at construction sites. In addition, the board should require LEAs to periodically monitor operations in the excluded tier to ensure that they still meet the requirements for this tier. Finally, in its triennial assessments of each LEA, the board should review the LEA's compliance with these requirements regarding excluded sites.

Board Action: Pending.

The board stated that it engaged in discussions regarding this recommendation with entities such as the Enforcement Advisory Council and the California Conference of Directors of Environmental Health. The board also stated that while it has the authority to request information it deems necessary to evaluate LEAs, it does not have the authority to require the implementation of a tracking system. Nevertheless, the board stated that LEAs are still responsible for being aware of changes in activities located in their jurisdiction. However, the board has stated that it began discussions with LEAs about the idea of developing, in concert with other local regulatory entities, a mechanism for identifying and tracking activities that may trigger additional regulatory requirements. In addition, the board stated that on September 10, 2004, the governor signed Assembly Bill 2159 into law. The bill requires LEAs to maintain a record of, and take any action that the LEA is authorized to take regarding a complaint, referral, or inspection relating to the operation of a solid waste facility or other activity within the LEA's jurisdiction. The new requirement became effective January 1, 2005.

Finding #5: Board evaluations are substantially appropriate in scope, but do not meet the three-year mandate.

Our review of five LEA evaluations the board completed found that the established scope of the evaluation is appropriate and that the board complied with that scope. The evaluation covers all six specific areas of interest identified in regulations and further ensures that the LEAs continue to comply with certification requirements. However, the board is not timely with its LEA evaluations, beginning or scheduling evaluations to begin on average about 11 months after the end of the mandated three-year cycle. However, the board's definition of what represents a three-year cycle increases the problem. The board defines the three-year cycle as beginning at the conclusion of the LEA's last evaluation and ending at the date the next evaluation is initiated. Our interpretation of the statutory requirement, however, is that LEA performance evaluations should be completed every three years or more frequently. Thus, if an evaluation is completed on February 1, 2001, the next should be completed no later than February 1, 2004. The board's approach, when combined with the time required to actually conduct an evaluation and develop a workplan, if necessary, may delay the discovery and resolution of potential performance shortcomings in an LEA.

We recommended that to comply with existing law, the board should complete evaluations of LEAs within the three-year cycle. If that is not feasible, the board should propose a change in law that would allow a prioritization system to ensure that it at least evaluates LEAs with a history of problems every three years.

Board Action: Partial corrective action taken.

The board stated that staff indicated that it should be able to accomplish the evaluation cycle within the three-year timeframe, in part by examining internal practices in order to streamline the evaluation process and establishing firmer deadlines for internal fact-finding and report review. Further, if these methods are not adequate, staff will examine, as needed, alternative approaches to the current statutory scheme for LEA evaluation, such as establishment of a prioritization system, and/or examine other evaluation models to identify if the board needs to modify its current system. The board stated that the third cycle of evaluations began in April 2003 and staff had completed 33 evaluations with an additional

10 scheduled for completion within six months. Given the rate of completion, the board stated that staff expects to complete all evaluations within the three-year timeframe.

Finding #6: Legal challenges can significantly delay correction of identified problems at noncomplying solid waste sites.

Even if all regulations were in place, all monitoring occurred promptly, and enforcement actions were initiated promptly, identified problems would not necessarily be corrected immediately. The process to correct violations can be lengthy, and it may involve hearings and legal proceedings, including appeals of decisions in each. The Waste Act contains a comprehensive enforcement scheme for solid waste facilities, designed to allow LEAs to bring various enforcement actions against owners and operators for violations of the Waste Act. Under certain circumstances, the board may take enforcement actions itself. This enforcement scheme includes the ability to issue a corrective action order or a cease and desist order, to administratively impose civil penalties, and to suspend or revoke a permit under certain conditions. However, this enforcement scheme allows a person who is the subject of any of these enforcement actions to request a hearing before a local hearing panel, which must be established pursuant to the requirements and procedures delineated in Public Resources Code, and then before the board. If a hearing is requested, the enforcement order is "stayed," or rendered inoperative, until all appeals to the local hearing panel and the board have been exhausted or the time for filing an appeal has expired, unless the LEA can make a finding that the activity constitutes an imminent threat to the public health and safety or environment. Consequently, a person who is the subject of an LEA enforcement order can continue the activity that is the subject of the order until all appeals have been exhausted.

We recommended that the Legislature may wish to consider amending the current provisions of the Waste Act that allow a stay of an enforcement order upon the request for a hearing, and to streamline or otherwise modify the appeal process to make it more effective and timely and enhance the ability to enforce the Waste Act.

Legislative Action: Partial legislation passed.

The Legislature introduced and amended Assembly Bill 2159, which provides that a request for a hearing would not stay a cease and desist order, under specified conditions, and revised the procedures for appealing hearing panel or hearing officer decisions to the board. It also requires an enforcement agency to maintain a record of, and take any action that the enforcement agency is authorized to take regarding a complaint, referral, or inspection relating to the operation of a solid waste facility or other activity within the jurisdiction of the enforcement agency that is an excluded operation, as specified.

Board Action: Pending.

The board stated that its staff agrees that this issue warrants further consideration.

DEPARTMENT OF FISH AND GAME

Investigations of Improper Activities by State Employees, August 2002 Through January 2003

ALLEGATIONS I2002-636, I2002-725, AND I2002-947 (REPORT I2003-1), APRIL 2003

Department of Fish and Game's response as of February 2003[1]

Investigative Highlights . . .

Employees of the Department of Fish and Game (department) engaged in the following improper governmental activities:

- ☑ *Improperly claimed 479 hours of leave balances, a benefit worth approximately $20,322, to which he was not entitled.*
- ☑ *Circumvented competitive-bidding requirements.*
- ☑ *Violated conflict-of-interest prohibitions.*
- ☑ *Mistreated subordinates and breached other norms of good behavior in a way that brought discredit to the department.*

We asked the Department of Fish and Game (department) to investigate on our behalf allegations that a regional manager claimed vacation and sick leave hours he was not entitled to receive, engaged in various contracting improprieties, and mistreated employees.

Finding #1: The department mismanaged its leave-accounting system.

A manager of one of the department's regions failed to ensure his region made monthly updates to the State's leave-accounting system for more than two years, and even after the region took steps to bring the system up to date, the manager improperly claimed 479 hours of leave balances to which he was not entitled.

The State's leave-accounting system tracks vacation, sick leave, and annual leave as well as other employee leave balances, such as compensatory time off and personal holidays. The leave-accounting system automatically posts credits to the employees' monthly leave balances, but regional staff must account for any leave its employees have taken—which it had not done for more than two years. Thus, for the 180 regional employees the manager oversaw, the region reported leave balances that were greater than the employees' actual balances. In doing so, the region exposed the State to undue liability in that employees might have taken more leave than they were entitled to. Also, employees may have found planning vacations difficult, given

[1] Since we report the results of our investigative audits only twice a year, we may receive the status of an auditee's corrective action prior to a report being issued. However, the auditee should report to us monthly until its corrective action has been implemented. As of January 2004, this is the date of the auditee's latest response.

that they did not receive an accurate accounting of their leave balances. To correct this problem, regional staff, under the manager's direction, began reconciling each employee's leave balances. In most cases, staff assigned to perform the reconciliation easily resolved cases in which individuals identified discrepancies. In some instances regional staff were unable to locate employees' time sheets. In such cases, their only recourse was to grant those employees the automatic leave accrual, even though the employees might already have taken time off, because the region lacked supporting documentation by which to reduce the employee's leave balances. However, some controversy remained involving the manager's leave balances. The manager disputed his staff's recalculation and rather than provide documentation to support his dispute, he supplied staff with amounts he believed were correct. When the department's investigators questioned him, the manager stated that he had support for these adjustments; however, after reviewing the information the manager provided, the department concluded that the support was inadequate. The department concluded that the manager received a combined 479 hours of sick leave and annual leave that he was not entitled to, a benefit worth approximately $20,322.

Finding #2: The manager and other employees violated contracting and conflict-of-interest laws.

Contrary to state laws, regional staff split various transactions into smaller ones enabling them to circumvent competitive bidding requirements. These transactions related to the purchase of equipment or services provided by companies that a seasonal employee of the department owned or was affiliated with. For example, from February through June 2001, two companies—the employee owned one and founded the other—invoiced the department a total of $62,000 for five underground storage tanks used to provide water for sheep and deer. Instead of treating this as one transaction, regional staff spread these costs among five purchase orders, thereby circumventing competitive-bidding requirements. In addition, supporting documents associated with the purchase of the five underground storage tanks lacked evidence that the department actually obtained competitive bids. The manager and regional staff also allowed one of the companies to begin work related to the underground storage tanks before the department had established contracts for the work, thereby exposing the State to additional liabilities. The department concluded that the seasonal employee violated

conflict-of-interest prohibitions because one of his companies submitted a $10,667 invoice for one underground storage tank at the time he was a state employee.

Finding #3: The manager mistreated subordinates.

The department investigated several complaints concerning the manager's conduct and concluded that the manager made sexually suggestive comments or jokes in the presence of female staff members (who found his comments offensive), made inappropriate gestures to a staff member on several occasions, repeatedly cursed in staff members' presence, and intimidated staff by yelling at them to an extent that they perceived as unprofessional.

Department Action: Corrective action taken.

The department initiated an administrative action against the manager for violating provisions of the Government Code: inexcusably neglecting his duty; treating the public or other employees inappropriately; and breaching other norms of good behavior, either during or after duty hours, in a way that discredited the department. A subsequent May 2002 agreement between the department and the manager called for a reduction in the manager's pay by 5 percent for five months, a reduction in his leave balances by 479 hours; and required the manager to complete department-specified training, including topics on management techniques, equal employment opportunity, conflicts of interest, and contracting. However, the department did not reduce the manager's leave balances by the agreed-upon amounts until February 4, 2003, after we made further inquiries into the matter.

CALIFORNIA ENERGY MARKETS

The State's Position Has Improved, Due to Efforts by the Department of Water Resources and Other Factors, but Cost Issues and Legal Challenges Continue

REPORT NUMBER 2002-009, APRIL 2003

Department of Water Resources' response as of June 2004

Audit Highlights . . .

The Department of Water Resources (department) has renegotiated 23 power contracts with 14 suppliers to improve the energy delivery, financial, and legal aspects of these contracts. In addition, the investor-owned utilities are once again responsible for purchasing the net short.

- ☑ *The portfolio better fits California's power needs due to changes in energy products and a reduction of forecasted demand.*
- ☑ *Reported contract cost reductions were estimated at $5.5 billion on a nominal basis and based on assumptions at the time of the renegotiations.*
- ☑ *Based on March 2003 market assumptions, replacement power costs, and discounting to present value, the department consultant currently estimates ratepayer savings as $580 million.*
- ☑ *The legal terms and conditions of the restructured contracts significantly improved reliability, but the department remains restricted in its ability to assign contracts.*

continued on next page . . .

The California Water Code, Section 80270, requires the Bureau of State Audits to conduct two financial and performance audits of the Department of Water Resources' (department) implementation of the power-purchasing program: the first due by December 31, 2001, and the second due by March 31, 2003. We completed the first required audit on December 20, 2001, and this audit fulfills the requirement for the second audit report. In this audit, we follow up on the department's actions with respect to the recommendations from our 2001 audit. To assist us in forming our conclusions related to the economic issues involved, we retained the services of an energy economics firm to perform various analyses.

Finding #1: With renegotiated contracts and a reduction in forecasted demand, the contracted electricity portfolio better matches California's needs and better tracks changes in fuel costs.

The department has renegotiated the terms and conditions of 23 long-term power contracts with 14 suppliers, representing over one-half of the total value of the portfolio. These renegotiated contracts contribute to the improved fit of the portfolio to the State's forecasted demand by converting significant amounts of nondispatchable power—power that the department was obligated to purchase regardless of the need—to power deliveries the department can use when needed. In addition, the renegotiated portfolio increases power deliveries in Northern California in 2002 and 2003 to meet demand. Further, the department was able to shift some deliveries of power from Southern to Northern California, which reduced the amount of surplus power projected in Southern California. The department also renegotiated for more capacity tied to tolling agreements—

☑ *Even though the investor-owned utilities have resumed purchasing the net short, the department retains substantial responsibilities related to the long-term contracts.*

cost management arrangements that allow the department either to purchase the fuel needed for the power facilities under contract or to tie the fuel cost to the current cost of natural gas. However, most of the improvement in the fit of the power supply to the demand has resulted from significant changes in the demand forecast rather than from significant improvements in the power contracts. These forecast changes include reductions in the demand for power from the investor-owned utilities for a variety of reasons, including the ability of certain electricity customers to buy electricity from alternate suppliers.

We recommended that the department persistently and aggressively manage the long-term contracts to capture opportunities to improve the overall supply portfolio including opportunities to further improve the match of power deliveries from the contracts to California's power needs.

Department Action: Partial corrective action taken.

Since the April 2003 release of our audit, the department indicates it has renegotiated three power contracts and in its June 2004 one-year response to us, the department reported that with the new administration in place, it anticipates renewed renegotiation activity. The department indicates that the renegotiated contracts have improved the match of power deliveries to the State's needs by reducing the amount of must take power deliveries (power that must be purchased regardless of the power need).

Finding #2: While the renegotiation efforts will provide some savings to ratepayers, the department's portfolio still remains above market prices.

Throughout the energy crisis, the department and the governor's office reported both the contract costs and the savings in terms of the contract payments to suppliers. Thus, they reported that the estimated reductions in contract costs from the restructuring of the contracts totaled approximately $5.5 billion, which represents approximately 13 percent of the total original contract costs of $42.9 billion. These contract cost reductions were based on information available at the time of the renegotiations and were calculated using a negotiation model that the department used when evaluating the effect of different renegotiation options on the reduction in contract costs.

While this savings estimate reasonably reflects reductions in the nominal cost of the contract portfolio to the department, an alternative analysis would estimate the savings to the utilities' customers. With consideration of the replacement power costs and using the department's revenue requirement model, a department consultant estimated in March 2003 that the net savings to ratepayers in nominal terms is $1.5 billion. Also, because these savings will occur over the next 20 years, the department consultant estimated that the net present value of the future stream of savings to ratepayers is $580 million. These March 2003 estimates of customer savings are a function of economic, market, and dispatch assumptions used by the department consultant in its modeling and would change if those assumptions changed. Also, the department indicates that its revenue requirement model is not designed to value nonprice benefits resulting from the renegotiation efforts, such as the improved availability and reliability provisions in the contracts. Further, most of these contract cost reductions will result not from reducing the price per megawatt-hour of the power purchased but rather from shortening the length of the contracts or reducing the amount of power to be delivered. However, this reduction of contract length contributed to a department objective to shorten the time that it would have financial or legal responsibility for the contracts and, in the process, permit the utilities to procure energy themselves to meet the additional uncovered net short.

According to the department, the March 2003 estimate of savings to the consumer from the renegotiated contracts as of December 31, 2002, using its revenue requirement model, was made only at our request, and the department would not otherwise have made this calculation. In addition, the amounts are from its consultant's draft report, and had not gone through the department's ordinary standards of review. However, this is the only estimate the department provided to us of the savings to the consumer from the renegotiated portfolio as of December 31, 2002. Further, we observed that these forecasts are consistent with the forecasts prepared by the department consultant in establishing the department's revenue requirements and were also used in support of the revenue bonds that the department issued in October and November 2002.

We recommended that the department persistently and aggressively manage the long-term contracts to capture opportunities to improve the overall supply portfolio, including opportunities to achieve additional cost savings.

Department Action: Partial corrective action taken.

Since the April 2003 release of our audit, the department indicates it has renegotiated three power contracts and in its June 2004 one-year response to us, the department reported that with the new administration in place, it anticipates renewed renegotiation activity. The three renegotiated contracts have reduced contract costs by approximately $1 billion, in nominal terms. However, when considering the savings to consumers by taking into account the cost to replace the power that was eliminated through contract renegotiations, and by considering that the savings occur over time, the net present value (at 9 percent) of the total savings to customers is $322 million. The customer savings varies between approximately $24 million to $74 million from year to year through 2011, but we estimated the savings at approximately $29 million for 2003. The department's consultant calculated the total contract reductions and customer savings using market conditions at the time the three contracts were renegotiated, which is consistent with the methodology used in our audit report.

Finding #3: The renegotiated contracts improve the reliability and flexibility of the department's energy portfolio, but challenges remain.

Our review of the legal terms and conditions of the restructured contracts indicates that the renegotiations have generally resulted in improved terms over those in the original contracts. For example, we found that the restructured contracts have much stronger guarantees that the sellers will deliver the power promised under the contracts and build the new generation facilities promised in the contracts. As a result, the renegotiated contracts better meet the reliable energy goals of Assembly Bill 1 of the 2001–02 First Extraordinary Session (AB 1X) and thus better ensure the availability of electricity to satisfy consumer demand. These improvements are accomplished through stronger terms and conditions, such as termination rights for the State and penalty provisions when sellers fail to deliver energy or construct new generation facilities as promised under the contract. Changes in the type of energy products purchased under the contracts also increase the reliability of the department's contract portfolio. Both the stronger terms and conditions, and the product changes are likely to provide

economic benefits to ratepayers. Another benefit from the renegotiations is that the State has entered into settlement agreements with suppliers. In most of these settlements, the suppliers agreed to cooperate with the attorney general's energy investigation and to make financial settlements to the State.

While the restructured contracts are better from a legal standpoint, significant risks remain for the department, particularly in the contracts that the State has not renegotiated. An area of continuing concern is the restrictions on the department's ability to assign the contracts to other parties, particularly to the investor-owned utilities. The investor-owned utilities have resumed purchasing the net short and have also assumed the day-to-day management and operation of the contract portfolio. However, the department remains legally and financially responsible for the contracts, until either the investor-owned utilities meet certain credit standards or suppliers decide to release the department from this obligation. As a result, the department continues to have significant ongoing legal and technical responsibilities for the management of the long-term contracts and could retain those responsibilities for the remaining life of the contracts.

We recommended that the department persistently and aggressively manage the long-term contracts to capture opportunities to improve the overall supply portfolio, including opportunities to improve the terms and conditions of contracts that have not yet been renegotiated. In regard to its continuing responsibility to manage the long-term contracts, the department should monitor the performance of power suppliers relative to their contractual obligations and promptly address and resolve any supplier deviations from contractual obligations. We also recommended that the department review the appropriateness of the investor-owned utilities' proposed annual gas supply plans for contracts with tolling agreements.

Department Action: Partial corrective action taken.

Since the April 2003 release of our audit, the department indicates it has renegotiated three power contracts and in its June 2004 one-year response to us, the department reported that with the new administration in place, it anticipates renewed renegotiation activity. The department reports that three contracts have improved terms and conditions. For example, one contract now includes anti-market gaming provisions and allows the department to assign it to a credit-worthy investor-owned utility. Another contract also

includes a settlement of claims with the attorney general and other parties, which the department indicates is valued at approximately $1.5 billion. In addition, the Governor's Office reported in April 2004 that it reached a settlement with an energy company valued at approximately $282 million, of which $256 million will be refunded directly to the department and the investor-owned utilities.

To ensure that the investor-owned utilities exercise due care in the handling of the contracts, the department indicates that its staff and consultants conduct weekly internal coordination meetings as well as weekly conference calls with the investor-owned utilities. Further, the department and the investor-owned utilities work together to review the gas supply plans related to each of the gas tolling contracts. Additionally, for those contracts that are tied to new power plant construction, the department indicates that its staff and consultants are witnesses at performance demonstration tests, which are designed to ensure compliance with contract terms either before a power plant begins commercial operation or as an annual performance test of an existing power plant. Finally, the department states that staff periodically visits construction sites for new power plants to ensure that the progress is consistent with the contract.

Finding #4: Sales of surplus power have not significantly affected the cost of the power-purchasing program.

In our December 2001 audit, we indicated that in future years the department's long-term contracts would likely require it to purchase more power than would be needed during some hours. Those quantities would be expected to be sold as surplus and thus have the potential to increase the overall cost of power. In 2002 the department did sell surplus power, but these sales were not significant in proportion to its total purchases. Further, our consultant advises us that the costs from the sales do not appear unreasonable. Although the department's renegotiation efforts have reduced the potential for surplus power sales in future years, it is still likely that significant sales will occur, particularly in the years 2003 through 2005.

To monitor the efforts of investor-owned utilities to limit power sales, the department should routinely collect and analyze data (including settlement data from the California Independent System Operator) on power sales by the investor-owned utilities.

Department Action: Corrective action taken.

The department indicates that it negotiated with the investor-owned utilities and the California Independent System Operator to receive the information needed to monitor the investor-owned utilities' sales of surplus energy from the energy contracts. The department uses this information along with data from counterparties to the sales to ensure that sales of surplus energy are appropriate.

Finding #5: The department was not able to achieve coordinated dispatch of power supplies that could reduce costs.

The department was not able to achieve a coordinated dispatch of power supplies between the contract portfolio and the investor-owned utilities' generating facilities so as to minimize costs to ratepayers. The electric power that the retail customers of the investor-owned utilities purchase is obtained from a variety of sources, each with a different cost per unit of power delivered during different times of the day and week. As such, there is an opportunity each day to optimize this mix of sources to provide power at the lowest possible cost. However, the department has been unable to implement a coordinated dispatch of power sources with the investor-owned utilities. It attributes this inability, to some degree, to the investor-owned utilities' failure to share with the department information about the availability of their generating facilities and the terms of their third-party contracts, as well as to fluctuations in demand forecasts by the investor-owned utilities that make minimizing purchase costs more difficult.

Recognizing the California Public Utilities Commission's (CPUC) established role in overseeing the dispatch decisions of the investor-owned utilities, the department should routinely monitor resource scheduling and other data provided by each utility to ensure that dispatch decisions are consistent with established operating protocols and its fiduciary responsibility to bondholders.

Department Action: Corrective action taken.

As we had recommended, the department reports that it continues to receive all dispatch information from the investor-owned utilities on a daily basis. This information allows the department to compare actual dispatch of contract energy with projected dispatches and to determine

whether there will be any significant deviations to the department's cash flow as a result of the investor-owned utilities' dispatch decisions.

Finding #6: The department will continue to face cost and legal challenges.

Substantial work remains to be done by others to restore California's electric markets to full health and to manage the power portfolio assembled by the department during its two-year tenure as power buyer for the State. Issues involving the creditworthiness of the investor-owned utilities must be resolved, plans must be made for the long-term governance of the utilities' power-procurement practices, and changes are needed in the power market structure to assure that the markets are effective and well monitored. Although California's power supply situation has improved over the past two years, accounting and credit issues have affected many companies in the power supply industry, raising questions regarding the further development of new supplies. Furthermore, substantial outstanding investigations and litigation associated with the power crisis are still unresolved. In addition to marketwide issues, the department's ongoing stewardship of the Electric Power Fund and the contract portfolio will be an important component of the State's power supply for years to come. The contract portfolio is likely to remain under department management for much of the next decade and will require continued vigilance to mitigate the potentially high costs of those contracts. Attendant upon those responsibilities will be the need for the department to manage its operating partnerships with the utilities to schedule and deliver the power and to procure fuel. In addition, the department will be responsible for the administration of bonds issued to finance the cost of the AB 1X power program. These remaining responsibilities carry substantial ongoing obligations to manage costs and risks and will require a sustained professional organization at the department to properly protect the State's interests.

We recommended that the department be alert for situations in which the credit standing of the investor-owned utilities may adversely affect the department's costs. Further, the department needs to maintain the capability to analyze conditions in electricity and gas markets. The department should also use the servicing agreements with the investor-owned utilities to monitor dispatch statements from the investor-owned utilities relative to their accounting statements to the department.

Finally, to fulfill its responsibilities for servicing the revenue bonds, the department should prepare revenue requirements filings for the CPUC and advise the CPUC when its regulatory oversight of the investor-owned utilities intersects with the department's responsibilities under the revenue bonds; act to mitigate risks, such as CPUC ratemaking practices, that may adversely affect bondholders; and perform financial and accounting activities necessary to support its obligations under the revenue bonds.

Department Action: Corrective action taken.

The department reports a variety of actions to address our recommendations. The department notes that it and the investor-owned utilities have determined that they can purchase gas at a lower cost under tolling agreements than having generators supply the gas needed to produce power. Since the investor-owned utilities act as the department's agent when making gas purchases, the credit standing of the investor-owned utilities has not affected the cost to purchase gas as the gas sellers are relying on the department's credit standing. Concerning the need to maintain capabilities to analyze conditions in the electricity and gas markets, the department subscribes to various gas and power market information services, participates in procurement review groups with each investor-owned utility, and is a member of a natural gas working group with the CPUC and several other state departments. Additionally, the department actively follows and monitors CPUC proceedings that may impact or change the operating agreements with the investor-owned utilities and that might be adverse to the department or its responsibilities under AB 1X, or be perceived adversely by the financial community. When such issues are identified, the department files memoranda or comments in these proceedings to preserve its rights and explain its position to the CPUC. Further, the department believes the implementation of several automated tools allows it to better monitoring dispatch statements from the investor-owned utilities. Finally, the department indicates that it continues to prepare the annual revenue requirement for the CPUC and perform the financial and accounting activities required to support the department's obligations under the revenue bonds.