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# Key Points of Report

## Contract Management Processes at the Texas Natural Resource Conservation Commission

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September 1996

### Overall Conclusion

The Texas Natural Resource Conservation Commission (Commission) has recently enhanced contract administration by establishing a centralized contract management function. However, improvements are still needed for the overall agency and within individual programs. Commission processes for monitoring contractor compliance with performance and financial requirements do not always detect deviations from contract expectations and requirements. No fraud was detected during our limited review. During fiscal year 1995, the Commission reported expending approximately \$142 million on contractual relationships. The Commission estimated \$169 million in contractual obligations for 1996.

### Key Facts And Findings

- While management has streamlined the Petroleum Storage Tank reimbursement process, oversight of contractual relationships within the program is not yet sufficient to ensure that the program has paid for actual services performed. We questioned approximately \$31,753 in reimbursements made to claimants who submitted deficient supporting documentation and who did not explain variances from approved amounts. Statutorily required claims audits were not initiated by the Commission for over a year, and program inspections are not based on a formal risk assessment.
- Current Waste Tire Recycling program administration practices allow for significant exceptions to established rules and do not address known deficiencies of the program or its participants in a timely manner. During our audit, we determined that reimbursements have been made to processors who did not meet registration rule requirements. Additionally, inspection violations of some processors have not resulted in timely enforcement action.
- Contract monitoring practices within the Clean Rivers program are not sufficient to ensure that payments are made for appropriate activities and expected results. We questioned approximately \$32,250 in payments made to river authorities from the Clean Rivers program for charges not adequately supported, and for charges appearing to be unreasonable or not directly attributable to the program. Additionally, financial monitoring and formal audits are not conducted for program fund recipients.
- Contract management practices regarding start-up phase contracts appear sufficient within the state-funded Superfund program to ensure that appropriate and qualified contractors will be selected, and that deliverables will meet negotiated cost and performance expectations.

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## Office of the State Auditor

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*This audit was conducted in accordance with Government Code, § 321.015(a) and (b)(1).*

## Executive Summary

The Texas Natural Resource Conservation Commission (Commission) has recently implemented enhancements in its overall contract management process. However, opportunities for improvement still exist at both the agency and program levels.

We found instances in our limited test work where the monitoring of contractor compliance with performance and financial requirements was not consistent, and in some cases not sufficient. In two agency programs, we detected approximately \$64,000 (out of \$645,000 tested) in questionable costs due to deficient supporting documentation, unexplained variances, and charges appearing to be unreasonable or not directly attributable to the program. We also noted significant exceptions to established rules in another agency program.

The occurrence of questionable costs lessens the Commission's ability to ensure that payments are made for eligible services received from contractors. The allowance of deviations from established rules weakens the enforcement role of the Commission.

During fiscal year 1995 the Commission reported approximately \$142 million expended on contractual obligations. The Commission anticipated \$169 million in contractual obligations for 1996. Thus, it is essential that the Commission's management of its contracted services be strengthened.

During the course of our work, Commission management was very receptive to input provided by the state auditors regarding the identification of significant contracting tasks requiring improvement. In many cases, corrective action was taken immediately.

### Continue Improving Agency Contract Management Processes to Correct Historical Deficiencies

Prior to January 1996, the Commission did not have a complete and comprehensive contract management function in place which ensured that the agency consistently acquired quality goods and services at the best price. As a result, during our audit from November 1995 through June 1996 we found inefficiencies and deficiencies in the way contracts have been developed, awarded, monitored, and evaluated within the agency. Our initial findings were consistent with agency findings generated from several past contract administration assessments.

In response to the past assessments of Commission contract practices, current management has focused agency efforts on implementing recommendations to strengthen contract administration. The results of these efforts have been:

- Implementation of a centralized contract management function
- Establishment of common contracting policies and procedures
- Enhancement of the contract administration training program
- Commencement of development of a comprehensive contracts database

To further enhance overall contract management, the Commission should continue to support its newly established centralized contracting function. The Commission will also need to improve its overall performance and financial oversight of contractors by:

## Executive Summary

- Enhancing reviews of invoices and performance reports
- Planning and focusing contractor review activities based on defined risk factors and established criteria; documenting all visits and results; and ensuring noted deficiencies are corrected, reported, and brought to closure
- Effectively communicating internal procedures on detecting fraud, and resolving complaints to all relevant Commission staff
- Implementing a comprehensive contract management information system to assist management with planning, reporting, and assessment needs

In general, an effective contract management system should be sufficient to ensure that public funds are used appropriately and efficiently regardless of the method of contracting, with an overall objective of ensuring that the State is paying the best price to the most effective and efficient contractors.

### **Strengthen Oversight Practices Within the Petroleum Storage Tank Reimbursement Program to Ensure Payments Are Made for Actual Services Received**

While program management has streamlined the reimbursement process, the oversight of contractual relationships within the Petroleum Storage Tank program is not yet sufficient to ensure that the program is paying for actual services performed. Although no fraud was detected in the claims reviewed during our audit, program oversight practices provide opportunities for owners to receive reimbursement for work that has not been

performed, or that is in excess of the costs incurred for work performed.

We questioned approximately \$31,753 in reimbursements made to claimants who submitted deficient supporting documentation and who did not explain variances from approved amounts. Additionally, statutorily required claims audits were not initiated by the Commission from March 1995 through June 1996, and program inspections have not been based on a formal risk assessment. Finally, the program's reimbursable cost guidelines, developed in 1992, have never been updated to reflect actual and current costs of clean-up work.

### **Enhance Oversight Practices Within the Waste Tire Program to Ensure Funds Are Consistently Expended for Eligible Activities**

Current Waste Tire Recycling program administration practices allow for significant exceptions to established rules and do not address known deficiencies of the program or its participants in a timely manner.

Reimbursements have been made to tire processors who did not meet registration rule requirements. At least two processors received reimbursements (totaling over \$2.0 million) for six months or more while operating with expired registrations. Additionally, inspection violations of some processors have not resulted in timely enforcement action. Past Commission audit activities have not been scheduled based on objective and documented consideration of the riskiest aspects of the program. No fraud was detected during our limited review.

## Executive Summary

### **Improve Contract Management Practices Within the Clean Rivers Program to Ensure Payments Are Made for Appropriate Activities and Expected Results**

We questioned approximately \$32,250 in payments made to river authorities from the Clean Rivers program for charges not adequately supported, and for charges appearing to be unreasonable or not directly attributable to the program. Payments have also been made when performance has not met expectations. Additionally, financial monitoring and formal audits are not conducted for recipients of program funds.

### **Start-Up Phase Contract Management Practices Within the State-Funded Superfund Program Appear Sufficient to Ensure That Appropriate Contractors Will Meet Contract Expectations**

Contract management practices regarding start-up phase contracts appear sufficient within the state-funded Superfund program to ensure that appropriate and qualified contractors will be selected, and that deliverables will meet negotiated cost and

performance expectations. The efficiency of the steps involved in the state-funded Superfund contracting process was not evaluated during this audit.

### **Summary of Management's Responses**

The Commission fundamentally concurs with the key issues contained in this report, and has begun implementing many of the recommendations.

### **Summary of Audit Objective and Audit Scope**

The objective of the audit was to evaluate and report on the effectiveness of the Commission's administration of its purchased service contracting process, in accordance with Government Code, Section 321.015(a) and (b)(1).

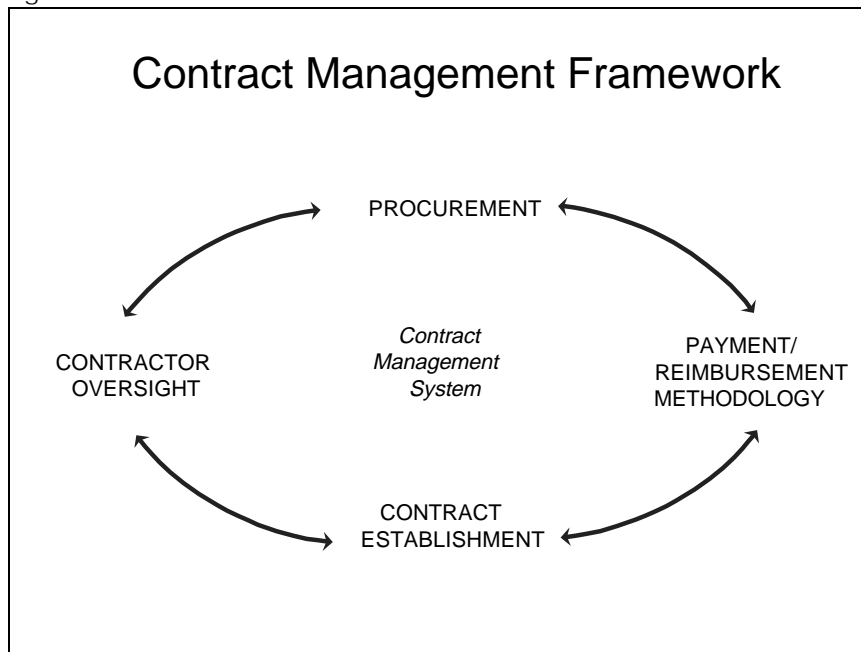
The scope of this audit was limited to a general review of purchased service processes and a specific review of contractual relationships within four Commission programs that paid out over \$109 million in fiscal year 1995.

## Continue Improving Agency Contract Management Processes to Correct Historical Deficiencies

Recently, the Texas Natural Resource Conservation Commission (Commission) implemented some much needed enhancements in its overall contracts management process. However, prior to January 1996 the Commission did not have a complete and comprehensive contract management function in place which ensured that the agency consistently acquired quality goods and services at the best price. As a result, during our audit from November 1995 through June 1996, we found inefficiencies and deficiencies in the way contracts have been administered within the agency. For example, we noted the following early in our review:

- Lack of a fully developed, centralized contracting infrastructure
- Lack of comprehensive contracting policies and procedures
- Undefined roles and responsibilities of contracting personnel
- Lack of contractor reviews based on a risk assessment methodology
- Minimal use of sanctions
- Weak Historically Underutilized Businesses (HUB) contractor monitoring

Figure 1



In general, contracting responsibilities had been delegated across multiple program areas with no formal comparisons or evaluations to identify and implement the most cost efficient or effective contracting activities. The conditions noted above cover all aspects of the contract management cycle, from procurement to oversight. (See Figure 1.)

In response to common recommendations contained in at least six agency assessments generated since 1993, current Commission management has focused agency efforts on implementing the suggestions for strengthening contract administration.

The common foundation for recommendations throughout the earlier assessment reports focused on a centralized Grants and Contracts Management infrastructure. Recognizing the consistently reported need for such an infrastructure, the fiscal year



1996 Operating Budget provided for the establishment of three sections (Contracts Management; Grants Management; and Compliance, Evaluation and Audit) within a new Contracts and Grants Management infrastructure. Two of the three sections were in place, yet not fully staffed, at the start of the 1996 fiscal year in September 1995. The new centralized infrastructure and the third section were established in January 1996.

Management also established workgroups represented by multiple agency programs to begin the development of common contracting policies and procedures.

Section 1-A:

### **Fully Support the New Centralized Contract Management Function to Ensure Contracting Consistency and Effectiveness Throughout the Agency**

The newly implemented function must overcome the current fragmented and inconsistent treatment of contracts throughout the agency. A consistent, comprehensive, and evaluative approach to contracting at the Commission should be

established to better manage the growing number and high dollar volume of contracts and grants extended by the Commission. Without such an approach, contracting dollars will continue to be expended within deficient, inefficient, and incomplete contract administration procedures, as noted earlier and throughout this report

#### **Effective Contract Management System**

An effective system of contract management should be sufficient to ensure that public funds are used appropriately and efficiently **regardless of the method of contracting.**

To ensure success, the Commission's new centralized contract management infrastructure will need extensive effort and agencywide support as many current contracting practices require improvement. During fiscal year 1995, the Commission reported spending approximately \$142 million on

contracts and contractual relationships related to mainly environmental clean-up activities. The Commission anticipates that it will establish \$169 million in contractual obligations for 1996. Thus, it is essential that the Commission's management of contracted services be strengthened.

#### **Recommendation:**

The Commission's executive management should provide full and continued support to management of the newly created function to ensure contracting consistency and effectiveness throughout the agency. Information regarding the function's objectives, structure, clear position in the organization, responsibilities, and authority should be communicated periodically and agencywide. Management of the new function should

**Overall Objective of a  
Contract Management System**

To ensure that the State is paying the best price to the most effective and efficient contractors.

be focused on and held accountable for establishing goals and timelines, policies and procedures, and a comprehensive contract training program. A goal of the new function should be to enhance contracting coordination between agency program areas. The primary objective of the new function should be to establish a contract management system which ensures that the agency is paying the best price to the most effective and efficient contractors.

Section 1-B:

**Improve Contract Monitoring and Audit Activities in Order to  
Better Hold Contractors Accountable**

Current agency monitoring and audit activities are not sufficient to ensure that contractors are meeting contract provisions. Considering the large volume and dollar amounts of contracts at the Commission, there are potentially significant dollars that are not effectively monitored.

Contract monitoring activities at both the program and agency levels are not evaluated for effectiveness. Monitoring results are not standardized across common aspects, vary widely in format and detail, and are not routinely communicated outside of the program area. Thus, comparisons of results and their impact between programs is difficult. Monitoring procedures range from periodic phone calls to the appointment of field site monitors. In the spirit of "partnering," monitoring phone calls are often used to provide technical assistance to the contractor and not to determine the status of deliverables or compliance with contract provisions.

Site monitoring visits and inspections have not been scheduled based on a formal risk assessment process, and are often conducted when time or contractor location is convenient. For example, Clean Rivers program site visits usually occur in conjunction with attending general contractor meetings and do not include procedures for reviewing contractor records associated with program activities. (Additional examples are described in Sections 2, 3, and 4 of this audit report.)

Formal and required audits conducted by the Commission on significant contractors within its multiple programs areas have been inadequate. An internal letter written by an executive manager to the Commissioners on December 20, 1995, stated that, "except for the Petroleum Storage Tank, Waste Tire, and Superfund programs, our contractors and sub-grantees have for the most part never before received an audit from the Commission nor its predecessor agencies." For example, although there is a statutory requirement for claims audits to be conducted for recipients of Petroleum Storage Tank clean-up funds, the Commission did not initiate any audits of program recipients from March 1995 through June 1996. In fact, Commission staff who would normally be conducting such audits were stated to be "on loan" to other program audit activities at the time our audit began.

Contractors that have been audited were not selected using a formal, comprehensive, and documented risk assessment process. The agency used a subjective and informal risk assessment process to select contractors for audits, and all contractors were not considered in the selection process.

Audit plans have not always been systematically prepared or completed. For example, when the Commission established its centralized audit function within the new contracts management infrastructure, a comprehensive audit plan did not exist for the intended activities of the new audit function from September 1995 through March 1996.

Audit results have not been consistently tracked or followed up, and closure procedures for audit findings have not been developed. Examples of these concerns are noted throughout the body of this report.

Recommendation:

Management of the new centralized contracting infrastructure should focus efforts on improving contract monitoring and audit activities within the agency in order to better hold contractors accountable. Infrastructure management, with support from Commission management, should:

- Evaluate monitoring processes across the agency.
- Develop and implement effective monitoring practices for different contract types.
- Ensure shared monitoring results across programs to prevent other areas of the agency from continuing to contract with poor performers.
- Consider joint monitoring efforts for common contractors.

Input from the Commission's internal audit division should be considered during these efforts as this division has performed effective and comprehensive reviews of the Commission's contracting processes during fiscal years 1994 and 1995.

The Commission should also develop and implement risk-based monitoring and audit processes. Monitoring and audit efforts should be focused based on the size and risk of a contract, at a minimum, so as to better allocate agency resources. Monitoring and audit activities should specifically address compliance with contract provisions for performance, financial and oversight requirements. Procedures for the follow-up of results from monitoring and audit activities should be developed and put into place as soon as possible.

Section 1-C:

### **Effectively Communicate Procedures for Fraud Detection and Complaint Resolution to Increase Assurance That Contractors Are Acting Appropriately**

The Commission cannot ensure that fraud and poor performance among contractors will be detected and brought to resolution. Many Commission contracting staff are not aware of established internal processes and procedures for detecting fraud and resolving complaints. While no fraud or abuse was detected during our audit, it is possible that such activities may be occurring.

Information regarding contractor irregularities or poor performance, if detected through monitoring or audit activities, is usually maintained within each program or sub-program area and is not shared agencywide. Among key contracting personnel, there is not a common understanding of where fraud should be referred within the agency (i.e., legal? enforcement? both?). A Commission audit team leader stated that agency contract auditors have not been required to attend fraud training and the team leader was not even sure if she would be able to detect such situations. Specific audit procedures regarding fraud detection were not present in audit programs utilized by auditors.

Incoming concerns and complaints of an environmental nature involving contracts or contractors may be received anywhere within the Commission. Once received by the agency, complaints are not required to be resolved by following a formal or documented process. While the Commission does have a complaint resolution process within its Office of Public Assistance, the agency does not have a centralized information system in place to process and resolve complaints. Because of the lack of required record keeping and tracking, it is possible that follow-up work or referrals regarding complaints may never be performed. Additionally, this key information regarding complaints is not available or used when planning for contract monitoring, auditing, and evaluating activities.

#### **Recommendation:**

Commission management should effectively communicate detection and resolution processes for handling fraud and complaints in order to increase assurance that contractors are engaging in appropriate activities. This initiative should be developed and implemented in conjunction with the new processes and procedures being established by the centralized contract management infrastructure. Detection and resolution processes and procedures for fraud and complaints should be disseminated agencywide, as well as addressed in a comprehensive contracts management manual. The results of detection and resolution processes should be maintained in a central database for historical evaluation of contractors and complaint patterns, and should also be factored into monitoring and audit risk assessments for planning and/or resource allocation.

Section 1-D:

## **Consolidate Contracting Information to Facilitate Management Planning, Reporting, and Assessment Needs**

Contracting information is widespread throughout the agency within multiple and duplicative databases which do not interface with each other. Access to and assessment of comprehensive contracting information was found to be cumbersome during our review. During the audit we were unable to obtain a comprehensive report, inclusive of reimbursement contractual relationships, on total contract dollars spent, awarded, and amended by the agency in fiscal year 1995; as well as how many and what contracts were being administered by each agency program area; and who was the contract manager for each contract. In some cases, program staff had to spend considerable amounts of time compiling information manually to respond to external requests. The lack of comprehensive contracting information impedes management's ability to adequately plan for contract administrative and training needs. Such information is also key to the evaluation of overall contracting activities and their effectiveness.

The accuracy of the data scattered across the various contracts' databases became questionable as some program staff described processing only weekly or monthly updates. Additionally, some staff were maintaining more than one database to meet information needs. Because of this lack of accurate and comprehensive contracting information, management cannot easily evaluate overall data to identify problems and inefficiencies within the agency.

Contract assessment reports are often compiled to meet ad hoc requests and the information between like reports is not always consistent. For example, in March 1996 the Commission responded to an external request for the *Total Dollars in Contracted Services for Fiscal Year 1996* with an amount of \$125,116,047. In May 1996, while responding to a similar request, the Commission drafted a report which reflected \$116,629,989 in contract costs anticipated for fiscal year 1996. The Commission later revised its draft report in June and formally reported an amount of \$169,449,843 in anticipated contract costs for fiscal year 1996.

Routinely generated contract assessment reports are not always reviewed and resolved. For example, during the course of the audit a routine report was produced in January 1996 which identified contracts with little to no activity occurring over an extended period of time. A large number (134) of contracts were listed in this "inactive" category. Further research by the Commission revealed that nearly half were eligible for immediate closure.

Information regarding the usage of Historically Underutilized Businesses (HUB) on agency contracts is not consistently collected and maintained within a comprehensive database. While the Commission appears to have made a good faith effort to comply with state HUB requirements, the Commission is not able to assess and report complete information toward the achievement of state HUB goals.

Recommendation:

Commission management should consolidate agency contracting information to assist with planning and assessment needs. In coordination with the new centralized contracts management infrastructure, a task force should be established to identify the key data which needs to be captured and maintained by a comprehensive database. Procedures and controls should be developed for the input and manipulation of data within the database so that all data is current, accurate, and protected from inadvertent loss. There should also be a plan established for the periodic evaluation of the effectiveness of agency contracting processes overall, with the results being reported to executive management.

Section 2:

## **Strengthen Oversight Practices Within the Petroleum Storage Tank Reimbursement Program to Ensure Payments Are Made for Actual Services Received**

While program management has streamlined the reimbursement process, the oversight of contractual relationships<sup>1</sup> within the Petroleum Storage Tank program is not yet sufficient to ensure that the program is paying for actual services performed. Although no fraud was detected in the claims reviewed during our audit, the current program oversight practices provide opportunities for owners to receive reimbursement for work which has not been performed or which exceeds the costs of work performed.

We questioned approximately \$31,753 in reimbursements made to claimants who submitted deficient supporting documentation and who did not explain variances from approved amounts. The basis for the questioned costs focuses on whether the reimbursements were for activities which actually occurred and not whether the activities were allowable under the program guidelines. Additionally, statutorily required claims audits were not initiated by the Commission for over a year, and program site inspections are not based on a formal risk assessment. Finally, the program's reimbursable cost guidelines, developed in 1992, have never been updated to reflect actual and current costs of clean-up work.

The Commission paid \$75 million during fiscal year 1995 to owners and contractors for petroleum storage tank clean-up work. Per agency management, funds budgeted for clean-up payments in fiscal year 1996 exceed \$123 million. During our audit, three reimbursed owners were selected for review based on significance of contractual amount, significance of the program within the agency, and agency audit plans. Total payments received by the three in fiscal year 1995 totaled \$16 million, of which

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<sup>1</sup> Through the Petroleum Storage Tank Reimbursement Program, the State has offered monetary consideration to eligible storage tank owners who accept the conditions of the program and perform eligible clean-up work related to leaking petroleum storage tanks. The Commission has been designated the oversight entity for this program.

\$420,000 in claims were tested. Samples for testing were determined judgmentally, thus results cannot be statistically projected to the program's population.

Section 2-A:

### **Enhance Reviews of Reimbursement Requests to Better Detect Unsupported Costs and Better Reflect Justified Variances**

The Commission has reimbursed owners for petroleum storage tank clean-up work not adequately supported with expense documentation, not sufficiently justified when variances occurred from approved work plans and amounts, or not appropriate for the claimed activity. As a result, it is possible that the Commission has paid for services which have not been performed at the indicated clean-up sites.

#### **Contractor Oversight**

Ensure that the State receives the best value for its contracting dollars by determining if contractors consistently provide quality services (by measuring performance against well-communicated expectations), and if public funds are spent effectively and efficiently.

During our audit, we found several reimbursements made to owners for work which was not adequately supported within the request for payment. Examples of missing support included:

- Lack of subcontractor invoices
- Lack of time sheets
- Lack of original lab reports
- Lack of equipment invoices

Instances were also found where payments were made to owners for fees incurred on other sites, for inflated mark-ups, and for duplicate charges for services and equipment. Charges in excess of preapproved amounts by line item categories or total cost were paid without required justifications by either program staff or the owner on file. The fact that approximately \$31,753 in questionable payments have been made without adequate support and without required justifications indicates that improvements are needed in the reviews of reimbursement requests.

#### **Recommendation:**

Program management should enhance its reimbursement review process to better detect unsupported costs and better reflect justified variances. Worksheets used by program staff during preapproval and reimbursement request reviews should be revised to include comprehensive checklists of support verified and justifications provided. Exceptions allowed to program policies and procedures should be documented on the worksheet by the reviewer. Program staff should also seek assistance regarding effective and efficient reimbursement review practices from the Commission's new centralized contracts management function.

Section 2-B:

### **Implement a Plan to Conduct Audits to Meet Current Statutory Requirements and to Detect and Follow-Up on Reimbursements Made for Unallowable, Inappropriate or Non-Existent Services**

The Commission did not initiate any statutorily required claims audits of Petroleum Storage Tank reimbursement recipients from March 1995 through June 1996. Claims which were audited prior to March were not selected based on a formal risk assessment process and audit results were not brought to closure. For example, eight comprehensive audits were conducted by an external firm in late 1993. Although the results from the audits identified \$840,000 in questioned costs, the Commission did not bill the owners for repayment or pursue the audit findings until May 1996.

At the time of our audit, we noted that when an owner received reimbursement for clean-up work, it was unlikely that the reimbursement documentation would be reviewed again by the Commission staff to detect compliance with program rules and verify the appropriateness of the payment. When audits did occur for reimbursement requests, they were performed either on an ad hoc or an informally selected basis. Because the agency has not developed an audit closure process, results from such reviews were not always followed up on or resolved.

#### Recommendation:

Commission management should develop and implement a risk-based plan for conducting statutorily required claims audits of reimbursements made from the Petroleum Storage Tank program. This initiative should be coordinated directly by or with the newly centralized contracts management function. The audits should contain procedures for detecting reimbursements made for unallowable, inappropriate or non-existent services. Additionally, an audit resolution process should be developed and implemented immediately.

Section 2-C:

### **Improve Inspections of Leaking Petroleum Storage Tank Sites by Developing a Risk-Based Approach for Scheduling, and Include Verification of Clean-Up Activities When Applicable**

Commission inspections have not been scheduled using a formal, documented risk assessment process. Without such a formal process and with limited inspection staff, it is highly possible that inspections are not occurring at the most risky leaking sites. Inspection reports for leaking petroleum storage tank facilities do not clearly reflect, when applicable, the verification of clean-up work eligible for reimbursement. Thus, it is possible that clean-up activities are reimbursed without verification of their occurrence. Additionally, we found that inspections of lab analysis facilities required by the Commission's Quality Assurance Project Plan were insufficient. These facilities are used during clean-up work at a leaking petroleum storage tank site.



Inspections were conducted at 469 leaking sites during fiscal year 1995. The inspections were not formally scheduled according to the risks associated with the site. According to Field Operations staff, inspections were scheduled at the beginning of each fiscal year with estimated commitment numbers assigned per region and per type of inspection. Commitment numbers and sites selected were determined informally, and were not determined using a formal, documented risk assessment methodology.

Additionally, these inspections did not always occur during the clean-up phase of a leaking site, which is the phase eligible for reimbursement by the program. Nor did the inspection reports clearly reflect that clean-up work, if in progress, was verified by the inspector.

Petroleum Storage Tank program management has indicated that there are 18,773 leaking storage tank facilities reported in Texas, of which there are 9,671 facilities where the clean-up has not been completed. The Commission anticipated that it would reimburse owners \$104.3 million in eligible clean-up costs during 1996.

Regarding lab facility inspections, we found only 9 percent out of approximately 160 lab facilities tracked by the Commission had been inspected during 1995. Those inspections were selected judgmentally and not selected based upon risk. We also noted that over 20 percent of the tracked labs reflected no record of inspection ever having occurred.

Quality assurance provisions for the Petroleum Storage Tank Program require that contractors use Commission inspected lab facilities when performing leaking petroleum storage site clean-up work. However, due to resource limitations Commission inspectors have conducted very few inspections, which has prevented contractors from complying with program provisions.

Recommendation:

Field Operations management should develop and implement a formal risk-based methodology for determining inspection commitment numbers and resources to be allocated for the inspections of leaking petroleum storage tanks and related activities. Field Operations management should work closely with Petroleum Storage Tank program staff to identify factors which would designate a leaking tank site or owner as high risk.

When applicable, inspection reports should clearly reflect the verification of clean-up work eligible for reimbursement. The results of this effort should increase the agency's assurance that reimbursements for clean-up work associated with leaking petroleum storage tanks are being made for eligible and actual activities. For the Commission as a whole, a formal risk-based methodology should be used for determining all inspection needs and allocating resources within the agency.

Section 2-D:

### **Update the Program's Reimbursable Cost Guidelines to Reflect Current Costs and Historical Variances**

The Petroleum Storage Tank program's reimbursable cost guidelines were originally developed in 1992 based on a survey of the industry. Since that time, the guidelines have not been updated to reflect actual and current costs of clean-up work. Given that the reimbursable cost guidelines serve as the program's key cost containment control, the Commission may not be paying the best price for leaking petroleum storage tank clean-up services.

Program management attempted to update the reimbursable cost guidelines in early 1995 through the use of a market survey. Management has reported that surveys were mailed to 360 registered corrective action specialists but only 23 responses were received. Due to the low response, program management decided not to use the results of the survey and no further attempts were made to update the guidelines.

Owners submit all costs anticipated for the clean-up of a leaking petroleum storage tank site to Commission program staff, who compare the proposed costs to those allowed by the reimbursable cost guidelines. Program staff allow variances from the guidelines for activities which, through experience, are known to cost more than the guidelines permit. However, the history of variances allowed is not adequately documented within program files and tracked for inclusion into the standing guidelines. As a result, time is spent by program staff subjectively reassessing common variance situations. During our audit, we also found that these subjective assessments are not consistent between program staff. For example, an owner's cost proposal was given to different program staff for assessment. Each staff member calculated a different approval amount, with a net difference of \$3,000 between them. With such variations allowed by program staff, compliance monitoring and audit efforts do not have consistent standard cost criteria in order to detect discrepancies.

#### **Recommendation:**

Program management should update the program's reimbursable cost guidelines to reflect current costs and historical variances. This initiative could be accomplished by seeking industry resources, such as publications or survey information, as well as other available Commission information which could be useful in updating the reimbursable cost guidelines. Management should also establish a process whereby periodic updates of the guidelines would become routine.

The reimbursable cost guidelines should be used consistently among program staff, and should provide standard cost criteria for compliance monitoring and audit activities. Program staff should seek assistance regarding establishing and applying effective cost criteria from the Commission's new centralized contracts management function. Any cost variances allowed by program staff should be clearly documented within program files.

Section 3:

## **Enhance Oversight Practices Within the Waste Tire Recycling Program to Ensure Funds Are Consistently Expended for Eligible Activities**

Current Waste Tire Recycling program administration practices allow for significant exceptions to established rules and do not address known deficiencies of the program or its participants in a timely manner.

During our audit, we determined that reimbursements have been made to processors who did not meet registration rule requirements. We also noted that inspection violations of some processors have not resulted in timely enforcement action. Commission audit activities have not been scheduled based on a documented, formal risk assessment process. During our audit, reviews of tire processor records revealed questionable record keeping practices, although no fraud was detected.

Payments from the Waste Tire Recycling program for fiscal year 1995 totaled approximately \$22.4 million. Three of approximately 19 current tire processors were selected for audit review based on significance of contractual amount, significance of the program within the agency, and agency audit plans. Three locations were reviewed for the three tire processors selected. Total payments received by the three locations in fiscal year 1995 were approximately \$9.8 million, of which \$2.2 million was tested. Samples for testing were determined judgmentally, thus results cannot be statistically projected to the program's population.

Section 3-A:

### **Actively Manage Participant Compliance With Established Rules and Guidelines to Prevent Noncompliance Situations**

Contractor noncompliance with established rules and guidelines for the Waste Tire Recycling program has continued due to a lack of timely interaction and delayed enforcement action by the Commission. As a result, we found that the Commission has continued providing reimbursements to tire processors with deficient registration credentials and, in one case, a history of inspection violations. Such situations can lead to a weakening of the perceived enforcement ability of the Commission. It may also become difficult to collect assessed fines and penalties, should the Commission later determine that such sanctions apply, because of the implied approval of monthly operations associated with the reimbursement payments.

For example, at least two tire processors received reimbursements (totaling over \$2.0 million) for six months or more of operations during 1995 when their required operating registration was technically expired. Program staff admit that the registration process can be lengthy, and that it is not actively managed. A processor's re-application for registration is due 60 days prior to the expiration date of its current registration. Program staff discovered, approximately 30 days after expiration

occurred, that information had not been received from one of the processors mentioned above. Then program staff continued to work with the processor for a total of five months in an attempt to obtain the necessary re-registration paperwork. All paperwork still had not been submitted at the time a major fire halted the processor's operations in the following sixth month. Program staff have indicated that there are other processors who have also continued to operate and receive reimbursement while their registrations are technically expired.

The processor in the above example has also had a history of site inspection violations. This processor had eight recurring fire code violations noted in site inspection reports during 1995. Enforcement action was recommended by a Commission field inspector in June 1995, but no action had been taken by the time a major fire occurred at the facility in December 1995.

An overriding goal of the Waste Tire Recycling program is the need to have tire waste collected, processed, stored, and recycled in an overall waste management effort. Program staff must manage this overall tire waste stream while holding tire processors accountable for established rules and guidelines. This results in conflicting priorities.

Recommendation:

Waste Tire Recycling program staff should be more active in requiring that tire processors comply with established rules and guidelines. Timelines for infrequent but expected document submissions from the tire processors should be monitored by the program and notices sent to the processors prior to deadlines. Recurring inspection violations should result in more timely enforcement action. Enforcement action options should be evaluated to determine those most effective for violations or noncompliance issues while balancing the need to continue the managed waste stream. Resulting enforcement decisions, or the lack thereof, should be documented.

Section 3-B:

### **Improve Audits to Ensure Adequate Coverage and to Detect Reimbursements Made for Questionable and Non-Existent Activities**

A formal, documented risk assessment process was not used to select tire processors for previous audits. Additionally, reviews of tire processor records during this audit revealed questionable and inaccurate record keeping practices, although no fraud was detected. Inadequate record keeping practices make detecting reimbursements made for questionable and non-existent activities difficult.

Out of approximately 24 original tire processing sites, the agency has initiated six comprehensive audits since the inception of the Waste Tire Recycling program in 1992. However, these audits were not selected using a formal and documented risk assessment system. Without such a system, it is possible that the riskiest processors were not reviewed by the agency. Recognizing the need to consider risk, the agency developed a more formal system to schedule tire processor audits for late fiscal year 1996 and fiscal year 1997. In addition, Commission management has initiated the incorporation of additional requirements of Senate Bill 776 (effective June 1995). This statute requires audits for not only all tire processors, but also for all tire recycling facilities and all tire derived fuel facilities during each biennium period.

Field reviews of tire processor records during our audit revealed the following:

- Discrepancies between processor records and monthly operational reports to the Commission
- Discrepancies between transportation manifests and processor daily logs
- Mathematical and data entry errors regarding manifests
- Incomplete information on manifests
- Incomplete weigh ticket information
- The appearance that some transporters are completing the generator portion of the manifests

No patterns were detected within these questionable record keeping practices and no occurrence of fraud or inappropriate reimbursement was found. However, such inadequate record keeping practices will “muddy” possible audit trails which are essential in detecting reimbursements made for questionable and non-existent activities.

#### Recommendation:

The Commission management should continue its efforts to adopt risk-based selection processes for the audits of Waste Tire Recycling participants. This initiative should be coordinated directly by or with the newly centralized contracts management function. With such a process, the Commission can more effectively allocate available resources to achieve the most productive reviews. Audit procedures should be designed to

identify questionable activities which may be receiving reimbursement from the program. Audit procedures should also include steps to detect potential fraudulent situations. Program and audit staff should emphasize to the processors the importance of maintaining accurate and traceable records.

Section 4:

## **Improve Contract Monitoring Practices Within the Clean Rivers Program to Ensure Payments Are Made for Appropriate Activities and Expected Results**

Current contract monitoring practices within the Clean Rivers program are not sufficient to ensure that payments are made for appropriate activities and expected results. We questioned approximately \$32,250 in reviewed payments made to river authorities from the Clean Rivers program for charges not adequately supported, and for charges appearing to be unreasonable or not directly attributable to the program. Payments have also been made when performance has not met expectations. Additionally, financial monitoring and formal audits are not conducted for recipients of program funds.

Payments from the Clean Rivers program for fiscal year 1995 total approximately \$4.5 million. Three of 14 river authorities were reviewed based on significance of contractual amount, significance of the program within the agency, and agency audit plans. One Clean Rivers baseline contract was reviewed at each river authority selected. The three contracts totaled \$1.7 million and covered a two year period, of which approximately \$769,000 was paid during fiscal year 1995. Expenditures of \$225,000 were tested during our review. Samples for testing were determined judgmentally, thus results cannot be statistically projected to the program's population.

Section 4-A:

### **Significantly Improve Invoice Review Practices to Include Verification of Supporting Documentation for Costs Incurred**

The Commission has reimbursed river authorities for inappropriate expenses because charges were not adequately supported within the invoice submission. The existing Clean Rivers contracts require that "invoice submittal shall include copies of all receipts, bills, or other documents which represent work completed." However, we found numerous examples where program staff approved reimbursement payments with little to no supporting documentation provided with the invoices.

At all three river authorities reviewed, contractors were reimbursed for costs which appeared to be attributable to other programs or appeared not reasonable and necessary to achieve the goals of the Clean Rivers program. In all such costs questioned, there

was no cost justification documentation on file. For example, charges were billed to the Clean Rivers program for activities associated with the Household Hazardous Waste program and the Non-Point Source program. There was no documentation on file as to why the charges had been applied to the Clean Rivers program.

Additionally, we found charges for the following:

- After-hours long distance phone calls
- Weekend lodging not linked to program activities
- Local meals
- Meal tips
- Labor in excess of corresponding time reports
- Handling fees

Instances were also noted where duplicate charges for services and direct costs were paid. One river authority was billing the Commission for direct and indirect costs incurred while implementing the Clean Rivers program; however, its indirect cost calculation included some direct costs already billed.

While the examples noted above cannot be generalized to the entire program due to sample size and judgmental sampling techniques, the fact that payments have been made which are not adequately supported or appropriate indicates that improvements are needed in the reviews of river authority invoices.

Recommendation:

Program management should enhance its invoice review process to verify the adequacy of supporting documentation and better detect inappropriate charges. Program staff should seek assistance regarding effective and efficient invoice review practices from the Commission's new centralized contracts management function. Invoice submissions should have complete and legible supporting documentation attached or river authorities should be required to maintain all original invoices on file for review. In the case of limited Commission resources, intermittent invoice reviews could be selected using a formal risk assessment process. Disallowed charges resulting from invoice reviews should be recorded and maintained within the program. Such charges detected subsequent to payment should be collected back from the river authorities. A process should be developed for resolving detected discrepancies noted in invoice submissions and payment reviews. The development of this process should be coordinated with the new contracts function. Additionally, decisions made to apply costs to the Clean Rivers program that appear inappropriate or unnecessary should be well-documented and maintained as supporting documentation to program invoices.

Section 4-B:

## **Improve Financial and Performance Compliance Monitoring Activities to Ensure That Contract Provisions and Expectations Are Met**

Current program monitoring activities are not effective in determining compliance with requirements of Clean River contracts because financial compliance monitoring and contractor audits are not conducted at either the agency or program levels.

In the spirit of “partnering,” program staff have focused their interactions with river authorities on providing technical assistance and program guidance. As a result, payments have been made for activities not allowable or beneficial to the Clean Rivers program. Additionally:

- Independent financial audits required of the river authorities are submitted to the Commission but are never reviewed by Clean Rivers program staff.
- Contracts require indirect cost rates to be adjusted by the river authorities at the end of the contract period based on the final audited rate, yet one authority of the three reviewed had not adjusted their rate six months into the next fiscal year.
- Subcontracts and the contract management processes of the river authorities are not evaluated by program staff to ensure compliance with Clean Rivers program requirements as tasks are delegated from river authorities to subcontractors.

Program performance monitoring activities do not hold contractors accountable for contract provisions. Per program staff, all Clean River contracts required extensions during the first two contracting cycles because deliverable timelines were not met. Requested contract payments were made to one river authority whose status reports on file with the program did not provide enough descriptive information so that performance progress could be accurately assessed. Finally, river authorities are not meeting, or reporting to the Commission, goals set forth for usage of HUBs as outlined in the contract provisions.

### Recommendation:

Program management should improve financial and performance compliance monitoring activities to ensure that Clean Rivers contract provisions and expectations are met. These improvements should be coordinated with the Commission’s new centralized contracts management function. A financial compliance monitoring process should be clearly defined, developed, and implemented within the agency program. The invoice processing reviews should be a part of the financial compliance monitoring process. Management should also clearly define elements to be assessed during contractor audits. Clean Rivers contractor audits should be established using a



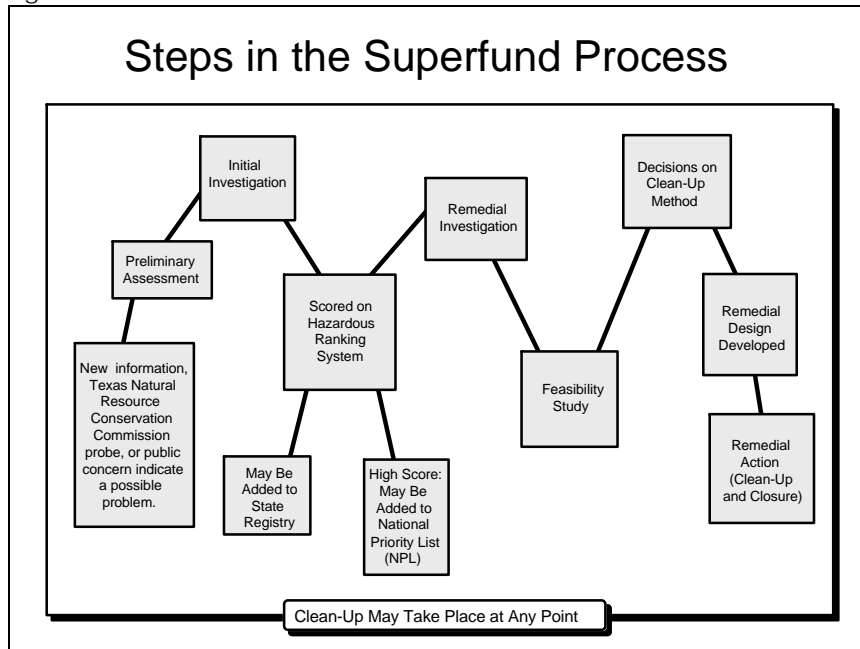
formal risk-based assessment process. Performance expectations and deliverables should be clearly defined in contracts, with performance activities adequately described in progress reports to ensure effective monitoring by program staff. Discrepancies noted during all monitoring and audit activities should be followed up on and resolved using a standard resolution process.

Section 5:

## Start-Up Phase Contract Management Practices Within the State-Funded Superfund Program Appear Sufficient to Ensure That Appropriate Contractors Will Meet Contract Expectations

Contractors for a Superfund site's start-up phase work are selected using an objective and fair methodology. The selection methodology is well-documented and contractor qualifications are evaluated uniformly. Contract provisions are sufficient to hold contractors accountable for delivery of quality services. The provisions are clear, comprehensive, and cite appropriate statutes. Contract provisions are also sufficient to discourage the inappropriate or inefficient use of public funds. Through a qualified negotiated bid process, rate setting methods are sufficient to ensure payment of fair and reasonable prices for services. Reimbursement is based on allowable costs and delivery of a site status report. Detailed financial review procedures for invoices exist. The Commission contractor oversight includes the assignment of an agency project manager to oversee all critical fieldwork, the preparation of monthly contractor evaluations based on performance, and the completion of detailed compliance audits.

Figure 2



All start-up phase (Remedial Investigation/Feasibility Study) contracts were reviewed based on significance of contractual amount, significance of the program within the agency, and agency audit plans. The three contracts totaled \$9.5 million and covered multiple years. The three contractors received \$1.7 million in contract payments during fiscal year 1995, of which \$417,000 was tested. The main performance expectation of these contractors is for a site assessment report and not for actual site clean-up work.

Payments from the state-funded Superfund program for fiscal year 1995 total \$7.2 million. Samples for testing were determined judgmentally and results cannot be statistically projected to the program's population. The efficiency of the steps involved in the state-funded Superfund contracting process was not evaluated during this audit.

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## Management's Response

Barry R. McBee, *Chairman*  
R. B. Ralph Marquez, *Commissioner*  
John M. Baker, *Commissioner*  
Dan Pearson, *Executive Director*

TEXAS NATURAL RESOURCE CONSERVATION COMMISSION  
*Protecting Texas by Reducing and Preventing Pollution*

September 13, 1996

Ms. Kyle Kelly  
Project Manager  
State Auditor's Office  
206 East 9th Street  
Austin, Texas 78701

Dear Ms. Kelly:

The Texas Natural Resource Conservation Commission (TNRCC) appreciates the opportunity to provide formal comments regarding the State Auditor's Office contract management audit report of the TNRCC. Enclosed are responses developed by TNRCC management.

The TNRCC fundamentally concurs with the key issues contained in this report. The agency will use the findings of the audit to further enhance its contracting policies and procedures. The TNRCC appreciates the State Auditor's office for working diligently with the Agency during the audit to resolve issues and develop recommendations to correct deficiencies.

Should you have any questions regarding our Agency's response, please contact me at 239-0007.

Sincerely,

William D. Briggs  
Chief Financial Officer

Enclosure

P.O. Box 13087 • Austin, Texas 78711-3087 • 512/239-1000

TEXAS NATURAL RESOURCE CONSERVATION COMMISSION  
**RESPONSE**

TO

State Auditor's Office Audit of  
Contract Management Processes at the  
Texas Natural Resource Conservation Commission

The Texas Natural Resource Conservation Commission (TNRCC) appreciates the opportunity to provide formal comments regarding the State Auditor's Office recent audit of "Contract Management Processes at the Texas Natural Resource Conservation Commission". We welcome the audit and the insight it has provided for the agency as it works diligently to address and implement recommendations made in the final report.

The Agency will address each recommendation made in the report and will follow the Table of Contents by Section.

**Section 1 - Continue Improving Agency Contract Management Processes to Correct Historical Deficiencies**

**Section 1A - Fully Support the New Centralized Contract Management Function to Ensure Contracting Consistency and Effectiveness Throughout the Agency**

Agency Response

With full support from Executive Management, the TNRCC has established a grants and contracts infrastructure and has organized it within the office of the Chief Financial Officer. Centralization within the Office of the Chief Financial Officer provides for full accountability in terms of fiscal management as well as adherence to sound contract management principles. Thus, the Agency has implemented corrective action to address this recommendation. The agency has established a centralized grants and contracts management infrastructure, has developed and provided training on the comprehensive policies and procedures now in place at the agency, has defined roles and responsibilities of contracting personnel, has developed and implemented an audit plan which includes risk assessment methodologies (Waste Tire, COGs, etc.), is now performing final evaluations and assessing liabilities and sanctions on auditees, is revising its contracting shells to incorporate performance standards and stricter reimbursement methodologies and will be working with the Agency HUB Coordinator to improve HUB monitoring and reporting.

The management of this centralized function has been given the responsibility and authority to establish goals and timelines, policies and procedures, a comprehensive contracts management training program and enhancing contracting coordination between agency program areas. This

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effort shall result in establishing a contract management system which ensures that the agency is paying the best price to the most efficient and effective contractors.

**Section 1B - Improve Contract Monitoring and Audit Activities in Order to Better Hold Contractors Accountable**

Agency Response

Contract monitoring is an essential component of the contract management framework. The TNRCC has increased resources and will dedicate the resources to contract monitoring both at the program and agency levels. In FY 1997, the Clean Rivers program will hire two additional Contract Specialists who will be charged with the responsibility of conducting fiscal reviews of vouchers to be paid and to conduct on-site monitoring visits which shall determine the status of deliverables and compliance with contract provisions. In addition, the Clean Rivers program will also fund an Auditor position within the Compliance, Evaluation and Audit Section of the new Grants and Contracts Management Infrastructure. Also to improve contract monitoring, the infrastructure has developed and implemented a centralized "Contracts Management Database" designed to ensure that contracts are developed, processed, tracked and evaluated consistently and expeditiously throughout the contracts life cycle. The database will be described in greater detail in Section 1D.

In terms of audit activities, the TNRCC, as part of its centralized grants and contracts management infrastructure, has implemented a Compliance, Evaluation and Audit Section. The main purpose of this section is to conduct audits of contractors, grantees and fee revenues owed the agency. This shall be achieved by selecting auditees based on formal risk assessment methodologies and applying appropriate audit standards to the audits. To date, the section has developed and implemented formal risk assessment models for the Waste Tire Program and, most recently, for the Council of Governments audits. This section shall also perform field audits which shall ensure contracts and grants are in compliance with contract terms and agency regulations. The objective of this section, along with the entire contracts management system, is to ensure that grant and contract funds are expended effectively [in the acquisition of desired goods and/or services] and efficiently [in obtaining the best value for the dollars spent] in the pursuit of agency program goals and objectives.

Therefore, contract monitoring and audit activities have been enhanced to ensure compliance with contract provisions for performance and financial oversight requirements. The "Contracts Management Database" will enhance monitoring of contract processes across the agency, improve joint monitoring efforts for common contractors and ensure monitoring results are communicated across programs areas.

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**Section 1C - Effectively Communicate Procedures for Fraud Detection and Complaint Resolution to Increase Assurance that Contractors Are Acting Appropriately**

Agency Response

Complaint resolution and fraud detection are important elements to effectively control risks in a contract and audit environment. Increased and focused attention has been placed on these elements by the TNRCC. The agency recently (August 1996) created the Office of Public Assistance (previously the agency's Office of the Ombudsman) which is charged with the responsibility to address and resolve complaints registered with the agency. Complaints are received and coordinated with the affected agency program to ensure that problem areas are addressed and resolved. Existence of the newly created Office of Public Assistance was widely communicated to agency staff via its monthly newsletter (August 1996) and will be widely communicated to a wide segment of the agency's constituency via the agency quarterly external newsletter (TNRCC Natural Outlook). The Agency does recognize the need to improve reporting processes for handling external complaints. The aforementioned improvements will be implemented by notifying all TNRCC staff of the appropriate actions to be taken for any external complaints received by the Agency.

In terms of fraud awareness and detection, the Section Manager for the Compliance, Evaluation and Audit Section has an extensive background in fraud awareness and detection, established a fraud investigation unit within the City of Austin and has increased communication and coordination with the Special Investigation Unit of the Agency. The agency's Special Investigations Unit has effectively dealt with fraud throughout the agency and especially in the Waste Tire Program. In addition, fraud training was conducted for TNRCC staff in July of 1995 and will be a regular training requirement for Grants and Contracts Management staff. The Grants and Contracts Management infrastructure is responsible for being aware of the characteristics and types of illegal expenditures and acts associated with the area being audited in order to be able to identify indications that these acts may have occurred. They should be alert for possible intentional wrongdoing, errors and omissions, inefficiency, waste, ineffectiveness, conflicts of interest, inadequate controls and high risk conditions and activities.

In addition, as previously mentioned, the "Contracts Management Database" will be capturing fields of data which will directly reflect a contractor's performance as evaluated and judged by the agency representative. In determining the contractor's performance, any complaint registered regarding that specific contractor will be duly noted and considered in the final "report card" regarding that contractor's performance.

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Thus, detection and resolution processes for complaints and fraud are being widely disseminated throughout the agency. Via the agency's "Contracts Management Database", historical evaluations of contractors and complaint patterns will be factored into monitoring and audit risk assessments for planning and/or resource allocation.

**Section 1D - Consolidate Contracting Information to Facilitate Management  
Planning, Reporting and Assessments Needs**

Agency Response

The Grants and Contracts Management Infrastructure is the result of a concerted effort on the part of agency management to improve and consolidate contracting information and monitoring. The monitoring of contracting information has been enhanced by the development and implementation of a "Contracts Management Database". The database was designed to ensure the Agency's contracting/grant management process is effective and efficient, that key participants of the process can be held accountable, and to ensure that contracts are developed, processed, tracked and evaluated consistently and expeditiously. The database is currently a centralized microcomputer-based Paradox 5.0 application written for Microsoft Windows 3.1 which can be accessed through the Agency LAN Network. The database is used to enter the data collected from various documents (Contract Initiation Form, Routing/Reviewer Checklist, Contract Initiation Form for Major Amendments, Procurement Form, Contract or Purchase Order, HUB/MWBE Progress Assessment Reports for Subcontractors) which contain information needed to manage the contracts, generate reports and graphs, and display summary information by using the print screen review. These features will be used to review all facets of the contracts, including the beginning, development, implementation and life of the contracts. The database is currently being used by the Contracts Section for tracking proposed contracts and for preliminary contracts monitoring, with plans to allow others within the Agency to use the system (*read only*) to check on the status of their contracts. The database is to be improved and enhanced as time and resources become available.

Below is a list of the majority of the functions the Contracts Database offers at this time:

- Support for: Contract Section (*electronically on-line*) and Agency-wide staff (*hard copy reports only at this time*)
- Tracking of: Precontract status; Processing time; Amendment status; Information by the Linking Federal Grants' database with the Contract Database; Insurance and Bonding Status; HUB/Subcontractors status per contract; Closeout status, Audit Status; and Current contract status such as last payment and current balance of a contract.



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- Flexible report printing for: Precontract Status Report; Subcontractor HUB type reports; Contract type by Office; Audit due reports; Ending dates of contracts; and Closeout due reports.

Therefore, the "Contracts Management Database" will provide access to and assessment of agency contracting information. As a result of compiling and maintaining accurate and comprehensive contracting information, agency management will easily evaluate the overall data to identify and resolve problems and/or inefficiencies within the agency's contracts management process.

**Section 2 - Strengthen Oversight Practices Within the Petroleum Storage Tank  
Reimbursement Program to Ensure Payments Are Made for Actual Services Received  
Section 2A - Enhance Reviews of Reimbursement Requests to Better Detect  
Unsupported Costs and Better Reflect Justified Variances**

Agency Response

Management of the Petroleum Storage Tank Reimbursement Program has developed and implemented new policies and procedures to address and comply with the State Auditor's recommendation. The Petroleum Storage Tank program allows the contractor to exceed the total pre-approved cost by 7% with a valid technical justification for the overage, this is documented in the TNRCC publication Preapproval For Corrective Action Activities [RG-111, September 1995, page 5]. This is to allow for minor technical changes to occur in the field, without requiring the contractor to stop work and contact the TNRCC for a written pre-approval of the excess costs. If the technical changes are estimated to exceed the pre-approved amount by more than 7%, the TNRCC required the contractor to contact the TNRCC prior to initiating these technical changes. The auditor has recommended that the program modify its "review worksheet" to require acknowledgment of variances and require justifications for variances. Worksheets used by program staff during the preapproval and reimbursement request reviews have been revised to include comprehensive checklists of support verified and justifications provided. The new policy requires that all exceptions are to be documented on the "review worksheet". The program implemented the change effective July 15, 1996. The Petroleum Storage Tank program is also in the process of developing a policy to determine when a variance is small enough that it would cost the TNRCC more to reprocess the reimbursement claim than the total cost of the variance.

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**Section 2B - Implement a Plan to Conduct Audits to Meet Current Statutory Requirements and to Detect and Follow-up on Reimbursements Made for Unallowable, Inappropriate or Non-existent Services**

Agency Response

As a result of the implementation of the Grants and Contracts Management Infrastructure, the Compliance, Evaluation and Audit section has resolved or taken steps to resolve each of the issues relating to the audits of Petroleum Storage Tank reimbursements. All outstanding audit findings have been addressed appropriately and details of these actions have been provided to the State Auditor's Office. The Compliance, Evaluation and Audit section is establishing policies to comply with audit standards, which will specifically include resolution of audit findings.

However, it is important to note that the TNRCC has been performing PST audits included in its FY96 Audit Plan. Audits of claims may have stopped for a period of time after an initial 8 audits were completed but have been restarted in FY 96 through assistance provided to the State Auditor's Office and an ongoing audit of another PST claimant. In addition, the Compliance, Evaluation and Audit section is currently preparing the FY97 audit plan based on risk assessment/audit selection assistance from and in conjunction with the State Auditor's Office. Our purpose is to use the audit selection and risk analysis techniques in order to best deploy audit resources. Audit efforts should result in increased voluntary compliance with TNRCC regulations and to increased identification of funds due the TNRCC. Our efforts to comply with this recommendation will include: 1) investigate strategic approaches to audit selection and risk analysis, 2) identify potential audit selection/risk analysis policies and procedures, 3) gather and analyze available data using risk assessment techniques and finally, 4) develop and implement an FY 1997 Audit Plan.

**Section 2C - Improve Inspections of Leaking Petroleum Storage Tank Sites by Developing a Risk-based Approach for Scheduling, and Including Verification of Clean Up Activities When Applicable**

Agency Response

Field Operations has now developed a formal risk-based method for determining inspections. There is, however, no risk-based method for determining inspection numbers. That process is based upon available resources. We already work with the PST Division when there is a concern about the clean-up at an LPST site. We can formalize the procedure. However, our inspections are not geared towards oversighting contractors conducting clean-up activities. Rather, our

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inspection goals are to determine compliance that would avoid contamination. But when contamination is discovered, we follow through by means of our enforcement process to assure that remediation occurs. In order to oversight cleanup activities at the reported 9300 active leaking sites under the reimbursement program, we would need an additional 104 inspectors. In regard to inspection reports verifying clean-up work, this is accomplished through another mechanism in the PST Division of review of documentation. All program areas in Field Operations have now gone to a risk-based method for determining inspections (i.e. targeting strategy). Allocating resources where they are needed is limited due to funding constraints and general lack of sufficient resources. However, we do allocate resources within the limits allowed.

**Section 2D - Update the Program's Reimbursable Cost Guidelines to Reflect Current Cost and Historical Variances**

Agency Response

The TNRCC is in the process of updating the reimbursable cost guidelines. Since the cost guidelines need to be adopted by rule prior to its use, the TNRCC suggests that the guidelines be updated on a two year schedule. However, the TNRCC has a copy of the Cost Guide for Remediation Equipment at UST Sites, by Dataquest, and has purchased two books, Environmental Restoration Assemblies Costs Data 1996 and Environmental Restoration Unit Cost Data 1996 publications that focus on costs and pricing information for activities associated with the cleanup of leaking underground storage tanks. The TNRCC intends to utilize this information, cost information from State-Lead Contracts bid information, information submitted on proposals, information (variances) obtained through the pre-approval process, and a industry task force to update the Reimbursable Cost Guidelines. In addition, the program has been developing standardized proposal review spreadsheets to aid in a standardization of the review process. Also, the program has modified the reimbursement review worksheet to address the need to better document allowed variances. With the use of the modified reimbursement review worksheet, these variances will be clearly documented within the program file. In order to ensure consistency among program staff regarding establishing and applying effective cost criteria, the program will closely communicate and coordinate with the new centralized grants and contracts infrastructure.

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**Section 3 - Enhance Oversight Practices Within the Waste Tire Program to Ensure Funds Are Consistently Expended for Eligible Activities**

**Section 3A - Actively Manage Participant Compliance with Established Rules and Guidelines to Prevent Noncompliance Situations**

Agency Response

The Commission has developed procedures and guidelines for informal and formal enforcement action that ensures action is taken in a timely and appropriate manner and that due process laws are observed. As a result, Regional Office staff often attempt to resolve violations on an informal basis initially. Only when the Regional inspector believes compliance with program rules and/or requirements will not be achieved through continued effort at the field level is the case referred to the Central Office with a request that formal enforcement action be initiated.

In addition, when other enforcement actions are underway at a specific facility by other regulatory branches of this agency, or by other agencies, the commission may be requested to delay its own administrative action until a later date.

Both of the above situations have occurred in the past in the WTRF program. However, in an effort to ensure noncompliant processors are not reimbursed in the future, the Waste Section of the Enforcement Division and the WTRF program have developed a new voucher check process that will be implemented on or about September 1, 1996. Under this process, a voucher will have to pass four reviews prior to WTRF Section signature and approval for further processing. These four steps are: (1) determination whether fire and/or other field violations have been documented during the monthly reimbursement inspection; (2) review and confirmation that complete and accurate records accompanied the voucher from the processor's facility; (3) confirmation that adequate recycling credits exist for reimbursement; and (4) ensure that adequate financial assurance exists for the shredded tires stored on-site. If the processor fails to meet any of the above conditions, the voucher process is halted and the Enforcement Division (with the assistance of the WTRF program for item #3 issues) assumes responsibility for the processor's return to compliance. During this process, the appropriateness of penalties will be considered.

To further enhance a close working relationship between enforcement and the WTRF program, the WTRF was transferred to the Office of Compliance and Enforcement effective July 1, 1996. This places both enforcement and WTRF under the same Deputy Director. The audit report specifically discussed a situation where the Central Office received an enforcement action request from a Regional Office in June, 1995 but enforcement action was not initiated until December, 1995. It is important to note that this case was delayed due to on-going criminal actions by another agency. Pursuing and finalizing civil actions can jeopardize criminal

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prosecution. The results of the TNRCC's efforts were very successful in obtaining criminal convictions as well as very significant civil penalties and a suspension of an authorization of this processor.

Also it is important to note that TNRCC has, in fact, worked with several tire processors to bring them into compliance over admittedly extended time frames. The underlying reasons for this is that decisive enforcement action which cuts off payment to a facility causes substantial problems for Texas citizens in that tire retailers lose what is often their only legal option for disposing of waste tires and, if the enforcement action causes bankruptcy, large inventories of tire shreds may wind up as a liability of the state. If not for the need to manage the waste stream, which the TNRCC has had to consider in each and every case, initial and recurring violations would have been dealt with in a more timely and aggressive manner. The agency will document its estimation of the impact on the waste stream versus potential enforcement action to address compliance.

The audit findings also indicated that program staff do not actively manage and track the registration renewal process. Since the Internal Audit staff reviewed the WTRF program in 1994, the program has been involved in development of a comprehensive tire data management system. The software being developed for this program will automatically review existing files and identify entities whose registrations will expire in 60 days. If the renewal application has not yet been received by the WTRF program, the system will print a letter notifying the registrant that registration expiration will occur within 60 days and a renewal application should be submitted for review and approval immediately. This software program is not yet on-line, however, the agency recognizes the need for an interim process and has designed a system that allows the program engineer to check manually, on a monthly basis, for registrations that will expire in 60 days. Those facilities identified by the review will receive a notification letter.

**Section 3B - Improve Audits to Ensure Adequate Coverage and to Detect Reimbursements Made for Questionable and Non-existent Activities**

Agency Response

The TNRCC does now have a formal documented risk assessment process which was utilized in the selection of tire processors for fiscal year 1996 and 1997. The formal risk assessment model has been provided to the State Auditor's Office. The 74th Legislature in 1995 adopted Senate Bill 776 which mandated that the Commission fiscally audit all individuals and companies receiving reimbursement from the fund on a biennial basis. In response to that directive, the newly created Grants and Contracts Management Division developed and utilized a risk assessment process during the audit sequence determination phase of the fiscal inspection project over the biennial period. As a result of that process, those entities that presented the

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greatest risk to the Commission were identified and were subsequently scheduled for fiscal review earlier during the 1996-1997 biennium.

**Section 4 - Improve Contract Monitoring Practices Within the Clean Rivers Program to Ensure Payments Are Made for Appropriate Activities and Expected Results**  
**Section 4A - Significantly Improve Invoice Review Practices to Include Verification of Supporting Documentation for Costs Incurred**

Agency Response

We appreciate the insight provided by the State Auditor's report in this particular program. Steps are being taken to ensure that the necessary resources and efforts are dedicated to this program in support of its goals and objectives. Beginning in FY97, the program will fund two positions (a Business Manager and a Contract Specialist) to conduct fiscal monitoring of these contracts and will also fund one Auditor in Grants and Contracts Management to conduct on-site field audits of these same contracts. Other technical, quality assurance and programmatic site visits are scheduled as appropriate. It is important to note that extensive on-site technical support, quality control audits and programmatic and performance monitoring have occurred. On-site financial monitoring and formal audits will be conducted beginning in FY97 with dedicated staff within the program and in the Grants and Contracts Management Infrastructure. As previously stated, the Grants and Contracts Management Infrastructure, specifically the Compliance, Evaluation and Audit Section, will work closely with the program to ensure a formal risk assessment process is in place which results in effective and efficient review practices that include verification of supporting documentation for cost incurred. In addition, justifications for costs allowed which appear to be unrelated to the program will also be documented.

Therefore, with the additional Commission resources dedicated to this program, intermittent invoice reviews will be conducted to ensure legible supporting documentation is attached and any discrepancies noted.

**Section 4B - Improve Financial and Performance Compliance Monitoring Activities to Ensure that Contract Provisions and Expectations Are Met**

Agency Response

As previously noted in Section 1B, the TNRCC has increased resources and will dedicate those resources to contract monitoring both at the program and agency levels. In FY 1997, the Clean Rivers program will hire a Business Manager and a Contract Specialist who will be charged with the responsibility of conducting fiscal reviews of vouchers to be paid and to conduct on-site monitoring visits which shall determine the status of deliverables and compliance with contract

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provisions. In addition, the Clean Rivers program will also fund an Auditor position within the Compliance, Evaluation and Audit Section of the new Grants and Contracts Management Infrastructure. Also to improve contract monitoring, the infrastructure has developed and implemented a centralized "Contracts Management Database" designed to ensure that contracts are developed, processed, tracked and evaluated consistently and expeditiously throughout the contracts life cycle.

Thus, with the additional resources to be dedicated at the program and agency levels, performance expectations and deliverables will be clearly defined. Contracts with performance activities will be adequately described in progress reports in order to ensure effective monitoring by program staff. With the development of audit policies and procedures, all monitoring and audit activities will be followed-up on and resolved using a standard resolution process.

**Section 5 - Start-up Phase Contract Management Practices Within the State-funded Superfund Program Appear Sufficient to Ensure that Appropriate Contractors Will Meet Contract Expectations**

Agency Response

Agency management concurs with the facts of finding.

## Objective, Scope, and Methodology

### Objective

The objective of the audit was to determine if the Texas Natural Resource Conservation Commission sufficiently administers its contracts so as to ensure that state funds used for program-related purchased services were spent appropriately and effectively. We focused on determining the following:

- Do procedures used to select contractors ensure that the best contractor is fairly and objectively selected?
- Do payment reimbursement methodologies ensure that services are received for a reasonable and perhaps best price?
- Are contract provisions sufficient to hold the contractor accountable for delivering quality services?
- Are contract monitoring functions sufficient to ensure that contractors consistently provide quality services?
- Are contract monitoring functions sufficient to ensure that contractors spend state funds appropriately?

### Scope

The scope of this audit included purchased service contracts and contractual relationships in effect during fiscal year 1995. Our audit work included the contracting processes for the agency overall and within four agency programs: Petroleum Storage Tank Remediation program, Waste Tire Recycling program, State-Funded Superfund program, and the Clean Rivers program. Contracts reviewed were for services received regarding petroleum storage tank site clean-ups, waste tire shredding, Superfund site clean-ups, and watershed assessments. Our sample consisted of 11 judgmentally selected contracts based on amount of dollars flowing through the program, dollar amount of the contract, risk for fraud, and agency input. We reviewed multiple judgmentally selected contractor invoices per contract to determine if state funds were spent appropriately.

Areas addressed during our review included:

- Contractor selection policies and practices
- Rate-setting methodology, policies, and practices
- Contract provisions
- Contract monitoring methodologies, policies, and practices



## Methodology

The methodology used on this audit consisted of collecting information, performing audit tests and procedures, analyzing the information, and evaluating the information against pre-established criteria.

Information collected to accomplish our objectives included the following:

- Interviews with management and staff of the Commission and relevant programs
- Interviews with contractor personnel
- Documentary evidence such as:
  - Policies and procedures related to contract administration and rate-setting.
  - Applicable state statutes and guidelines
  - Commission contract files/contractor selection files/payment files

Procedures and tests conducted:

- Reviewed the completeness and comprehensiveness of contract provisions
- Reviewed agency performance and financial monitoring activities to determine if contractors had been monitored in accordance with Commission policies and contract provisions
- Reviewed contractor selection procedures to determine if contractors were fairly and objectively selected in accordance with relevant statutes and Commission policies.
- Reviewed invoices and related documentation submitted by contractor for reimbursement.

Criteria used:

- Federal guidelines and cost principles - OMB Circulars A-87, A-122, A-110, and A-102 and Federal Acquisition Regulations 48 CFR Ch. 1
- State guidelines - Uniform Grants and Contract Management Standards
- Commission rules, policies and procedures
- Best business practices related to contract administration
- Contract management model developed by the State Auditor's Office
- Standard auditing criteria

Fieldwork was conducted from February 5, 1996, through June 7, 1996. The audit was conducted in accordance with applicable professional standards, including:

- Generally Accepted Auditing Standards
- Generally Accepted Government Auditing Standards

There were no significant instances of noncompliance with these standards.

The audit work was performed by the following members of the State Auditor's staff:

- Kyle Kelly, MBA (Project Manager)
- Marios Parpounas, MPA
- Francine Gutierrez, CPA
- Ester Jayme
- Hugh On, CPA, CIA, MBA
- Beatrice Hernandez, MBA
- Melody Lopez, MPA
- Victoria Harris
- Nancy Davis
- Kevin Baker, CPA
- Cindy Reed, CPA (Quality Control Reviewer)
- Kay Wright Kotowski, CPA, MNS (Audit Manager)
- Craig D. Kinton, CPA (Audit Director)

We would like to extend our appreciation to the following Commission auditors who directly assisted us during our audit:

- Rod Campbell
- Gerald Keating
- Ida Maiden

## Elements of an Effective Contract Administration System

All four of the control areas are important to an effective system of contract management. However, the significance of each control area varies depending on the nature of the contracting relationship.

Control Area	Elements
Contractor Selection	<p><b>Procurement process should be sufficient to ensure that the best contractors are fairly and objectively selected.</b></p> <ul style="list-style-type: none"> <li>• Whenever feasible, and unless otherwise prohibited by law or other restrictions, contractors should be selected through competitive procurement procedures.</li> <li>• Past performance should be considered in subsequent selection/contract renewal decisions.</li> <li>• Formal, documented procedures should be used to assess prospective contractors' strengths and weaknesses.</li> </ul>
Contract Provisions	<p><b>Contract provisions and agency regulations should be sufficient to hold contractors accountable for delivery of quality services and prevent the inappropriate or inefficient use of public funds .</b></p> <p>Contract provisions should contain all of the following:</p> <ul style="list-style-type: none"> <li>• Clear statements of services and goods expected from the contractor</li> <li>• Clearly defined performance standards and measurable outcomes</li> <li>• Clear statements of how contractor performance will be evaluated</li> <li>• Sanctions sufficient to hold contractors accountable for failing to meet intended objectives</li> <li>• Appropriate restrictions regarding the contractors' use of public funds</li> <li>• Specific audit clauses which allow the funding agency and other oversight entities access to the contractors' books and records</li> </ul>
Payment Reimbursement Methodology	<p><b>Methods used to establish contractor reimbursement should be sufficient to ensure that the State pays fair and reasonable prices for services.</b></p> <ul style="list-style-type: none"> <li>• Prior to the contract award, the cost of services, as well as the services themselves, should be analyzed in order to determine the most effective payment methodology.</li> <li>• Approval of proposed contractor budgets should focus on ensuring that proposed expenses are reasonable and necessary to accomplish program objectives. Both program results and contractor efficiency should be considered as part of the budget approval process.</li> <li>• For unit-rate contracts, the rate setting process should ensure that there is a reasonable correlation between the quality of the services provided, costs of providing the services, and the rate paid.</li> </ul>
Contractor Oversight	<p><b>Contractor oversight should be sufficient to ensure that contractors consistently provide quality services (by measuring performance against well-documented expectations) and that public funds are spent effectively and efficiently.</b></p> <ul style="list-style-type: none"> <li>• Monitoring functions should focus on the outcomes of services provided and the cost-effectiveness/prudence of contractor expenditures in addition to compliance with regulations.</li> <li>• Results of monitoring reviews, audits and investigations should be routinely followed up on to ensure corrective actions have been taken and to identify common problem areas.</li> <li>• A formalized risk assessment process should be used to select contractors for review and identify the level of review necessary at each contractor.</li> <li>• Standardized criteria should be established to evaluate contractor performance.</li> </ul>