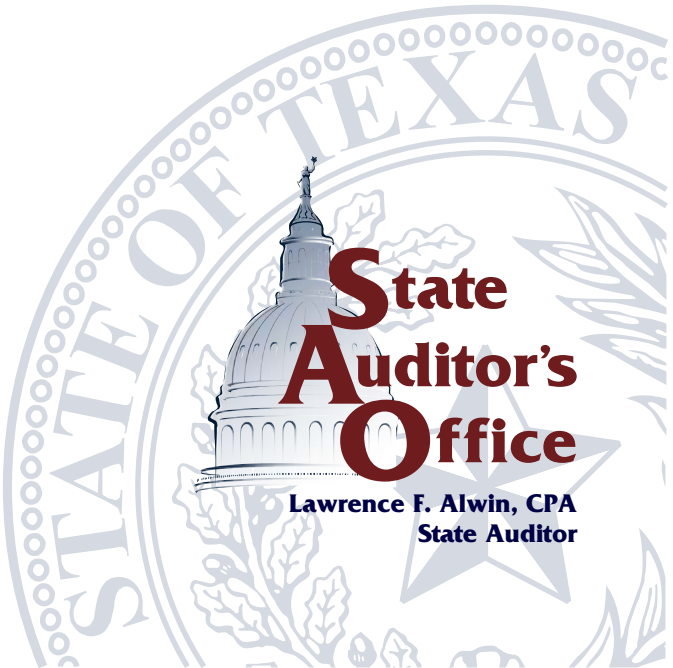
An Audit Report on

The Commission on Environmental Quality's Enforcement and Permitting Functions for Selected Programs

December 2003

Report No. 04-016



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Overall Conclusion

For the air, water quality, and public water supply programs we evaluated, the Commission on Environmental Quality's (Commission) enforcement function does not consistently:

- Issue enforcement orders or settle enforcement cases within its required timeframes. For the cases we tested, late enforcement orders included $299,489 in penalties and yielded economic benefits of $720,253 to the violators.
- Classify supplemental environmental projects (SEPs) according to established criteria or monitor SEPs administered by third parties. The misclassification of the 2002 and 2003 SEPs we tested resulted in a loss of $319,590 to the State.
- Calculate penalties accurately or fully collect delinquent penalties. As of May 2003, the Commission had outstanding delinquent penalties of $571,322.

Commission on Environmental Quality

The Commission on Environmental Quality permits and regulates environmental activities in Texas. The Commission had approximately 3,000 employees, 16 regional offices, and a $365.4 million annual appropriated budget for fiscal year 2003. Most of this budget is funded by program fees. The Commission issues and enforces 101 types of permits. In fiscal year 2002, the Commission collected $276 million in fee revenue, assessed $5.6 million in penalties, and arranged for violators to offset $2.2 million in penalties through supplemental environmental projects.

Sources: General Appropriations Act, 2002 Annual Financial Report, and 2002 Annual Enforcement Report

If unaddressed, these inconsistencies could limit the Commission's ability to collect penalties on a timely basis, hold environmental violators accountable, and deter future instances of noncompliance.

The Commission's permitting function for these programs generally operates in accordance with state statute and agency policy, although we noted some areas for improvement in the availability of information used for permitting. In addition, while the Commission complies with federal law regarding notification about pending air permits, the Commission's current process can reduce the effective public comment period to less than the federally required 30 days.

Finally, we noted that the Commission's recent changes to its penalty policies may reduce their effectiveness as a deterrent to polluters. We also found that current statutes related to air emissions caps and policies for discounted fees could be modified to increase agency revenue by approximately $25 million per year.

State Auditor's Office
Lawrence F. Alwin, CPA
State Auditor

This audit was conducted in accordance with Government Code, Sections 321.0131 and 321.0132.

For more information regarding this report, please contact Julie Ivie, Audit Manager, at (512) 936-9500.

Key Points

The lack of timely enforcement orders and settlement of enforcement cases could allow violations to continue and slows penalty collections.

The Commission does not consistently issue enforcement orders to alleged violators within required timeframes. Forty-five percent of the cases from 2001 to 2003 that we tested had enforcement orders that were not mailed out on time, exceeding the deadline by an average of 76 days. The assessed penalties for these cases totaled $299,489, and the alleged violations yielded economic benefits to the violators estimated at $720,253. In addition, the Commission does not always settle enforcement cases within its established timeframe. The Commission's philosophy is to promote voluntary compliance. The Commission reports that it works with entities to correct violations prior to finalizing the enforcement order and collecting the penalty. However, in accordance with the Commission's philosophy statement, a strong enforcement function is important in protecting the State's human and natural resources. Therefore, these delays in the enforcement process could result in violators' continuing to pollute and cause the State to lose the use of penalty funds.

The Commission does not have an effective process for collecting delinquent penalties.

The Commission's Financial Administration Division lacks an adequate process to collect delinquent administrative penalties. As of May 2003, the outstanding delinquent administrative penalties for air, public drinking water, water quality, and multimedia totaled $571,322.

Misclassifications and inadequate monitoring of supplemental environmental projects reduces environmental benefits owed to the State.

The misclassification of supplemental environmental projects (SEPs) that were started in fiscal year 2002 or 2003 resulted in a loss of $319,590 in environmental benefits. Additionally, while the Commission has an adequate process to monitor the SEPs directly administered by violators or by the Commission, the lack of adequate monitoring for third-party SEPs increases the risk that the associated funds could be used inappropriately, resulting in an overall loss of environmental benefits to the State. SEPs are an option available to violators to offset all or part of a penalty. Based on Commission records, the Commission assessed $67,896,295 in penalties from September 1995 through August 2003. Of this, $15,325,964 (22.6 percent) was offset by SEPs.

The Commission complies with notification requirements for air permits but could better promote public participation for some citizens.

The Commission complies with federal requirements regarding public comment for pending air permit applications. However, the Commission's policy establishing the beginning of the 30-day public comment period for prospective air permits could reduce the amount of time that some members of the public who miss the newspaper notice have to comment.

Poor file management limits the availability of information for public participation and permitting processes.

The Commission is not properly maintaining the files in its central records. Many of the files we requested for testing purposes could not be located. There is a risk that these files may not be readily available for permitting and enforcement processes or for public review.

Data used to monitor compliance with some water quality permits is not accurate.

The Commission does not monitor or review data that a contractor enters and that the Commission uploads to the Environmental Protection Agency's (EPA) Permit Compliance System. We tested four months of 2003 data entry and found that 20 percent of the records contained errors or were not entered into the database. Ninety-seven percent of these errors were attributable to the contractor. The Commission provides this data to the EPA and also uses it to identify entities that have exceeded their discharge limits.

Other Issues for Consideration

Recent changes to penalty calculation policies may not deter violations.

Recent changes to penalty policies may reduce their effectiveness as a deterrent to polluters. Violators often have economic benefits that exceed their penalties, which could reduce their incentive to comply. For 80 fiscal year 2001, 2002, and 2003 cases we tested, the total economic benefit gained by violators during the period of noncompliance was $8,647,005. However, these entities were fined only $1,683,635, which is approximately 19 percent of the economic benefit gained from being out of compliance.

Eliminating the air emissions fee cap could result in increased revenue and decreased emissions.

Current statute (Health and Safety Code, Section 382.0621[d]) precludes the Commission from imposing a fee for certain air emissions over 4,000 tons. As a result, a facility that reports emissions of 4,000 tons of air pollutants pays the same fee as a facility that reports emissions of 85,990 tons, thus not providing an incentive for facilities to limit their emissions once they exceed 4,000 tons. Based on fiscal year 2002 data, we calculated that if the cap were eliminated, the Commission's potential revenue could increase by approximately $25 million per year.

Summary of Management's Response

The Commission generally agrees with our recommendations and has agreed to implement them. However, it does not agree with our conclusions in two areas, supplemental environmental projects and public comment for pending air permit applications.

Summary of Information Technology Review

During our fieldwork, the two information systems we reviewed did not require users to change passwords from their initial passwords, which are assigned by the Central Registry system administrator. The Central Registry contains general data about regulated entities. The Consolidated Compliance and Enforcement Data System (CCEDS) contains data about enforcement actions. Without periodic password changes, there is a greater risk that a password could be compromised and that an unauthorized individual could gain access. Also, the Commission lacks a business continuity plan, which leaves it unprepared for a disaster.

Summary of Objectives, Scope, and Methodology

The primary objectives of this audit were to determine whether the permitting and enforcement functions for selected Commission programs ensure that the Commission (1) issues and enforces permits in accordance with state statutes and Commission policies and (2) collects and accounts for fees appropriately.

Our scope generally included data and processes completed in fiscal year 2002, but in some cases we reviewed data from September 1, 2001, to May 31, 2003, as indicated.

Our methodology consisted of gathering information by interviewing management and staff from the Commission's headquarters and regional offices, observing Commission operations, mapping permitting and enforcement processes, reviewing policies and procedures, testing controls and related documentation, and reviewing data from information technology systems.

Table of Results and Recommendations
denotes entry is related to information technology

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- ♦ The frequency of sending out delinquency letters.
- ♦ The circumstances and timing of warrant holds.
- ♦ Guidelines on when to refer delinquent accounts to the Office of Legal Services.

- Request tax identification numbers on permit, license, and registration application forms to facilitate placing default accounts on warrant hold.
- Ensure that CCEDS data is current and complete so that the Commission can send delinquent letters to all delinquent accounts.

Public comment policy could reduce the effective comment period. (Page 15)

The Commission should:

- Ensure that notices and letters contain instructions on how to contact the Commission about the dates of the public comment period so that citizens can find out when the comment period begins and ends.
- Ensure that the Office of the Chief Clerk and other applicable Commission staff are aware of the public comment period dates or know to whom to refer citizens when they have inquiries about public comment periods.

Poor file management limits the availability of information for public participation and permitting. (Page 16)

Central Records should enforce current policies and ensure that it addresses procedures for the creation, maintenance, and inventory of files.

The Commission does not monitor contractor data entry for accuracy. (Page 18)

The Enforcement Division should:

- Implement a process to perform a quality review of data entry provided by contractors.
- Develop additional procedures to ensure that all of the submitted reports are entered into PCS.

Allowing the Commission's compliance-monitoring coordinators to edit permit limits in PCS creates a risk of unauthorized edits. (Page 19)

The Commission should request that the EPA modify the user rights to reflect the job functions of entering permit limits and requirements and of monitoring compliance.

Unauthorized solid waste disposal fee discount reduces the Commission's revenue. (Page 21)

The Commission should reconsider the discount granted to federal facilities. If the Commission decides to continue the discount, it should update its current rules and, if necessary, request statutory authority to officially authorize the discount.

Delays in annual revenue reconciliations may prevent the Commission from reporting accurate data in its Annual Financial Report. (Page 21)

The Financial Administration Division should reconcile amounts recorded in Prophecy against USAS data in a timely manner to ensure that revenue is properly recorded, accounted for, and reported in its AFR.

Outdated MOU could create difficulties in revenue transfers. (Page 22)

The Department of Public Safety and the Commission should update their MOU as required. The revenue directors and staff involved in the collection, transfer, and receipt of funds should meet annually to discuss changes that affect these processes.

The funds transfer process between the Commission and the Department could be improved. (Page 23)

The Department should establish better communication with the Commission in order to address any changes that may affect the process of transferring funds.

In particular, the Department should take steps to:

- Transfer funds using the Commission-requested Program Cost Accounts and fund numbers.
- Transfer interagency transfer voucher sales on a regular basis.
- Reconcile its monthly reports to its accounting system prior to providing them to the Commission.
- Provide the Commission with appropriate documentation so it can independently determine its share of sales by certificate type.

Table of Results and Recommendations denotes entry is related to information technology
The lack of required password changes in the Central Registry and CCEDS puts data security at risk. (Page 25)
The Commission should activate the feature that prompts users to change their initial passwords when they first log in. Periodic changes to passwords should be required for the Central Registry.
The lack of a business continuity plan jeopardizes the Commission's ability to provide services during a disaster. (Page 26)
The Commission should finalize its business continuity plan and have it approved by executive management. The plan should be tested at least annually.

Recent SAO Work		
Number	**Product Name**	**Release Date**
03-040	A Review of Fiscal Year 2002 Encumbrances and Payables at Selected Agencies	June 2003
01-020	An Audit Report on the Petroleum Storage Tank Program at the Natural Resource Conservation Commission	February 2001
00-005	An Audit Report on Revenue Processing at Four State Agencies	November 1999
99-019	A Follow-up Audit Report on the Texas Natural Resource Conservation Commission	December 1998
98-070	A Review of the Enforcement Function at the Texas Natural Resource Conservation Commission	August 1998

Other SAO Products		
Number	**Product Name**	**Release Date**
03-360	A Legislative Summary Document Regarding Texas Commission on Environmental Quality (formerly the Natural Resource Conservation Commission)	January 2003
01-445	Natural Resource Conservation Commission Legislative Summary Document	March 2001

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Chapter 1

The Enforcement Process Does Not Consistently Ensure that Violators Are Held Accountable

The Commission on Environmental Quality's (Commission) enforcement process does not ensure that enforcement orders are issued on a timely basis or that enforcement cases are settled by the established deadlines. In addition, the accuracy of final inspection reports cannot be verified because the Commission does not keep inpsection field notes. For the files we tested, the issuance of enforcement orders took an average of 76 days longer than the established timeframes of 30 days and 120 days (deadlines depend on the priority assigned to the case). The Commission's philosophy is to promote voluntary compliance, and it reports that it works with entities to correct violations prior to finalizing the enforcement order and collecting the penalty (see text box). However, in accordance with the second approach outlined in the Commission's philosophy statement, a strong enforcement function is important in protecting the State's human and natural resources. Therefore, these delays in the enforcement process could result in violators' continuing to pollute and cause the State to lose interest revenue on these penalties.

The Commission on Environmental Quality Mission Statement

"The Texas Commission on Environmental Quality strives to protect our state's human and natural resources consistent with sustainable economic development. Our goal is clean air, clean water, and the safe management of waste."

The Commission's Philosophy Statement includes the following two approaches:

- "Ensure consistent, just, and timely enforcement when environmental laws are violated;
- "Promote and foster voluntary compliance with environmental laws and provide flexibility in achieving environmental goals."

Source: Commission's 2003–2007 Strategic Plan

There is currently no way for enforcement staff or other reviewers to verify the accuracy of final inspection reports or the reliability of data in the Consolidated Compliance and Enforcement Data System (CCEDS). The Commission does not keep the field notes used to write inspection reports and enter the data into CCEDS. The inspection reports are the basis for enforcement actions and penalties, and inaccuracies in these reports could affect the Commission's ability to settle these cases.

Chapter 1-A

The Lack of Timely Enforcement Orders May Allow Violations to Continue and Slows Penalty Collection

The Commission does not consistently review and approve investigation reports or issue enforcement orders to alleged violators within the timeframes established in its policies. A Notice of Violation notifies the business or other regulated entity of the alleged violation. An enforcement order is the notification that a penalty is due. Although the Commission reports that it works with violators to correct issues of noncompliance while the enforcement orders are being finalized, not issuing these orders on time may allow violations to continue and delays the State's receipt of penalty funds, which go into the General Revenue fund. Specifically:

Office of Compliance and Enforcement

The Commission's Office of Compliance and Enforcement oversees enforcement, emergency response, dam safety, monitoring activities, and the operation of 16 regional offices across the state.

- Of the investigation reports that we reviewed for air, public water supply, and

water quality programs, 11 percent were not approved by the required deadlines. There were 31,916 investigations in fiscal year 2002 and 2003. Commission policy requires that investigation reports be approved and entered into CCEDS within 60 days of the last day of the investigation.

Economic Benefit

The Commission calculates a violator's economic benefit during the penalty calculation process. The Commission's policy defines economic benefit as:

Monetary gain derived from a failure to comply with TCEQ rules or regulations. Economic benefit may include any or all of the following: (1) the return a respondent can earn by delaying the capital costs of pollution control equipment; (2) the return a respondent can earn by delaying a one-time expenditure; and (3) the return a respondent can earn by avoiding periodic costs.

Source: Commission's Penalty Policy, September 2002

- Forty-five percent of the fiscal year 2001 to 2003 enforcement orders for the air, public water supply, and water quality programs we tested were not mailed out by the established deadline. The overdue orders exceeded their deadlines by an average of 76 days. The assessed penalties for the overdue cases we tested totaled $299,489, and the alleged violations resulted in economic benefits to the violators estimated at $720,253 (see text box).

The deadline for mailing the initial draft of the "agreed order" depends on the severity of the alleged violations. The most urgent cases, Priority 1 and Priority 5, must be mailed within 30 days of case screening. Priority 2 and Priority 6 cases must be mailed within 60 days of screening, and Priority 3 and Priority 4 cases have a 120-day deadline.

Recommendations

The Enforcement Division should:

- Develop a system of benchmarks for meeting enforcement report deadlines. These deadlines should be closely monitored, and if a deadline is missed, the reason for the delay should be noted within the report.

- Monitor upcoming and overdue cases on a weekly basis and ensure that it issues enforcement orders within the timeframes established in policy.

Management's Response

Staff resources routinely dedicated to this function were used to develop the compliance histories. As a result of these activities, we did not meet the agency's self-imposed deadlines.

Working with violators to correct conditions of non-compliance results in the desired outcome of increased compliance. An additional benefit is that we avoid the costs and time related to the hearings and judicial processes. Many violations are corrected prior to the culmination of settlement negotiations and as a direct result of them.

We agree with the recommendations, and the Enforcement Division Director is responsible for implementation by January 30, 2004.

Chapter 1-B

Delays in Settling Enforcement Cases May Affect the Timely Collection of Fines

The Commission does not settle enforcement cases within its established deadline of 60 days from the mailing of the draft agreed order. For the two most common types of agreed orders, 1660 orders and findings orders (see text box), we found that from September 1, 2001, to May 31, 2003, it took an average of 134 days and 125 days, respectively, to settle cases for which there was no deferral of penalties. For this same time period, 1660 orders with a deferral of all or part of the penalty came closer to meeting the deadline, with an average settlement time of 68 days. The time to settle findings orders with deferrals ranged from 106 days to 1,898 days. Only 14 findings orders with deferrals were settled during the time period our review covered. (See Chapter 3-C for a discussion of the financial impact of penalty deferrals.)

1660 Orders and Findings Orders

A 1660 order contains statements saying that:

- The occurrence of any violation is in dispute and the agreed order does not constitute an admission of guilt.
- The agreed order will not be admissible against the respondent in civil proceedings. (The Attorney General's office is exempt from this requirement.)

A findings order does not contain these statements and may be used against the respondent in civil proceedings. Findings orders are always used in default matters and for orders resulting from administrative hearings.

If a case is not settled within the 60-day timeframe, Commission policy requires that the case be forwarded to the Litigation Division. It takes the Commission an average of 140 days to forward 1660 orders to the Litigation Division and 131 days to forward findings orders.

Delays in reaching settlements with respondents result in the loss of interest revenue (from uncollected penalty dollars) and coordinators' productivity, as they spend more time on each case that they continue to negotiate past the deadline.

Recommendation

The Commission should ensure that enforcement coordinators forward cases to the Litigation Division once settlement negotiations have exceeded 60 days.

Management's Response

Staff resources routinely dedicated to this function were used to develop the compliance histories. As a result of these activities, we did not meet the agency's self-imposed deadlines.

Working with violators to correct conditions of non-compliance results in the desired outcome of increased compliance. An additional benefit is that we avoid the costs and time related to the hearings and judicial processes.

We agree with the recommendations to ensure that enforcement coordinators forward cases to the Litigation Division once settlement negotiations have exceeded 60 days. The Enforcement Division director is responsible for implementing these recommendations by January 30, 2004.

Chapter 1-C

Field Note Destruction Policy Prevents Accountability

Enforcement field notes and checklists are used to write investigation and inspection reports and to enter data into CCEDS. The Commission's policy requires that these notes be destroyed within 60 days of the last day of the investigation. Destroying these notes and checklists prevents the Commission and outside reviewers from verifying the accuracy of inspection reports and the reliability of CCEDS data. The inspection reports are the basis for enforcement actions, and penalties and errors in these reports could affect the Commission's ability to settle cases.

Field Operations Division policy requires that the field notes remain part of the investigation package until the investigation report is finalized and has received a quality control review. In two regions we visited, we noted that field notes were not used to verify the accuracy of the final reports. This creates a risk that if the report is not accurate, the field notes used to write the report would not be available for later review.

Recommendation

The Commission should revise its policy of destroying field notes and checklists and should retain these records to facilitate the review of inspection reports and data in CCEDS.

Management's Response

TCEQ agrees with the recommendation. The Field Operations Division Director is responsible for implementing this recommendation by January 30, 2004.

Chapter 2

Misclassification and Inadequate Monitoring of Supplemental Environmental Projects Reduces Environmental Benefits Owed to the State

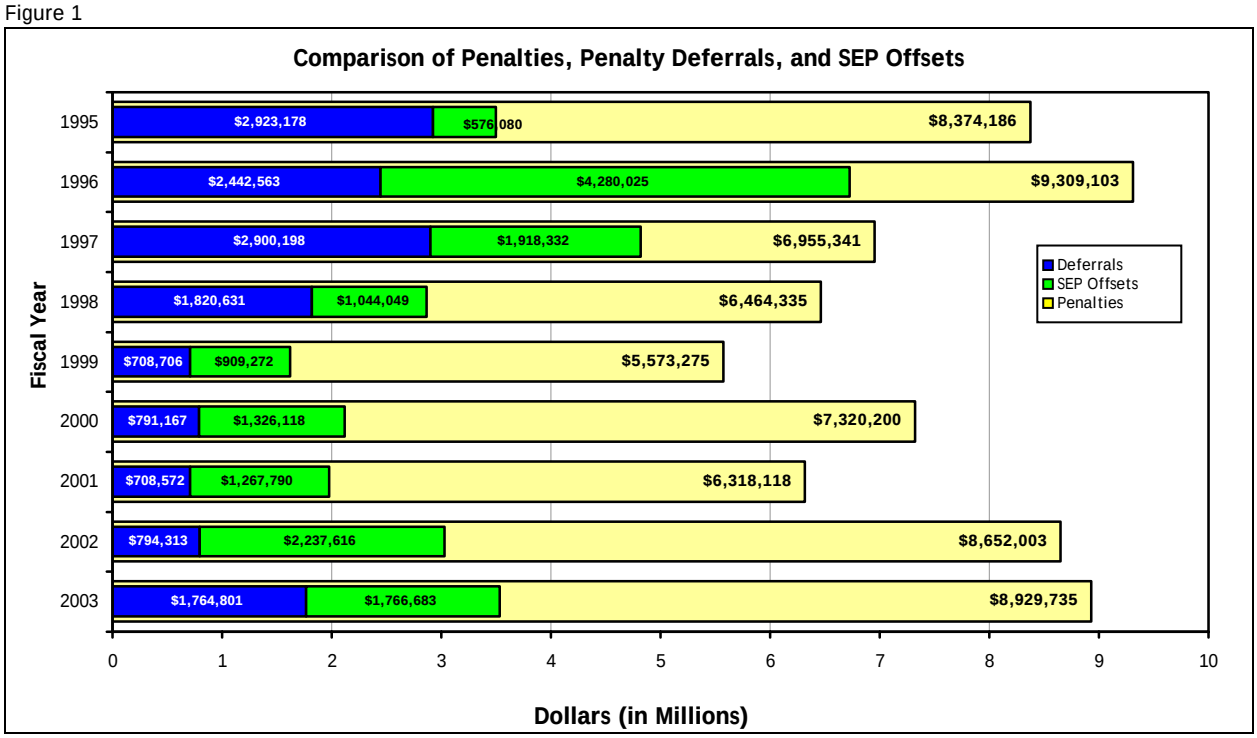
In the sample of supplemental environmental projects (SEPs) that we tested, five were not correctly classified, resulting in a loss of $319,590 in environmental benefits. SEPs are an option available to violators that allows them to offset all or part of a penalty. The amount of offset depends on whether the SEP is classified as having a direct or indirect environmental benefit. Five of the SEPs in our sample that were classified as having a direct benefit did not meet the criteria for this type of benefit. There were 212 SEPs initiated during our review period of September 2001 through April 2003. Of these, 209 were classified as having a direct benefit.

Examples of the programs that did not have a direct environmental benefit include an educational program about water efficiencies for children in grade school and the purchase of equipment, repairs, vehicles, and vehicle maintenance for local fire departments.

The Commission is also not adequately monitoring third-party SEPs to ensure that SEP funds are managed appropriately. Third-party SEPs are administered by non-profit or governmental organizations. Sixty percent of the third-party SEPs we reviewed did not show evidence of appropriate monitoring.

Based on Commission records, the Commission assessed $67,896,295 in penalties from September 1995 through August 2003. Of this, $15,325,964 (22.6 percent) was offset by SEPs (see Figure 1).

Figure 1



Source: Unaudited Commission enforcement reports

Chapter 2-A

Misclassification of SEPs Results in a Loss of Environmental Benefits

Of the 71 SEP cases tested, 5 that were classified as having a direct environmental benefit did not meet the criteria for providing this type of benefit. These misclassifications resulted in a loss of $319,590 in benefits from environmental projects because the rate at which a SEP offsets a penalty varies based on the tax status of the entity and the environmental benefit the SEP provides:

- For a SEP to be classified as having a direct benefit, it must have an immediate environmental effect, such as cleaning up an illegal dump site or purchasing electric lawn mowers with reduced exhaust emissions. Each dollar spent on a SEP with a direct benefit offsets $1 of an assessed penalty.

- An indirect environmental benefit does not have an immediate environmental effect. Indirect SEPs include educational projects or research projects involving environmental enhancement. For indirect SEPs, every $3 spent on the project offsets $1 of an assessed penalty.

- Non-profit entities can have up to 100 percent of their penalties offset by a SEP. For-profit entities are limited to a 50 percent offset.

Examples of the misclassified SEPs include:

- A water usage educational program. This program provides educational information and faucet kits to children in grade schools. The Commission's policy for SEP classifications state that educational programs are not a direct benefit. This program was classified as a 1:1 offset when it should have been 3:1. Four SEPs used this program; they represent $38,010 in SEP funds.

- Purchase of equipment and repairs for local fire departments. The purchases consisted of 20 pagers, an engine replacement for an emergency operations center vehicle, an emergency management vehicle, and other questionable items totaling $16,829. Many of the items are equipment that can be used for standard fire fighting operations and are not directly associated with environmental improvements or protection. The total for this SEP case was $121,785.

Recommendations

The Commission should:

- Expand the SEP categories to clarify in detail what qualifies as a direct environmental benefit, what qualifies as an indirect environmental benefit, and why.

- Develop a classification system to account for projects that consist of both direct and indirect benefit characteristics to accurately apply offset values to SEPs.

Management's Response

TCEQ agrees that implementing the recommendations will improve and clarify the program. This type of policy change is at the discretion of the Commission. The Director of the Litigation Division is responsible for presenting the following changes to the Commission for consideration by August 31, 2004:

- *Expand the SEP categories to clarify in detail what qualifies as a direct environmental benefit, what qualifies as an indirect environmental benefit, and why.*

- *Develop a classification system to account for projects that consist of both direct and indirect benefit characteristics to accurately apply offset values to SEPs.*

While we agree there is an opportunity to improve and clarify the program, we believe each of the SEPs reviewed by the SAO is correctly classified and that each reflects the appropriate offset percentage, according to TCEQ's SEP guidance document.

Auditor's Follow-up Comment

According to both the Commission's Regulatory Guidance (RG-367) document, *Use of Supplemental Environmental Projects*, provided to regulated entities and the SEP Standard Operating Procedures (April 2003), only SEP projects that directly benefit the environment are allowed a 1:1 offset. The SEP Standard Operating Procedures specifically state that environmental education is considered an indirect benefit and requires a 3:1 offset.

The Regulatory Guidance document, in discussing an indirect benefit, uses the example of a research project that seeks to find an alternative way to treat wastewater for reuse. It characterizes this project as indirect because it "may not result in the development of new techniques. Even if it did, there would probably be no way to **guarantee** (emphasis added) that those techniques would be implemented or used by others."

In the case of the Waterwise program, the Commission has no way to guarantee that the students are installing the low-water devices (faucet aerators and low-water showerheads) in their homes. With certain exceptions, all plumbing fixtures sold after January 1, 1992, are required by state law to be low-water devices, so presumably many children are already using low-water devices in their homes.

The Regulatory Guidance document further states that exceptions to the SEP policy may be made only if there is "extraordinary benefit to human health or the environment that outweighs the considerations used in developing this policy." We do not believe that the Waterwise program meets this requirement.

The purchase of pagers, vehicles, and vehicle repairs for a fire department also does not meet the stated criteria for a direct benefit to the environment or for an exception to the SEP policy.

Chapter 2-B

Monitoring of Third-Party SEPs May Not Ensure that Funds Are Used Appropriately

While we found that the Commission has an adequate process for monitoring SEPS administered by the Commission or by violators, it does not adequately monitor SEPs conducted by third parties for compliance with the terms of their agreements. We reviewed the files for 10 third-party SEPs and found that 6 of them were not monitored on a timely basis. For example, one of the third-party SEPs was completed in December 2001, but the Commission did not send a letter requesting the required report until January 2003. Inadequate monitoring of third-party SEPs reduces the assurance that the money entrusted to these organizations is being used in the most efficient manner to provide the greatest environmental benefit.

The SEP coordinator and the SEP attorney are required to monitor SEPs until completion. This includes ensuring that reports are submitted as required, that reports contain the required evidence of completion, and that expenditures relate directly to the approved costs. The 10 third-party SEPs we reviewed offset $540,628 in penalties. The fiscal year 2002 and 2003 third-party SEPs totaled $1,514,964.

Recommendations

The Commission should:

- Enter report due dates on SEP tracking sheets to increase visibility and aid in tracking.
- Standardize reporting timeframes.
- Standardize the format for reporting financial information and expenditures to simplify and expedite the review process.
- Incorporate third-party reporting requirement data into a monthly "Pending SEPs for Required Reporting" log in order to generate a single report log that includes respondent and third-party reporting dates.
- Require refunds of SEP monies from third parties that are not complying with their agreements.

Management's Response

We agree with the SAO's recommendation to implement a standardized reporting form and to create a "Pending SEPs for Required Reporting" log. The Litigation Division Director will complete these actions by September 1, 2004. TCEQ will continue requiring payment of SEP dollars to the General Revenue Fund by third parties who are not complying with their agreements, where appropriate.

While we agree there is an opportunity to improve and clarify the program, we believe that third-party SEPs have been adequately monitored. Specifically, 30% of the files SAO pulled for this issue related to the third-party SEP performed by one entity. This entity has been in continuing discussions with the agency regarding its ability to perform the SEP without funding for administrative costs. The entity recently received authorization from the Legislature to use SEP funds to cover administrative costs. With this development, the entity should be able to perform its projects. If that is not the case, TCEQ is prepared to require the entity to pay any unused portion of the SEP funds to the General Revenue Fund.

Auditor's Follow-up Comment

Regardless of whether the Commission was negotiating with the entity regarding the use of SEP funds, we saw no evidence in any of the files we reviewed that indicated that these negotiations were occurring. Part of monitoring should include making regular updates to files to indicate their current status. Presumably there was communication between the Commission and the entity regarding these negotiations that could have been included in these files but was not. This would have constituted a form of monitoring, as would notes of any verbal discussions. We selected a statistical sample of third-party SEPs, and 30 percent of the sample were projects performed by this entity.

We believe that the lack of monitoring of third-party SEPs creates a risk that funds are not used appropriately. We do not question the Commission's authority or ability to request that funds be returned if they are not used appropriately. However, these SEPs must be monitored in order for the Commission to be able to determine if funds should be repaid. Without effective monitoring, the Commission has no way to ensure that these funds are used appropriately.

Chapter 2-C

Information in the SEP Database Does Not Agree with the SEP Documentation

Forty-one percent of the SEP cases we tested did not have the same information in the SEP database as in the permanent SEP case file. The information contained within the SEP database should accurately reflect the core information contained within the permanent SEP case file. The SEP coordinator uses the SEP database to produce a case tracking sheet to assist in monitoring and tracking. Failure to have an accurate flow of information from the case file to the SEP database reduces the overall effectiveness of using the SEP tracking sheet as a tool to assist in managing and monitoring SEP projects.

Recommendations

The Commission should:

- Ensure that all pertinent data from the respondent's file is entered into the SEP database.
- Ensure that all data is merged into the SEP tracking sheet to assist in monitoring ongoing SEP projects.
- Enter report due dates on SEP tracking sheets to assist in identifying delinquent reports.
- Revise the current SEP tracking sheet to include the respondent/third-party reporting schedule.

Management's Response

TCEQ agrees with the recommendation. The Litigation Division Director will implement measures to ensure that database information and file documentation are consistent by September 1, 2004.

Reviewing the accuracy of penalty calculations, considering the cost-benefit of penalty deferrals, and improving the process for collecting delinquent administrative penalties could help improve the Commission's process for deterring violators. Specifically, we found that:

- The Commission lacks an adequate review process for its penalty calculations. In four of the cases we tested, the Commission failed to correctly identify and adjust penalties for repeat violators. These four incorrect calculations resulted in a loss of $7,023.

- The Commission offers penalty deferrals to violators as a means of settling cases faster. However, the average time of all case settlements from September 1, 2001, to May 31, 2003, was 103 days, which exceeds the Commission's goal of 60 days. The average time to settle 1660 cases in which a penalty was assessed but in which there were no deferrals was 134 days. Deferrals during this time totaled approximately $2.6 million, which is approximately 32 percent of the $8.1 million in penalties assessed.

- The Financial Administration Division lacks an adequate process for collecting delinquent administrative penalties. For fiscal years 2002 and 2003, the Commission assessed approximately $5.9 million in penalties. As of May 2003, the delinquent administrative penalties totaled $571,322.

Chapter 3-A
Penalties Are Not Always Calculated Accurately

The Commission does not consistently assess penalties in accordance with its policies and standards. The policies are complex, and it is difficult to calculate penalties accurately. Of the 73 fiscal year 2002 and 2003 penalty calculation worksheets we tested, 4 contained inaccuracies:

- In one case, the Commission offered a repeat violator a penalty deferral, which is against the Commission's policies. Unnecessary deferrals affect the collection of General Revenue—when the Commission grants a deferral, the State loses 20 percent of the assessed penalty. This case resulted in a loss of $2,550 to the State's General Revenue fund.

- In two other cases, the Commission did not properly increase penalties for repeat violators. Failing to correctly identify and adjust penalties for repeat violators reduces the penalties' effectiveness as a deterrent to polluters. The State also loses interest revenue on the uncollected dollars. Title 30 of the Texas Administrative Code, Section 60.2, defines an entity as a repeat violator if it commits multiple major violations within a five-year period. If the entity is a repeat violator, the Commission is supposed to increase the penalty by 25 percent. The two cases that lacked penalty enhancements resulted in a loss of $2,136 to the State's General Revenue fund.

- In one case tested, software problems with the penalty calculation worksheet resulted in an incorrect penalty. The assessed penalty was $2,337 less than the penalty subtotal. This error occurred because the automated formulas in the calculation worksheet are not protected, allowing enforcement coordinators to inadvertently change them when using the worksheet.

Recommendations

The Commission should:

- Revise its review process to ensure that deferrals are offered in accordance with policies.

- Revise and streamline its penalty policy and penalty calculation worksheet.

Management's Response

TCEQ agrees to review our process to ensure deferrals are offered in accordance with policies. We also agree to review the penalty policy. However, please note that the statute requires the Commission to consider certain items, and we believe the policy addresses those items. Penalty policy must be flexible to accommodate hardship circumstances, and the Commission is authorized to exercise discretion. Discussion of the Penalty Policy will be the topic of an upcoming work session. Lastly, we will continue to seek a cost-effective solution to the penalty calculation worksheet concern. The Enforcement Division Director is responsible for implementing these recommendations by June 30, 2004.

Chapter 3-B
The Cost of Penalty Deferrals May Outweigh the Benefits

The Commission's practice of deferring penalties for some violators may not be cost-effective. The Commission deferred approximately $2.6 million of the $8.1 million in penalties assessed between September 1, 2001, and May 31, 2003. The average settlement time for cases with deferrals was shorter than those without deferrals. However, the Commission still did not settle cases with deferrals within the established deadline of 60 days.

It took the Commission an average of 68 days to settle 1660 cases with deferrals compared with 134 days for cases in which penalties were assessed but in which there were no deferrals. Settlement of 1660 cases without deferrals ranged from 5 to 2,637 days.

The Commission offers a deferral to any violator that has not committed the same or a similar violation in the past. However, it is possible for violators with lengthy enforcement histories to qualify for the deferral as long as none of the previous violations were for the same or a similar violation.

Recommendation

The Commission should determine whether the cost of deferrals is worth the benefit of shortening the settlement time, given that offering a deferral generally does not shorten the settlement time enough for the Commission to meet its deadline.

Management's Response

TCEQ agrees with this recommendation. The Executive Director will present the issue to the Commission for consideration during an upcoming Commission work session.

Chapter 3-C

The Commission Does Not Have an Effective Process for Collecting Delinquent Penalties

The Financial Administration Division (Division) lacks an adequate process to collect administrative penalties that are delinquent. As of May 2003, the outstanding delinquent administrative penalties for air, public drinking water, water quality, and multimedia totaled $571,322. We tested 15 of 81 delinquent accounts, which accounted for 72 percent of the total delinquent penalties. All 15 accounts were past due by more than 90 days, and the amounts due to the Commission ranged from $5,000 to $92,000. Testing showed that:

- The Commission did not place 5 of the 15 accounts on warrant hold because the Commission did not have the violators' tax identification numbers. The Commission placed seven other accounts on warrant hold one day after we requested this information.

- The Commission mailed letters to delinquent violators only twice during calendar year 2002. In addition, some of the delinquent violators did not receive letters. The Penalty Payment Database, which provides entities' names and addresses, has incomplete and obsolete data that prevents the Commission from ensuring that it mails the letters to all eligible accounts. In fiscal year 2002, the Enforcement Database was the source for the data in the Penalty Payment Database. Now, the Comprehensive Compliance and Enforcement Data System (CCEDS) is the source of this data.

The Division does not have policies and procedures that directly address the handling of administrative penalties that default. As a result, the Division does not collect penalties owed to Commission in a timely manner. When these funds are not collected, the State does not receive money it is owed in interest on these funds. We did not test the process to collect other types of accounts in default.

Recommendations

The Commission should:

- Develop and implement written policies and procedures for the handling of administrative penalties in default. These policies and procedures should include:
  - The frequency of sending out delinquency letters.
  - The circumstances and timing of warrant holds.
  - Guidelines on when to refer delinquent accounts to the Office of Legal Services.
- Request tax identification numbers on permit, license, and registration application forms to facilitate placing default accounts on warrant hold.
- Ensure that CCEDS data is current and complete so that the Commission can send delinquent letters to all delinquent accounts.

Management's Response

TCEQ agrees with the recommendation to implement written policies and procedures for the collection of administrative penalties. The Financial Administration Division Director is responsible for implementing written policies and procedures for collection of administrative penalties by January 30, 2004.

We currently solicit tax identification numbers when regulated entities complete all permit, license and registration applications via the core data form. However, TCEQ does not have authority to require customers' Social Security identification numbers (Social Security numbers are the tax identification numbers for many of our regulated entities) in permit, license, and registration applications. This does not preclude a regulated entity from voluntarily providing this information. TCEQ will explore options for identifying customers for warrant hold other than through the use of Social Security identification numbers.

Lastly, a data quality check has been programmed into CCEDS. This check requires a docket number, respondent name and address before the record can be saved.

Chapter 4

The Commission Complies with Public Notification Requirements for Air Permits but Could Better Promote Public Participation for Some Citizens

The Commission's permitting processes for the air, water, and public water supply permits comply with statute and Commission policy. The 29 air permits and 61 general permits we reviewed had all of the required documents and were processed according to statute and policy. However, while the Commission complies with federal law regarding public notification, the current policies for public participation in the air permitting process could decrease the effective time available for commenting on the issuance of a permit. In addition, poor file management processes decrease the information available to the public and to permit writers.

In April 2002, the Commission embarked on a project intended to reduce the backlog in issuing permits. It developed aggressive time lines for the issuance of permits, and employees worked overtime to reduce the backlog from 1,126 permits in April 2002 to 276 in September 2003. According to the Commission's data as of September 1, 2003, the number of water quality permits exceeding the timeframe goals quadrupled since hitting low numbers in January 2003. We verified the September 2003 backlog against reports from the Commission's various automated systems, but we did not verify the accuracy of the data in these systems. (See Appendix 3 for additional information.)

Chapter 4-A

Public Comment Policy Could Reduce the Effective Comment Period

The Commission's policies for informing the public of pending air permit applications create a risk that citizens will miss the federally required 30-day comment period or have less than 30 days in which to comment.

The public comment period begins when the permit applicant publishes a notice in a local newspaper. Permit applicants have up to 10 days after the date of publication to notify the Commission's Office of the Chief Clerk that the notice was published and that the public comment period has started. During those 10 days, the Office of the Chief Clerk is not always aware that the public comment period has started or of when it is going to end. If citizens miss seeing the newspaper notice and ask the Office of the Chief Clerk for the dates of the comment period, they may not receive the correct information. This, in effect, shortens the time citizens have to comment.

Federal law requires that the permitting authority provide at least 30 days for public comment.

Recommendations

The Commission should:

- Ensure that notices and letters contain instructions on how to contact the Commission about the dates of the public comment period so that citizens can find out when the comment period begins and ends.

- Ensure that the Office of the Chief Clerk and other applicable Commission staff are aware of the public comment period dates or know to whom to refer citizens when they have inquiries about public comment periods.

Management's Response

We agree with the recommendations. The TCEQ currently includes instructions on how to contact the Commission about the public comment process. We will continue this practice, and we will remind staff on how to handle public participation inquires.

Chapter 4-B

Poor File Management Limits the Availability of Information for Public Participation and Permitting

The Commission's Central Records office does not adequately control the files entrusted to it. In testing the enforcement and permitting functions, we observed that some case files were missing while others were incomplete. Commission staff use the files when drafting permits and monitoring entities' compliance; therefore, incomplete information can adversely affect the Commission's functions. Citizens use the files to learn about permit applicants and regulated entities in their communities. Investigation files are also available at regional offices, and these files are generally complete. However, they are not readily available to permit writers working in Austin or to the public seeking information from Central Records.

In addition, the Central Records office's poor file management does not comply with Government Code, Section 441.183, which requires state agencies to establish and maintain a records management program (see text box).

Per Government Code 441.183, Records Management Programs in State Agencies, agencies shall:

(1) establish and maintain a records management program on a continuing and active basis;

(2) create and maintain records containing adequate and proper documentation of the organization, functions, policies, decisions, procedures, and essential transactions of the agency designed to furnish information to protect the financial and legal rights of the state and any person affected by the activities of the agency.

The Commission's Internal Audit Department addressed problems with Central Records in a May 2000 audit report.

Our testing of 81 records for compliance with enforcement policies and procedures showed that:

- 68 percent (55 of 81) of the records were missing investigation reports.

- 55 percent (16 of 29) of the records requiring notices of enforcement, notices of

violations, and general compliance letters were missing these documents.

- 76 percent (16 of 21) of the records requiring general correspondence letters were missing these documents.

Additionally, while testing the permitting process we found that:

- 22 percent (8 of 37) of the files we requested could not be located.
- Current policy does not indicate how soon a file must be returned to Central Records for processing and inventory after completion of a permit project.
- Central Records has a significant number of records sitting on shelves waiting to be processed.

Recommendation

Central Records should enforce current policies and ensure that it addresses procedures for the creation, maintenance, and inventory of files.

Management's Response

TCEQ agrees with this SAO recommendation. In May 2003, the TCEQ Records Management Officer requested a facilitated review from the TCEQ Office of Internal Audit. The advisory service was conducted in October 2003 and provides additional recommendations for improved process control which are being implemented by the Central File Room.

Chapter 5

Data Used to Monitor Compliance with Some Water Quality Permits Is Not Accurate

The Commission does not monitor or review data that a contractor enters and that the Commission uploads to the Environmental Protection Agency's (EPA) Permit Compliance System (PCS). The data comes from water discharge reports submitted by regulated entities. In addition to providing this information to the EPA, the Commission uses it to identify entities that report that they exceeded their limits. We tested data for January and April 2003 and found several errors, most of which were attributable to the contractor.

In addition, the Commission's compliance-monitoring coordinators have the ability to modify permit limits in PCS. Although we did not find any incidences where this occurred, there is a risk that compliance-monitoring coordinators could increase permit limits to prevent a regulated entity from violating its permit.

Chapter 5-A

The Commission Does Not Monitor Contractor Data Entry for Accuracy

A contractor enters the majority of the water quality self-reported data (see text box) for facilities classified as "minor." The Commission's Water Quality Monitoring Team does not review the results of the contractor's data entry for accuracy. Testing of the data entered in the system identified a 7 percent error rate. In addition, 13 percent of the reports we tested had not been entered. Ninety-seven percent of these errors and omissions were attributable to the contractor. Inaccurate or incomplete data entry will prevent the Water Quality Monitoring Team from effectively monitoring water quality permits and identifying deviations from the approved permit limits.

Self-Reported Data

The Commission collects 105 different types of self-reported data. Entities submit this data to the Commission as part of their permitting or enforcement requirements. Self-reported data is used for monitoring and analysis and can be used for enforcement actions.

The Enforcement Division generates a monitoring report twice a week that identifies data that has been entered but not uploaded into PCS. A quarterly monitoring report identifies entities that reported exceeding their permit limits. However, neither monitoring report will identify information that is incorrectly entered in PCS if the entity has not reported exceeding its permit limit.

Recommendations

The Enforcement Division should:

- Implement a process to perform a quality review of data entry provided by contractors.
- Develop additional procedures to ensure that all of the submitted reports are entered into PCS.

Management's Response

TCEQ does quality assure all monitoring data prior to initiating an enforcement action or issuing an NOV.

We agree with the recommendations. The Enforcement Division Director is responsible for implementing these recommendations by June 30, 2004.

Chapter 5-B

Allowing the Commission's Compliance-Monitoring Coordinators to Edit Permit Limits in PCS Creates a Risk of Unauthorized Edits

The compliance-monitoring coordinators can change the permit limits in PCS. The coordinators review the self-reported data received from water quality entities monthly. They are responsible for identifying violations and processing notices of violations. The Commission's Permitting Division is responsible for entering permit limits and reporting requirements in PCS.

The two functions of entering permit limits and requirements and of monitoring compliance are properly segregated within the Commission. However, the database access rights should be aligned with the functions to reduce the risk of unauthorized edits to PCS.

Recommendation

The Commission should request that the EPA modify the user rights to reflect the job functions of entering permit limits and requirements and of monitoring compliance.

Management's Response

We agree with the recommendation and will forward the SAO issue to the EPA for consideration.

Chapter 6

Fee Collection Processes Ensure that the Majority of Fees Are Collected, but Opportunities Exist to Increase Revenue

In general, the Commission's assessment, billing, and fee collection process for the consolidated water quality, solid waste disposal, and air emissions fees is adequate. In fiscal year 2002, the Commission collected almost 99 percent of the fees assessed.

According to Health and Safety Code, Section 382.0621(b), fees imposed by the Commission on Title IV and Title V air permits covered by the federal Clean Air Act should be at least enough to cover all reasonable costs of the permit program. We evaluated these fees and program costs for fiscal years 2002 and 2003 and determined that revenues for these programs were sufficient to cover expenditures.

In general, the Office of the Comptroller of Public Accounts (Comptroller) and the Department of Public Safety collect and transfer to the Commission its share of each fee they administer and collect on behalf of the Commission (see Table 1).

The majority of the Commission's revenue comes from fees. Among the many fees the Commission assesses, six fees are expected to generate at least 70 percent of the Commission's revenue (see Table 1).

Table 1

Fiscal Year 2002 Revenue from Consolidated Water Quality, Solid Waste Disposal, and Air Emissions Fees

Fee Type	FY02 Assessed Revenue	FY02 Revenue Collected/ Transferred	Agency that Administers and Collects Fees
Air Emissions	$ 36,788,503	$ 35,816,108	Commission
Solid Waste Disposal	35,977,622	35,041,565	Commission
Consolidated Water Quality	-	-	Commission (new fee for fiscal year 2003)
Motor Vehicle Inspection, Auto Emissions Inspection, and On-Board Diagnostic Test	37,566,862	37,288,120	Department of Public Safety
Petroleum Delivery	80,333,943	80,319,206	Comptroller
Lead Acid Battery	14,056,557	14,050,782	Comptroller
Total	**$204,723,487**	**$202,515,781**	
Collected/Transferred Revenue as a Percentage of Total Revenue		**98.9%**	

Fee Details

Air Emissions fees are based on allowable levels and/or actual emissions, which the regulated entities report themselves.

Solid Waste Disposal fees are assessed quarterly based on amounts the regulated entities report themselves.

Consolidated Water Quality fees are assessed on authorized limits stipulated in permits.

The **Motor Vehicle Inspection (MVI) and Auto Emissions Inspection (AEI)** fees are assessed during vehicles' annual safety inspections. The AEI fee applies only to vehicles registered in counties designated as non-attainment areas. The Commission receives $2 per MVI sticker, 20 percent of AEI fees, and $6 for **On-Board Diagnostic** tests. Funds are deposited in the Clean Air Act account.

The **Petroleum Delivery** fee is assessed on the withdrawal of petroleum products. The Commission receives 98 percent of the fee, and it is deposited in the Petroleum Storage Tank Remediation account.

The **Lead-Acid Battery** fee is assessed on the sale, storage, use, or consumption of new or used lead-acid batteries, not for resale. The Commission receives 96 percent of the fee, and funds are deposited in the Hazardous and Solid Waste Remediation account.

Sources: Unaudited information from the Comptroller of Public Accounts, the Department of Public Safety, Commission records, and the Uniform Statewide Accounting System

Chapter 6-A

Unauthorized Solid Waste Disposal Fee Discount Reduces the Commission's Revenue

Since 1990, the Commission has granted federal facilities a 49 percent discount on solid waste disposal fees. For fiscal year 2002, the Commission forfeited $28,747 in solid waste disposal fees because of this discount. While we were not able to quantify the effect of the discount for the past 12 years, the revenue lost could be significant.

Neither state statutes nor the Texas Administrative Code give the Commission authority for granting this discount. The lack of official authority opens the door for other facilities to request a discount.

Recommendation

The Commission should reconsider the discount granted to federal facilities. If the Commission decides to continue the discount, it should update its current rules and, if necessary, request statutory authority to officially authorize the discount.

Management's Response

TCEQ agrees with the recommendation. The Deputy for the Office of Permitting, Remediation and Registration is responsible for implementing this recommendation by June 2005.

Federal facilities may have a legally supportable claim that they are not required to pay the part of this fee that is dedicated for use by local governments and regional planning commissions.

Chapter 6-B

Delays in Annual Revenue Reconciliations May Prevent the Commission from Reporting Accurate Data in Its Annual Financial Report

The Financial Administration Division (Division) has not reconciled fiscal year 2002 collected revenue between Prophecy (the internal billing and accounts receivable system) and the Uniform Statewide Accounting System (USAS). Accounting Policy Statement No. 029 from the Comptroller requires agencies to reconcile their program and accounting records to USAS.

USAS is the Commission's accounting system. Reconciling it with Prophecy would help ensure that revenue is properly recorded, accounted for, and reported in the Commission's Annual Financial Report (AFR). Reporting accurate and reliable information is essential as the AFR is used by both internal and external users for decision making.

Recommendation

The Financial Administration Division should reconcile amounts recorded in Prophecy against USAS data in a timely manner to ensure that revenue is properly recorded, accounted for, and reported in its AFR.

Management's Response

TCEQ agrees with this recommendation, and the Financial Administration Division does reconcile Prophecy and USAS data on a monthly basis. FA performs an annual reconciliation between Prophecy and USAS after USAS closes for the fiscal year (November 20th of each year). USAS data is not available early enough to reconcile for the AFR.

Chapter 6-C

Outdated MOU Could Create Difficulties in Revenue Transfers

The memorandum of understanding (MOU) between the Department of Public Safety (Department) and the Commission regarding the handling and transfer of motor vehicle and auto emissions inspection fees received by the Department has not been updated since December 1996. Texas Administrative Code, Chapter 30, Rule 7.110, requires the agencies to update this MOU at least every five years.

The MOU covers the establishment, planning, implementation, oversight, and evaluation of primary responsibilities for these agencies. Without a current MOU, there is a risk of miscommunication regarding the handling and transfer of auto inspection fees, which could make it difficult for the Department and the Commission to carry out their responsibilities.

Recommendation

The Department and the Commission should update their MOU as required. The revenue directors and staff involved in the collection, transfer, and receipt of funds should meet annually to discuss changes that affect these processes.

Department of Public Safety Management's Response

DPS agrees with the recommendation. The Supervisor of Accounting Systems has met with TCEQ and is in the process of developing a team to address the MOU draft to resolve all current issues that outlines the current situation in appropriate detail. The MOU draft initial completion date is estimated on January 31, 2004 depending on scheduling of appropriate staff.

Commission on Environmental Quality Management's Response

TCEQ agrees with this recommendation. The CFO is responsible for implementing the recommendation by April 30, 2004.

Chapter 6-D

The Funds Transfer Process Between the Commission and the Department Could Be Improved

The Department's process to transfer motor vehicle inspection and auto emissions fees to the Commission is adequate. We did not test the process used to collect the fees. However, there are opportunities to improve the process and to assist the Commission in tracking and allocating the corresponding fees:

- As of August 2003, the Department had transferred 99.26 percent ($37,288,120) of fiscal year 2002 sales to the Commission. The remaining 0.74 percent, or $278,742, was not transferred (see Table 1 on page 20).

- During fiscal year 2003, there was confusion between the Department and the Commission as to the correct number of Program Cost Accounts necessary to adequately allocate fees to the Commission's programs.

- Testing of fiscal year 2002 records shows that the Department waited until year end to transfer sales of certificates collected via interagency transfer vouchers. In addition, the amount transferred at year end does not reconcile to interagency transfer voucher sales recorded by the Department in the reports it provided to the Commission. At the end of the fiscal year, the Department transferred approximately $14,000 in these vouchers to the Commission.

- The report provided by the Department, which reflects monthly certificate sales by type, does not match transfer amounts recorded in USAS.

These problems are a result of a lack of communication between the agencies' personnel. The Commission depends on information provided by the Department in order to allocate collected fees among its programs. For the on-board diagnostic (auto emission) fee, the Commission transfers 100 percent of revenue collected to counties that participate in the Low Income Repair Assistance Program (LIRAP). Without adequate information, the Commission spends unnecessary time and resources reconciling the information in USAS against monthly reports provided by the Department.

Recommendations

The Department should establish better communication with the Commission in order to address any changes that may affect the process of transferring funds.

In particular, the Department should take steps to:

- Transfer funds using the Commission-requested Program Cost Accounts and fund numbers.
- Transfer interagency transfer voucher sales on a regular basis.
- Reconcile its monthly reports to its accounting system prior to providing them to the Commission.
- Provide the Commission with appropriate documentation so it can independently determine its share of sales by certificate type.

Department of Public Safety Management's Response

DPS agrees with the recommendations and has already implemented weekly contacts with appropriate TCEQ personnel to enhance communications. The Comptroller's Office has made the requested coding changes to the Rapid Deposit system to accommodate TCEQ's needs. Deposit reports are reconciled and monthly adjustment transfers are made on a more timely basis.

Chapter 7

Weak Password Controls and the Lack of a Business Continuity Plan Could Affect the Integrity of the Commission's Data

Central Registry and CCEDS, the two main information systems used for permitting and enforcement at the Commission (see text box), do not require users to change passwords from their initial passwords, which are assigned by the Central Registry system administrator. Without periodic password changes, there is a greater risk that a password could be compromised and that an unauthorized individual could gain access. Also, the Commission lacks a business continuity plan, which leaves it unprepared for a disaster.

Central Registry and CCEDS

The Commission has two primary data systems, Central Registry and the Consolidated Compliance and Enforcement Data System (CCEDS).

Central Registry is a data repository that contains data that is migrated from smaller legacy systems each month. It contains descriptive information on customers (called core data), as well as their relationships to a regulated entity. Core data includes the name, address, phone number, customer number, regulated entity number, permits, and registrations for each customer and regulated entity that is, or has been, of environmental interest to the Commission.

CCEDS is a system developed to replace the Compliance and Enforcement Division's legacy system. It contains information on investigations and enforcement actions. The Central Registry and CCEDS are linked.

Chapter 7-A

The Lack of Required Password Changes in the Central Registry and CCEDS Puts Data Security at Risk

Passwords for the Central Registry and CCEDS are assigned to new users by the Central Registry team. Neither CCEDS nor the Central Registry require the users to change their initial assigned passwords. In addition, there are no requirements to periodically update passwords in the Central Registry. The systems have the necessary features programmed to require users to change their passwords; however, this feature is not turned on. Once new users log on, they should be prompted to change their passwords. There can be problems with accountability in a system where the users do not change the initial passwords assigned to them. In the case of erroneous or unauthorized changes to data, it would be hard to track who made changes.

Recommendation

The Commission should activate the feature that prompts users to change their initial passwords when they first log in. Periodic changes to passwords should be required for the Central Registry.

Management's Response

TCEQ agrees with this recommendation, and we are evaluating the policy and mechanism for changing passwords.

Chapter 7-B

The Lack of a Business Continuity Plan Jeopardizes the Commission's Ability to Provide Services During a Disaster

The Commission still does not have a complete and tested business continuity plan. It is aware of this deficiency and has reported that it is in the process of developing a plan. However, we also identified this issue in our *Legislative Summary Document Regarding Texas Commission on Environmental Quality* (SAO Report No. 03-360, January 2003). At that time, the Commission stated that it planned to have its business continuity plan developed and tested by August 31, 2003. The lack of a complete and tested business continuity plan leaves the Commission unprepared for a disaster, which could result in a delay in providing services to the public or in not providing services at all for an extended period of time.

Texas Administrative Code (TAC), Title 1, Section 202.6 states that:

> Business Continuity Planning covers all business functions of an agency and it is a business management responsibility. Agencies should maintain a written Business Continuity Plan so that the effects of a disaster will be minimized, and the agency will be able to either maintain or quickly resume mission-critical functions. The agency head shall approve the Plan. The Plan shall be distributed to key personnel and a copy stored offsite.

Recommendation

The Commission should finalize its business continuity plan and have it approved by executive management. The plan should be tested at least annually.

Management's Response

The TCEQ agrees with this recommendation. The Business Continuity Plan (BCP) will be presented to Executive Management for approval by February 28, 2004. The BCP will be tested annually.

At the Commission's request, we also reviewed the reimbursement rules for the Petroleum Storage Tank Remediation Program during our fieldwork in order to determine whether the rules apply to a contractor's actual costs. Based on our review of the reimbursement rules, we believe that the current rules relating to actual costs apply to the owner's or operator's expenses, not the contractor's. The Texas Water Code and rules set by the Commission indicate that the program is designed to reimburse eligible owners/operators for their remediation expenses. Therefore, the rules as currently constructed do not apply to a contractor's underlying operating expenses, such as overhead and indirect costs.

As a result, it appears that contractors performing and managing remediation services under an owner or operator assignment can be reimbursed up to the maximum allowable rate regardless of the contractor's operating expenses. Under the Commission's current rules, as long as contractors' claims do not exceed the maximum reimbursement rates, contractors can be paid for expenses that would not be reimbursable had the owner/operator claimed them. This situation puts the State at risk of overpaying for the cleanup of leaking tank sites.

Management's Response

We appreciate the SAO's assistance in reviewing the PST rules. We have already initiated the rule making process and anticipate the proposed rule changes will be presented to the Commission in the next several months.

During our fieldwork, we noted the following issues that may warrant further consideration from the Commission or the Legislature:

- Recent changes to the penalty policy reduce penalty enhancements, which could weaken the Commission's ability to deter violations.

- The current air emissions cap does not provide an incentive for facilities to limit emissions once they exceed 4,000 tons. Current statute (Health and Safety Code, Section 382.0621[d]) precludes the Commission from imposing a fee for any amount of emissions over 4,000 tons per year from any source. The cap also causes the Commission to miss an opportunity to collect more fee revenue. Using fiscal year 2002 data, we calculated that if the cap were eliminated, the Commission's potential revenue could increase by approximately $25 million per year.

Chapter 9-A

Recent Changes to Penalty Calculation Policies May Not Deter Violations

The Commission's revised 2002 penalty policy reduces penalty enhancements from their 1999 penalty policy levels for entities with long histories of prior violations. This new penalty policy has the potential to weaken the influence of enforcement actions on the regulated community, as well as decrease the penalty dollars assessed and collected.

Culpability. Under its 1999 policy, the Commission evaluated an entity's culpability based on whether the entity had received a prior notice of violation (NOV) for the same or a similar violation. Under the 2002 policy, the Commission no longer considers NOVs when evaluating culpability but does consider them with regard to compliance history. Culpability is further limited to the existence and discovery of documentation suggesting prior knowledge of the deficiency. As a result, there is little evidence left with which to determine culpability. Not using NOVs to determine culpability will allow repeat violators to avoid paying penalty enhancements.

Good-Faith Effort to Comply. The reduction for a good-faith effort to comply allows entities six months or longer to resolve violations and have their penalties reduced. Under established guidelines, the Commission has up to two months to issue an NOV and up to four months after screening to issue a draft order. If the violator addresses the violation during this time, the Commission reduces the penalty. The reductions result in a forfeiture of penalty dollars collected and interest revenue earned by the State.

Compliance History. The 2002 policy added a consideration for compliance history, but NOVs considered as part of compliance history are now limited to those issued after September 1, 1999, and 1660 orders are limited to those issued after February 1, 2002. As a result, entities with a long history of the same or similar violations may not be treated differently than an entity without a prior history.

Economic Benefit. The 2002 revision subjects all entities that receive more than $15,000 in economic benefits from noncompliance to a penalty enhancement of 50 percent of the base penalty. The entities that are subject to the enhancement often have economic benefits that exceed their penalties, which could reduce their incentive to comply. The enhancement does not significantly increase the impact because the penalty enhancement is a percentage of the base penalty, not a percentage of the benefit gained by noncompliance.

For example, if a violation with a base penalty of $2,000 allows an entity to save $20,000 during the period of noncompliance, the Commission increases the entity's penalty by 50 percent to $3,000. Even after paying the penalty, the violation provides the entity with a net economic benefit of $17,000. For the 80 fiscal year 2001, 2002, and 2003 cases tested, the amount of economic benefit gained by entities during noncompliance was $8,647,005. The Commission fined these entities a total of $1,683,635, which is approximately 19 percent of the entities' economic benefit.

The Commission contends that the cost of making repairs or adjustments to come into compliance should be considered in the enforcement process, and the cost of coming into compliance is often greater than the economic benefit gained. However, because these repairs or adjustments are needed for the entity to operate legally, their costs should not be considered as part of the penalty.

Chapter 9-B

Eliminating the Air Emissions Fee Cap Could Result in Increased Revenue and Decreased Emissions

According to the Health and Safety Code, Section 382.0621(d), "The Commission may not impose a fee for any amount of emissions of an air contaminant regulated under the federal Clean Air Act Amendments of 1990 in excess of 4,000 tons per year from any source." This allows some facilities to emit more than 4,000 tons of air pollutants without having to pay for more than 4,000 tons. For example, one facility reported emitting 85,990 tons of sulfur dioxide in fiscal year 2002 but paid a fee for emitting only the first 4,000 tons.

This cap does not provide an incentive for facilities to limit their emissions once they exceed 4,000 tons, and the Commission misses an opportunity to collect more fee revenue. We estimate that the Commission forfeited approximately $25 million in additional revenue during fiscal year 2002 because of the 4,000-ton cap.

Appendices

Appendix 1

Objectives, Scope, and Methodology

Objectives

Our objectives were to determine whether the permitting and enforcement functions for selected programs at the Commission on Environmental Quality (Commission) ensure that:

- Permits are issued in accordance with state statutes, regulations, agency policies, and best practices.
- Current processes for Title V Air Permits allow for effective public participation, review, and comment.
- Enforcement functions are carried out in accordance with state statutes, regulations, agency policies, and best practices.
- Selected program fees are collected and accounted for appropriately.
- Current management information systems adequately support the regulatory structure.

At the Commission's request, we also reviewed the petroleum storage tank reimbursement rules to determine whether the Commission has a process in place that clearly identifies allowable costs.

Scope

We primarily analyzed data and processes completed in fiscal year 2002, but in some cases we reviewed data from September 1, 2001, to May 31, 2003, as indicated. For the fee work performed, we coordinated efforts with the Commission's Internal Audit Department.

For the Permitting function, we reviewed the following permits:

- Air Permits – Title V and New Source Review Construction (this included new permits, renewals, amendments, and flexible permits) and Site Operating Permits received, approved, completed, and issued between September 1, 2001, and May 31, 2003.
- Water Quality:
  - Texas Pollutant Discharge Elimination System (TPDES) Multi-Sector General Storm Water Permit TXR05000
  - Wastewater General Permit TXG11000 (which includes authorizations TXG11 – Discharges of facility wastewater and contact storm water from

ready-mixed concrete plants; TXG34 – Discharges of facility wastewater and contact storm water from petroleum bulk stations and terminals; TXG83 – Discharges of petroleum contaminated water; and TXR05 – Storm water discharges associated with industrial activity). The population was composed of Notices of Intent that were completed, approved, and issued from September 1, 2001, through May 31, 2003.

- Air Permits subject to Public Participation – These permits include Construction and Site Operating Permits. Our review covered new permits as well as renewals and amendments completed from September 1, 2002, to May 31, 2003.

For the enforcement function, we focused on air, water quality, and public drinking water programs from the Houston, Beaumont, Corpus Christi, and Austin regions. Our population consisted of active enforcement cases from September 1, 2001, through May 31, 2003. Areas of emphasis included:

- Timeliness of issuing enforcement orders.

- The classification and monitoring of supplemental environmental projects (SEPs).

- Effectiveness of the penalty policy, which includes adjustments for economic benefit, repeat violator classification, culpability, good-faith effort, and compliance history.

Some of the Commission's fees are administered and collected by other state agencies. The time period we reviewed was fiscal year 2002, except as noted. Our review also included processing of fee payments received and posted to the Prophecy system (the Commission's billing and accounts receivable system) and USAS.

- The Commission administers the solid waste disposal, air emissions, and consolidated water quality fees. The consolidated water quality fee became effective on October 6, 2002 (fiscal year 2003), and it replaces the water quality assessment and waste treatment inspection. For the most recent fee, our review included the fee assessment and billing processes because they are performed at the beginning of the fiscal year (fiscal year 2003).

- The Office of the Comptroller of Public Accounts administers the petroleum storage delivery and lead-acid battery fees.

- The Department of Public Safety administers the motor vehicle safety inspection and auto emission fees. The auto emission fee also includes the on-board diagnostic fee, which is assessed only in certain counties and for vehicles newer than 1996.

- We also reviewed air, water quality, and public drinking water administrative penalties with agreed order dates from September 2001 to May 2003.

The information systems reviewed include the Commission's Central Registry and the Consolidated Compliance and Enforcement Data System (CCEDS) applications as well as selected legacy information systems that transfer data to CCEDS.

Methodology

Our methodology consisted of gathering information through interviewing management and staff from Commission headquarters and regional offices, reviewing policies and procedures, testing controls and related documentation, and reviewing data from information technology systems.

Procedures and tests conducted included the following:

- Reviewed state laws, regulations, and the Commission's policies and procedures
- Reviewed the Department of Public Safety's (Department) policies and procedures
- Reviewed the Office of the Comptroller of Public Accounts' (Comptroller) policies and procedures
- Reviewed prior State Auditor's Office (SAO) reports and the Commission's internal audit reports
- Reviewed working papers for the current SAO project "Controls Over the Tax Revenue System at the Office of the Comptroller of Public Accounts"
- Reviewed the Commission's 2002 self-assessments for selected divisions
- Reviewed the Commission's fiscal year 2002 Annual Financial Report
- Review the Comptroller's 2002 Annual Cash Report
- Reviewed the Environmental Protective Agency Code of Federal Regulations
- Conducted interviews with Department and Comptroller management and staff
- Conducted interviews with public interest groups
- Observed various functions to gain an understanding and verify the existence of controls
- Recalculated penalties assessed by the Commission and generated in Quattro Pro spreadsheets
- Analyzed SEPs' classifications
- Analyzed effectiveness of administrative penalties, including adjustments and deferrals based on previous and current policy changes
- Compared data elements for consistency between different information systems and hard copy data
- Determined Central Registry and CCEDS data accuracy and completeness
- Evaluated Central Registry and CCEDS access rights and system security

- Reconciled data in the Enforcement Database against Financial Administrative Division (Division) records of administrative penalties due
- Reconciled Division records against data independently obtained from USAS
- Reconciled Division records against Comptroller and Department data

Criteria used included the following:

- Texas statutes
- Texas Administrative Code
- General Appropriations Act (76th and 77th Legislatures)
- The Department's and the Comptroller's policies and procedures
- The following Commission policies and procedures:
  - Penalty policies: fiscal year 2000 revision (effective January 1, 1999) and fiscal year 2003 revision (effective September 1, 2002)
  - Penalty calculation worksheet instructions
  - Enforcement Division standard operating procedures
  - SEP standard operating procedures dated April 2003
  - Field Operations Division's standard operating procedures
  - Financial Administration Revenue Manual
  - Information technology policies and procedures regarding access and security

Other Information

We conducted fieldwork from April 2003 through September 2003. The audit was conducted in accordance with generally accepted government auditing standards.

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

- Sandra Donoho, MPA, CISA (Project Manager)
- Ileana Barboza, MBA (Assistant Project Manager)
- Allen Ackles
- Romeo Diaz
- Shaniqua Johnson
- Robert Kiker
- Patricia Perme, CPA
- Juan Sanchez, MPA

- Serra Tamur, MPAff, CISA, CIA
- Rene Valadez
- Leslie Ashton, CPA (Quality Control Reviewer)
- Julie Ivie, CIA (Audit Manager)
- Frank Vito, CPA (Audit Director)

TEXAS COMMISSION ON ENVIRONMENTAL QUALITY

Protecting Texas by Reducing and Preventing Pollution

December 8, 2003

Mr. Lawrence F. Alwin, CPA
Office of the State Auditor
P.O. Box 12067
Austin, Texas 78711-2067

Dear Mr. Alwin:

Thank you for the opportunity to review the draft, *An Audit Report on The Commission on Environmental Quality's Enforcement and Permitting Functions for Selected Programs.* The TCEQ generally agrees with the SAO recommendations and has already initiated implementation. While we agree with the recommendations, we have not seen adequate evidence to support the SAO's conclusions in two areas. Specifically, while there is room for programmatic improvement, we believe project classification and monitoring in the Supplemental Environmental Project program has been appropriate. Additionally, we agree with the SAO conclusion that our permitting processes comply with statute and agency policy; however, we do not agree that our public comment policy could reduce the effective comment period.

We are grateful to Julie Ivie, Sandy Donoho and the entire audit team. Their efforts will be helpful as we move forward in our work to protect our state's precious human and natural resources, consistent with sustainable economic development.

Sincerely,

Margaret Hoffman

Margaret Hoffman
Executive Director

Attachment

cc: Kathleen Hartnett White, Chairman, TCEQ
R.B. "Ralph" Marquez, Commissioner, TCEQ
Larry R. Soward, Commissioner, TCEQ
Steve Goodson, CIA, CISA, CGAP, Chief Audit Executive, TCEQ
Frank Vito, CPA, SAO Assurances Services Director
Julie Ivie, CIA, SAO Audit Manager
Sandy Donoho, CISA, SAO Project Manager

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Appendix 3

Permitting Timeframe Reduction Project

The following information is based on unaudited information provided by the Commission.

Due to a significant backlog of 1,126 permit applications, in April 2002 the Office of Permitting, Remediation and Registration (Office) initiated a Permitting Timeframe Reduction (PTR) program to address this backlog. The PTR program had two goals:

- To evaluate and establish the maximum number of days to complete permits internally
- To implement streamlining measures in order to meet those deadlines

The Office started by setting maximum target dates for the completion of permit actions to meet its first goal. In addition, projects were categorized as either Priority One or Priority Two projects (see text box).

Project Classification

Priority One projects are those projects that require an action on behalf of the Commission before an applicant can proceed with construction or modification.

Priority Two projects are those projects for which action on behalf of the Commission is not a prerequisite to beginning or continuing business operations.

Applications receiving a hearing request are not included in the above categories due to staff's inability to influence their closure.

To meet its second goal, the Office implemented a number of streamlining measures. Some of the highlights include:

- Requesting duplicate applications so that the technical review could begin while the application was undergoing the administrative review.
- Developing general permits for water quality and wastewater needs and standard permits for air sources.

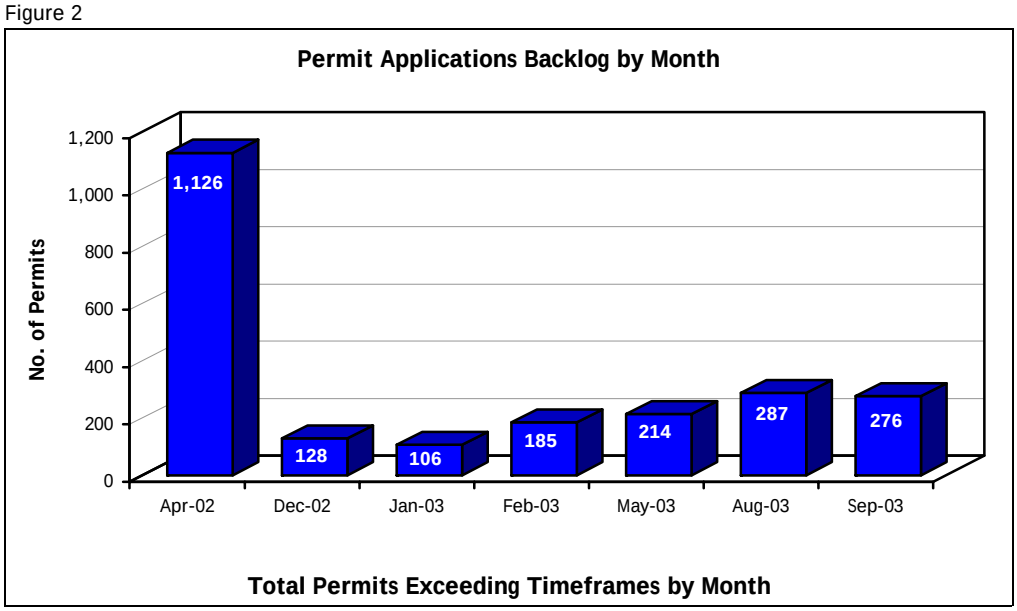
The Office also established monetary bonuses and overtime where appropriate for high performers and employed interns.

As of January 31, 2003, the Office was able to reduce the Priority One backlog from 1,126 applications to 106 (a 91 percent reduction). Based on information provided by the office, as of September 1, 2003 (seven months later), the backlog increased 160 percent from 106 to 276 permits, or the equivalent of 25 percent of the original April 2002 backlog (see Figure 2).

Since January 2003, the most significant increases (based on percentage) have occurred in the Water Quality Division, with an increase from 29 applications to 119, and in the Water Supply Division, with an increase from 3 permit applications to 35 exceeding their timeframes. However, it is the Air Division, with 77 applications, and the Water Quality Division, with 119 applications, that account for 71 percent of the September 30, 2003, backlog of 276 permit applications.

We were not able to project how long it will take for the backlog to build up to a degree similar to that of April 2002 because the Office does not track the progress of overdue permits each month and because we did not audit the data the Office was able to provide. In addition, the data is derived from various data systems that were not in the scope of our information systems audit work. We did trace the September 2003 numbers back to the automated reports from these systems.

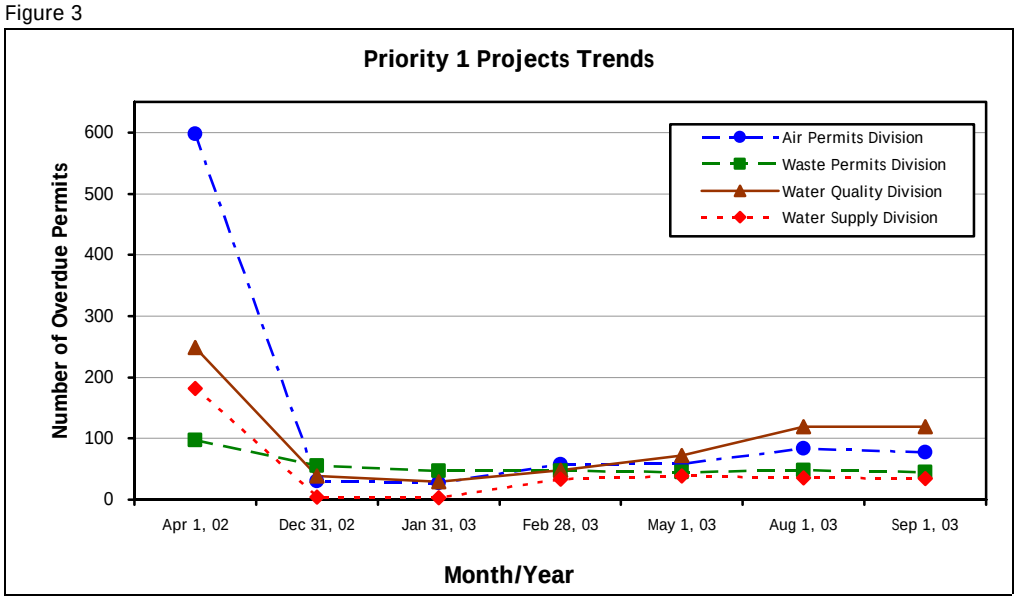
Figure 2



Source: Unaudited data from the Office of Permitting, Remediation and Registration, Commission on Environmental Quality

Figure 3 graphs the number of permits exceeding the timeframe goal according to category by month/year since April 1, 2002. The graph indicates that the number of permits exceeding the timeframe goals has evened out after hitting low numbers in December 2002.

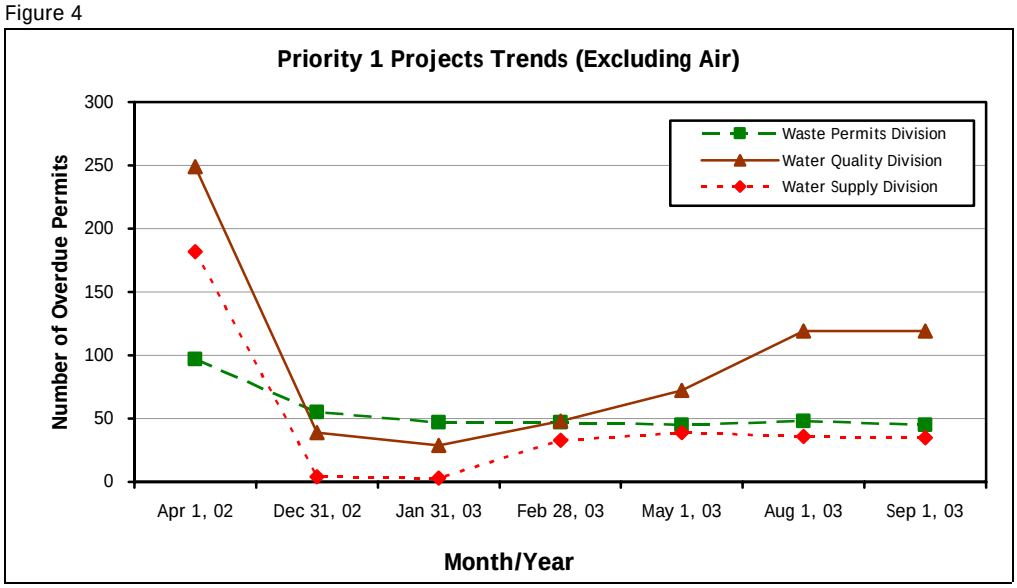
Figure 3



Source: Unaudited data from the Office of Permitting, Remediation and Registration, Commission on Environmental Quality

Figure 4 excludes the air permits because they appear to be skewing the trends. A review of the trends in this graph indicates that the overdue water quality permits have risen to approximately 50 percent of the April 2002 level. The number of overdue water quality permits has quadrupled since hitting low numbers in January 2003. The number of overdue water supply permits has risen as well.

Figure 4



Source: Unaudited data from the Office of Permitting, Remediation and Registration, Commission on Environmental Quality

Copies of this report have been distributed to the following:

Legislative Audit Committee

The Honorable Tom Craddick, Speaker of the House, Chair
The Honorable David Dewhurst, Lieutenant Governor, Vice Chair
The Honorable Teel Bivins, Senate Finance Committee
The Honorable Thomas "Tommy" Williams, Member, Texas Senate
The Honorable Talmadge Heflin, House Appropriations Committee
The Honorable Ron Wilson, House Ways and Means Committee

Office of the Governor

The Honorable Rick Perry, Governor

Commission on Environmental Quality

Ms. Kathleen Hartnett White, Chairperson
Mr. R. B. "Ralph" Marquez, Commissioner
Mr. Larry R. Soward, Commissioner
Ms. Margaret Hoffman, Executive Director

Department of Public Safety

Ms. Colleen McHugh, Chairperson
Mr. James B. Francis, Jr., Board Member
Mr. Robert B. Holt, Board Member
Colonel Thomas Davis, Executive Director

Office of the Comptroller of Public Accounts

The Honorable Carole Keeton Strayhorn, Comptroller of Public Accounts
Mr. Billy Hamilton, Deputy Comptroller