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June 27, 2003

Mr. Jeff McMahan,
State Auditor and Inspector
State of Oklahoma
Office of the Auditor and Inspector
2300 North Lincoln Boulevard
Room 100, State Capitol
Oklahoma City, OK 73105-4801

Dear Mr. McMahan:

At your request, we are providing the following response to address the May 13, 2003 "draft" response to our report dated April 11, 2003. The "draft" response was signed by Tom Daxon, Acting General Administrator of the Oklahoma Corporation Commission, and is styled "RESPONSE AND CORRECTION OF LAW AND FACTS CONTAINED IN MSI BARNES & ASSOCIATES' REPORT OF THE PETROLEUM STORAGE TANK DIVISION".

COMMENTS ON OCC COVER LETTER

Representations concerning EPA's favorable evaluation of the Oklahoma program

In the OCC cover letter, mention is made of the Oklahoma program being "rated" the best such program in the country. We have been unable to find any "rating" of the Oklahoma Storage Tank program or any other state program by the EPA. Additionally, we have reviewed the most recent End of Year report issued by EPA Region 6 on February 3, 2003, and we found no reference to the Oklahoma Storage Tank program being rated "the best underground storage tank clean up program in the country" as stated in the cover letter. As part of our procedures, we had reviewed all of the documents provided by the OCC regarding the approval of Oklahoma's program along with the End of Year reports from EPA and found no such rating or distinctive comment.

The cover letter also stated that EPA particularly praised Oklahoma's Pay for Performance ("PfP") contract process. Since the OCC cover letter does not name the EPA official who purportedly made these statements, we are unable to verify that the statements were made nor the basis upon which they were made. In fact, after a careful review of EPA's resources on the PfP method of contracting, it appears that EPA must have, in the past, performed some analysis on states with active PfP programs. We noted that within EPA's website there is a "PfP toolbox" regarding PfP contracts. *Within this document it is stated "Negotiated PfP cleanup prices to date have not been significantly lower than traditional T&M contracts."* Given this perspective of

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EPA on the dubious value of PfP contracts in the absence of competitive bidding, we question the basis for any statement by an EPA official that the Oklahoma PfP program is worthy of praise.

OCC suggests an "informed reading of the statutes" as to "certain" questioned expenditures

The OCC response cover letter states that, as to "certain" questioned expenditures "an informed reading of the statutes shows that PSTD acted within its authority." Nothing in the OCC "draft" responses, in our opinion, contradicts our findings. We have enumerated, within this response, specific instances where OCC expresses a contrary point of view. It is noteworthy that in numerous instances within the OCC response, the OCC quotes that its statutory authority for a particular action undertaken is found in 17 OS § 323 which sets forth many of the powers and duties of the Petroleum Storage Tank Division (PSTD) and are broad in scope. This statute is apparently utilized by OCC as a basis for overriding other statutory requirements. Specifically, the OCC's response utilizes 17 OS § 323 in its responses III, X, XXII.

OCC is critical of the fact that our firm's report was not performed in accordance with Generally Accepted Government Auditing Standards (GAGAS) and that OCC had no advance notice of findings

The OCC response asserts that the agreed-upon procedures engagement was directed only by the Office of State Auditor and Inspector. In fact, use of agreed upon procedures for this engagement was discussed with and was in accordance with the engagement letter signed by the then Office of State Finance (OSF) Director, Tom Daxon and the then State Auditor and Inspector, Clifton H. Scott (see attached). It is interesting that Mr. Daxon in his role as acting administrator of OCC would later find fault with a decision that he was a party to when he was director of OSF.

Prior to conducting any procedures we asked that the Office of State Auditor and Inspector and the Office of State Finance work with the Senate staff to determine the legislative intent of the terms used in HB 2536 including, but not limited to, the term "investigative audit", which term is not defined by GAGAS. They determined that the legislative intent of HB 2536 could best be met by engaging our firm to conduct an "agreed-upon procedures engagement", which would investigate certain areas of performance of the OCC's PSTD. It should be noted that, while the engagement is not one which involves GAGAS in its entirety, many of the procedures are those which would have been required in a GAGAS "audit" and none of the procedures employed are prohibited by GAGAS.

The cover letter states that the OCC was not given the opportunity to review the report prior to its release. In fact, the official exit conference did take place the day before it was released (and all findings were discussed in detail in the meeting). Moreover, the findings themselves were discussed on an ongoing basis with PSTD management as the engagement was conducted.

The OCC criticized the failure to apply GAGAS to our engagement but failed to mention what we believe to be a relevant fact. For many years, Oklahoma Statutes (17 OS § 326) have called for an "independent audit" to be performed annually. We requested copies of those audit reports but were only provided with copies of reports of agreed-upon procedures performed each year by Grant Thornton, LLP. The terminology of 17 OS § 326 of "independent audit", unlike "investigative audit" is clearly defined by GAGAS. An "agreed-upon procedures engagement" is

not an "independent audit" as required by the statute. We asked to examine the files of Grant Thornton, LLP, but unrestricted access was denied by Grant Thornton, LLP despite repeated requests by the Office of the State Auditor and Inspector. Thus we have received no explanation from Grant Thornton, LLP why they performed an "agreed upon procedures" engagement rather than an "independent audit" in accordance with GAGAS and Oklahoma statutes. We are likewise unsure why OCC is critical of the nature of our report but makes no mention of the apparent long-term practice of Grant Thornton, LLP performing "agreed-upon procedures" rather than audits. It should be noted that none of the Grant Thornton, LLP reports provided to us made any mention of material problems with the performance of the PSTD. Not having had unrestricted access to the files, we cannot draw any conclusions about the reason for that either.

We have recommended to the Office of the Auditor and Inspector that they inquire further into this matter with the objective of determining why the deficiencies in the PSTD's operations were not discovered by the procedures employed by Grant Thornton, LLP. We believe that it was reasonable for the Office of the State Auditor and Inspector to have relied upon the expertise of a nationally recognized firm such as Grant Thornton, LLP to determine the nature of the engagement to perform under the applicable statute. Having decided to conduct an agreed-upon procedures engagement, which was apparently what was conducted, Grant Thornton, LLP had an obligation to perform the engagement in accordance with attestation standards established by the American Institute of Certified Public Accountants (AICPA). The performance of such procedures under the AICPA standards, require that the users of the report agree upon the sufficiency of the procedures. We have not received any documentation which would indicate that the users of the report have agreed to the sufficiency of the procedures, although we have made inquiries.

Inconsistencies between OCC response and OCC letter to Sen. Hobson, dated one day later

We find it noteworthy that while the "draft" response denies problems in certain key areas, to the contrary, in a letter dated May 14, 2003 (one day after the OCC "draft" response was issued) to Senate President Cal Hobson, the OCC seems to take an inconsistent position on key findings. With respect to the lack of competitive bids in the PfP process, OCC states in their response to our report that competitive bidding was not required due to the PfP program (a position we believe is incorrect, as described in our accompanying response). Within their response they allude to the fact that they believe that their current practice of "negotiating" the PfP contract, including the equipment and installation costs, is cost efficient as the process has reduced the price of cleanups as compared to the older time and materials system. Furthermore, in their response, they state, "We plan to consider whether it is appropriate to change our policy, but we think the state has benefited from the increased competition that has resulted." We find these statements very interesting for two reasons. First, in the letter to Sen. Hobson (one day later) they state that one of the changes to the PfP program the OCC will implement is to "require tank owners to obtain at least three bids from contractors prior to hiring a consultant and entering a PfP contract...In this way, we may be able to reduce costs." The second interesting area has to do with the idea that they believe they have a "competitive" system in place currently. We are uncertain as to how a negotiated process utilizing tailored software has fostered competition when a bid process, as required by Oklahoma statutes, would seem more "competitive".

A second area noted as a significant finding in our report was that of the method of making progress payments under the Pay for Performance program which essentially allows contractors to receive the majority of the contract amount without achieving commensurate cleanup results.

The OCC's response, dated one day earlier, provides an example of how the OCC calculates the percent reduction. They further state that "We do not think Oklahoma has been ill served by our present system...". However, in that same paragraph of their response they write, "(we) concur that we should review our policies to determine if we should make changes." The letter to Sen. Hobson, one day later, states the OCC will "Change the method of calculating progress payments to disallow readings below SSTL."

CONCLUSION

In our opinion, none of the OCC "draft" responses gives rise to a need to retract or amend any of the findings in our report.

After considering the OCC responses to some of the larger issues, such as the issue of collusion and the issue of the management and operation of the Pay for Performance program as a whole, the original concerns expressed in our report persist. The issue of collusion is raised in two different areas of our report and the OCC's response indicates that they do not consider violations of the non-collusion affidavits to be a problem worthy of addressing in a meaningful way (see OCC's responses included in IX, XII, and XXVII). As for the responses provided to many of the Pay for Performance program findings, concern persists on our part as to whether agency management adequately understands the technical aspects of what is involved in site remediation [see OCC's responses included in XXIII 1. (b) and (f) and 2. (b) and (c)].

Please review the response provided herein and should you have further questions or have a need for further clarification of points made in this response, please contact us.

Sincerely,

MSI Barnes & Associates, P.A.

MSI BARNES & ASSOCIATES, P.A.

cc: Nancy N. McElyea

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I. 17 O.S. §324 provides for three acceptable uses of Petroleum Storage Tank Release Environmental Cleanup Indemnity Fund monies. These uses include reimbursements to eligible persons for eligible expenses, reimbursement of actual costs incurred in evaluating claims and determining whether specific claims qualify for payment or reimbursement by the Indemnity Fund Program, and reimbursement of actual costs incurred for the administration of the Program. There is no provision for the use of Indemnity Fund monies for legal fees related to a lawsuit to which the Indemnity Fund is not an original party.

The Commission makes the argument that the expenditures were appropriate because 17 O.S. §357 provides for the Administrator of the Fund to represent and protect the fund. However, the Fund was already protected by a provision in its standard contract which states, "The consultant shall hold harmless, defend and indemnify the Applicant, the Oklahoma Petroleum Storage Tank Release Indemnity Program, the Petroleum Storage Tank Release Environmental Cleanup Indemnity Fund and the State of Oklahoma against any patent infringements and liability for damage, costs or expenses caused by the Consultant." Furthermore, it stretches the bounds of credibility to believe that former management of the PSTD fund who were involved with the initial formation of the Oklahoma PfP program and the underlying contracts, were unaware of the firm that held patents on the technology in question *as the patent holder became a primary shareholder in a company they formed.* It seems reasonable to infer that these former fund managers anticipated that these types of lawsuits would come to fruition, thus the unique terminology in the contracts as stated above. The argument made by the OCC as to the reason for their involvement in this lawsuit appears to us to be ill founded. In addition, we have contacted many of the other state trust fund programs and have found none that have been willing to become a party to such a lawsuit.

In addition, the Division's classification of these legal fees as claims processing fees was not appropriate. These fees did not relate to the evaluation of claims or determining whether specific claims qualify for payment or reimbursement by the Indemnity Fund Program as required by 17 O.S. §324. Classification of these costs as administrative costs, in addition to the classification errors noted in finding II. A. 2, would have resulted in administrative costs in excess of $1,000,000. 17 O.S. §360 limits annual expenditures from the Fund for costs incurred for the administration of the Indemnity Fund to $1,000,000 per fiscal year.

II. No response required.

III. The OCC responds that they had a statutory duty to cooperate with other state agencies regarding petroleum storage tank issues. This fact is not in question within our finding. Our finding centers on the fact that we were unable to locate any type of statutory authority to pay for site remediation costs in advance of incurring them. Additionally, we did not locate any type of projected cost analysis for the cleanup of the petroleum impacted portion of the site, thus, we are unsure of how the $1,100,000 was determined to be the minimum amount the cleanup could cost (for both the cleanup and management of the cleanup by the DEQ). Nothing in 17 OS § 323, which is offered as statutory authority for the payment, eliminates the need to comply with 17 OS § 356.

IV. No response required.

V. No response required.

VI. The $5,000 deductible is not listed in the PSTD database as a deductible. Furthermore, upon examination of the PSTD database, the amount denied was less than $5,000 and the amount in the deductible field was $0.

VII. No response required.

VIII. No response required.

IX. The OCC responds "due to the manner in which PSTD negotiates a fee for a Pay for Performance Contracts, it does not matter to the Fund who pays the deductible." First, of the 160 confirmation requests sent to tank owners, many of which proved the absorption of deductibles by consultants, **none** were for Pay for Performance contract claims. Secondly, the statement that "it does not matter to the Fund who pays the deductible" is in direct conflict with strong statements made by PSTD management as to the issue of non-collusion between tank owners and their consultants and contractors. This PSTD position is evidenced in letters sent to tank owners and consultants/contractors and in the non-collusion affidavits required with every case. Furthermore, please refer to page 60 of our report regarding the non-collusion issue. Since the issuance of our report, we have found other instances of potential violations of the non-collusion affidavits for which we are further delineating the nature of the relationships. The response by OCC that "it does not matter who pays the deductible" is further basis for concern regarding the administration and management of the Fund, as it appears that the issue of collusion is continually disregarded.

X. In the OCC's response, it is stated "When towns have asked us to help them *assess* and, *if necessary*, cleanup abandoned service stations, we have formed a cooperative arrangement with the town to accomplish that goal." We still are unable to locate statutory authority to pay for site "*assessment*" costs. The Indemnity Fund uses are stated in 17 O.S. § 324 and do not include coverage for site "*assessment*" costs. We found no other instances where the Indemnity Fund has paid for other applicants' site assessment costs where there has been no reason for a suspicion of a release to have occurred. With respect to the OCC's response regarding the $6,000 per site that has been paid to the towns for "oversight", we are still unable to locate statutory authority to pay these costs as well. A good analogy would be tank owners who direct the cleanup of their sites are not paid a $6,000 fee for doing so. It would appear from the response that OCC regards 17 0S § 323 as overriding 17 0S § 324. We question this interpretation of the statutes.

XI. Site "assessment" actions were undertaken at this site for several months prior to the OCC realizing that both sites had a current operator, therefore, a party that qualified as an "eligible party." This situation appears unusual.

XII. No response required.

XIII. No response required.

XIV. No response required.

XV. No response required.

XVI. No response required.

XVII. Our finding noted that a new category, defined by PSTD management, of "impacted property owner" was created that is not defined by statute or by regulation.

XVIII. No response required.

XIX. No response required.

XX. No response required.

XXI. No response required.

XXII. The nature of our finding was the ability of the OCC to make decisions as it did without statutory authority to do so. Collection of a one-cent tax to remediate petroleum-contaminated sites, in this case, was effectively used to donate property to a particular county/school. At issue is again whether 17 OS § 323 overrides 17 OS § 324, which spells out the uses of Indemnity Fund monies.

XXIII. 1. Equipment Issues

(a) The OCC response states that our report focuses on the wrong section of the statutes. The response goes on to state that due to the adoption of statutes governing Pay for Performance contracts within 17 OS § 356 Sections Q and R, competitive bids are no longer required. The OCC response states that competitive bidding is not required for the Pay for Performance contracts per Subsection Q of 17 OS § 356. However, many of the PfP contracts reviewed actually included language regarding bid requirements, such as the following examples:

Language included in the PfP for case 064-1728, "As a precondition to this agreement the consultant certifies that, except for services provided by the consultant, all acquisitions, contracts or subcontracts for labor or equipment for performance of the performance based corrective action plan which exceed two thousand five hundred dollars ($2,500.00) from any one vendor have been the subject of competitive bids which have been awarded to the lowest and best bidder contingent upon the execution of this written mutual agreement. These competitive bids were accompanied by noncollusion affidavits consistent with the requirements of section 85.22 of Title 74. Documentation evidencing proof shall be available for inspection by the Indemnity Fund as it may require."

Language included in the PfP for case #064-2198 states the following: "The Consultant is required to obtain bids and noncollusion statements consistent with the requirements of 17 OS § 356, 15.C.1. Documentation evidencing proof of obtaining bids and noncollusion statements shall be available for inspection by the Indemnity Fund as it may require."

The aforementioned contract language directly contradicts the OCC's response. If the PfP process did eliminate the requirements for competitive bidding as stated in the OCC's response, why would these statements be part of the PfP contract?

(b) Part of the OCC's response to this finding states that "the water table obscured the actual pollution. What looked like a decrease in the benzene level was actually a masking of the saturated and contaminated area that resided below the water table." It

is noteworthy that the OCC's response to this finding is very similar to their response included in item XXIII 2 (b), below, which also discussed the "water table which temporarily obscured the seriously polluted area..." *In essence, the OCC is stating that they knew that the dissolved-phase concentrations in the wells being sampled were not representative results. If this is the case, then the question becomes why would the OCC base an entire performance-based contract, or make a milestone payment, based on data that they themselves say is not representative?* It is due to these kinds of statements for which additional concern should be raised regarding the management and administration of the PfP contract process.

In our report we stated that the four cases in question had equipment installed and PfP contracts secured that appear to be inconsistent with the contamination in the area. It is important to note that one of the sites in question (OCC case number 064-0523) had an operating remediation system present on-site prior to signing of the PfP contract in June of 1999. During our fieldwork we noted that, for some unknown reason, the onsite wells for this case were sampled within 5 days of signing the contract. However, we further noted that the offsite wells, down gradient from the site, were not sampled, even though *it was these offsite wells that were selected to be "key wells" for purposes of the PfP.* The PfP, for some reason, was designed only to address the offsite problem and not address the onsite source area, which we found questionable. The USTs on this site were removed in 1998 and the on-site remediation system was deactivated prior to signing of the PfP contract, although concentrations in excess of the SSTLs (2.5 ppm benzene) were still present on-site. The remediation system installed as part of the PfP contract was designed only to address down gradient migration of the plume off-site rather than addressing the area with the highest observed contaminant concentrations on-site. Additional investigation completed on-site in February 2001 indicated benzene concentrations in groundwater near the existing building above the approved SSTLs in 4 of 8 samples collected in soil borings (3.49 to 8.81 ppm benzene). We found it unusual that groundwater monitoring wells were not set in these locations despite concentrations in excess of the SSTLs. The remediation system for the down gradient property, which was the system that was installed as part of the PfP contract, was subsequently deactivated in May 2001 and approved for closure and system decommissioning in May 2002 *even though the onsite source area had not been completely remediated.*

Additional groundwater sampling completed recently (March 2003) for the on-site property, indicated that concentrations in existing site monitoring wells were below the SSTL's (2.5 ppm) with the exception of MW-5A (2.64 ppm). *However, within this March 2003 sampling event, data was not collected near the locations that exhibited the highest benzene concentrations during the February 2001 event because the borings were not set as monitoring wells. As a result, concentrations above the approved SSTLs may still exist on-site.* In conversations with the OCC PSTD project managers, the concentrations at the site do not pose a significant threat to human health based on the current property usage. However, the property usage does not appear to have changed significantly since the ORBCA (the Risk Based Assessment report) was completed (the site was an auto repair facility at the time of the ORBCA and is still an auto repair facility). No documentation was observed in the file that the OCC reevaluated the ORBCA and determined a higher SSTL for on-site concentrations. If concentrations of 8.81 ppm benzene as observed in 2001 are acceptable to leave on-site, then why was a remediation system ever installed down gradient? In addition, all down gradient wells were abandoned prior to the March 2003 sampling event, and thus there is no way to verify if the plume has migrated. The PTSD claims the plume on-site to be stable, yet a

remediation system was installed in 1999 to address the migration of hydrocarbons from the plume that is claimed to be stable.

Compounding the questions surrounding these sites is the unchanged fact that all but one (and it was only slightly above the SSTL's) of the "key wells" (which were offsite) that were sampled at the baseline sampling event on January 21, 2000 were below the SSTL's. And of even greater interest is the fact that the baseline sampling event was completed five weeks after system activation even though it was required to be done two weeks prior. All of these factors seem quite questionable considering the fact that the contractor was able to obtain 80% of the contract amount and all of the equipment and installation costs within a 9-month period and still not address the onsite source area.

(c) The OCC's response states that "the report raises the question of who owns the equipment used by the contractor but does not conclude who should own the equipment." Our procedures were not designed to determine who should own the equipment. The final statement in OCC's response is "The majority of the contracts provide that the contractor owns the equipment and this is consistent with standards in the construction industry." This statement is inconsistent with respect to the petroleum trust fund programs operated by other states. In many of the states with which we are familiar, the equipment is owned by the state and is routinely used at other sites without the state paying for the equipment again.

(d) No response required.

(e) No response required.

(f) The OCC response states "the vertical extent of the plume was not originally identified". The process of plume delineation is part of the Tier II process and is the basis for the PfP contract as a whole. While the OCC states that "The Fund has not and will not pay for the repair of equipment damaged by the contractor", we again point out that the system has been inoperable for almost 3 years, thus allowing the site to remain contaminated and for contamination to possibly migrate.

2. <u>Baseline sampling issues</u>

   (a) Our report stated that the contractor was able to achieve 100% of their goal within 5 months of system activation. However, to clarify, the contractor achieved a 100% reduction in the average concentrations in all key monitoring wells, thus securing an 80% payment. This did occur within 5 months. Thus, the contractor received the majority of their contract price (80%) in 5 months. While the site did not meet a 100% reduction in all wells until May 2002, our finding is still correct and important in light of stalled cleanups. The OCC did not address this concern; it focused instead on the long-term nature of the clean up rather than the inordinately short period of paying out 80% of the contract price.

   (b) The OCC's response states "The Barnes report may have misunderstood the science involved in the clean up. There was a four-foot rise in the water table which temporarily obscured the seriously polluted area reflected by earlier lab results that was now below the surface of the groundwater." It further stated "the baseline samples do not reflect the actual levels of pollution below the surface of the water table." We do not represent ourselves to be scientists. However, we do believe that

among our personnel resources we possess the technical skills to understand the remediation process quite well. If the PSTD understood the technical aspects of the remediation process it seems totally inappropriate that they would have allowed the analytical results to be utilized as the baseline if they were NOT representative. (Please refer back to our response to OCC response number XXIII 1 (b) as the finding here relates also to these four sites) The baseline results are the basis/backbone of ALL clean-up goals and associated payments. Additionally, the rising water table may reduce groundwater concentrations; however, it can also increase concentrations depending on where the adsorbed-phase hydrocarbons are located in the "smear zone".

(c) The OCC's response to this finding is very notable for several reasons. The OCC responds that "free product is the most serious contamination that must be reduced before the remediation plan progresses to the next phase." First, the finding in our report focused on the fact that the OCC allowed the contractor to sample for dissolved-phase concentrations in key wells that contain free product (which is petroleum floating on the water table). It is a known industry fact that you cannot accurately measure a well for dissolved-phase concentrations if it contains free product because the concentrations may be non-representative (and will likely be high). *The OCC did not address the fact that groundwater samples were collected from wells containing a measurable thickness of free product and the results were utilized for the baseline in a PfP contract.* In order to sample a well for dissolved-phase concentrations, the free product *must be removed* before utilizing the well as a "key well" in the PfP process.

While it is a known fact that "free product" is more serious and more difficult to clean-up as stated in OCC's response, common sense tells us that if a well is sampled that has measurable free product in and around the well annulus, the dissolved-phase concentrations will more than likely be elevated due to the presence of free product. The purging activities performed during sampling causes the free product to mix with the groundwater potentially resulting in higher dissolved-phase concentrations. *By having elevated dissolved-phase concentrations included in the baseline sampling event, the percent reduction within the context of the PfP contract is absolutely much easier to achieve.* We find OCC's response unusual considering OCC Division management, when presented with this finding during our fieldwork, acknowledged that they made a mistake.

A second reason we find the OCC's response noteworthy is that we have recently found many cases in Oklahoma where free product is not only allowed to stay on site, but cases are actually closed with extremely high thicknesses of free product.

(d) According to the OCC response, "Inspection revealed that two monitoring wells were actually in the tankpit. The contractor was required to install two new monitoring wells at its expense and new baseline sampling was done. No incorrect payment has been made because we never used the contractor's flawed baseline information."

As included in the OCC file, a historical table indicates that MW-3 and MW-7 were destroyed sometime on or before March 9, 2001 and replaced with MW-3A and MW-7A, respectively. In addition, MW-2 was replaced with MW-2A between the March 9, 2001, and July 19, 2002 baseline monitoring event. Review of the site map indicates that MW-2 and MW-3 appear to be adjacent to the tankpit; however, MW-7 is located

approximately 33 feet northeast of the nearest UST. Replacement wells MW-2A, MW-3A, and MW-7A were installed sometime prior to the July 18, 2002 baseline sampling event. According to sampling results from the baseline event conducted on July 18, 2002, monitoring wells MW-3 A and MW-7A indicated benzene concentrations of 28.127 ppm and 15.874 ppm, respectively. NAPL was observed in all other key wells including MW-2A at the time of baseline sampling. Based on the OCC response, the OCC claims that these wells (MW-3A and MW-7A) were installed in the tankpit and had to be replaced again (after already replacing MW-3 and MW-7 between March 9, 2001 and July 18, 2002) prior to the next monthly sampling event of August 20, 2002.

The above-referenced concentrations of 28.127 ppm and 15.874 ppm were reported as the baseline concentration for MW-3A and MW-7A, respectively, in Table 3 of the As-Built Report. The first and second milestone payments totaling $137,420.40 for reduction of free product were issued on September 19, 2002. The payment request submitted for these two milestone payments indicates baseline concentrations as observed on July 18, 2002 for MW-3A and MW-7A. This milestone payment was based on gauging data observed on September 9, 2002. *However, The next milestone payment of $68,712.20 was issued on November 12, 2002 based on gauging and sampling data collected on October 18, 2002. On this third milestone payment request, the baseline sampling date is listed as July 18, 2002; however, the data listed as baseline for MW-3A and MW-7A indicated a benzene concentration of 45.62 ppm and 20.12 ppm, respectively. This data was actually collected on August 20, 2002. The August 20, 2002 benzene concentrations observed (following system startup in July 2002) are approximately 50% higher than those observed during baseline which would quite certainly make achieving a milestone payment easier.*

Contrary to the OCC's response, MW-2, MW-3, and MW-7 appear to have been replaced prior to baseline sampling rather than after the event on July 18, 2002. Documentation pertaining to a flawed baseline event was not observed in the file at the time of review. As a result, a payment was made based on the incorrect baseline data from MW-3A and MW-7A.

3. Milestone Payment Issues

(a) No response required.

(b) Within the OCC's response, they continue to contend that it is possible to achieve greater than a 100% reduction in average concentrations. We again reiterate that this system has allowed, and continues to allow, contractors to receive large portions of their contract costs far in advance of achieving commensurate cleanup results. This practice is highly unusual in light of the fact that two of the other states, South Carolina and Florida, that have embraced PfP on a scale similar to Oklahoma, recognize that you cannot have a greater than 100% average reduction, as permitting the calculation to work in this way allows a contractor to receive payments in advance of achieving commensurate cleanup results. When this issue was discussed with PSTD fund management during the exit conference, they contended that while they did not want to perform the calculation in the manner it is currently performed, they were pressured to perform it this way. When asked who the pressure was from, they replied, "the contractors."

4. Key Well Issues

(a) While OCC's response to this finding is that they are in the process of revoking the license of that consultant, we further would like to point out that the OCC was aware of this activity and when we questioned management many times about their response to the situation, we were told many times that nothing more was being done. We find it noteworthy that action is being taken in conjunction with the release of our report.

Concerning case 064-1381, the OCC response is regarding actions taken in March 2001 by the consultant. However, our report references activities performed following baseline sampling events (injection of microsolv surfactant into key wells). It appears that the OCC has chosen not to respond to this finding.

(b) No response required.

(c) According to the OCC's response, "the 'key well' referred to here was no longer in existence so no samples could be taken." However, our review of the case file shows as follows: The results from the July 11, 2001 sampling event for "key wells" MW-1, MW-4, MW-7, and MW-19 were used to request final payment of $103,203; however, sampling results from MW-5 (also another "key well") collected on July 11, 2001 and submitted to the OCC indicate a benzene concentration of 3,700 ppb benzene (500 ppb above the SSTL). This fact completely contradicts OCC's response in that actual results are shown for this well in the final payment calculation. Despite the concentration being above the SSTL, the contract was approved for final payment on September 20, 2001 by the OCC. According to the OCC, it was determined that "the last recalcitrant contaminated area was best addressed by digging it up and removing the soil. The 'missing key well' was in that dug up soil. Though the well no longer existed, the site was obviously clean." We found that a dig and haul was completed on August 16, 2001 and results were submitted to OCC; however, the results were not observed in the file so we were unable to determine if groundwater samples were collected in the vicinity of well MW-5 that was reportedly destroyed during the dig and haul. Documentation from the dig and haul operation including the extent of the dig, groundwater and soil analytical results, and soil disposal manifests are necessary to verify that the final payment was justifiable considering that the final pay request was based upon July 11, 2001 sampling data indicating that MW-5 was above the SSTL.

5. Encumbrance Issues

(a) No response required.

(b) We continue to question the management and administration of the PfP contract process as a whole for all of the reasons highlighted in our responses included herein.

XXIV. No response required.

XXV. The OCC response states that the "contractor filed a lawsuit in 2000 to recover additional disallowed amounts, including the $776.01 previously disallowed in the 1999 settlement." The lawsuit filed in 2000 was actually filed by the site owner and not the contractor, as stated as such by OCC in their response. This suit, in fact, included duplicative amounts, including this $776.01, as these costs were, in fact, incurred by the contractor and disallowed as part of the 1999 informal settlement (as no lawsuit was filed by the contractor). $13,004.25 was paid in 2001 to the site owner, through their legal counsel and, in fact, was duplicative of the amount previously negotiated with the contractor in 1999.

XXVI. The OCC states that they have informed EPA of all rule changes including the removal of "out of date financial responsibility rules." However, EPA's codification of Oklahoma's rules still reference all of Oklahoma's rules included when the program was approved years earlier.

XXVII. OCC responds that they concur with this finding, however, they also state they feel there was special circumstances in the instance noted. Since the conclusion of our fieldwork, we have found further evidence that tank owners have had significant ownership interests in the companies cleaning up their sites, beyond the explanations provided by OCC management.

Response to closing statement of OCC "draft" response

The OCC response concludes with the statement "The Petroleum Storage Tank Division of the Oklahoma Corporation Commission is annually audited by Grant Thornton, LLP under the oversight of the State Auditor and Inspector's office. These annual audits cover much of the same information reviewed in the MSI Barnes & Associates report." Based on all the information we have been provided it is clear to us that, contrary to the OCC reference to "audits" Grant Thornton, LLP has not conducted annual "audits" as required by 17 OS § 326. However, in the reports which were furnished to us, they purport to have conducted "agreed-upon procedures". We repeat here part of the information in our cover letter in response to the concluding remarks of the OCC response.

The OCC criticized the failure to apply GAGAS to our engagement but failed to mention what we believe to be a relevant fact. For many years, Oklahoma Statutes (17 OS § 326) have called for an "independent audit" to be performed annually. We requested copies of those audit reports but were only provided with copies of reports of agreed-upon procedures performed each year by Grant Thornton, LLP. The terminology of 17 OS § 326 of "independent audit", unlike "investigative audit" is clearly defined by GAGAS. An "agreed-upon procedures engagement" is not an "independent audit" as required by the statute. We asked to examine the files of Grant Thornton, LLP, but unrestricted access was denied by Grant Thornton, LLP despite repeated requests by the Office of the State Auditor and Inspector. Thus we have received no explanation from Grant Thornton, LLP why they performed an "agreed upon procedures" engagement rather than an "independent audit" in accordance with GAGAS and Oklahoma statutes. We are likewise unsure why OCC is critical of the nature of our report but makes no mention of the apparent long-term practice of Grant Thornton, LLP performing "agreed-upon procedures" rather than audits. It should be noted that none of the Grant Thornton, LLP reports provided to us made any mention of material problems with the performance of the PSTD. Not having had unrestricted access to the files, we cannot draw any conclusions about the reason for that either.

We have recommended to the Office of the Auditor and Inspector that they inquire further into this matter with the objective of determining why the deficiencies in the PSTD's operations were not discovered by the procedures employed by Grant Thornton, LLP. We believe that it was reasonable for the Office of the State Auditor and Inspector to have relied upon the expertise of a nationally recognized firm such as Grant Thornton, LLP to determine the nature of the engagement to perform under the applicable statute. Having decided to conduct an agreed-upon procedures engagement, which was apparently what was conducted, Grant Thornton, LLP had an obligation to perform the engagement in accordance with attestation standards established by the American Institute of Certified Public Accountants (AICPA). The performance of such procedures under the AICPA standards, require that the users of the report agree upon the sufficiency of the procedures. We have not received any documentation which would indicate that the users of the report have agreed to the sufficiency of the procedures, although we have made inquiries.

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January 2, 2003

State of Oklahoma
Office of State Finance and
State Auditor and Inspector's Office

This letter constitutes addendum #2 to our original engagement letter dated October 29, 2002. The purpose of this letter is to outline additional procedures you wish us to perform in connection with that agreed-upon procedures engagement.

The additional procedures include:

II. Procedures regarding Indemnity Fund expenditures

A. Petroleum Storage Tank Division (PSTD) direct expenditures (administrative, claims processing, and regulatory)

1. Examine 100 cash disbursements of non-personnel PSTD direct expenditures paid during the fiscal year ended June 30, 2002 and verify the accuracy of the cost center classification (administrative, claims processing, and regulatory) and extrapolate the results to the entire population of PSTD direct expenditures for the fiscal year ended June 30, 2002.

2. Compare the allocation of personnel costs among the various cost centers according to the PSTD salary allocation report for the fiscal year ended June 30, 2002 to results from an employee survey/questionnaire completed by each employee in the division. Calculate the percentage and dollar amount variances.

B. PSTD indirect expenditures (Oklahoma Corporation Commission overhead allocations)

1. Verify the total indirect personnel costs for the fiscal year ended June 30, 2002 of the Oklahoma Corporation Commission (OCC) allocated to the divisions within the OCC.

2. Compare the OCC allocation percentages of costs to the results of a survey/questionnaire completed by each of the directors of the OCC administrative divisions (legal, data processing, administration, and office of administrative proceedings). Calculate the percentage and dollar amount variances.

3. Compare the payments/transfers from the PSTD to the OCC during the fiscal year ended June 30, 2002 to OCC's actual incurred costs attributable to the PSTD.

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MSI Barnes & Associates, P.A. is a member of MSI, an international network of independent professional firms

III. Procedures regarding the fairness and consistency of Indemnity Fund procedures and practices

A. Claims processing

Review all claims over $100,000, all claims paid to other governmental agencies, and 50 additional claims, using the systematic approach (every nth claim), received during the fiscal year ended June 30, 2002 and all claims over $500,000 for the quarter ended September 30, 2002 from the tracking log of the PSTD database and perform the following:

1. Verify that the claims that were submitted were logged into the PSTD database, reviewed and approved/denied in the statutory amount of time or within some consistent time frame as dictated by PSTD guidance.

2. Select five invoices that represent a range of activities and verify that the rates that were approved and paid were consistent with guidance documents issued by the PSTD for "customary and reasonable rates" at the time the work was performed. Verify that the level of effort that was expended and subsequently approved and paid was consistent with guidance documents issued by the PSTD at the time the work was performed.

3. Verify that the eligibility application submitted by the claimant was reviewed in either the statutory amount of time or within some consistent time frame as dictated by PSTD guidance.

4. Verify that the pre-approval requests submitted by the claimant were reviewed and approved/denied in the statutory amount of time or within some consistent time frame as dictated by PSTD guidance. Verify that the work scopes and amounts approved were consistent with PSTD guidance.

B. Eligibility applications

Review 10 eligibility applications that were approved and 10 that were not approved during the fiscal year ended June 30, 2002 from the report maintained by the eligibility officer regarding the review status of eligibility application, using the systematic approach (every nth claim), and perform the following:

1. Verify that the eligibility application was logged into the system and reviewed/approved in the statutory amount of time or within some consistent time frame as dictated by PSTD guidance.

2. Verify that the eligibility application was reviewed/approved in a manner consistent with Oklahoma statutes for eligibility to the PSTD Fund.

C. Pre-approval requests

Review 25 pre-approval requests that were approved and 25 that were not approved during the fiscal year ended June 30, 2002, using the systematic approach (every nth request), and perform the following:

1. Verify that the pre-approval request was reviewed/approved in the statutory amount of time or within some consistent time frame as dictated by PSTD guidance.

2. Engage a specialist to determine if the work that was proposed and approved/denied was consistent with statutory guidelines or PSTD guidance.

D. PSTD contractor selection process

1. Document the process by which the PSTD selects contractors to perform site remediation work.

2. Review the procedures implemented by the PSTD in the selection of the five contractors who contracted the most ($) with the State during the fiscal year ended June 30, 2002.

E. Document the PSTD's current practice in conducting site assessments utilizing the equipment available through the EPA grant.

F. Review 10 property damage (third party) claims, using the systematic approach (every nth claim), during the fiscal year ended June 30, 2002 and verify that the PSTD processed those claims in accordance with Oklahoma Statute Title 17 Chapter 15.

IV. Procedures regarding the encumbrances, cash balances, and future liability of the Indemnity Fund.

A. Encumbrances

1. Compare the encumbrance balances of the Indemnity Fund for each month for the fiscal year ended June 30, 2002.

2. Review all amounts encumbered for "pay for performance" contracts over $300,000 and all pre-approval amounts over $50,000 and 20 additional amounts encumbered, using the systematic approach (every nth claim), at June 30, 2002 and perform the following:

a. Compare to the applicable purchase order(s) and extrapolate the results to the entire population of claims encumbered as of June 30, 2002.

b. Compute the number of days between the date the contract was submitted/approved and the date the work was performed.

c. Engage a specialist to verify that the scope of work encumbered by the work order/contract was consistent with statutory guidelines.

3. Review "pay for performance" contracts that have not had a "milestone" payment made between August 16, 2000 and August 15, 2002.

a. Engage a specialist to determine if cleanup is essentially stalled and review any correspondence regarding the site's circumstances.

b. Review findings with fund staff in order to document process.

4. Compare each claim paid during first two months of the fiscal year ending June 30, 2003 to the amount encumbered at June 30, 2002.

B. Cash balances

1. Obtain copies of monthly bank reconciliations of the Indemnity Fund cash balance at the end of each quarter for the fiscal year ended June 30, 2002 and perform the following:

    a. Confirm the bank balance.

    b. Test the clerical accuracy of the bank reconciliation and detail supporting schedules, if applicable.

    c. Trace deposits in transit and outstanding checks per the bank reconciliation to the subsequent bank statement and determine the time period between book and bank recording.

2. Confirm the balances of all Indemnity Fund certificates of deposit at the end of each quarter for the fiscal year ended June 30, 2002.

3. Recalculate the "maintenance level" at the end of each quarter for the fiscal year ended June 30, 2002 and compare it to the total cash balance of the Indemnity Fund.

C. Future liability

1. Inquire of the PSTD's general council as to pending litigation and settlement agreements and confirm the tank owners/consultants participation.

2. Confirm the existence of settlement agreements and payments to tank owners/consultants.

3. Compare the "active" cases in the PSTD database with the "active" cases in the UST database and report the differences.

4. Compare the "closed" cases in the PSTD database with the "closed" cases in the UST database and report the differences.

5. Report the number of "non-assessed" cases from the UST database.

V. Procedures regarding the management and the administration of the Indemnity Fund

A. Review 10 active, 10 closed, and 10 non-assessed sites from the Underground Storage Tank (UST) database and verify compliance with EPA and Oklahoma Statutes and Regulations. (Engage a specialist if necessary)

B. Confirm with the State of Oklahoma Office of Attorney General that all guidelines, policies, and procedures authored during the fiscal year ended June 30, 2002 comply with the State of Oklahoma Constitution, the Administrative Procedures Act, and the Open Meetings Act.

C. Review the EPA approval of the Indemnity Fund Program and perform the following: (engage a specialist if necessary)

1. Verify that the PSTD is in compliance with the approved program.

2. Verify that subsequent changes to the Indemnity Fund Program have been approved by the EPA.

D. Inquire from current employees if the current management system allows them to carry out their separate duties and responsibilities and note any comments that are applicable.

E. Calculate the percentage of all non-claim expenditures of the Indemnity Fund to the total expenditures of the Indemnity Fund and compare it to other states with available statistics.

VI. Present in the form of a schedule the expenditures of the Indemnity Fund for the fiscal year ended June 30, 2002 before and after adjustments related to findings resulting from procedures performed above.

VII. Inquire of the Office of State Auditor and Inspector and the Office of State Finance if there are any specific sites, responsible parties, or transactions that should be included in any of the above procedures.

The sufficiency of the procedures is solely the responsibility of the specified parties of the report, thus the signatures below indicate agreement to the sufficiency of the procedures herein described.

All the terms of our original engagement letter will apply to this addendum. This addendum will become effective as soon as you sign and date the original and copy of this letter and return the signed copy to us.

Please fax back a signed copy to 954-776-5567 and mail the original to us at the address below.

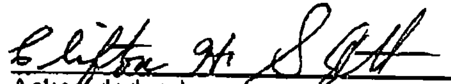
Very truly yours,

MSI Barnes + Associates, P.A.

MSI BARNES & ASSOCIATES, P.A.

Acknowledged
(Office of State Finance)

Date: 1/10/03



Acknowledged
(State Auditor and Inspector's Office)

Date: 1-9-03

CLC/OK Contract/Engagement Letter Addendum #2

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December 5, 2002

State of Oklahoma
Office of State Finance and
State Auditor and Inspector's Office

This letter constitutes addendum #1 to our original engagement letter dated October 29, 2002. The purpose of this letter is to outline additional procedures you wish us to perform in connection with that agreed-upon procedures engagement.

The additional procedures include:

> Edit the "Questions to consider as a basis for the investigative audit required by Section 3 of Enrolled House Bill No. 2536 (2002) : (updated 9-25-02)" which was drafted by State Senate Staff to assist in the formulation of procedures to be agreed upon by the Office of State Finance and the State Auditor and Inspector's Office. The editing is being undertaken at your direction to consolidate, clarify and focus the questions to assist you in determining which procedures are best employed in the conduct of our engagement.

The sufficiency of the procedures is solely the responsibility of the specified parties of the report, thus the signatures below indicate agreement to the sufficiency of the procedures herein described.

All the terms of our original engagement letter will apply to this addendum. This addendum will become effective as soon as you sign and date the original and copy of this letter and return the signed copy to us.

Please fax back a signed copy to 954-776-5567 and mail the original to us at the address below.

Very truly yours,

MSI Barnes & Associates, P.A.

MSI BARNES & ASSOCIATES, P.A.

Acknowledged
(Office of State Finance)

Date: 12/27/02

Acknowledged
(State Auditor and Inspector's Office)

Date: 12-10-02

CLC/OK Contract/Engagement Letter Addendum

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MSI Barnes & Associates, P.A. is a member of MSI, an international network of independent professional firms