

Sonoma County

Auditor-Controller-Treasurer-Tax Collector

Internal Audit Report

**Follow-up of the
Contract Compliance Audit:
Department of Transportation and Public
Works**

Original Report Dated
March 15, 2016

Engagement No: 3370
Report Date: June 15, 2017



Erick Roeser
Auditor-Controller-Treasurer-Tax Collector

Table of Contents

**Follow-up of the
Contract Compliance Audit: Department of Transportation and Public Works
Engagement No. 3370**

Original Report Dated March 15, 2016

	<u>Page</u>
Executive Summary	1
Introduction, Background, Objective, Scope & Methodology	2
Prior Recommendations & Current Status	3
Staff Acknowledgement	6

Executive Summary

As part of the 2016/2017 Annual Audit Plan, the Internal Audit Division of the Sonoma County Auditor-Controller-Treasurer-Tax Collector's Office (ACTTC) conducted a follow-up audit of the Contract Compliance Audit: Department of Transportation and Public Works (DTPW) Report dated March 15, 2016. The original report contained eleven recommendations which were accepted by management. Out of these eleven recommendations

- ten have been implemented and
- one is in the process being implemented

As a result of implementing some of the recommendations, the following benefits will accrue to the County:

- The franchise fee revenue will increase by approximately \$230,000 over the five year period from the date the updated rates took effect and continue to grow through the remainder of the contract period. The change in various factors impacting the franchise fee growth is difficult to accurately project beyond fiscal year 2020.
- The DTPW will be better able to ensure that key operating goals of the contract such as required diversion of materials from landfills are achieved.
- The DTPW will have a higher level of assurance that the County's share of the franchise fees are accurately calculated.

The objective of this follow-up is to determine the status of implementation of the audit recommendations. Further discussion is provided on page 3.

Introduction, Background, Objective, Scope & Methodology

Introduction

The ACTTC conducted the follow-up audit in accordance with the *International Standards for the Professional Practice of Internal Auditing (Standards)*. These Standards require that we identify, analyze, evaluate, and document sufficient information and evidence to achieve audit objectives. We believe that the evidence obtained provides a reasonable basis for the conclusions contained in our audit report. The Standards require that we establish a follow-up process to monitor and ensure that management has effectively implemented actions or that senior management has accepted the risk of not taking actions. We conducted this audit from December 2016 through March 2017.

Background

The purpose of the Contract Compliance Audit: DTPW, dated March 15, 2016, was to assess the Operators' compliance with certain terms of the Solid Waste Collection and Franchise Fee Agreement (Agreement) and determine if the Operator accurately calculated and reported (1) the diversion rates, and (2) the franchise fees earned by the County.

Objective

The objective of this follow-up audit was to determine the status of implementation of the recommendations contained in the Contract Compliance Audit: DTPW dated March 15, 2016 and, where applicable, the impact of actions taken by management.

Scope & Methodology

Our procedures were limited to reviewing evidence supporting actions taken by the DTPW, as of June 12, 2017, towards implementation of the report recommendations. To accomplish our audit objectives, we reviewed:

- The Operator's recalculation and payment of the franchise fees owed to the County for the period covered by our audit,
- DTPW's recalculation of service rates for the audit period,
- The amended Franchise Fee Agreement,
- One month of pay cycle reports (revenue reports produced from the operator's system),
- Audited franchise fee statements provided by the Operator to DTPW for the period July 1, 2011-June 30, 2016,
- DTPW's application for Discharge of Accountability for uncollected franchise fee,
- Recalculation of diversion rate by the Operator for the audit period.

We also conducted interviews with the DTPW management.

Prior Recommendations and Current Status

The following is a discussion of the status of implementation of the prior audit report recommendations. Each recommendation is referenced to the prior audit report.

Recommendation No. 1. Require the Operator to recalculate fees owed to the County from FY 2011 through FY 2015 based on reporting periods required by the Agreement.

Status: Implemented.

The Operator recalculated franchise fee owed to the County from FY 2011 through FY 2015 as recommended and remitted the additional fee of \$5,355 to the County.

Recommendation No. 2. Require the Operator to correct the diversion rates reported to the County for FY 2011 through FY 2015 and to resubmit the corrected diversion rate reports. Going forward, the diversion rate calculation should exclude materials obtained from the transfer stations unless the origin of the materials can be determined.

Status: Implemented.

The operator's recalculated diversion rate does not agree with that calculated by ACTTC during the audit. However the misstatement does not materially affect service rate calculations.

Recommendation No. 3. Adjust the service rates based on the corrected diversion rates as specified by the Agreement for FY 2012 through FY 2015.

Status: Implemented.

We estimate that the County will receive an additional \$230,000 over the five year period from fiscal year 2016 through fiscal year 2020 as a result of this correction. We were not able to estimate the franchise fee revenue impact over the remaining seven years of the contract, however the DTPW will continue to receive significantly more franchise fee revenue as a result of corrected service rate calculations. The diversion rates were not recalculated in time to be reflected in the adjusted service rates approved by the Board of Supervisors on November 3rd 2015. However, based on our analysis, franchise fee revenue was not impacted materially as a result.

Recommendation No. 4. Clarify Section 1.28 of the Agreement to better define the treatment of revenue from the sale of recyclable materials purchased from unincorporated County area businesses.

Status: Implemented.

Section 1.28 of the Agreement was amended and section 1.36A-Non-Franchised Recycling was added as part of the 3rd Amendment to better define the treatment of revenue from the sale of recyclable materials purchased from unincorporated County area businesses. The revenue from the sales of some types of recyclables received from these businesses will be excluded from the franchise fee calculation as required by the terms of the current contract.

Prior Recommendations and Current Status

Recommendation No. 5. Add to Section 7.1 of the Agreement that pay cycle reports are to be submitted to the County on a monthly basis.

Status: Implemented.

Section 1.49-Summary Pay Cycle Reports was added and Section 3.2-Payment of Franchise Fees was amended as part of the 3rd Amendment to the Agreement. The Pay Cycle reports generated from the Operator's proprietary billing system are submitted monthly to the DTPW for review and to support the franchise fee calculation.

As a result of this change, the Department will have a higher level of assurance over the revenues reported by the Operator.

Recommendation No. 6. Enforce Paragraph 5.9 of the Agreement to ensure that the Operator conducts a waste characterization study annually.

Status: Implemented.

The DTPW observed a waste characterization study performed by the Operator on June 12, 2017. The DTPW documented the process. Future audits will be conducted on an annual basis. Results from the audit will be used to allocate revenues from the sale of Recyclable Materials under the Franchise Agreement and verified by DTPW's Refuse Enforcement Specialist.

Recommendation No. 7. Add to Paragraph 5.9 of the Agreement that the DTPW shall verify that the results of the Operator's waste characterization study are accurately reflected in the Operator's Recycling Revenue Allocation Model.

Status: Implemented.

Section 3.2 -Payment of Franchise Fees and Section 5.9 -Waste Characterization Services and Audits have been amended to include the following language: " Such audited statement of Franchise Fees shall include a certification that the Company's Recycling Revenue Allocation Model reflects any changes resulting from the Company's waste characterization study." as part of the 3rd Amendment.

The DTPW has requested that the Statements (audited by an independent accounting firm) should include language mandated by Sections 3.2 and 5.9 of the 3rd Amendment. In addition, DTPW has requested that the Operator provide an updated June 30, 2016 statement, which includes the aforementioned language.

Recommendation No. 8. Add to Paragraph 5.9 of the Agreement that the Operator is required to submit documentation showing the costs of services and the amount of materials actually recycled by a non-affiliated company. Based on the results of the documentation provided by the Operator, the County should determine whether to allow the diversion of the already processed material from the County landfill. The County should also determine whether the residuals from the materials that were transported outside of the County service area for processing must be returned to the County landfill.

Prior Recommendations and Current Status

Status: Implemented.

Section 4.2.6-Notification of Delivery of Source Separated Recyclable Materials to a Non-Affiliated Company was added as part of the 3rd Amendment. The Operator notified the County about transporting materials outside the County for further processing. The Operator provided, and will continue to provide, DTPW with all documentation required under Section 4.2.6 of the 3rd Amendment.

Materials delivered to non-affiliated companies are counted towards the Operator's diversion calculation. Per Section 12.2 the Master Operations Agreement, only Residuals of Source Separated Materials processed within the County are committed to being delivered to County Facilities.

Recommendation No. 9. DPTW should ensure that the sources of recyclable materials indicated in the reports provided by the Operator are in accordance with the contract and all tonnage used in the diversion calculation is accurate. A potential option for consideration by the DTPW includes requiring an independent audit of the diversion rate.

Status: In process.

Currently, the Operator is self-certifying the accuracy of the reports provided to the DTPW. Although self-certification is an improvement, the risk of errors going undetected remains.

To reduce the likelihood of errors going undetected, the DTPW Enforcement Specialist will ensure that the sources of recyclable materials indicated in the reports provided by the Operator are in accordance with the contract and that all tonnage used in the diversion calculation is accurate. This task will be completed by December 2017.

Recommendation No. 10. Revise Section 7.3.2 of the Agreement from "By April 1 of each year, Company shall deliver to the County two (2) copies of the audited franchise fee statements of franchise fees for the Company's preceding fiscal year" to "By October 1 of each year, Company shall deliver to the County two (2) copies of the audited franchise fee statements of franchise fees for the County's preceding fiscal year."

Status: Implemented.

Section 7.3.2 of the Agreement was amended to realign the tracking of franchise fee payments based on the County's fiscal year instead of the Company's calendar year.

The Operator resubmitted the audited franchise fee statements to the County from FY 2011 through FY 2015 based on reporting period required by the Agreement. The June 30, 2016 audited franchise fee statement incorporates the County's fiscal year as required by the Agreement.

Recommendation No. 11. The DTPW should consult the County Counsel and consider appropriate actions including retroactively billing customers and adjusting service rates to recover prior underpayments. DTPW should seek relief of accountability in accordance with the County’s established policies, if the decision is to forego collection.

Status: Implemented.

In collaboration with County Counsel, the DTPW decided to forego collection because the likelihood of collection does not warrant the expense involved. In accordance with the County’s established policies, the DTPW filed with the Auditor-Controller-Treasurer-Tax Collector an “Application for Discharge of Accountability” in accordance with California Government Code Sections 25257 -25259.5 and County policy.

Staff Acknowledgement

We would like to thank Trish Piseni, Donna Caldwell and Adrian Diaz for their helpfulness and cooperation in conducting this Follow-Up Audit.