

Internal Audit Department

O R A N G E C O U N T Y
6th Largest County in the USA

Internal Control Audit: ORANGE COUNTY WASTE & RECYCLING FEE GENERATED REVENUE

For the Period March 1, 2010
through February 28, 2011

During the audit period, OC Waste & Recycling generated \$87 million in revenue from negotiated contract rates and \$6 million in non-negotiated “posted rates” and applicable surcharges. OCWR is funded solely by disposal fees established at a level to support the County’s waste management system.

We audited OC Waste & Recycling’s (OCWR) Fee Generated Revenue to evaluate the adequacy of internal controls over the fee development processes, methodologies, and assumptions used for establishing cost-recovery fees charged to the public for Licenses, Permits and Franchises and Charges for Services submitted for Board approval; to evaluate compliance with County Accounting Manual procedures for preparing and submitting fee requests; and to determine if the fee development process is efficient and effective.

Our audit found internal controls over OCWR’s fee development processes are adequate with some exceptions noted. Enhancements are needed in posted rate cost-recovery fees to be compliant with County Accounting Procedure R-3 – *Revenue Policy, Requirements & Responsibilities*, and in establishing written departmental policies and procedures for OCWR’s fee development process. We identified **three (3) Control Findings** to improve controls with regards to fee development policies and procedures and compliance with County revenue policy.

AUDIT No: 1023

REPORT DATE: OCTOBER 4, 2011

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RISK BASED AUDITING

GAO & IIA Peer Review Compliant – 2001, 2004, 2007, 2010



American Institute of Certified Public Accountants Award to Dr. Peter Hughes as 2010 Outstanding CPA of the Year for Local Government

GRC (Government, Risk & Compliance) Group 2010 Award to IAD as MVP in Risk Management



2009 Association of Certified Fraud Examiners’ Hubbard Award to Dr. Peter Hughes for the Most Outstanding Article of the Year – Ethics Pays



2008 Association of Local Government Auditors’ Bronze Website Award



2005 Institute of Internal Auditors’ Award to IAD for Recognition of Commitment to Professional Excellence, Quality, and Outreach

 ORANGE COUNTY BOARD OF SUPERVISORS'
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GAO & IIA Peer Review Compliant - 2001, 2004, 2007, 2010

Providing Facts and Perspectives Countywide

RISK BASED AUDITING

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OC Fraud Hotline (714) 834-3608



Transmittal Letter



Audit No. 1023 October 4, 2011

TO: Michael B. Giancola, Director
OC Waste & Recycling

FROM: Dr. Peter Hughes, CPA, Director
Internal Audit Department

SUBJECT: Internal Control Audit: OC Waste &
Recycling Fee Generated Revenue

We have completed an Internal Control Audit of OC Waste & Recycling's Fee Generated Revenue for the period March 1, 2010 through February 28, 2011. We performed this audit in accordance with our *FY 2010-11 Audit Plan and Risk Assessment* approved by the Audit Oversight Committee and the Board of Supervisors. Our final report is attached for your review.

Please note we have a structured and rigorous **Follow-Up Audit** process in response to recommendations and suggestions made by the Audit Oversight Committee (AOC) and the Board of Supervisors (BOS). Our **first Follow-Up Audit** will begin at six months from the official release of the report. A copy of all our Follow-Up Audit reports is provided to the BOS as well as to all those individuals indicated on our standard routing distribution list.

The AOC and BOS expect that audit recommendations will typically be implemented within six months and often sooner for significant and higher risk issues. Our **second Follow-Up Audit** will begin at six months from the release of the first Follow-Up Audit report, by which time **all** audit recommendations are expected to be addressed and implemented. At the request of the AOC, we are to bring to their attention any audit recommendations we find still not implemented or mitigated after the second Follow-Up Audit. The AOC requests that such open issues appear on the agenda at their next scheduled meeting for discussion.

We have attached a **Follow-Up Audit Report Form**. Your agency should complete this template as our audit recommendations are implemented. When we perform our first Follow-Up Audit approximately six months from the date of this report, we will need to obtain the completed document to facilitate our review.

Each month I submit an **Audit Status Report** to the BOS where I detail any critical and significant audit findings released in reports during the prior month and the implementation status of audit recommendations as disclosed by our Follow-Up Audits. Accordingly, the results of this audit will be included in a future status report to the BOS.

As always, the Internal Audit Department is available to partner with your staff so that they can successfully implement or mitigate difficult audit recommendations. Please feel free to call me should you wish to discuss any aspect of our audit report or recommendations. Additionally, we will request your department complete a **Customer Survey** of Audit Services. You will receive the survey shortly after the distribution of our final report.

ATTACHMENTS

Other recipients of this report are listed on the **OC Internal Auditor's Report** on page 7.

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OC Waste & Recycling
Fee Generated Revenue
Audit No. 1023*

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Audit No. 1023

October 4, 2011

TO: Michael B. Giancola, Director
OC Waste & Recycling

FROM: Dr. Peter Hughes, CPA, Director
Internal Audit Department

SUBJECT: Internal Control Audit: OC Waste & Recycling
Fee Generated Revenue

Audit Highlight

OCWR is self-funded solely by disposal fees (user fees per ton disposal charge) established at a level to support the County's waste management system. OCWR's main sources of revenue are from negotiated rates in Waste Disposal Agreements (\$70 million) and Importation Agreements (\$17 million). Importation Agreements have been a vital part of the County's bankruptcy recovery plan.

Other sources of revenue are from non-negotiated "posted rates" and applicable surcharges (\$6 million).

Our audit found internal controls need to be enhanced to ensure OCWR's "posted rate" cost-recovery fees are reviewed and updated in compliance with County Accounting Procedure R-3 – *Revenue Policy, Requirements & Responsibilities*. In addition, procedures should be established for OCWR's fee development process to enhance efficiency and effectiveness of the fee development process.

We identified **three (3) Control Findings** with regards to written policies and procedures and compliance with countywide policies and procedures.

OBJECTIVES

In accordance with our *FY 2010-11 Audit Plan and Risk Assessment* approved by the Audit Oversight Committee and the Board of Supervisors, the Internal Audit Department conducted an Internal Control Audit of OC Waste & Recycling (OCWR) Fee Generated Revenue. Our audit included an evaluation of internal controls, testing compliance with OCWR and County policies; and evaluating process efficiencies and effectiveness. Our audit was conducted in conformance with professional standards established by the Institute of Internal Auditors. The objectives of this audit were to:

1. Evaluate the adequacy of internal controls over fee development processes, methodologies, and assumptions used for establishing cost-recovery fees charged to the public for Licenses, Permits and Franchises and Charges for Services submitted for Board approval.
2. Evaluate compliance with County Accounting Manual Procedures Nos. R-3 – *Revenue Policy, Requirements & Responsibilities*, and B-2 – *Billing Rates and Indirect Costs*, and the impact on fee development from the recently passed State Proposition 26.
3. Determine if the process is efficient and effective (e.g., no backlogs, duplication of work, manual processes that could be automated).

RESULTS

Objective #1: Our audit found OCWR has adequate internal controls with one exception noted over fee development processes, methodologies, and assumptions used for establishing cost-recovery fees for Licenses, Permits and Franchises and Charges for Services submitted for Board approval. We identified **one (1) Control Finding** regarding having written policies and procedures over the fee development process.

Objective #2: Our audit found OCWR has not been in full compliance with County Accounting Manual Procedure No. R-3 – *Revenue Policy, Requirements & Responsibilities* because OCWR's main revenue sources are derived from negotiated rate contracts that are not prepared in accordance with the revenue policy. However, some posted rate fees are subject to policy requirements. OCWR has addressed the impact of Proposition 26 on the fee development process. We identified **two (2) Control Findings** to ensure compliance with County revenue policy.

OC Internal Auditor's Report



Objective #3: Our audit found the fee development process is efficient and effective (e.g., no backlogs, duplication of work, manual processes that could benefit from automation).

The following table summarizes our findings and recommendations based for this audit. See further discussion in the *Detailed Findings, Recommendations and Management Responses* section of this report. See *Attachment A* for a description of Report Item Classifications.

Finding No.	Finding Classification	Finding	Recommendation	Concurrence by Management?	Page No. in Audit Report
1.	Control Finding	Fee Development Process Policies and Procedures	Develop written policies and procedures over the fee development process.	Yes	8
2.	Control Finding	Compliance with County Revenue Policy	Take measures to ensure compliance with County Accounting Manual Procedure R-3.	Yes	10-11
3.	Control Finding	Compliance with County Revenue Policy	Evaluate the process for establishing the Standard Charge per Ton for compliance with County Accounting Manual Procedure R-3.	Yes	10-11



BACKGROUND

OC Waste & Recycling (OCWR) operates a network of three active landfills and four household hazardous waste collection centers. OCWR core services are to provide solid waste disposal, manage former County waste disposal sites, coordinate Countywide waste-related programs, and provide unincorporated area collection and recycling services on behalf of 34 cities and over three million residents. OCWR is divided into five divisions: Administration, Government & Community Relations, North Region Landfill Operations, Central Region Landfill Operations, and South Region Landfill Operations. Under Administration, **Management Services** is responsible for administering and reviewing fees, waste disposal agreements and managing contracts for solid waste and collection services in the unincorporated areas.

OCWR Fee-Generated Revenues

OCWR is funded solely by disposal fees (user fee per ton disposal charge) established at a level to support the waste management system. No general fund tax dollars are utilized. OCWR's fee-generated revenue is derived from Waste Disposal Agreements, Importation Agreements, Posted Rates, and Franchise Rates, Deferred Payment Program Fees and Miscellaneous Fees as discussed below:

- **Waste Disposal Agreements (Negotiated Contract Rates)**

OCWR's main source of revenue is derived from negotiated contract rates in Waste Disposal Agreements. **Waste Disposal Agreements generated \$70 million in revenue** during our audit period. Waste Disposal Agreements are negotiated with Orange County cities, sanitary districts and facility operations for a 10-year term. OCWR works with various consultants (financial consultants, legal counsel, etc.) to develop the Waste Disposal Agreements. The consultants aid in the development of the rates including indirect costs, cost of living adjustments, etc. The fee studies are developed using various assumptions that include disposal tonnage, population growth, expected revenues and expenditures, budgets and cash available for future operational needs. Upon completing a draft agreement, OCWR has various meetings and presentations with parties involved (cities, waste haulers, etc.) to present the agreements. All parties involve go through a lengthy negotiation process with the County. Thus, the contract rates are extensive with many factors that will impact the final amount (i.e., increased costs, mandated costs, inflation, special charges, escalation, etc.), and can take up to two years for development.

The latest Waste Disposal Agreements were approved by the Board of Supervisors in 2009 for a 10-year term effective July 1, 2010 through June 30, 2020 in which the standard charge per ton increases annually on July 1st by the Consumer Price Index (CPI) based on a formula contained in the Waste Disposal Agreements. The Waste Disposal Agreement rates in effect during the audit period are shown below:

Description	Rate March 2010 – June 2010	Rate July 2010 – Feb. 2011
Standard charge per ton	\$ 22.00	\$29.95
Hard-to-handle charge per ton	\$ 27.00	\$35.95

Note: The intent of our Fee Generated Revenue audits is to evaluate controls over fee development for department/agency cost-recovery fees subject to annual fee studies and approval by the Board of Supervisors as required in County Accounting Manual Procedure No. R-3 – *Revenue Policy, Requirements & Responsibilities*. Waste Disposal Agreements are negotiated rates with external parties to the County and are effective for 10 year period. As such, we did not include Waste Disposal Agreements in the scope of this audit, except to obtain a general understanding of them and recalculate the automatic annual fee increases based upon the Consumer Price Index (CPI) and rate increase formulas contained in the agreements and approved by the Board of Supervisors in 2009.



- Importation Agreements (Negotiated Contract Rates)**

OCWR's second leading source of revenue is derived from **Importation Agreement fees (\$17 million in revenue** during the audit period). Importation fees are derived from long-term contracts between the County of Orange and two waste haulers (Republic Waste Services of California LLC and Burrtec Waste Industries, Inc.) to deliver a minimum amount of imported waste annually to County-owned landfills, or pay the County the difference resulting from tonnage shortfall. Importation contract rates also contain additional factors that impact the final negotiated rate (i.e., escalation, increase in government fees, settlement rate surcharges, etc.). The existing settlement surcharge rate of \$0.12 per ton was implemented for an under billing during 2005 on imported waste. The additional \$0.12 went into effect on December 19, 2006 to recover the difference in the under billed rate. The settlement surcharge is projected to end around November 2011. The surcharge is not subject to the automatic annual rate adjustment.

The current Importation Agreements are in effect until June 30, 2016 in which the charge per ton increases annually on January 1st by the Consumer Price Index (CPI) based on a formula contained in the Importation Agreements. Similar to the Waste Disposal Agreements, the fee studies used to develop Importation Agreement contract rates did not go to Auditor-Controller/Revenue & Budget or CEO/Budget Office for review since these are negotiated rates.

Description	Rate March 2010 – June 2010	Rate July 2010 – Feb. 2011	Settlement Surcharge
Importation charge per ton	\$22.00	\$22.01	\$0.12
Hard-to-handle charge per ton	\$27.00	\$27.01	\$0.12

Note: The intent of our Fee Generated Revenue audits is to evaluate controls over fee development for department/agency cost-recovery fees subject to annual fee studies and approval by the Board of Supervisors as required in County Accounting Manual Procedure No. R-3. Importation Agreements are negotiated rates with external parties to the County and are effective for 10-year period. As such, we did not include Importation Agreements in the scope of this audit except to obtain a general understanding of them and recalculate the automatic annual fee increases based upon the Consumer Price Index (CPI) and rate increase formulas contained in the agreements and approved by the Board of Supervisors in 2006.

- Posted Rates (Cost-Recovery, Non-Negotiated Fees)**

OCWR's third source of revenue is from non-negotiated rates known as "posted rates." Posted rates are disposal rates for individuals and businesses that do not have a negotiated Waste Disposal Agreement or Importation Agreement with the County. Fee revenue during the audit period was **\$4 million** and AB 939 Surcharges totaled about **\$2 million**. The AB 939 Surcharge is a State-mandated surcharge imposed on self-hauled waste for those who are not using material processing facilities to reduce the disposal of recyclable materials in OC landfills. The Posted Rates in effect during the audit period are shown below and have not been revised or updated in the last 10 years with the exception of the AB 939 surcharge and the standard charge per ton:

Description	Rate	AB 939 Surcharge	Total
Auto – minimum	\$ 5.00	-	\$5.00
Truck – minimum	\$12.00	\$8.00	\$20.00
Hard-to-Handle	\$ 5.00	-	\$5.00
Standard Charge per Ton: March – June 2010	\$27.00	\$19.00	\$46.00
Standard Charge per Ton: July 2010 – Feb. 2011	\$34.95	\$19.00	\$53.95

Note: Posted rates are cost-recovery fees subject to annual reviews and updates per County Accounting Manual Procedure No. R-3 – *Revenue Policy, Requirements & Responsibilities*.



AB 939 Surcharges

The Assembly Bill (AB) 939 surcharge became effective on July 1, 2006. The Board of Supervisors approved the AB 939 surcharge on a prorated basis for truck and standard charges and decided not to add the surcharge to the auto fee. A public hearing was held for the adoption of the AB 939 surcharge.

The standard charge per ton was updated in July 2010 to \$34.95 per ton exclusive of the \$19.00 surcharge (\$53.95 total charge per ton). The fee study conducted in the Waste Disposal Agreements was utilized for the development of the standard charge. OCWR decided to set the standard charge \$5 greater than the disposal rate for those with a County contract (Waste Disposal Agreement). The standard charge per ton increases annually on July 1st by the Consumer Price Index based on a formula contained in the Waste Disposal Agreements. A public hearing was held for the adoption of the standard charge per ton.

- ### Franchise Rates (Cost-Recovery, Non-Negotiated Fees)

Franchise rates are set to cover the Franchisee's share of the County's total cost of administrating franchise agreements for the collection of solid waste in the unincorporated area of the County. Franchise fee revenue during the audit period was **\$105,000**. The franchise rates were updated in December 2009 based on formulas contained in the Franchise Agreements approved by the Board of Supervisors. A public hearing was held for the adoption of the franchise rates.

Description	Rate
Application fee for non-exclusive franchise	\$ 1,000
Franchise fee	Formula
Non-exclusive franchise fee	Formula

- ### Deferred Payment Program Fees & Miscellaneous Fees (Cost-Recovery/Mandated, Non-Negotiated Fees)

Other fees such as deferred payment program fees and other miscellaneous fees (fee revenue during the audit period was **\$1,366**) derived from as follows:

- Deferred payment program fees for replacement of a deferred payment card issued to an entity for each vehicle the entity uses to deliver waste to County disposal sites.
 - As part of the construction and demolition policy and program to divert a certain percentage of total construction and demolition waste from landfills, an application fee is charged to cover the staff time and materials to review and process documentation.
 - Returned check fees are mandated in accordance with California Civil Code Section 1719.
 - Copy requests sent via mail and facsimile are charged for any copies made for the deferred payment program. OCWR is uncertain on the establishment of the copy request fees for the program.

Description	Rate
Replacement of deferred payment card	\$ 5.00
Administration of construction and demolition policy and program	\$ 25.00
Returned checks (1 st incident) – mandated	\$ 25.00
Returned checks (subsequent incidents) – mandated	\$ 35.00
Copy requests – pick up or will call	\$ 0.15
Copy requests – fax	\$ 0.28

Note: Franchise rates, deferred payment and miscellaneous fees are cost-recovery fees subject to annual reviews and updates per County Accounting Manual Procedure No. R-3 – *Revenue Policy, Requirements & Responsibilities* and were included in this audit.



Factors Impacting OCWR Fee-Generated Revenue

OCWR informed us it has maintained a conservative approach when dealing with its agreements and fees and not impose a high dollar amount. Fees and rates are regularly reviewed through the quarterly budget reports and long-term projections. The current executive management takes a conservative approach when dealing with rates, which was also the philosophy with preceding directors.

The fee factors are derived mainly from the cities and their ability to negotiate a rate. Rate adjustments are possible in the contracts since they were designed with specific re-openers in the event that they arise (i.e. state regulations, etc.). Contractors (i.e., cities) were willing to negotiate with the County when dealing with those specific events allowing for rate adjustments when deemed necessary. The re-openers are detailed in the agreements.

Importation fees help pay for the bankruptcy efforts which are expected to end in 2015-2016. However, there are regulations that must be met such as limited space, closure and maintenance. Diversion programs are getting stringent in the percentage of tonnage that needs to be diverted away from landfills. Importation agreements have political implications and the extension of the agreements is uncertain as to whether they will be extended past 2016.

OCWR takes into account various assumptions to ensure a reasonable fee. Costs are not the only drivers in the fee due to the operation of OCWR. Tonnage levels, federal and state regulations and laws, population growth and the economy all play a role in the OCWR's operations. OCWR informed us that tonnage has decreased, which might be based on the economy, specifically since construction is down which was a huge contributor to tonnage.

Impact of Proposition 26

In November 2010, Proposition 26 was passed by California voters. Proposition 26 requires that certain state and local fees are approved by two-thirds vote. The impact of Proposition 26 expands the definition of a tax which classifies some fees and charges as taxes that the government formerly imposed with a simple majority vote. As a result, more revenue proposals, formerly fees but now taxes, require approval by two-thirds of the Legislature or by local voters. Prior to the passage of Proposition 26, elected officials at the state and local levels could legislate higher revenue proposals by classifying them as fees in order to pass with a simple majority instead of a two-thirds majority required by law for taxes.

OCWR evaluated its existing fees and made a determination that all OCWR fees meet the exception to the proposition's definition of a "tax" except for the AB 939 Surcharge fee. Therefore, only the AB 939 surcharge might be considered a "tax" for Proposition 26; however, this requires further review by the County and County Counsel.

SCOPE AND METHODOLOGY

Our audit covered the period March 1, 2010 through February 28, 2011 and included the following:

1. Evaluated the adequacy of internal controls over fee development processes, methodologies, and assumptions used for establishing cost-recovery fees charged to the public for Licenses, Permits and Franchises and Charges for Services submitted for Board approval. **Note:** We obtained an understanding of fee development for Waste Disposal Agreements and Importation Agreements, but did not audit the process and controls since it involves hiring consultants to perform fee studies and negotiating contract rates with external entities. These negotiated agreements do not go through the same process as other County cost-recovery fees under CAM R-3.



2. Evaluated compliance with County Accounting Manual Procedures Nos. R-3 – *Revenue Policy, Requirements & Responsibilities*, and B-2 – *Billing Rates and Indirect Costs*, and the impact on fee development from the recently passed State Proposition 26. Posted rates, franchise rates, deferred payment rates and miscellaneous fees are subject to this Countywide policy and to our audit of fee development.
3. Evaluated the efficiency and effectiveness of the fee development process, such as for backlogs, duplication of work, manual processes that could benefit from automation.

SCOPE EXCLUSIONS

We did not review Charges for Services generated from fees set by statutes as those are mandated. In addition, we did not review internal controls over cash receipts over the established fees. Furthermore, we did not determine the reasonableness of methodologies and assumptions used in the development of the fees.

Management's Responsibilities for Internal Controls

In accordance with the Auditor-Controller's County Accounting Manual section S-2 *Internal Control Systems*, "All County departments/agencies shall maintain effective internal control systems as an integral part of their management practices. This is because management has primary responsibility for establishing and maintaining the internal control system. All levels of management must be involved in assessing and strengthening internal controls." Control systems shall be continuously evaluated by Management and weaknesses, when detected, must be promptly corrected. The criteria for evaluating an entity's internal control structure is the Committee of Sponsoring Organizations (COSO) control framework. Our Internal Control Audit enhances and complements, but does not substitute for OCWR's continuing emphasis on control activities and self-assessment of control risks.

Inherent Limitations in Any System of Internal Control

Because of inherent limitations in any system of internal controls, errors or irregularities may nevertheless occur and not be detected. Specific examples of limitations include, but are not limited to, resource constraints, unintentional errors, management override, circumvention by collusion, and poor judgment. Also, projection of any evaluation of the system to future periods is subject to the risk that procedures may become inadequate because of changes in conditions or the degree of compliance with the procedures may deteriorate. Accordingly, our audit would not necessarily disclose all weaknesses in OCWR's operating procedures, accounting practices, and compliance with County policy.

Acknowledgment

We appreciate the courtesy extended to us by OC Waste & Recycling during our audit. If we can be of further assistance, please contact me directly or Eli Littner, Deputy Director at 834-5899 or Michael Goodwin, Senior Audit Manager at 834-6066.

Attachments

Distribution Pursuant to Audit Oversight Committee Procedure No. 1:

Members, Board of Supervisors
Members, Audit Oversight Committee
Thomas G. Mauk, County Executive Officer
Alisa Drakodaidis, Deputy CEO, OC Infrastructure
Dylan Wright, Deputy Director, Administration, OC Waste & Recycling
Alan Yuki, Manager, Budget Services, OC Waste & Recycling
Mike Montijo, Manager, Accounting Services, OC Waste & Recycling
Foreperson, Grand Jury
Darlene J. Bloom, Clerk of the Board of Supervisors



Objective #1: Evaluate the adequacy of internal controls over fee development processes, methodologies, and assumptions used for establishing cost-recovery fees charged to the public for Licenses, Permits and Franchises and Charges for Services submitted for Board approval.

Finding 1 – Fee Development Process Policies and Procedures

Summary

OCWR has an extensive fee development process; however, the fee development policies and procedures are not documented. In addition, we noted that there are no policies and procedures to ensure that fees and charges that are adopted or amended are reviewed to ensure compliance with Proposition 26. **(Control Finding)**

Details

OCWR has various types of fees (i.e., Waste Disposal Agreements, Importation Contracts, posted disposal fees, franchise fees, deferred payment program fees, and administrative cost recovery fees) that are developed by different methods. The fee development process is articulated in the agreements, resolutions, board agendas, etc. The main source of revenue is derived from negotiated Waste Disposal and Importation Agreements which includes an extensive fee development process negotiated for a long term period (i.e., 10-years). Since there are various methods utilized for the different types of fees generated and due to the significance of OCWR revenue, policies and procedures should be documented to strengthen its internal controls, reduce its operational risks, and ensure compliance with regulations and laws.

The development and use of policy and procedures are an integral part of a successful quality assurance system as it provides personnel with the information to perform their duties properly, facilitates consistency in the quality and integrity of an end-result, and ensures compliance with governing documentation. As authored by Daniel Edds, “User Fees – Putting Policies and Structures in Place Now for the Future” *Government Finance Review*, April 2011, states that “while user fees cannot replace lost revenues, the current economic state of affairs provides a critical opportunity to review and update user fee policies, cost structures, policies, and internal procedural processes. By taking steps now, jurisdictions can be ready to make improvements as soon as economic recovery begins. Setting clear policies and procedures for cost recovery is a way to prepare for anticipated services needs and future growth.”

Documented fee development policies and procedures should ensure revenues do not exceed the estimated amount required to provide those services and all revenue producing contracts shall include provisions for full County cost recovery wherever possible.

OCWR understands the importance of written policies and procedures. OCWR indicated the fee development process is extensive, takes a couple of years to obtain the final agreements executed, and are critical for the operation of OCWR. As such, it is important this process be documented to provide guidance for staff responsible for fee development.

Recommendation No. 1

OCWR develop and implement written policies and procedures over the fee development process, including the process for ensuring compliance with Proposition 26. Documented policy and procedures should be reviewed and approved by management and current versions need to be readily accessible for reference by personnel responsible for the fee development process.



OC Waste & Recycling Management Response:

Concur. OCWR will prepare a policy & procedure memorializing fee development and review processes. For landfill disposal fees, which are established through negotiations, OCWR will prepare a consolidated reference document delineating that process.

With respect to ensuring compliance with Proposition 26, County Counsel review will be required prior to the establishment of new or revision to existing fees. Development of the policy & procedure has commenced. Target completion date of the new procedure is by the end of March, 2012. The new procedure will be referenced to when the Department begins its Waste Disposal Agreement renewal process in 2017.

Objective #2: Evaluate compliance with County Accounting Manual Procedures Nos. R-3 – Revenue Policy, Requirements & Responsibilities, and B-2 – Billing Rates and Indirect Costs, and the impact on fee development from the recently passed State Proposition 26.

Findings 2 and 3 – Compliance with County Revenue Policy

Summary

Due to the nature of OCWR's main sources of revenue derived from negotiated rate contracts (Waste Disposal Agreements and Importation Contracts); OCWR was not in full compliance with the County's revenue policy, requirements and responsibilities (CAM R-3). **(Control Finding)**

Details

OCWR did not have documentation to show compliance with the following County revenue policies and procedures:

1. **Frequency of Cost Recovery Rate Updates** (CAM R-3, Section 2.1). The policy requires that "all cost recovery revenue rates shall be updated once each year to reflect current costs. When the cost associated with making this annual determination appears to be excessive, with the approval of CEO and Auditor-Controller, a complete update should be made no later than every third year." Our audit noted that Posted Rates have been in place as follows:

Posted Rate	Amount	AB939 Surcharge	Last Updated/Revised
Auto Disposal Rate	\$5.00		July 2006
Truck Disposal Rate	\$12.00	\$8.00	July 2006
Standard Disposal Rate	\$34.95	\$19.00	July 2011
Hard-to-Handle Fee	\$5.00		1980s
Administrative Cost Recovery Fee for Construction & Demolition	\$25.00		August 2007
Deferred Payment Program Fees (card replacement, returned check, copies/faxes)	\$5.00 – card replacement \$0.28 – copies \$0.15 - faxes		October 2009

The fees noted above were not updated to ensure full cost recovery to ensure consistency with Board policies, nor did we see CEO and Auditor-Controller approval to update the fees every third year. OCWR indicated they regularly review certain cost recovery fees and rates, but that the reviews are not documented if they are not submitted for Board approval.



2. **Checklist for New or Revised Fees** (CAM R-3, Section 3.5). The policy requires “all new and revised department/agency fees (except those listed in 3.5.3) presented to the Board of Supervisors...must be accompanied by a completed checklist.” Our audit noted that Fee checklist forms were not consistently used for new/revised fees noted above.
3. **Reviews by the County Executive Office and Auditor-Controller** (CAM R-3, Section 3). The policy requires cost recovery rate updates to be submitted to the County Executive Office and to the Auditor-Controller for review prior to obtaining approval from the Board of Supervisors. Our audit found that OCWR determines its posted rate for a Standard Charge Per Ton (currently \$34.95 plus surcharge of \$19.00) when establishing the negotiated contract rates in the 10-year Waste Disposal Agreements, and are not submitted to the CEO and Auditor-Controller for review, and Fee Checklists are not used.

Instead, these rates are supported with detailed fee studies prepared by consultants and the agreements are approved by the Board. This has been OCWR’s practice for several years. There are provisions and formulas in the agreement for increasing rates annually during the 10-year term based upon the CPI. We recalculated the formulas using CPI and validated that OCWR is using the proper rate and adjusts it according to terms of the agreement.

OCWR understands the importance of following County revenue policies and procedures; however, the main focus of OCWR is the development of the Waste Disposal and Importation Agreements since they are OCWR’s main sources of revenue. OCWR indicated that all rates are reviewed at some point; however, the reviews might not be memorialized in writing.

Recommendation No. 2

OCWR take measures to ensure compliance with County Accounting Manual Procedure R-3, specifically with maintaining documentation to show fees were reviewed for cost-recovery and consistent use of Fee Checklist forms.

OC Waste & Recycling Management Response:

Concur. OCWR will review applicable fees and develop measures to ensure compliance with County Accounting Policy R-3. OCWR will also develop a standardized report to document when fees were reviewed and approved by OCWR Executive Management and County Departments when applicable. The compliance measures will be developed by March 2012 and review and reporting will commence at the end of calendar year 2012.

Recommendation No. 3

OCWR evaluate its process for establishing the Standard Charge per Ton and determine if it should be developed in accordance with the requirements of County Accounting Manual Procedure R-3.

OC Waste & Recycling Management Response:

Concur. OCWR has evaluated its process for establishing the Standard Charge per Ton and which was developed as part of the Waste Disposal Agreement negotiations with Orange County cities and approved by the Board of Supervisors for the period July 1, 2010 through June 30, 2020. OCWR has determined that, as the Standard Charge per Ton is dependent on the Waste Disposal Agreement rate, it should not be developed in accordance with the requirements of County Accounting Policy R-3. OCWR will continue to perform annual analysis of the financial model used to negotiate the current disposal rates and will report findings to executive management.

Detailed Results, Findings, Recommendations and Management Responses



Should analysis indicate a need to adjust disposal rates, action will be taken in accordance with the methodology set forth in the Waste Disposal Agreements, as approved by the Board of Supervisors.

Objective #3: Determine if the fee development process is efficient and effective (e.g., no backlogs, duplication of work, manual processes that could benefit from automation).

Summary

Our audit found the fee development process is efficient and effective. We did not observe any backlogs, duplication of work, or manual processes that could benefit from automation in OCWR's fee development process.

As such, we have no findings and recommendations under this audit objective.



ATTACHMENT A: Report Item Classifications

For purposes of reporting our audit observations and recommendations, we will classify audit report items into three distinct categories:

▶ **Critical Control Weaknesses:**

Serious audit findings or a combination of Significant Control Weaknesses that represent critical exceptions to the audit objective(s) and/or business goals. Management is expected to address Critical Control Weaknesses brought to their attention immediately.

▶ **Significant Control Weaknesses:**

Audit findings or a combination of Control Findings that represent a significant deficiency in the design or operation of internal controls. Significant Control Weaknesses generally will require prompt corrective actions.

▶ **Control Findings:**

Audit findings concerning internal controls, compliance issues, or efficiency/effectiveness issues that require management's corrective action to implement or enhance processes and internal controls. Control Findings are expected to be addressed within our follow-up process of six months, but no later than twelve months.



ATTACHMENT B: OC Waste & Recycling Management Responses



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TO: Dr. Peter Hughes, MBA, CPA, CIA
Internal Audit Department

FROM: Michael B. Giancola, Director
OC Waste & Recycling 

DATE: September 29, 2011

SUBJECT: Response to Draft Report on the Internal Control Audit of OC Waste & Recycling Fee Generated Revenue for the Period March 1, 2010 through February 28, 2011 (Audit No. 1023)

OC Waste & Recycling has prepared its response to the Draft Report on the Internal Control Audit of Fee Generated Revenue for the period March 1, 2010 through February 28, 2011. The recommendation numbers used in your report reference our responses.

Recommendation No. 1

OCWR develop and implement written policies and procedures over the fee development process, including the process for ensuring compliance with Proposition 26. Documented policy and procedures should be reviewed and approved by management and current versions need to be readily accessible for reference by personnel responsible for the fee development process.

OC Waste & Recycling Management Response:

Concur. OCWR will prepare a policy & procedure memorializing fee development and review processes. For landfill disposal fees, which are established through negotiations, OCWR will prepare a consolidated reference document delineating that process.

With respect to ensuring compliance with Proposition 26, County Counsel review will be required prior to the establishment of new or revision to existing fees.

Development of the policy & procedure has commenced. Target completion date of the new procedure is by the end of March, 2012. The new procedure will be referenced to when the Department begins its Waste Disposal Agreement renewal process in 2017.

Recommendation No. 2

OCWR take measures to ensure compliance with County Accounting Manual Procedure R-3, specifically with maintaining documentation to show fees were reviewed for cost recovery and consistent use of Fee Checklist forms.



ATTACHMENT B: OC Waste & Recycling Management Responses

OC Waste & Recycling Management Response:

Concur. OCWR will review applicable fees and develop measures to ensure compliance with County Accounting Policy R-3. OCWR will also develop a standardized report to document when fees were reviewed and approved by OCWR Executive Management and County Departments when applicable. The compliance measures will be developed by March 2012 and review and reporting will commence at the end of calendar year 2012.

Recommendation No. 3

OCWR evaluate its process for establishing the Standard Charge per Ton and determine if it should be developed in accordance with the requirements of County Accounting Manual Procedure R-3.

OC Waste & Recycling Management Response:

Concur. OCWR has evaluated its process for establishing the Standard Charge per Ton and which was developed as part of the Waste Disposal Agreement negotiations with Orange County cities and approved by the Board of Supervisors for the period July 1, 2010 through June 30, 2020. OCWR has determined that, as the Standard Charge per Ton is dependent on the Waste Disposal Agreement rate, it should not be developed in accordance with the requirements of County Accounting Policy R-3. OCWR will continue to perform annual analysis of the financial model used to negotiate the current disposal rates and will report findings to executive management. Should analysis indicate a need to adjust disposal rates, action will be taken in accordance with the methodology set forth in the Waste Disposal Agreements, as approved by the Board of Supervisors.

If you have any questions or follow-up questions please contact me or Dylan Wright at (714) 834-4137.

cc: Alisa Drakodaidis, Deputy CEO, OC Infrastructure
Michael Goodwin, Senior Audit Manager
Lisette Free, Senior Internal Auditor
OCWR Executive Team