



Transmitted via e-mail

November 21, 2012

Ms. Caroll Mortensen, Director  
Department of Resources Recycling and Recovery  
1001 I Street, MS 25A  
Sacramento, CA 95814

Dear Ms. Mortensen:

**Final Report—Pennzoil Quaker State Company, California Used Oil Recycling Fees Audit**

The Department of Finance, Office of State Audits and Evaluations, has completed its audit of Pennzoil Quaker State Company's (Pennzoil) Used Oil Recycling Fee Returns for the period July 1, 2010 through June 30, 2011.

The enclosed report is for your information and use. Pennzoil's response to the report findings are incorporated into this final report. Pennzoil agreed with our findings and we appreciate its willingness to implement corrective action. This report will be placed on our website.

We appreciate the assistance and cooperation of Pennzoil. If you have any questions regarding this report, please contact Kimberly Tarvin, Manager, or Alma Ramirez, Supervisor, at (916) 322-2985.

Sincerely,

Original signed by Richard Sierra for:

David Botelho, CPA  
Chief, Office of State Audits and Evaluations

Enclosure

cc: Mr. Mark E. Leary, Chief Deputy Director, Department of Resources Recycling and Recovery  
Mr. Tom Estes, Deputy Director, Administration, Finance and Information Technology Services Division, Department of Resources Recycling and Recovery  
Ms. Shirley Willd-Wagner, Branch Chief, Financial Resources Management Branch, Department of Resources Recycling and Recovery  
Ms. Sarah Keck, Chief Accounting Officer, Accounting Section, Fiscal Services Branch, Department of Resources Recycling and Recovery  
Mr. Brian Kono, Manager, Statewide Disbursements Section, Office of Audits, Department of Resources Recycling and Recovery  
Mr. Donald Fancher, Tax Officer, Shell U.S. Tax Organization  
Ms. Florida Grimes, Audit Coordinator, Shell U.S. Tax Organization

Pennzoil Quaker State Company  
Used Oil Recycling Fee Returns

For the Period July 1, 2010  
through June 30, 2011

Prepared By:  
Office of State Audits and Evaluations  
Department of Finance

**MEMBERS OF THE TEAM**

Kimberly Tarvin, CPA  
Manager

Alma Ramirez, CPA  
Supervisor

Muang Saeteurn  
Auditor

Final reports are available on our website at <http://www.dof.ca.gov>

You can contact our office at:

Department of Finance  
Office of State Audits and Evaluations  
915 L Street, 6<sup>th</sup> Floor  
Sacramento, CA 95814  
(916) 322-2985

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# BACKGROUND, SCOPE AND METHODOLOGY

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## BACKGROUND

The Legislature enacted the California Oil Recycling Enhancement Act (Act), sections 48600 through 48691 of the Public Resources Code, to reduce illegal disposal of used oil, recycle and reclaim used oil in order to recover valuable natural resources, and avoid damage to the environment and threats to public health. This Act gives the Department of Resources Recycling and Recovery (CalRecycle) the authority to adopt and implement a used oil recycling program, and to collect fees from oil manufacturers at a rate of 26 cents for each gallon of lubricating oil sold, transferred, or used in California. These fees support the California Used Oil Recycling Fund from which various state and local programs are operated. These programs help promote local efforts to recycle used oil before harmful environmental impacts can occur.

Pennzoil Quaker State Company (Pennzoil) is a worldwide supplier of consumer automotive products and vehicle care. Pennzoil was formed in 1998 as a result of a merger of Quaker State Corporation and Pennzoil Company. Pennzoil was later acquired by Shell Oil Company, an affiliate of the Royal Dutch/Shell Group of Companies (now Royal Dutch Shell plc). In 2003, Pennzoil began doing business as SOPUS Products.<sup>1</sup>

## SCOPE

The Department of Finance, Office of State Audits and Evaluations, conducted an audit of Pennzoil's Used Oil Recycling Fee Returns (Returns) submitted to CalRecycle. The audit objective was to determine whether Pennzoil accurately reported the industrial and lubricating oil sold, transferred, or used in California, and remitted the proper fees in accordance with the terms and conditions of the Act for the period July 1, 2010 through June 30, 2011. In order to design adequate procedures to conduct our audit, we obtained an understanding of the relevant internal controls. We did not assess the efficiency or effectiveness of program operations.

Pennzoil is responsible for ensuring accurate reporting of the oil recycling fees and oil sales, and ensuring compliance with applicable laws and regulations. CalRecycle is responsible for evaluating the efficiency and effectiveness of the program operations.

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<sup>1</sup> Excerpts from <http://www.quakerstate.com/#/about-quaker-state>

## **METHODOLOGY**

To determine whether Pennzoil accurately reported the used oil recycling fees and oil sales in accordance with the terms and conditions of the Act, we performed the following procedures:

- Interviewed key personnel to obtain an understanding of the internal controls related to the recording, classification, reporting of sales transactions, and preparation of the Returns.
- Obtained a limited understanding of the system used to account for oil sales.
- Reviewed Pennzoil's oil sales and fee reports to determine if the oil quantities and fees reported on the Returns were accurate and complete.
- Reviewed the product category list of lubrication and industrial oil to determine whether all products were correctly classified and reported.
- Determined whether the quantities on reports for industrial and lubrication oil were supported by sales orders, invoices, and other relevant documents.
- Determined whether the correct conversion factor was used to convert non-volume measurements.
- Determined whether export sales were delivered to a location outside California.

We conducted this performance audit in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

Pennzoil Quaker State Company (Pennzoil) did not accurately report the industrial and lubricating oil sales in compliance with applicable laws and regulations for the period July 1, 2010 through June 30, 2011, as presented in Tables 1 and 2 below. Additionally, see Finding 1.

**Table 1: Schedule of Industrial Oil Sales<sup>2</sup>**

Categories	Reported Sales (Gallons)	Audited Sales (Gallons)	Audit Adjustment (Gallons)
Total Industrial Oil Sold	1,133,409	2,496,828	1,363,419
Industrial Oil Exported or Sold for Export	767,274	1,054,081	286,807

**Table 2: Schedule of Lubricating Oil Sales & Fees**

Categories	Reported Sales (Gallons)	Audited Sales (Gallons)	Audit Adjustment (Gallons)
Total Lubricating Oil Sold	30,823,685	34,934,003	4,110,318
Other Exemptions	12,585,811	15,337,355	2,751,544
Lubricating Oil Subject to the Fee	<b>18,237,874</b>	<b>19,596,648</b>	<b>1,358,774</b>
<b>Total Fees Due (26 cents per gallon)</b>			<b>\$353,281</b>

**Finding 1: Underpayment of \$353,281 Due to Inaccurate Reporting**

As noted in Tables 1 and 2, Pennzoil underreported its Industrial and Lubricating Oil sales and exempt transactions resulting in an underpayment of \$353,281 in lubricating oil fees. This occurred because Pennzoil did not report some industrial and lubricating oil sales and some exempt transactions were either not supported by an exemption certificate or the exemption certificate was signed after the sales were made.

California Public Resources Code, section 48761, states that oil manufacturers who sell lubricating or industrial oil in the state shall report to CalRecycle the amount of lubricating or industrial oil sold each month. California Public Resources Code (PRC) section 48616, defines industrial oil and section 48618 defines Lubricating oil. Additionally, Code of Regulations, Title 14, section 18626, states that an exemption certificate which is not issued in a timely

<sup>2</sup> No fees are assessed on industrial oil.

manner is not retroactive, and will not relieve the seller of the responsibility for the fee. To be considered timely, an exemption certificate shall be issued as follows:

- Before the seller bills the purchaser for the lubricating oil.
- Within seller's normal billing and payment cycle.
- Prior to delivery of the subject oil to the purchaser.

Missing and inaccurate reporting could result in over or underpaid fees. A similar finding was previously reported in a February 2010 Department of Finance audit.

**Recommendations:**

- A. Ensure that lubricating and industrial oil sold or transferred to California and all related exemptions are adequately captured in reports and accurately reported in the Returns.
- B. Timely obtain and retain exemption certificates to support exempted sales.
- C. Remit \$353,281 to CalRecycle.





Shell Oil Company  
Shell U S Tax Organization  
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October 25, 2012

David Botelho, CPA  
Chief, Office of State Audits and Evaluations  
915 L Street  
Sacramento, CA 95814

RE: Pennzoil Quaker State Company, California Used Oil Recycling Fees  
Audit - Period July 1, 2010 through June 30, 2011

Dear Mr. Botelho:

We have received and reviewed the draft audit report for Pennzoil Quakers State Company. The findings outlined in this draft report agree with those as discussed during the October 10, 2012 phone exit conference with Auditor, Muang Saeteurn and Supervisor, Alma Ramirez.

Should you require additional information, please contact Florida Grimes, Audit Coordinator are (713) 241-6406.

Regards,

Donald Fancher, Manager  
Indirect Tax Audit Operations  
Shell Oil Products United States  
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