



February 19, 2010

Mr. Tom Estes, Deputy Director
Department of Resources Recycling and Recovery
Administration and Finance Division
1001 I Street, MS 19A
P.O. Box 4025
Sacramento, CA 95812-4025

Dear Mr. Estes:

Management Letter—CalRecycle Grant Management and Fee Payer Oversight

In accordance with an interagency agreement between the Department of Finance, Office of State Audits and Evaluations (Finance), and the California Integrated Waste Management Board (Board), we audited grantees and fee payers during the period October 1, 2008 to September 30, 2009. On January 1, 2010, the California Integrated Waste Management Board was abolished and its duties were transferred to the new Department of Resources Recycling and Recovery (CalRecycle).

During our reviews of grants and fee payers we became aware of several matters that are opportunities for strengthening CalRecycle's internal controls and operating efficiency, enhancing CalRecycle's monitoring and compliance functions, and increasing grantee and fee payer accountability. This management letter summarizes our comments and suggestions regarding those matters. When discussing the observations below, we refer to the Board as the governing body over the grants and fee payers at the time the audits were performed. The Board provided comments regarding each observation on December 31, 2009. However, CalRecycle is responsible for implementing the recommendations.

Grants

The objective of the grant audits was to determine the grantee's compliance with applicable laws, regulations, and grant requirements. We did not assess the efficiency or effectiveness of program operations; this responsibility rests with CalRecycle. The responsibility for financial reporting and compliance rests with the grantee. We audited 31 grants comprised of 18 used oil grants, 5 waste grants, and 8 tire grants.

During the course of the grant audits, we observed the practices followed by the Board's grant managers in monitoring and overseeing grant operations. Some of these practices conflict with the Board's published procedures and requirements as explained below.

Observation 1—Reimbursement of Ineligible Grant Expenditures

The Board inappropriately authorized reimbursement of some expenditures that were ineligible based on the grant agreement requirements. The ineligible expenditures included payments for services that were not included in the scope of work or budget, were outside the grant term, and/or were not timely pre-approved via written grant modifications. The following are examples of these expenditures.

- A. The Board approved \$223,930 of ineligible overhead costs claimed by a grantee through an intra-department billing for cleanup costs. The Board's grant manager considered the relationship between the grantee's internal departments to be one between grantee and subcontractor and therefore approved the costs. However, because the grantee was one organization, the overhead costs were not eligible for reimbursement. The Standard Agreement states that eligible costs do not include overhead or indirect costs, unless pre-approved in writing by the grant manager.
- B. The Board approved \$19,857 in unauthorized billboard advertisement costs claimed by a grantee. The billboard costs were not included in the grant's original budget or scope of work. The billboard expenditures were claimed and approved on the final expenditure itemization summary. The Board's current grant manager communicated to us he believed the billboard advertising was approved by a prior grant manager based on the Budget Reconciliation Statement. However, the Budget Reconciliation Statement that the current grant manager relied on to make this determination was prepared by the grantee and submitted to the Board at the conclusion of the grant. As a result, neither the grantee nor the Board provided evidence of written pre-approval of the billboard advertisements.
- C. The Board approved \$5,719 for a grantee's previously-acquired semi van trailer. The grantee sought approval for the purchase 15 days prior to the grant expiration date and seven months after the vehicle purchase. Even though the grantee had not followed the requirements specified by the grant agreement, the Board approved the purchase on March 23, 2007, eight days prior to the grant's expiration date.

The Grant Agreement's Terms and Conditions state that the Board shall reimburse the grantee only for the activities and costs specified in the approved work plan, and approved budget itemization, and incurred during the term of the grant agreement. Furthermore, the grant manager's written approval is required for any changes or modifications to the approved work plan or approved budget itemization prior to the performance of the changed work or expenditure of funds. The grant agreement also states that failure to obtain prior written approval of expenditures may result in withholding or disallowance of grant reimbursements.

- D. The Board pre-approved a grantee's Used Oil Recycling media campaign of television and radio advertisements running 20 days past the grant eligibility end date of June 30, 2009. The grantee was reimbursed for the full cost of the campaign. The Board's grant manager stated the campaign summary had not been properly reviewed prior to approval.

The inadequate review of grantee documentation increases the risk of funds being used for unauthorized purposes, grant goals and objectives not being met, and may ultimately reduce the effectiveness of the Board's Used Oil Recycling program.

A similar finding related to the reimbursement of ineligible expenditures was reported in our management letter dated August 9, 2004. The ineligible expenditures included payments for services and products outside the grant period, ineligible overhead and indirect costs, and reimbursement of expenditures without pre-approval from the grant manager.

Recommendation: Ensure claimed expenditures are incurred within the grant period, are supported by invoices, meet eligibility requirements, and represent actual costs incurred. Ensure claimed expenditures are based on the approved budget, and that subsequent budget modifications are pre-approved in writing.

Board's Response: The Board concurs with this observation and is implementing corrective action through enhanced grant management training, development of a Grant Management Desk Manual, establishment of a Grants Work Group for continuous improvement on grant fiscal processes, and the creation of a Fiscal and Process Oversight Unit for monitoring the implementation of fiscal grant processes.

Observation 2—Clarify Grantee Requirements for Reviewing Subcontractor Supporting Documentation

We noted that grantees do not always request, obtain, and review adequate supporting documentation, such as personnel expenditure summaries, from their subcontractors as part of their claim review/approval process. Although the Board's grant agreements have a general provision for grantees to ensure subcontractors comply with the grant agreement, this requirement is often overlooked or misinterpreted by grantees. Without clarification as to the types and level of documentation required for a proper subcontractor claim review, grantees may not be holding their subcontractors accountable. In two of the grants we audited, the grantee did not require personnel expenditure summary reports from their subcontractors, hampering their ability to identify and/or dispute any potential ineligible costs billed to the grant. On the other hand, when grantees required such documentation, ineligible costs were identified and disputed, and subcontractors were deterred from claiming ineligible costs.

Recommendation: Include clarifying language in the grant agreements on the level and types of documentation required from subcontractors. Grantees should obtain and review this documentation as part of the claims approval process.

Board's Response: The Board concurs with this observation and will address needed modification of its grant agreements regarding the level and types of documentation required from subcontractors.

Fee Payers

The scope of the fee payer audits was to determine whether the fee payers accurately reported oil sales and fees, assess whether the fee payers' internal control systems allow for the accurate accounting of oil sales subject to the California Oil Recycling Enhancement Act (Act),

and verify compliance with laws and regulations contained in the Act. During our audits of two fee payers, we identified the following observations:

Observation 3—Monitoring of Exempted Oil Transactions Could be Enhanced

We identified two areas where the monitoring of exempted oil transactions could be enhanced as follows:

- The Board’s regulations do not require oil manufacturers to obtain updated exemption certificates from purchasers on a periodic basis, e.g. annually, to ensure that the purchases of oil continue to meet the exemption. During one fee payer audit, the fee payer was exempting oil sales made during fiscal year 2007-2008 from the oil recycling fee based on exemption certificates dating back to 1999 and 2001. The lack of up-to-date exemption certificates decreases the fee payer’s ability to monitor exemptions and increases the risk of misuse of exemptions to evade the tax.
- The Board’s regulations do not provide audit authority for the non-oil manufacturers (e.g. wholesalers, distributors, etc.) which take possession of lubricating oil in California, but exempt their purchases as sales for export. For one fee payer reviewed, 11 non-oil manufacturers exempted their transactions under the “oil to be exported or sold for export from the state” category, but took possession of the oil in California. Without the audit authority to validate that the exempted oil purchased by non-oil manufacturers was shipped out of state, the Board may not be collecting fees that should be paid to the Used Oil Recycling Fund.

Recommendation: Revise the regulations to require regular updates of exemption certificates, and incorporate authority for the Board to audit non-oil manufacturers taking possession of lubricating oil in California and using the export exemption.

Board’s Response: The Board concurs with this observation and will pursue incorporation of appropriate language in regulations.

Observation 4—Regulations Do Not Address Consequences of Fee Payer Non-Compliance with Recordkeeping Requirements.

The California Code of Regulations, Title 14, Section 18613, requires fee payers to maintain adequate records. However, the regulations do not address the consequences of non-compliance with this requirement such as deficiency determinations, fines, penalties, administrative actions, and/or other civil actions. Therefore, fee payers are not deterred from willful disregard for the recordkeeping requirement and the Board may be prevented from enforcing compliance. While Section 48680 of the Public Resources Code provides fines for violations of the California Oil Recycling Enhancement Act Chapter, this section is not always incorporated or referred to in the Title 14 regulations.

Recommendation: Revise regulations to address the consequences of fee payer non-compliance with recordkeeping requirements including, but not limited to, deficiency determinations, fines, penalties, and/or civil actions.

Board's Response: The Board concurs with this observation and will pursue incorporation of appropriate language in regulations.

Observation 5—Cash Flow Could Be Enhanced by Changing the Fee Return Filing Period

The Board requires filing of returns on a quarterly basis regardless of the fee payer's lubricating oil sales volume. Some of the larger fee payers report oil recycling fees in the million dollar range. The Board's cash flow operations could benefit from more frequent cash receipts and potential interest earnings from a monthly filing requirement for the larger fee payers. This practice is followed by other state and federal taxing authorities.

Recommendation: Consider imposing a monthly filing requirement for fee payers with significant lubricating oil sales volume.

Board's Response: The Board concurs with this observation and will pursue incorporation of appropriate language in regulations.

This letter is intended as an internal management tool to assist CalRecycle in improving control and accountability of grantees and fee payers.

In accordance with Finance's policy of increased transparency, this management letter will be placed on our website. Additionally, pursuant to Executive Order S-20-09, CalRecycle is required to post this management letter in its entirety to the Reporting Government Transparency website at <http://www.reportingtransparency.ca.gov/> within five working days of this transmittal.

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

Sincerely,

Original signed by:

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

Enclosure

cc: Ms. Susan Villa, Branch Manager, Administration and Finance Division, Department of Resources Recycling and Recovery
Ms. Shirley Willd-Wagner, Manager, Financial Assistance Division, Department of Resources Recycling and Recovery
Mr. Brian Kono, Audit Manager, Audit and Evaluation Unit, Department of Resources Recycling and Recovery