



Transmitted via e-mail

March 27, 2013

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

Dear Ms. Mortensen:

Final Report—ConocoPhillips Company, California Used Oil Recycling Fees Audit

The Department of Finance, Office of State Audits and Evaluations (Finance), has completed its audit of ConocoPhillips Company's (ConocoPhillips) Used Oil Recycling Fee Returns for the period October 1, 2009 through March 31, 2012.

The enclosed report is for your information and use. After review of the draft report, ConocoPhillips chose not to provide a written response. This report will be placed on our website.

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

Sincerely,

Original signed by:

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

Enclosure

cc: Mr. Ken DaRosa, 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, Chief, Financial Resources Management Branch, Department of Resources Recycling and Recovery
Ms. Audrey Traina, Chief, Audits Office, Department of Resources Recycling and Recovery
Ms. Sarah Keck, Manager, Fiscal Services Branch, Department of Resources Recycling and Recovery
Mr. Kevin Campbell, Senior Management Auditor, Audits Office, Department of Resources Recycling and Recovery
Mr. Barry Walling, Indirect Tax Director, ConocoPhillips Company
Mr. Bob Johnson, Excise Tax Advisor, ConocoPhillips Company
Ms. Melissa Winkler, Motor Fuel Audit Coordinator, ConocoPhillips Company
Ms. Janie Laughlin, Tax Analyst, ConocoPhillips Company

ConocoPhillips Company
Used Oil Recycling Fee Returns

For the Period October 1, 2009
through March 31, 2012

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

MEMBERS OF THE TEAM

Kimberly Tarvin, CPA
Manager

Rick Cervantes, CPA
Supervisor

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

You can contact our office at:

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BACKGROUND, SCOPE AND METHODOLOGY

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 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.

ConocoPhillips Company (ConocoPhillips) has operations in almost 30 countries. ConocoPhillips explores for, produces, transports, and markets crude oil, natural gas, natural gas liquids, liquefied natural gas, and bitumen on a worldwide basis. The portfolio includes legacy assets in North America, Europe, Asia and Australia; growing North American shale and oil sands businesses; a number of major international development projects; and a global exploration program.¹

SCOPE

The Department of Finance, Office of State Audits and Evaluations, conducted an audit of ConocoPhillips' Used Oil Recycling Fee Returns (Returns) submitted to CalRecycle. The audit objective was to determine whether ConocoPhillips accurately reported the industrial, rerefined, 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 October 1, 2009 through March 31, 2012. 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.

ConocoPhillips 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.

¹ Excerpts from http://www.conocophillips.com/EN/about/who_we_are/Corporate_Overview/Pages/index.aspx

METHODOLOGY

To determine whether ConocoPhillips 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 ConocoPhillips' 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, rerefined, and industrial oil to determine whether all products were correctly classified and reported.
- Determined whether the quantities on reports for industrial, rerefined, 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.

ConocoPhillips Company (ConocoPhillips) did not accurately report the industrial, lubricating, and rerefined oil sales and exports in compliance with applicable laws and regulations for the period October 1, 2009 through March 31, 2012, as presented in Tables 1 through 3 and Finding 1.

Table 1: Schedule of Industrial Oil Sales

Categories	A Reported Sales (Gallons)	B Sales (Gallons)	C=A-B Audit Adjustment	D Unaudited Adjustments Provided by ConocoPhillips (Gallons)	E=C+D Total Adjustment (Gallons)
Industrial Oil Sold	4,291,004	5,623,277	1,332,273	14,611,574	15,943,847
Industrial Oil Exported or Sold for Export	2,398,998	2,398,963	35	7,287,859	7,287,894

Table 2: Schedule of Lubricating Oil Sales

Categories	A Reported Sales (Gallons)	B Sales (Gallons)	C=A-B Audit Adjustment	D Unaudited Adjustments Provided by ConocoPhillips (Gallons)	E=C+D Total Adjustment (Gallons)
Total Lubricating Oil Sold	33,691,736	33,691,736	0	10,464,559	10,464,559
Exemptions	5,654,338	5,654,338	0	10,464,559	10,464,559
Fee Accessible Gallons	28,037,398	28,037,398	0	0	0
Total Fees Due (26 cents per gallon)					\$0

Table 3: Schedule of Rerefined Oil Sales

Categories	A Reported Sales (Gallons)	B Sales (Gallons)	C=A-B Audit Adjustment	D Unaudited Adjustments Provided by ConocoPhillips (Gallons)	E=C+D Total Adjustment (Gallons)
Total Rerefined Oil Sold	15,768	15,768	0	165	165
Exemptions	220	220	0	165	165
Fee Accessible Gallons	15,548	15,548	0	0	0
Total Fees Due (12 cents per gallon)					\$0

Finding 1: Inaccurate Reporting of Industrial, Lubricating, and Rerefined Oil Sales

In January 2011, ConocoPhillips stopped reporting non-fee accessible (industrial, exempt lubricating, and exempt rerefined) oil sales on the California Oil Recycling Fee Returns (Return). This occurred because its new information technology system is not programmed to convert non-fee accessible sales into gallons. Further, the industrial oil sales were underreported by 1,332,273 gallons for the period July 1, 2010 through December 31, 2010.

ConocoPhillips provided the estimated amounts listed in the “Unaudited Adjustments Provided by ConocoPhillips” column included in Tables 1 through 3. ConocoPhillips did not provide detailed supporting documentation listing the transactions in gallons because manually converting this information would have required significant staff resources. Therefore, the accuracy of this information could not be verified.

California Public Resources Code, section 48671, 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. The Return instructions require the reporting of industrial oil, lubricating oil, and rerefined oil sold or transferred in California and exported or sold for export from California.

Recommendation:

Ensure that all industrial oil and exempt lubricating and rerefined oil sales are adequately captured in supporting detail reports and accurately reflected in future Returns.