



Transmitted via e-mail

August 14, 2014

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

Dear Ms. Mortensen:

Final Report—Department of Resources Recycling and Recovery, 2013 Financial Statement Audit of the Used Oil Recycling Fund

The Department of Finance, Office of State Audits and Evaluations, has completed its audit of the Used Oil Recycling Fund for the fiscal year ended June 30, 2013.

The enclosed report is for your information and use. The financial statements were fairly presented in accordance with a comprehensive basis of accounting other than generally accepted accounting principles. Because there were no audit findings requiring a response, we are issuing the report as final. This report will be placed on our website.

We appreciate the assistance and cooperation of the Department of Resources Recycling and Recovery. If you have any questions regarding this report, please contact Kimberly Tarvin, Manager, or Jennifer Arbis, Supervisor, at (916) 322-2985.

Sincerely,

Original signed by:

Richard R. Sierra, 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
Mr. Howard Levenson, Deputy Director, Materials Management and Local Assistance Division, Department of Resources Recycling and Recovery
Ms. Kellie Schneider, Branch Chief, Administrative Services Branch, Department of Resources Recycling and Recovery
Ms. Sarah Keck, Chief Financial Officer, Fiscal Services Branch, Department of Resources Recycling and Recovery
Mr. Kevin Campbell, Senior Management Auditor, Office of Audits, Department of Resources Recycling and Recovery

A FINANCIAL STATEMENT AUDIT

Department of Resources Recycling and Recovery
California Used Oil Recycling Fund
For the Fiscal Year Ended
June 30, 2013

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

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This report is also available on our website at <http://www.dof.ca.gov>

You can contact our office at:

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EXECUTIVE SUMMARY

The Department of Finance, Office of State Audits and Evaluations, performed this audit in accordance with an interagency agreement with the Department of Resources Recycling and Recovery (CalRecycle). The objectives of our audit were to:

- Express an opinion on the *Balance Sheet and Statement of Revenue, Expenditures, and Changes in Fund Balance* of the California Used Oil Recycling Fund (Fund) for the fiscal year ended June 30, 2013.
- Verify that the financial statements were prepared in conformity with a statutory basis of accounting, which comprise a comprehensive basis of accounting other than generally accepted accounting principles.
- Report on internal control and compliance weaknesses, and provide recommendations for improving controls over operations of the Fund.

Audit Results

- The aforementioned financial statements are fairly presented for the fiscal year ended June 30, 2013 in accordance with a statutory basis of accounting.
- We noted matters involving internal control over financial reporting and its operation that we reported to CalRecycle. See the CalRecycle Internal Control Over Fiscal Processes and Procedures report issued December 12, 2013 for further details.

This report is intended solely for the information and use of the Fund's management, those charged with governance, and the Legislature, and is not intended to be used by anyone other than these specified parties. However, this report is a matter of public record and its distribution is not limited.

INDEPENDENT AUDITOR'S REPORT

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

We have audited the accompanying financial statements (statutory basis) of the governmental activities of the California Used Oil Recycling Fund (Fund) as of and for the year ended June 30, 2013, and the related notes to the financial statements, which collectively comprise the Fund's basic financial statements as listed in the table of contents.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements in accordance with a statutory basis of accounting described in Note 1C. This includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.

Auditor's Responsibility

Our responsibility is to express an opinion on these financial statements based on our audit. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we obtained is sufficient and appropriate to provide a basis for our audit opinion.

The Department of Finance (Finance) and the Department of Resources Recycling and Recovery (CalRecycle) are both part of the State of California's Executive Branch. As required by various statutes within the California Government Code, Finance performs certain

management and accounting functions. Under *Government Auditing Standards*, performance of these activities creates an organizational impairment with respect to independence. However, Finance has developed and implemented safeguards to mitigate the organizational impairment so reliance can be placed on the work performed.

Opinion

In our opinion, the financial statements referred to above present fairly, in all material respects, the respective financial position and operations of the governmental activities of the Fund as of June 30, 2013, and the respective changes in financial position for the year then ended, in accordance with a statutory basis of accounting described in Note 1C.

Emphasis of Matter

As discussed in Note 1B, the financial statements of the Fund are intended to present the financial position and the changes in financial position of only that portion of the governmental activities of the State of California that is attributable to the transactions of the Fund. They do not purport to, and do not, present fairly the financial position of CalRecycle or the State of California as of June 30, 2013, or the respective changes in its financial position for the year then ended in conformity with a statutory basis of accounting.

As described in Note 1C, the financial statements are prepared in accordance with a statutory basis of accounting, which is a basis of accounting other than generally accepted accounting principles in the United States of America.

Our opinion is not modified with respect to these matters.

Other Reporting Required by *Government Auditing Standards*

In accordance with *Government Auditing Standards*, we have also issued our report dated June 30, 2014 on our consideration of CalRecycle's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, grant agreements, and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering CalRecycle's internal control over financial reporting and compliance.

Restriction on Use

Our report is intended solely for the information and use of Fund management, those charged with governance, and the Legislature, and is not intended to be used by anyone other than these specified parties. However, this report is a matter of public record and its distribution is not limited.

Original signed by:

Richard R. Sierra, CPA
Chief, Office of State Audits and Evaluations

June 30, 2014

BALANCE SHEET
STATUTORY BASIS

Department of Resources Recycling and Recovery
California Used Oil Recycling Fund
Balance Sheet—Statutory Basis
As of June 30, 2013

Assets

Cash and Pooled Investments	\$ 16,618,435
Receivables	7,583,010
Due From Other Funds or Appropriations (Note 3)	3,244,710
Due From Other Governments	128,929
Total Assets	<u>27,575,084</u>

Liabilities

Accounts Payable	2,315,546
Due To Other Funds or Appropriations (Note 3)	2,444,176
Total Liabilities	<u>4,759,722</u>

Fund Balance (Note 1.I)

Deferred Payroll	226,852
Reserved for Encumbrances	2,157,741
Contingency Reserve for Economic Uncertainties	20,430,769
Total Fund Balance	<u>22,815,362</u>

Total Liabilities and Fund Balance	<u>\$ 27,575,084</u>
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The notes to the financial statements are an integral part of this statement.

STATEMENT OF REVENUE, EXPENDITURES, AND
CHANGES IN FUND BALANCE—STATUTORY BASIS

**Department of Resources Recycling and Recovery
California Used Oil Recycling Fund
Statement of Revenue, Expenditures, and Changes in Fund Balance
Statutory Basis
For the Fiscal Year Ended June 30, 2013**

Revenue	
Fees	\$ 29,302,489
Interest	52,860
Escheatment	19,551
Total Revenue	<u>29,374,900</u>
Expenditures	
Consultant and Professional Services	3,282,240
Incentive Payments	4,862,489
Local Government Grants	12,763,135
Administrative Support	3,990,392
Total Expenditures	<u>24,898,256</u>
Excess of Revenue Over Expenditures	4,476,644
Other Financing Uses	
Operating Transfers Out (Note 4)	<u>(226,000)</u>
Net Change in Fund Balance	4,250,644
Fund Balance, July 1, 2012	<u>18,564,718</u>
Fund Balance, June 30, 2013	<u>\$ 22,815,362</u>

The notes to the financial statements are an integral part of this statement.

NOTES TO FINANCIAL STATEMENTS

**Department of Resources Recycling and Recovery
California Used Oil Recycling Fund
Notes to the Financial Statements—Statutory Basis
For the Fiscal Year Ended June 30, 2013**

NOTE 1 Definition of Reporting Entity and Summary of Significant Accounting Policies

A. Definition of Reporting Entity

The California Used Oil Recycling Fund (Fund) was created with passage of the California Used Oil Recycling Enhancement Act of 1991 (Act). State law places administration of the Act with the Department of Resources Recycling and Recovery (CalRecycle).

Pursuant to the Act, every oil manufacturer shall pay a fee for any lubricating oil sold or transferred into the state, or imported into the state for use in the state. Fees received by CalRecycle from oil manufacturers are deposited into the Fund.

The Act authorizes CalRecycle to pay a recycling incentive to certified used oil collection centers and registered curbside collection programs for used lubricating oil collected from the public, or for used lubricating oil generated by certified used oil collection centers or registered industrial generators, and transported to qualifying used oil recycling facilities. In addition, all registered participants are required to report to CalRecycle the amount of used oil transported, the location to which it is transported, and the source of the used oil. Further, each used oil recycling facility located in California is required to report to CalRecycle the amount of used oil received and the amount of recycled oil produced.

The Act stipulates that all monies deposited in the Fund shall be used to pay recycling incentives, pay the necessary costs to administer the program, provide a reserve for contingencies, and make available block grants for the implementation of local used oil collection programs.

Pursuant to the Act, the balance of monies deposited in the Fund remaining after the payment of all expenditures, except as noted above, shall be available to CalRecycle for specified uses. The Act limits the use of the remaining balance to expenditures for the development and implementation of an information and education program for the promotion of alternatives to the illegal disposal of used oil, for certain types of grants and contracts, and to fund the disposal of used oil that is contaminated by excessive hazardous materials and collected by a certified used oil collection center.

Chapter 353, Statutes of 2009 (Senate Bill 546), established a dual fee structure and dual incentive rates effective January 1, 2010, and replaced the reimbursable grant program (formerly known as the Used Oil Block Grant Program [UBG]) to a payment program (referred to as the Oil Payment Program [OPP]) effective July 1, 2010.

B. Basis of Presentation—Fund Accounting

The financial statements are presented in accordance with State of California laws and accounting procedures. The Fund is classified as an Other Governmental Cost Fund, which is used to account for revenues restricted by law for specified purposes.

CalRecycle administers the Fund, which is shared between CalRecycle, Office of Environmental Health Hazard Assessment (OEHHA), Department of Toxic Substances Control (DTSC), and California Environmental Protection Agency (Cal/EPA). The Legislature makes appropriations to OEHHA, DTSC, and Cal/EPA from the Fund for used-oil-recycling activities administered by those agencies. The financial statements present information of the financial activities of the Fund only, and do not represent all of the financial activities of CalRecycle, OEHHA, DTSC, Cal/EPA, or the State of California as of June 30, 2013.

C. Measurement Focus and Basis of Accounting

The accompanying financial statements have been prepared using a current financial resources measurement focus. This measurement focus concentrates on transactions that increase or decrease resources available for spending in the near future. Accordingly, non-current or long-term assets and liabilities are not presented in the accompanying financial statements; instead, these items are presented in the notes.

The Fund follows a statutory basis of accounting prescribed by the California Government Code and California State Administrative Manual (SAM), which comprise a comprehensive basis of accounting other than generally accepted accounting principles. Revenues are recorded when they become measurable and available to finance expenditures of the current period. Expenditures are recorded when the related liability is incurred. Encumbrances of \$2.1 million at year-end are excluded from liabilities and expenditures, and are established as reserve for encumbrances against the fund balance. The OPP prepayments of \$11.2 million to other governments are accounted for as expenditures in the period paid. Furthermore, as described in Note I, the June 2013 payroll expenditures are deferred to July 2013.

D. Budget and Budgetary Control

The accounting policies of CalRecycle conform to SAM and are based on the state's budgetary provisions. Program funds are continuously appropriated without regard to fiscal year. Management is responsible for exercising budgetary control to ensure available amounts are not overspent. In addition, the State Controller's Office (SCO) is responsible for statewide appropriation control and does not allow expenditures in excess of authorized appropriations.

E. Investment Basis and Allocation of Investment Income

Investments consist of cash in excess of current needs on deposit in the Surplus Money Investment Fund (SMIF). The Fund participates in the State of California's Pooled Money Investment Program, whereby cash balances in excess of \$1,000 with the State Treasury are transferred to SMIF for investment purposes. All earnings from investments are apportioned to the contributing fund as provided in Government Code. The participant's shares are valued on an amortized cost basis, which approximates fair value. Because the difference between the amortized cost and fair value are not material, no adjustment has been made in the financial statements.

As a shared fund, deposits in SMIF are not recorded in any one department's accounting records. Rather, they are recorded in the Fund's accounting records as overseen by the State Controller's Office (SCO). Therefore, the Cash and Pooled Investments line item includes an adjustment of \$16.6 million to present the Fund's balance in SMIF as listed in the SCO Fund Reconciliation Report at June 30, 2013.

F. Revenue

Revenue consists of oil recycling fees imposed on the sale or transfer of lubricating oil and re-refined oil in the state or imported into the state, interest income earned on funds deposited in SMIF, and unclaimed checks escheated to the issuing fund. Revenues are accrued if the underlying transaction has occurred as of the last day of the fiscal year, and the due date for the revenue is within 12 months of the end of the fiscal year.

G. Accounts Receivable

Receivable balances for the Fund primarily consist of oil fee returns. Other receivable amounts include, but are not limited to, abatements and deferred receivables.

H. Accounts Payable

Payable balances include, but are not limited to, used oil incentive payments and local collection programs, oil fee refunds, re-refining incentive payments, and administrative costs.

I. Fund Balance

Fund balance is the excess of a fund's assets over its liabilities. Fund balance is increased during a fiscal period when receipts exceed disbursements. Conversely, fund balance is decreased during a fiscal period when disbursements exceed receipts. Part or all of the total fund balance may be reserved as a result of law or statutory basis of accounting. Reserves represent those portions of the fund balance that are legally segregated for specific uses. The fund balance as of June 30, 2013 has been categorized as follows:

- *Deferred Payroll:* Represents the amount of June 2013 payroll expenditures deferred to July 2013 per Control section 12.45 of the Budget Act of 2010. June 2013 Payroll expenditures will be realized in July 2013.

- *Reserved for Encumbrances*: Represents a portion of fund balance segregated for expected expenditures.
- *Contingency Reserve for Economic Uncertainties*: Represents the unappropriated balance as of June 30 that is available for appropriation during the following year.

NOTE 2 Investments

For disclosures related to investment policy and related investment risk categories, see the State of California Comprehensive Annual Financial Report.

NOTE 3 Due To/Due From Other Funds or Appropriations

The Due To Other Funds account balance represents the amounts due from the Fund to other state funds. The Due From Other Funds account balance represents the amounts due from other state funds to the Fund.

As with deposits in SMIF (Note 1E), SCO oversees the Fund’s short-term loan activity; therefore, the Due From Other Funds account includes the amount owed to the Fund from the General Fund at June 30, 2013 in the amount of \$2,700,000. Repayment of this loan is anticipated to be within the ensuing fiscal year.

The ending balances of Due To Other Funds and Due From Other Funds accounts include the following:

Table 1: Due To Other Funds	
CA Beverage Container Recycling Fund	\$ 1,773,270
Integrated Waste Management Account	533,506
Various Other Funds	137,400
Total Due To Other Funds	\$ 2,444,176

Table 2: Due From Other Funds	
General Fund	\$ 2,700,000
Deferred Payroll	226,852
Tire Recycling Management Fund	157,437
E-Waste Recovery and Recycling Account	132,065
Various Other Funds	28,356
Total Due From Other Funds	\$ 3,244,710

NOTE 4 Interfund Balances and Transfers

As of June 30, 2013, the Interfund Loan Receivable balance was \$5 million. A schedule of long-term Interfund Loan balances is shown in the following table:

Table 3: Interfund Loans Receivable			
Description (Fund/Loan Number)	Beginning Balance 7/1/2012	Ending Balance 6/30/2013	Due in Full
Loan to General Fund – 0001/1341	\$2,500,000	\$2,500,000	6/30/2017
Loan to General Fund – 0001/1348	\$2,500,000	\$2,500,000	6/30/2017
Total Interfund Loans Receivable	\$5,000,000	\$5,000,000	

Legally authorized transfers between state funds during the current period are reported as Operating Transfers and are accounted for as reductions or increases in residual equity. Operating Transfers Out balance represents a transfer of \$226,000 from the Fund to the Farm and Ranch Solid Waste Cleanup and Abatement Account, pursuant to Public Resources Code section 48100 and as authorized by the Budget Act of 2012.

NOTE 5 Subsequent Event

During March 2014, CalRecycle was notified that one fee payer may submit a refund request for approximately \$6.2 million for overpaid lubricating oil fees impacting fiscal years 2011-12 through 2013-14. No refund claims have been filed with CalRecycle as of the date of this report. Therefore, no provision for the potential liability has been made in the financial statements as of June 30, 2013.

INDEPENDENT AUDITOR'S REPORT

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

We have audited, in accordance with the auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States, the governmental activities of the California Used Oil Recycling Fund (Fund) as of and for the year ended June 30, 2013, and the related notes to the financial statements, which collectively comprise the Fund's financial statements and have issued our report thereon dated June 30, 2014.

Internal Control over Financial Reporting

In planning and performing our audit of the financial statements, we considered the Department of Resources Recycling and Recovery's (CalRecycle) internal control over financial reporting (internal control) to determine the audit procedures that are appropriate in the circumstances for the purpose of expressing our opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of CalRecycle's internal control. Accordingly, we do not express an opinion on the effectiveness of the internal control.

A deficiency in internal control exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct misstatements on a timely basis. A material weakness is a deficiency, or combination of deficiencies, in internal control, such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented, or detected and corrected on a timely basis. A significant deficiency is a deficiency, or a combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance.

Our consideration of internal control was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control that might be material weaknesses or significant deficiencies and therefore, material weaknesses or significant deficiencies may exist that were not identified. Given these limitations, during our audit we did not identify deficiencies in internal control that we consider to be material weaknesses. However, material weaknesses may exist that have not been identified. We did identify certain deficiencies in internal control, described in a separate report on CalRecycle's Internal Control Over Fiscal Processes and Procedures, communicated to CalRecycle on December 12, 2013, that we consider to be significant deficiencies. These findings remained uncorrected during fiscal year 2012-13.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether CalRecycle's financial statements are free of material misstatement, we performed tests of compliance with certain provisions of laws, regulations, contracts, and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*.

Purpose of this Report

The purpose of this report is solely to describe the scope of our testing of internal control and compliance and the result of that testing, and not to provide an opinion on the effectiveness of the entity's internal control or on compliance. This report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the entity's internal control and compliance. Accordingly, this communication is not suitable for any other purpose.

Original signed by:

Richard R. Sierra, CPA
Chief, Office of State Audits and Evaluations

June 30, 2014