



Transmitted via e-mail

May 17, 2011

Mr. Mark E. Leary, Acting Director
Department of Resources Recycling and Recovery
801 K Street, MS 25A
Sacramento, CA 95814

Dear Mr. Leary:

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

The Department of Finance, Office of State Audits and Evaluations (Finance), has completed its audit of Pennzoil Quaker State Company's (Pennzoil) Used Oil Recycling Fee Returns for the period July 1, 2008 through June 30, 2009.

The enclosed report is for your information and use. Pennzoil's response to the report finding and our evaluation of the response is incorporated into this final report.

This report will be placed on our website. Additionally, pursuant to Executive Order S-20-09, please post this report 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 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:

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

Enclosure

cc: On following page

cc: Mr. Tom Estes, Deputy Director, Administration, Finance and Information Technology
Division, Department of Resources Recycling and Recovery
Ms. Susan Villa, Chief, Fiscal Services Branch, Department of Resources Recycling
and Recovery
Ms. Shirley Willd-Wagner, Chief, Financial Resources Management Branch,
Department of Resources Recycling and Recovery
Ms. Audrey Traina, Acting Audits Branch Manager, Audits Branch, Department of Resources
Recycling and Recovery
Mr. Brian Kono, Audit Manager, Statewide Disbursements Section, Audits Branch,
Department of Resources Recycling and Recovery
Ms. Sarah Keck, Accounting Administrator, Fiscal Services Branch, 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
Ms. Rosey Hodge, Senior Tax Accountant, Shell U.S. Tax Organization

AN OIL RECYCLING FEE AUDIT

Pennzoil Quaker State Company Used Oil Recycling Fee Returns

For the Period July 1, 2008
through June 30, 2009

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

MEMBERS OF THE TEAM

Kimberly Tarvin, CPA
Manager

Alma Ramirez, CPA
Supervisor

Alice Yip
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
300 Capitol Mall, Suite 801
Sacramento, CA 95814
(916) 322-2985

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AN OIL RECYCLING FEE AUDIT

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 California Integrated Waste Management Board (Board) the authority to adopt and implement a used oil recycling program, and to collect fees from oil manufacturers at a rate of 16 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. On January 1, 2010, the Board was abolished and its duties were transferred to the new Department of Resources Recycling and Recovery (CalRecycle).

Pennzoil Quaker State Company (Pennzoil), DBA Shell Oil Products United States (SOPUS Products), is a wholly owned subsidiary of Royal Dutch Shell. Pennzoil is a worldwide automotive consumer products company formed in 1998. It conducts business in the United States and 90 other countries through its five segments: lubricants, consumer products, international, Jiffy Lube, and supply chain investments.

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, 2008 through June 30, 2009. 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.

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 export sales delivery address was to a location outside California.

The results of the audit are based on our review of documentation, other information made available to us, and interviews with Pennzoil's staff. The audit was conducted from January 2010 through January 2011.

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. See Finding 1 below. The reported sales and fees are presented in Table 1.

Table 1: Schedule of Reported Sales and Fees

Pennzoil Quaker State Company Used Oil Recycling Fee Returns For the Period July 1, 2008 through June 30, 2009	
Categories	Reported Sales and Fees
Industrial Oil Sold (Gallons)	1,048,330
Industrial Oil Exported or Sold for Export (Gallons)	401,226
Gross Lubrication Oil Sold (Gallons)	19,672,435
Lubrication Oil Fees (\$0.16 per gallon)	\$3,147,590

Finding 1: Incomplete Reporting of Industrial and Lubricating Oil Sales

Pennzoil did not report all of its industrial oil and lubricating oil sales to California on its fee returns for fiscal year 2008-09. Specifically,

- Industrial oil sales were not reported for the period July 2008 through December 2008. During the audit Pennzoil provided reports for this period totaling 1,151,928 in industrial oil gallons sales to California. However, the reports did not provide evidence on whether exempt sales (e.g. exports) are included in this number.
- All lubricating oil sold, transferred or used in California was not reported. Pennzoil asserts that the Gross Lubrication Oil Sold gallons quantity of 19,672,435 presented above is net of exemptions. However, only partial data for the fiscal year on lubricating oil exempt sales was provided for our review; this included 6,261,600 gallons of lubricating oil exports for the period January 2009 through June 2009. No data on exempt sales was provided for the period July 2008 through December 2008.

Because of the significant omission of data, Pennzoil has not demonstrated that it has accurately and completely reported all of its California industrial oil and lubricating oil sales, and paid all the relevant lubricating oil fees to CalRecycle. The California Code of Regulations Title 14, Division 7, Chapter 8, Article 2, section 18613 requires oil manufacturers to maintain adequate records including books of account that are ordinarily maintained by the average prudent business person engaged in the same activity. Further, it requires that automatic data processing systems have built into its program a method of producing visible and legible records

which will provide the necessary information to determine compliance with the California Oil Recycling Enhancement Act. Lastly, section 18614 (b) states reports, notices, and applicable supporting data must be accurate and complete.

Recommendations:

- A. Amend and submit to CalRecycle the fee returns, including all California industrial oil and lubricating oil sales and exemptions.
- B. Remit the appropriate fees to CalRecycle based on the amended returns.
- C. Develop policies and procedures to ensure lubricating and industrial oil sold or transferred to California and all related exemptions are adequately captured in reports and accurately included in the Returns.



**Shell Oil Company
Shell U S Tax Organization
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April 19, 2011

Department of Finance
Office of State Audits and Evaluations
300 Capitol Mall, Suite 801
Sacramento, CA 95814

**RE: Draft Report – Pennzoil Quaker State Company, California Used Oil Recycling Fees
Audit - Period July 1, 2008 through June 30, 2009**

Department of Finance
Office of State Audits and Evaluations
300 Capitol Mall, Suite 801
Sacramento, CA 95814

Dear Sir/Madam:

This letter is to acknowledge the receipt of the draft report for the above referenced audit as prepared by your office.

We concur that details to support 2008 3rd Quarter report were not available. This and previous reports were generated from data stored in a system previously used by the Company. This system has since been decommissioned.

The implementation of a global SAP system to store the Company's lubricants data has resulted in improvements in the quality of reports being filed beginning with 2008 4th Quarter Recycling Fee Return. As evident with that and subsequent returns, the Company continue to make significant strides to ensure that our reporting is in compliance with your agency's requirements and that adequate records are maintained to support those reports.

To that end, Pennzoil Quaker State, dba Shell Oil Products US maintains that proper fees were collected and remitted to your agency in accordance with regulations.

Should you have any questions, feel free to contact me.

Regards,

Original signed by:

Donald Fancher,
Tax Officer
Shell Oil Products United States
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EVALUATION OF RESPONSE

We have reviewed Pennzoil's response to the draft report. Our evaluation of the response follows:

Finding 1: Incomplete Reporting of Industrial and Lubricating Oil Sales

Pennzoil concurs that detailed data for the 3rd quarter (July through September 2008) fee return was not available. However, Pennzoil states that beginning with the 4th quarter (October through December 2008) there was improvement in the quality of reports. While Pennzoil did provide more detailed reports for the months of November and December 2008, these reports were not in a format that allowed quantification of oil transactions reported under the various fee return line items. Therefore, the finding remains as originally stated in the report.