



November 10, 2009

Mr. Mark Leary, Executive Director
California Integrated Waste Management Board
1001 I Street, MS-25A
P.O. Box 4025
Sacramento, CA 95812-4025

Dear Mr. Leary:

Final Report—Lubricating Specialties Company, California Used Oil Recycling Fees Audit

The Department of Finance, Office of State Audits and Evaluations (Finance), has completed its audit of Lubricating Specialties Company's (LSC) Used Oil Recycling Fee Returns for the period July 1, 2007 through June 30, 2008.

The enclosed report is for your information and use. After review of the draft report, LSC chose not to provide a written response.

In accordance with Finance's policy of increased transparency, 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 LSC. 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. Sydney Thwaites, Chief Financial Officer, Lubricating Specialties Company
Mr. Joseph Yu, Controller, Lubricating Specialties Company
Ms. Shirley Willd-Wagner, Manager, Financial Assistance Division, California Integrated
Waste Management Board
Ms. Susan Villa, Branch Manager, Administration and Finance Division, California Integrated
Waste Management Board
Ms. Sarah Keck, Accounting Administrator, Administration and Finance Division, California
Integrated Waste Management Board
Mr. Brian Kono, Audit Manager, California Integrated Waste Management Board

AN OIL RECYCLING FEE AUDIT

Lubricating Specialties Company Used Oil Recycling Fee Returns

For the Period July 1, 2007
through June 30, 2008

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

MEMBERS OF THE TEAM

Kimberly Tarvin, CPA
Manager

Alma Ramirez, CPA
Supervisor

Staff
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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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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, and to recycle and reclaim used oil in order to recover valuable natural resources, and to 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.

Lubricating Specialties Company (LSC), headquartered in Pico Rivera, California, manufactures, packages, and distributes lubricant oils and grease products for sale to commercial enterprises both domestically and internationally.

SCOPE

The Department of Finance, Office of State Audits and Evaluations, conducted an audit of LSC's Used Oil Recycling Fee Returns (Returns) submitted to the Board. The audit objective was to determine whether LSC 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, 2007 through June 30, 2008. We did not assess the efficiency or effectiveness of program operations.

The LSC is responsible for ensuring accurate reporting of the used oil recycling fees and oil sales and ensuring compliance with applicable laws and regulations. The Board is responsible for evaluating the efficiency and effectiveness of the program operations.

METHODOLOGY

To determine whether LSC 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.
- Obtained an understanding of the internal controls related to the preparation of the Returns.
- Obtained an understanding of the Oracle system used for accounting and sales.

- Reviewed LSC's accounting records and other reports.
- Reviewed the customer master list to determine completeness in reporting California sales.
- Reviewed the product list of lubrication and industrial oil to determine completeness in reporting California sales.
- Traced the reported gallons of industrial and lubrication oil sold in California to purchase orders, bills of lading, invoices, and other relevant documents.
- Determined whether valid exemption certificates were on file for exempt transactions claimed on the Returns.

The results of the audit are based on our review of documentation, other information made available to us, and interviews with LSC's staff. The audit was conducted from February 2009 to September 2009.

We conducted our audit in accordance with *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and recommendations based on our audit objectives. We believe the evidence obtained provides a reasonable basis for our findings and recommendations.

Lubricating Specialties Company (LSC) accurately reported the sales and fees for lubrication oil in compliance with applicable laws and regulations. However, the industrial oil that was exported or sold for export was not accurately reported as discussed in the Finding below. The audited sales and fees are presented in Table 1.

Table 1: Schedule of Reported and Audited, and Questioned Sales and Fees

Lubricating Specialties Company Used Oil Recycling Fee Returns For the Period July 1, 2007 through June 30, 2008			
Categories	Reported Sales and Fees	Audited Sales and Fees	Over/ (Under) Reported
Industrial Oil Sold (Gallons)	4,887,624	4,887,624	0
Industrial Oil Exported or Sold for Export (Gallons) Included in Industrial Oil sold in the line above.	2,650,231	1,046,203	1,604,028 ¹
Gross Lubrication Oil Sold (Gallons)	19,534,263	19,534,263	0
Less: Exempt Transactions (Gallons)	17,905,840	17,905,840	0
Total Lubrication Oil Sold (Gallons Subject to Fee)	1,628,423	1,628,423	0
Lubrication Oil Fees (\$0.16 per gallon)	\$260,548	\$260,548	\$ 0

FINDING: Overstatement of Industrial Oil Exported

LSC overstated the industrial oil exported or sold for export by 1,604,028 gallons on the Used Oil Recycling Fee Returns (Returns) for the period July 1, 2007 through June 30, 2008, as follows:

- For the first two quarters LSC incorrectly reported 1,881,951 gallons of domestic (in-state) industrial oil sales as exports on line 3 of the Return.

¹ Industrial oil is required to be reported, but no fees are required to be assessed.

- For the last two quarters LSC incorrectly excluded 277,923 gallons of industrial oil sales to out-of-state customers from line 3 on the Return.

These reporting errors occurred because the Return preparer had incorrect interpretations of the information required to be reported on the Industrial Oil Exported or sold for Export line of the Returns. LSC does not have written procedures for Return preparation and the Returns are not reviewed by someone other than the preparer to ensure accuracy. The California Oil Recycling Enhancement Act, Public Resources Code 48671, requires every oil manufacturer who sells or offers to sell industrial oil in California to report to the Board the amount of industrial oil sold for each month. Further, Section 48650 (a) (2) states that no payment is required for oil exported or sold for export from the state.

Recommendation: LSC should develop procedures for Return preparation which include a review of the fee return process by someone other than the preparer to ensure accurate reporting of oil sales to the Board.