

COUNTY OF MONTEREY



AUDITOR - CONTROLLER

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August 30, 2023

Chair Supervisor Luis A. Alejo - District 1
Supervisor Glen Church - District 2
Supervisor Chris Lopez - District 3
Supervisor Wendy Root Askew - District 4
Supervisor Mary L. Adams - District 5
Valerie Ralph, Clerk of the Board

RE: Waste Management Franchise Fees Audit

Dear Board of Supervisors,

Pursuant to Monterey County's 2022-23 Internal Audit Plan, as approved by the Board of Supervisors, the Auditor-Controller's Internal Audit Division issues the attached report of the Waste Management Franchise Fees Audit.

The report includes an Action Plan matrix that summarizes each audit issue, the corresponding recommendations for improvement and the Environmental Health Bureau's plan for implementation and timeframe for each recommendation. The plan also includes the response of the Auditor-Controller's General Accounting Division to recommendations pertaining to its role in the processing of a monthly fee paid by Waste Management, Inc. to the County.

While the audit found that the fees owed to the County were generally accurate and supported by adequate documentation, there were undetected errors in which certain fees and charges were not accurately calculated. These errors resulted in \$133,043 billing overcharges to customers, \$357,599 underpayment of monthly fees to the County, and \$76,041 in late fees owed to the County. Further, during the past 13 years, the County did not opt to have a billing and performance review study to which it was entitled under the agreement. Such a review study could have identified sooner the billing and fees related issues in this audit.

The audit found that key internal controls, including the review study, in the County's oversight of the franchise agreement were lacking to better ensure that rates charged to customers are

reasonable, services provided to customers meet required standards, and fees owed to the County are calculated accurately and paid timely.

We appreciate the Environmental Health Bureau's cooperation during this audit, as well as the department's agreement with the recommendations made in this report.

Sincerely,

Rupa Shah, CPA
Auditor-Controller

James Lam, CIA, CFE, CGAP
Chief Deputy Auditor-Controller, Internal Audit Division

CC: Sonia M. De La Rosa, County Administrative Officer; Nick Chiulos, Chief Assistant County Administrative Officer; Ezequiel Vega, Assistant County Administrative Officer; Elsa Jimenez, Health Department Director; Ric Encarnacion, Environmental Health Bureau Chief; Robin Kimball, Management Analyst III; Karla Tinajero, Finance Manager II.

COUNTY OF MONTEREY

OFFICE OF THE AUDITOR – CONTROLLER

INTERNAL AUDIT DIVISION

WASTE MANAGEMENT FRANCHISE FEES AUDIT



July 2023

RUPA SHAH, CPA

AUDITOR-CONTROLLER

**Health Department, Environmental Health Bureau
WASTE MANAGEMENT FRANCHISE FEES AUDIT**

Management Response & Action Plan

Fnd. No.	Finding	Rec. No.	Recommendation	Department Response	Timeline for Implementation
FRANCHISE FEE					
1.	Excess Late Fees were charged to commercial customers by WM, prompting WM to refund \$133,043 to customers.	1.1	EHB should: Verify that WM issued refunds to active commercial customers and adequately attempted to refund inactive commercial customers who were charged the extra 1% fee in error.	Environmental Health will confirm completion of refund to commercial customers.	8/31/2023
DIVERSION PROGRAMS AND ADMINISTRATION FEE					
2.	An incorrect index was used to adjust the Diversion Fee in six of the thirteen contract years, resulting in a cumulative underpayment to the County of \$357,599.	2.1	EHB should: Recoup the underpayment of the Diversion Fee and ensure that WM applies the CPI rather than RRI to adjust future Diversion Fee payments.	Environmental Health will confer with County Counsel for best approach to recover underpayment.	12/31/2023
		2.2	EHB should: Work with County Counsel to draft an amendment to Section 13.13.2.2 to provide additional clarity of the applicability of the CPI to the annual adjustment of the Diversion Fee.	Environmental Health will confer with County Counsel regarding amendment of Section 13.13.2.2.	9/30/2023

**Health Department, Environmental Health Bureau
WASTE MANAGEMENT FRANCHISE FEES AUDIT**

Management Response & Action Plan

Fnd. No.	Finding	Rec. No.	Recommendation	Department Response	Timeline for Implementation
LATE FEE					
3.	Late Fees were not charged by the County to WM for submitting Franchise and Diversion Fee payments past the due date.	3.1	EHB should: Review the possibility of recovering past Late Fees due to the County.	Environmental Health will confer with County Counsel for best approach to recover late fees.	9/30/2023
		3.2	EHB should: Notify WM that the County will enforce Late Fees moving forward per the franchise agreement.	Environmental Health will notify Waste Management of enforcement of late fees.	9/30/2023
		3.3	EHB should: Ensure that WM includes a Late Fee when it is certain that the monthly payment will not arrive at the County by the due date.	Environmental Health will confirm if late fee is included in payment if received late.	9/30/2023
		3.4	EHB should: Charge Late Fees when payments are not received by the due date and do not already include Late Fees.	Environmental Health will provide notice to Waste Management when payment is received late without late fee included.	9/30/2023

**Health Department, Environmental Health Bureau
WASTE MANAGEMENT FRANCHISE FEES AUDIT**

Management Response & Action Plan

Fnd. No.	Finding	Rec. No.	Recommendation	Department Response	Timeline for Implementation
INTERNAL CONTROLS					
4.	The County lacks adequate internal controls for the oversight of the fees remitted by WM, such as tracking payment receipt and maintaining adequate documentation and records.	4.1	EHB and ACO-GA should: Consistently record the date of receipt of the Franchise Fee and Diversion Fee payments.	Environmental Health will create internal AR spreadsheet to track receipt of payment from Waste Management. ACO-GA has implemented the recommendation and will consistently record the Franchise Fee and Diversion Fee payments receipt date.	July 31, 2023 July 2023
		4.2	ACO-GA should: Notify EHB when Franchise Fee payments are not received on time.	ACO-GA has implemented recommendation and will notify Environmental Health when Franchise Fee payments are not received on time.	June 2023
		4.3	EHB should: Require WM to provide documentation prior to each new year that supports the calculation of the CPI adjustment index and Diversion Fee amount to be remitted to the County.	Environmental Health will request documentation in addition to the documentation already provided if not included.	September 30, 2023
		4.4	EHB should: Maintain minutes and related documents of monthly meetings	Environmental Health has implemented monthly meeting agenda and minutes.	July 31, 2023

**Health Department, Environmental Health Bureau
WASTE MANAGEMENT FRANCHISE FEES AUDIT**

Management Response & Action Plan

Fnd. No.	Finding	Rec. No.	Recommendation	Department Response	Timeline for Implementation
			with WM, and documentation that explains key decisions and understandings between both parties in a central location.		
5.	The County has not opted to have a full Billing and Performance Review performed at WM’s expense.	5.1	EHB should: Coordinate with ACO-IA and schedule to have a Billing and Performance Review performed by an external consulting firm within the current agreement term, which ends on June 30, 2025.	Environmental Health will request from ACO-IA and coordinate a billing and performance review with an external consulting firm.	By the end of FY 2023-24.
		5.2	EHB should: Add a contract provision in future agreements to have Billing and Performance Reviews be performed every three years, and to have the selected refuse collection provider cover the costs of these reviews.	Environmental Health will include in the future Unified Franchise Agreement.	June 30, 2025

Objective

The audit’s objective was to verify that the Franchise Fees, Diversion Programs and Administration Fees, and Late Fees required of Waste Management, Inc. under the waste collection franchise agreement have been accurately calculated and timely paid to the County. The audit was conducted in accordance with Generally Accepted Government Auditing Standards.

Background

On February 2, 2010, after a competitive procurement process, the Monterey County Board of Supervisors awarded the exclusive franchise agreement (UFA Agreement A-11631) to Waste Management, Inc. (“WM”), dba USA Waste of California, Inc., dba Carmel Marina Corporation per Title 10, Chapter 10.41 Solid Waste Collection and Disposal of the Monterey County Code.

The agreement has been amended 14 times for a variety of reasons, such as annual rate adjustments, service modifications, and term extensions, including an amendment that extended the term to June 30, 2025, which would mark the end of the 15-year maximum duration of the agreement allowed by Monterey County Code. The franchise agreement grants WM the exclusive franchise, right, privilege, and duty to collect from customers and transport solid waste, recyclables, e-waste, and other waste materials to the designated facilities.

WM is required to pay to the County the following fees on an ongoing monthly basis: a Franchise Fee, Diversion Programs and Administration Fee, and any Late Fee. The agreement is managed by the Environmental Health Bureau (“EHB”) of the Health Department.

Franchise Fee

The Franchise Fee is 10% of the gross revenue collected from customers each month. Payment of the Franchise Fee is due on the 20th day of the month following the month the Franchise Fees are collected and must be accompanied by an “accounting” or supporting documentation of WM’s gross revenues collected during the preceding month. WM mails the monthly Franchise Fee payment to the Auditor-Controller’s Office, where its General Accounting Division (“ACO-GA”) processes the payments on behalf of the County Administration Office.

Each year, customer service rates are adjusted by the Refuse Rate Index (“RRI”), which is based on various cost indices, such as labor, fuel costs and vehicle replacement. Table 1 below summarizes the annual amounts of Franchise Fees collected during the three calendar years.

Table 1.
Total Franchise Fees

CY 2020	CY 2021	CY 2022	CYTD 2023
\$2,893,945	\$3,390,691	\$3,579,685	\$1,375,345

Diversion Programs and Administration Fee

WM is also required to pay the Diversion Programs and Administration Fee (“Diversion Fee”), which was established at \$520,000 for the first year of the franchise agreement in 2010 and, subsequently, adjusted by the Consumer Price Index (“CPI”) as set forth in Exhibit 2 of the franchise agreement. The Diversion Fee payment is due on the 20th day of each month in 12 equal installments during each agreement year. The Diversion Fee payments are mailed to EHB and are then processed by the department’s finance staff. Table 2 below summarizes the monthly amount and annual total of the Diversion Fee.

Table 2.
Total Diversion Programs and Administration Fees

	CY 2020	CY 2021	CY 2022	CY 2023
Monthly	\$52,736	\$52,736	\$54,555	\$56,683
Total	\$632,830	\$632,830	\$654,663	\$680,190

What We Found

The audit found that the fees owed to the County were generally accurate and supported by adequate documentation. However, there were mistakes in which certain fees were not accurately calculated. The audit also found that simple internal controls have been missing in the County’s oversight of the franchise agreement.

FRANCHISE FEE

Overall, we found that the monthly Franchise Fee payments remitted to the County were correctly computed and were supported by the reported monthly gross revenues. In reviewing WM’s charges to customers from October 2021 to March 2022 to determine whether the charges were consistent with rates approved by the Board, the audit found a few discrepancies pertaining to late fees charged to commercial customers.

According to the franchise agreement, WM can charge a delinquent customer a late fee of \$5.00 or 1.5% per month (not compounded),

Finding #1

Excess Late Fees were charged to commercial customers by WM, prompting WM to refund \$133,043 to customers.

whichever is greater. In a sample of transactions, several commercial customers were found to have been charged a 2.5% rather than 1.5% late fee. After the audit team inquired with WM, the company reviewed all customer accounts and confirmed that an incorrect billing code was in place since the inception of the franchise agreement.

This incorrect billing code resulted in a cumulative overcharge of \$133,043, including 18% interest, to be refunded to commercial customers. WM indicated that it would refund active customers on their October 2022 invoice, while all attempts would be made to provide refunds to customers with canceled or inactive accounts.

Recommendation

EHB should:

- 1.1 *Verify that WM issued refunds to active commercial customers and adequately attempted to refund inactive commercial customers who were charged the extra 1% fee in error.*

DIVERSION PROGRAMS AND ADMINISTRATION FEE

Finding #2

An incorrect index was used to adjust the Diversion Fee in six of the thirteen contract years, resulting in a cumulative underpayment to the County of \$357,599.

According to franchise agreement, the Diversion Fee is to be adjusted annually by the change in the annual average of the CPI (Consumer Price Index). From 2011 to 2015, the CPI adjustment factor was used to adjust the Diversion Fee.

However, from 2016 to 2021, WM applied the RRI (Refuse Rate Index) rather than the CPI, which led to the Diversion Fee not being adjusted in 2016, 2017 and 2021, and being adjusted at a reduced percentage in 2018, 2019 and 2020, resulting in a cumulative underpayment to the County of \$357,599. Both EHB and WM could not provide an explanation for using the RRI to adjust the Diversion Fee, or documentation that attests to a mutual agreement for such a change. None of the 14 amendments included this change.

Table 3 below shows the ACO's re-calculation of the Diversion Fee owed to the County, using the CPI as stipulated in the contract.

Table 3.
Diversion Fee Adjustment Differences

CY	WM Calculation			ACO Re-Calculation			Annual Difference
	Prior Yr. Monthly Fee	Index Used	New Monthly Fee	Prior Yr. Monthly Fee	Index Used	New Monthly Fee	
2011	\$43,333	1.26%	\$43,879	\$43,333	1.24% ¹	\$43,871	-\$104
2012	\$43,879	2.66%	\$45,047	\$43,871	2.66%	\$45,038	-\$107
2013	\$45,047	2.65%	\$46,242	\$45,038	2.65%	\$46,231	-\$110
2014	\$46,240	2.26%	\$47,285	\$46,231	2.26%	\$47,276	-\$112
2015	\$47,285	2.85%	\$48,633	\$47,276	2.85%	\$48,623	-\$115
2016	\$48,633	0.00%	\$48,633	\$48,623	2.60%	\$49,886	\$15,041
2017	\$48,633	0.00%	\$48,633	\$49,886	3.09%	\$51,428	\$33,536
2018	\$48,633	2.77%	\$49,980	\$51,428	3.22%	\$53,084	\$37,242
2019	\$49,980	2.58%	\$51,270	\$53,084	3.97%	\$55,192	\$47,068
2020	\$51,270	2.86%	\$52,736	\$55,192	3.15%	\$56,933	\$50,367
2021	\$52,736	0.00%	\$52,736	\$56,933	2.94%	\$58,609	\$70,472
2022	\$52,736	3.45%	\$54,555	\$58,609	3.45%	\$60,628	\$72,874
2023TD	\$54,555	3.90%	\$56,683	\$60,628	3.90%	\$62,992	\$31,546
							\$357,599
							Total

Recommendations

EHB should:

- 2.1 *Recoup the underpayment of the Diversion Fee and ensure that WM applies the CPI rather than RRI to adjust future Diversion Fee payments.*
- 2.2 *Work with County Counsel to draft an amendment to Section 13.13.2.2 to provide additional clarity of the applicability of the CPI to the annual adjustment of the Diversion Fee.*

LATE FEES

Finding #3

Late Fees were not charged by the County to WM for submitting Franchise and Diversion Fee payments past the due date.

The franchise agreement stipulates that monthly payments of both the Franchise and Diversion Fees must include a late fee equal to one-half percent (1.5%) per month (not compounded) of the amount of any payment obligations that were not received by the County by the 20th day of each month.

In a sample period from January 2021 to April 2023, the audit found that the County did not charge any Late Fees on several late fee payments received from WM. In the sample period, Late Fees that

¹ The CPI adjustment index for 2011 was based on the percentage change in the average CPI between FY 2009 and FY 2010. Due to a subsequent amendment, the CPI adjustment index was based on the percentage change in the average CPI between the two previous calendar years. The audit’s calculation of the 2011 CPI index is 2 basis points less than WM’s calculation.

could have been charged to WM are \$76,041, as shown in Table 4 below. According to EHB, the County has historically not levied Late Fees on WM for late fee payments.

Table 4.
Potential Late Fees Not Charged

	CY 2021	CY 2022	CYTD 2023	Total
Franchise Fee	\$19,376	\$37,445	\$10,383	\$67,204
Diversion Fee	\$4,746	\$4,092	\$0	\$8,838
Total	\$24,122	\$40,718	\$2,991	\$76,041

Recommendations

EHB should:

- 3.1 *Review the possibility of recovering past Late Fees due to the County.*
- 3.2 *Notify WM that the County will enforce Late Fees moving forward per the franchise agreement.*
- 3.3 *Ensure that WM includes a Late Fee when it is certain that the monthly payment will not arrive at the County by the due date.*
- 3.4 *Charge Late Fees when payments are not received by the due date and do not already include Late Fees.*

INTERNAL CONTROLS

In verifying whether Franchise Fees, Diversion Fees and Late Fees required under the franchise agreement have been accurately calculated and timely paid to the County, the audit also assessed the adequacy of internal controls in place for the review and oversight of these fees. We found that better controls are needed to provide reasonable assurance that the calculated fees are accurate, complete, reliable, and timely remitted to the County.

Most Fee payments were not tracked for the date of receipt.

An important internal control is to record the date in which payment is received. However, both County parties, ACO-GA and EHB, that receive and process the monthly payments have been inconsistent in documenting when the payments are received, making it difficult to

Finding #4

The County lacks adequate internal controls for the oversight of the fees remitted by WM, such as tracking payment receipt and maintaining adequate documentation and records.

determine the timeliness of WM payments to the County, and whether to charge Late Fees as stipulated in the agreement.

Recommendations

Both ACO-GA and EHB should:

4.1 Consistently record the date of receipt of the Franchise Fee and Diversion Fee payments.

ACO-GA should:

4.2 Notify EHB when Franchise Fee payments are not received on time.

Adequate supporting documentation for the Diversion Fee is not requested by EHB or provided by WM.

WM provides ample supporting documentation each month on how the Franchise Fee is calculated, including transactional-level data on the gross revenue collected from customer service charges. But when pertaining to the Diversion Fee, the County should expect more adequate supporting documentation from WM. No documentation was provided that illustrates how the Diversion Fee is calculated for the coming year or how the Fee was calculated in prior years. This should be a simple spreadsheet that could be updated yearly and linked to the CPI index calculation.

Recommendation

EHB should:

4.3 Require WM to provide documentation prior to each new year that supports the calculation of the CPI adjustment index and Diversion Fee amount to be remitted to the County.

Historical records and documentation pertaining to the Fees paid to the County are not adequate, weakening contract oversight.

EHB indicated that its staff meets with WM monthly to discuss any contract changes, education outreach, operations, customer complaints, among other matters. It was stated that open communication and flexibility between EHB and the contractor has been key in their working relationship. However, the personnel in both parties can change. Historical information can be easily lost.

Misunderstanding and disagreements regarding the execution of the franchise agreement can arise. Thus, it is critical that significant decisions and agreed-upon understandings, particularly relating to the fee-related provisions within the agreement, are well documented in meeting notes or minutes, which are an important internal control.

Recommendations

EHB should:

4.4 *Maintain minutes and related documents of monthly meetings with WM, and documentation that explains key decisions and understandings between both parties in a central location.*

Billing and Performance Reviews

Finding #5

The County has not opted to have a full Billing and Performance Review performed at WM's expense.

A Billing and Performance Review can serve as an important internal control to ensure that rates charged to customers are reasonable and services provided to customers meet required standards. According to the franchise agreement, the County at its sole discretion can perform a Billing and Performance Review. The County can opt to have a qualified firm conduct the Review.

Such Billing and Performance Reviews, if performed sooner, could have identified the billing related findings in this report, in addition to potential performance and customer service delivery related findings upon verification of program compliance provisions of the agreement not covered in the scope of this audit. Unfortunately, since the inception of the franchise agreement in November 2010, no such review has been conducted by the County or an outside contractor hired by the County. In the current second term of the agreement, if the County were to opt to have such a review conducted in 2023, WM would be responsible for the CPI-adjusted cost of up to \$100,626.

We recommend that the County schedule a full Billing and Performance Review to be conducted within the next two years before the agreement term ends in June 2025. ACO maintains a pool of pre-approved audit and consulting firms, and can support this effort by securing and overseeing an outside contractor to perform this review.

The County should modify future agreement terms to require more regular Billing and Performance Reviews, perhaps every three years. More regular reviews would provide greater accountability to ensure

that customer billing rates and fees owed to the County are accurately calculated, and that the vendor's performance meets the service expectations defined in the agreement.

Recommendations

The EHB should:

- 5.1 Coordinate with ACO-IA and schedule to have a Billing and Performance Review performed by an external consulting firm within the current agreement term, which ends on June 30, 2025.*
- 5.2 Add a contract provision in future agreements to have Billing and Performance Reviews be performed every three years, and to have the selected refuse collection provider cover the costs of these reviews.*

Distribution

Monterey County Board of Supervisors
Valerie Ralph, Clerk of the Board
Sonia M. De La Rosa, County Administrative Officer
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Audit Team

James Lam, Chief Deputy Auditor-Controller, Internal Audit Division
Kimberly Munckton, Internal Auditor II

Issued on August 30, 2023

James Lam, CIA, CFE, CGAP
Chief Deputy Auditor-Controller, Internal Audit Division
County of Monterey, California