CALIFORNIA STATE AUDITOR

Department of Resources Recycling and Recovery:

Deficiencies in Forecasting and Ineffective Management Have Hindered the Beverage Container Recycling Program

June 2010 Report 2010-101

Independent NONPARTISAN TRANSPARENT Accountability

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June 22, 2010 2010-101

The Governor of California
President pro Tempore of the Senate
Speaker of the Assembly
State Capitol
Sacramento, California 95814

Dear Governor and Legislative Leaders:

As requested by the Joint Legislative Audit Committee, the State Auditor's Office presents this audit report concerning the Department of Resources Recycling and Recovery's (department) management of the Beverage Container Recycling Program (beverage program) and the financial status of the Beverage Container Recycling Fund (beverage fund).

This report concludes that because of forecasting deficiencies, the department was not always able to reliably project the revenues and expenditures in the beverage fund. Moreover, ineffective supervision and errors hindered the department's forecasting reliability and more recently resulted in a $158.1 million overstatement of the projected beverage fund balance in the 2009–10 Governor's Budget. Further, we found that the department could do more to effectively manage the beverage program. For example, the department has not followed its plan to audit the top 100 beverage distributors that provided 90 percent of the revenues to the beverage fund, and when audits were conducted, a significant lag existed between the audit's completion and billing for identified underpayments, which increased its risk for failing to collect underpayments before the two-year statute of limitations. In fact, we noted three instances where the department exceeded the statute of limitations and lost the opportunity to collect up to $755,000. Further, the department could improve its efforts to prevent fraud by better tracking fraud leads and having a systematic method for analyzing recycling data for potential fraud. In addition, the department is currently conducting enhanced efforts to prevent fraud before it occurs, but has not yet set specific goals to evaluate the success of these efforts. Our review also revealed that the department did not consistently oversee recycling grants and for six grants we reviewed—it did not ensure that grantees met their commitments, which ultimately cost the State nearly $2.2 million. Finally, although the department has a strategic plan, we believe it should consider establishing benchmarks or metrics that would allow it to more clearly measure the success of the beverage program.

Respectfully submitted,

Elaine M. Howle

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State Auditor

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Summary

Results in Brief

The Beverage Container Recycling Program (beverage program) was created in 1986 by the California Beverage Container Recycling and Litter Reduction Act (act). The intent of the act is to encourage and increase consumer recycling; it has a goal of recycling 80 percent of the aluminum, glass, plastic, and bimetal beverage containers sold in California. The act requires beverage distributors to make a redemption payment to the Beverage Container Recycling Fund (beverage fund) for every qualified beverage container sold or offered for sale. The cost of the redemption payment is passed along to consumers when they purchase beverages and, to encourage recycling, consumers can return used containers to recycling centers and receive a payment representing the initial California refund value (refund value). The Department of Resources Recycling and Recovery (department) is responsible for enforcing the act; its Division of Recycling administers the beverage program and the beverage fund.[1]

Because of deficiencies in its forecasting process, the department is not always able to reliably project the revenues and expenditures for the beverage fund. We observed that over the past five fiscal years, the department's forecasting model has produced results that differ by between 3 percent and 15 percent from the actual revenues and expenditures. Ineffective supervisory oversight and lack of review of the accuracy of the forecasts have also weakened the value of the forecasting model. For example, the department's errors in forecasting the condition of the beverage fund resulted in a $158.1 million overstatement of the projected fund balance in the 2009–10 Governor's Budget, which was used to make budgeting decisions for the department. In addition, the actual balance in the beverage fund was understated in the governor's budget for three fiscal years—2004–05 through 2006–07—because revenues were not corrected to include prior year adjustments. A projected fund balance deficit in May 2009 prompted the department to reduce payments to program participants, as required by law.

Further, the department can more effectively manage the beverage program. State law requires it to establish an auditing system to ensure that redemption payments that are made comply with the act. However, the department has not followed its plan to audit certain beverage distributors, and when audits are conducted, a significant lag exists between the audit's completion and billing

1 Until January 1, 2010, the Department of Conservation administered the Beverage Container Recycling Program.

Audit Highlights . . .

Our audit of the Beverage Container Recycling Program (beverage program) at the Department of Resources Recycling and Recovery (department) revealed the following about the department:

- *Its forecasting process is outdated and not able to reliably project revenues and expenditures.*
  - *Over the past five years projections have differed from actuals by between 3 percent and 15 percent.*
  - *Errors in forecasting the condition of the Beverage Container Recycling Fund resulted in a $158.1 million overstatement in the 2009–10 Governor's Budget.*
  - *A projected fund balance deficit in May 2009 prompted the department to reduce payments to beverage program participants.*
- *Significant lags exist between the completion of an audit of redemption payments and billing for any identified underpayments.*
  - *For one audit with identified underpayments of $941,000 including interest, the department took six months to bill the distributor.*
  - *In two instances, the department could not collect a total of $324,000 because it exceeded the two-year statute of limitations on collecting underpayments.*

continued on next page . . .

» *It may be missing opportunities to detect fraud because it lacks a systematic and documented methodology for analyzing data regarding the volume of recycled containers.*

» *It does not always perform key steps to monitor grants awarded to private entities and local governments and ensure that funds are properly used by visiting grantees and obtaining project status reports.*

» *It did not ensure grantees met their commitments for six completed market development and expansion grants that we reviewed—ultimately costing the State nearly $2.2 million.*

for identified underpayments. For example, at the conclusion of the fieldwork in June 2008 for one audit, the beverage distributor agreed that it had underpaid $941,000 with interest over a three-year period. Because of the large underpayment identified, and because the beverage distributor agreed with the amount, we assumed the department would quickly act to collect the underpayment. However, because of lags in the review process, it did not bill the beverage distributor until December 2008, six months later. The department's lengthy audit process may also increase its risk of failing to collect on underpayments, because it exceeds the two-year statute of limitations. We noted two instances in which the department exceeded the statute of limitations and lost the opportunity to collect a total of $324,000, and a third instance in which it did not complete an audit, potentially losing the opportunity to collect $431,000.

The department also conducts investigations of recyclers that collect used beverage containers from consumers to ensure that they do not commit fraud when claiming reimbursements from the beverage fund. Fraudulent activities include turning in beverage containers from other states or paying the refund value for ineligible materials. However, the department fails to document fraud leads it decides not to investigate. Also, because the department does not have a systematic and documented methodology for analyzing data regarding the volume of recycled containers, it is potentially missing opportunities to detect fraud.

To encourage and support recycling activities, the act authorizes the department to award grants to private entities and local governments, which totaled approximately $67.5 million in fiscal year 2008–09. Although it has a process to monitor grantees to ensure that funds are used properly, the department does not always perform key steps, such as visiting grantees and obtaining status reports on how projects are progressing. Furthermore, when funding market development and expansion (market development) grants, which are intended to encourage new and innovative recycling techniques, the department accepts a level of risk that financial institutions would not accept. As a result, for six completed market development grants we reviewed, the department did not ensure that grantees met their commitments, which ultimately cost the State nearly $2.2 million.

Recommendations

To improve its forecasting of revenues and expenditures for the beverage fund, the department should do the following:

- Implement a new forecasting model in time for it to be used for the fiscal year 2011–12 Governor's Budget.

- Place appropriate controls over the forecast model, including having management review the reliability of forecasting results before they are used and monitoring the reliability of forecast results against actual figures on a monthly and yearly basis.

- Ensure that the actual fund balances of the beverage fund in future governor's budgets reflect actual revenues and expenditures from its accounting records.

The department should better follow its three-year plan to audit beverage distributors. Steps to accomplish this goal could include performing an analysis of risks that could result in underpayment of redemption payments or implementing policies to terminate audits after the department's initial assessment of a beverage distributor concludes that it is unlikely that an underpayment exists.

To avoid exceeding the statute of limitations for collecting underpayments, and to bill for collection sooner, the department should strive to complete the fieldwork for audits in a more timely fashion. Further, the department should take steps to implement policies to shorten the time needed to review completed audits before billings are made, and should also develop policies to expedite reviews when an audit identifies a significant underpayment.

To improve management of its fraud investigations, the department should take the following actions:

- Track all fraud leads that the investigations unit receives and track the disposition of those leads, as well as document the reasons for closing leads without an investigation.

- Formalize the approach used to analyze recycling data for potential fraud and develop criteria for staff to use when deciding whether to refer anomalies for investigation.

To improve oversight of grants and ensure that the intended value is received from the grant funds it awards, the department should do the following:

- Perform site visits to ensure that grantees are progressing on projects as expected.
- Require that grantees provide regular status reports that sufficiently describe their progress toward meeting the goals of the grant.
- More closely scrutinize the risks associated with proposed market development grants.
- For recipients of market development grants that are unable to meet the goals of their grants, maintain contact with grantees after the project is completed to determine if the goals may ultimately be achieved.

Agency Comments

In its response, the department agreed with the recommendations and provided additional perspective and information related to our findings.

Introduction

Background

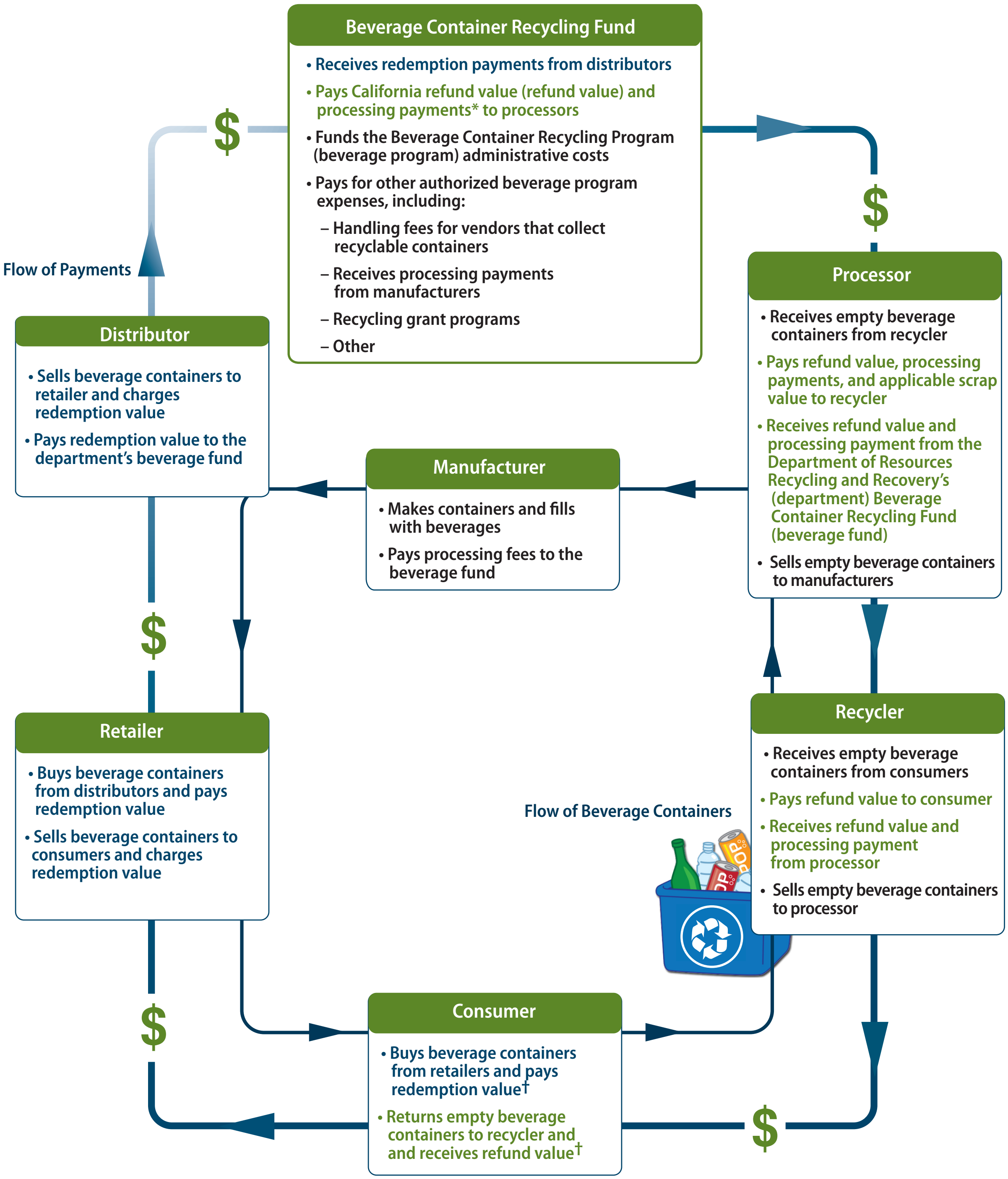
The Beverage Container Recycling Program (beverage program) was created in 1986 by the California Beverage Container Recycling and Litter Reduction Act (act). The intent of the act is to encourage and increase consumer recycling; it has a goal of recycling 80 percent of the aluminum, glass, plastic, and bimetal beverage containers sold in California that contain certain beverages. Beverage containers covered under the act include those filled with carbonated soft drinks and carbonated mineral water, noncarbonated soft drinks, wine coolers and distilled spirit coolers, and beer and malt beverages, as well as noncarbonated water and mineral water, sports drinks, and coffee and tea drinks. The act does not cover containers filled with milk, wine, or infant formula.

Further, the act requires beverage distributors to make a redemption payment to the Department of Resources Recycling and Recovery (department), which is deposited into the Beverage Container Recycling Fund (beverage fund) for every beverage container sold or offered for sale.[2] Currently, the redemption payment is 5 cents or 10 cents, depending on the size of the container, less 1.5 percent for the beverage distributor's administrative costs. Beverage distributors recoup the redemption payment when they sell the eligible beverages to beverage retailers (retailers), and retailers pass the cost on to consumers at the time of purchase. Consumers are paid the California refund value (refund value) when they return empty beverage containers to recycling centers, which are repaid by the processing centers they sell the containers to. The department then pays the refund value to the processors. Figure 1 on the following page provides an overview of how the recycling program works.

The department is responsible for enforcing the act. Its Division of Recycling (division) administers the beverage program and the beverage fund. The division had approximately 248 budgeted positions for fiscal year 2009–10; Figure 2 on page 7 provides an organizational chart of the division and the general duties of its staff. State law requires the department to establish an auditing system to ensure that redemption payments and refund values paid comply with the act. The department also investigates recyclers that collect used containers from consumers to ensure that they do not commit fraud when claiming reimbursements from the beverage fund.

2 Until January 1, 2010, the Department of Conservation administered the Beverage Container Recycling Program.

Figure 1
Flow of Payments and Recycling of Containers Under the Beverage Container Recycling Program

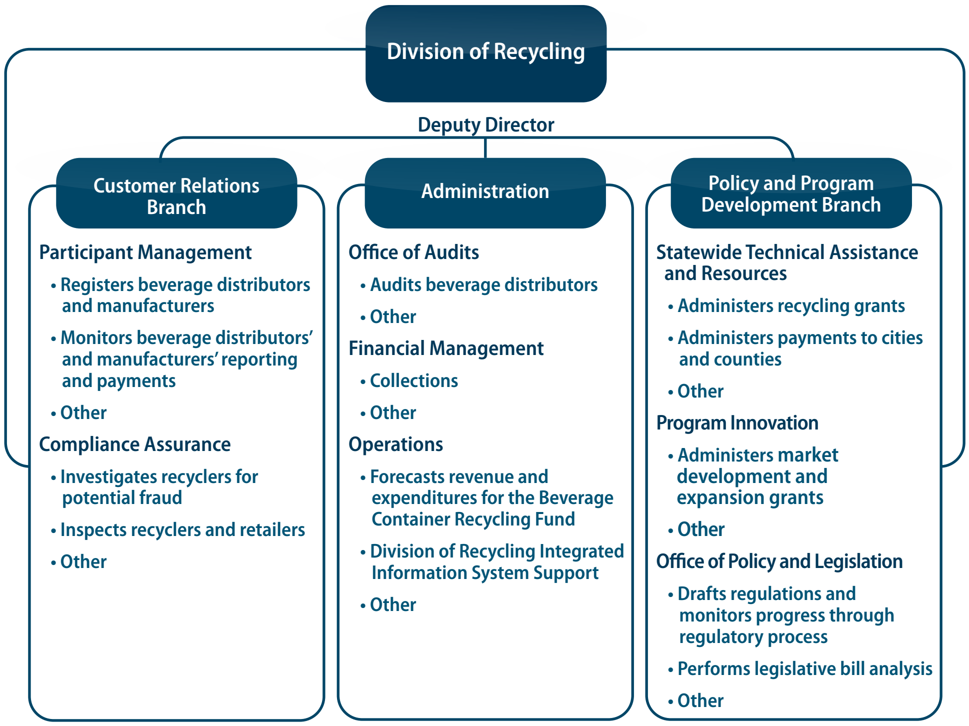


Source: Department of Resources Recycling and Recovery.

* Processing payments are paid to recyclers equaling the difference between the average cost to recycle and the average scrap value received. Processing fees are equal to a percentage of processing payments ranging from 10 percent to 65 percent.

† California redemption value (blue text) is paid when a beverage container is purchased. California refund value (green text) is received when a beverage container is returned for recycling.

Figure 2
Division of Recycling Organizational Chart
Fiscal Year 2009–10



Source: Department of Resources Recycling and Recovery.

All redemption payments from the beverage distributors are deposited into the beverage fund, which is used to fund the beverage program's activities, pay for refund values and processor administrative fees, and provide a reserve for contingencies. Because redemptions are paid for every eligible beverage container sold in California but refund values are paid only for the containers that consumers recycle, surplus funds historically have existed in the beverage fund. During fiscal year 2008–09 the department collected approximately $1.2 billion in redemption payments and paid approximately $1 billion in refund values. The remaining funds supported all the beverage program's administrative expenses, which totaled $46.4 million, as well as other authorized program expenses totaling approximately $254.8 million, including handling fees for vendors that collect recyclable containers, payments to support local curbside programs, recycling grant programs, transfers for processing fees, and other recycling activities. Even after these expenses, the beverage fund sometimes had a surplus balance that was loaned to other funds, including the State's General Fund. Further, the act requires the department to maintain a contingency reserve in the beverage fund that is no more than 5 percent of the total amount paid to processors during the previous calendar year.

Amounts Borrowed From the Beverage Fund

For the past five years, various amounts have been borrowed from the beverage fund and transferred to other funds. Our review determined that all of these loans were authorized through the budget acts for each year. Specifically, for fiscal years 2004–05 through 2008–09, the budget act authorized temporary interdepartmental transfers of funds totaling approximately $13.1 million in loans from the beverage fund to the Department of Conservation's general fund and its other funds for cash‑flow needs, and has since been repaid. In addition, the budget acts of 2008 and 2009 authorized two loans totaling $67 million—$32 million in fiscal year 2008–09 and $35 million in fiscal year 2009–10—from the beverage fund to the Air Pollution Control Fund. Further, the budget act of 2009 authorized a $99.4 million loan to the General Fund in fiscal year 2009–10. The budget act provisions for the Air Pollution Control Fund and the General Fund are currently the subject of lawsuits filed by several recyclers and processors. Table 1 shows the loans from the beverage fund over the past five fiscal years. Not shown in the table are loans from years prior to fiscal year 2004–05 to the General Fund, which totaled approximately $286.3 million as of June 30, 2009, and were still outstanding as of May 2010.

Division of Recycling Integrated Information System

Division of Recycling Integrated Information System Program Objectives

- Provide comprehensive and accurate program information.
- Provide an integrated system that is a centralized data repository.
- Eliminate redundant data entry.
- Reduce the reimbursement timeline.
- Implement a modern and flexible technical architecture.
- Increase system support flexibility.
- Improve customer service.
- Improve business practices and processes.

Source: Division of Recycling Integrated Information System Feasibility Study Report, January 31, 2003.

The division has many responsibilities that require the use of information technology; it notes that past systems were implemented in a piecemeal manner and not integrated. The Division of Recycling Integrated Information System (DORIIS) is the department's solution to the various problems it believes existed with information management in the division's past systems. Some of those problems included limited access to comprehensive and accurate recycling program information, limited integration of the division's information systems, significant manual and/or redundant processes, limited system support, inadequate customer service to stakeholders, and obsolete business practices and processes. The objectives of DORIIS are described in the text box. The department is implementing DORIIS in two phases. The first phase was completed in March 2009 and focused on financial issues and the ability of participants to file claims electronically. It anticipates implementing the second phase in July 2010, which focuses on case management, participant management, report development, and productivity enhancements for staff.

Table 1
Revenue, Expenditures, and Loans From the Beverage Container Recycling Fund
Fiscal Years 2004–05 Through 2008–09
(In Millions)

	FISCAL YEAR				
	2004–05	2005–06	2006–07	2007–08	2008–09
Beginning fund balance	$73.0	$196.0	$308.5	$292.8	$306.6
Revenue*	926.1	911.5	975.1	1,189.6	1,194.3
Expenditures					
Administrative costs	(29.7)	(31.5)	(41.6)	(48.2)	(46.4)
California refund value paid	(585.2)	(601.2)	(753.6)	(905.6)	(1,005.4)
Processing fees	(114.7)	(58.0)	(97.5)	(65.9)	(88.3)
Handling fees	(26.5)	(33.1)	(31.2)	(30.5)	(47.3)
Grants	(37.8)	(39.1)	(35.1)	(70.8)	(67.5)
Other†	(9.1)	(36.1)	(31.8)	(54.8)	(51.7)
Total expenditures	**($803.0)**	**($799.0)**	**($990.8)**	**($1,175.8)**	**($1,306.6)**
Net receipts (expenditures)	**$123.1**	**$112.5**	**($15.7)**	**$13.8**	**($112.3)**
Loans					
Department of Conservation's general fund	(1.3)	-	(3.6)	(1.8)	(2.0)
State's General Fund‡	-	-	-	-	-
Bosco-Keene Fund	(0.3)	-	-	-	-
Soil Conservation Fund	(2.3)	-	-	-	-
Air Pollution Control Fund	-	-	-	-	(32.0)
Transfers in	**$3.8**	-	**$3.6**	**$1.8**	-
Ending fund balance	**$196.0**	**$308.5**	**$292.8**	**$306.6**	**$160.3**

Source: Prepared by Bureau of State Audits from information provided by the Department of Conservation, which managed the Beverage Container Recycling Program until January 1, 2010.

* Revenue is primarily redemption payments.

† Other includes expenditures for curbside programs, quality incentives, recycler incentives, public education, and charges from other state departments.

‡ Not shown in the table are loans to the General Fund totaling approximately $286.3 million that were made prior to fiscal year 2004–05 and were still outstanding as of May 2010. In addition, another $99.4 million loan was made to the General Fund in fiscal year 2009–10.

Other States' Beverage Programs and Procedures

In addition to California, 10 other states have enacted beverage container recycling laws, according to the Container Recycling Institute (institute). Similar to California's beverage program, these states' programs provide consumers with incentives to recycle by charging a deposit on beverages sold. Each of these states requires beverage container manufacturers to pay a deposit on many types of beverage containers they sell. This deposit is passed on to retailers, who pass it on to consumers, who can turn in their used containers to redeem the deposit. The recycling programs vary from state to state in the following ways: who keeps the deposits on beverage containers that consumers do not redeem, deposit amounts, and the level of government involvement with the recycling program.

According to the institute, California, Connecticut, Hawaii, Maine, and Massachusetts retain the unredeemed deposits. These states use the funds for purposes such as administration of the state's beverage container recycling program, recycling grants, and the state's general fund.[3] Michigan and New York retain the majority of unredeemed deposits, but Michigan shares 25 percent with retailers and New York shares 20 percent with manufacturers to offset handling costs. Alternatively, in Oregon, Iowa, Vermont, and Delaware, beverage distributors retain the unredeemed deposits. Among the states, the deposit amounts vary slightly, with Michigan having the highest deposit amount per standard-sized container (10 cents) and most other states having a deposit of 5 cents for similar-sized containers. Moreover, California, Hawaii, and New York also play a significant role in their respective beverage container recycling programs. For example, the governments of California and Hawaii manage a fund for the beverage container deposits, and recyclers have to submit claims for reimbursement.

Scope and Methodology

The Joint Legislative Audit Committee (audit committee) asked the Bureau of State Audits (bureau) to review the department's management of the beverage program and the financial status of the beverage fund. Specifically, the audit committee requested that the bureau determine the receipts, expenditures, transfers, and balances in the beverage fund for the past five fiscal years. Thus, our audit period focused on fiscal years 2004–05 through 2008–09 and an additional six months—July 2009 to December 2009. We were also asked to determine amounts borrowed from the beverage fund, including the reasons for borrowing and any approvals obtained. Moreover, the audit committee wanted us to determine how the department forecasts revenues and expenses as well as the methodology it used to calculate the reductions in payments

3 Maine retains the unredeemed deposits only for those beverage containers that are not part of an approved commingling agreement.

and fee offsets. Also, we were directed to sample the costs for administering the beverage program to determine whether they were allowable and reasonable.

The audit committee requested that the bureau evaluate procedures in place to track trends and identify fraud. In addition, we were asked to assess the current procedures and any planned changes to ensure that all fees are collected from beverage distributors. The audit committee also directed us to review and assess the department's policies and procedures to ensure that grant funds are awarded and used only for allowable purposes. Further, we were to review a sample of grant award expenditures for the past five years and determine how the department monitored these funds to ensure that they were used properly. Finally, the audit committee requested that we evaluate the department's ability to assess the efficiency and effectiveness of the beverage program.

We examined the department's policies and procedures governing the beverage fund and beverage program activities and reviewed relevant portions of state law. To determine the receipts, expenditures, transfers, balances, and amounts borrowed from the beverage fund during our testing period, we reviewed the department's accounting and budgeting records. For the amounts borrowed, we interviewed staff and determined how the amounts were authorized. To determine the effectiveness of the department's forecasting of the beverage fund balance, we interviewed staff, reviewed the forecasts for accuracy, and analyzed the effectiveness of the forecasting methodology by comparing the forecast amounts to the actual amounts for our audit period. To understand the department's rationale and calculations for implementing recent reductions in payments and fee offsets, we interviewed forecasting unit staff and obtained relevant documents.

Because it audits beverage distributors to ensure that they do not underpay the fees due, we interviewed department staff and reviewed procedures and documents, including a list of planned audits for fiscal years 2006–07 to 2008–09, to understand the process used for these audits. Further, we examined a sample of completed audits, reviewed the department's progress in completing planned audits, and followed up to determine if the department was pursuing any identified underpayments in a timely manner. Also, to determine whether the department is effectively identifying and registering all beverage distributors, we interviewed its staff, obtained pertinent procedures and documents, and reviewed a sample of case files to determine if the department followed its registration process.

To evaluate its fraud detection methods, we interviewed department staff and reviewed procedures for identifying and tracking potential fraud. We also selected a sample of fraud investigations to review if the department appropriately completed them.

To evaluate whether grants were awarded and used only for allowable purposes, we interviewed department staff, reviewed pertinent laws, and examined the department's procedures for grant selection, for grant monitoring, and for ensuring that grant funds provide the value intended. Further, we reviewed a sample of both active and completed grant files to evaluate whether the department followed its procedures.

To determine whether the administrative expenditures charged to the beverage program were allowable and reasonable, we reviewed accounting records of all programs administered by the department and its predecessor, the Department of Conservation to identify charges to the beverage fund between July 2004 and December 2009. Further, we sampled administrative expenditures to determine if beverage funds were spent for allowable purposes. We also sampled payroll expenses to ensure that the employees performed work related to the beverage program. Based on our review, we found that the expenditures charged to the beverage fund were allowable, reasonable, and consistent with the beverage program.

Finally, to evaluate the department's ability to assess the efficiency and effectiveness of the beverage program, we interviewed management of various units and reviewed documents to understand how the department measures success in meeting its objectives.

Audit Results

Deficiencies Exist in Forecasting Revenues and Expenditures

The Department of Resources Recycling and Recovery (department) believes that the current model it uses to forecast revenues and expenditures of the Beverage Container Recycling Fund (beverage fund) is outdated and that the projections the model produces are no longer reliable. We observed that over the past five fiscal years, the department's forecasting model has produced results that differ by between 3 percent and 15 percent from the actual revenues and expenditures. Ineffective oversight and errors in forecasting the condition of the beverage fund by the department have hindered the forecasting model's effectiveness and, more recently, resulted in a $158.1 million overstatement of the projected balance in the 2009–10 Governor's Budget for the beverage fund. The department also believes market forces were responsible for this overstatement. Recognizing these problems, the department is in the process of hiring an economist to take over its forecasting efforts. Finally, the fund balance of the beverage fund was understated in the governor's budget for three fiscal years—2004–05 to 2006–07—before being revised because the Department of Conservation was not adjusting revenue to reflect prior year adjustments.[4]

The Department Acknowledges That Its Forecasting Model Is Outdated

The department uses forecasting to build a projected annual budget because of variations in the revenues it receives for redemption payments on beverage containers and the expenditures it makes for payments to recyclers. Actual revenue and expenditure amounts for a particular month are not available until several months later. According to the deputy director (deputy director) of the department's Division of Recycling (division), who took this position in August 2009, the current forecasting model used to project the beverage fund financial condition, which is used to provide revenue and expenditure estimates for the governor's budget, is outdated and in October 2009 projected recycling rates of over 100 percent of sales. Because of its concerns with the model, the department capped the recycling rate projections at 90 percent of sales for fiscal years 2010–11 and 2011–12; it believes this will result in a more accurate forecast of expenditures.

The department uses a "month over month" forecasting model that projects the monthly figures for the number of containers sold and the weight of the containers recycled. Each month's figure

[4] Until January 1, 2010, the Department of Conservation administered the Beverage Container Recycling Program.

is projected by calculating the percentage of change between the same months in the two prior years and applying that percentage to increase or decrease the prior year's figure and create the projected figure. The two months used for the projection can be a combination of actual data and projected data, depending on the information available at the time the forecasting is done. To complete the forecast, the department uses the redemption payment to convert the projected number of containers sold to a revenue amount and a California refund value (refund value) per pound, which varies based on the material, to convert the projected weight of the containers recycled to an expenditure amount. Until recently, the department used the forecast produced by the model without attempting to identify any factors that may require an adjustment to the forecasts. In Table 2 we provide an example of how the department's forecasting model projects different amounts for the same period—July 2009 to October 2009—based on data available at different times.

Table 2
Differences in Expenditure Forecasting Accuracy for Fiscal Year 2009–10 Between November 2008 and May 2009 (In Millions)

DATE	NOVEMBER 2008 FORECAST*	MAY 2009 FORECAST†	ACTUAL
Fiscal Year 2009–10			
July 2009	$101.3	$101.4	$98.2
August 2009	123.2	85.7	91.7
September 2009	93.1	101.1	92.8
October 2009	102.7	97.4	91.7
Subtotals, July Through October	**$420.3**	**$385.6**	**$374.4**
Remainder of fiscal year November through June	660.5	660.9	NA
Total Forecast	**$1,080.8**	**$1,046.5**	

	JULY TO OCTOBER FORECAST (NOVEMBER 2008) VERSUS ACTUAL	JULY TO OCTOBER FORECAST (MAY 2009) VERSUS ACTUAL
Forecast	$420.3	$385.6
Actual	374.4	374.4
Difference	**$45.9**	**$11.2**

Source: Bureau of State Audits' analysis of information provided by the Department of Resources Recycling and Recovery's (department) forecasting unit. Note that slight variances exist between figures because of updates to previous figures.

Projection based on two actual figures.

Projection based on one actual figure and one forecast.

NA = Not available.

* As discussed later in this section, the department committed an error in forecasting the fiscal year 2009–10 expenditures in the November 2008 forecast. The November 2008 forecast column shows the department's corrected November 2008 projections.

† According to the department, by May 2009 it should have had actual expenditure data available to make projections from July 2009 to January 2010 based on two actual expenditure points, but implementation of the Division of Recycling Integrated Information System delayed availability of actual data.

According to the deputy director, the forecasts are assumed to be most reliable when based on two months of actual data. Under the State's budgeting process, the department prepares estimates for the governor's budget approximately seven months before the fiscal year starts, typically in November. However, as noted in Table 2, the November 2008 expenditure projections that were used for the 2009–10 Governor's Budget included only one month (July) that was based on actual data, while the other 11 months relied on one month of actual data and one month of forecast data, thus reducing the reliability of the forecasting model. We compared the difference between the forecast and actual figures for the two forecasts shown in Table 2 and confirmed the department's assertion that forecasts are more reliable when based on two actual months of data. Our comparison is limited to the first four months of fiscal year 2009–10, July through October, because the department did not have actual data available in May 2009 for the remaining months to use in its forecast. Nevertheless, the November 2008 forecast, which shows only one month with a forecast based on actual data, differs from actual expenditures by $45.9 million, while the May 2009 forecast, which relies on three more months of forecasts based on actual data, differs from actual expenditures by only $11.2 million.

Ineffective Supervisory Oversight Has Weakened the Value of the Forecasting Model

Despite their importance to the Beverage Container Recycling Program's (beverage program) budget, the forecasts produced by the model have not been subjected to sufficient review. Currently, the two staff members of the forecasting unit collaborate to prepare the forecasts, and they, along with other staff, review the calculations before submitting the forecasts for supervisory review. However, according to the manager of the financial management recycling program, the supervisory review of the forecast results were cursory and did not include a thorough verification of the supporting calculations. The deputy director acknowledged to us that an error in the forecast figures prepared in November 2008 was included in the 2009–10 Governor's Budget. The forecast understated the expected expenditures for 10 months, which caused the department to overstate the balance of the beverage fund for fiscal year 2009–10 by $158.1 million, reporting that it would have a projected surplus balance of $81 million instead of the correct projection of a $77.1 million deficit.

The forecast understated the projected expenditures for 10 months, which caused the department to report a projected surplus balance of $81 million instead of the correct projection of a $77.1 million deficit—a $158.1 million error.

The department did not detect this error until four months later in March 2009, when the forecasting unit updated the projected fund condition for fiscal year 2009–10 using more recent data. This updated forecast gave a projected fund deficit of $154.1 million for fiscal year 2009–10. This represented a $235.1 million decrease from the projected $81 million surplus the department reported in the 2009–10 Governor's Budget. Due to the difference between the two forecasts, the forecasting unit decided to review its prior projections and, in doing so, identified that in addition to market changes, a computational error existed in the original November 2008 forecast. Although the forecasting unit recognized that an error had occurred, it did not perform an analysis at that time to determine the magnitude of the error, nor did it immediately notify department management of the error.

The deputy director confirmed that the department presented the erroneous November 2008 forecast of its fund condition to the Legislature during an April 2009 budget hearing. However, he also told us that even though the forecasting unit staff were aware of an error, they did not inform the department's executive management about the error until after the budget hearing. The deputy director indicated that upon learning of the error after the April 2009 hearing, the department informed the Department of Finance (Finance), through a series of informal meetings, that a correction was needed. The department did not include the specific factors contributing to the need for the correction because it had not analyzed the magnitude of the error. Another budget hearing was held in May 2009 at which time the department notified the Legislature that it was now forecasting a deficit in the beverage fund and that the fiscal year 2009–10 budget needed to be corrected. However, the department did not notify legislative members at this hearing of the specific factors requiring the change.

The department had not analyzed the magnitude of the error and, thus, learned of the scope of the error when we preformed our assessment of the projection's accuracy in April 2010.

The department learned of the scope of the error only when we performed our assessment of the projection's accuracy in April 2010. Our analysis revealed that had the forecasting unit prepared the projection properly, the projected fund deficit for fiscal year 2009–10 would have been $77.1 million, which was $158.1 million less than the projected surplus balance of $81 million the department originally reported. Had supervisors conducted a more thorough review of the unit's forecasts and discovered this error, the department may have been able to implement a proportional reduction in payments to participants in the beverage program either earlier or incrementally (discussed later in this section). Furthermore, it would have been able to notify the Legislature of the projected inadequacy when it prepared the forecast in November 2008 rather than at the May 2009 budget hearing. However, according to the deputy director, although there were errors in the forecast, market changes that occurred after the forecast was prepared, including declining beverage sales and increased recycling rates, and a $99.4 million loan to the State's General Fund made in fiscal year 2009–10, required a proportional reduction.

Our analysis shows that over the past five fiscal years the department's forecasting model has produced results that differ by between 3 percent and 15 percent from the actual revenues and expenditures. According to the deputy director, the department does not compare the forecasts to the actual figures when the data become available three to four months later to validate the effectiveness of the model. However, he acknowledged that such a comparison would be valuable. In Table 3 and Table 4 on the following page, we compare the revenue and expenditure forecasts over five fiscal years to the actual figures to determine the reliability of the model over our audit period.

Table 3
Comparison of Forecast Revenues to Actual Revenues (Dollars in Millions)

FISCAL YEAR	REVENUE FORECAST	REVENUE ACTUAL	DIFFERENCE (OVERSTATED)	PERCENTAGE DIFFERENCE
2004–05	$955.3	$910.9	($44.4)	(4.9%)
2005–06	1,077.3	940.5	(136.8)	(14.6)
2006–07	937.5	981.2	43.7	4.5
2007–08	1,247.1	1,198.7	(48.4)	(4.0)
2008–09	1,342.5	1,166.7	(175.8)	(15.1)

Source: Prepared by the Bureau of State Audits from information provided by the Department of Resources Recycling and Recovery's forecasting unit.

Note: The actual revenue amount used in the comparison is the redemption payment reported by distributors in a given month, which does not include other income such as interest and penalty assessments.

Table 3 indicates that the forecasting model has overstated revenues during four of the past five fiscal years by as much as $175.8 million, with the only exception occurring in fiscal year 2006–07, when revenue was understated. We noted that the actual revenue increased each year between fiscal years 2004–05 and 2007–08. Further, in two of the years the revenue overstatement exceeded 10 percent of the actual amount (fiscal years 2005–06 and 2008–09).

Table 4 on the following page shows that the forecasting model understated expenditures for three of the past five fiscal years. The expenditure understatement in two of the three fiscal years—2004–05 and 2006–07—exceeded 10 percent of the actual expenditures. The differences between forecasts and actual figures for both revenues and expenditures shown in tables 3 and 4 affect the final projected fund balance. For example, for the fiscal year 2004–05 forecast, revenues were overstated by $44.4 million while expenditures were understated by $72.7 million, resulting in a net fund balance overstatement of $117.1 million.

Table 4
Comparison of Forecast Expenditures to Actual Expenditures
(Dollars in Millions)

FISCAL YEAR	EXPENDITURE FORECAST	EXPENDITURE ACTUAL	DIFFERENCE (OVERSTATED)	PERCENTAGE DIFFERENCE
2004–05	$492.3	$565.0	$72.7	12.9%
2005–06	642.4	602.2	(40.2)	(6.7)
2006–07	647.9	754.6	106.7	14.1
2007–08	880.5	911.4	30.9	3.4
2008–09	1,099.3	988.4	(110.9)	(11.2)

Source: Prepared by the Bureau of State Audits from information provided by the Department of Resources Recycling and Recovery's forecasting unit.

Note: The actual expenditure amount used in the comparison is the refund amount claimed by recyclers in a given month. This amount differs from the annual amounts used by accounting, which are equal to the cash transactions plus accruals.

During the five fiscal years shown in tables 3 and 4, the department's forecasting model has generally overstated the balance in the beverage fund by overstating revenues and understating expenditures. From the department's perspective, the deputy director indicated that it prepared these forecasts during a period in which revenues were growing but expenditures were stable. However, by fiscal year 2009–10, he indicated that market conditions had changed and revenues had begun to decrease while expenditures were growing. We believe that in the future, the department should conduct analyses similar to ours of the results of its forecasting against actual figures to gauge the model's reliability and take steps to improve its model as appropriate. Investigating the differences between projected and actual figures could also provide insights into events that affect recycling revenues and expenditures.

The Department Reduced Payments to Recyclers and Others Based on the Projected Shortfall in the Beverage Fund

When the department realized in May 2009 that it had a projected fund deficit for fiscal year 2009–10, it had to reduce certain payments to beverage program participants. State law requires the department to conduct a quarterly review to ensure that there is adequate money in the beverage fund to make payments specified by law for recycling grants and processing fee reductions. If the department determines that insufficient funds exist to make these specified payments and maintain a minimum fund balance required by law (as we discuss later in this section), it must reduce all payments by the same proportion, a process known as proportional reduction. The first column in Table 5 shows the department's original May 2009 forecast for fiscal year 2009–10, which shows that the beverage fund was projected to have a $154.1 million deficit.

Table 5
Effect of Proportional Reduction and Loans on the Beverage Container Recycling Fund Forecast
(In Millions)

	ORIGINAL MAY 2009 FORECAST	MAY FORECAST WITH 85 PERCENT PROPORTIONAL REDUCTION
Fiscal Year 2009–10		
Beginning fund balance	**$136.4**	**$136.4**
Revenue	**1,195.0**	**1,195.0**
Expenditures		
Administrative costs	($49.9)	($49.9)
California refund value paid	(1,046.5)	(1,046.5)
Processing fees	(98.8)	(14.8)
Handling fees	(48.9)	(7.3)
Grants	(59.5)	(8.9)
Other*	(49.5)	(11.3)
Total expenditures	**($1,353.1)**	**($1,138.8)**
Net receipts (expenditures)	**($158.1)**	**$56.2**
Loans		
State's General Fund	($99.4)	($99.4)
Air Pollution Control Fund	(35.0)	(35.0)
Transfers in	**2.0**	**2.0**
Ending fund balance (deficit)	**(154.1)**	**60.2**

Source: Prepared by the Bureau of State Audits from information provided by the Department of Resources Recycling and Recovery's forecasting staff.

* Other includes expenditures for curbside programs, quality incentives, recycler incentives, public education, and charges by other state agencies.

Due to the projected deficit, the department reduced payments, including processing fees, handling fees, and grants, by 85 percent in July 2009. In doing so, it forecast that it would have a fund balance of $60.2 million, as shown in the second column of Table 5, which the department indicated represented a fund balance reserve of 5 percent of projected revenue. Following the July 2009 reduction in payments, the department reviewed the beverage fund on a monthly basis to validate the continued reduction in payments. In November 2009, based on these reviews, the department determined that it needed to eliminate payments altogether, as its updated fund forecasts projected a worsening shortfall.

The department also overstated the required reserve for the beverage fund when it implemented a proportional reduction during fiscal year 2009–10. According to the deputy director, the department included a prudent reserve amounting to 5 percent of projected revenue in its calculation of the proportional reduction percentage. However, state law stipulates that the reserve for the beverage fund shall not be greater than 5 percent of the total amount paid to processors in the previous calendar year. Following state law, we calculated an allowable reserve amount of $51.8 million, which is $8.4 million less than the department's reserve amount of $60.2 million. Had the department calculated the reserve at $51.8 million, it could have reduced payments by 81.7 percent rather than 85 percent to reach the fund balance reserve. Thus, it may have been able to implement a lower proportional reduction. The deputy director told us that in past calculations of its fund balance reserve, the department has historically used a reserve amount of 5 percent of revenues plus 5 percent of expenditures, which would have resulted in a significantly higher reserve amount and proportional reduction. Nevertheless, the department's past practice in calculating the reserve did not follow the law.

According to the deputy director, market changes and the $99.4 million loan to the General Fund were the main factors behind the implementation of the proportional reduction. He noted that projected sales were higher than actual sales, which resulted in less revenue than expected. Further, actual recycling volumes were higher than previously expected, which resulted in increased expenditures. The department notified Finance in April 2009 that the $99.4 million loan, as authorized by the 2009 budget act from the beverage fund to the General Fund, would contribute to the projected deficit. However, the loan was still made, and the department's forecast in Table 5 shows that this loan was a factor in the projected fund deficit that triggered the proportional reduction. In March 2010 a new law was implemented that mandated repayment, subject to availability of funds, of the payments that were proportionally reduced between January 2010 and June 2010. It also temporarily suspended funding for certain grant programs until the end of 2011.

Inaccurate Fund Balances for the Beverage Fund Were Reported in Prior Governor's Budgets

Because the Department of Conservation's budget office used amounts provided by the market research branch for reporting past year actual revenues rather than amounts from the accounting records, inaccurate fund balances for the beverage fund were reported in prior governor's budgets.

Inaccurate balances for the beverage fund were reported in the governor's budgets for fiscal years 2004–05 through 2006–07. These errors occurred because, according to the budget officer of the Department of Conservation, the budget office did not use revenue data for past year actual revenues from accounting records for the governor's budget.[5] Rather, the budget office relied on amounts for past year actual revenues provided by the

[5] Until January 1, 2010, the Department of Conservation administered the Beverage Container Recycling Program.

market research branch, which collects revenue data reported by beverage distributors.[6] However, these revenue data did not include prior year revenue adjustments. He indicated that the budget office did not compare the two sets of data (revenue data per the market research branch compared to the accounting records) for consistency. The budget office discovered the error when it finally compared the revenue amount provided by the market research branch to the accounting records during fiscal year 2007–08.

According to the Department of Conservation's budget officer, to correct for this error a prior year adjustment of $198.3 million was made to the fiscal year 2007–08 actual revenue reported in the 2009–10 Governor's Budget to increase the reported fund balance. Of this amount, $61.4 million was for the fiscal year 2007–08 prior year revenue adjustment, while the remaining $136.9 million was primarily to correct for the exclusion of the revenue adjustments for fiscal years 2004–05 through 2006–07. Since taking over responsibility for the beverage program, the department has submitted beverage fund information for inclusion in the governor's budget. According to the department's budget officer, its budget office will reconcile its revenue figures with accounting data before submitting the fund condition statements that will be included in the governor's budget.

To correct errors in the fund balance from prior governor's budgets, a $198.3 million adjustment was made to the fiscal year 2007–08 actual revenue reported for the 2009–10 Governor's Budget.

To Address Its Forecasting Problems, the Department Is Hiring an Economist

To address the issues with its forecasting model, the deputy chief of the division (deputy chief) told us the department has initiated the process to hire an economist to update the forecasting model and expects to fill this position by June 2010. In August and October 2009, the department had informal meetings with Finance and the Legislative Analyst's Office to obtain recommendations on revising the department's forecasting methodology. According to the deputy chief, both agencies recommended that the department include economic indicators in its forecasting model. As a guideline for creating a similar position, Finance provided the department with a job description for its employees who perform forecasting.

The department has determined that it has enough workload for a full-time employee to be in charge of forecasting. According to the deputy chief, the economist would not only be responsible for revising and maintaining the forecasting model for the beverage fund, but the person in this position would also perform forecasts

6 The market research branch is now part of the Department of Resources Recycling and Recovery's administration branch.

for other department-administered funds. This individual will be funded proportionally by the beverage fund and the other funds, based on workload. Further, the person in this position would need to monitor legislation and market developments to determine their possible impacts on the funds. The department also plans to assign special projects to the economist.

The Department Audits Beverage Distributors Inconsistently and Could Do More to Pursue Underpayments

Although the department has a plan to ensure that the top 100 revenue-paying distributors, mid-sized distributors, and other distributors that pose a risk to the beverage fund are audited every three years, it does not consistently do so. Also, because of the time it takes managers to review completed audits, the department increases the risk that billings for identified underpayments are not promptly sent to distributors. In contrast, the department has adequate processes in place to identify unregistered beverage distributors and is actively pursuing regulatory changes to strengthen this process by requiring distributors to register with it.

The Department Does Not Audit All Distributors as Planned

The department is not following through with its three-year plan covering fiscal years 2006–07 through 2008–09 to audit the redemption payments that beverage distributors submit. The beverage fund is dependent on revenue received from beverage distributors, and because beverage distributors self-report the redemption payments they owe on their sales of beverage containers, the department audits distributors to ensure that they are not underpaying. The department's office of audits (audits office) developed the three-year plan based on actual staff available to audit the top 100 distributors, who provide 90 percent of the revenues to the fund. In addition, the department's plan includes procedures to audit a sample of mid-sized distributors and others that pose a risk to the beverage fund.

Audits of the top 100 beverage distributors were still in progress for eight distributors and four others had not been started as of April 2010, even though its three-year audit cycle ended on June 30, 2009.

The acting manager of the audits office (acting audit manager) told us that for the audits of the top 100 distributors, eight were still in progress and four others had not been started as of April 2010. Thus, the department audited beverage distributors that represented 83 percent of the revenues to the beverage fund. She told us that the eight audits in progress will be completed in fiscal year 2010–11, that one of the four not yet begun will start in fiscal year 2009–10, and that the other three will be started in fiscal year 2010–11. The acting audit manager also told us that of the 309 mid-sized and other distributors it planned to audit by June 30, 2009, the department did not start 31 and did not complete 36 during this same three-year period. The acting audit manager told us that 31 audits were not started because of staff vacancies, and 36 audits were not completed because either the audits were complex and required additional time or staff were redirected to higher-priority audits.

The department did not always audit beverage distributors with identified underpayments from prior audits. One such distributor was the fifth largest and had an identified underpayment of $285,000 from a prior audit completed during fiscal year 2005–06.

Moreover, the department did not always audit beverage distributors with identified underpayments from the prior three-year audit cycle. For example, among the 12 audits of the top 100 revenue-paying beverage distributors that were not completed in the three-year cycle ending June 30, 2009, one that was not started was the fifth largest distributor in the State and had an identified underpayment of $285,000 from an audit completed during fiscal year 2005–06 as part of the prior three-year audit plan.[7] Also, among the 36 audits of mid-sized and other distributors that were not completed, one had an identified underpayment of $148,000 from an audit completed in fiscal year 2005–06. We determined that the department eventually collected this $148,000 underpayment. For the remaining audits of mid-sized and other distributors that were not started or that were not completed, the acting audit manager indicated that all but four had underpayments from the prior audit cycle. The underpayments ranged from $372 to $83,000, but she asserted that these beverage distributors were less of a risk than those the department actually audited. The supervisor of the Sacramento audit office stated that the number of audits in the audit office's plan is a goal and not a set number that must be completed each year. Further, she told us that even if the audits office were fully staffed, it would not have sufficient staff to audit all the beverage distributors included in the audit plan. The acting audit manager explained that the three-year audit plan was initially created at the end of fiscal year 2005–06, and was based on staffing at that time. She modifies the plan by assigning audit referrals and high-risk audits to staff and putting lower-risk audits on hold to be assigned once staff become available. Nevertheless, because most of these beverage distributors had underpayments identified during the prior three-year audit cycle, we believe it would be reasonable for the department to consider them to be higher risk.

The department is currently developing changes that it believes will improve its audit process. The Sacramento audit supervisor told us the audits office will begin conducting preliminary fieldwork to

7 As discussed later in this section, the department failed to collect this $285,000 underpayment because the statute of limitations had expired.

identify those distributors posing the greatest risk of underpayment. The audits office also plans to close out an audit any time it determines that the benefit of the audit would be less than its cost to complete. The acting audit manager was unable to provide an estimate for the additional number of audits the department will be able to complete using this approach. She stated that the outcomes of the preliminary fieldwork of future audits will determine the number of completed audits. Also, the acting audit manager informed us that instead of completing full audits of beverage distributors that failed to report their redemption payments, the department will perform only limited reviews to determine the reasons why the distributor failed to report. With this change, the acting audit manager believes the audit office will be able to perform nine additional audits during the next three-year cycle.

A Significant Lag Exists Between Audit Completion and Billing of Underpayments

The department does not always complete its audits within a reasonable time frame in relationship to the two-year statute of limitations for collecting underpayments identified in its audits, but it generally collects identified underpayments. We noted two instances in which the department exceeded the statute of limitations and did not collect on $324,000. State law requires the department to take action to collect underpayments or penalties within two years after it discovers or should have discovered a violation during an audit. The acting audit manager stated that the audits office does not have written guidelines for the timeliness and completion of audits. The Sacramento audit supervisor told us that, in general, staff are expected to complete an audit within a year after starting fieldwork and that the three levels of review (supervisor, quality control, and branch manager) take an additional six months more before the demand letter is sent out. She further told us that leaves six months to take action to collect any underpayments that the audit identifies before the two-year statute of limitations ends. Moreover, the department has a tool to track the time spent on each step of the audit process. However, the tool is not now accurately tracking all information that could be used by the department. Because an audit may identify an underpayment of fees owed to the department, the sooner an audit is completed and reviewed, the more time the department has to take action to collect underpayments. However, as shown in Table 6, in the sample of 11 audits we reviewed, the review process can take longer than six months in practice.

The sooner the audit is completed, the more timely the department can take action to collect any underpayments identified. There is a two-year statute of limitations to take action for collecting underpayments identified in audits—we noted two instances in which the department was not able to collect on $324,000 because it exceeded the statute of limitations.

Table 6
Sample Audit Time Frames
Fiscal Years 2006–07 Through 2008–09

	FIELDWORK		REVIEW		LENGTH OF AUDIT				
BEVERAGE DISTRIBUTOR*	DAYS BETWEEN START OF AUDIT AND REPORT DATE†	APPROXIMATE MONTHS	DAYS BETWEEN REPORT DATE† AND AUDIT COMPLETION DATE	APPROXIMATE MONTHS	DAYS	APPROXIMATE MONTHS	UNDERPAYMENT IDENTIFIED	AMOUNT COLLECTED	DAYS BETWEEN DEMAND LETTER DATE AND COLLECTION DATE
Audit 1	122	4	176	6	298	10	$941,000	$941,000	24
Audit 2	1,217	40	NA	Report never completed	NA	Report never completed	Report never completed	NA	NA
Audit 3	21	1	171	6	192	6	0	NA	NA
Audit 4‡	524	17	854	28	1,378	46	700,000	700,000	1
Audit 5	87	3	248	8	335	11	0	NA	NA
Audit 6	79	3	259	9	338	11	804	804	23
Audit 7	18	1	382	13	400	13	0	NA	NA
Audit 8	36	1	472	16	508	17	0	NA	NA
Audit 9	30	1	145	5	175	6	0	NA	NA
Audit 10	97	3	214	7	311	10	0	NA	NA
Audit 11	69	2	129	4	198	7	323	323	6

Source: Bureau of State Audits' analysis of beverage distributor audits conducted by the Department of Resources Recycling and Recovery (department).

NA = Not applicable.

* Because these audits relate to financial information of the beverage distributors, the department asserts that their identities are confidential under Public Resources Code, Section 14554.

† According to the acting audit manager of the office of audits, the report date is considered the end-of-fieldwork date. However, additional fieldwork may be performed when needed as determined by supervisory and quality control review. Further, the audit demand letter date is the audit completion date and is issued even if no underpayments were identified to provide the results of the audit.

‡ According to the department's legal counsel, this audit included multiple violations discovered on a variety of dates, but that the most significant violations were discovered and resolved before the statute of limitations expired.

The 11 audits we examined took between 129 days (approximately four months) and 854 days (approximately 28 months) to be reviewed, with each of the three review steps contributing to the time taken for review. For example, at the conclusion of fieldwork in June 2008 for one audit, the auditor determined that the beverage distributor underpaid redemption payments by $883,000 over a three-year period, which with interest was eventually billed at $941,000. At the exit conference, the auditor noted that the beverage distributor agreed with the underpayment amount. Given the large underpayment identified, we would expect that the department would act quickly to collect the underpayment and would therefore quickly bill the distributor. In fact, the auditor informed the beverage distributor that it could expect to receive a billing about a month after the exit conference. However, because of the lag in the review process, which took 176 days, the department did not bill the beverage distributor until six months later. Specifically, the supervisor completed the review of the audit about a month later, in July 2008. The next step in the review process, quality control, was not finished until September 2008, and the manager did not sign off on the audit until November 2008. It took the department another month to send a demand letter to the beverage distributor. The beverage distributor sent payment to the department 24 days after it received the demand letter. The acting audit manager stated that audits are prioritized for review based on a variety of factors, such as the number of findings, the statute-of-limitations date, and the likelihood that the beverage distributor will dispute the findings.

When questioned about this audit, the acting audit manager replied that since the statute of limitations was not an issue for this audit because the fieldwork was completed in four months, and due to the large finding amount, the department felt that it was better for the audit report to be strongly supported. Further, she informed us that there have been instances in which the auditee initially agreed with the finding during the exit conference but later disputed it when the bill was issued. Nevertheless, in our review of this audit we noted that the underpayment amount did not change during the review process, and the auditee's quick payment would seem to indicate that it agreed with the audit's finding that it underpaid. Although the department collected the full amount of the underpayment, it did so only at the end of the six-month period allowed under its informal time frame, and there was no indication that the audits office took steps to prioritize this audit for review.

The department's lengthy audit process may increase its risk for failing to collect on underpayments due to the statute of limitations expiring.

Although it generally collects underpayments within the two-year statute of limitations, the department's lengthy audit process may increase its risk for failing to collect on underpayments due to the statute of limitations expiring. As noted in Table 6, of the two audits in our sample for which the fieldwork took more than a year to complete, one was never completed. According to a department memo dated July 2008 from the former audit manager, the audit started in early 2003 and was submitted for supervisory review nearly three years later in November 2006. In March 2007 and again in May 2007, the report was returned to the auditor for revision and more work. However, the final report and demand letter were never issued because the former audit manager decided that the audit report did not fully substantiate the potential underpayment by the beverage distributor, which was approximately $431,000, and the audit and collection periods were beyond the statute of limitations. The acting audit manager was unable to provide specific information on this audit because the supervisor and audit manager who worked on the audit are no longer with the department.

To further review the department's effectiveness in collecting underpayments, we performed an additional review of 16 cases with outstanding underpayments and found two instances in which the department failed to collect an underpayment within the statute of limitations. This included one instance discussed previously in which the department failed to audit a distributor in its most recent three-year audit plan. In the distributor's previous audit, completed in May 2006, the department identified an underpayment of $285,000. However, because of the review process, it did not issue a demand letter until April 2008. According to the supervisor of the Sacramento audit office, department staff responsible for the quality control review on this audit could not recall why 23 months elapsed between finishing the audit and issuing the demand letter. Moreover, according to the department's records, in May 2008 the beverage distributor contested the department's ability to collect this underpayment because the statute of limitations had expired. According to the manager of the financial management recycling program, for this reason the department will not pursue further collection on this audit, and it is in the process of closing the case. We noted another audit in which the department did not collect an underpayment of $39,000 due to the statute of limitations expiring. The supervisor of the Sacramento audit office indicated that the audit file did not contain any details about why the department failed to collect the underpayment, and staff currently with the department could not provide additional clarification. Because the department missed the statute of limitations for these two completed audits, it lost the opportunity to collect $324,000, and in an audit that was never completed, lost the potential to collect an additional $431,000.

The Department Is Proposing Regulatory Changes to Better Ensure That It Collects All Funds From Beverage Distributors

To improve the collection of redemption payments in certain situations, the department is proposing regulatory changes. To minimize paperwork, the department currently allows a beverage distributor to collect fees from its customers and remit the fees to the department. However, current regulations do not require beverage distributors to report information on redemption payment agreements with customers. The department recognizes that the lack of a reporting requirement for these arrangements can cause problems. In one significant instance, the department audited a beverage distributor that declared bankruptcy before the department was able to bill it for underpaying fees by $4.9 million over a three-year period. This beverage distributor was an out-of-state company that collected fees from its 47 California customers, which are other beverage distributors, and was supposed to remit the fees to the department. However, according to the audit file, this distributor failed to report and pay these fees. This audit started in January 2006, and the auditor held the exit conference with the beverage distributor in October 2006;

Current regulations do not require beverage distributors to report information on redemption payment agreements with customers, which can cause problems. In one instance, a distributor declared bankruptcy before the department was able to bill it for underpaying fees by $4.9 million.

however, the distributor declared bankruptcy in November 2006. The acting audit manager stated that given the multitude of findings, the time between the exit conference and the distributor's bankruptcy—approximately three weeks—was insufficient to complete the review process and issue the demand letter. According to its supervising legal counsel, the department will be unlikely to receive payment because of the company's bankruptcy.

The department is making efforts to collect the redemption fees from the distributors' customers (other beverage distributors). As of April 2010 the department had collected $2 million.

The department has determined, however, that the customers of this beverage distributor are responsible for the redemption fees owed. It is making efforts to collect the fees from these customers and, as of April 2010, was able to collect $2 million from 40 of the 47 beverage distributors. To address situations such as this and to provide the department with more awareness of these redemption payment agreements, the department is proposing regulations that would require a beverage distributor to notify it in writing if another entity has agreed to report and make payments on behalf of that distributor. The proposed regulations would provide the department with notice of which entity is paying and possibly help it avoid the situation that occurred in this audit.

Processes Are in Place to Follow Up With Potential Beverage Distributors

By law, beverage distributors are required to make redemption payments on their beverage containers and, according to the department, can do so only after registering with the department. However, current law does not require beverage distributors to register with the department. The department identifies potential unregistered distributors in several ways, such as retail inspections to check for unfamiliar beverage products for sale, referrals received from the Department of Alcohol and Beverage Control, and referrals from other beverage distributors and recyclers. When a potentially unregistered distributor is identified, the department contacts the distributor to determine if it sells or buys beverages that fall within the beverage program.

Based on our review, the department generally follows its written procedures to follow up and register beverage distributors in a reasonable period of time. Furthermore, the department has proposed regulatory changes to require beverage distributors to register with the division. According to the branch chief of its policy and program development branch, the regulations will be ready for public comment by July 2010. By requiring the distributors to register with the division, the department should be able to increase its ability to identify potential distributors.

The manager of the participant management recycling program (program manager) told us that the department does not quantify or estimate the number of unregistered distributors or the amount of uncollected fees from unregistered distributors, nor has it performed any assessment of the level of risk involved with unregistered beverage distributors. He informed us that due to a shortage of staff and the fact that the top 100 distributors, responsible for more than 90 percent of the funds, are already registered, it may not be cost-beneficial to conduct such a study. Moreover, the program manager indicated that inspections of retailers during fiscal year 2008–09 for the sale of beverages that were not included in the beverage program resulted in only 17 violations, indicating to him a high level of compliance.

Weaknesses Exist in the Department's Investigation of Potential Recycling Fraud

Similar to its audits of beverage distributors to ensure proper reporting and submission of redemption payments on beverages sold, the department investigates recyclers that collect used containers from consumers to ensure that they do not commit fraud when claiming reimbursements from the beverage fund. As was mentioned in the Introduction, payments are made from the beverage fund to consumers to refund the deposit charged on beverage containers when they return them to recycling centers. To ensure that they are not fraudulently claiming refund values, the department conducts investigations to examine and review recyclers' activities and records. If an investigation confirms that fraud occurred, the department is authorized to seek monetary actions such as civil penalties and restitution, or to take other actions such as revoking a recycler's certification to pay refund value to customers. Several types of fraudulent recycling activities are shown in the text box. The department has a process to follow up on leads it receives about alleged fraud committed by recyclers. However, it does not have a method to ensure that the process is followed, because it does not track the fraud leads it receives to ensure that staff follow up or initiate investigations on leads. Also, the department does not have a systematic and defined method for analyzing data on recycling volume to detect fraud. It does, however, generally follow its procedures for completing investigation reports.

Examples of Recycling Fraud

- Recycling beverage containers that have already been recycled.
- Improper record-keeping practices at recycling centers.
- Recycling beverage containers that came from outside of California for which no redemption payment was made to the Beverage Container Recycling Fund.
- Recycling beverage containers that were never filled with a qualifying beverage.

Source: Department of Resources Recycling and Recovery Web site, http://www.calrecycle.ca.gov/BevContainer/Fraud/default.htm.

Fraud Leads Are Not Tracked to Ensure That Staff Follow Up or Initiate Investigations

Although the department tracks the status of the investigations that have been initiated or completed, it does not track all fraud leads received, nor does it record how it determined that no follow-up was needed on fraud leads that were not investigated. The department's records indicate that for the past five years, from March 2005 to March 2010, it has initiated or completed 217 investigations. These investigations were initiated based on information from a variety of sources, including 17 initiated from fraud tip-line calls, 43 from other or previous investigations, and 18 from the analysis of past and current recycling volumes. The majority of the remaining 139 investigations came from internal referrals from the division. For example, according to department records, the recycler inspection unit conducts annual inspections of approximately 2,100 to 2,600 recyclers to examine their operations for compliance with beverage program regulations. The supervisor of the recycler inspection unit told us that inspectors observe a recycling center's procedures and determine whether transactions are being recorded properly. Inspectors who notice potential fraud are instructed to forward the information to the investigations unit.

The department does not log all fraud leads received by the fraud tip line or document why fraud leads were closed. Thus, we are unable to determine how fraud leads were resolved for 278 of the 295 fraud tips received over a five-year period.

The acting manager of the compliance assurance program (acting program manager) stated that the responsible investigations unit supervisor reviews fraud leads received to determine whether an investigation is warranted. Depending on the supervisor's decision, he or she will then either assign staff to investigate or close the lead. However, there is not a log of all leads received, or documentation indicating why fraud leads were closed. For calls to the fraud tip line, the department does track all calls received and the details of the tip in a log. The log sometimes indicates that an initial investigation activity was to be done, but it lacks any indication of how the department resolved the tip. Of the 295 tips received and tracked in the log from 2005 through early 2010, only 17 resulted in an investigation, as mentioned previously. Since the department does not track the resolution of the fraud tips, we are unable to determine how it resolved the other 278 tips. We cannot provide similar comparisons for the other types of fraud leads, because the department does not track the receipt of these leads.

The supervisor of the data management unit (data supervisor) told us that the new Division of Recycling Integrated Information System (DORIIS) will allow for tracking of all fraud leads received, the disposition of those leads, and the follow-up that staff perform if the lead is investigated. However, we cannot determine how effective it will be in tracking these leads, because the department has not yet started using this function. By not currently tracking the disposition of all fraud leads, the department lacks assurance that the leads are properly reviewed and resolved in a timely manner.

Although it fails to track fraud leads, the department does have a procedure manual for staff to follow when investigating potential fraud. Our review of 10 completed investigations found that staff generally conducted these investigations in an appropriate and timely manner.

Analysis of Recycling Data for Potential Fraud Could Be More Robust

The department could improve its process for analyzing recycling data to detect potential fraud. As we noted previously, one of the sources for fraud tips is the analysis of recycling volumes to detect potential instances of fraud. According to the data supervisor, one employee is currently devoted to periodically generating 11 different types of reports using data the department receives. The data supervisor told us that these reports identify potential fraud by analyzing changes in recycling volumes, inspection history, and background information about recyclers. The reports must then be manually reviewed to identify any anomalies that may indicate fraud is occurring. Any anomalies noted are referred to the investigations unit for resolution. He indicated, however, that there are no guidelines for identifying when anomalies exist; instead, decisions to make referrals are based on the judgment of the employee who generates the reports. No log is kept of the anomalies referred to the investigations unit and, as noted in the previous subsection, other than knowing that it initiated or completed 18 investigations based on these referrals since 2005, the investigations unit does not track fraud leads it receives from these data anomalies. The data supervisor indicated that DORIIS does not currently have the capability to generate the 11 types of fraud detection reports now used. Once the next phase of DORIIS is implemented in July 2010, the data supervisor expects that it will take an additional six months to one year before this function is added to DORIIS. Until then, the existing process will be used.

Although the department generates reports to identify potential fraud using various data it receives and refers anomalies to the investigations unit for resolution, no guidelines for identifying anomalies exist.

The Department Has Not Determined if the New Fraud Prevention Project Is More Effective

In response to concerns it had in October 2009 over unusually high recycling rates, particularly for plastics, the department began an enhanced effort to determine if recyclers are submitting fraudulent claims for reimbursement of the refund value or are accepting ineligible materials. For example, the department noted that the recycling rate for HDPE (high-density polyethylene), a type of plastic used in beverage containers, was more than 116 percent, which it believes could be the result of fraud. This effort, called the fraud prevention project, is intended to significantly increase the presence of department staff at recyclers and processors, and to prevent fraud before it occurs. According to the deputy director, the fraud prevention project focused on four counties with high recycling volumes in the State. The department indicated that the following activities are occurring under this project: risk assessment reviews of selected recyclers to determine if a more comprehensive investigation should take place, inspections at processors of recycled materials to determine if recyclers' shipments contain only eligible containers, observations of recyclers to validate that they are accepting only eligible containers, prepayment inspections of certain recyclers to confirm that the content of their shipments agree with the recyclers' records, and test sales to ensure that recyclers are properly inspecting loads of empty containers. To accomplish this effort, the department redirected investigations staff and staff from other program areas. As a result, fewer investigations of specific allegations are being performed while these broad deterrence activities are being performed.

Because the department redirected investigations staff and staff from other program areas to perform broad deterrence activities (fraud prevention project), fewer investigations of specific allegations are being performed.

According to the acting program manager, as of March 2010, the accomplishments of the fraud prevention project included inspections of 8,248 recyclers' shipments of beverage containers at 20 major processors, with a savings of $730,000 through the identification of ineligible materials; identification of 20 high-risk recyclers whose shipments must be reviewed before the department will reimburse them; issuance of more than 100 violations to recyclers that failed to properly inspect recyclables received from consumers; and removal of 29 recyclers from the beverage program. He indicated that the department has not yet set specific goals for the project to evaluate whether these results indicate that the project is successful. According to the deputy director, the department considered the merits of continuing the fraud prevention project three months and six months after it began, and both times concluded that the project is adding value.

More recently, he directed the acting program manager to analyze recycling volumes before and after the project started to determine its impact on potentially fraudulent recycling activities. Based on a preliminary review of this analysis, which was completed in late May 2010, the deputy director believes the fraud prevention project has been successful in curbing fraud in some areas of recycling. For example, the recycling volumes in three counties have generally gone down at a higher rate than the statewide average decrease for plastic recycling materials, indicating to him that the project has deterred fraud in these counties.

However, he acknowledged that the results also identify other recycling materials that will require further review to determine whether fraud exists.

Grant Management Is Generally Effective, Except for Conducting Certain Monitoring Activities

As noted in the Introduction, the department is authorized to use the beverage fund to award grants and issue payments to cities and counties to promote recycling. The text box describes these grants. The department has a process for evaluating the grant applications, which we found it generally followed. It also established grant monitoring procedures that would be effective if enforced; however, it does not always follow its process. In addition, the department does not consistently take steps to ensure that it receives the intended value from its payments to local governments, and it did not receive the intended $2.2 million in value for several market development and expansion (market development) grants.

Tables 7 and 8 on the following pages summarize our evaluation of the department's monitoring efforts based on our assessment of its actions related to nine ongoing grants and 10 completed grants that we reviewed.[8] We applied three "grades" when evaluating the department's monitoring efforts. As shown in the tables, a "yes" grade (green ✓) indicates that the department's monitoring of the project always met the criteria, a "marginal" grade (yellow ■) reflects our determination that it did not always meet the monitoring criteria but did so at least 50 percent of the time, and a "no" grade (red ✕) means that its monitoring efforts met the criteria for less than 50 percent of the time. Based on our review, we found that the department generally followed its procedures for awarding grants, but it did not consistently follow its grant management and oversight process.

Beverage Container Recycling Grant Programs

Market Development and Expansion Grants

Competitively awarded grants totaling $20 million annually for beverage container recycling market development and expansion-related activities, including research and development for sustainable products or packaging.

Statewide Technical Assistance and Resources (STAR) Grants

- **Beverage Container Recycling:** Up to $1.5 million competitively awarded annually for grants to provide convenient beverage container recycling opportunities and litter reduction programs.
- **City/County Payment Program:** $10.5 million distributed annually for beverage container recycling and litter cleanup activities to cities (minimum of $5,000) and counties (minimum of $10,000).
- **Local Community Conservation Corps:** $15 million annually plus a cost-of-living adjustment for grants to certified community conservation corps for beverage container recycling and litter reduction programs, and in fiscal year 2007–08 only, $20 million for grants to certified community conservation corps to promote increased recycling of beverage containers.
- **Multifamily Beverage Container Recycling:** A one-time allocation of $15 million competitively awarded for grants to place source-separated beverage container recycling receptacles in multifamily housing communities. Grantees must spend the funds during 2008.
- **Low-Income Multifamily Beverage Container Recycling:** A one-time allocation of $5 million competitively awarded for grants to place source-separated beverage container recycling receptacles in low-income multifamily housing communities. Grantees must spend the funds during 2007.

Sources: Department of Resources Recycling and Recovery Web site, http://www.calrecycle.ca.gov/BevContainer/Grants/; California Public Resources Code.

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8 There are no active payments to cities and counties as of April 2010.

Table 7

Summary of the Department of Resources Recycling and Recovery's Monitoring Activity of Active Grants

	MARKET DEVELOPMENT AND EXPANSION GRANTS					STATEWIDE TECHNICAL ASSISTANCE AND RESOURCES (STAR)*			
						MULTIFAMILY BEVERAGE CONTAINER RECYCLING	MULTIFAMILY BEVERAGE CONTAINER RECYCLING	BEVERAGE CONTAINER RECYCLING	LOCAL COMMUNITY CONSERVATION CORPS
	STRATEGIC MATERIALS, INC.	GREEN BLUE INSTITUTE	PLASTIC RECYCLING CORPORATION OF CALIFORNIA	PENINSULA PLASTICS RECYCLING, INC.	OMNI RESOURCE RECOVERY, INC.	SAN LUIS OBISPO COUNTY INTEGRATED WASTE MANAGEMENT AUTHORITY	WASTE MANAGEMENT, INC.	STANFORD UNIVERSITY ATHLETICS	SACRAMENTO REGIONAL CONSERVATION CORPS
Amount awarded	$547,000	$400,000	$1,000,000	$4,935,000	$990,000	$444,000	$500,000	$121,000	$243,000
Grant term	December 2007 Through December 2010	December 2007 Through December 2010	December 2007 Through December 2010	December 2008 Through December 2011	December 2008 Through December 2011	November 2008 Through November 2010	January 2009 Through December 2010	January 2009 Through May 2010	July 2009 Through September 2011
Grant Management									
Initial site visit occurred†	✗	✗	✗	✗	✗	✓	✓	✓	✗
Site visits are appropriately documented	NA	NA	NA	NA	NA	✓	✓	✓	NA
Invoices include adequate supporting documentation	✓	✓	✓	✓	✓	✓	✓	✓	NA
10 percent withheld from payments	✓	✓	✓	✓	✓	✓	✓	✓	NA
Status Reports									
Received	✗	□	□	✓	✗	□	□	✗	✓
Included sufficient information	□	✓	✓	✓	NA	✓	✓	NA	✓

Source: Bureau of State Audits' analysis of grants managed by the Department of Resources Recycling and Recovery (department).

* There are no active payments to cities and counties as of April 2010.

† We tested only for the required initial and final site visits. Other site visits may have occurred during the grant period.

✓ = Yes. The department's monitoring of the project always met the criteria.

□ = Marginal. The department did not always meet the monitoring criteria, but did so at least 50 percent of the time.

✗ = No. Monitoring efforts met the criteria less than 50 percent of the time.

NA = Not applicable.

Table 8

Summary of the Department of Resources Recycling and Recovery's Monitoring of Closed Grants

	MARKET DEVELOPMENT AND EXPANSION GRANTS					STATEWIDE TECHNICAL ASSISTANCE AND RESOURCES (STAR): LOW-INCOME MULTIFAMILY BEVERAGE CONTAINER RECYCLING	STAR: LOW-INCOME MULTIFAMILY BEVERAGE CONTAINER RECYCLING	STAR: BEVERAGE CONTAINER RECYCLING	STAR: LOCAL COMMUNITY CONSERVATION CORPS	PAYMENTS TO CITIES AND COUNTIES*
	DOGGED ENTERPRISES	ECULLET, INC.	CALRECOVERY	PLASTIC ENERGY CALIFORNIA LLC	ENVIRONMENTAL PLANNING CONSULTANTS	CITY OF LOS ANGELES, BUREAU OF SANITATION	COMMUNITY HOUSING PARTNERSHIP	I LOVE A CLEAN SAN DIEGO	SEQUOIA COMMUNITY CORPS	CITY OF ALAMEDA
Amount paid	$95,000	$109,000	$176,000	$841,000	$431,000	$1,782,000	$58,000	$92,000	$1,500,000	$20,000
Grant term	April 2006 Through March 2008	May 2006 Through March 2008	May 2006 Through March 2008	May 2006 Through March 2009	December 2006 Through November 2008	October 2007 Through August 2009	October 2007 Through December 2009	March 2005 Through January 2008	July 2007 Through September 2008	Fiscal year 2008–09
Grant Management										
Initial site visit occurred†	✗	✗	✗	✗	✗	✗	✗	✗	✗	NA
Final site visit occurred†	✗	✗	✗	✓	✗	✗	✗	✗	✗	NA
Site visits are appropriately documented	NA	NA	NA	✓	NA	NA	NA	NA	NA	NA
Invoices include adequate supporting documentation	✓	✓	✓	✓	■	✓	✓	✓	NA	NA
10 percent withheld from payments	✓	✓	✓	✓	✓	✓	✓	✓	NA	NA
Status Reports										
Received	✓	■	✓	✓	✗	✓	✓	■	✓	NA
Included sufficient information	✓	✓	✓	✓	✓	✓	✓	■	✓	NA
Grant Outcomes										
Final report submitted	✓	✗	✗	✓	✓	✓	✓	✓	✓	NA
Grantee delivered what was proposed	■	✗	✗	■	■	✓	✓	✓	✓	NA

Source: Bureau of State Audits' analysis of grants managed by the Department of Resources Recycling and Recovery (department).

* The department does not use these monitoring procedures for the payments to cities and counties.

† We tested only for the required initial and final site visits. Other site visits may have occurred during the grant period.

✓ = Yes. The department's monitoring of the project always met the criteria.

■ = Marginal. The department did not always meet the monitoring criteria, but did so at least 50 percent of the time.

✗ = No. Monitoring efforts met the criteria less than 50 percent of the time.

NA = Not applicable.

The Department Did Not Consistently Follow Its Grant Management Oversight Process

Although the department established a grant management oversight process that is intended to effectively monitor projects and ensure that grant funds—which during fiscal year 2008–09 totaled $67.5 million—are used properly, it did not always follow its grant management manual or grant agreements. Its monitoring approach would, if followed consistently, provide the information necessary to adequately assess the status of grants and determine whether grantees are using funds appropriately. As identified in tables 7 and 8, however, the department is not consistently adhering to its grant oversight processes; the following sections discuss our concerns with specific oversight activities.

Site Visits

Based on the department's grant management manual, staff will complete site visits during the term of each grant as needed, based on the scope and complexity of the grant project, with a minimum of two visits. An initial site visit is to be completed within 30 days after the grant is awarded to review with the grantee the agreement terms and conditions and meet key staff. A closing site visit should be done to confirm the content of the grantee's final draft report and to clarify any needed information. The manual further states that site visits provide the department an opportunity to validate a grantee's status reports and verify that the grantee used the funds in accordance with program guidelines and its grant proposal. Additionally, site visits enable the department to identify, investigate, and resolve issues, concerns, and problems and to provide technical assistance to the grantee. For Local Community Conservation Corps grants, the department's procedures state that if activities or the grantees' staff have not changed, initial site visits within the first 30 days of receiving an approved grant agreement may not be necessary. However, final site visits are conducted to verify equipment purchases, confirm that the projects are complete, and review outcomes.

The department did not consistently conduct the initial or—in the case of closed grants—final site visits of market development grants, nor did staff document site visit reports as required in the manual.

During our review of five active and five closed market development grants, we found that the department did not consistently conduct the initial or—in the case of closed grants—final site visits, nor did staff document site visit reports as required in the manual. The manual states that the site visit report should include grantee and project information; the date, time, and purpose of the site visit; the nature of the discussions that department staff had with grantee staff; and the findings resulting from the review, including any identified issues, problems, or concerns and corrective actions recommended or taken. However, none of the 10 market development grants had an initial site visit conducted within the initial 30 days, and only one closed grant had a final site visit.

According to the manager of market development grants (market development manager), who took her position in November 2009, the nature of the project determines the need for initial and final site visits. For example, when the grantee is performing only a research study—which was true for only two of the 10 grants we reviewed—no site visits are conducted because no actual physical site exists. Moreover, she explained that department budget constraints can prevent staff from making site visits. In these instances, the department relies on the grantee to document the project's progress in periodic status reports and in the final report. However, the current grant management manual does not detail this process. Instead it discusses the value of site visits to provide the department with an opportunity to meet the grantee, review the parameters of the grant agreement, and confirm project progress. The market development manager indicated that in the future the department will conduct site visits consistent with the grant manual.

Similarly, based on our review, the department did not consistently conduct site visits for the Statewide Technical Assistance and Resources (STAR) grants. For the four active and five closed STAR grants we reviewed, staff conducted an initial site visit within 30 days for only three of the eight grants to which this criterion applied. Further, no final site visits were conducted for the four closed grants that required such a visit. According to the manager of STAR grants (STAR manager), because of staffing and budget constraints and a high volume of grants awarded within a one-month period, the department was not able to meet the 30-day requirement for the initial visits. She explained that the department's goal is to conduct the initial site visit before the grantee submits its first invoice and that the department will update the grant management manual to better reflect its ability to conduct these visits. The STAR manager asserted that site visits were done but not documented for the two Local Community Conservation Corps grants and that site visits are typically done twice a year. Further, for the one payment to cities and counties that we reviewed, she explained that site visits are not required by statute or department procedures. She indicated that department staff may have some informal discussions with cities and counties if they have any questions about the grant, but these discussions are informal and not documented. We recognize that the department would not be able to visit all cities and counties receiving payments, but visiting some of them would provide the department more assurance that the funds are being used for allowable purposes.

No final site visits were conducted for four closed Statewide Technical Assistance and Resources grants that required such a visit.

Invoices and Payment Retention

Under the procedures in the department's grant manual, grantees are required to provide supporting documentation with invoices to ensure that expenses incurred conform to the budget in their grant agreements and occurred within the grant period. Also, to ensure that each grantee completes its project, the department retains 10 percent of progress payments, which the grantee receives after the department accepts that it has successfully achieved the grant's goals.

For the market development grants, the department generally obtained adequate supporting documentation for progress invoices and consistently retained 10 percent from each progress payment. However, we noted that for one closed market development grant, the department accepted payroll invoices that simply included the hours the employee worked and the pay rate but did not include any specifics about the type of work completed or its relationship to the grant award, as required by the grant manual.

Our review of the STAR grants found that the department obtained supporting documentation and retained 10 percent from each progress payment. The STAR manager told us that for the Local Community Conservation Corps program, grantees submit a monthly funding request describing how the funds will be used and that the department does not retain 10 percent from the funding request. Rather, the final payment is withheld until the department accepts the grantee's final report.

Because the department does not require any reporting on how cities and counties are using their funds, combined with the lack of any site visits, the department has minimal assurance that the grant funds are spent only for recycling and litter cleanup activities.

The department does not require supporting documentation or retention of payments for cities and counties. State law specifies that these grants be used for beverage container recycling and litter cleanup activities. The STAR manager explained that payments to the cities and counties program are different from those to the grant programs in that the statute does not state that a city or county has to provide an outcome. She also told us that the money paid to a city or county is used to administer its recycling program. The city or county does have to provide a signed resolution that it will use the money for a recycling program. The city or county also fills out an application and describes how it will use the funds. However, lacking any reporting of how the money was used, combined with the lack of any site visits, as previously noted, the department has minimal assurance that the grant funds are spent only for recycling and litter cleanup activities.

Status Reports

The department's grant manual also requires grantees to submit periodic status reports to describe their progress in achieving the grant program goals and objectives established in the proposals and solicitations. Status reports must demonstrate compliance with grant agreements and must detail tasks performed, identify outcomes, and justify expenditures. These reports are typically required on a monthly or quarterly basis. However, our review found that the department did not consistently receive timely status reports from grantees.

For instance, according to the department's records, of the 10 active and closed market development grants, three grantees submitted their status reports when due at least 50 percent of the time, two more submitted reports when due less than 50 percent of the time, and one did not submit any reports. The remaining four grantees generally submitted their status reports. Moreover, for the status reports received, the market development grantees generally provided sufficient information. The market development manager confirmed that the department did not consistently obtain the status reports for all these grants, but she could not provide specific reasons why the status reports were not submitted on time or why staff did not obtain these reports. Without regular status reports, the department cannot accurately assess progress. She told us that in the future the department will require status reports consistent with grant agreements and the grant manual.

Of the 10 active and closed market development grants we reviewed, three grantees submitted their status reports when due at least 50 percent of the time, two more submitted reports when due less than 50 percent of the time, and one submitted no reports.

Based on our review of nine active and closed STAR grants, we found that four grantees submitted the required status reports, three submitted the reports on at least 50 percent of the occasions when they were due, and one did not submit any status reports. The remaining grant was a payment to a city, and according to the STAR manager, the department does not require periodic status reports for payment to cities and counties because such reports are not required by statute. The STAR manager explained that for the active grants, a stop work notice prevented many grantees from submitting status reports, since no work was being done. She further stated that in the future, the department will be more diligent about obtaining status reports on time and will update the manual to more accurately describe the procedures so they are consistent with the grant agreement.

The Department Does Not Always Receive the Intended Value From Market Development Grants

Some of the market development grants the department awarded have not resulted in the value intended. According to the deputy director, the department accepts a certain level of risk when funding market development grants that financial institutions may not choose to accept. Further, it awards these grants based on innovative but realistic projects related to recycling market development and expansion activities, including research and development of sustainable products or packaging.

Of the five closed market development grants we reviewed, none delivered a final product that is currently being used.

However, of the five closed market development grants we reviewed, none delivered a final product that is currently being used. For example, one grantee was to prepare a scientific study on improving the recovery of recycled materials. The grantee's research was incomplete when the two-year grant ended in March 2008, and the grantee had received $157,000 but had not completed the study. The grantee submitted a grant extension to the department to complete the study, and it continued to submit invoices for the work done after the grant ended. However, the department failed to process the extension in a timely manner, resulting in its denial, and could not pay the grantee the unspent funds remaining on the grant. Subsequently, the grantee submitted a claim for $19,000 to the Victim Compensation and Government Claims Board (Claims Board) requesting reimbursement for the work performed after the grant ended, which the Claims Board approved.[9] According to the department staff person overseeing this grant, he has not contacted the grantee to determine if the study is available. Thus, the department received nothing of value for the $176,000 paid to the grantee.

In another instance, the grantee proposed to design a glass recycling sorter but was unable to complete the work before the grant expiration date. This grantee also applied for a grant extension, but the department again failed to process it in a timely manner. Subsequently, the grantee submitted a claim for $34,000 to the Claims Board that was approved. The grantee received a total of $109,000 but was still unable to complete the project or produce a final report. According to the market development manager, due to the expiration of the grant term and the grant term extension not being approved, the grantee did not continue the project and did not submit a final report. She also told us that the grantee did submit a status report providing a detailed summary of the progress

9 The Victim Compensation and Government Claims Board helps resolve claims against state agencies and employees for money or damages.

achieved. Nevertheless, she confirmed that the grantee will not be providing a final report and that the grant is considered closed and incomplete.

The third grantee was paid $841,000 to build a pilot plant that would recycle certain types of plastic more cleanly. This grantee was able to build the pilot plant by the time the grant ended in March 2009, but needed additional time to collect data on the plant's operations and submit a final report. The grant term had already ended and all competitive grants had been given notice to stop work, which prohibited the department from paying this grantee even after it submitted a final report in October 2009. Subsequently, the grantee submitted a claim to the Claims Board for the 10 percent the department had retained from each payment. The Claims Board approved the grantee's claim in October 2009. This grantee's final report indicated that the project achieved most of its goals, but that the purity of the plastic was not yet at an acceptable level, and that more technical and economic analysis was needed before a full-scale plant could be built.

The fourth grantee was paid $95,000 to work with a private company to develop countertops containing no less than 80 percent recycled glass. In October 2007 the grantee submitted a final report stating that it had successfully engineered this process and that the company had begun to offer countertops to select customers. The report indicates that for long-term sustainability, the company would need additional capacity to lower its production costs and that it would need to find additional sources for recycled glass. However, according to the company's Web site and a phone conversation with a sales representative we conducted in April 2010, the technology is still in development, and the company does not know when the countertops will be available for purchase.

The fifth grantee was paid $431,000 to design, construct, and test a prototype of a low-impact materials sorting system. The grantee was able to complete the project and submit a final report, but the equipment is currently not in use because the subcontractor was not able to add the concept to its facility. Nevertheless, the grant file indicates that the grantee is working to identify a community that would like to continue to test the concept.

One grantee was paid $431,000 to design, construct, and test a prototype of a low-impact materials sorting system; yet the equipment is currently not in use because the subcontractor was not able to add the concept to its facility.

Because of the issues we noted with the outcomes for these five completed market development grants, we tested an additional 10 closed market development grants to determine if a final report was delivered and if the final product provided value. Based on the grantees' final reports, we determined that nine of the 10 grantees reported delivering a final product that was put to use. For example, one grantee successfully completed a facility and system upgrade that accommodated more incoming recycling materials, improved recovery rates, and recovered higher-quality material. Another grantee installed a system that increased the volume of glass beverage container material recovered by an additional 11 tons per month.

One grantee out of the 10 additional grants we reviewed, who was paid $508,000, reported being unable to fully deliver what was proposed under the grant. This grantee's final report showed that its technology for using mixed-color recycled glass in the production of new glass products can be done, but the grantee indicated that due to a lack of resources and the down economy, the installation of the system at a plant was not economically feasible. The deputy director told us that, when funding market development grants, the department accepts a level of risk that financial institutions would not accept, in order to encourage new and innovative recycling techniques. We acknowledge that when funding market development grants the department takes risks that the private sector might not. Nonetheless, the six market development grants discussed in this subsection cost the State nearly $2.2 million. Although grants may not always result in a completely usable product, given the problems with the grants we reviewed, the department should more closely scrutinize the risk of potential failure of a project when awarding future grants under the market development program. Moreover, the department's failure to promptly process grant extensions for two of these grants also contributed to the problems.

We acknowledge that when funding market development grants the department takes risks that the private sector might not; however, the six market development grants discussed did not fully deliver what was proposed and cost the State nearly $2.2 million.

Based on our review, we found that the department received the intended value from the STAR grants. For example, one low-income multifamily grant we reviewed proposed to place beverage container collection receptacles at approximately 7,560 low-income apartment buildings (102,786 residential units) and provide blue bin containers for the storage of recyclables. By the end of the grant term, the grantee reported that 87,765 multifamily residential units were receiving collection services through the funding provided and that approximately 12,000 units were being served by city collection services. The city's work was cut short due to a stop work notice, but the department accepted the city's progress as substantially complete.

The Department Is Taking Steps to Assess the Efficiency and Effectiveness of Its Programs

The department has a strategic plan for the beverage program, with three high-level goals and outcomes for fiscal years 2010–11 through 2012–13, including expected completion dates. For example, the first goal is to "improve the eco-effectiveness of recycling," with a strategic outcome to "increase the amount of [recycled] materials to industry." The department's initiative to implement this goal includes the implementation of DORIIS, which the department indicates, among other things, will provide comprehensive and accurate program information, provide an integrated system that is a centralized data repository, and increase system support flexibility. Another initiative under the goal of "identify the division's transition skill gap" is the succession management plan, with action steps that include identifying backup personnel for key positions and identifying processes to document and transfer historical knowledge. Although the strategic plan includes expected completion dates and the percentages of completion for the action steps listed, the department should consider establishing benchmarks or metrics that would allow it to more clearly measure the success of its beverage program.

The department should consider establishing benchmarks or metrics that would allow it to more clearly measure the success of its beverage program.

Also, in our review of the areas discussed in previous sections of this report, we identified some benchmarks that other units within the beverage program are using that could be incorporated into the strategic plan. For example, as noted earlier, the department has a goal of auditing the top 100 beverage distributors over a three-year period, but fell short of this goal by 12 audits. The department could use this auditing goal—coupled with a metric to evaluate the quality of these audits—as a means to measure its progress in implementing an action step for monitoring beverage distributors' submission of redemption payments to the beverage fund. Similar benchmarks could be established to measure the department's progress in implementing other action steps related to specific activities it undertakes to administer the beverage program, provided these benchmarks include metrics to measure the quality of the outcomes. Another example is the fraud prevention project, which is the department's enhanced effort to prevent fraud by recyclers. While we do not question that the department has received value from this project, establishing specific action steps along with metrics to measure the project's value, would provide the department with a more systematic method of evaluating the success of the fraud prevention project.

In addition to the strategic plan for the beverage program, the department performs other activities to assess the program's effectiveness. For example, the department publishes biannual reports that detail recycling rates, as required by law. To create these reports, the department gathers information directly from beverage distributors' sales data and from recyclers' volumes of beverage containers recycled. It uses this information to calculate the recycling rates for different material types, which it then includes in the reports. Also, as a result of new legislation, the department will review the beverage fund and provide a quarterly status report on its Web site to ensure that adequate funds are available to make the payments specified in law, including payments for curbside programs, quality incentives, recycler incentives, public education, and processing fees. Moreover, the division conducts weekly management meetings to share information among different units. Each of these activities adds value to the division's efforts to administer the beverage program and, combined with metrics to measure the quality of these activities, could be integrated into the strategic plan as specific action steps.

Recommendations

To improve its forecasting of revenues and expenditures for the beverage fund, the department should do the following:

- Implement a new forecasting model in time for it to be used for the fiscal year 2011–12 Governor's Budget.
- Place appropriate controls over the forecast model, including having management review the reliability of forecasting results before they are used and monitoring the reliability of forecast results against actual figures on a monthly and yearly basis.
- Ensure that the contingency reserve for the beverage fund does not exceed the statutory limit specified in the Public Resources Code.
- Continue with its efforts to hire an economist to lead its forecasting efforts.
- Ensure that the actual fund balances of the beverage fund in future governor's budgets reflect actual revenues and expenditures from its accounting records.

The department should better follow its three-year plan to audit beverage distributors. Steps to accomplish this goal could include performing an analysis of risks that could result in underpayment of redemption payments or implementing policies to terminate audits after the department's initial assessment of a beverage distributor concludes that it is unlikely that an underpayment exists.

To avoid exceeding the statute of limitations for collecting underpayments, and to bill for collection sooner, the department should strive to complete the fieldwork for audits in a more timely fashion. Further, the department should implement policies to shorten the time needed to review completed audits before billings are made, and should also develop policies to expedite reviews when an audit identifies a significant underpayment.

The department should continue with its efforts to implement regulation changes that will require beverage distributors to register with the department and to notify the department if another entity has agreed to report and make payments on behalf of that beverage distributor.

To improve management of its fraud investigations, the department should take the following actions:

- Track all fraud leads that the investigations unit receives and track the disposition of those leads, as well as document the reasons for closing leads without an investigation.

- Formalize the approach used to analyze recycling data for potential fraud and develop criteria for staff to use when deciding whether to refer anomalies for investigation. Because DORIIS will be a central data source for recycling activities once it is implemented, the department should continue with its plan to automate the review of recycling data within DORIIS to identify potential fraud.

- Continue to evaluate the effectiveness of the fraud prevention project and whether it is a cost-beneficial activity.

To improve oversight of grants and ensure that the intended value is received from the grant funds it awards, the department should do the following:

- Perform site visits to ensure that grantees are progressing on projects as expected.

- Require that grantees provide regular status reports that sufficiently describe their progress toward meeting the goals of the grant.

- More closely scrutinize the risks associated with proposed market development grants.

- For recipients of market development grants that are unable to meet the goals of their grants, maintain contact with grantees after the project is completed to determine if the goals may ultimately be achieved.

- Make determinations to approve grant extension requests in a timely manner.

- Implement policies to ensure that cities and counties spend grant funds for recycling purposes by requiring periodic reporting of expenses or reporting of how funds were used after the grant ends.

The department should weave benchmarks, coupled with metrics to measure the quality of its activities, into the strategic plan for the beverage program to allow it to better measure progress in meeting goals. Further, it should ensure that the strategic plan incorporates all relevant activities of the beverage program.

We conducted this review under the authority vested in the California State Auditor by Section 8543 et seq. of the California Government Code and according to generally accepted government auditing standards. We limited our review to those areas specified in the audit scope section of the report.

Respectfully submitted,

Elaine M. Howle

ELAINE M. HOWLE, CPA
State Auditor

Date: June 22, 2010

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For questions regarding the contents of this report, please contact
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(Agency response provided as text only.)

California Natural Resources Agency
1416 Ninth Street, Suite 1311
Sacramento, CA 95814

June 10, 2010

Elaine M. Howle
555 Capitol Mall, Suite 300
Sacramento, CA 95814

Dear Ms. Howle,

Thank you for the opportunity to review a draft copy of the audit regarding the Beverage Container Recycling Program (BCRP) and its operation over the last five years. We commend the cooperative approach utilized by Bureau of State Audits (BSA) staff in completing this review. Their recognition of the recent improvements CalRecycle has implemented in the BCRP is greatly appreciated.

On Jan. 1 2010, California's recycling and waste diversion efforts were streamlined into the new Department of Resources Recycling and Recovery (CalRecycle), a result of Senate Bill 63 (Chapter 21, Stats. of 2009). CalRecycle manages programs created through two landmark initiatives -- the Integrated Waste Management Act and the Beverage Container Recycling and Litter Reduction Act -- that were formerly part of the California Integrated Waste Management Board and the Department of Conservation.

Since its inception, CalRecycle has placed great emphasis on finding ways to improve effectiveness of programs without compromising program delivery. The department has identified areas where functional realignment is possible and is moving forward to reorganize program responsibilities for the long-term sustainability of the organization.

Without question, the BCRP has been effective in challenging Californians to recycle their bottles and cans. Since the BCRP began in 1987, more than 200 billion beverage containers have been recycled and, the overall recycling rate for 2009 was 82 percent. Numerous recycling grants have also been awarded to help cities, counties, businesses, and organizations recycle.

The BSA audit report makes recommendations in five major areas -- forecasting of the recycling fund, audit planning and implementation, fraud detection, grant management, and strategic planning. The department has already implemented a number of changes that address these recommendations.

For example, CalRecycle has a process in place to regularly project beverage container fund revenues and is working to redesign its fund forecasting methodology. This redesign will ensure that forecast results are compared with actual data and allow CalRecycle to make adjustments as needed to improve the quality of future forecasts. To further assist in forecasting, the department is moving forward to hire an economist.

CalRecycle also is implementing risk-based evaluations as part its annual update of the current three-year audit plan. And, audit payment tracking will be enhanced by the Division of Recycling Integrated Information System (DORIIS), which began operation in March 2009. DORIIS is designed to provide comprehensive and accurate program information, act as a centralized data repository, reduce reimbursement timelines, and improve business practices and customer service, among other things. The

Elaine M. Howle, State Auditor
June 10, 2010
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second phase of DORIIS, expected to be implemented in summer 2010, includes an audit support function to track activity from the initial audit plan to the collection of findings, with specific attention to the statute of limitations for each audit.

As explained in the Audit Report, CalRecycle investigates potential fraud. To more closely monitor fraud leads, the DORIIS system will also provide the department with tracking functionality for all beverage container program related fraud tips, from receipt of the tip, to assignment and ultimate resolution. Additionally, CalRecycle's enhanced Fraud Prevention Project (FPP) has been effective in reducing fraud, which helps the department maintain the integrity of the BCRP.

Finally, to monitor grant projects and ensure funds are used properly, CalRecycle has a grant management process in place. The department is currently reviewing all of its grant manuals to determine instances where guidelines could be revised to delineate between grant types.

Again, thank you for the opportunity to provide comments on this audit. Our findings and recommendation responses are attached. Please contact CalRecycle Director Margo Reid Brown at 916-322-4032 if you have any questions.

Sincerely,

(Signed by Lester Snow)

Lester Snow
Secretary for Natural Resources

1. FORECASTING

To improve its forecasting of revenues and expenditures for the beverage fund the department should do the following:

- **Implement a new forecasting model in time for it to be used for the fiscal year 2011-12 Governor's Budget.**
- **Place appropriate controls over the forecast model, including management review of the reliability of forecasting results before they are used and monitoring the reliability of forecast results against actual figures on a monthly and yearly basis.**
- **Continue with its efforts to hire an economist to lead its forecasting efforts.**

CalRecycle currently has a process in place to regularly project revenues and is working to redesign its fund forecasting methodology. The redesign will provide for detailed review and approval by department management and will also ensure that forecast results are compared with actual data and allow CalRecycle to make adjustments as needed to improve the quality of future forecasts. Additionally, the department will conduct monthly, quarterly, and yearly reviews to compare actual sales and returns values with prior projections.

As explained in the Audit Report, CalRecycle is also moving forward to hire an economist who will assist the department in revising its forecasting model. To further inform this process, the department met with Department of Finance and Legislative Analyst Office forecasting staff in fall 2009 to discuss forecasting processes and to gain information about effective model design that could enhance CalRecycle's forecasting methodology.

- **Ensure that the contingency reserve for the beverage fund does not exceed the statutory limit specified in the Public Resources Code.**

CalRecycle believes that a 5 percent prudent reserve would only tolerate an increase in consumer recycling of slightly more than 3 percent. Therefore, CalRecycle believes that by reading Government Code coupled with Public Resources Code to establish a prudent fund reserve, the department was acting in the best interest of consumers. However, as identified by the BSA, following Public Resources Code alone is a more appropriate interpretation of the law. Moving forward the department will follow this interpretation and will work with the Administration and the Legislature to change the fund reserve statute to ensure the recycling fund's ability to pay consumers deposits when they recycle.

- **Ensure that the actual fund balances of the beverage fund in future governor's budgets reflect actual revenues and expenditures from its accounting records.**

CalRecycle's budget office will annually review department records and reconcile them with State Controller's data to ensure the Department of Finance has correct data for preparing the governor's budget.

2. AUDITS

- **The department should better follow its three-year plan to audit beverage distributors. Steps to accomplish this goal could include performing an analysis of risks that could result in underpayment of redemption payments or implementing policies to terminate audits after the department's initial assessment of a beverage distributor concludes that it is unlikely that an underpayment exists.**

CalRecycle is implementing risk-based evaluations during audits and is updating its current three-year audit plan to reflect this change. This plan includes an analysis that allows the department to terminate audits should an initial assessment show that it is unlikely an underpayment exists so that audit hours can be spent on audits with the highest probability of finding underpayments. CalRecycle believes these revisions will help the department better follow and manage the plan. The department anticipates that auditors will receive training on this risk-based process within the first quarter of fiscal year 2010/11.

- **To avoid missing the statute of limitations for collecting underpayments and to bill for collections sooner, the department should strive to complete the field work for audits in a more timely fashion. Further, the department should implement policies to shorten the time needed to review completed audits before billings are made and also consider policies to expedite reviews when an audit identifies a significant underpayment.**

The Audit Report recognizes that CalRecycle generally collects underpayments within the two-year statute of limitations and has a process in place to prioritize high-risk audits annually. The department currently utilizes a system to track and manage Beverage Container Recycling Program participant payments and reporting. The Division of Recycling Integrated Information System (DORIIS) began operation in March 2009 and is designed to provide comprehensive and accurate program information, act as a centralized data repository, reduce reimbursement timelines, and improve business practices and customer service, among other things. In summer 2010 DORIIS will include an audit support function to track activity from the initial audit plan to the collection of findings, with specific attention to the statute of limitations for each audit. In addition to the full implementation of DORIIS, the department is working to develop criteria to rank findings and prioritize review and completion of audits.

- **The department should continue with its efforts to implement regulation changes that will require beverage distributors to register with the department and to notify the department if another entity has agreed to report and make payments on behalf of that beverage distributor.**

As identified by the BSA, CalRecycle has procedures in place to identify unregistered beverage distributors and is actively pursuing regulatory changes to strengthen the audit process and protect the recycling fund.

<u>3. FRAUD PREVENTION</u>

To improve management of its fraud and investigations the department should take the following actions:

- **Track all fraud leads that the investigations unit receives and track the disposition of those leads as well as documenting the reasons for closing leads without an investigation**

To more closely monitor fraud leads, the DORIIS system was designed to provide CalRecycle with tracking functionality for all beverage container program related fraud tips, from receipt of the tip, to assignment and ultimate resolution. This functionality will be in place in summer 2010 as part of DORIIS phase two. In the interim, CalRecycle is implementing steps to ensure that fraud tips received are logged and tracked by either CalRecycle (civil/administrative) or via referral to the Department of Justice (criminal).

- **Formalize the approach used to analyze recycling data for potential fraud and develop criteria for staff to use when deciding whether to refer anomalies for investigation. Because DORIIS will be a central data source for recycling activities once it is implemented, the department should continue with its plan to automate the review of recycling data for potential fraud within DORIIS.**

Modification of DORIIS to implement fraud detection modules is currently in the design phase and will be developed and implemented six to 12 months following DORIIS phase two completion. CalRecycle collects a variety of data from manufacturers, distributors, recyclers and processors and analyzes it for anomalies, outliers and potential fraud indicators. While the department follows an informal practice for extracting and interpreting data to direct investigations, it agrees that a systematic and defined documentation of current practices and methodology is valuable.

- **Continue to evaluate the effectiveness of the fraud prevention project and whether it is a cost-beneficial activity.**

CalRecycle believes its enhanced Fraud Prevention Project (FPP) has been effective in reducing fraud and the Audit Report does not question that the FPP provides value. CalRecycle currently has six months of data regarding the effectiveness of the FPP and is using this data to evaluate the project. The FPP has generated information that often warrants further field analysis and investigation. CalRecycle agrees it will continue to evaluate the effectiveness of FPP to measure whether its benefits are worth the cost.

4. GRANTS

To improve oversight of grants and ensure that the intended value is received from the grant funds it awards, the department should do the following:

- **Perform site visits to ensure grantees are progressing on projects as expected.**

As identified in the Audit Report, CalRecycle has a management process in place to monitor grant projects and ensure funds are used properly. The department's beverage container recycling grant management manual explains that site visits will be conducted, based on the scope and complexity of the grant project. However, the department agrees with BSA that site visits have been inconsistent. The department is currently reviewing all of its grant manuals to determine instances where guidelines could be revised to delineate between grant types. This review will help the department make clear distinctions among grants to identify when site visits are necessary and when they are not, based upon the type of grant.

- **Require that grantees provide regular status reports that sufficiently describe progress toward meeting the goals of the grants.**
- **Implement policies to ensure that cities and counties spend grant funds for recycling purposes by requiring periodic reporting of expenses or reporting of how funds were used after the grant ends.**

The department recognizes the need to meet these requirements and will ensure that regular status reports are submitted on time. CalRecycle is also working to implement a reporting requirement that will allow the department to review city and county expenditures.

- **More closely scrutinize the risks associated with proposed market development grants.**

As a part of the CalRecycle functional reorganization, the department is evaluating grants and loans and the risk associated with each. The Division of Recycling's experience in the administration of grants and the former California Integrated Waste Management Board's experience in the administration of loans will help the department as it reviews all scoring criteria to ensure that risk is assessed before funds are awarded.

- **For market development grants recipients that are unable to meet the goals of their grants, maintain contact with grantees after the project is completed to determine if the goals may be ultimately achieved.**
- **Make determinations to approve grant extension requests in a timely manner.**

In February 2010, CalRecycle began to review past market development grants to determine factors contributing to their success and sustainability. The evaluation is not complete but will be expanded to include this review and contact with grantees. Additionally, CalRecycle will work with grant recipients to ensure timely completion of grants, and will process grant extensions in a timely manner.

5. STRATEGIC PLANNING

- **The department should weave benchmarks coupled with metrics to measure the quality of its activities into the strategic plan for the beverage program to allow it to better measure progress in meeting goals. Further, it should ensure that the strategic plan incorporates all relevant activities of the beverage program.**

The merger of the California Integrated Waste Management Board and the Division of Recycling provides an opportunity to analyze and adopt practices that have proven successful in each respective department. Since its creation in January 2010, CalRecycle has identified areas where functional realignment is possible, and is moving forward to reorganize program responsibilities to realize efficiencies for the organization. CalRecycle leadership has also adopted a set of core values that will guide the department's work to achieve its priority goals and objectives, including protection of the environment and preservation of natural resources, streamlining and evaluating opportunities for the development of new markets, increased levels of compliance, and achievement of operational efficiencies. As the department refines its strategic plan, relevant Beverage Container Recycling Program activities -- such as metrics to achieve audit plans, inspections, and enforcement objectives -- as well as other CalRecycle program activities, will be incorporated along with the means to measure the quality of these outcomes.

cc: Members of the Legislature
Office of the Lieutenant Governor
Milton Marks Commission on California State
Government Organization and Economy
Department of Finance
Attorney General
State Controller
State Treasurer
Legislative Analyst
Senate Office of Research
California Research Bureau
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