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Auditor-Controller/
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April 29, 2013

Gerry Newcombe, Director
Department of Public Works
825 East Third Street
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SUBJECT: **AUDIT OF SOLID WASTE MANAGEMENT DIVISION CLOSURE/POST CLOSURE, POLLUTION REMEDIATION AND RECEIVABLES FOR THE FISCAL YEAR ENDED JUNE 30, 2011**

Introductory Remarks

In compliance with Article V, Section 6 of the San Bernardino County Charter, we have completed a financial audit of the Solid Waste Management Division's pollution remediation liability, closure/postclosure liability and receivables. The period covered by the audit was July 1, 2010 through June 30, 2011. Our audit was conducted in accordance with the International Standards for the Professional Practice of Internal Auditing developed by the Institute of Internal Auditors. These standards require that we plan and perform the audit to obtain sufficient, reliable, relevant and useful evidence to achieve the objectives.

Background

The Solid Waste Management Division (Division) within the Department of Public Works of San Bernardino County (County) is responsible for the operation and management of the County's solid waste disposal system, which consists of five regional landfills and nine transfer stations. The Division also administers the County's solid waste handling franchise program, the refuse collection permit program, which authorizes and regulates trash collection by private haulers in the unincorporated area, and the state mandated waste diversion and recycling program.

The Division's financial statements contain significant estimates included in the San Bernardino County Comprehensive Annual Financial Report (CAFR). Reliability of financial reporting is affected by the degree of estimation in the measurement process and by uncertainties inherent in what is being measured. The presentation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets at the date of the financial statements. Significant estimates were entered into the determination of the amounts reported at June 30, 2011 for the pollution remediation liability of $68.3 million and the closure/postclosure liability of $99.9 million (rounded to the nearest tenth million). Due to the risk inherent in the use of significant estimates affecting the CAFR, the Internal Audits Section was tasked with performing an audit of these areas.

Objectives, Scope and Methodology

Our overall objective was to determine whether the Division's significant estimates for pollution remediation and closure/postclosure, and receivables were in accordance with generally accepted accounting principles in the United States of America in the Division's financial statements for the fiscal year ending June 30, 2011.

Conclusion

Based on the audit work performed, we concluded that the Division's financial statement accounts mentioned above were, in all material respects, in accordance with generally accepted accounting principles in the United States of America in the Division's financial statements for the fiscal year ended June 30, 2011.

During the fiscal year ending June 30, 2011, the Division changed its estimate of the number of years that pollution remediation efforts must continue from 15 to 30 years. The pollution remediation liability compared to last fiscal year increased by $39.7 million, mainly due to the extension of the clean-up period. This change was based on an outside consultant study. The methodology used in the study and industry standards were reviewed by us during our audit. The change appears to be based on sound assumptions that were not known at the time of the original estimate. The accounting for this change in the Division's pollution remediation obligation was properly reported as a change in accounting estimate rather than a prior period adjustment in accordance with United States Generally Accepted Accounting Principles.

In connection with our audit, nothing came to our attention that caused us to believe that the estimate methodologies used by the Division for pollution remediation and closure/postclosure were not in compliance with GASB Codification Sections P40 and L10. However, we identified procedures and practices over revenue recognition that could be improved. We have listed these areas and our recommendations for improvement in the Findings and Recommendations section of this report.

We sent a draft report to the department on March 18, 2013 and discussed our observations with management on March 25, 2013. Management's responses have not been altered in any way and are included below as they were provided to us.

Findings and Recommendations

Finding 1: Revenue recognition processes need improvement.

Governmental Accounting Standards Board (GASB) Codification Section N50, paragraph .118 requires a receivable and revenue be recognized once all applicable eligibility requirements for a voluntary nonexchange transaction have been met. Preparing year-end accruals provides accurate and reliable financial information that is useful in the decision-making process over the Division's operations. During our audit, we noted that the Division did not accrue a California Department of Recycling Resources and Recovery grant of $77,839 for which eligibility was met prior to fiscal year-end. The grant was not accrued at June 30, 2011 because the expenditures and revenues were budgeted for fiscal year 2012. Not properly accounting for necessary year-end accruals can potentially have a material effect on the financial statements.

Recommendation:

We recommend that the Division become familiar with GASB Codification Section N50 requirements and recognize a receivable and revenue for any voluntary nonexchange transaction meeting the eligibility requirements prior to fiscal year end.

Management's Response:

Department staff have become more familiar with GASB Codification Section N50. Staff is now aware of the requirements to recognize voluntary non-exchange grant revenue for the fiscal year period awarded even if not budgeted, nor expended. The division currently only receives one voluntary non-exchange grant and will ensure it is booked appropriately at fiscal year end.

Auditor's Response:

The Division's planned actions will correct the deficiencies noted in the finding.

Finding 2: There is no allowance for uncollectible special assessments receivable.

According to Governmental Accounting Standards Board Statement No. 20, proprietary activities should apply Financial Accounting Standards Board (FASB) statements issued on or before November 30, 1989. FASB Statement No. 5, paragraph 8 (codified by the GASB in Statement 62, paragraph 102 for periods beginning after December 15, 2011) requires the accrual of a loss contingency for the collectibility of receivables. The allowance method is appropriate in situations where it is probable that an enterprise will be unable to collect all amounts due and that the amount of the loss can be reasonably estimated. Service type special assessment revenues should be treated like user fees and recognized on the accrual basis of accounting as the Division uses enterprise fund type accounting. During our audit, we noted that the Division accrued special assessments receivable for amounts that were up to 27 years old for land use fees and 5 years old for hauler fees, which may indicate a collectibility issue due to the age of the receivables. Since there are assessments receivable that may not be fully collectible, an allowance for doubtful accounts may be necessary. Preparing financial statements with an allowance for doubtful accounts provides accurate and reliable financial information that is useful in the decision making process over the Division's operations.

Recommendation:

We recommend the Division review special assessments receivable for collectibility and create an allowance for doubtful accounts.

Management's Response:

The Division's practice of accruing 100% of the unpaid special assessments receivables listed on the Property Tax Division's annual reports has been done in the same consistent manner. Past financial audits did not raise this issue based upon GASB 6 principles that have been in place since approximately 1988.

For fiscal year ending June 30, 2012, the division only accrued an average of 35% of the total outstanding special assessment revenues based upon on our estimate of prior year's collections. Since the recommendation to establish an allowance for doubtful accounts was not provided timely by the Internal Audits Section, it was not implemented for fiscal year ending June 30, 2012. The division will work with General Accounting to implement this recommendation for fiscal year ending June 30, 2013.

Auditor's Response:

The Division's planned actions will correct the deficiencies noted in the finding.

Thank you very much for the cooperation extended by your staff during the course of this audit.

Respectfully submitted,

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