

# Internal Audit Department

O R A N G E C O U N T Y  
6<sup>th</sup> Largest County in the USA

## Internal Control Audit: OC WASTE & RECYCLING CONTRACT ADMINISTRATION FOR THE LA PATA AVENUE GAP CLOSURE PROJECT

As of June 30, 2013

### Key Control Audit

OC Waste & Recycling (OCWR) entered into a Memorandum of Understanding with OC Public Works (OCPW) to share costs associated with the La Pata Avenue Gap Closure Project through the Prima Deshecha Landfill site. In August 2013, OC Public Works reported to the Board of Supervisors that the estimated project costs will total \$92 million.

At the request of OCWR, we audited the contract administration process to ensure compliance with selected terms and conditions in the Memorandum of Understanding between OCWR and OCPW for the La Pata Avenue Gap Closure Project and Settlement Agreement approved by the Board of Supervisors. In addition, we evaluated OCWR's accounting and budget practices for the project and processes to accumulate expenses for cost-sharing. We noted **three (3) Significant Control Weaknesses** and **five (5) Control Findings** for enhancing contract administration for the La Pata Avenue Gap Closure Project.

AUDIT NO: 1334  
REPORT DATE: JANUARY 6, 2014

**Director:** Dr. Peter Hughes, MBA, CPA, CIA  
Senior Audit Manager: Michael Goodwin, CPA, CIA  
Audit Manager: Kenneth Wong, CPA, CIA

#### RISK BASED AUDITING

GAO & IIA Peer Review Compliant – 2001, 2004, 2007, 2010



American Institute of Certified Public Accountants Award to Dr. Peter Hughes as 2010 Outstanding CPA of the Year for Local Government

GRC (Government, Risk & Compliance) Group 2010 Award to IAD as MVP in Risk Management



2009 Association of Certified Fraud Examiners' Hubbard Award to Dr. Peter Hughes for the Most Outstanding Article of the Year – Ethics Pays



2008 Association of Local Government Auditors' Bronze Website Award



2005 Institute of Internal Auditors' Award to IAD for Recognition of Commitment to Professional Excellence, Quality, and Outreach

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**Internal Audit Department**

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**OC Fraud Hotline (714) 834-3608**

# Letter from Dr. Peter Hughes, CPA



## Transmittal Letter



**Audit No. 1334 January 6, 2014**

**TO:** Dylan Wright, Director  
OC Waste & Recycling

**FROM:** Dr. Peter Hughes, CPA, Director  
Internal Audit Department

**SUBJECT:** Internal Control Audit: OC Waste & Recycling  
Contract Administration for the La Pata Avenue  
Gap Closure Project

At the request of OC Waste & Recycling, we have completed an Internal Control Audit of OC Waste & Recycling Contract Administration for the La Pata Gap Avenue Closure Project as of June 30, 2013. We performed this audit in accordance with our *FY 2013-14 Audit Plan and Risk Assessment* approved by the Audit Oversight Committee and the Board of Supervisors. Our final report is attached for your review.

Please note we have a structured and rigorous **Follow-Up Audit** process in response to recommendations and suggestions made by the Audit Oversight Committee (AOC) and the Board of Supervisors (BOS). Our **First Follow-Up Audit** will begin at six months from the official release of the report. A copy of all our Follow-Up Audit reports is provided to the BOS as well as to all those individuals indicated on our standard routing distribution list.

The AOC and BOS expect that audit recommendations will typically be implemented within six months and often sooner for significant and higher risk issues. Our **Second Follow-Up Audit** will begin at six months from the release of the first Follow-Up Audit report, by which time **all** audit recommendations are expected to be addressed and implemented. At the request of the AOC, we are to bring to their attention any audit recommendations we find still not implemented or mitigated after the second Follow-Up Audit. The AOC requests that such open issues appear on the agenda at their next scheduled meeting for discussion.

We have attached a **Follow-Up Audit Report Form**. Your department should complete this template as our audit recommendations are implemented. When we perform our first Follow-Up Audit approximately six months from the date of this report, we will need to obtain the completed form to facilitate our review.

Each month I submit an **Audit Status Report** to the BOS where I detail any material and significant audit findings released in reports during the prior month and the implementation status of audit recommendations as disclosed by our Follow-Up Audits. Accordingly, the results of this audit will be included in a future status report to the BOS.

As always, the Internal Audit Department is available to partner with your staff so that they can successfully implement or mitigate difficult audit recommendations. Please feel free to call me should you wish to discuss any aspect of our audit report or recommendation. Additionally, we will request your department complete a **Customer Survey** of Audit Services. You will receive the survey shortly after the distribution of our final report.

### ATTACHMENTS

Other recipients of this report are listed on the **OC Internal Auditor's Report** on page 4.

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OC Waste & Recycling  
Contract Administration for the La Pata Avenue Gap Closure Project  
Audit No. 1334*

As of June 30, 2013

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Audit No. 1334

January 6, 2014

TO: Dylan Wright, Director  
OC Waste & Recycling

FROM: Dr. Peter Hughes, CPA, Director  
Internal Audit Department

SUBJECT: Internal Control Audit: OC Waste & Recycling Contract  
Administration for the La Pata Avenue Gap Closure Project

## Audit Highlight

OC Waste & Recycling entered into a memorandum of understanding with OC Public Works to share costs associated with the La Pata Avenue Gap Closure Project through the Prima Deshecha Landfill site. In August 2013, OC Public Works reported to the Board of Supervisors that the estimated project costs will total \$92 million.

An audit was conducted of OC Waste & Recycling's contract administration process to ensure compliance with the memorandum of understanding between OC Waste & Recycling and OC Public Works for the La Pata Avenue Gap Closure Project and settlement agreement approved by the Board of Supervisors. In addition, an evaluation was completed on OC Waste & Recycling's accounting and budget practices for the project and processes for accumulating expenses for cost-sharing. We noted **three (3) Significant Control Weaknesses** and **five (5) Control Findings** for enhancing contract administration processes for the project.

## OBJECTIVES

In accordance with our *FY 2013-14 Audit Plan and Risk Assessment* approved by the Audit Oversight Committee and the Board of Supervisors, and at the request of OC Waste & Recycling (OCWR), the Internal Audit Department conducted an Internal Control Audit of OCWR's Contract Administration for the La Pata Avenue Gap Closure Project. Our audit included an evaluation of internal controls and compliance with the Memorandum of Understanding (MOU) between OCWR and OC Public Works (OCPW) and County policies. This audit was conducted in conformance with the International Standards for the Professional Practice of Internal Auditing prescribed by the Institute of Internal Auditors. The objectives of this audit were to:

1. Evaluate compliance with terms and conditions in the MOU between OCWR and OCPW for the La Pata Avenue Gap Closure Project.
2. Evaluate compliance with the directives from the Board of Supervisors for the 7.2% cost share allocated to OCWR.
3. Evaluate OCWR's accounting and budget practices in fulfilling its financial obligations for the La Pata Avenue Gap Closure Project.
4. Ensure all expenses incurred by OCWR are included in the cost share.

## RESULTS

**Objective #1:** We found that OCWR is in compliance with selected terms and conditions in the MOU with OC Public Works, and that OCWR's accounting and budgetary practices are generally in place to fulfill its financial obligations to the project. We describe in **three (3) Significant Control Weaknesses** and **three (3) Control Findings** recommendations for enhancing contract administration processes.

**Objective #2:** We did not note any exceptions or non-compliance with the directives for the 7.2% cost share allocated to OCWR.

**Objective #3:** OCWR accounting and budget practices processes are generally in place to fulfill financial obligations for the La Pata Avenue Gap Closure Project. See Objective No. 4 below.

**Objective #4:** Our audit of OCWR's process for accumulating expenses incurred for the cost-share with OCPW disclosed **two (2) Control Findings** regarding job cost accounting and allocation of indirect costs.



The following table summarizes our findings and recommendations for this audit. See further discussion in the *Detailed Results, Findings, Recommendations and Management Responses* section of this report. See *Attachment A* for a description of Report Item Classifications.

**Summary Table of Findings and Recommendations**

Finding No.	Finding Classification (see Attachment A)	Finding and Page No. in Audit Report	Recommendation	Concurrence by Management?
1.	<b>Significant Control Weakness</b>	Description for the scope of work on the Settlement Agreement and Memorandum of Understanding was inconsistent regarding basis to allocate cost sharing (i.e., total project costs vs. construction costs) (p.5-6).	Clarify with OCPW the scope of work regarding the basis on which to allocate OCWR's cost-sharing and financial responsibility.	Yes
2.	<b>Significant Control Weakness</b>	Estimated project costs are inconsistent between OCWR and OCPW (p.7).	Clarify with OCPW the components of project costs and estimated project costs.	Yes
3.	<b>Significant Control Weakness</b>	A recurring process was not in place to monitor project costs (p.7-8).	Ensure job cost reports are monitored by management and amounts are supported with appropriate documentation.	Yes
4.	<b>Control Finding</b>	Project costs were not reported or reimbursed between OCWR and OCPW (p.8).	Communicate with OCPW on project costs, scheduling, and completion.	Yes
5.	<b>Control Finding</b>	A methodology has not been determined to quantify the market value of the right-of-way and soil needed for the project (p.8-9).	Confer with OCPW about determining the market value for the right-of-way and soil used for the project.	Yes
6.	<b>Control Finding</b>	Transfer of ownership for the roadway was executed prior to the completion of the project (p.9).	Confer with OCPW about the transfer of ownership of the roadway and document the final disposition.	Yes
7.	<b>Control Finding</b>	A job number for the project costs did not include amounts incurred prior to establishing the job number nor identify project costs eligible for cost-sharing (p.11-12).	Ensure accounting records document and support accumulated costs and identify costs eligible for cost-sharing.	Yes
8.	<b>Control Finding</b>	Indirect costs were not allocated to the project (p.12).	Allocate indirect costs throughout the project.	Yes



## BACKGROUND

The mission of OC Waste & Recycling (OCWR) is “to provide waste management services, protect the environment, and promote recycling in order to ensure a safe and healthy community for current and future generations.” OCWR accomplishes its mission and strategic objectives through the following five divisions:

1. Business Services
2. Government & Community Relations
3. Central Regional Landfill Operations
4. North Regional Landfill Operations
5. South Regional Landfill Operations

The La Pata Avenue Gap Closure Project primarily involves South Regional Landfill Operations, Business Services and Government & Community Relations.

**Settlement Agreement.** On October 22, 2002, the Board of Supervisors approved a Settlement Agreement with the Rancho Mission Viejo Company that resolved claims to a prior general development plan for the Prima Deshecha Landfill and a related environmental impact report. The settlement agreement included a provision that the County's Integrated Waste Management Department, now known as OC Waste & Recycling, is responsible for **7.2% of the project costs** to improve, widen, realign, reconstruct or extend La Pata Avenue or any portion of La Pata Avenue to meet primary arterial highway standards.

**La Pata Avenue Gap Closure Project.** This project will widen La Pata Avenue from three to five lanes from south of Ortega Highway in the City of San Juan Capistrano to the existing road terminus at the Prima Deshecha Landfill; implement a gap closure by constructing four new lanes from the existing Prima Deshecha Landfill terminus to Calle Saluda and Avenida La Pata in the City of San Clemente; and extend Camino del Rio from its existing terminus in the Forster Ranch community of San Clemente to the proposed Avenida La Pata.

**Memorandum of Understanding.** In February 2009, OCWR and OC Public Works (OCPW) entered into a Memorandum of Understanding (MOU) that stipulated cost sharing for the construction of the La Pata Avenue Project through the Prima Deshecha Landfill site. The MOU requires OCWR to pay 7.2% of the total cost of construction of the La Pata Avenue Gap Closure Project through the Prima Deshecha Landfill site less the following activities:

1. The market value cost of OCWR-owned right-of-way that OCPW will require in order to construct the La Pata Avenue Gap Closure Project on OCWR-owned property.
2. The market value cost of approximately four (4) million cubic yards of soil on OCWR-owned property that OCPW will use to construct the sub-base of the roadway.
3. The cost of biological mitigation to be installed by OCWR at the Prima Deshecha Landfill to compensate for the biological impacts associated with the La Pata Project.

To the extent the sum of the costs for the above three activities exceeds 7.2% of the total cost of construction of the La Pata Avenue Gap Closure Project, OCPW will pay the excess to OCWR. Should any relocation of existing OCWR facilities become necessary, all associated relocation costs will be paid by OCPW.

**Memorandum Requesting Assistance.** On January 29, 2013, OCWR and OCPW entered into an agreement that OCWR would perform certain work for the La Pata Project. The cost sharing arrangement for OCWR to pay 7.2% of the total construction cost for the La Pata Project was unchanged; however, OCPW will pay OCWR for the following work described in the memorandum:

1. NEPA Phase 2 investigation of waste to be removed from Waste Management Unit 2.
2. Relocation of four (4) ground water monitoring wells.
3. Relocation of three (3) gas probes.
4. AQMD permit for excavation of waste from Waste Management Unit 2.
5. Permit for relocation of a diesel tank.



## SCOPE AND METHODOLOGY

Our audit scope evaluated internal controls and compliance over OC Waste & Recycling's contract administration for the La Pata Avenue Gap Closure Project as of June 30, 2013.

## SCOPE EXCLUSIONS

We did not review contracts or other activities other than the La Pata Avenue Gap Closure project. In addition, we did not assess, evaluate or obtain independent validation regarding the necessity, reasonableness, cost, time and justifications associated with the La Pata Avenue Gap Closure Project. In addition, we did not review OC Public Works' contract administration, budget or payment processes related to the La Pata Avenue Gap Closure Project.

## Management's Responsibilities for Internal Controls

In accordance with the Auditor-Controller's County Accounting Manual section S-2 *Internal Control Systems*, "All County departments/agencies shall maintain effective internal control systems as an integral part of their management practices. This is because management has primary responsibility for establishing and maintaining the internal control system. All levels of management must be involved in assessing and strengthening internal controls..." Control systems shall be continuously evaluated (by Management) and weaknesses, when detected, must be promptly corrected. The criteria for evaluating an entity's internal control structure is the Committee of Sponsoring Organizations (COSO) control framework. Our Internal Control Audit enhances and complements, but does not substitute for OCWR's continuing emphasis on control activities and self-assessment of control risks.

## Inherent Limitations in Any System of Internal Control

Because of inherent limitations in any system of internal controls, errors or irregularities may nevertheless occur and not be detected. Specific examples of limitations include, but are not limited to, resource constraints, unintentional errors, management override, circumvention by collusion, and poor judgment. Also, projection of any evaluation of the system to future periods is subject to the risk that procedures may become inadequate because of changes in conditions or the degree of compliance with the procedures may deteriorate. Accordingly, our audit would not necessarily disclose all weaknesses in OCWR's operating procedures, accounting practices, and compliance with County policy.

## Acknowledgment

We appreciate the courtesy extended to us by OC Waste & Recycling during our audit. If we can be of further assistance, please contact me directly or Michael Goodwin, Senior Audit Manager at 834-6066.

## Attachments

Distribution Pursuant to Audit Oversight Committee Procedure No. 1:

Members, Board of Supervisors  
Members, Audit Oversight Committee  
Michael B. Giancola, County Executive Officer  
Mark Denny, Chief Operating Officer  
Dick Harabedian, Division Manager, OCWR South Regional Landfill Operations  
Glenn Pattillo, Senior Project Manager, OCWR South Regional Landfill Operations  
Rochelle Carpenter, Division Manager, OCWR Business Services  
Alan Yuki, Section Manager, OCWR Budget Services  
Vivian Canton, Section Manager, OCWR Accounting Services  
Shane Silsby, Director, OC Public Works  
Harry Persaud, Manager, OCPW Planned Communities Development Services  
Foreperson, Grand Jury  
Susan Novak, Clerk of the Board of Supervisors  
Macias Gini & O'Connell LLP, County External Auditor



**Objective #1:** Evaluate compliance with terms and conditions in the Memorandum of Understanding between OCWR and OCPW for the La Pata Avenue Gap Closure Project.

## AUDIT STEPS AND RESULTS

To accomplish this objective, we audited compliance with selected terms and conditions in the Memorandum of Understanding (MOU) between OCWR and OCPW for the La Pata Avenue Gap Closure Project. We performed the following audit steps:

- ✓ Reviewed the Settlement Agreement, MOU, and Memorandum Requesting Assistance between OCWR and OCPW for the La Pata Avenue Gap Closure Project.
- ✓ Held meetings and conducted interviews with OCWR and OCPW management and staff responsible for La Pata project management, budget and contract administration.
- ✓ Held meetings and conducted interviews with OCWR Accounting and OCPW Accounting concerning the identification, tracking and reimbursement of La Pata project costs.
- ✓ Evaluated Agenda Staff Reports, Minute Orders and various cost schedules prepared for the La Pata Avenue Gap Closure Project.

## CONCLUSION

We did not note any instances of non-compliance with selected terms and conditions in the MOU between OCWR and OCPW for the La Pata Avenue Gap Closure Project. However, our audit disclosed **three (3) Significant Control Weaknesses** and **three (3) Control Findings** to clarify the basis for OCWR's cost sharing allocation; determine and communicate actual and estimated project costs; establish a process to monitor and report project costs; establish a methodology to report and reimburse costs between departments; establish a methodology to determine the market value of the right-of-way and soil; and to clarify the transfer of ownership of the roadway. The findings are discussed below:

### Finding 1 – Inconsistent Description in Scope of Work for Cost Sharing Allocation (Significant Control Weakness)

#### Summary

The MOU between OCWR and OCPW is inconsistent with the Settlement Agreement in respect to OCWR's basis for its 7.2% cost share allocation as described in the scope of work for the La Pata Avenue Gap Closure Project. Clarification needs to be obtained whether the basis is "applicable project costs" or limited to "construction costs."

#### Details

On October 22, 2002, the Board of Supervisors approved the Settlement Agreement and Covenant & Declaration of Restrictions between the County and Rancho Mission Viejo. Under Section 7.2, the executed agreement states:

*"The County believes that La Pata Avenue meets landfill access needs to the Prima Deshecha Landfill. Notwithstanding, if the County, the Orange County Transit Authority, or any other party chooses to improve, widen, realign, reconstruct or extend La Pata Avenue (or any portion thereof to meet primary arterial highway standards), then County will be **responsible for 7.2% of the applicable project costs.**"*

# Detailed Results, Findings, Recommendations and Management Responses



The MOU between OCWR and OCPW, dated February 11, 2009, states:

*“Per the Orange County Board of Supervisors approval of the Settlement Agreement between the County and Rancho Mission Viejo (RMV), dated October 22, 2002, OC Waste & Recycling is **responsible for 7.2% of the total cost of construction** for the improved La Pata Avenue.”*

The MOU indicates that OCWR’s commitment is limited to 7.2% of the total cost of construction with no other financial responsibility for the remaining phases of work. The estimated total project cost breakdown provided by OCPW indicated the following:

Construction costs	\$ 94,865,633
Non-construction costs	<u>14,700,000</u>
Total project costs	\$109,565,633

It should be noted that 7.2% of estimated non-construction costs for the La Pata Avenue Gap Closure Project is \$1,058,400.

A project life cycle has multiple phases of work. Phases of work generally include the following:

1. **Initiation** – Plans the implementation of the authorized project.
2. **Planning** – Completion of functional analysis, alternative studies, site selection, hazardous material and geotechnical studies, utility and third party coordination, environmental compliance, and real estate acquisition.
3. **Design** – Project requirements are translated into detailed drawings and specifications that will be used for the construction contract documents.
4. **Bid & Award** – Involves preparing invitations for bids, publicizing the invitation for bids, collecting the bids, evaluating the bids, and awarding the contracts.
5. **Construction** – Contractors construct the project’s facilities, and fabricate and install equipment.
6. **Commissioning** – Validating the project’s facilities in coordination with the operating personnel and third parties.
7. **Closeout** – Oversight of the final settlement of project contract, acceptance of contract deliverables, collection of contract documents and records, and approval of final payments.

When the MOU does not clearly reflect the basis for the cost-sharing allocation in the scope of work in respect to the requirements in the Settlement Agreement, the risk of misunderstandings with respect to OCWR’s financial responsibility for the project is increased.

## **Recommendation No. 1**

OC Waste & Recycling clarify with OC Public Works the scope of work and financial responsibility that is the basis for OCWR’s cost-sharing allocation for the La Pata Avenue Gap Closure Project.

### **OCWR Management Response:**

Concur. OC Waste & Recycling will meet with OC Public Works by January 30, 2014 to clarify the scope of work and OCWR’s financial responsibilities.



## Finding 2– Variances Between Estimated Project Costs (Significant Control Weakness)

### Summary

Estimated project costs were inconsistent between OCWR and OCPW. OCWR and OCPW informed us that the estimated costs for the La Pata project were **\$80 million and \$110 million**, respectively. OCPW later informed the Board of Supervisors in an Agenda Staff Report (ASR) dated August 20, 2013, that the estimated total costs of the project are approximately **\$92 million**.

### Details

In July 2013, we interviewed OCWR and OCPW management on the La Pata Avenue Gap Closure Project. A Budget Manager from OCWR informed us that OCPW provided estimated project costs totaling \$80 million, but OCWR did not receive a copy of the project budget. We obtained a written copy of the project budget from the OCPW Project Manager. The project budget from OCPW stated the estimated total project cost breakdown was approximately \$110 million (\$30 million or 38% greater than OCWR's estimated amount).

On August 20, 2013, OCPW requested the approval from the Board of Supervisors for the plans and specifications and authorization to advertise the La Pata Avenue Gap Closure Project for bid. The ASR supporting the request for approval stated the estimated total construction costs of the project was approximately \$92 million. Consistent project cost estimates are necessary to make decisions in the best financial interest of the County and will help each department budget for the anticipated project costs.

### Recommendation No. 2

OC Waste & Recycling clarify with OC Public Works the components of project costs and estimated project costs for the La Pata Avenue Gap Closure Project.

### OCWR Management Response:

Concur. OC Waste & Recycling will meet with OC Public Works by January 30, 2014 to clarify project cost components and estimates.

## Finding 3 – Limited Monitoring of Project Costs (Significant Control Weakness)

### Summary

OCWR's South Regional Landfill Division (Prima Deshecha) is responsible for project management and technical advice for the La Pata Avenue Gap Closure Project. However, the division did not have a process to monitor and report project costs to OCWR Administration. Some of the initial labor costs associated with the project did not have documented support.

### Details

In July 2013, we requested a listing of project costs from the South Regional Landfill Division and received a draft ad hoc report. A job cost report was not previously prepared by the division. It was noted that the draft ad hoc listing reported contractor costs based upon amounts shown on the *Notice to Proceed* rather than the amount paid to the contractor. OCWR personnel indicated that the reported labor costs from staff were based upon estimated hours and in some cases not supported with a documented and approved time card. It was noted that the draft ad hoc listing of job costs used salary rates to calculate the cost of labor but did not consider employee benefits.

With the responsibility assigned to the South Regional Landfill Division for providing project management and technical advice for the La Pata Avenue Gap Closure Project, accurate and recurring job cost reports are needed to ensure sufficient monitoring and oversight.



## Recommendation No. 3

OC Waste & Recycling ensure job cost reports are monitored by management and amounts are supported with appropriate documentation.

### OCWR Management Response:

Concur. OCWR Accounting will prepare monthly La Pata job cost reports that are supported by documentation for full-cost recovery.

## Finding 4 – Project Costs Not Reported or Reimbursed (Control Finding)

### Summary

OCWR and OCPW have not yet reported or reimbursed project costs to each other.

### Details

In July 2013, we interviewed OCWR and OCPW management on the La Pata Avenue Gap Closure Project. Both departments informed us that project costs were not being reported to the other department. In addition, both departments indicated that no project cost reimbursements have been processed to date. As of June 30, 2013, OCWR and OCPW reported project costs totaling \$2,295,477 and \$12,306,300, respectively.

Auditor-Controller's County Accounting Manual, Section J-1, *Cost Applied and Interfund Transactions*, states "Recurring cost transfers should be recorded on a monthly basis, unless the amount is immaterial to the department being billed, in which case the billing can be made quarterly."

## Recommendation No. 4

OC Waste & Recycling enhance communication with OC Public Works on how project costs are to be reported and reimbursed, and determine the start date and frequency of reports and reimbursements for the La Pata Avenue Gap Closure Project.

### OCWR Management Response:

Concur. OC Waste & Recycling will meet with OC Public Works by January 30, 2014 to determine the start date and frequency of reports and reimbursements.

## Finding 5 – Methodology Not Determined for Market Value (Control Finding)

### Summary

OCWR and OCPW have not determined a methodology to quantify the market value of the right-of-way and soil needed for the La Pata Avenue Gap Closure Project as described in the MOU.

### Details

The MOU between OCWR and OCPW, dated February 11, 2009, states:

*"OC Waste & Recycling will pay 7.2% of the total cost of construction of the La Pata Avenue Gap Closure through the Prima Deshecha Landfill site, minus (i) the market value cost of OC Waste & Recycling-owned right-of-way that OC Public Works will require in order to construct the La Pata Avenue Gap Closure Project on OC Waste & Recycling-owned property, (ii) the market value cost of approximately 4 million cubic yards of soil on OC Waste & Recycling-owned property that OC Public Works will use to construct the subbase of the roadway and, (iii) the cost of Prima Deshecha Landfill to compensate for the biological impacts associated with the La Pata Avenue Gap Closure Project. To the extent the sum of (i), (ii) and (iii) exceed 7.2% of the total cost of construction of the La Pata Avenue extension project, OC Public Works will pay the excess to OC Waste & Recycling."*



Both OCWR and OCPW informed us that a methodology to determine the market value for the right-of-way and soil needed to construct the subbase of the roadway has not been agreed upon. A specific methodology for determining the market value lessens misunderstandings and miscommunication regarding the project costs.

## **Recommendation No. 5**

OC Waste & Recycling confer with OC Public Works about determining the market value for the right-of-way and soil used for the La Pata Avenue Gap Closure Project.

### **OCWR Management Response:**

Concur. OC Waste & Recycling will confer with OC Public Works about determining the market value for the right-of-way and soil used for the La Pata Avenue Gap Closure Project.

## **Finding 6 – Transfer of Ownership Occurred Prior to Project Completion (Control Finding)**

### **Summary**

The transfer of ownership for La Pata Avenue was executed prior to the completion of the La Pata Avenue Gap Closure Project.

### **Details**

The MOU between OCWR and OCPW, dated February 11, 2009, states:

*“La Pata Avenue is owned and operated by OC Waste & Recycling as a private access road for the Prima Deshecha Landfill. OC Waste & Recycling is currently responsible for all La Pata Avenue maintenance costs. With the completion of the La Pata Avenue Gap Closure Project, La Pata Avenue will become a public arterial roadway, and the ownership of La Pata Avenue will be transferred from OC Waste & Recycling to OC Public Works. From that time forward, OC Public Works will be solely responsible for all La Pata Avenue maintenance costs.”*

On December 11, 2012, the Board of Supervisors adopted a resolution at the request of OCPW that declared La Pata Avenue a County highway for the County Maintenance Road System. In July 2013, we interviewed OCPW management on the La Pata Avenue Gap Closure Project. The Project Manager from OCPW informed us that the resolution made OCPW the owner of La Pata Avenue. This resolution transferred ownership from OCWR to OCPW prior to the completion of the La Pata Avenue Gap Closure Project. During an interview with OCWR management, the department was not aware of the action to transfer ownership of the roadway to OCPW and thought it would occur after project completion.

## **Recommendation No. 6**

OC Waste & Recycling confer with OC Public Works about the transfer of ownership of La Pata Avenue and document the final disposition.

### **OCWR Management Response:**

Concur. OC Waste & Recycling will meet with OC Public Works by January 30, 2014 to resolve the transfer of ownership of La Pata Avenue and document the final disposition.



**Objective #2:** Evaluate compliance with the directives from the Board of Supervisors for the 7.2% cost share allocated to OC Waste & Recycling.

## AUDIT STEPS AND RESULTS

To accomplish this objective, we audited compliance with the directives from the Board of Supervisors for the 7.2% cost share allocated to OCWR. We performed the following audit steps:

- ✓ Reviewed the Settlement Agreement and Covenant & Declaration of Restrictions between the County and Rancho Mission Viejo approved by the Board of Supervisors and Agenda Staff Reports and Minute Orders regarding the La Pata Avenue Gap Closure Project.
- ✓ Reviewed the MOU and request for assistance between OCWR and OCPW for the La Pata Avenue Gap Closure Project.
- ✓ Held meetings and conducted interviews with OCWR and OCPW project management responsible for selected terms and conditions in the MOU and request for assistance.

## CONCLUSION

We did not note any instances of non-compliance with the directives from the Board of Supervisors for the 7.2% cost share allocated to OCWR. As indicated under **Objective No.1, Finding No. 4**, there have been no La Pata project costs formally reported to OCWR from OCPW and no reimbursements have been made. Our audit did not disclose any other issues under this Audit Objective.

As such, we have no findings and recommendations under this objective.

**Objective #3:** Evaluate OC Waste & Recycling's accounting and budget practices in fulfilling its financial obligations for the La Pata Avenue Gap Closure Project.

## AUDIT STEPS AND RESULTS

To accomplish this objective, we audited certain OCWR accounting and budget practices. We performed the following audit steps:

- ✓ Reviewed the MOU and request for assistance between OCWR and OCPW for the La Pata Avenue Gap Closure Project.
- ✓ Held meetings and conducted interviews with OCWR Accounting and OCPW Accounting that are responsible for identifying, tracking, reporting and reimbursing project costs for the La Pata project.
- ✓ Evaluated OCWR accounting and budget records for the La Pata project.

## CONCLUSION

Our audit of OCWR accounting and budget practices disclosed processes are generally in place to fulfill financial obligations for the La Pata Avenue Gap Closure Project. However, our audit disclosed two (2) **Control Findings** that are included under **Audit Objective No. 4** below regarding job cost accounting and allocation of indirect costs. No other findings and recommendations were noted under this objective.



**Objective #4:** Ensure all expenses incurred by OC Waste & Recycling are included in the cost share.

## AUDIT STEPS AND RESULTS

To accomplish this objective, we audited the process for accumulating expenses incurred by OCWR for the cost-share with OCPW. We performed the following audit steps:

- ✓ Reviewed the MOU and request for assistance between OCWR and OCPW for the La Pata Avenue Gap Closure Project.
- ✓ Held meetings and conducted interviews with OCWR Accounting and OCPW Accounting that are responsible for identifying, tracking, reporting and reimbursing project costs for the La Pata project.
- ✓ Evaluated OCWR accounting and job costing records for the La Pata project.

## CONCLUSION

Our audit of the process for accumulating expenses incurred by OCWR for the cost-share with OCPW disclosed **two (2) Control Findings** regarding the job cost accounting and allocation of indirect costs. The findings are discussed below:

### Finding 7 – All Project Costs Not Segregated (Control Finding)

#### Summary

OCWR established a job number to accumulate costs for the project. However, the job number accumulated costs do not include the project costs incurred prior to establishing the job number nor identify project costs eligible for cost-sharing.

#### Details

In January 2013, OCWR established a job number to track work performed by OCWR chargeable to OCPW for the La Pata Avenue Gap Closure Project, effective 2013. During interviews with OCWR management and review of documentation, the following was noted:

1. The inception to date balance for the job number totaled \$192,202 as of June 30, 2013. However, it was noted that the project costs incurred prior to establishing the job number are not reflected in the balance. OCWR estimated project costs totaling \$1,911,931 were incurred between July 1, 2007 and June 30, 2012.
2. In July 2013, we requested a listing of job costs for the project from the South Regional Landfill Division and received a draft ad hoc report. OCWR management informed us that the listing showed costs associated with the La Pata Avenue Gap Closure Project; however, not all costs on the listing are associated with the work eligible to reduce the amount owed for 7.2% of the total construction costs.

When a job number clearly identifies costs eligible to reduce the portion owed for the project, the reliability of the cost-share process increases.

#### Recommendation No. 7

OC Waste & Recycling ensure the accounting records adequately document and support the accumulated costs for the La Pata Avenue Gap Closure Project from inception to completion. In addition, the accounting records should be maintained to identify costs eligible for cost-sharing with OC Public Works.



## **OCWR Management Response:**

Concur. OCWR Accounting will adequately document the accumulated costs for the La Pata Avenue Gap Closure Project from inception to completion. Costs eligible for cost-sharing with OC Public Works will be identified.

## **Finding 8 – Indirect Costs Not Allocated to Project (Control Finding)**

### **Summary**

OCWR did not allocate indirect costs to the project in accordance with County policy.

### **Details**

OCWR accumulates direct costs in a job number for the La Pata Avenue Gap Closure Project. Direct costs are incurred for activities or services that benefit the specific project and recorded to the job number. Because these activities and services are easily traced to the project, the costs are charged to the project on an item-by-item basis.

An OCWR manager informed us that OCWR does not allocate indirect costs to the project. It was noted that the County's policy for charging County services includes appropriate County and department indirect costs. When indirect costs are allocated to a project, OCPW will recover a larger share of project costs.

Auditor-Controller's County Accounting Manual, Section B-2, *Billing Rates and Indirect Costs*, states "County policy for charging the costs of County services to outside agencies, businesses, and individuals, and other County funds, is for full cost recovery whenever possible. This necessitates that departments'/agencies' billings include appropriate County and department/agency indirect costs."

### **Recommendation No. 8**

OC Waste & Recycling allocate indirect costs to the La Pata Avenue Gap Closure Project throughout the project period in the most equitable basis practical.

## **OCWR Management Response:**

Concur. OCWR will calculate indirect costs and allocate indirect costs to the project throughout the project period.



## ATTACHMENT A: Report Item Classifications

For purposes of reporting our audit observations and recommendations, we will classify audit report items into three distinct categories:

▶ **Critical Control Weaknesses:**

These are Audit Findings or a combination of Auditing Findings that represent critical exceptions to the audit objective(s) and/or business goals. Such conditions may involve either actual or potential large dollar errors or be of such a nature as to compromise the Department's or County's reputation for integrity. Management is expected to address Critical Control Weaknesses brought to their attention immediately.

▶ **Significant Control Weaknesses:**

These are Audit Findings or a combination of Audit Findings that represent a significant deficiency in the design or operation of internal controls. Significant Control Weaknesses require prompt corrective actions.

▶ **Control Findings:**

These are Audit Findings concerning internal controls, compliance issues, or efficiency/effectiveness issues that require management's corrective action to implement or enhance processes and internal controls. Control Findings are expected to be addressed within our follow-up process of six months, but no later than twelve months.



## ATTACHMENT B: OC Waste & Recycling Management Response



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December 30, 2013

Dr. Peter Hughes, CPA, Director  
OC Internal Audit Department  
12 Civic Center Plaza, Room 232  
Santa Ana, CA 92701

**Subject: Audit No. 1334 – OC Waste & Recycling Contract Administration for the La Pata Avenue Gap Closure Project**

Dear Dr. Hughes:

Thank you for your Department's Internal Control Audit No. 1334 – OC Waste & Recycling Contract Administration for the La Pata Avenue Gap Closure Project (Project). By following the recommendations contained in the audit, OC Waste & Recycling (OCWR) will be able to track and manage all OCWR related costs in a much more comprehensive and consistent manner.

Please see the attached document for OCWR's responses to Audit No. 1334.

Thank you again for the excellent work performed by your Department. Should you have any questions, please contact me directly at (714) 834-4122.

Sincerely,

Dylan Wright  
Director

cc: Mike Giancola, CEO  
Mark Denny, COO  
Shane Silsby, OC Public Works  
Harry Persaud, OC Public Works  
Dick Harabedian, OC Waste & Recycling

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## ATTACHMENT B: OC Waste & Recycling Management Response (continued)

### **OCWR Response to Audit 1334 - OC Waste & Recycling Contract Administration for the La Pata Avenue Gap Closure Project**

#### **Audit Finding No. 1 – Inconsistent Description in Scope of Work for Cost Sharing Allocation (Significant Control Weakness)**

**Audit Recommendation No. 1** – OC Waste & Recycling clarify with OC Public Works the scope of work and financial responsibility that is the basis for OCWR's cost-sharing allocation for the La Pata Avenue Gap Closure Project.

#### **OCWR Response No. 1**

Concur. OC Waste & Recycling will meet with OC Public Works by January 30, 2014 to clarify the scope of work and OCWR's financial responsibilities.

#### **Audit Finding No. 2 – Variances Between Estimated Project Costs (Significant Control Weakness)**

**Audit Recommendation No. 2** – OC Waste & Recycling clarify with OC Public Works the components of project costs and estimated project costs for the La Pata Avenue Gap Closure Project.

#### **OCWR Response No. 2**

Concur. OC Waste & Recycling will meet with OC Public Works by January 30, 2014 to clarify project cost components and estimates.

#### **Audit Finding No. 3 – Limited Monitoring of Project Costs (Significant Control Weakness)**

**Audit Recommendation No. 3** – OC Waste & Recycling ensure job cost reports are monitored by management and amounts are supported with appropriate documentation.

#### **OCWR Response No. 3**

Concur. OCWR Accounting will prepare monthly La Pata job cost reports that are supported by documentation for full-cost recovery.

#### **Audit Finding No. 4 – Project Costs Not Reported or Reimbursed (Control Finding)**

**Audit Recommendation No. 4** – OC Waste & Recycling enhance communication with OC Public Works on how project costs are to be reported and reimbursed, and determine the start date and frequency of reports and reimbursements for the La Pata Avenue Gap Closure Project.



## ATTACHMENT B: OC Waste & Recycling Management Response (continued)

### **OCWR Response No. 4**

Concur. OC Waste & Recycling will meet with OC Public Works by January 30, 2014 to determine the start date and frequency of reports and reimbursements.

### **Audit Finding No. 5 – Methodology Not Determined for Market Value (Control Finding)**

**Audit Recommendation No. 5** – OC Waste & Recycling confer with OC Public Works about determining the market value for the right-of-way and soil used for the La Pata Avenue Gap Closure Project.

### **OCWR Response No. 5**

Concur. OC Waste & Recycling will meet with OC Public Works by January 30, 2014 to determine a procedure for determining the market value for the right-of-way and soil used for the project.

### **Audit Finding No. 6 – Transfer of Ownership Occurred Prior to Project Completion (Control Finding)**

**Audit Recommendation No. 6** – OC Waste & Recycling confer with OC Public Works about the transfer of ownership of La Pata Avenue and document the final disposition.

### **OCWR Response No. 6**

Concur. OC Waste & Recycling will meet with OC Public Works by January 30, 2014 to resolve the transfer of ownership of La Pata Avenue and document the final disposition.

### **Audit Finding No. 7 – All Project Costs Not Segregated (Control Finding)**

**Audit Recommendation No. 7** – OC Waste & Recycling ensure the accounting records adequately document and support the accumulated costs for the La Pata Avenue Gap Closure Project from inception to completion. In addition, the accounting records should be maintained to identify costs eligible for cost-sharing with OC Public Works.

### **OCWR Response No. 7**

Concur. OCWR Accounting will adequately document the accumulated costs for the La Pata Avenue Gap Closure Project from inception to completion. Costs eligible for cost-sharing with OC Public Works will be identified.

### **Audit Finding No. 8 – Indirect Costs Not Allocated to Project (Control Finding)**



## ATTACHMENT B: OC Waste & Recycling Management Response (continued)

**Audit Recommendation No. 8** – OC Waste & Recycling will allocate indirect costs to the La Pata Avenue Gap Closure Project throughout the project period in the most equitable basis practical.

**OCWR Response No. 8**

Concur. OCWR will calculate indirect costs and allocate indirect costs to the project throughout the project period.