

ASHLAND, INC.

Audit Report

MOTOR OIL FEE PROGRAM

July 1, 2013, through June 30, 2016



BETTY T. YEE
California State Controller

April 2019



BETTY T. YEE
California State Controller

April 2, 2019

Karen Ross, Secretary
California Department of Food and Agriculture
1220 N Street
Sacramento, CA 95814

Dear Ms. Ross:

The State Controller's Office conducted a performance audit of Ashland, Inc.'s California Motor Oil Fee (MOF) program. The purpose of our audit was to determine the propriety of assessed and remitted MOFs for the period of July 1, 2013, through June 30, 2016, pursuant to Title 4, *California Code of Regulations* (4 CCR), Division 9, Chapter 8, section 4305.

Our audit found that Ashland, Inc. did not properly assess and remit MOFs in accordance with 4 CCR 4305. As reported in our finding, we found that Ashland, Inc. over-reported 73,176 gallons, or \$2,927 in MOFs, during the audit period.

If you have any questions, please contact Andrew Finlayson, Chief, State Agency Audits Bureau, by telephone at (916) 324-6310.

Sincerely,

Original signed by

JIM L. SPANO, CPA
Chief, Division of Audits

JLS/as

cc: Kristin Macey, Director

Fuels, Lubricants and Automotive Products Program
Division of Measurement Standards

California Department of Food and Agriculture

Clark Cooney, Chief, Enforcement Branch

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Audit Report

Summary

The State Controller's Office (SCO) conducted a performance audit of Ashland, Inc.'s California Motor Oil Fee (MOF) program. The purpose of our audit was to determine the propriety of assessed and remitted MOFs for the period of July 1, 2013, through June 30, 2016, pursuant to Title 4, *California Code of Regulations* (4 CCR), Division 9, Chapter 8, section 4305.

Our audit found that Ashland, Inc. did not properly assess and remit MOFs in accordance with 4 CCR 4305. Ashland, Inc. over-reported 73,176 gallons, or \$2,927 in MOFs, for products incorrectly categorized as subject to and exempt from the MOF during the audit period.

Background

The MOF program is administered by the California Department of Food and Agriculture (CDFA) Division of Measurement Standards, pursuant to 4 CCR, Division 9, Chapter 8, sections 4300 through 4308. The Division of Measurement Standards is responsible for providing administrative oversight to motor oil dealers by establishing reporting and accounting guidelines for assessments and receipts. The dealers/producers are required to provide assessment reports and remit the MOFs.

The MOF is a fee paid by motor oil dealers who produce and sell motor oil products in California, regardless of whether they are packaged in retail containers. Pursuant to 4 CCR 4304, the MOF was established at four cents per gallon for the audit period. All participants are responsible for paying MOFs and are required to file returns with the CDFA on a quarterly basis (for each quarter ending September 30, December 31, March 31, and June 30). Each quarterly return includes, in part:

- Volume, in gallons, of motor oil produced, sold, or manufactured in, or imported to, California;
- Volume of MOFs paid to suppliers; and
- Net volume of MOFs subject to assessment.

The CDFA receives approximately \$4 million in MOFs from motor oil dealers annually. Approximately 200 dealers produce, sell, or distribute motor oil in California.

Separation of Valvoline Brand from Ashland, Inc.

Until September 2016, including throughout our audit period, the Valvoline brand of lubricants was a fully owned subsidiary of the Ashland Corporation. Valvoline became an independent company in September 2016 and Ashland, Inc.'s ownership shares of stock in Valvoline were distributed to Ashland, Inc. shareholders on May 12, 2017. Valvoline, Inc. and Ashland, Inc. currently operate as independent companies and Ashland, Inc. currently has no ownership interest in Valvoline, Inc. Valvoline, Inc., through a tax matters agreement with Ashland, Inc., assumes responsibility for the MOF audit and any additional fees that could be assessed as a result of the audit.

Objective, Scope, and Methodology

We conducted a performance audit of motor oil dealer Ashland, Inc., selected by the CDFA for the MOF program assessment. The objective of our audit was to determine the propriety of assessed and remitted MOFs.

The audit period was July 1, 2013, through June 30, 2016. To achieve our audit objective, we:

- Assessed reporting timeliness, delinquency, penalties, and the CDFA's efforts and enforcement actions to conform to the MOF assessment and reporting requirements;
- Reviewed quarterly MOF reports, remittance advice, and other correspondence to gain an understanding of reported assessments and fees, and to identify reported anomalies with emphasis on volumes produced, volumes subject to assessment, and fees remitted;
- Gained an understanding of the dealer's organization, business model, and business components by inquiring with and observing the dealer's responsible function groups for MOF assessment to understand and evaluate effectiveness of applicable internal control, including but not limited to the accounting system, purchase and sales records, and claim preparation process; and
- Examined all accounting records and purchase and sales records to determine whether MOFs were assessed and remitted properly:
 - Gallons Reported – Sold, Imported, Purchased, or Manufactured:
Population: 12 quarterly returns, totaling \$800,960, or 20,023,991 gallons.
 - Gallons with Fee Paid to Supplier:
Population: Zero transactions.
 - Remitted MOFs:
Population: 12 quarterly returns, totaling \$800,960, or 20,023,991 gallons.

We conducted this performance audit in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objective. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objective.

Conclusion

Our audit found that Ashland, Inc. did not properly assess and remit MOFs in accordance with 4 CCR 4305. Ashland, Inc. over-reported 73,176 gallons, or \$2,927 in MOFs, during the audit period, as summarized in the accompanying Schedule (Summary of Reported and Audited Motor Oil Fees) and described in the Finding and Recommendation section of this report.

**Follow-up on
Prior Audit
Findings**

Ashland, Inc. did not have any prior audits related to the objective of this report.

**Views of
Responsible
Officials**

We issued a draft report on December 28, 2018. Jennifer Clark, Transaction Tax Manager, responded by email on February 1, 2019, stating that all errors were corrected prior to the beginning of this audit.

Restricted Use

This report is solely for the information and use of Ashland, Inc., the CDFA, and the SCO; it is not intended to be and should not be used by anyone other than these specified parties. This restriction is not intended to limit distribution of the final report, which is a matter of public record and is available on the SCO website at www.sco.ca.gov.

Original signed by

JIM L. SPANO, CPA
Chief, Division of Audits

April 2, 2019

Schedule—
Summary of Reported and Audited Motor Oil Fees
July 1, 2013, through June 30, 2016

Cost Element	Reported Amount	Audited Amount	Audit Adjustment
Total Gallons Sold, Imported, Purchased, or Manufactured (Less: Gallons with Fee Paid to Supplier)	20,023,991 -	19,950,815 -	(73,176) -
Total Gallons Assessed MOF	<u>20,023,991</u>	<u>19,950,815</u>	<u>(73,176)</u>
Total MOF @ \$0.04/gallon	<u>\$ 800,960</u>	<u>\$ 798,033</u>	<u>\$ (2,927)</u>

Finding and Recommendation

**FINDING—
Products
incorrectly
categorized as
subject to and
exempt from the
MOF**

Ashland, Inc. incorrectly reported the number of gallons sold, fee-assessable gallons, and MOFs due on its July 1, 2013, through June 30, 2016 MOF quarterly returns as follows:

Product Type	Gallons Overstated/ (Understated)	Audit Adjustment
Fee-exempt Products	79,911	\$ (3,196)
Fee-assessable Products	(6,735)	269
Total	73,176	\$ (2,927)

Ashland, Inc. personnel did not follow the company's own internal processes and procedures to ensure that products were correctly categorized as either "motor oil," which is subject to the MOF, or other "non-motor oil lubricants" such as transmission fluid or hydraulic fluids, which are exempt from the MOF.

During our review of Ashland, Inc.'s product listings, we found 22 MOF-exempt product items that were categorized, from July 2013 through April 2015, as subject to the MOF. Products included non-motor oil lubricants, such as transmission and hydraulic fluids, which are not subject to the fee. In addition, we found two motor oils that were incorrectly categorized by Ashland, Inc. as being exempt from the MOF; in fact, they are subject to the MOF and were not included in the calculation of MOFs due in the quarterly returns.

4 CCR 4304 – Fees and Returns states, in part:

- (1) A return for each quarter shall include:
- A. The amount, in gallons of motor oil purchased, sold, manufactured in California, or imported into California.
 - B. The total amount of gallons of motor oil with fees paid to suppliers.
 - C. The net amount of motor oil gallons to which the fee is applied. This is calculated by the gallon.

Recommendation

We recommend that Ashland, Inc.:

- Implement processes to ensure that employees follow its procedures to correctly categorize products as being either subject to or exempt from the MOF; and
- Work with CDFA to recover any overpaid MOFs.

Ashland/Valvoline's Response

Representatives of Ashland/Valvoline stated that all products [classification errors] were corrected by Ashland/Valvoline prior to the start of the audit during their internal review process.

SCO Comment

Our audit finding remains unchanged.

Product classification errors were determined in collaboration with the SCO audit staff during the audit. Quarterly MOF returns audited by the SCO contained errors.

**State Controller's Office
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