

OLD WORLD INDUSTRIES, LLC

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 Old World Industries, LLC's (OWI) 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*, Division 9, Chapter 8, section 4305.

Our audit found weaknesses within OWI's internal controls for reporting compliance with MOF regulations. These controls were unreliable due to the flawed design of reporting practices. MOFs assessed and remitted during the audit period were improperly reported because OWI reported non-motor oil and exempt gallon sales, and included non-motor oil and exempt gallon sales deductions within the reported prepaid fee totals. We noted several areas for improvement within the implemented MOF reporting practices, proper product categorizations, and MOF assessments to ensure MOF compliance. OWI underpaid MOFs by 31,898 gallons, or \$1,276, due to under-reported motor oil and over-reported prepaid fees 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

Fuels, Lubricants and Automotive Products Program

Division of Measurement Standards

California Department of Food and Agriculture

Kevin Schnepf, Environmental Program Manager I

Fuels, Lubricants and Automotive Products Program

Division of Measurement Standards

California Department of Food and Agriculture

Rebecca Bland, Staff Services Manager I

Administrative Services Unit

Division of Measurement Standards

California Department of Food and Agriculture

Contents

Audit Report

Summary	1
Background	1
Objective, Scope, and Methodology	1
Conclusion	2
Follow-up on Prior Audit Findings.....	3
Views of Responsible Officials.....	3
Restricted Use	3
Schedule—Summary of Reported and Audited Motor Oil Fees	4
Findings and Recommendations.....	5

Audit Report

Summary

The State Controller's Office (SCO) conducted a performance audit of Old World Industries, LLC's (OWI) 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 weaknesses within OWI's controls for reporting compliance with MOF regulations. These controls were unreliable due to the flawed design of reporting practices. MOFs assessed and remitted during the audit period were improperly reported because OWI reported non-motor oil and exempt gallon sales, and included non-motor oil and exempt gallon sales deductions within the reported prepaid fee totals. We noted several areas for improvement within the implemented MOF reporting practices, proper product categorizations, and MOF assessments to ensure MOF compliance. OWI under-paid MOFs by 31,898 gallons, or \$1,276, due to under-reported motor oil and over-reported prepaid fees 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.

Objective, Scope, and Methodology

We conducted a performance audit of motor oil dealer OWI, 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 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;
- Assessed prior program-related issues, concerns, and corrective actions;
- 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 on a judgmentally selected non-statistical sample basis to determine whether MOFs were assessed and remitted properly:
 - Gallons Reported – Sold, Imported, Purchased, or Manufactured:
Sample: 72 transactions, totaling \$2,217, or 55,416 gallons.
Population: 3,117 transactions, totaling \$128,354, or 3,208,840 gallons.
 - Prepaid MOF:
Sample: 69 transactions totaling \$17,874, or 446,862 gallons.
Population: 291 transactions, totaling \$68,863, or 1,721,567 gallons.

Errors found in the sample were not projected to the population.

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 OWI did not properly assess and remit MOFs in accordance with 4 CCR 4035. OWI underpaid MOFs by 31,898 gallons, or \$1,276, due to under-reported motor oil and over-reported prepaid fees during the audit period, as summarized in the accompanying Schedule and described in the Findings and Recommendations section of this report.

**Follow-up on
Prior Audit
Findings**

CDFA's Division of Measurement Standards conducted a Motor Oil Assessment Fee Audit of OWI. The audit objective was to determine whether MOFs assessed and remitted in California were properly reported for the period of January 1, 2007, through December 31, 2009.

The report, issued in July 2010, identified one audit finding regarding inaccurate reporting. CDFA determined that OWI failed to report 696,347 gallons of sales and purchases of motor oil for the audit period, and therefore owed a total amount of \$15,319.63. This issue has been resolved.

**Views of
Responsible
Officials**

We issued a draft report on December 28, 2018. Laura Ghents, Sales/Use and Local Tax Manager, responded by email on February 1, 2019, stating that OWL "does not have an official management response that will be incorporated into the final report."

Restricted Use

This report is solely for the information and use of OWI, 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)	3,213,124 <u>(2,327,037)</u>	3,239,631 <u>(2,321,646)</u>	26,507 <u>5,391</u>
Total Gallons Assessed MOF	<u>886,087</u>	<u>917,985</u>	<u>31,898</u>
Total MOF @ \$0.04/gallon	<u>\$ 35,443</u>	<u>\$ 36,719</u>	<u>\$ 1,276 ¹</u>

¹ The breakdown of the total audit adjustment is as follows:

Amount	Reference
\$ 1,060	Finding 1
216	Finding 2
<u>\$ 1,276</u>	

Findings and Recommendations

FINDING 1— Improper Assessment of Reported Gallons Sold, Imported, Purchased, or Manufactured

During the audit period, we determined that OWI under-reported 26,507 net gallons, or \$1,060 in MOFs, due to improper MOF assessments.

Based on our understanding that MOFs are assessed based on product descriptions, we judgmentally targeted products that would most likely result in an error from the 12 MOF returns during the audit period. We judgmentally selected a non-statistical sample of 72 transactions from the total of 3,117 sales transactions targeting the product criteria. These 72 selections resulted in 60 exceptions that were the result of improper MOF assessments.

As the errors identified in the sample were specifically targeted, there was not a need to increase the sample size.

Due to OWI's improper assessments of MOFs, 41,678 gallons were not identified as assessable, resulting in \$1,667 in unremitted MOFs over 60 transactions. The 60 transactions involved products that met the definition of "Motor Oil" as described in 4 CCR 4300. OWI is responsible for paying \$0.04 per assessable gallon on a quarterly basis (4 CCR 4304) because it is the first motor oil dealer to produce, sell, or distribute motor oil in California (4 CCR 4302).

When reviewing all 12 quarterly MOF returns, we determined that OWI also improperly assessed and reported non-applicable and exempt motor oil gallons. Although OWI made adjustments for deductions to final assessable gallons, the improper procedures led OWI to inaccurately over-report 15,171 net non-applicable motor oil gallons, or \$607 in MOFs. The 15,171 net gallons were not properly assessed and remitted per the definition of "Motor Oil" as described in 4 CCR 4300.

Recommendation

We recommend that OWI:

- Implement an internal auditing function;
- Strengthen internal controls related to the accurate reporting of motor oil gallons sold, imported, purchased, or manufactured; and
- Work with CDFA to remit any underpaid MOFs.

FINDING 2— Improper Assessment of Reported Gallons with Fee Paid to Suppliers

During the audit period, we determined that OWI improperly recorded and reported prepaid MOFs by including non-applicable and exempt sales gallon deductions with prepaid fees (deduction adjustments made within Finding 1). 4 CCR 4304 states, "A return for each quarter shall include the total amount of gallons of motor oil with fees paid to suppliers." We determined that OWI over-reported and underpaid a net total of \$216, or 5,391 gallons, in prepaid MOFs, due to improper assessments of reported prepaid gallons during the audit period.

Of the 291 prepaid transactions, we judgmentally selected 69 transactions to review and identified one significant exception within the 69 transactions under review. The transaction was improperly assessed and under-paid by \$40, or 1,000 gallons. When reviewing all 12 quarterly MOF returns, we determined that OWI also improperly recorded and assessed various transactions of prepaid fees. The effect of improperly recording and assessing prepaid fees was 60,152 prepaid gallons over-reported, which led to an overstated deduction of \$2,406 in the remitted MOF and 55,761 gallons, or \$2,230, in prepaid fees under-reported during the audit period.

Recommendation

We recommend that OWI:

- Implement an internal auditing function;
- Strengthen internal controls related to the accurate reporting of motor oil gallons sold, imported, purchased, or manufactured; and
- Work with CDFA to remit any underpaid MOFs.

**State Controller's Office
Division of Audits
Post Office Box 942850
Sacramento, CA 94250**

<http://www.sco.ca.gov>