

# **BP LUBRICANTS USA, INC.**

Audit Report

## **MOTOR OIL FEE PROGRAM**

*July 1, 2013, through June 30, 2016*



**BETTY T. YEE**  
California State Controller

December 2018



**BETTY T. YEE**  
California State Controller

December 28, 2018

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 BP Lubricants USA, Inc.'s (BP) 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 in BP's controls for reporting compliance with MOF regulations. The assessed and remitted MOFs during the audit period were improperly reported. We noted that BP's accounting system miscategorized products and incorrectly assessed MOFs; procedures for reviewing all motor oil product and transaction categorizations would help improve MOF compliance. BP did not properly assess and remit MOFs in accordance with 4 CCR 4305. BP under-reported 182,515 gallons, or \$7,301 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*

**JEFFREY V. BROWNFIELD, CPA**  
Chief, Division of Audits

JVB/ljs

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

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California Department of Food and Agriculture

Kevin Schnepf, Environmental Program Manager I

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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

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# Audit Report

## Summary

The State Controller's Office (SCO) conducted a performance audit of BP Lubricants USA, Inc.'s (BP) 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 BP has weaknesses within the controls in place to ensure compliance with the MOF regulations. MOFs assessed and remitted during the audit period were improperly reported. We noted that BP's accounting system miscategorized products and incorrectly assessed MOFs; procedures for reviewing all motor oil product and transaction categorizations would help improve MOF compliance. We determined that BP under-reported 182,515 gallons, or \$7,301 in MOFs, 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 4309. 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 to 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 BP, selected by the CDFA for the MOF program assessment. Our audit objective 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 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: 744 transactions, totaling \$7,779, or 194,480 gallons.  
Population: 207,087 transactions, totaling \$1,285,009, or 32,125,231 gallons.
  - Prepaid MOF:  
Sample: 68 transactions, totaling \$10,238, or 255,956 gallons.  
Population: 1,805 transactions, totaling \$290,892, or 7,272,310 gallons.

Errors found in the samples 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 BP has weaknesses within the controls in place to ensure compliance with the MOF regulations. MOFs assessed and remitted during the audit period were improperly reported. We noted that BP's accounting system miscategorized products and incorrectly assessed MOFs; procedures for reviewing all motor oil product and transaction categorizations would help improve MOF compliance. We determined that BP under-reported 182,515 gallons, or \$7,301 in MOFs, during the audit period, as described in the Finding and Recommendation section of this report.

**Follow-up on  
Prior Audit  
Findings**

The California Department of Finance, Office of State Audits and Evaluations, conducted an audit of BP's Used Oil Recycling Fee Returns submitted to the California Department of Resources Recycling and Recovery (CalRecycle). The audit objective was to determine whether the reported industrial and lubricating oil sold, transferred, or used in California, as well as the remitted fees, were properly reported for the period of July 1, 2009, through June 30, 2010.

The report, issued in February 2012, identified two audit findings:

- Returns did not include all required information, under-reporting industrial oil and lubrication oil by 10.8 million gallons and 350,000 gallons of industrial exports.
- BP did not obtain exemption certificates to support 17,645 gallons of exempt sales.

Issues identified during this audit have been resolved.

**Views of  
Responsible  
Officials**

We issued a draft report on May 25, 2018. Jon Sanders, Excise Tax Planning and Audits, BP, responded by email on June 8, 2018. Mr. Sanders agreed with the audit results. Mr. Sanders' responses have been incorporated into the final report and the entire response has been included as an attachment to this report (Attachment).

**Restricted Use**

This report is solely for the information and use of BP 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.

*Original signed by*

JEFFREY V. BROWNFIELD, CPA  
Chief, Division of Audits

December 28, 2018

**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)	31,919,068 <u>(7,272,236)</u>	32,101,583 <u>(7,272,236)</u>	182,515 <u>-</u>
Total Gallons Assessed Motor Oil Fee	<u>24,646,832</u>	<u>24,829,347</u>	<u>182,515</u>
Total Motor Oil Fee @ \$0.04/gallon	<u>\$ 985,873</u>	<u>\$ 993,174</u>	<u>\$ 7,301</u>



# Finding and Recommendation

## **FINDING— Improper Product Categorizations and Assessments of MOFs**

During the audit period, we determined that BP under-reported 182,515 gallons, or \$7,301 in MOFs, due to improper product categorizations and assessments of appropriate MOFs.

Based on our understating that MOFs are assessed based on product descriptions, we judgmentally targeted products listed in the 12 MOF returns during the audit period that would most likely cause errors. We judgmentally selected a non-statistical sample of 744 transactions from the total of 207,087 sales transactions targeting the product criteria. These 744 selections resulted in 666 exceptions that were due to: 1) product incorrectly categorized as non-taxable or MOF not assessed by accounting system; and 2) customers improperly categorized as MOF-exempt.

As the errors identified in the sample were specifically targeted, there was no need to increase the sample size.

As a result of products being incorrectly categorized as non-taxable or MOFs not being assessed by BP's accounting system, 40,211 gallons were not identified as being assessable. This led to \$1,609 in unremitted MOFs for 61 transactions. The 61 of 666 transactions were not properly assessed and remitted while meeting the definition of "Motor Oil" as described in 4 CCR 4300. Dealers are responsible for paying \$0.04 per assessable gallon on a quarterly basis (4 CCR 4304) because they are the first motor oil dealers to produce, sell, or distribute motor oil in California (4 CCR 4302).

Additionally, BP improperly categorized customers as exempt from the MOF. We determined that three customers were not included in BP assessable and remitted gallons. This led to an under-reporting of 142,304 gallons and unremitted MOFs of \$5,692 for 605 of 666 exceptions.

4 CCR 4302 defines fee responsibility and exemption as follows:

- (a) The first motor oil dealer that produces, sells or distributes motor oil in California, whether or not packaged in retail containers, shall pay the fee for all such motor oil sold in California.
- (b) Motor oil exported for sale outside California is exempt from the motor oil fee.
- (c) A person assigned a motor oil dealer permit number and not actively engaged in the business of producing, distributing, or selling motor oil is required to notify the Department in writing within the next reporting period upon ceasing operations dealing with motor oil.

Specific details of the under-reported gallons were as follows:

Motor Oil Type	Audit Issue Type	Transactions	Unreported Gallons	Motor Oil Fees
Turbine Oil	Improperly categorized as "Item Exempt"	21	385	\$ 15.40
Turbine Oil	MOF not assessed by accounting system	16	3,216	128.64
Engine Oil	MOF not assessed by accounting system	21	33,803	1,352.12
Marine Engine Oil	MOF not assessed by accounting system	1	2,642	105.68
Motorcycle Engine Oil	Improperly categorized as "Item Exempt"	2	165	6.60
Engine Oil	Improperly categorized as "Customer Exempt"	226	32,786	1,311.44
Engine Oil	Improperly categorized as "Customer Exempt"	119	41,936	1,677.44
Engine Oil	Improperly categorized as "Customer Exempt"	260	67,582	2,703.28
		<u>666</u>	<u>182,515</u>	<u>\$ 7,301 *</u>

\*Rounded to the nearest dollar

### Recommendation

We recommend that BP:

- Implement procedures for reviewing all motor oil product and transaction categorizations, to ensure that the accounting system accurately assesses MOFs; and
- Work with CDFA to remit any underpaid MOFs.

### BP's Response

BP is in agreement with the tax due amount of \$7,301. Although your report states "Based on our audit, we identified weakness in BP's controls for reporting compliance with MOF regulations," we believe the two issues identified were relatively small and have been corrected per the business.

### SCO Comment

We have not verified any corrective actions that BP may have implemented subsequent to our audit. Any further actions should be addressed with the CDFA.

**Attachment—  
BP Lubricants USA, Inc.’s Response to Draft Audit Report**

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**Mock, Michael**

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**From:** Shah, Dina M  
**Sent:** Friday, June 8, 2018 12:04 PM  
**To:** Mock, Michael  
**Cc:** Sanders, Jon  
**Subject:** FW: S17-MOF-0001 BP Lubricants USA, Inc. - PDF

Mike,

Please see below response from Jon Sanders.

Thank you,  
Dina  
*Dina Shah*  
*BP America Inc*  
*Tax Audits & Planning*

Safety    Respect    Integrity    Courage    One Team

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**From:** Sanders, Jon  
**Sent:** Friday, June 08, 2018 12:50 PM  
**To:** MMock  
**Cc:** Shah, Dina M  
**Subject:** FW: S17-MOF-0001 BP Lubricants USA, Inc. - PDF

Mike,

BP is in agreement with the tax due amount of \$7,301. Although your report states "Based on our audit, we identified weaknesses in BP's controls for reporting compliance with the MOF regulations", we believe the two issues identified were relatively small and have been corrected per the business.

Jon

Jon Sanders  
Sr. Manager, Excise Tax Planning and Audits

**State Controller's Office  
Division of Audits  
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