Management and Financial Audit of the Deposit Beverage Container Program, June 30, 2012

A Report to the Governor and the Legislature of the State of Hawai‘i

Report No. 13-08
November 2013

THE AUDITOR
STATE OF HAWAI‘I

Office of the Auditor

The missions of the Office of the Auditor are assigned by the Hawai‘i State Constitution (Article VII, Section 10). The primary mission is to conduct post audits of the transactions, accounts, programs, and performance of public agencies. A supplemental mission is to conduct such other investigations and prepare such additional reports as may be directed by the Legislature.

Under its assigned missions, the office conducts the following types of examinations:

1. Financial audits attest to the fairness of the financial statements of agencies. They examine the adequacy of the financial records and accounting and internal controls, and they determine the legality and propriety of expenditures.

2. Management audits, which are also referred to as performance audits, examine the effectiveness of programs or the efficiency of agencies or both. These audits are also called program audits, when they focus on whether programs are attaining the objectives and results expected of them, and operations audits, when they examine how well agencies are organized and managed and how efficiently they acquire and utilize resources.

3. Sunset evaluations evaluate new professional and occupational licensing programs to determine whether the programs should be terminated, continued, or modified. These evaluations are conducted in accordance with criteria established by statute.

4. Sunrise analyses are similar to sunset evaluations, but they apply to proposed rather than existing regulatory programs. Before a new professional and occupational licensing program can be enacted, the statutes require that the measure be analyzed by the Office of the Auditor as to its probable effects.

5. Health insurance analyses examine bills that propose to mandate certain health insurance benefits. Such bills cannot be enacted unless they are referred to the Office of the Auditor for an assessment of the social and financial impact of the proposed measure.

6. Analyses of proposed special funds and existing trust and revolving funds determine if proposals to establish these funds are existing funds meet legislative criteria.

7. Procurement compliance audits and other procurement-related monitoring assist the Legislature in overseeing government procurement practices.

8. Fiscal accountability reports analyze expenditures by the state Department of Education in various areas.

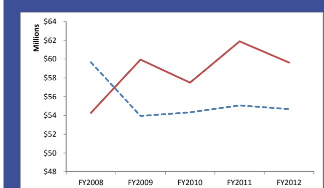
9. Special studies respond to requests from both houses of the Legislature. The studies usually address specific problems for which the Legislature is seeking solutions.

Hawai‘i’s laws provide the Auditor with broad powers to examine all books, records, files, papers, and documents and all financial affairs of every agency. The Auditor also has the authority to summon persons to produce records and to question persons under oath. However, the Office of the Auditor exercises no control function, and its authority is limited to reviewing, evaluating, and reporting on its findings and recommendations to the Legislature and the Governor.

THE AUDITOR
STATE OF HAWAI‘I
Kekuanao‘a Building
465 S. King Street, Room 500
Honolulu, Hawai‘i 96813

Office of the Auditor
465 S. King Street
Rm. 500
Honolulu, HI 96813
Ph. (808) 587-0800

Jan K. Yamane
Acting State Auditor
State of Hawai'i



Over the past four fiscal years, DBC Program Fund expenditures have been rising while revenues remain flat.

Recommendations

Response

Prior Audits

Management and Financial Audit of the Deposit Beverage Container Program, June 30, 2012

Report No. 13-08, November 2013

Mismanagement of the Deposit Beverage Container Program puts its continued operation at risk

Unaddressed program flaws result in millions of dollars in overpayments and undermine financial sustainability

This is our fourth audit of the Deposit Beverage Container (DBC) Program. As in our previous audits, we found that the program relies on self-reported data from distributors who may be fraudulently or erroneously under-reporting beverage containers sold or distributed, and certified redemption centers that may be fraudulently or erroneously over-reporting beverage containers redeemed. This flaw, coupled with an absence of a detailed audit function, exposes the program to abuse and risk of fraud, which threaten the financial sustainability of the program. For example, from FY2010 through FY2012, the DBC Program paid $6.2 million in deposit refunds for almost 7.5 million pounds of materials that cannot be accounted for. As a result of these and other inefficiencies, over the past three fiscal years, the program has paid out $28 million more in handling fees than it has collected in container fees, contributing to a steady increase in fund expenditures.

The Department of Health, which administers the DBC Program, has been aware of these systemic weaknesses for some time. As early as 2006 it proposed switching to a "back-end" payment system, which would address many of these issues. Paying redemption centers on the back-end means reimbursing them for the number of containers *shipped* to end-user recyclers instead of the number that they *claim* to receive from customers. (Under the current system, these claims are not validated.) Implementing such a change would require amending the program's administrative rules. We found that the program's deputy attorney general prepared draft amendments in June 2012; but, according to department officials, as of June 2013, moving to a back-end payment system is still under consideration.

Inattention to basic management functions exacerbates program's inability to prevent fraud and abuse

The DBC Program lacks adequate management to effectively and efficiently guide its enforcement functions and payment process. For instance, management has not addressed inappropriate position descriptions for program inspectors, in place since the program's inception more than a decade ago. This misalignment of qualifications with actual job duties has led to a high turnover rate of program inspectors, who, between FY2008 and FY2012, had an average length of employment of only 16 months. Currently, all four of the program's inspector positions are vacant, with one filled by an 89-day hire on an interim basis. In addition, management relies on a single person to issue and approve more than $54 million in payments to redemption centers statewide. The program manager recognizes the risks associated with this assignment of duties but has only recently begun to approve requests for additional accounting support. When we asked why he does not perform various management functions, the program manager stated that he lacked the time to do so. He said that he serves as a "fire fighter" for the program and spends his time fixing problems.

Agency Response

In its response to our draft report, the department objected to our finding that "Inattention to basic management functions exacerbates program's inability to prevent fraud and abuse." It expressed appreciation and support for the current program manager, who is responsible for the day-to-day management of the program, describing him as a valued and hard-working employee. However, the department did not provide any additional information to dispute this or any other of our findings. The department did provide specific comments on the 13 recommendations we made in the draft report. Judging by the recent actions undertaken by management as described in its response, the department appears to be in general agreement with our conclusions and recommendations.

For the full text of this and other reports, visit our website: http://auditor.hawaii.gov/

Management and Financial Audit of the Deposit Beverage Container Program, June 30, 2012

A Report to the Governor and the Legislature of the State of Hawai‘i

Conducted by

The Auditor
State of Hawai‘i
and
Accuity LLP

Submitted by

THE AUDITOR
STATE OF HAWAI‘I

Report No. 13-08
November 2013

Foreword

This is a report on the management and financial audit of the Department of Health's Deposit Beverage Container Program, June 30, 2012. We conducted this audit pursuant to Section 342G-107, Hawai'i Revised Statutes, which requires the Office of the Auditor conduct a management and financial audit of the Deposit Beverage Container Program and Special Fund in fiscal years ending in even-numbered years, after the initial audit for the fiscal year ended June 30, 2005. This audit was conducted by the Office of the Auditor and the certified public accounting firm of Accuity LLP.

We wish to express our appreciation for the cooperation and assistance extended by the officials and staff of the Department of Health and other offices and individuals whom we contacted during the course of our audit.

Jan K. Yamane
Acting State Auditor

Table of Contents

List of Exhibits

List of Appendices

Chapter 1
Introduction

Hawai‘i’s Legislature has long recognized the importance of managing and protecting the state’s environment through recycling efforts. Glass container importers have been paying a glass advance disposal fee of one and one-half cents per container since 1994. The revenue from these fees was deposited into an account in the State’s Environmental Management Special Fund under the Department of Health and financed county glass recovery programs. To further protect the environment, increase recycling, and reduce litter, the 2002 Legislature passed Act 176, Session Laws of Hawaii (SLH) 2002, known as the “bottle bill,” to establish the Deposit Beverage Container Program.

In the act’s preamble, the Legislature stated that recycling is an important element of an integrated solid waste management system, which can protect and preserve environmental resources and reduce economic costs to residents and businesses. The Legislature also noted a need to expand participation in recycling programs and minimize costs to participants and the government. The purpose of Act 176, SLH 2002, was to increase participation and recycling rates for specified deposit beverage containers, provide a connection between manufacturing decisions and recycling program management, and reduce litter. The nickel-redemption program aims to recover 80 percent of the bottles and cans used in Hawai‘i.

Hawai‘i is one of ten states that has some form of beverage container recycling program. The others are California, Connecticut, Iowa, Maine, Massachusetts, Michigan, New York, Oregon, and Vermont.

Background
Audit requirement

Act 176, SLH 2002, codified as Chapter 342G, Part VIII, Hawai‘i Revised Statutes (HRS), requires the Auditor to conduct a management and financial audit of the Deposit Beverage Container Program for FY2005, FY2006, and each even-numbered fiscal year thereafter. The Auditor is also required to submit a report, including the amount of any unredeemed refund value and recommendations, to the Legislature and the department no later than 20 days prior to the convening of the next regular session. For FY2012, we conducted the management audit and contracted with a CPA firm, Accuity LLP, to undertake the financial audit.

Inception of the Deposit Beverage Container Program

The State Department of Health's Environmental Management Division, Solid and Hazardous Waste Branch, Office of Solid Waste Management administers the Deposit Beverage Container (DBC) Program and the Deposit Beverage Container Deposit Special Fund (DBC Fund). Chapter 342G, HRS, defines a *deposit beverage container* as an "individual, separate, sealed glass, polyethylene terephthalate, high-density polyethylene, or metal container less than or equal to 68 fluid ounces used for containing, at the time of sale to a consumer, a beverage intended for use or consumption in Hawai'i." Such beverages include all nonalcoholic drinks (e.g. soda, water, juice, tea, coffee) and some alcoholic drinks (e.g. beer, malt beverages, mixed spirits, mixed wine).

According to the department, the DBC Program was implemented on September 1, 1994, when glass distributors began paying an advance disposal fee of one and one-half cents per glass container. However, after Act 176 was passed, the department set a July 1, 2002 deadline for deposit beverage distributors to register with the State. According to Chapter 342G, HRS, a *deposit beverage distributor* is a "manufacturer of deposit container beverages in the state, or an entity that imports or engages in the sale of filled deposit beverage containers to a dealer or consumer." This definition includes federal agencies and military distributors but excludes airlines or shipping companies that merely transport deposit beverage containers.

On October 1, 2002, distributors began paying into the DBC Fund a deposit beverage container fee of one-half cent for each plastic or metal container they manufactured or imported into Hawai'i. On October 1, 2004, this container fee increased to one cent per container; and glass beverage containers, as well as plastic and metal containers, were included in the program.

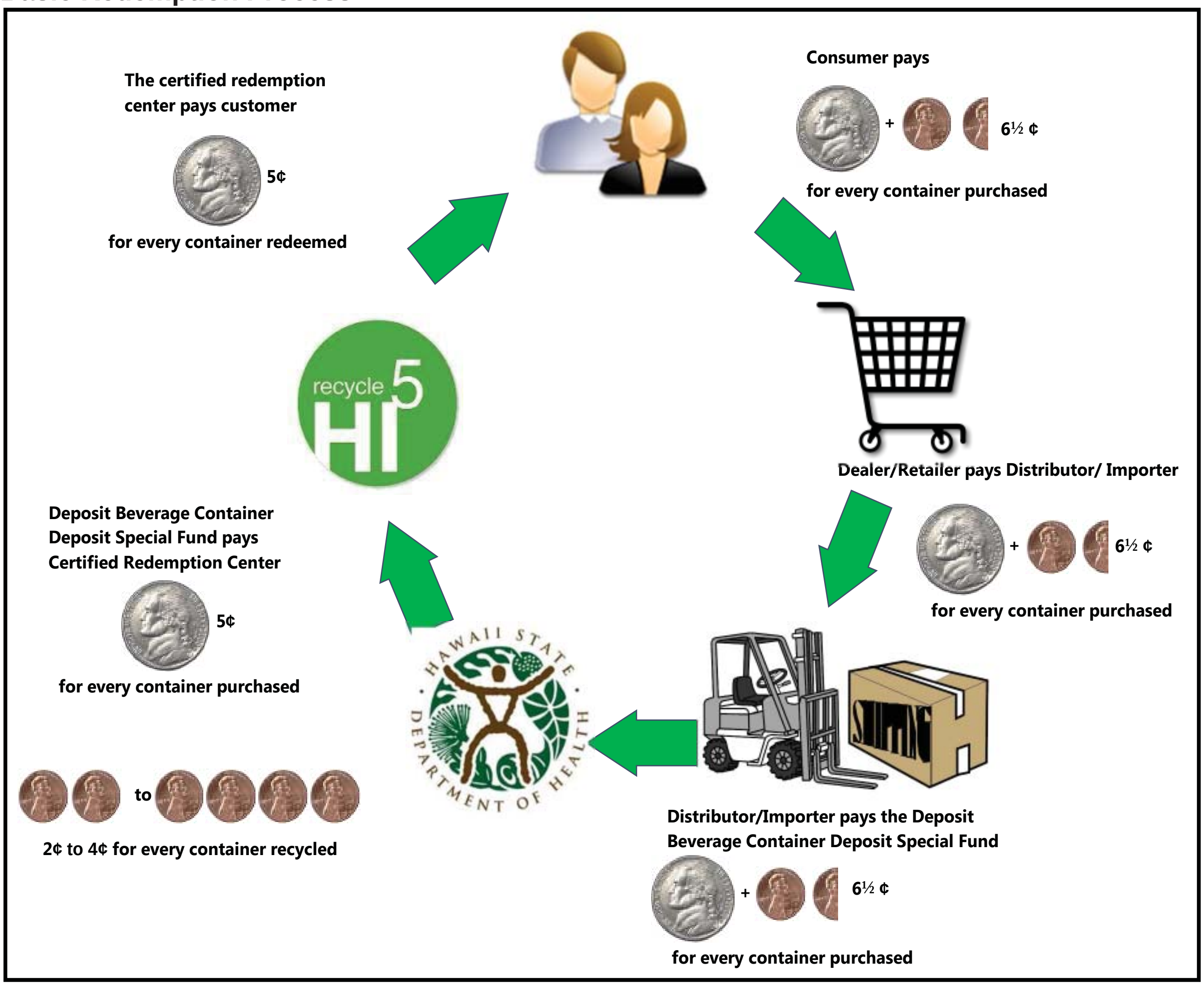
On January 1, 2005, the five-cent deposit refund fee went into effect along with the requirement that all deposit beverage containers be labeled with a five-cent redemption value. The five-cent deposit is refunded to customers when they take their empty containers to a redemption center to be recycled. A *redemption center* is "an operation that accepts redeemable containers from consumers, provides their refund value, and ensures the empty containers are properly recycled."

The DBC law authorizes the department to adopt administrative rules to implement the program. The department adopted Title 11, Chapter 282, Hawai'i Administrative Rules (HAR), in April 2007.

The redemption process

The department collects both a five-cent deposit refund fee and a container fee from distributors for each eligible beverage container sold in the state. Effective September 1, 2012, following its press release that the current fee structure and declining special fund balance would leave the program underfunded in 2014 and unable to continue operations, the department raised the container fee from one-cent to one and one-half cents. The department reimburses the five-cent deposit to certified redemption centers for each recycled container and pays a two-cent handling fee on O‘ahu and a three-cent handling fee on neighbor islands to ensure redemption centers recycle all redeemed containers. Effective September 15, 2008, the department adjusted the handling fee for glass deposit containers to two cents for construction and agriculture applicants and four cents for remanufacturing applicants. Moneys are deposited into and paid out of the DBC Fund. Exhibit 1.1 illustrates the basic redemption process.

Exhibit 1.1
Basic Redemption Process



Source: Office of the Auditor

An individual or business that wants to operate a redemption center must receive both a solid waste permit and a redemption center certification from the department. In addition to conditions listed in the permit and certification, redemption centers must comply with statutory requirements in Section 342G-114, HRS, which are to accept all types of empty deposit beverage containers for which a deposit has been paid; verify that all containers to be redeemed bear a valid Hawaiʻi refund value; pay the redeemer for the full refund value in either cash or a redeemable voucher for all deposit beverage containers; ensure each deposit beverage container is recycled through a contractual agreement with an out-of-state recycler or an in-state recycling facility permitted by the department (not applicable if redemption center is operated by a recycler permitted by the department); and forward the documentation necessary to support claims for payment.

Counties are eligible for money from the DBC Fund to assist in continuing redemption center operations. The department signed separate contracts for FY2011 and FY2012 with Hawaiʻi and Kauaʻi counties for $1.53 million and $530,000, respectively. The City and County of Honolulu and Maui County did not contract for funding.

As of June 2012, the department authorized a total of 117 certified redemption centers on Oʻahu and the neighbor islands. The one-cent non-refundable container fee collected by redemption centers is used to cover the costs of supporting redemption operations, collection, handling, transportation, and administrative costs. Exhibit 1.2 shows a breakdown of redemption centers by each island.

Exhibit 1.2
Certified Redemption Centers, by Island

Island	Number of Centers
Oʻahu	67
Hawaiʻi	20
Maui	17
Kauaʻi	10
Molokaʻi	2
Lānaʻi	1
TOTAL	**117**

Source: Department of Health

The department requires redemption centers to sort deposit containers from non-deposit containers; sort by material type (aluminum, bi-metal, glass, and plastic); empty containers of liquid or other foreign material, although rinsing containers is not necessary; and remove caps from containers. Initially, containers could not be flattened; however, as of July 7, 2005, flattened containers are accepted at redemption centers but not by reverse vending machines.

Certified redemption centers may weigh loads of empty deposit beverage containers and pay deposits based on weight rates by material type. Consumers may request hand-counts of loads of 200 containers or fewer. When containers are weighed, redemption centers must use state-provided segregated rates to calculate the number of redeemed containers per pound. Segregated rates are based on an average number of containers per pound, so a consumer may receive more or less than five cents per container. The number of containers per pound by material type is required to be posted at redemption centers. Non-deposit beverage containers can also be recycled, but without a refund. Exhibit 1.3 shows the current segregated rates.

Exhibit 1.3
Hawai'i Deposit Beverage Container Law Segregated Rates, Effective December 1, 2010

Deposit Container Material Type	No. of Containers per Pound	Price per Pound
Aluminum	32.0	$1.60
Bi-metal	5.9	$0.30
Glass	2.4	$0.12
Plastic (mixed rate: sizes 0-68 fl. oz.)	18.8	$0.94
Plastic (small rate: sizes 0-17 fl. oz.)	26.3	$1.32

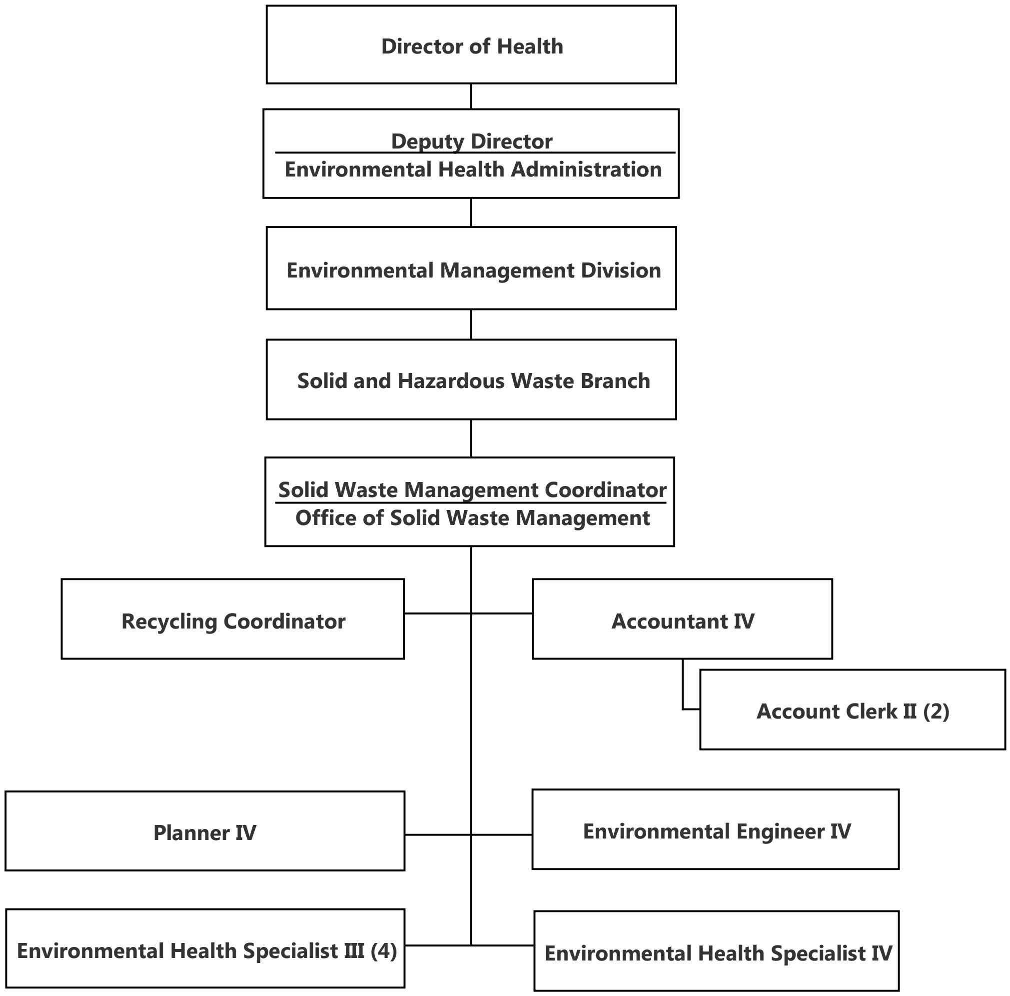
Source: Department of Health

Organization of the Deposit Beverage Container Program

The Department of Health's Environmental Management Division, Solid and Hazardous Waste Branch, Office of Solid Waste Management is headed by the Solid Waste Management coordinator, and has a total of 14 positions.

Of the 14, ten civil service positions are assigned to the program: an accountant IV, two account clerk IIs, a planner IV, an environmental engineer IV, four environmental health specialist IIIs, and an environmental health specialist IV. One environmental health specialist III position was downgraded to an environmental health specialist II as an 89-day hire. A recycling coordinator oversees implementation of the DBC Program under law. Exhibit 1.4 illustrates the program's organization.

Exhibit 1.4
Deposit Beverage Container Program Organizational Chart



Source: Office of the Auditor

The Deposit Beverage Container Deposit Special Fund

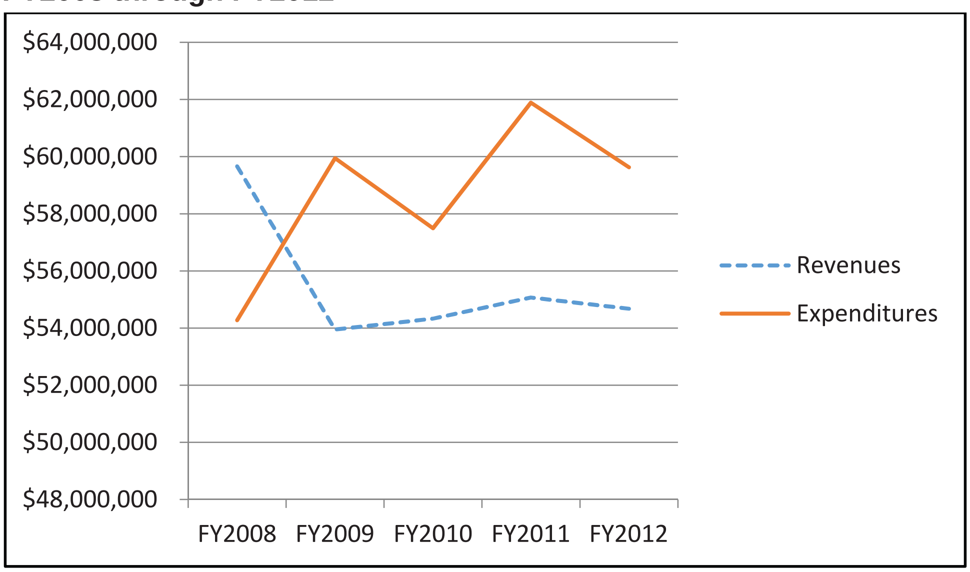
Section 342G-104, HRS, established the DBC Fund as a means to finance the DBC Program. The intent of the fund was for program revenues to support the program's recycling expenditures. The distributors' five-cent deposit and one- or one-and-one-half-cent container fee for each eligible beverage container sold in the state produces revenue for the fund.

Pursuant to Act 79, SLH 2009, the director of finance deposited interest earned by the DBC Fund into the State's general fund and also paid for central services administrative expenses effective July 1, 2009 to June 30, 2015. In addition, Acts 192, SLH 2010, and 124, SLH 2011, transferred a combined $1.3 million in excess funds from the DBC Fund to the general fund during FY2011.

The fund's expenditures include the five-cent deposit paid as a reimbursement to certified redemption centers for each container redeemed and a handling fee per container of two cents on O'ahu and three cents on the neighbor islands. The program may also use the money in the special fund to pay for administrative, audit, and compliance activities associated with collection and payment of the deposits and handling fees of the program; conduct recycling education and demonstration projects; promote recyclable market development activities; support the handling and transportation of the deposit beverage containers to end-markets; hire personnel to oversee implementation of the deposit beverage container program, including permitting and enforcement activities; and pay for associated office expenses.

The department reported collecting more than $54 million in FY2012. This includes both deposits and container fees collected from distributors. The department reported paying out more than $59 million in expenditures, including $36 million in redemption fees, $18 million in handling fees, and $5 million in administrative and other operating expenditures. Exhibit 1.5 shows the total revenues and expenditures on a cash basis for the DBC Fund for FY2008 through FY2012.

Exhibit 1.5
Deposit Beverage Container Deposit Special Fund Revenues and Expenditures (Cash Basis), FY2008 through FY2012



Source: Department of Budget and Finance

Reporting requirements

The law establishes numerous reporting requirements for involved entities. Section 342G-15, HRS, requires the Solid Waste Management coordinator to submit an annual report of the office's activities to each county, the director, the governor, and the Legislature 20 days prior to the convening of each regular session.

Redemption centers must submit reports to the department in order to receive payment for handling fees and refund values. Using forms prescribed by the department, redemption centers must provide: 1) the number or weight of containers of each material type accepted at the redemption center for the reporting period; 2) the amount of refund paid out by material type; 3) the number or weight of containers of each material type transported out-of-state or to a permitted recycling facility; and 4) copies of out-of-state transport and weight receipts or acceptance receipts from permitted recycling facilities. If the redemption center and recycling facility are the same entity, copies of out-of-state transport and weight receipts, or documentation of end-use accepted by the department, must also be included. Requests for payment by redemption centers must be at least twice a month.

Beverage distributors are required to submit a monthly report to the department on the number of deposit beverage containers sold, donated, or transferred by container size and type.

The DBC Program does not apply to deposit beverage containers sold or delivered to an entity operating a commercial passenger vessel when the container is intended for use and consumption on the commercial passenger vessel. However, to be exempt, the entity operating the vessel must have a beverage container recycling plan prescribed or approved by the department. Plans must include the name and address of the recycling facility accepting the empty containers. Deposit beverage containers covered under this exemption must not be redeemed for a refund or handling fee.

Prior Audits

The Office of the Auditor has conducted three audits of the Deposit Beverage Container Program. In our 2005 Report No. 05-09, *Audit of the Deposit Beverage Container Program,* we found that numerous delays at the Department of Health negatively impacted program planning and implementation. The department failed to submit a timely budget request for program funding, losing valuable time in preparing for when consumers could start redeeming empty beverage containers. The department was late in hiring staff, which limited program planning and implementation efforts. Redemption centers were poorly operated, with inconsistent operations, because the department had not developed standard redemption procedures or levels of service. Inspections by environmental health specialists were limited, sporadic, and reactive. Public education efforts were untimely and static, overlooking the greater environmental message. The department failed to develop procedures to verify that data submitted by distributors were accurate or that resulting payments received from distributors were justified. Payments to redemption and recycling centers were based on unverified numbers.

Lastly, the department failed to establish a financial accounting system for the program, was unable to complete reconciliations of accounting records or adjustments to prepare the financial statements, and lacked internal controls.

The *State of Hawai'i Deposit Beverage Container Deposit Special Fund Financial and Program Audit June 30, 2008*, conducted by Accuity LLP, found that the program lacked adequate procedures to prevent or detect whether distributors fraudulently or erroneously under-reported containers sold or distributed, or whether certified redemption centers fraudulently or erroneously over-reported containers redeemed. Deposit and fee collections from distributors as well as payments to certified redemption centers were based on unverified numbers with limited inspections performed by program personnel. The program lacked controls to prevent or detect unauthorized beverage containers from entering the redemption stream. Since inception of the program, exempt commercial passenger vessel companies had not been inspected. The program's management also misstated the DBC Fund's balance by $5 million in FY2007, which resulted in a $5 million restatement of the beginning fund balance in FY2008.

The *State of Hawai'i Deposit Beverage Container Deposit Special Fund Financial and Program Audit June 30, 2010*, also conducted by Accuity LLP, found that despite five years of experience, several deficiencies exposed the program to fraud, including over-reliance on self-reporting by program personnel and lack of systematic compliance inspections. Deposits and fee collections from distributors as well as payments to redemption centers were unsupported. Four redemption centers refused to provide support for amounts redeemed and the related reimbursements requested. At least one large redemption center operator increased the weights reported on redemption forms submitted to the program to correct for errors made by its employees. Exempt commercial passenger vessel companies had not been inspected since the program's inception, which continued to expose the program to risk of unauthorized containers entering the redemption stream. Consequently, the program was potentially operating at a greater cost than necessary, and the reported redemption rate may not have been reliable.

Objectives of the Audit

1. Assess the efficiency and effectiveness of the Department of Health's management of the Deposit Beverage Container Program.

2. Conduct a financial audit of the program, including information on the amount of unredeemed refund value.

3. Make recommendations as appropriate.

Scope and Methodology

We conducted a management and financial audit of the Deposit Beverage Container Program for the fiscal year ended June 30, 2012. The audit considered information from prior and subsequent fiscal years as available and relevant to our overall objectives.

We conducted interviews with key program staff and reviewed relevant documents, including those regarding the program's management to determine whether relevant laws and policies were met; the system is efficiently and effectively managed; and there was documentary evidence of ongoing performance monitoring. We assessed whether the program was provided sufficient oversight by department and program management and reviewed planning, personnel, and other documents for compliance with applicable policies, procedures, agreements, and other relevant criteria.

Accuity LLP conducted a financial audit, including:

1. Assessing the adequacy, effectiveness, and efficiency of the systems and procedures for financial accounting, internal control, and financial reporting of the program; recommending improvements to such systems, procedures, and reports, and to report on the fair presentation of program's revenues, expenditures, and fund balance;

2. Ascertaining whether expenditures or deductions and other disbursements have been made and all revenues or additions and other receipts have been collected and accounted for in accordance with applicable laws, rules, regulations, policies, and procedures of the State of Hawai‘i; and

3. Making recommendations as appropriate.

Our audit was performed from March 2013 through August 2013 and conducted according to the Office of the Auditor's *Manual of Guides* and 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 objectives. We believe the evidence we obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

Chapter 2

Mismanagement of the Deposit Beverage Container Program Puts Its Continued Operation at Risk

This is our fourth financial and program audit of the Deposit Beverage Container (DBC) Program. As in our previous audits, we found that the program relies on self-reported data from distributors that may be fraudulently or erroneously under-reporting beverage containers sold or distributed, and certified redemption centers that may be fraudulently or erroneously over-reporting beverage containers redeemed. This systemic flaw, coupled with the absence of a detailed audit function, exposes the program to abuse and risk of fraud. For example, from FY2010 through FY2012, certified redemption centers could not account for approximately 7.5 million pounds of recycled materials they claimed to have received and were reimbursed $6.2 million by the DBC Program. We found that the Department of Health, which administers the program, has been aware of this flawed payment system since 2006 but has done little to address it, either with changes to the program or through enforcement and inspections.

We also found the program manager, who is limited to a reactionary, "fire-fighting" role, is unable to effectively and efficiently manage the program's resources. Moreover, a lack of staffing in critical positions hampers the program's ability to ensure that certified redemption centers and recyclers are held accountable for submitting proper payment claims. For example, a single employee is responsible for issuing more than $54 million in payments, a situation that further exposes the program's operations to risks, since there is no other employee capable of performing this vital function.

Summary of Findings

1. Unaddressed program flaws result in $6.2 million in overpayments and undermine the Deposit Beverage Container Program's financial sustainability.

2. Inattention to basic management functions exacerbates the program's inability to prevent possible fraud and abuse.

3. Significant deficiencies in internal controls over distributors and certified redemption centers expose the program to fraud.

Unaddressed Program Flaws Result in $6.2 Million in Overpayments and Undermine the Program's Financial Sustainability

Our audit found that from FY2010 through FY2012, the DBC Program paid $6.2 million in deposit refunds for almost 7.5 million pounds of materials that cannot be accounted for. Management has known about its flawed payment system for years but has done little to address the defect. Further, the program's inspection and enforcement functions are ineffective as a deterrent to fraud. These systemic flaws continue to negatively impact the financial sustainability of the Deposit Beverage Container Deposit Special Fund (DBC Fund).

Management has done little to address flawed payment system, resulting in loss of millions of dollars

According to one of its managers, the DBC Program has changed the public's attitude towards stewardship of the environment and recycling. However, we found significant problems with the program's payment system, which pays the five-cent deposit refund fee to certified redemption centers and recyclers based on what they *claim to have received* rather than what they *actually ship* to recyclers. This "front-end" payment system makes the program susceptible to fraud, since some redemption centers and recyclers appear to receive more deposit refunds than they should. We found that the department identified overpayments as a concern as early as 2007; however, it has taken no action to address this issue, resulting in the loss of millions of taxpayer dollars.

Program regularly pays deposit refunds to redemption centers for materials that cannot be accounted for

In FY2010, the program could not account for more than one million pounds of aluminum cans, of which deposit refunds of more than $1.6 million had already been paid to a single redemption center, RRR Recycling. This has allowed certain redemption centers to abuse the program by receiving payment for materials that cannot be accounted for. The department pays redemption centers a handling fee for each deposit beverage container redeemed by a consumer in addition to the refund value of each deposit beverage container based on collection reports submitted by the center.

The DBC Program payment system requires redemption centers to submit separate forms for reimbursement requests for deposit refunds (5¢ Deposit Refund Request Form DR-1) and handling fees for containers redeemed (Handling Fee Request Form HR-1). The program payment system was designed to have the amount of materials submitted on the DR-1 form equal, or be corroborated by, the amount of materials reflected on the HR-1 form. The program's policies further specify that all weights reported on the HR-1 form must reference an incoming load number previously reported on a DR-1 form.

Redemption centers receive their refunds without verification of the weights or amounts claimed. Deposit refunds require a summary sheet prepared by redemption centers; however, no supporting documentation to verify amounts claimed is required. Handling fee payments, however, do require verification of weights claimed, as redemption centers must submit documentation from a shipping company of the weight of materials shipped. Nevertheless, once the program pays deposit refund fees (five cents per container), it has no formal procedures to recoup payments made for materials claimed on DR-1 forms that are not reflected on the weights included with HR-1 forms.

In describing the DBC Program payment system, the program's accountant IV stated that the DR-1 form sets a ceiling on the amount of materials a redemption center can claim in handling fees, since payment will not be made if weights on an HR-1 form are more than those on a corresponding DR-1 form. However, if the reported weight on a DR-1 form ends up being more than the weight claimed on a corresponding HR-1 form, the program does not seek to recover the five-cent refund that has already been paid. The accountant IV tracks the weights claimed and reported by redemption centers on the DR-1 and HR-1 forms via a spreadsheet.

We reviewed the spreadsheet and calculated the differences in weights reported on DR-1 and HR-1 forms. We then calculated the value those differences represented by using the program's various rates for different materials. For example, we used the rate of 32 aluminum cans per pound to determine the total number of aluminum containers, then multiplied the number of containers by the five-cent refund fee. We determined the program has been potentially overpaying redemption centers the refund fee when weights reported on HR-1 forms are *less* than those reported on DR-1 forms.

For example, if a DR-1 form claims 1,000 pounds of aluminum cans, five-cent refunds are paid for 1,000 pounds of cans—i.e., $1,600 is paid to the redemption center. The corresponding HR-1 form should then claim handling fees for 1,000 pounds of cans. However, the redemption center might only claim handling fees for 900 pounds of cans, meaning that only 900 pounds of cans were actually shipped to the end-recycler. As a result, in this scenario, the program would have overpaid the redemption center $160 in refunds (the difference of a hundred pounds of cans multiplied by five cents per can). Exhibit 2.1 provides further details on overpayments that result from differences in weights reported on DR-1 and HR-1 forms.

Exhibit 2.1
Deposit Refund Potential Overpayments Due to Differences on Self-Reported DR-1 and Verified HR-1 Forms

Actual Pounds of Aluminum Cans Based on HR-1	Deposit Refund Payment Made Based on DR-1	Deposit Refund Overpayments If 10% Difference in Weight	Deposit Refund Overpayments If 20% Difference in Weight	Deposit Refund Overpayments If 40% Difference in Weight
1,000	$ 1,600	$ 160	$ 320	$ 640
50,000	$ 80,000	$ 8,000	$ 16,000	$ 32,000
250,000	$ 400,000	$ 40,000	$ 80,000	$160,000
1,000,000	$1,600,000	$160,000	$320,000	$640,000

Source: Office of the Auditor

This system, which pays deposit refund and handling fees separately, contributes to the program's ineffectiveness and exposes it to fraud and abuse. Abuse involves behavior that is deficient or improper when compared with behavior that a prudent person would consider reasonable and necessary business practices. We found abuse was evident because the program has paid $6.2 million for 7.5 million pounds of claimed material it cannot account for.

For example, in FY2010, the program overpaid more than $4 million in deposit refund fees for more than 4.3 million pounds of unaccounted-for material. Further, we found that a single redemption center, RRR Recycling, accounted for a difference of more than two million pounds of claimed material, which resulted in it receiving about $2.2 million in potential overpayments of deposit fees. The accountant IV told us that the program inquired about the large discrepancy, but the redemption center was unable to explain the difference in weights reported; as a result, the department decided not to pay handling fees to RRR Recycling for unaccounted for materials. However, the accountant IV acknowledged that despite RRR Recycling's inability to account for the discrepancy, the department did not require it to return any overpayments of deposit fees it had received for unaccounted for materials. Exhibit 2.2 highlights some of the larger differences reported by select redemption centers in FY2010.

Exhibit 2.2
Differences in Weight Reported By and Possible Overpayments to Redemption Centers, FY2010

Redemption Center	DR-1 Self-Reported Weight (lbs)	HR-1 Actual Weight (lbs)	Difference in DR-1 and HR-1 (lbs)	Potential Overpayment
Atlas Recycling	6,491,871	6,197,650	294,221	$ 457,570
Island Container	8,609,308	7,734,958	874,350	$ 416,162
RRR Recycling	11,547,896	9,505,538	2,042,358	$2,218,680

Source: Office of the Auditor

We asked the Solid Waste Management (SWM) coordinator what action the department was taking to address differences in weight reported on DR-1 and HR-1 forms. The coordinator said the department was unable to do anything about this due to a lack of resources. He said that with only one inspector currently on staff, the department is unable to follow-up and investigate this issue due to the lack of time. He added that the accountant IV keeps him apprised of issues and shares information with him on a regular basis.

The Solid and Hazardous Waste (SHW) Branch chief, who assisted with developing the DBC Program, stated that the separate payment system was intended to serve as a check-and-balance system. In the early stages of program implementation, redemption centers needed assistance in establishing their operations, so the five-cent deposit refund payment helped establish a cash flow to recoup refunds already paid. Planners envisioned that the requirements for additional documentation when requesting payment of handling fees would serve as a control to keep recyclers honest. The branch chief acknowledged these controls have not functioned as intended. He also expressed frustration that payments are not adjusted for errors that occur at redemption centers and asked why the program should pay for such errors.

Our analysis revealed a sharp decline in weight differences between the DR-1 and HR-1 forms and resulting possible overpayments from FY2010 to FY2012. In FY2010, the difference in weight between the forms was about 4.3 million pounds, amounting to a possible overpayment of almost $4.1 million. In FY2012, the difference was about 1.6 million pounds, amounting to potential overpayments of approximately $973,000. While these results show noticeable improvement, we note that between FY2010 and FY2012 the DBC Program nevertheless delivered possible overpayments of approximately $6.2 million in total.

While abuse is evident, it is clear the program may also be at risk of fraud by certain redemption centers and recyclers. Fraud involves obtaining something of value through willful misrepresentation.

However, a determination of fraud must be made through the judicial or other adjudicative system and is beyond auditors' professional responsibility.

Program has considered changing its payment system for more than six years, with no decision to date

Since 2006, the DBC Program and Office of Solid Waste Management annual reports have contained references to a departmental proposal for a "back-end" payment system. Such a system would require that claims for both five-cent container refunds and handling fees be based on the number of containers *shipped* to end-user recyclers, instead of the number that redemption centers claim they *receive* from customers at redemption centers. Despite identifying weaknesses with the current payment system, the department has not acted on its proposal to move to a back-end payment system.

The first DBC Program report to the Legislature was released prior to the start of the 2007 legislative session. In its inaugural report, the department said it was proposing "a major change in how redemption and recycling companies make claims for deposit refunds and handling fees," which was to shift to a back-end payment system. According to the report, the DBC Program was concerned that quantities claimed by redemption centers were not reflective of actual materials collected, because the materials could be affected by factors such as shrinkage, theft, and contamination. The department's proposal was to combine the DR-1 and HR-1 forms, resulting in both refunds and handling fees being paid at the same time. The department expected opposition from redemption centers and recycling companies, since payments would be made later, making them responsible for any discrepancies between what was collected and what was shipped.

In its 2008 DBC Program report, the department again said it was assessing a procedural change to a combined deposit and handling fee form. The department noted that an informal survey of redemption centers indicated that such centers would oppose the change. The department intended to continue to evaluate the negative impacts of such a procedural change, since it could lead to the closing of redemption facilities and a possible reduction in the rate of deposit beverage container redemption (i.e., recycling by consumers).

Thereafter, the 2009, 2010, and 2011 DBC Program reports and the 2012 Office of Solid Waste Management annual report (which replaced the DBC Program Report) contained identical language about the proposed change. The department acknowledged, in some cases, that there were significant differences between the number of containers claimed for deposit refunds and the number of containers shipped to recyclers. The reports state the negative impacts of the proposed change—potential closing of some redemption centers and a possible reduction in redemption rates—were being assessed. As of June 2013, the SWM coordinator and the Solid and Hazardous Waste Branch chief confirmed that moving to a back-end payment system is still under consideration.

Both officials also told us that moving to back-end payments would require amending the program's administrative rules and that the program's deputy attorney general is in the process of drafting such rules. The program's deputy attorney general, however, told us that draft rules had been prepared and provided to the program's coordinator for review in June 2012. In fact, he said the draft had been prepared by the deputy attorney general on his own initiative. Both the current and prior program deputy attorneys general determined there was a need to move to a back-end payment system when they noticed the likelihood of overpayment. To proceed through the rule-making process, DBC program management must review and comment on the draft rules. Thereafter, the Department of the Attorney General will ensure the amendments conform to existing laws, then send the draft rules to the program for finalization and publication, with public hearings to follow.

Program inspection and enforcement functions are ineffective as a deterrent to fraud

We found that the DBC Program's routine compliance inspection activities do not address the risk of overpayment of deposit refund fees to certified redemption centers nor underpayment by distributors. As a result, improper payments resulting from the flawed payment system continue to go undetected and unaddressed.

The program has broad authority to inspect and audit the records of any distributor, redemption center, or commercial passenger-vessel company. The law also provides that records of deposit beverage distributors, dealers, redemption centers, and recycling facilities must be made available upon request for inspection by the department, or State Auditor. In addition, by rule, the program is authorized to inspect information relating to deposit beverage containers of a person who manufactures, distributes, sells, stores, handles, transports, redeems, recycles, or disposes of them. If the director of health determines that any provision of the DBC law or rule has been violated, the director may issue field citations or an order assessing an administrative penalty for any past or current violation, or initiate a civil action.

Redemption centers have an inherent incentive to overstate the amount to be refunded for deposit beverage containers because the department reimburses them for the amount they pay to consumers without verification. There is a similar incentive for distributors to under-report sales/distributions of deposit beverage containers since they pass on beverage container costs to retailers. Distributors could collect deposits and container fees from retailers but not pay them to the program. The department does not verify these numbers either.

In our 2005 Report No. 05-09, *Audit of the Deposit Beverage Container Program*, we identified the risk that the DBC Program pays redemption centers on the basis of unconfirmed or unverified numbers, since it does not require redemption centers to provide documentation to substantiate the numbers reported on DR-1 forms. As a result, the program could have been overpaying redemption centers. The department also was not verifying that data on distributor forms or payments the department received were correct; thus, the department may have been under-collecting fees from distributors. In response to the audit, the department said that it took the possibility of fraud seriously and was working to prevent it. The department also acknowledged the need to verify payment claims.

Environmental health specialists (inspectors) are responsible for investigating compliance and complaints associated with the program, including redemption centers. Under the general supervision of the program manager, the environmental health specialist IV (lead inspector) acts as the program's primary enforcement officer. According to the position description, the lead inspector should provide technical assistance and coordination of daily inspection, compliance monitoring and enforcement activities, and investigate complex allegations of non-compliance and complaints associated with the program.

There are four different types of inspections within the DBC Program: 1) routine; 2) complaint-driven; 3) investigative; and 4) audit. Routine inspections are scheduled or unannounced inspections that use a checklist to test for compliance with the law. The complaint inspections are narrower in scope and are designed to ascertain the validity of a complaint. Investigative inspections are conducted to obtain more information from distributors or redemption centers. Audit inspections are specialized and detailed, involving a review of an organization's information and records to verify numbers reported to the program for refunds or handling fees.

If a violation is found during an inspection, the program initiates an enforcement action through a warning letter signed by the SHW Branch chief. Inspectors then conduct follow-up inspections to see if the violation has been resolved. If a violation continues, the program issues a formal enforcement notice with assessed penalties signed by the deputy director of environmental health and the deputy attorney general.

We found that the program conducts primarily routine or compliance inspections, which it defines as non-complaint-driven inspections of certified redemption centers and smaller deposit beverage dealers/distributors. From FY2010 through FY2012, the program averaged 153 routine inspections per year—217 in FY2010, 107 in FY2011, and 134 in FY2012.

To conduct routine inspections, inspectors use a checklist for both distributors and redemption centers. A copy of the redemption center inspection report form is shown in Appendix A and the dealer/distributor inspection report form is at Appendix B.

We note that routine inspections are not designed to validate information contained in reports submitted by redemption centers and distributors. For instance, redemption center inspections are designed to address signage/certification, operational, and permitting/recordkeeping. Inspectors look at such things as signage with operating hours and refund values, whether the scale is approved and functions properly, and whether the redemption center has a current Solid Waste Permit and Certification. Likewise, dealer/distributor inspections cover operational issues such as whether a dealer is charging customers deposit value on non-labeled containers or ineligible containers or has a sign at each public entrance identifying the closest redemption center location; a distributor is registered with the department; or deposit beverage container fees are charged to the customer at the register.

We also found that the program conducts investigative inspections through a Request For Information (RFI) from distributors or redemption centers. The accountant IV stated the program seldom issues RFIs to distributors, and when it did a few years ago, it was not to verify distributor underpayments. On the other hand, the accountant IV may self-initiate an RFI to a redemption center when the difference in weights reported on the DR-1 and HR-1 forms is too large, or when "something does not look right." The discrepancy is reviewed with the lead inspector, who then issues an RFI to request supporting documentation. In addition, the accountant IV may withhold payment of handling fees reflected in the HR-1 form until the redemption center provides supporting documents. While an investigation through an RFI serves as a mechanism for the program to obtain more information, it is not an audit.

Although the program is aware of the need to audit redemption center and distributor reports to address the risk of overpayment to redemption centers and underpayment by distributors, it has not audited those reports since 2008. In our 2008 and 2010 program and financial audits and our 2012 departmental financial audit, we concluded that the program's overreliance on self-reporting from redemption centers and distributors exposes the program to risks of overpayments to certified redemption centers and underpayments by distributors. In response to our 2012 audit, the department stated that it has not been able to audit reports and deposits received from distributors or reconcile redemption center reports.

According to the department, a lack of resources has hindered the program from following up with an audit to verify the overpayment of deposit fees claimed by RRR Recycling and recovering the amount overpaid. As a result, the program could only withhold payment of handling fees for those unaccounted materials. Department staff acknowledged that deposit refund fees had already been paid for the unaccounted materials, yet the program has not pursued the potential $2.2 million overpayment in FY2010 to RRR Recycling as shown in Exhibit 2.2.

Our review of enforcement actions during the audit period found that actions filed against redemption centers and distributors were not a result of discrepancies observed in claims submitted. Instead, the program took enforcement actions against redemption centers for repeated violations uncovered during routine inspections that remained unaddressed over multiple follow-up inspections, and against distributors for late filing of distributor reports.

We found one instance of a successful enforcement action prior to our audit period that resulted in the program being reimbursed $1.7 million. In May 2008, the DBC Program notified Honolulu Recovery Systems that it must reimburse the program more than $2 million since it had failed to account for more than 44 million deposit beverage containers it claimed to have collected and for which it received refund fees in FY2006. Exhibit 2.3 shows the numbers of containers claimed for refund and handling fees by Honolulu Recovery Systems in FY2006.

Exhibit 2.3
DBC Containers Claimed by Honolulu Recovery Systems, FY2006

	Number of Containers Claimed for Deposit Refunds	Number of Containers Submitted for Handling Fees	Percentage Difference	Potential Overpayment
Aluminum	29,662,634	12,407,100	58.2%	$ 862,777
Plastic	33,702,379	17,113,704	49.2%	$ 829,434
Glass	41,504,228	31,255,826	24.7%	$ 512,420
Bi-metal	48,096	43,208	10.2%	$ 244
Total	**104,917,337**	**60,819,838**		**$2,204,875**

Source: Department of Health

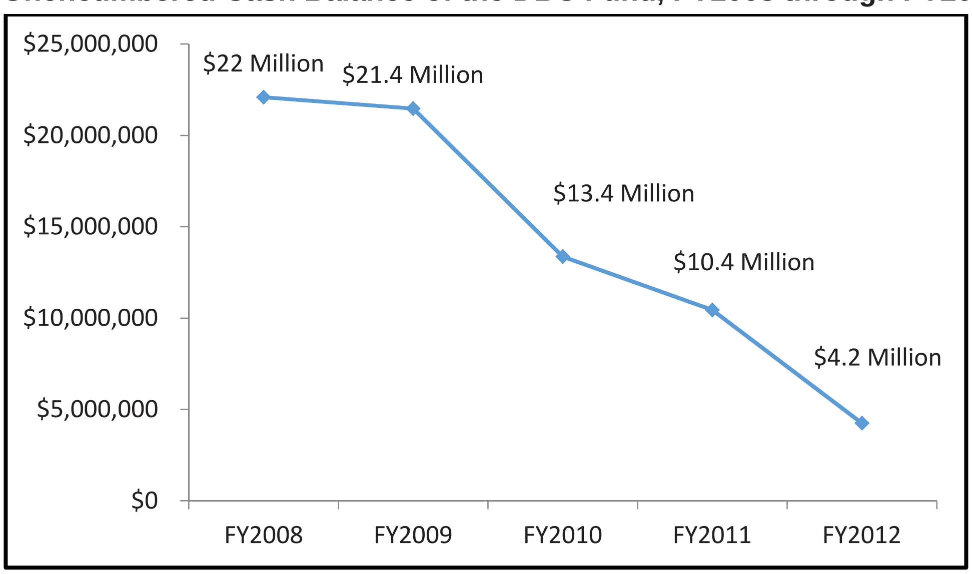
Honolulu Recovery Systems failed to provide weight receipts from permitted recycling facilities, or other evidence or documentation of end-use recycling as required by state law, despite requests from the DBC Program. Honolulu Recovery Systems explained the large weight differences were due to a multitude of factors such as contamination, internal and external theft, and consumer fraud. Ultimately, the DBC Program and Honolulu Recovery Systems agreed on a settlement of $1.7 million, which was paid in full to the program in February 2012.

The recovery of overpayments to Honolulu Recovery Systems was the only enforcement action we could find; however, the outcome illustrates that such actions can be effective if diligently pursued.

The DBC Fund is no longer sustainable

On a cash-basis accounting system, the DBC Fund's unencumbered cash balance has been declining—most notably from FY2010 through FY2012. At the end of FY2012, the cash balance less encumbrances was about $4.2 million, which the department said was too low to fund DBC Program operations. Thus, the department increased the container fee charged to manufacturers, distributors, and importers of beverages to Hawai'i from one cent to one and one-half cents effective September 1, 2012. Exhibit 2.4 shows the unencumbered cash balance of the DBC Fund from FY2008 through FY2012.

Exhibit 2.4
Unencumbered Cash Balance of the DBC Fund, FY2008 through FY2012



Source: Department of Health

Based on figures received from the program, the DBC Fund is paying more money per container than it is taking in. In spite of the deposit fee increase, handling fees paid for containers are still higher than revenues received from deposit fees.

Further, the DBC law mandates the program "pay to each certified redemption center a *handling fee of not less than the prevailing deposit beverage container fee* for each deposit beverage container redeemed by a consumer" (emphasis added). A plain language reading of this provision requires the program pay a higher rate for handling fees, currently fixed at two to four cents depending on the material, than the container fee collected—one and one-half cents as of September 1, 2012—per deposit beverage container. Thus, the fund intentionally pays out more than it receives per deposit beverage container.

To illustrate the per-container losses experienced by the DBC Fund, Exhibit 2.5 shows the reported figures for revenues generated by container fees (at a rate of one cent per container) and expenditures consisting of handling fees.

Exhibit 2.5
DBC Program Container and Handling Fee Revenues and Expenditures, FY2010 through FY2012

	FY2010	FY2011	FY2012	Total
Container fee revenues	$ 9,001,961	$ 9,204,588	$ 9,112,843	**$ 27,319,392**
Handling fee expenditures	$ 18,540,915	$ 18,454,022	$ 18,563,081	**$ 55,558,018**
Net Loss	**($ 9,538,954)**	**($ 9,249,434)**	**($ 9,450,238)**	**($ 28,238,626)**

Source: Office of the Auditor based on Department of Health data

As shown in Exhibit 2.5, in the previous three fiscal years, the fund has paid out $28 million more in handling fees than it has collected in container fees. Even with the higher container fees of one and one-half cents per container, the program will still pay more per container than it receives. Exhibit 2.6 shows our analysis of the program's projected revenues and expenditures for FY2013 with the increased container fee, which results in a deficit of more than $5.2 million.

Exhibit 2.6
Analysis of Projected Revenues and Expenditures, FY2013

	FY2012 actual	FY2013 projections based on FY2012 actuals
Number of containers sold	907,093,351	
Container fee revenues at $0.015 per container		907,093,351 x $0.015 = $13,606,400
Number of containers redeemed	697,259,004 containers redeemed bearing variable handling fees	
Handling fees expenditures at average of $0.027 per container*		697,259,004 x $0.027 = $18,825,993
Net Loss		**($5,219,593)**

*Aluminum and plastic containers bore handling fees of two-cents per container while glass containers merited handling fees of four-cents per container.

Source: Office of the Auditor

Inattention to Basic Management Functions Exacerbates Program's Inability to Prevent Fraud and Abuse

The DBC Program lacks adequate management to effectively and efficiently guide its enforcement functions and payment process. The SWM coordinator, who is the program manager, is performing none of the five basic management functions of planning, organizing, staffing, leading, or controlling. For example, the coordinator has not established goals and objectives for the program or its inspection and enforcement activities in order to guide the use of public resources. The absence of adequate management also hinders staffing of the program's enforcement functions. Currently, all four inpsector positions are vacant, although one is filled by an 89-day hire on an interim basis. The difficulty in recruiting and retaining inspectors is partly due to management's failure to correct inaccurate position descriptions that have remained unchanged since the program's inception. Minimum qualifications do not align with the position's duties. In addition, management relies on one person to issue and approve more than $54 million in payments to redemption centers statewide. Management recognizes this predicament but has only recently begun to approve requests for additional accounting support. However, it will be some time before a position can be established and filled. These management deficiencies exacerbate the program's flaws.

Management's inadequate guidance leaves program's enforcement function adrift

Management and officials entrusted with public resources are responsible for providing services to taxpayers effectively, efficiently, economically, ethically, and equitably within the statutory boundaries of a specific government program. According to the Government Accountability Office (GAO), the concept of accountability for use of public resources and government authority is key to our nation's governing processes. As manager of the DBC Program, the SWM coordinator is accountable for the proper use of public resources for the program. We found that the coordinator cannot demonstrate the effective and efficient use of the program's resources to perform inspection and enforcement activities.

To operate effectively and efficiently, a manager must perform several basic functions. According to the *Encyclopedia for Business, 2nd Edition*, management is "the acquisition, allocation, and utilization of resources through planning, organizing, staffing, leading, and controlling." It adds that managing involves five basic functions: 1) planning; 2) organizing; 3) staffing; 4) leading; and 5) controlling. We found the program manager is performing none of these basic management functions. The results of our analysis are shown in Exhibit 2.7.

Exhibit 2.7
Analysis of Program Manager's Performance of Five Basic Management Functions

Function	Organizational Functions	Function Performed?
Planning: Developing specific strategies designed to achieve organizational goals	Goals and objectives established for the DBC Program	No
	Strategic plan/strategy prepared for how the DBC Program will achieve its goals and objectives	No
Organizing: Structuring an entity's resources in a way that allows it to achieve its goals and objectives	Functional statement related to the DBC Program reviewed and edited to ensure alignment with current program operations	No
	Organizational structure and staffing resources reviewed in order to assist the program in addressing its operational needs to monitor and audit distributors and certified redemption centers on a regular basis	No
Staffing: Finding and sustaining a labor force that is adequate to meet organization objectives	Labor needs for inspection and reinforcement functions analyzed to facilitate recruiting the skills requested to meet these needs	No
	Inspector position descriptions reevaluated in order to improve the program's inspection functions	No
	Formal training and development program implemented for DBC Program staff	No
	Performance appraisals of DBC Program staff conducted by program manager	No
Leading: Guiding and influencing other people to achieve goals	Program manager directs staff on how to conduct inspections	No
	Work priorities established for DBC Program in order to provide guidance to the inspection and enforcement staff	No
Controlling: Measuring and evaluating the outcome of planning, organizing, staffing, and leading efforts	Performance standards or measures established for DBC Program inspections and enforcement	No
	Monitoring program performance by requiring status reports from DBC Program staff on their work activities and progress	No

Source: Office of the Auditor

Planning—the first management function—is the development of specific strategies designed to achieve organizational goals and serves as the foundation for the other functions. Forward-looking managers use planning to develop strategies, policies, and methods for achieving agency objectives. The program manager's position description includes conducting planning relative to the program's personnel. However, the program manager told us he does no planning. In addition, he has not established any goals or objectives for the program or its inspection and enforcement activities.

Although the department published a strategic plan in 2012, the plan is high-level and does not include goals, objectives, strategies or initiatives specific to the DBC Program. Even the department's work plan, a companion to the strategic plan, has only a high-level initiative to support and regulate statewide recycling efforts for the Environmental Management Division, which includes the DBC Program. In addition, the department does not have "Act 100" planning documents. In enacting Act 100 (SLH 1999), the Legislature expressed that the development of goals and objectives is essential for state departments and agencies to determine priorities, guide decisions, and measure the effectiveness of programs and services. The purpose of the act was to require all departments and agencies to identify their goals, objectives, and policies to provide a basis for determining priorities and allocating limited public funds and human resources.

The second management function—organizing—is the process of structuring an organization's resources, such as personnel and materials, in a way that allows it to achieve its objectives. It entails a fundamental three-step process: developing tasks, labor units, and positions.

In accordance with Administrative Directive 95-06, *Interim Policy and Procedures for Effecting Changes in Organization*, the Department of Budget and Finance requires departments to annually update their organization charts and functional statements. The Department of Health's Administrative Services Office coordinates the department's update. When asked, the program manager recalled seeing a functional statement for the Office of Solid Waste Management when he first started with the program in 2012. He told us he briefly looked at it, and recalls that, even then, the functional statement for the Office of Solid Waste Management was outdated and inaccurate, adding that 50 percent of it was incorrect. However, he took no action, and thereby lost an opportunity to rectify inaccuracies in the program's functions through the reorganization process.

In addition, the program manager has not re-evaluated his staff's position descriptions and was not aware of an inaccuracy in a program planner

IV position description, which has existed since December 2005. The description states that the program planner IV spends 75 percent of their time conducting inspections. However, when interviewed, the planner IV said he does not conduct any inspections. Instead, his key job responsibility involves tracking redemption and segregated rates.

The third management function—staffing—encompasses activities related to finding and sustaining a labor force that is adequate to meet an organization's objectives. Managers must first determine exactly what their labor needs are and recruit those skills and characteristics. Managers must train workers. They must also devise a method of compensating and evaluating performance that complements objectives, including conducting performance appraisals.

We found that the program manager has not determined how many inspectors are needed to carry out program inspection and enforcement activities. Absent this analysis, though, he expressed mixed feelings about his intent to abolish one inspector position and reestablish it as an accountant III to assist an overburdened accountant IV. He revealed that they (the program) could be "shooting themselves in the foot" because this action will send the message that the program has too many inspectors. He affirmed that the program still has a need for additional inspectors.

The program manager is aware he is responsible for conducting performance appraisals of his staff. According to the *Performance Appraisal System Supervisory Manual*, the State's performance appraisal system is used to annually evaluate whether civil service employees meet performance requirements of their positions. The program's ten employees are in civil service positions, with one filled by an 89-day hire. However, the program manager has yet to prepare any performance appraisals for his staff since becoming manager in January 2012.

The program manager is also responsible for developing and implementing a formal training program for his staff. However, he acknowledged he has not implemented such a program for his staff, including any training for inspectors.

The fourth management function—leading—is the act of guiding and influencing other people to achieve goals. It involves leadership, communication, and motivation skills. The program manager is responsible for providing guidelines to staff to assure daily work quality and productivity in meeting and maintaining program objectives, but he has not provided guidance to inspectors on how to conduct inspections. On the contrary, it is the lead inspector (environmental health specialist IV) who provides guidance to the program manager. Although the program manager knows he should provide guidance, he said he does not

have the time to formally document his ideas.
An inspector took the initiative to create a *Deposit Beverage Container Program Operations Manual* in December 2012. The manual provides guidelines and procedures for general operations, including inspection, monitoring, and enforcement of certified redemption centers, dealers, and distributors. However, the manual was not reviewed or approved by management; in fact, the program manager was unaware of its existence until we brought it to his attention.

The fifth function—controlling—consists of activities that measure and evaluate the outcome of planning, organizing, staffing, and leading efforts. Controlling is an essential part of management because it helps determine the fruitfulness of the other functions, guide employee efforts towards an agency's goals, and distribute an agency's resources efficiently and effectively. The program manager should provide weekly oversight of the quantity and quality of inspections and the attainment of program measures of effectiveness.

The program manager, however, has not established performance measures for DBC Program inspection and enforcement functions. Although the program has a single measure of effectiveness—the deposit beverage container redemption rate—it does not relate to its enforcement function. The program manager said he does not monitor program progress nor receive status reports from inspectors. There are no metrics on reporting progress. The program manager noted that other departmental programs have established metrics, but he has not had time to develop some for the DBC Program. Rather, his assessment of inspector work is largely subjective. When asked how he would be able to determine whether inspectors are doing good work, the program manager replied that the inspectors work long hours, their reports are concise, they are passionate about their work, and they ask good questions. This is not an objective assessment.

Overall, when asked why he does not perform the various management functions, the program manager stated it was due to a lack of time. He said that he serves as a "fire fighter" for the program and spends his time fixing problems. He also spends time handling media inquiries on compliance and enforcement issues. Although the program manager has some ideas on how to guide the DBC Program, he does not have time to proactively plan. However, unless he provides adequate management in the form of goals, objectives, work priorities, or a training program, the program manager will continue spending time responding to day-to-day operational crises, since employees have little direction or leadership. In regards to program monitoring, he said his management of the program is reactive, and he does not have time to set up a systematic approach to monitor its progress. The program manager's inability to carry out basic management functions leaves the program's enforcement functions adrift. One of the results of which is that he cannot justify current or future program needs.

Chronic staffing issues impede program's ability to mitigate unwarranted risk

Lack of timely management action has left the DBC Program with inappropriate and inadequate staffing for its enforcement and accounting activities. The program has faced continuous inspector vacancies due to management's failure to correct misaligned position descriptions in place since the program's inception in 2002. Inspector position descriptions do not accurately reflect the requirements needed to fulfill the program's enforcement activities, which makes it difficult to recruit and retain inspectors. Further, only one employee understands how the payment process to redemption centers works and single-handedly approves more than $54 million in payments to redemption centers statewide.

Misaligned position descriptions and minimum qualifications hamper recruitment and retention of inspection and enforcement staff

The DBC Program has had difficulty recruiting and retaining environmental health specialist IIIs, whose main duties are to investigate compliance and complaints associated with the program. According to the lead inspector, an environmental health specialist IV, the environmental health specialists are the only program staff who conduct inspections and enforcement functions. From FY2008 through FY2012, of the program's ten positions, vacancies have occurred more often with the four environmental health specialist III positions than with the other six positions. The vacancy problem is not new. In its first annual report to the Legislature dated December 2006, the program reported it was having difficulty in hiring environmental health specialists. Exhibit 2.8 shows staffing for the program for FY2008 through FY2012.

Exhibit 2.8
DBC Program Staffing, FY2008 through FY2012

DBC Program Position	FY2008	FY2009	FY2010	FY2011	FY2012
1 Environmental Health Specialist III	**Vacant**	**Vacant**	Filled	Filled	Filled
2 Environmental Health Specialist III	**Vacant**	Filled	Filled	**Vacant**	**Vacant**
3 Environmental Health Specialist III	Filled	**Vacant**	**Vacant**	**Vacant**	Filled
4 Environmental Health Specialist III	Filled	Filled	Filled	Filled	**Vacant**
5 Environmental Health Specialist IV	Filled	Filled	Filled	Filled	Filled
6 Planner IV	Filled	Filled	Filled	**Vacant**	Filled
7 Engineer (Environmental) IV	Filled	Filled	Filled	Filled	Filled
8 Accountant IV	Filled	Filled	Filled	Filled	Filled
9 Account Clerk II	Filled	Filled	Filled	Filled	Filled
10 Account Clerk II	Filled	Filled	Filled	Filled	Filled
Total Filled	8	8	9	7	8
Total Vacant	2	2	1	3	2
TOTAL	**10**	**10**	**10**	**10**	**10**

Source: Department of Health, Human Resources Office

From FY2008 through FY2012, the four environmental health specialist III positions have been filled by nine different people with an average length of employment of 16.2 months. Exhibit 2.9 illustrates the average length of employment for the environmental health specialist III positions.

Exhibit 2.9
Analysis of Environmental Health Specialist III (DBC Program Inspectors) Staffing, FY2008 through FY2012

Number of positions	4
Number of different people who have filled positions	9
Average length of employment in months	16.2
Shortest length of employment in months	2
Number of months inspection team fully staffed	0

Source: Office of the Auditor analysis based on information provided by Department of Health

The science education requirement for the Environmental Health Specialist III positions, which is a minimum qualification, reduces the applicant pool, according to the Public Health Administrative Officer within the Environmental Health Administration. The position description requires a knowledge of scientific laws and principles, including the properties of hazardous chemicals; use of highly technical instruments; experience with computers; and knowledge of laboratory and field tests applicable to solid waste management. Another requirement is graduation from an accredited college or university with a major in a physical, biological, or environmental science.

Although the position description requires knowledge of scientific laws and principles, there is little opportunity to apply such knowledge on the job. Environmental health specialists carry out routine compliance inspections of redemption centers, including:

- Signage/certification: Looking for proper signage required by the department. One requirement is the posting of a facility's hours of operation prominently at the facility entrance;

- Observing transactions: Checking to see that a certified redemption center operator is removing containers from customers' bags, bins, or boxes at the redemption center. At a minimum, containers must be transferred from customers' receptacles to the redemption center's bins for inspection prior to weighing and/or redeeming; and

- Weighing/counting procedures: Checking scales for the state certification seal. Scales must have been certified by the Department of Agriculture within one year of the inspection date.

In our 2005 audit of the DBC Program, we found that none of the position descriptions for program employees, including the environmental health specialist IIIs, were tailored to the program's needs. Instead, position descriptions were based on existing branch positions to facilitate initial approval of program positions. At the time, we recommended the department reevaluate the program's organization, staffing, and position descriptions. Although the department in 2006 claimed that a reevaluation was done, we found that current position descriptions for all four environmental health specialist IIIs are still dated 2004 or 2005.

The program manager realizes that current position descriptions are not a good match for the program since they were not written with the DBC Program in mind. He wants to hire people with an interest in recycling, but may not be able to attract them because the position description is geared towards someone with an interest in environmental contamination issues, such as air, soil, or water quality. The program manager said he would also prefer someone with an accounting background to facilitate audits of redemption centers. However, he also acknowledged that the position descriptions do not reflect these requirements.

According to the Department of Human Resources Development, position descriptions should accurately reflect the work assigned. They should be updated when there are significant changes in the work assigned and be reviewed and updated, if necessary, prior to establishing performance standards and filling vacancies. Since management retains the authority to assign the work to be performed, supervisors are generally responsible for writing position descriptions. Instead of updating the DBC Program environmental health specialist III position descriptions, the program manager said he has adjusted the interview questions. For example, questions include asking what kind of accounting experience candidates have. The program manager told us there is no plan to revise the position description. The branch chief articulated ideas on how to amend the position descriptions but likewise has no plan to do so.

Even if the position descriptions were amended and appropriate staff were hired, the program needs to reframe its inspection and enforcement activities. First, the program lacks direction, since the manager has not established goals and objectives for the program or its inspection and enforcement activities. Second, the manager must establish work priorities and a training program for inspectors. Finally, inspectors' position descriptions must be updated because misaligned requirements may cause dissatisfaction among staff, which in turn contributes to vacant positions.

A single employee is responsible for approving and issuing more than $54 million in payments and is the only one who understands the process

Payments to certified redemption centers, which totaled more than $54 million in FY2012, are dependent upon one employee, the accountant IV. The program reimburses five cents to certified redemption centers for each container redeemed and also pays a handling fee to ensure redemption centers recycle all redeemed containers. Moneys are paid out of the DBC Fund. Only the accountant IV fully understands the payment process and is authorized to approve payments.

With only one person who has the knowledge and ability to approve reimbursements to certified redemption centers, the program risks facing a *single point of failure*. This term, used in management information technology and personnel management sectors, refers to an organization's over-reliance on a single piece of equipment or employee. If only one person knows how to support a given technology and they are out of the office unexpectedly, over an extended period of time, or any other similar scenario, then the organization is at risk. According to the accountant IV, she is responsible for managing the fiscal operations of all programs under the Office of Solid Waste Management, which includes the DBC Program and the glass and tire recycling programs. The majority of her time, about 85–90 percent, is spent on the DBC Program. Her duties include tracking payments made by the program based on DR-1 and HR-1 forms, performing monthly reconciliations to ensure accuracy, and tracking and depositing moneys received from distributors. When the accountant IV is absent, payments and reimbursements are not processed.

In addition, the GAO's *Standards for Internal Control in the Federal Government* stipulate that no one individual should control all key aspects of a transaction or event. This is referred to as *segregation of duties*. Key duties and responsibilities should be divided among different people to reduce the risk of error or potential fraud. This includes separating the responsibilities for authorizing transactions, processing and recording them, reviewing them, and handling any related assets. Segregation of duties is one example of a *control activity*; control activities are the policies, procedures, techniques, and mechanisms that enforce management's directives. They help ensure that actions are taken to address risks and are an integral part of an entity's planning, implementing, reviewing, and accountability for stewardship of government resources and achieving effective results.

The program manager disclosed that there is no process in place to issue deposit refund and handling fee payments when the accountant IV is out of the office. He further acknowledged that the DBC Program would be "dead in the water" without the accountant IV. The branch chief also said he was aware the program was dependent on the accountant IV and that it is not a good situation to be dependent on one employee. Both the program manager and the branch chief said this situation has been communicated to upper management, including the deputy director and director of health.

As of April 29, 2013, in order to help the accountant IV, the program planned to abolish a vacant environmental health specialist III position and reestablish it as an accountant III position. According to the program manager, the accountant III would assist the accountant IV in completing journal vouchers, updating FAMIS (the State accounting system), and updating the program's QuickBooks. He said that currently the accountant IV is overwhelmed by the volume of work that needs to be done; and that even after establishing the accountant III position, he will still need to recruit to fill that position. He acknowledged it will take some time for that to happen. As of April 24, 2013, the draft position description for the accountant III is being reviewed by the program's support office.

Issues for Further Study

During our audit, we encountered areas of concern that were outside our scope but which we believe warrant further study.

Hiring of an independent auditor

In an effort to audit the transactions and records of redemption centers in 2010, the department hired PKF Pacific Hawaii LLP (PKF), an independent accounting firm. The contract called for audits of six certified redemption centers at a cost of $340,000. The contract was amended three times resulting in: 1) increasing the cost by an additional $203,374; 2) extending the contract by one year; and 3) reducing the number of redemption centers to be audited from six to two. Despite these changes and extension, PKF issued only one final report and one draft report, at a cost of nearly $550,000. We believe this instance of apparent contract mismanagement warrants further examination.

Inspections of exempt commercial passenger-vessel companies

During our audit work, we discovered that exempt commercial passenger vessel companies have not been inspected since the program's inception, which exposes it to the risk that unauthorized beverage containers are entering the redemption stream. The program receives and approves recycling plans from commercial passenger vessel companies. However, the program has no inspection forms for commercial passenger vessel companies. Rather than inspect such companies, the program merely looks at the companies' recycling plans to identify which redemption center(s) they take their deposit beverage containers to. The program checks with those centers to see if the reported containers are received from the relevant exempt companies. According to the program manager, there could be a high number of deposit beverage containers being recycled—meaning a deposit fee is being paid—when they should not be receiving a fee.

Significant Deficiencies in Internal Controls Over Distributors and Certified Redemption Centers Expose Program to Fraud

Our contract auditor, Accuity LLP, also concluded that the DBC Program's over-reliance on self-reporting from distributors and certified redemption centers exposes the program to fraud. Because these deficiencies fail to address inherent incentives for distributors, certified redemption centers, and exempt companies to misreport data, the program is exposed to fraud, which may result in higher program costs and a greater burden on consumers. Further, uncertified redemption centers may be operating in violation of state law and program rules.

Deposits and fee collections from distributors are unsupported

Sections 342G-105 and -110, HRS, require distributors to report the number of deposit beverage containers sold/distributed and pay beverage container deposits and container fees to the program on a monthly (semiannual for smaller companies) basis. While distributors are supposed to maintain adequate records and support for beverage sales, the program continues to rely on the unsupported amounts reported by distributors. The department has no verification or inspection process that prevents distributors from fraudulently or erroneously underpaying beverage container deposits and container fees. We found evidence of such underpayment in a sample of distributor receipts we tested.

Program reliance on self-reported amounts increases risk of under-reporting by distributors

Section 342G-105, HRS, requires payment of the deposit beverage container fee and deposits to be made monthly, based on inventory reports of the deposit beverage distributors. All deposit beverage distributors must submit to the department sufficiently detailed documentation that identifies the net number of deposit beverage containers sold, donated, or transferred, by container size and type.

In addition, Section 342G-110, HRS, specifies that the deposit on each filled deposit beverage container must be paid by the beverage distributor, who manufactures or imports beverages in deposit beverage containers. Beverage distributors must also pay a deposit beverage container fee and register with the State.

Since distributors can pass on beverage container costs to retailers, they have an inherent incentive to under-report sales/distributions of deposit beverage containers, and collect deposits and container fees from retailers but not pay them to the program. However, the only regular review of reports submitted is the Solid Waste Management coordinator's scanning of monthly distributor reports and an account clerk's review for mathematical accuracy. No other support, such as shipping or sales records, is required.

Underpayments from distributors will result in the program having fewer funds available to pay for deposit redemptions and administrative costs. This could also lead to an overstated redemption rate because the number of deposit containers sold may be understated. An inaccurate redemption rate could lead to an unjustified increase in container fee rates to sustain the program's operations.

The DBC Program continues to lack a systematic process to detect under- and non-reporting by distributors

Section 342G-103, HRS, requires all beverage distributors operating within the State to register with the department and maintain records reflecting the manufacture of their beverages in deposit beverage containers as well as the import and export of deposit beverage containers. The records must be made available, upon request, for inspection by the department. By law, the department and the Auditor may audit or inspect distributor records.

In FY2011, the department performed 107 compliance evaluation inspections of regulated entities (including certified redemption centers, recycling facilities, and distributors); however, these inspections are not designed to substantiate distributor reports. The Solid Waste Management coordinator stated that detailed inspections of distributors by examining reports and supporting documents are not performed by the program due to vacant positions. The department's *Report to the Twenty-Fifth Legislature State of Hawaii 2009* (issued in November 2008) stated that the number of inspectors decreased after October 2007, resulting in a decrease in the number of inspections completed each month.

The Solid Waste Management coordinator admitted that the length of the hiring process and poor recruitment and retention were factors in position vacancies.

In other self-reporting programs, such as income and other tax filings, regulators have robust inspection/audit and enforcement programs that encourage compliance by penalizing subject entities for late and/or inaccurate filings, whether intentional or unintentional.

Although the DBC program has broad enforcement powers—including assessing an administrative penalty, ordering corrective action immediately or within a specified time, commencing civil action, and/or revoking a certification or permit—lack of effective compliance inspections on distributors hobbles the program from effectively deploying these enforcement tools. Robust enforcement would encourage distributors to pay deposits and container fees. Public announcements of violations could hurt distributors' reputations, creating an incentive to comply with the deposit beverage container laws. Such announcements could also heighten distributors' awareness of penalties, in addition to the required payment of under-reported amounts.

Payments to redemption centers are unsupported

The program reimburses and pays handling fees for beverage containers monthly, based on reports prepared by the certified redemption centers. We found, however, that the program lacks adequate internal controls to prevent or detect whether certified redemption centers fraudulently or erroneously over-report beverage containers redeemed and overcharge the program.

The DBC Program's continued reliance on self-reported amounts increases risk of over-reporting by redemption centers

Section 342G-119, HRS, specifies that the department shall pay certified redemption centers handling fees and deposit refunds based on collection reports submitted by the redemption centers. The redemption reports include the number or weight of deposit beverage containers of each material type accepted at the redemption center for the reporting period; the amount of refunds paid out by material type; the number or weight of deposit beverage containers of each material type transported out of state or to a permitted recycling facility; and copies of out-of-state transport and weight receipts or acceptance receipts from permitted recycling facilities. Additionally, Section 11-282-47, Hawai'i Administrative Rules (HAR), states that the department shall pay certified redemption centers handling fees and refund values based on reports submitted by redemption centers to the department.

Certified redemption centers can only receive 50 percent of the handling fees claimed at the time of their initial submission of the HR-1 form unless they include weight tickets reflecting the amount of material shipped to end-user recycling facilities. The remaining balance is paid upon receipt of corroborating weight reports prepared by end-user recycling facilities. Certified redemption centers are reimbursed by the program for the amount of deposit refunds paid to consumers based on reports prepared by themselves. Handling fees paid to certified redemption centers are based on container equivalents from the weight of containers redeemed and sent to recycling facilities as reported by both the certified redemption centers and recycling facilities.

However, the program does not require redemption centers to submit any supporting documents with deposit refund reimbursement requests. Similar to the monthly distributor reports, the Solid Waste Management coordinator only scans the deposit refund (DR-1) requests. Because the program reimburses certified redemption centers for all deposits refunded, there is nothing to prevent redemption centers from overpaying and/or reporting more redemptions than actually occurred. In addition, overpayment of deposit refunds may encourage more consumers to redeem deposit beverage containers at certain redemption centers, resulting in greater volume and, consequently, handling fees for that redemption center.

The program acknowledged this concern in its 2007, 2010, and 2011 reports to the Legislature, stating:

> This summer the program became concerned that the DBC quantity claimed by certified redemption centers is not a reliable indicator of the actual quantity of DBC material collected, which has been found to be affected/reduced by such factors as material shrinkage, theft, contamination, etc. (2007 report)
>
> The program has in some cases found significant differences between the number of containers claimed for deposit refunds and the number of containers reportedly shipped later. The DBC quantity claimed by redemption centers is sometimes not a reliable indicator of the actual quantity of material collected. (2010 and 2011 reports)

The program proposed procedural changes to address this concern by paying the combined deposit reimbursement and handling fees only on the quantity of deposit beverage containers shipped to and received by materials end-use recyclers. However, despite seeing indicators that overpayments have been occurring and planning changes for at least five years, the program has failed to adequately address these concerns by implementing planned changes.

Overpayments of redemptions will result in the program having fewer funds available to pay deposit refunds, which will necessitate an increase in the handling fees on beverage containers redeemed. During FY2012, the handling fees paid were between two cents and four cents per container, depending on the location of the redemption center and the end-use of the recycled containers. This is two to four times the amount of the container fees paid into the program by distributors. This could also lead to an overstated redemption rate, because the number of deposit containers redeemed may also be overstated. It may also lead program management to erroneously conclude that a higher container fee is justified and necessary to continue to operate the program.

The DBC Program continues to lack a systematic process to detect over-reporting by redemption centers

As previously noted, the program performed 107 compliance inspections in fiscal year 2011. However, the program issued and settled one Notice of Findings Violation and Order during this period for Honolulu Recovery Systems, a certified redemption center operator, totaling $1.7 million for the repayment of deposits and handling fees received on containers in FY2006 for which there was inadequate documentation of actual recycling.

According to the Solid Waste Management coordinator, many inspections are limited to checking daily customer transactions at certified redemption centers to determine if refunds were properly calculated, including use of proper segregated rates and investigating complaints received from the public, rather than inspecting deposit refund reimbursement request forms by reconciling amounts reported to redemption centers' supporting documents. The Solid Waste Management coordinator admits that the program has not scheduled and systematically performed compliance inspections of certified redemption centers with any regularity due to vacant positions, which we found are the result of poor recruitment and retention efforts.

Redemption centers have an inherent incentive to overstate the amount refunded for deposit beverage containers redeemed to increase the demand for their services and consequently the amount of handling fees generated. There is no financial disincentive for redemption centers for overpaying on deposit redemptions because the program reimburses for all that the centers refund to consumers. The program has failed to implement a systematic compliance inspection and enforcement process that would limit the risk of overpayment of redemptions.

Monitoring performed by DBC Program personnel is not utilized in enforcing requirements

The program's accountant performs an annual analysis comparing the total weight of containers reported on DR-1 and HR-1 payment request forms submitted by redemption center operators and the type of beverage container (i.e., aluminum, bi-metal, glass, or plastic). The accountant performs this analysis to identify any significant discrepancies in amounts reported, since HR-1 forms report the actual weight of containers recycled while DR-1 repayments are paid prior to containers being recycled. Ideally, the weights reported should be almost equal, allowing for some shrinkage in amounts ultimately recycled and reported on HR-1s.

Based on the analyses for FY2010 to FY2012, we noted there were significant differences in the total container weights reported on DR-1 and HR-1 forms for several redemption centers, indicating possible over-reporting and receipt of deposit reimbursements by these operators. However, the accountant noted that program management has not investigated further or taken any enforcement action on the operators in question.

Uncertified redemption centers may be operating in violation of the law and rules

Although state law requires redemption centers to be certified prior to commencing operations we found uncertified redemption centers that were redeeming container deposits to consumers. These centers were operated by a company that also runs certified redemption centers, raising the possibility that containers from the uncertified sites are mixed with those from certified sites, resulting in inappropriate reimbursements to the redemption center operator.

Two redemption centers operated without certification

Section 342G-114, HRS, requires the department to certify redemption centers prior to operation and may revoke a certification. According to Section 11-282-41, HAR, uncertified redemption activities are not eligible to collect deposit refunds or handling fees from the department. The department is required to certify redemption centers to control the redemption process and protect consumers. In addition, periodic recertification also provides the department with the remedy of decertifying a redemption center if it does not comply with applicable laws and rules.

We found that two of the RRR redemption centers selected for testing—1290 Beretania Street and 1173 21st Avenue, both in Honolulu—were not certified. As reported in the FY2010 audit, the DBC Program is not allowed to pay uncertified redemption centers for deposits redeemed or the related handling fees. Therefore, any payments by the DBC Program to uncertified redemption centers are against the law. Unlawful payments reduce the funds available for operating the program, including paying operators of certified redemption centers that have made additional investments in certification and may, therefore, be at a competitive disadvantage to lower-cost, uncertified redemption centers.

The DBC Program does not have a process that effectively identifies uncertified redemption centers

The DBC Program does not have controls in place to prevent redemption center operators from adding beverage containers from uncertified redemption centers with those of certified redemption centers when requesting payments. Since RRR operates redemption centers and is also a recycler, there is nothing to prevent it from comingling containers redeemed at its uncertified redemption centers with those from its certified redemption centers. This was highlighted in our testing of two uncertified redemption centers operated by RRR, where we redeemed deposit beverage containers.

If the DBC Program paid RRR deposit refund reimbursements and related handling fees for uncertified redemption centers, it would be in violation of Section 11-282-41, HAR.

Certified redemption center errors are passed on to the DBC Program

In our testing of deposits refunded by certified redemption centers, we found various errors in the amounts refunded to consumers based on the weight of deposit beverage containers redeemed. We found that the program's segregated rates, that are used to convert deposit beverage containers to container equivalents, were inaccurate compared to hand counting for several of the refunds we tested. We also noted errors in the redemption centers' calculations for other refunds tested. As the DR-1 forms submitted by redemption centers are based on weight, it is likely these errors are passed on to the program, resulting in more deposits and handling fees being paid out than are justified.

Program allows redemption of overweight and underweight containers

Section 11-282-46, HAR, provides that redemption centers are allowed to redeem deposit beverage containers and pay refund value based on the weight of containers presented for redemption as follows:

1. Empty beverage containers should be weighed, recorded, and reported in tons, pounds, or fractions thereof.

2. To be redeemed by weight, containers must be segregated by material.

3. Refund values should be posted and paid according to the container per pound conversion rates issued by the department in Section 11-282-61, HAR.

4. Certified redemption centers must inspect loads as required by Section 11-282-45, HAR.

5. If requested by a consumer, for loads of 200 containers or fewer, redemption centers must compute redemption value by container count rather than by weight.

Exhibit 2.10 shows the differences we found between deposit refunds we expected to receive, based on our hand count prior to taking containers to the redemption centers, and the amounts actually received at the redemption centers, based on the weight of the containers redeemed.

While the program allows weighing of deposit beverage containers, based on the official segregated conversion rates (see Exhibit 1.3), the converted container equivalents are expected to approximate a hand count on average. However, we found that when containers are weighed, it results in significant differences (greater than 5 percent) from the refunds that would be received based on hand counts, but are processed as redemptions anyway, as allowed under Section 11-282-46, HAR.

Exhibit 2.10
Differences Between Expected and Actual Refunds Due to Segregated Weights

							Redemption Refund			Count vs. Weight Variance	
Redemption Center	Date	Type	Container Count (a)	Weight in lbs (b)	Weight Conversion	Equivalent Containers (c)	By Count	By Weight	Actual Refund	Over (Under) Paid Count vs. weight	% (Rounded) Difference
Reynolds Mililani Town Center	2/10/2013	Cans	15	0.7	32	22	$ 0.75	$ 1.12	$ 1.12	$ 0.37	49.3%
		Glass	10	6.6	2.4	16	$ 0.50	$ 0.79	$ 0.79	$ 0.29	58.4%
		Plastic	10	0.7	18.8	13	$ 0.50	$ 0.66	$ 0.66	$ 0.16	31.6%
TOTAL							**$ 1.75**	**$ 2.57**	**$ 2.57**	**$ 0.82**	**46.9%**
Reynolds Kapiolani	9/8/2012	Cans	49	N/A	32	N/A	$ 2.45	Unknown	$ 2.08	Unknown	Unknown
		Glass	41	N/A	2.4	N/A	$ 2.05	Unknown	$ 1.81	Unknown	Unknown
		Plastic	14	N/A	18.8	N/A	$ 0.70	Unknown	$ 0.53	Unknown	Unknown
TOTAL							**$ 5.20**		**$ 4.42**	Unknown	Unknown
Reynolds Temple Valley	9/13/2012	Plastic	66	3.4	18.8	64	$ 3.30	$ 3.20	$ 3.20	$ (0.10)	-3.2%
CM Recycling	2/16/2013	Plastic	103	2.4	26.3	63	$ 5.15	$ 3.16	$ 2.25	$ (1.99)	-38.7%
RRR Kapahulu Ave	1/27/2013	Cans	30	1	32	32	$ 1.50	$ 1.60	$ 1.60	$ 0.10	6.7%
Island Container Redemption	1/27/2013	Plastic	35	1.4	26.3	37	$ 1.75	$ 1.84	$ 1.84	$ 0.09	5.1%
Garden Isle Disposal	4/29/2013	Plastic	24	1.5	26.3	39	$ 1.20	$ 1.97	$ 1.87	$ 0.77	64.2%
Reynolds Hobron Lane	1/31/2013	Glass	8	3.6	2.4	9	$ 0.40	$ 0.43	$ 0.43	$ 0.03	7.5%
		Plastic	8	0.4	18.8	8	$ 0.40	$ 0.38	$ 0.38	$ (0.02)	-5.0%
Atlas Recycling Redemption Center	9/20/2012	Plastic	7	0.6	18.8	11	$ 0.35	$ 0.56	$ 0.63	$ 0.21	60.0%
Keaau - Business Services Hawaii	9/21/2012	Plastic-large	10	0.8	18.8	15	$ 0.50	$ 0.75	$ 0.80	$ 0.25	50.0%
RRR 1173 21st Ave. (uncertified)	9/13/2012	Plastic	44	1.4	26.3	37	$ 2.20	$ 1.84	$ 1.84	$ (0.36)	-16.4%

a: Test sample brought to redemption center by Accuity
b: Amount as weighed by redemption center -- Accuity did not weigh beforehand
c: Weight multiplied by the "container per lb." approved rate by the DOH

Source: Accuity LLP

As part of our testing at redemption centers, we noted that scales appeared to be appropriately calibrated. However, as illustrated in Exhibit 2.10, we found seven redemption transactions resulting in significant overpayments of 5, 7, 8, 47, 50, 60, and 64 percent more than if the containers had been hand counted. We also noted four underpayments of 3, 5, 16, and 39 percent less than expected.

Overall, the differences in calculating container equivalents more often resulted in refunds for a greater number of deposit beverage containers than were actually returned. These net overpayments result in the program paying more in deposit redemptions than was originally collected and will eventually lead to a shortfall in the program's available funds, requiring the program to charge a higher container fee to sustain operations.

At Reynolds Kapi‘olani, our containers were redeemed by weight. However, the weights redeemed were not stated on the receipt and were not visible while the items were weighed. At CM Recycling, the redeemed amount was significantly less than the actual number of containers redeemed. We noted that the redemption center employee did not weigh the items long enough for an accurate weight to be determined.

Redemptions greater than five cents per container are paid out

We also found two redemption centers (shown in Exhibit 2.11) that intentionally paid more than five cents per container deposit. Atlas Recycling (Kona) and Kea‘au Business Services Hawai‘i paid additional amounts for the scrap value of containers redeemed. We received 80 and 60 percent more than expected for our redemption transactions at these redemption centers, respectively.

As noted during our FY2010 audit of the program, both redemption center operators stated the additional amounts paid were to increase volume, and that amounts in excess of five cents per container were paid out of the redemption centers’ profits, not reimbursed by the program. However, we were unable to obtain supporting documents at the level of detail necessary to validate this assertion. We noted that, if operators adjust the reported amount of containers redeemed to match the amounts actually paid out, the program will end up overpaying deposit refund reimbursements to these operators. Also, although handling fees are based on the actual weight of redeemed containers sent to recyclers/end users, such operators will gain a competitive advantage and receive greater handling fees from the increased volume of containers redeemed at those sites, which they may not have otherwise generated if not for higher deposit refunds to their customers. This may lead to increased demand for their services, at the expense of the program, the public, and other law-abiding redemption center operators.

Exhibit 2.11
Differences Between Expected and Actual Refunds Based on Weight

				Redemption Refund			Count vs. Actual Paid Variance	
Redemption Center	Date	Type	Container Count (a)	By Count	By Weight (b)	Actual refund	Over (Under) Paid Expected vs. Actual	% (Rounded) Difference
Reynolds Mililani Town Center	2/10/2013	Cans	15	$ 0.75	$ 1.12	$ 1.12	$ 0.37	49.3%
		Glass	10	$ 0.50	$ 0.79	$ 0.79	$ 0.29	58.0%
		Plastic	10	$ 0.50	$ 0.66	$ 0.66	$ 0.16	32.0%
TOTAL				**$ 1.75**	**$ 2.57**	**$ 2.57**	**$ 0.82**	**46.9%**
Reynolds Kapiolani	9/8/2012	Cans	49	$ 2.45	Unknown	$ 2.08	$ (0.37)	-15.1%
		Glass	41	$ 2.05	Unknown	$ 1.81	$ (0.24)	-11.7%
		Plastic	14	$ 0.70	Unknown	$ 0.53	$ (0.17)	-24.3%
TOTAL				**$ 5.20**		**$ 4.42**	**$ (0.78)**	**-15.0%**
CM Recycling	2/16/2013	Plastic	103	$ 5.15	$ 3.16	$ 2.25	$ (2.90)	-56.3%
RRR Kapahulu Ave	1/27/2013	Cans	30	$ 1.50	$ 1.60	$ 1.60	$ 0.10	6.7%
Island Container Redemption	1/27/2013	Plastic	35	$ 1.75	$ 1.84	$ 1.84	$ 0.09	5.2%
Garden Isle Disposal	4/29/2013	Plastic	24	$ 1.20	$ 1.97	$ 1.87	$ 0.67	55.8%
Reynolds Hobron Lane	1/31/2013	Glass	8	$ 0.40	$ 0.43	$ 0.43	$ 0.03	7.5%
		Plastic	8	$ 0.40	$ 0.38	$ 0.38	$ (0.02)	-5.0%
Atlas Recycling Redemption Center	9/20/2012	Plastic	7	$ 0.35	$ 0.56	$ 0.63	$ 0.28	80.0%
Keaau - Business Services Hawaii	9/21/2012	Plastic-large	10	$ 0.50	$ 0.75	$ 0.80	$ 0.30	60.0%
RRR 1173 21st Ave. (uncertified)	9/13/2012	Plastic	44	$ 2.20	$ 1.84	$ 1.84	$ (0.36)	-16.4%

a: Test sample brought to redemption center by Accuity

b: Amount as weighed by redemption center -- Accuity did not weigh beforehand

Source: Accuity LLP

Retrospective analyses of redemption rate and deposit liability were not performed

We noted that while program management evaluated the estimated redemption rate for deposits collected during FY2012, it did not have a policy in place to retrospectively evaluate historical actual redemption rates against the 80 percent estimated redemption rate used prior to FY2012 and the impact of any variances on the deposit container liability as of June 30, 2012. Management estimated that 76 percent of eligible deposit containers distributed in FY2012 would be redeemed (the redemption rate), which is consistent with the actual redemption rates in FY2010 and FY2011. Therefore, 24 percent of deposits collected during FY2012 were recognized into revenue in FY2012. Prior to FY2012, the estimated redemption rate was 80 percent and 20 percent of deposits collected were recognized as revenue. Through

FY2012, the actual redemption rates calculated by the program ranged between 41 percent (FY2005) and 79 percent (FY2009) and averaged 70 percent. As redemption operations under the program only began in the second half of FY2005, management elected to be conservative to avoid overstating revenues and understating liabilities. However, as redemption rates for FY2010 through FY2012 appear to have stabilized at approximately 76 percent, we recommended that management perform a retrospective analysis of estimates recorded against actual redemption rates. After performing the analysis, management determined it was appropriate to reduce the deposit container liability as of June 30, 2012, by approximately $19.5 million and recognize additional revenue related to deposits collected in prior fiscal years.

Conclusion

The DBC Program's continued reliance on certified redemption centers to self-report the amount of recyclable materials they receive and the absence of a detailed audit function to ensure those amounts are correct expose the program to fraud and abuse and threaten its continued operation. The department has been aware of these weaknesses for years, and as early as 2006 proposed an alternative payment system that would pay certified redemption centers for the quantity of materials *shipped* to end-user recyclers instead of the amounts they *claimed* to receive from customers. This "back-end" payment system would shift the responsibility of "shrinkage"—the discrepancy between the weight of materials collected and materials received—to redemption centers, significantly reducing the risk of fraud.

The department's own reports highlight the need to move towards a back-end payment system. In addition, we found that the Department of the Attorney General initiated administrative rule changes in June 2012, which are necessary to make changes to the payment system; however, program management has yet to respond to the proposed changes. As pointed out in this report, the program has myriad challenges; however, we strongly urge the department to transition to a back-end payment system as a priority. Such a change would significantly reduce the opportunities for fraud and abuse and help ensure sustainability of the Deposit Beverage Container Program and its special fund.

Further, the program should perform retrospective analyses of the estimated redemption rates to determine if previous estimates were correct or require adjustment to ensure the correctness of the program's fund financial statements.

Recommendations

DBC Program management should:

1. Combine the deposit redemption reimbursement request and handling fee request to streamline the payment process by moving beyond the multi-year assessment and adopting and implementing a back-end payment system. Review and adopt administrative rules to implement a back-end payment system.

2. Establish a systematic process for verifying the contents of reports submitted by distributors and redemption centers to mitigate the risk of fraud (underpayments by distributors and overpayments to redemption centers).

3. Consult with the attorney general to determine whether any action can be taken against certified redemptions centers and recyclers who had significant differences in the quantity of materials shipped to end-user recyclers versus the amounts they claimed to have received from customers (such as RRR Recycling). If the attorney general agrees action can be taken, including levying fines or receiving reimbursements, the program should initiate these actions as soon as possible.

4. Define program requirements for each inspection type. Define the program for inspecting redemption centers, distributors, retailers, and exempt commercial passenger vessels and related activities. Establish expectations, targets, and goals for each inspection type and monitor/evaluate staff to hold them accountable for the results. The program should publish audit results to serve as a deterrent to other companies.

5. Perform planning to define the resources and strategies required to achieve program goals and to operate efficiently and effectively. Planning should serve as the foundation for the other management functions—organizing, staffing, leading, and controlling—by providing direction for the program and increasing the program's potential for success in accomplishing its goals. This should allow management to become more proactive in its management style and avoid a crisis management style.

6. Re-evaluate and update the environmental health specialist III position descriptions to ensure that minimum qualifications (skills, knowledge, abilities, and education) accurately reflect a realistic appraisal of the duties required to inspect and audit distributors and

certified redemption centers on a regular, systematic basis to achieve program goals by performing the following:

a. Conduct a thorough and realistic analysis of the job duties required of the environmental health specialist III (tasks, duties, and responsibilities of the inspectors and the needs of the program regarding enforcement activities);

b. Identify the knowledge, experience, skills (competencies) that are useful for someone to have in performing these job duties; and

c. Based on the analysis performed, prepare new positions descriptions that outline the job's goals, responsibilities, and duties; the minimum knowledge, skills and abilities required; and reporting structure for this job.

7. Fill vacant positions to provide sufficient time and resources to perform inspection and enforcement responsibilities over distributors and certified redemption centers to substantiate proper transactions and to detect and prevent improper ones.

8. Review the knowledge and skills required by the program's inspectors to ensure its existing staff has the appropriate skills to inspect and audit distributors and certified redemption centers on a regular, systematic basis and that program goals are accomplished. Establish and conduct training necessary to give staff skills required to inspect and audit distributors and certified redemption centers.

9. Expedite the hiring of an accountant III to alleviate the burden that has been placed on the accountant IV. In the meantime, department administrators, such as the Solid Waste Management coordinator and recycling coordinator, should be trained and authorized to approve and issue payments in order to ensure the program does not stop operating when the accountant IV is not at work.

10. Perform an industry study, including an examination of what handling fee rates for various recycled materials should be to determine what changes can be implemented to balance the business interests of the entities involved in the recycling process with the fiscal feasibility of the DBC Fund. The study should also consider market costs for the shipping and processing of recycled materials as well as the value of end product recycled materials.

11. Implement controls to identify uncertified redemption centers and ensure deposit redemption reimbursements and handling fee requests are paid only to redemption center operators for beverage containers redeemed at certified redemption centers.

12. Regularly evaluate the segregated rates used to convert the weight of deposit beverage containers redeemed into container equivalents to ensure rates approximate hand counts.

13. Ensure that significant estimates such as the deposit beverage container liability and unredeemed deposits revenue are regularly reviewed, including retrospective reviews to determine if previous estimates were accurate or require adjustment.

This page is intentionally left blank.

Chapter 3
Financial Audit

This chapter presents the results of the financial audit of the Deposit Beverage Container Deposit Special Fund (the "Fund") of the Department of Health as of and for the year ended June 30, 2012. This chapter includes the report of independent auditors and the report on internal control over financial reporting and compliance and other matters based on an audit of financial statements performed in accordance with *Government Auditing Standards*. It also displays the fund's financial statements together with explanatory notes.

Summary of Findings

In the opinion of Accuity LLP, based on its audit, the financial statements present fairly, in all material respects, the financial position of the Fund as of June 30, 2012, and the results of its operations for the year then ended in conformity with accounting principles generally accepted in the United States of America. Accuity LLP noted certain matters involving the Fund's internal control over financial reporting and its operations that the firm considered to be significant deficiencies, as defined in the report on internal control over financial reporting and on compliance and other matters performed in accordance with *Government Auditing Standards*. Accuity LLP also noted that the results of its tests disclosed no instances of noncompliance that are required to be reported under G*overnment Auditing Standards*.

Report of Independent Auditors

The Auditor
State of Hawai'i

We have audited the accompanying balance sheet of the State of Hawai'i, Deposit Beverage Container Deposit Special Fund (the "Fund") as of June 30, 2012, and the related statements of revenues, expenditures and changes in fund balance, and budgetary comparison for the year then ended. These financial statements are the responsibility of the Fund's management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

As discussed in Note 1, the financial statements referred to above include only the financial activities of the Fund, and are not intended to present fairly the financial position, changes in its financial position, or budgetary comparison of the State of Hawai'i or the State of Hawai'i, Department of Health, in conformity with accounting principles generally accepted in the United States of America.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Fund as of June 30, 2012, and the changes in its financial position and budgetary comparison for the year then ended in conformity with accounting principles generally accepted in the United States of America.

In accordance with *Government Auditing Standards*, we have also issued our report dated October 25, 2013 on our consideration of the Fund's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audit.

Management has omitted management's discussion and analysis that accounting principles generally accepted in the United States of America require to be presented to supplement the basic financial statements. Such missing information, although not a part of the basic financial statements, is required by the Governmental Accounting Standards Board, who considers it to be an essential part of financial reporting for placing the basic financial statements in an appropriate operational, economic, or historical context. Our opinion on the basic financial statements is not affected by this missing information.

/s/ Accuity LLP
Honolulu, Hawai'i
October 25, 2013

Report of Independent Auditors on Internal Control Over Financial Reporting and on Compliance and Other Matters Based on an Audit of Financial Statements Performed in Accordance With *Government Auditing Standards*

The Auditor
State of Hawai‘i

We have audited the financial statements of the State of Hawai‘i, Deposit Beverage Container Deposit Special Fund (the "Fund"), as of and for the year ended June 30, 2012, and have issued our report thereon dated October 25, 2013. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

Internal Control Over Financial Reporting

Management of the Fund is responsible for establishing and maintaining effective internal control over financial reporting. In planning and performing our audit, we considered the Fund's internal control over financial reporting in order to determine our auditing procedures for the purpose of expressing our opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the Fund's internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of the Fund's internal control over financial reporting.

A *deficiency in internal control* exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct misstatements on a timely basis. A *material weakness* is a deficiency, or a combination of deficiencies, in internal control such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented, or detected and corrected on a timely basis.

Our consideration of internal control over financial reporting was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control over financial reporting that might be deficiencies, significant deficiencies or material weaknesses. We did not identify any deficiencies in internal control over financial reporting that we consider to be material weaknesses, as defined above. However, we identified deficiencies in internal control over financial reporting described in Chapter 2 of this report that we consider to be significant deficiencies in internal control over financial reporting. A *significant deficiency* is a deficiency, or combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the Fund's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*.

The Fund management's responses to the findings identified in our audit is described in the attached response. We did not audit the Fund's response and, accordingly, we express no opinion on them.

This report is intended solely for the information and use of the Auditor; the State of Hawai'i Legislature; management of the Fund; and the State of Hawai'i, Department of Health's management and is not intended to be and should not be used by anyone other than these specified parties.

/s/ Accuity LLP
Honolulu, Hawai'i
October 25, 2013

Description of Financial Statements

The following is a brief description of the financial statements audited by Accuity LLP, which are presented at the end of this chapter.

Balance Sheet

This statement presents the assets, liabilities and fund balance of the Deposit Beverage Container Deposit Special Fund as of June 30, 2012.

Statement of Revenues, Expenditures and Changes in Fund Balance

This statement presents the revenues, expenditures and changes in fund balance of the Deposit Beverage Container Deposit Special Fund for the year ended June 30, 2012.

Statement of Budgetary Comparison

This statement presents the comparison of the budgeted amounts with the actual amounts on a budgetary basis for the Deposit Beverage Deposit Special Fund for the year ended June 30, 2012.

Notes to Financial Statements

Explanatory notes that are pertinent to an understanding of the financial statements are discussed in this section.

State of Hawai'i

Deposit Beverage Container Deposit Special Fund

Balance Sheet

June 30, 2012

Assets	
Equity in cash and cash equivalents in State Treasury	$ 23,477,880
Accounts receivable	792,861
Total assets	$ 24,270,741
Liabilities and Fund Balance	
Liabilities	
Vouchers and contracts payable	$ 11,560,920
Accrued wages and employee benefits	21,937
Beverage container deposits	3,228,765
Total liabilities	14,811,622
Fund balance	
Committed to deposit beverage container program	9,459,119
Total fund balance	9,459,119
Total liabilities and fund balance	$ 24,270,741

The accompanying notes are an integral part of these financial statements.

State of Hawai'i

Deposit Beverage Container Deposit Special Fund

Statement of Revenues, Expenditures and Changes in Fund Balance
Year Ended June 30, 2012

Revenues	
Deposit beverage container fees	$ 9,071,290
Unredeemed deposits	30,342,805
Total revenues	39,414,095
Expenditures	
Administrative expenditures	1,073,334
Handling and redemption fees	18,744,528
Other operating expenditures	3,822,864
Total expenditures	23,640,726
Change in fund balance	15,773,369
Fund balance at July 1, 2011	(6,314,250)
Fund balance at June 30, 2012	$ 9,459,119

The accompanying notes are an integral part of these financial statements.

State of Hawai'i

Deposit Beverage Container Deposit Special Fund

Statement of Budgetary Comparison

Year Ended June 30, 2012

	Budgeted Amounts		Actual Amounts
	Original	Final	(Budgetary Basis)
Revenues			
Current-year funds	$ 71,117,852	$ 71,117,890	$ 54,677,348
Total revenues	71,117,852	71,117,890	54,677,348
Expenditures			
Environmental health administration	71,117,852	71,117,890	66,736,363
Total expenditures	71,117,852	71,117,890	66,736,363
Excess of expenditures over revenues	$ -	$ -	$ (12,059,015)

The accompanying notes are an integral part of these financial statements.

State of Hawai'i

Deposit Beverage Container Deposit Special Fund

Notes to Financial Statements

June 30, 2012

1. Reporting Entity

In 2002, the State of Hawai'i Legislature passed Act 176 to establish the Deposit Beverage Container Deposit Program. The Deposit Beverage Container Program established the Deposit Beverage Container Deposit Special Fund (the "Fund"). The purpose of Act 176 was to increase participation in deposit programs, increase recycling rates for specified deposit beverage containers, provide a connection between manufacturing decisions and recycling program management, and reduce litter.

Pursuant to Section 342G, Part VIII of the Hawai'i Revised Statutes ("HRS"), the Fund was initiated on July 1, 2005 to implement a deposit beverage container program, establish minimum standards for the collection of empty beverage containers, to foster systems of redemption which facilitate recycling of empty beverage containers, and to minimize costs without inconveniencing customers. Under the Fund, the State of Hawai'i (the "State") collects from manufacturers and distributors, a $0.05 per container refundable deposit on eligible beverage containers manufactured in or imported to the state that are expected to be sold in the State. The deposits are used to reimburse redemption centers. In addition, the Fund assesses a per container handling fee of $0.01 per container if the beverage container redemption rate is less than 70 percent, however may increase the handling fee to $0.015 per container if the redemption rate exceeds 70 percent.

The Fund is administered by employees stationed in the Solid Waste Branch, Environmental Management Division of the State of Hawai'i, Department of Health (the "Department").

The accompanying financial statements are intended to present the financial position and results of operations of only that portion of the State and Department that is attributable to the transactions of the Fund and are not intended to present the financial position, results of operations, and cash flows of the State or Department.

2. Measurement Focus, Basis of Accounting, and Financial Statement Presentation

The financial statements of the Fund are reported using the current financial resources measurement focus and modified accrual basis of accounting. Revenues are recognized as soon as they are both measurable and available. Revenues are considered available when they are collectible within the current period or soon enough thereafter to pay liabilities of the current period. For this purpose, the Fund considers revenues to be available if they are collected within 60 days after the end of the current fiscal year. Revenues susceptible to accrual include a $0.01 per beverage container sold handling fee. In addition, the amounts for deposits of $0.05 are deferred when collected, and the amount estimated to be forfeited is recognized into income at the end of the year. Management estimates that the redemption rate will be 76 percent of the deposits collected and is reevaluated periodically. In prior years, management used an estimated redemption rate of 80 percent.

Expenditures are generally recorded when a liability is incurred. However, expenditures related to compensated absences are recorded only when payment is due.

Encumbrances are recorded for obligations in the form of purchase orders or contracts at the time purchase orders or contracts are awarded and executed. Encumbrances outstanding at fiscal year end are reported as reservations of fund balance since they do not constitute expenditures or liabilities.

Had the financial statements been presented on the full accrual basis of accounting, additional adjustments would need to be recorded. These adjustments are recorded on a Department-wide level for all governmental activities of the Department. The Fund's portion of these Department-wide accruals includes adjustments for capital assets and accrued vacation. At June 30, 2012, the Fund's portion of these accruals was as follows:

Total fund balance on the modified-accrual basis of accounting	$ 9,459,119
Capital Assets used in governmental activities are not financial resources and therefore not reported as an asset in the governmental funds	1,891
Compensated absences reported in the statement of net assets do not require the use of current financial resources and therefore are not reported as liabilities in the governmental funds.	(52,453)
Total net assets on the full accrual basis of accounting	$ 9,408,557

At June 30, 2012, the Fund's portion of the Department-wide activities was not materially different from the Fund's activity.

Use of Estimates

In preparing financial statements in conformity with accounting principles generally accepted in the United States of America ("GAAP"), management is required to make estimates and assumptions that affect the reported amounts of assets and liabilities, the disclosure of contingent assets and liabilities at the date of the financial statements, and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

Equity in Cash and Cash Equivalents in State Treasury

All monies of the Fund are held in the State Treasury. The State Director of Finance is responsible for the safekeeping of cash in the State Treasury in accordance with State laws. The Director of Finance may invest any monies of the State, which in the Director's judgment, are in excess of the amounts necessary for meeting the immediate requirements of the State. Effective August 1, 1999, cash is pooled with funds from other State agencies and departments and deposited into approved financial institutions or in the State Treasury Investment Pool System. Funds in the investment pool accrue interest based on the average weighted cash balances of each account.

At June 30, 2012, information relating to the types, insurance, collateral, and related interest rate, credit and custodial risks of funds deposited with the State Treasury was not available for the Fund since such information is determined on a statewide basis. Cash deposits with the State Treasury are either federally insured or collateralized with obligations of the State or United States. All securities pledged as collateral are held either by the State Treasury or by the State's fiscal agents in the name of the State.

Accounts Receivable

Revenue is earned when it is considered measurable and available. The accounts receivable balance represents the expected receipts from distributors based on deliveries of the containers as of June 30, 2012.

Beverage Container Deposits

Deposits of $0.05 are made by distributors to the Fund for each qualifying container. The Fund maintains all deposits until the recycling centers claim reimbursement for the deposits that they pay out to the consumers. The Fund maintains the deposits that are expected to be redeemed.

Amounts paid out to the consumers are based on containers redeemed or a predetermined weight per type of container redeemed (i.e., aluminum, mixed plastics, etc.). These weights are determined based on the mix of containers redeemed and are reviewed when necessary. Management estimates, based on past collections and success of recycling in other states, that 76 percent of the containers will be recycled every year. The remaining 24 percent of the containers are expected to be unredeemed; therefore, 24 percent of the deposits collected are recognized into revenue each year. Historically, management periodically reevaluated the estimated redemption rate to determine the amount of unredeemed deposit revenue to recognize on an annual basis. In 2012, management changed its method of estimating the liability for unredeemed deposits. Under this new method, management adjusts the deposit liability balance and unredeemed deposit revenue recognized based on the amount of deposits reimbursed to redemption centers in the first three months of the subsequent fiscal year related to deposits collected prior to year end. The change in method was reflected in the financial statements as a change in accounting estimate and resulted in an additional $19.5 million in unredeemed deposits being recognized as revenue in 2012, as reflected in Note 4.

Administrative Costs

The accompanying financial statements do not reflect certain administrative costs, which are paid for by other sources of funding from the Department. These costs include the Department's and State's overhead costs which the Department does not assess to the Fund, since they are not practical to determine.

The Fund incurred approximately $3.3 million in central service expense, which represented five percent of the Fund's budgetary basis revenue, and other administrative expenditures payable to Department of Accounting General Services ("DAGS") for fiscal year 2012 that are included in other operating expenditures in the statement of revenues, expenditures and changes in fund balance.

New Accounting Pronouncements

In December 2010, the Governmental Accounting Standards Board (GASB) issued Statement No. 62, *Codification of Accounting and Financial Reporting Guidance Contained in Pre-November 30, 1989 FASB and AICPA Pronouncements*. The objective of this Statement is to enhance the usefulness of the Codification of Governmental Accounting and Financial Reporting Standards by incorporating guidance that previously could only be found in certain FASB and AICPA pronouncements. The requirements of this Statement are effective for reporting periods beginning after December 15, 2011. Management does not expect that this Statement will have a material effect on the Fund's financial statements.

In June 2011, GASB issued Statement No. 63, *Financial Reporting of Deferred Outflows of Resources, Deferred Inflows of Resources, and Net Position*. The objective of this Statement is to provide financial reporting guidance for deferred outflows of resources and deferred inflows of resources and their effects on a government's net position. The requirements of this Statement are effective for reporting periods beginning after December 15, 2011. Management has not yet determined the effect this Statement will have on the Fund's financial statements.

In April 2012, GASB issued Statement No. 65, *Items Previously Reported as Assets and Liabilities*. The objective of this Statement is to reclassify assets and liabilities as deferred outflows of resources and deferred inflow of resources for consistency in financial reporting. The requirements of this Statement are effective for reporting periods beginning after December 15, 2012. Management has not yet determined the effect this Statement will have on the Fund's financial statements.

In April 2012, GASB issued Statement No. 66, *Technical Corrections*. The objective of this Statement is to improve accounting and financial reporting for a governmental financial reporting entity. The requirements of this Statement are effective for reporting periods beginning after December 15, 2012. Management has not yet determined the effect this Statement will have on the Fund's financial statements.

In June 2012, GASB issued Statement No. 68, *Accounting and Financial Reporting for Pensions*. The objective of this Statement is to establish accounting and financial reporting requirements for pensions of governments. The requirements of this Statement are effective for reporting periods beginning after June 15, 2014. Management has not yet determined the effect this Statement will have on the Fund's financial statements.

3. Budgeting and Budgetary Control

The Fund follows these procedures in establishing the budgetary data reflected in the basic financial statements:

- *The Budget* – Not less than 20 days before the State Legislature convenes in every odd-numbered year, the Governor submits to the State Legislature, and to each member thereof, a budget which contains the program and budget recommendation of the Governor for the succeeding biennium. The budget in general contains: the State program structure; statements of statewide objectives; financial requirements for the next biennium to carry out the recommended programs; a summary of State receipts and revenues in the last completed fiscal year; a revised estimate for the fiscal year in progress; and an estimate for the succeeding biennium.

- *Legislative Review* – The State Legislature considers the Governor's proposed program and financial plan and budget, evaluates alternatives to the Governor's recommendations, adopts programs, and determines the State budget. It may, from time to time, request the Department of Budget and Finance and any agency to conduct such analysis of programs and finances as will assist in determining the State's program and financial plan and budget.

- *Program Execution* – Except as limited by policy decisions of the Governor, appropriations by the State Legislature, and other provisions of law, the agencies responsible for the programs administer the programs and are responsible for their proper management. The appropriations by the State Legislature for a biennium are allocated between the two fiscal years of the biennium in the manner provided in the budget or appropriations act and as further prescribed by the Director of Finance. No appropriation transfers or changes between programs or agencies can be made without legislative authorization. Authorized transfers or changes, when made, should be reported to the State Legislature.

Budgetary control is maintained at the appropriation line item level established in the appropriation acts.

A budget is adopted for the Fund and is prepared on the basis of cash receipts and amounts disbursed, which is a basis of accounting other than GAAP.

The major differences between the budgetary and GAAP bases are that: (1) the budget is prepared on the basis of cash receipts and amounts disbursed; and (2) encumbrances are recorded as the equivalent of expenditures under the budgetary basis.

Since budgetary basis differs from GAAP, budget and actual amounts in the budgetary comparison statements are presented on the budgetary basis. A reconciliation of expenditures in excess of revenues on a budgetary basis for 2012, to the change in fund balance presented in conformity with GAAP follows:

Excess of expenditures over revenues—actual on a budgetary basis	$ (12,059,015)
Reserve for encumbrances at year end	3,805,311
Expenditures for liquidation of prior year's encumbrances	(8,103,705)
Accruals and other adjustments	32,130,778
Change in fund balance—GAAP basis	$ 15,773,369

4. Beverage Container Deposits

The changes to the beverage container deposit liability during fiscal year 2012 were as follows:

Balance as of July 1, 2011	$ 24,409,272
Increase: Deposits received from distributor	45,354,668
Decrease: Payments made to recycling centers, net of refunds	(36,192,370)
Decrease: Unredeemed deposits recognized as revenue	(10,885,122)
Decrease: Additional unredeemed deposits revenue due to change in estimate	(19,457,683)
Balance at June 30, 2012	$ 3,228,765

5. Employee Benefit Plans

Substantially all eligible employees of the Fund participate in the State's retirement and post-retirement benefit plans. The State's plans include the Employee's Retirement System ("ERS") of the State of Hawai'i, post-retirement health care and life insurance benefits, a deferred compensation plan, and sick leave benefits. For information on the State's benefit plans, refer to the State of Hawai'i and ERS's Comprehensive Annual Financial Reports ("CAFR"), or the audited financial statements of the Department. The State's CAFR can be found at the DAGS website: http://ags.hawaii.gov/reports/financial-reports/. The ERS CAFR can be found at the ERS website: https://ers.ehawaii.gov/resources/financials.

6. Commitments and Contingencies

Insurance Coverage

The State maintains certain insurance coverage to satisfy bond indenture agreements as well as for other purposes, but is substantially self-insured for all other perils including workers' compensation. The State records a liability for risk financing and insurance related losses, including those incurred but not reported, if it is determined that a loss has been incurred and the amount can be reasonably estimated. The State retains various risks and insures certain excess layers with commercial insurance companies. At June 30, 2012, the State recorded estimated losses for workers' compensation, automobile, and general liability claims as long-term liabilities as the losses will not be liquidated with currently expendable available financial resources. The estimated losses will be paid from legislative appropriations of the State's General Fund. The Fund did not have a portion of the State's workers' compensation expense for the year ended June 30, 2012.

Litigation

The Department is a party to various legal proceedings, the outcome of which, in the opinion of management, will not have a material adverse effect on the Fund's financial position. Losses, if any, are either covered by insurance or will be paid from legislative appropriations of the State's General Fund.

Ceded Lands

The Office of Hawaiian Affairs ("OHA") and the State are involved in litigation regarding the State's alleged failure to properly account for and pay to OHA monies due to OHA under the provisions of the Hawai'i State Constitution and Chapter 10 of the Hawai'i Revised Statutes for use by the State of certain ceded lands. The ultimate outcome of this matter is still unknown. Full discussion of this matter and other legal matters between OHA and the State are disclosed in the State's CAFR and the Department's audited financial statements.

7. Subsequent Event

As the redemption rate has been over 70 percent since fiscal year 2008, the Director of Health increased the beverage container fee to $0.015 per container effective September 1, 2012.

Effective for fiscal year 2014, the Fund is exempted from paying the central service fee assessed by DAGS under Act 228, Session Laws of Hawai'i 2013.

Appendix A
Certified Redemption Center Inspection Report

STATE OF HAWAII
DEPARTMENT OF HEALTH
919 Ala Moana Blvd. Rm 212
Honolulu, HI 96814
Phone: 586-4226, Fax: 586-7509

CERTIFIED REDEMPTION CENTER INSPECTION REPORT

Date	Time In	Time Out	Cert #	Solid Waste #

Purpose of Inspection: 1-Routine 2-Complaint 3-Follow-up 4-Other

Facility Name:	**Facility Contact:**
Site Address:	**Phone:**
CRC Staff Present:	

Last Inspection Date: Violations: ☐ Yes ☐ No If Yes, Violation #(s):

REDEMPTION CENTER OPERATIONS
Violations Require Immediate Corrective Action

Y/N	Signage/Certification:
	1. Certification sign posted at entrance
	2. Refund value sign posted
	3. Hours of operation posted and complied with
	4. DOH Certification certificate kept on site
	Operational:
	5. Allowed access
	6. Operator removing deposit containers from customer's bag, box or receptacle
	7. Operator inspecting recyclable containers for redemption label and/or contamination
	8. Scale approved? ☐ Yes ☐ No Functions properly? ☐ Yes ☐ No Visible to customer? ☐ Yes ☐ No
	9. Attendant is accurately weighing containers
	10. Operator pays full refund value for all dbc
	11. Operator counting loads up to 200 containers when requested? ☐ Yes ☐ No Accepting customer counts? ☐ Yes ☐ No
	12. Operator accepts all types of required dbc
	13. Operator paying/claiming redemption value only on eligible Hawaii DBC
	14. Reverse Vending Machines functioning? Number of machines not functioning:
	15. Citation issued
	Permitting/Recordkeeping:
	16. Current Solid Waste Permit and Certification
	17. Operator submitted new application to Department prior to changes in operations
	18. Daily logs, records, and receipts complete, organized and available on-site for inspection
	19. Directs all collected recyclables to facilities indicated on certification application

Remarks:

Follow-Up: ☐ Yes ☐ No Comments:

Inspected By:	Print:	
Received By:	Print:	Title:

Appendix B
Inspection Report - Dealer/Distributor

STATE OF HAWAII
DEPARTMENT OF HEALTH
919 Ala Moana Blvd. Rm. 212
Honolulu, HI 96814
Phone: 586-4226 Fax: 586-7509
INSPECTION REPORT – Dealer / Distributor

Date:	**Time In:**	**Time Out:**	**Permit Number:**	**Code Number:**

Purpose of Inspection: 1 – Routine 2 – Complaint 3 – Follow-Up 4 – Other

Facility Name:	**Contact:**
Site Address:	**Phone:**

Last Inspection Date: Violations: ☐ Yes ☐ No If Yes, Violation #(s):

OPERATIONS – Violations Require Immediate Corrective Action

	1. Dealer charging customers deposit value on non-labeled containers or ineligible containers §342G-111
	2. Dealer lacks clear and conspicuous sign at each public entrance with name, address, and hours of operation of closest redemption center location §342G-113 (c)
	3. Label is not indelibly marked/securely affixed sticker/affixed on top or side of container §342G-112
	4. Label is less than one-eighth inch in size §342G-112
	5. Deposit beverage distributor operating within the state of Hawaii without registration with the Department §342G-103 (a)
	6. Distributor failed to pay the Department a deposit beverage container (dbc) fee on each dbc §342G-105
	7. Dealer lacks adequate records §342G-103(b)
	8. Deposit beverage container distributor/dealer failed to properly label each dbc sold in the State of Hawaii §342G-112

INVENTORY AUDIT – Deposit Beverage Containers

Beverage Name/Variety	Material Type AL, GL, PL, BM	Container Volume	Case or Individual Package	Labeled Y/N	Number of Containers on Shelf	DBC Charge at Register	Distributor

Remarks:

Follow-Up: ☐ Yes ☐ No **Comments:**

Inspected By:	Print:	
Received By:	Print:	Title:

Response of the Affected Agency

Comments on Agency Response

We transmitted a draft of this report to the Department of Health on October 18, 2013. A copy of the transmittal letter is included as Attachment 1. The department's response, dated October 28, 2013, but received on October 29, 2013, is included as Attachment 2.

The department objected to our finding that "Inattention to basic management functions exacerbates program's inability to prevent fraud and abuse." It expressed appreciation and support for the current program manager, who is responsible for the day-to-day management of the program, describing him as a valued and hard-working employee. However, the department did not provide any additional information to dispute this or any of our other findings. The department provided comments on each of our 13 recommendations; judging by the recent actions it says it has undertaken, the department appears to generally agree with our conclusions and recommendations.

For example, the department reports it is exploring different methodologies to streamline the payment process, including implementation of a "back-end" payment process. It says it is establishing an audit process to verify distributor and redemption center reports, and defining inspection requirements and establishing targets and goals for each inspection type. It says it has implemented new controls to address issues associated with payments to uncertified redemption centers; is evaluating resources required to achieve the program's goals; and has requested two additional accountant III and one account clerk positions. The program says it has consulted with the department's human resources office to reevaluate and update position descriptions and is actively recruiting candidates for vacant positions, including a new planner IV position to evaluate program handling fees and segregated rates. Finally, the program says it has implemented a procedure to review and record expenses and related liabilities for the DBC Deposit Special Fund.

ATTACHMENT 1

STATE OF HAWAI'I
OFFICE OF THE AUDITOR
465 S. King Street, Room 500
Honolulu, Hawai'i 96813-2917

JAN K. YAMANE
Acting State Auditor [redacted]

(808) 587-0800
FAX: (808) 587-0830

October 18, 2013

COPY

The Honorable Loretta J. Fuddy, Director
Department of Health
1250 Punchbowl Street
Honolulu, Hawai'i 96813

Dear Ms. Fuddy:

Enclosed for your information are three copies, numbered 6 to 8, of our confidential draft report, *Management and Financial Audit of the Deposit Beverage Container Program*. We ask that you telephone us by Tuesday, October 22, 2013, on whether or not you intend to comment on our recommendations. If you wish your comments to be included in the report, please submit them no later than Monday, October 28, 2013.

The Governor, and presiding officers of the two houses of the Legislature have also been provided copies of this confidential draft report.

Since this report is not in final form and changes may be made to it, access to the report should be restricted to those assisting you in preparing your response. Public release of the report will be made solely by our office and only after the report is published in its final form.

Sincerely,

Jan K. Yamane

Jan K. Yamane
Acting State Auditor

Enclosures

NEIL ABERCROMBIE
GOVERNOR OF HAWAII

LORETTA J. FUDDY, A.C.S.W., M.P.H.
DIRECTOR OF HEALTH

STATE OF HAWAII
DEPARTMENT OF HEALTH
P. O. BOX 3378
HONOLULU, HI96801-3378

In reply, please refer to:

RECEIVED
2013 OCT 29 AM 9:21
OFC. OF THE AUDITOR
STATE OF HAWAII

October 28, 2013

Ms. Jan K. Yamane
Acting State Auditor
Office of the Auditor, State of Hawaii
465 South King Street, Suite 500
Honolulu, Hawaii 96813

Dear Ms. Jan Yamane:

Attached are the Department of Health's comments for the Management and Financial Audit of the Deposit Beverage Container Program ending June 30, 2012.

We appreciate the opportunity to comment on the audit reports.

Sincerely,

Loretta J. Fuddy, A.C.S.W., M.P.H.
Director of Health
Promoting Lifelong Health & Wellness

Attachment

Subject: 2012 MANAGEMENT AND FINANCIAL AUDIT OF THE DEPOSIT BEVERAGE CONTAINER PROGRAM

We appreciate the opportunity to comment on the subject reports. The Department recognizes the auditor's constructive criticisms and has been and will continue to work diligently on the deficiencies outlined in the audit report. Prior to stating our specific comments to your recommendations, we would like to make the following general observations.

Audits serve as an important tool to assist management and administration with the development and direction of Programs. Unfortunately, prior to the publication of this audit, the auditor has not performed timely management and/or financial audits of the Program since the initial fiscal 2004-2005 audit. As a result, management and the administration were not afforded with the benefit of periodic recommendations from the auditor.

The Department objects to the unfair criticism of the current Solid Waste Management Coordinator for inattention to basic management functions. The current Solid Waste Coordinator is a valued DOH employee and we are appreciative of his hard work and contributions to our programs.

We offer the following specific comments on the recommendations made in the report:

Recommendation No. 1

Combine the deposit redemption reimbursement request and handling fee request to streamline the payment process by moving beyond the multi-year assessment and adopting and implementing a back-end payment system. Review and adopt administrative rules to implement a back-end payment system.

Program Comment No. 1

The Program has been exploring different methodologies that streamline the payment process and that are more reflective of the actual amount of redeemed beverage containers. The Program is considering a methodology we describe as "Back-End Payment". This methodology combines the payment of the deposit and handling fees based upon the certified weight and commodity of deposit beverage containers (DBC) loaded into shipping containers that are subsequently sealed and ready to be shipped to end user markets. On October 29, 2012 the Program determined that it is feasible to certify the weight and commodity of DBC in sealed shipping containers either by using a Certified Marine Surveyor or by Program inspection staff. After observing a recycler using a Certified Marine Surveyor for a year, the program realizes that it will not be able to inspect every shipping container throughout the state. An undetermined amount of additional inspector positions will be required to certify a limited amount of shipments leaving Oahu and neighbor islands. As a result, statute and rule changes are required to implement and allow random inspections to be performed by a limited number of inspectors. The Program will continue to evaluate the feasibility of certifying DBC loads and develop a claim and payment system that will accommodate the Back-End Payment methodology.

<u>Recommendation No. 2</u>

Establish a systematic process for verifying the contents of reports submitted by distributors and redemption centers to mitigate the risk of fraud (underpayments by distributors and overpayments to redemption centers).

<u>Program Comment No. 2</u>

Establishing a systematic auditing process for verifying the contents of reports submitted by distributors and redemption centers is one of the high priority tasks for the Program. An accountant IV (Position Number 31790) from the Environmental Resources Office will be directed to assist the program for a period of one year while a request to add two additional accountant IIIs and one account clerk to the Program is being considered. Obtaining and filling these positions will determine the Program's success in achieving this goal.

<u>Recommendation No. 3</u>

Consult with the attorney general to determine whether any action can be taken against certified redemption centers and recyclers who had significant differences in the quantity of materials shipped to end-user recyclers versus the amounts they claimed to have received from customers (such as RRR Recycling). If the attorney general agrees action can be taken, including levying fines or receiving reimbursements, the program should initiate these actions as soon as possible.

<u>Program Comment No. 3</u>

The Program's deputy attorney general was consulted on October 23, 2013 to determine whether any action can be taken against redemption centers and recyclers who had significant differences in the quantity of materials shipped to end-user recyclers versus the amount reported collected from the public. The Program is waiting for an unofficial response about this inquiry from the deputy attorney general. Depending on the outcome of the unofficial response from the attorney general's office, the Department will go through the formal process of obtaining an official written opinion from the attorney general's office and proceed accordingly on this matter.

<u>Recommendation No. 4</u>

Define program requirements for each inspection type. Define the program for inspecting redemption centers, distributors, retailers, and exempt commercial passenger vessels and related activities. Establish expectations, targets, and goals for each inspection type and monitor/evaluate staff to hold them accountable for the results. The program should publish audit results to serve as a deterrent to other companies.

Program Comment No. 4

Defining program requirements and establishing targets and goals for each inspection type is another high priority task for the Program. The Program will plan to achieve this task. This task is much more complex than it appears. Statute and rule changes may be required to define the requirements for an inspection program applied to redemption centers, distributors, retailers and exempt commercial passenger vessels. The Program will draft proposed inspection procedures for each area to decipher what changes in the statutes and rules will be required to implement each type of inspection program.

Expectations, targets, and goals for each inspection type to monitor and evaluate staff are defined by the respective position descriptions. Changing or redefining positions and/or the descriptions can take years. Prior to redefining position descriptions the Program will need to evaluate its organization to determine the most effective staffing requirements to achieve each inspection type followed by changing or redefining positions.

The Program intends to continue publishing press releases that will include results of audit reports.

Recommendation No. 5

Perform planning to define the resources and strategies required to achieve program goals and to operate efficiently and effectively. Planning should serve as the foundation for the other management functions—organizing, staffing, leading, and controlling – by providing direction for the program and increasing the program's potential for success in accomplishing its goals. This should allow management to become more proactive in its management style and avoid a crisis management style.

Program Comment No. 5

The administration recognizes that planning to define the resources and strategies is very important to determine the program's potential for success in accomplishing its goals. Administration will need to evaluate the Program's organization to make changes in the staffing level and structure that will be most effective to achieve Program's goals.

Recommendation No. 6

Re-evaluate and update the environmental health specialist III position descriptions to ensure that minimum qualifications (skills, knowledge, abilities, and education) accurately reflect a realistic appraisal of the duties required to inspect and audit distributors and certified redemption centers on a regular, systematic basis to achieve program goals by performing the following:

a. **Conduct a thorough and realistic analysis of the job duties required of the environmental health specialist III (tasks, duties, and responsibilities of the inspectors and the needs of the program regarding enforcement activities);**

b. **Identify the knowledge, experience, skills (competencies) that are useful for someone to have in performing these job duties; and**
c. **Based on the analysis performed, prepare new positions descriptions that outline the job's goals, responsibilities, and duties; the minimum knowledge, skills and abilities required; and reporting structure for this job.**

Program Comment No. 6

The Program consulted the Department's Human Resources office for assistance to start the process of re-evaluating the Environmental Health Specialist III position to ensure that minimum qualifications accurately reflect a realistic appraisal of the duties required to inspect and audit distributors and certified redemption centers on a regular, systematic basis. The Program must consider the risk that the environmental health specialist III positions could be downgraded or reclassified. If the position is reclassified the Program also runs the risk of losing the incumbent if they no longer qualify for the newly classified position.

Recommendation No. 7

Fill vacant positions to provide sufficient time and resources to perform inspection and enforcement responsibilities over distributors and certified redemption centers to substantiate proper transactions and to detect and prevent improper ones.

Program Comment No. 7

The Program has been actively recruiting candidates for all vacant positions since the hiring freeze was lifted by the Governor on September 9, 2011. The Program has filled three of the four vacant environmental health Specialist positions during fiscal year 2012. The Program is interviewing candidates to fill the vacant planner and account clerk positions but cannot fill the positions until the newly announced hiring freeze is lifted.

Recommendation No. 8

Review the knowledge and skills required by the program's inspectors to ensure its existing staff has the appropriate skills to inspect and audit distributors and certified redemption centers on a regular, systematic basis and that program goals are accomplished. Establish and conduct training necessary to give staff skills required to inspect and audit distributors and certified redemption centers.

Program Comment No. 8

The Program will determine the additional training necessary to assure staff is equipped with appropriate skills to inspect and audit distributors and certified redemption centers.

Recommendation No. 9

Expedite the hiring of an accountant III to alleviate the burden that has been placed on the accountant IV. In the meantime, department administrators, such as the Solid Waste Management coordinator and recycling coordinator, should be trained and authorized to approve and issue payments in order to ensure the program does not stop operating when the accountant IV is not at work.

Program Comment No. 9

The Environmental Resources Office is currently capable of assisting the Accountant IV. In addition, the Department is requesting two additional accountant III and one account clerk position in the departmental budget request for FY 15.

Recommendation No. 10

Perform an industry study, including an examination of what handling fee rates for various recycled materials should be to determine what changes can be implemented to balance the business interests of the entities involved in the recycling process with the fiscal feasibility of the DBC Fund. The study should also consider market costs for the shipping and processing of recycled materials as well as the value of end product recycled materials.

Program Comment No. 10

The Planner IV position has been responsible for examining the handling fee for the Program. Unfortunately, there has been a lack of stability filling this position. This position is currently vacant. On September 30, 2013 the Program offered the position to the leading candidate who turned down the offer in favor of a position in the private sector. The Program continues to actively recruit for this position. Examining the handling fee rates will likely not be addressed until the Program can hire and train someone in this position.

Marketing of recycled material is a very challenging component of this program due to the competitive nature of recycling industry. Much of the information that we have collected is anecdotal and often only for certain commodities. A study of the recycling industry may require the hiring of a contractor.

Recommendation No. 11

Implement controls to identify uncertified redemption centers and ensure deposit redemption reimbursements and handling fee requests are paid only to redemption center operators for beverage containers redeemed at certified redemption centers.

Program Comment No. 11

The Program recently implemented a "Master List" of certified redemption centers that all Program staff updates as new information becomes available. This list is checked by the Accountant IV to ensure that payments are made to *only* certified redemption centers. The two R.R.R. Recycling Services (RRR) sites at 1290 Beretania Street and 1173 21st Avenue mentioned in the audit were certified at one time. When the certifications were up for renewal RRR did not intend to operate each site at least 30 hours per week according to Sec. 342G-114(d)(5), therefore these sites became uncertified. Uncertified sites such as these take their collected deposit beverage containers (DBCs) to a certified redemption center to be "redeemed". The program does *not* issue payments directly to the RRR locations at 1290 Beretania Street or 1173 21st Avenue.

Recommendation No. 12

Regularly evaluate the segregated rates used to convert the weight of deposit beverage containers redeemed into container equivalents to ensure rates approximate hand counts.

Program Comment No. 12

The Planner IV has been responsible for examining the segregated rates for the Program. Unfortunately, there has been a lack of stability filling this position. This position is currently vacant. On September 30, 2013 the leading candidate for the position turned down of the offer in lieu of a position in the private sector. The Program continues to actively recruit for this position. Examining the segregated rates will likely not be addressed until the Program can hire and train someone in this position.

Recommendation No. 13

Ensure that significant estimates such as the deposit beverage container liability and unredeemed deposits revenue are regularly reviewed, including retrospective reviews to determine if previous estimates were accurate or require adjustment.

Program Comment No. 13

The State's financial Accounting Management and Information System "FAMIS" is maintained on a cash basis of accounting and the Program's Fund Accounting System "Quickbooks" is maintained on an accrual basis. A procedure has been implemented to properly review and record for expenses and related liabilities in the fiscal year in which they were incurred. The accrued cutoff date is determined to be prior to the closing date of issuing the department financial statements. We record invoices that post to FAMIS in July, August, and September, October (maybe even November) with invoice (services) dated June 30 and prior. The reconciliation for accrued liabilities is then verified in Quickbooks and FAMIS to ensure completeness.

This year an adjustment was made to the estimated unredeemed deposit liability balance. In the future the program will perform retrospective reviews on the historical redemption rate of beverage container deposits to ensure that previously recorded estimates were appropriate.