



Memorandum

TO: HONORABLE MAYOR AND
CITY COUNCIL

FROM: Vilcia Rodriguez

SUBJECT: SEE BELOW

DATE: September 25, 2008

Approved



Date

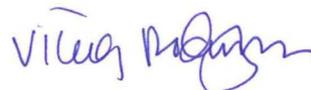


**SUBJECT: AN AUDIT OF COMMERCIAL SOLID WASTE FRANCHISE AND AB 939
FEE COLLECTION PROGRAM [Public Safety, Finance and Strategic
Support Committee – Item (g)]**

On September 18, 2008, staff presented the report on An Audit of Commercial Solid Waste Franchise and AB 939 Fee Collection Program to the Public Safety, Finance and Strategic Support Committee.

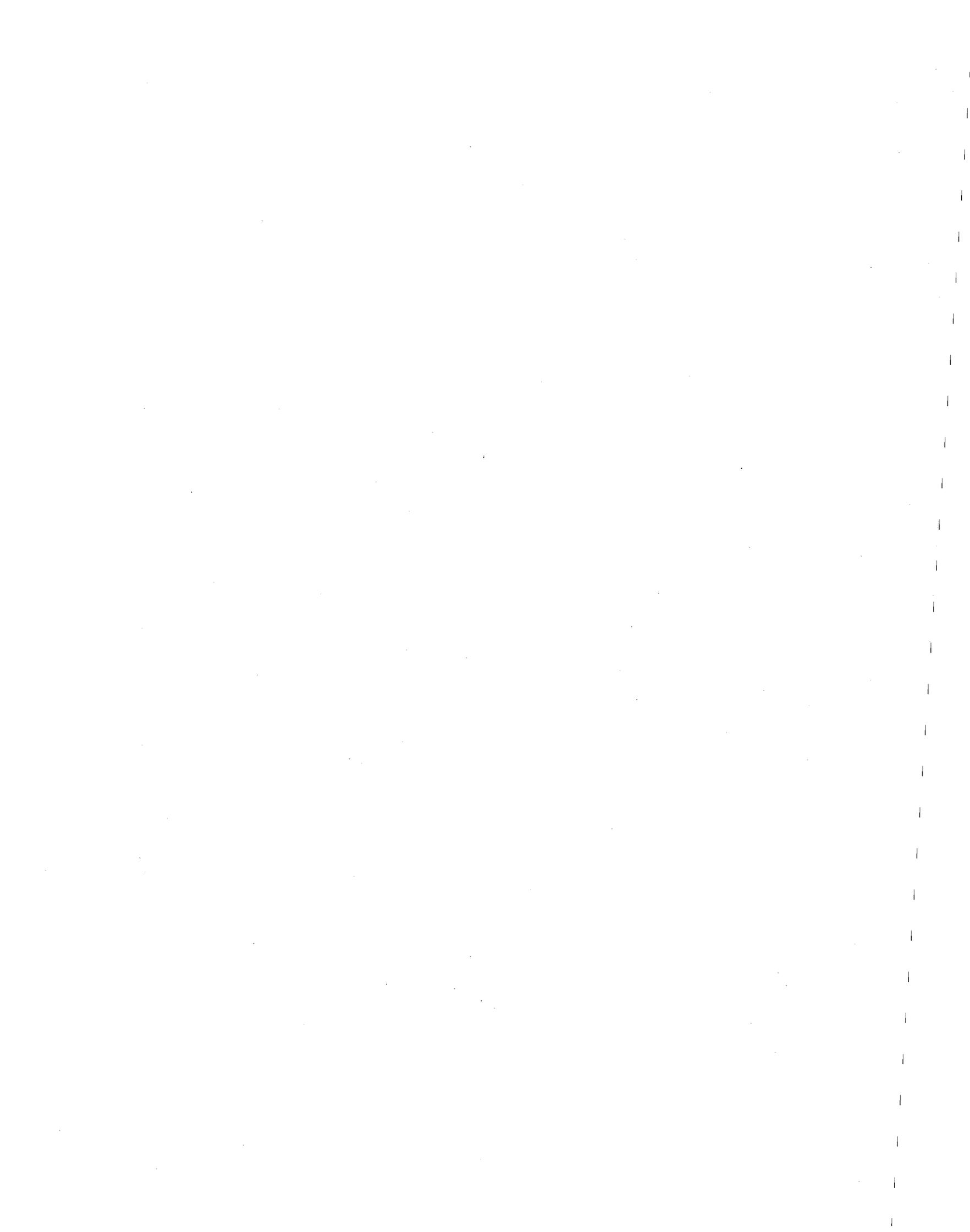
Upon motion by Vice Chair Pete Constant, and seconded by Councilmember Pierluigi Oliverio, the Public Safety, Finance and Strategic Support Committee accepted the report and requested the report to be cross-referenced to the September 30 Council agenda for full Council consideration. Attached is the report that was presented to the Public Safety, Finance and Strategic Support Committee.

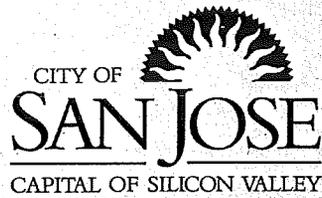
Please note that at the time the minutes were prepared, this item was going to report out to the City Council 10/7/08; however, the Rules Committee moved report out of this item to 9/30/07 at its September 24 meeting.



VILCIA RODRIGUEZ
Senior Executive Analyst

Attachment





Office of the City Auditor

**Report to the City Council
City of San José**

**AN AUDIT OF COMMERCIAL
SOLID WASTE FRANCHISE
AND AB 939 FEE COLLECTION
PROGRAM**

**The City's Policy Regarding Waiver Of
Public Agency-Related Franchise And
AB 939 Fees Is Unclear**

**Improvements Are Needed To Better
Enforce The City's Commercial Solid Waste
Fee Provisions**

**Report 08-03
September 2008**

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Office of the City Auditor
Sharon W. Erickson, City Auditor

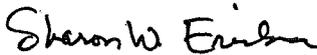
September 8, 2008

Honorable Mayor and Members
of the City Council
200 East Santa Clara Street
San Jose, CA 95113

Transmitted herewith is the report *An Audit of Commercial Solid Waste Franchise and AB 939 Fee Collection Program*. This report is in accordance with City Charter Section 805. An Executive Summary is presented on the blue pages in the front of this report. The City Administration's response is shown on the yellow pages before Appendix A.

This report will be presented at the September 18, 2008 meeting of the *Public Safety, Finance & Strategic Support Committee*. If you need any additional information, please let me know. The City Auditor's staff members who participated in the preparation of this report are Steven Hendrickson, Gitanjali Mandrekar, and Carolyn Huynh.

Respectfully submitted,


Sharon W. Erickson
City Auditor

finaltr
SE:bh

cc: John Stufflebean	Deanna Santana	Scott Johnson
Debra Figone	Jo Zientek	Dave McPherson
Christine Shippey	Michael Foster	Rick Doyle
Kerrie Romanow	Christine Wolter	Rosa Tsongtaatarii



Office of the City Auditor

**Report to the City Council
City of San José**

**AN AUDIT OF COMMERCIAL
SOLID WASTE FRANCHISE
AND AB 939 FEE COLLECTION
PROGRAM**

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Executive Summary

In accordance with the City Auditor's 2007-08 Audit Workplan, we have completed an audit of the Commercial Solid Waste Franchise and AB 939 Fee Collection Program of the Environmental Services Department (ESD). We conducted this audit in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions. We limited our review to the work specified in this memorandum.

The City Auditor's Office thanks ESD and Finance Department staff and the staff at two of the City of San Jose's (City) commercial solid waste haulers - Allied Waste Services of North America, LLC (DBA Allied Waste of Santa Clara County) and Los Altos Garbage Company (DBA Stevens Creek Disposal and Recycling) for their time, information and cooperation during the audit process.

Finding I The City's Policy Regarding Waiver Of Public Agency-Related Franchise And AB 939 Fees Is Unclear

The Integrated Waste Management Division (IWM) of ESD administers the Commercial Solid Waste and Recycling Program (Program) for the City. This involves monitoring fee payments and solid waste and recycling data submitted by the commercial waste haulers. However, we found that the City's current policy on public agencies is unclear and haulers frequently do not pay the City the franchise fees for solid waste hauled from the public agencies. Specifically, we found that:

- In 2006, the City signed tolling agreements with Allied Waste and Stevens Creek for a dispute regarding the payment of fees for services to certain public agencies;
- In 2007, the San Jose City Council resolved to exempt school districts from paying AB 939 fees and reimburse them for their portion of the franchise fee costs that they pay to the hauler and the hauler pays to the City;
- The City's proposed reimbursement process for franchise fees is burdensome and may require significant staff time to monitor;
- The County of Santa Clara does not pay the required AB 939 fees;

- The Valley Transportation Authority (VTA) and the United States Postal Service (USPS) have refused to pay fees; and
- Some non-profit agencies are refusing to pay AB 939 fees.

In our opinion, the City Attorney's Office should propose to the City Council a resolution to the City's dispute with Allied Waste to ensure that the monies that school districts have already paid to Allied Waste are paid to the City and reimbursed to the school districts in a timely manner, including outstanding disputes with other franchised haulers. Further, ESD in consultation with the City Attorney's Office, should propose to the City Council to either exempt school districts, set franchise and AB 939 fees to \$0, or otherwise simplify the City's current reimbursement process. In addition, ESD in consultation with the City Attorney's Office, should propose to the City Council that the City's agreement with the County of Santa Clara be amended to clarify whether the County should pay the AB 939 fees and consider including reporting requirements in return for the City reimbursement of the County's franchise fees. Furthermore, ESD should work with the Finance department to pursue collecting all unpaid franchise fees from the haulers and AB 939 fees from those agencies that should be paying the fees. Finally, ESD should require haulers to submit required documentation if a generator refuses to pay and act on those reports in a timely manner.

RECOMMENDATIONS

We recommend that the City Attorney's Office propose to the City Council:

Recommendation #1

A resolution to the City's dispute with Allied Waste to ensure that the monies that school districts have already paid to Allied Waste are paid to the City and reimbursed to the school districts in a timely manner including outstanding disputes with other franchise haulers. (Priority 3)

We recommend that Environmental Services Department in consultation with the City Attorney's Office:

Recommendation #2

Propose to City Council to either exempt school districts, set franchise and AB 939 fees associated with school districts at \$0, or otherwise simplify the City's current reimbursement process. (Priority 3)

We recommend that Environmental Services Department in consultation with the City Attorney's Office:

Recommendation #3 **Propose to the City Council that the City's agreement with the County of Santa Clara be amended to clarify whether the County should pay the AB 939 fees, and consider including reporting requirements in return for the City reimbursement of the County's franchise fees. (Priority 3)**

We recommend that Environmental Services Department:

Recommendation #4 **Work with the Finance Department to pursue collecting all unpaid franchise fees from the haulers and AB 939 fees from those agencies that should be paying the fees. (Priority 1)**

Recommendation #5 **Require haulers to submit required documentation if a generator refuses to pay, and act on those reports in a timely manner. (Priority 3)**

Finding II Improvements Are Needed To Better Enforce The City's Commercial Solid Waste Fee Provisions

We found that ESD staff needs to improve its current monitoring practices. Specifically, we found that

- ESD does not have written procedures to monitor commercial solid waste hauler fee collection and reporting;
- Allied Waste is not reporting its information by yardage making it difficult to verify whether appropriate fees have been applied;
- ESD staff allowed Stevens Creek to adjust at least \$50,000 in its fee remittance when its agreement specifically disallowed it; and
- ESD has not conducted required outreach efforts nor is the Division of Code Enforcement conducting regular agreement-required trainings for collection vehicle drivers.

In our opinion, ESD staff should develop procedures for collecting fees and penalties and interest. Furthermore, ESD should re-evaluate what kind of information and in what manner a hauler could provide that would make ESD's monitoring efforts more valuable and efficient. In addition, ESD should develop

procedures to ensure that haulers are adequately and consistently monitored including 1) disallowing any unapproved adjustments that haulers make, and 2) reaffirming parameters for assessing penalties and interest. Finally, ESD should provide the haulers with the required outreach materials for distribution as stated in its agreement with each of the haulers and work with the Division of Code Enforcement to develop regular agreement-required training for collection vehicle drivers.

RECOMMENDATIONS

We recommend that Environmental Services Department:

- Recommendation #6** **Develop procedures for collecting fees and penalties and interest. (Priority 3)**
- Recommendation #7** **Re-evaluate what kind of information and in what manner a hauler could provide that would make ESD's monitoring efforts more valuable and efficient. (Priority 3)**
- Recommendation #8** **Develop policies and procedures to ensure that haulers are adequately and consistently monitored, including:**
- **Disallowing any unapproved adjustments the haulers make; and**
 - **Reaffirming parameters for assessing penalties and interest. (Priority 2)**
- Recommendation #9** **Provide the haulers with the required outreach materials for distribution as stated in its agreements with each of the haulers. (Priority 3)**
- Recommendation #10** **Work with the Division of Code Enforcement to develop regular required training for collection vehicle drivers. (Priority 3)**

Introduction

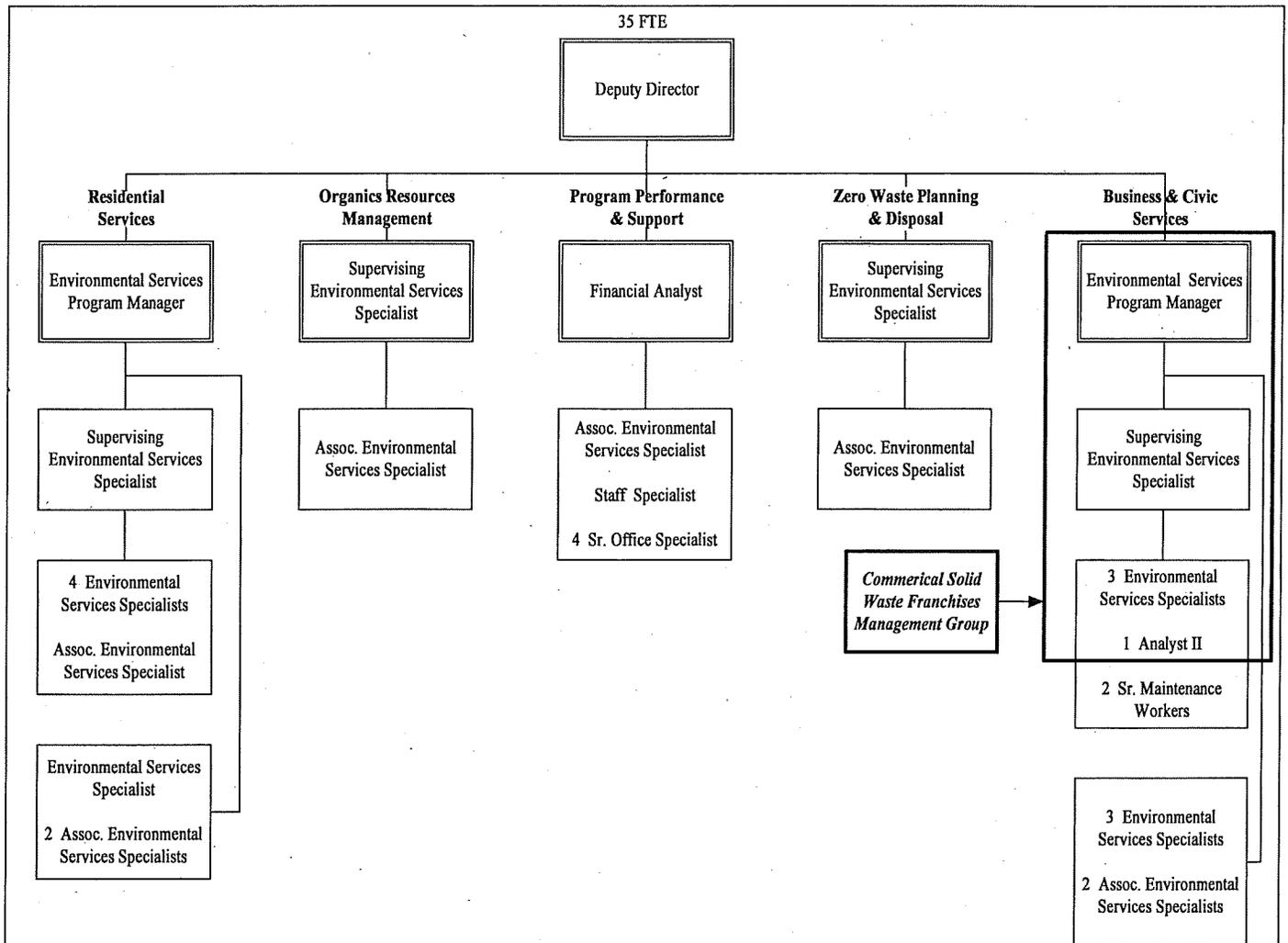
In accordance with the City Auditor's 2007-08 Audit Workplan, we have completed an audit of the Commercial Solid Waste Franchise and AB 939 Fee Collection Program of the Environmental Services Department (ESD). We conducted this audit in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions. We limited our review to the work specified in this memorandum.

The City Auditor's Office thanks ESD and Finance Department staff and the staff at two of the City of San Jose's (City) commercial solid waste haulers - Allied Waste Services of North America, LLC (DBA Allied Waste of Santa Clara County) and Los Altos Garbage Company (DBA Stevens Creek Disposal and Recycling) for their time, information and cooperation during the audit process.

Background

The Integrated Waste Management Division (IWM) of ESD administers the Commercial Solid Waste and Recycling Program (Program) for the City. The IWM Fund (Fund 423) funds these activities exclusively in ESD. Currently, there are 6.0 FTE staff assigned to administering the Program. Exhibit 1 illustrates ESD's IWM staffing.

Exhibit 1: Integrated Waste Management Organization Chart



Source: ESD.

Prior to 1995, the City franchised one hauler on an exclusive basis for commercial garbage collection services. The San Jose City Council (City Council) set the customer rates. The City also franchised rubbish collection services on a non-exclusive basis. Beginning in January 1995, the City merged the garbage and rubbish franchise into an integrated free market commercial solid waste franchise system. These franchises were granted on a non-exclusive basis and franchisees set their own customer rates.

The City imposes two fees for commercial solid waste hauling:

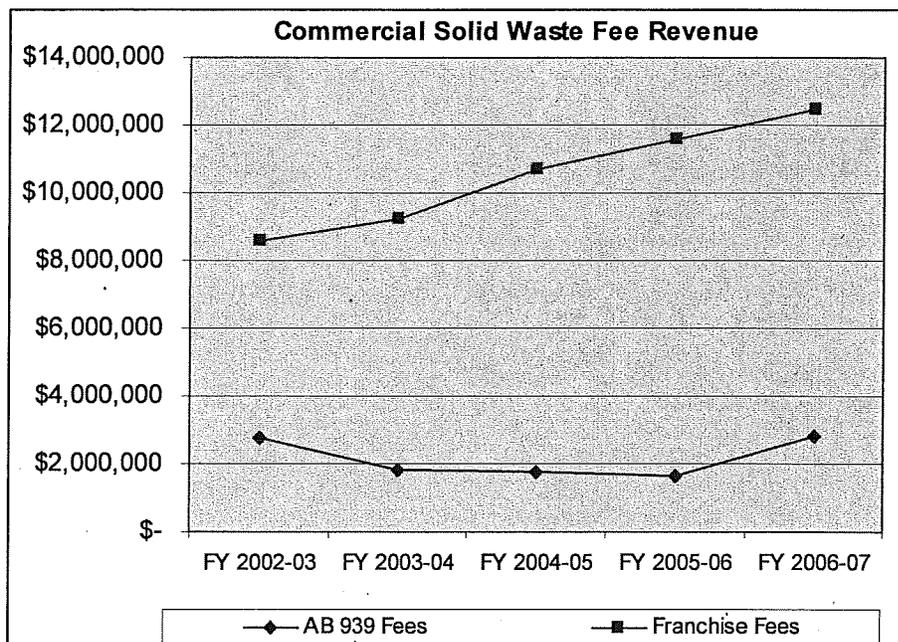
- *Franchise Fees* -- Commercial solid waste haulers remit monthly franchise fees to the City for the privilege of using city streets to conduct their business in the City. For 2008-09, franchise fees are set at \$3.67 per uncompacted cubic yard collected. The franchise

fees are deposited into the General Fund. According to the City's Financial Management System (FMS), General Fund revenues from the commercial solid waste franchise fees totaled \$12.5 million in 2006-07.

- *AB 939 Source Reduction and Recycling Fees* -- The California Integrated Waste Management Act of 1989 (commonly known as AB 939) requires cities and counties to prepare, adopt, and implement source reduction and recycling plans, and requires them to collect fees to cover their costs in doing so. Even though waste haulers collect and remit these fees, the garbage and rubbish generators are actually responsible for paying these fees. For 2008-09, AB 939 fees are set at \$0.89 per cubic yard collected. According to ESD, in 2006-07, \$2.8 million in AB 939 revenues went to the IWM Fund.

Exhibit 2 below shows the total commercial solid waste franchise and AB 939 fees the City received from 2002-03 to 2006-07. As the exhibit illustrates, the total AB 939 fees received decreased from 2002-03 until 2005-06. This was a result of a reduction in the AB 939 fee starting in 1998. According to ESD, the increases in franchise fees were as a result of Council-approved measures employed to stabilize franchise fee revenue to the General Fund.

Exhibit 2: Total Commercial Solid Waste Revenues From 2002-03 To 2006-07



Source: ESD.

Commercial Solid Waste Franchise and AB 939 Fee Collection Program

According to a June 2006 Council memorandum, a key goal in ESD's IWM Division has been to bring programs to cost recovery in order to ensure the financial integrity of the IWM fund and to meet program obligations. As shown below, the combined franchise and AB 939 Fee is \$4.56 per uncompacted and \$13.68 per compacted cubic yard of solid waste. The franchise and AB 939 fees for recyclables are set at \$0.

Exhibit 3: 2008-09 Commercial Solid Waste Franchise And AB 939 Fees

	Franchise Fees	AB 939 Fees	Total Fees
Uncompacted Solid Waste (garbage) – per cubic yard	\$3.67	\$0.89	\$4.56
Compacted Solid Waste (garbage) – per cubic yard	\$11.01	\$2.67	\$13.68
Uncompacted Approved Recyclables – per cubic yard	\$0	\$0	\$0
Compacted Approved Recyclables – per cubic yard	\$0	\$0	\$0

Source: ESD.

We should note that the volume-based franchise and AB 939 fees are calculated on bin capacity times the number of collections -- **not** the amount that is actually hauled away. Exhibit 4 illustrates the key differences between the AB 939 and franchise fees.

Exhibit 4: Key Differences Between Franchise And AB 939 Fees

AB 939 Fee	Franchise Fees
Currently set at \$0.89 per cubic yard.	Currently set at \$3.67 per cubic yard.
State authorized collection in 1989. City imposes the fee on generators of commercial solid waste.	City of San Jose Municipal Code authorized. City imposes the fee on commercial solid waste haulers for the privilege of doing business in San Jose.
Goes to the Integrated Waste Management Fund (423) to implement the diversion activities under State mandates.	Goes to the General Fund for operational expenses.
Per City resolution 73879, AB 939 Fee set to \$0 for public schools and adult education schools supported by public schools if they have an agreement with the City.	Per City resolution 73878, City will reimburse the San Jose Unified School District for that portion of the District's solid waste service costs attributable to franchise fees paid to the City by the District's solid waste services provider. ¹

Source: Auditor summary.

Fee Collection Process

Commercial haulers are required to submit monthly reports to the City which contain information on solid waste and recycling collections. Beginning in 2007, the City instituted an online reporting system which allows the haulers to submit these reports via the Internet. Commercial haulers submit their payments for franchise and AB 939 fees to the Finance Department. The Finance Department accepts the payment and forwards copies of the cancelled check and the postmarked envelopes to ESD. ESD's franchise managers are responsible for verifying the date of payment, imposing any late payment fines and penalties, and sending out letters to the hauler requesting them to pay the fines and penalties when appropriate.

The City Currently Has Multiple Franchised Haulers

Currently the City has twenty-one franchised haulers. According to ESD staff, Allied Waste Services (Allied Waste) and Stevens Creek Disposal and Recycling (Stevens Creek) generate about 87 percent of the total revenues collected from these franchisees.

¹ In August 2007, the City Council authorized the City Manager to negotiate and execute similar agreements with eligible public school districts, San Jose/Evergreen Community College District, and San Jose State University. The City intends to sign similar agreements with all 19 school districts.

In 2001, the City awarded new franchise agreements to haulers for an initial two-year term, renewable annually for three one-year terms, and notified all the existing franchised commercial solid waste haulers that the City may provide or contract for exclusive solid waste collections services for the non-residential sector after June 2006. The City Council subsequently renewed the current franchise agreements for four franchisees until June 30, 2008 and the remaining franchisees until June 30, 2009 with the option to extend. In December 2007, the City issued a continuation to the 2001 notice to all existing franchised haulers re-confirming that the City may provide or contract for exclusive solid waste collections services for the non-residential sector.

Audit Objective, Scope, And Methodology

In March 2007, the San Jose City Council approved the Administration's request to add a review of fee payments by the City's Commercial Solid Waste Franchised haulers to the City Auditor's 2007-08 Workplan. Our audit objectives were to review ESD's internal commercial solid waste franchise and AB 939 fees collection process to determine if ESD was effectively monitoring whether these fees have been properly paid and collected. To accomplish our audit objectives, we 1) interviewed staff from ESD, the Finance Department, Allied Waste, Stevens Creek, and Waste Management and 2) reviewed the Municipal Code, Council resolutions, franchise agreements, and legislations.

We also reviewed twelve months of supporting documentation for Allied Waste's and six months of supporting documentation for Stevens Creek's reports between 2005-06 and 2006-07. We reviewed these files to determine if the commercial waste haulers were properly collecting and submitting commercial solid waste fees. We performed limited testing of the haulers' internal data entry procedures to ensure data validity.

Finally, we surveyed the commercial solid waste programs at the City of Oakland, the Sacramento Regional Solid Waste Authority, and the City of San Diego, to compare their practices to the City of San Jose.

We should note that we only reviewed hauler data for the City's two largest haulers--Allied Waste and Stevens Creek. We did not review any other hauler data because these two haulers generated about 87 percent of the solid waste fee revenue.

Finding I The City's Policy Regarding Waiver Of Public Agency-Related Franchise And AB 939 Fees Is Unclear

The Integrated Waste Management Division (IWM) of ESD administers the Commercial Solid Waste and Recycling Program (Program) for the City. This involves monitoring fee payments and solid waste and recycling data submitted by the commercial waste haulers. However, we found that the City's current policy on public agencies is unclear and haulers frequently do not pay the City the franchise fees for solid waste hauled from the public agencies. Specifically, we found that:

- In 2006, the City signed tolling agreements with Allied Waste and Stevens Creek for a dispute regarding the payment of fees for services to certain public agencies;
- In 2007, the San Jose City Council resolved to exempt school districts from paying AB 939 fees and reimburse them for their portion of the franchise fee costs that they pay to the hauler and the hauler pays to the City;
- The City's proposed reimbursement process for franchise fees is burdensome and may require significant staff time to monitor;
- The County of Santa Clara does not pay the required AB 939 fees;
- The Valley Transportation Authority (VTA) and the United States Postal Service (USPS) have refused to pay fees; and
- Some non-profit agencies are refusing to pay AB 939 fees.

In our opinion, the City Attorney's Office should propose to the City Council a resolution to the City's dispute with Allied Waste to ensure that the monies that school districts have already paid to Allied Waste are paid to the City and reimbursed to the school districts in a timely manner, including outstanding disputes with other franchised haulers. Further, ESD in consultation with the City Attorney's Office, should propose to the City Council to either exempt school districts, set franchise and AB 939 fees to \$0, or otherwise simplify the City's current reimbursement process. In addition, ESD in consultation with the City Attorney's Office, should propose to the City Council that the City's agreement with the County of Santa Clara be amended to clarify whether the County should pay the AB 939 fees and consider including reporting requirements in return for the City reimbursement of the County's franchise fees. Furthermore, ESD should work with the Finance department to pursue collecting all unpaid franchise fees from the haulers and AB 939 fees from those agencies that

should be paying the fees. Finally, ESD should require haulers to submit required documentation if a generator refuses to pay and act on those reports in a timely manner.

In 2006, The City Signed Tolling Agreements With Allied Waste Services And Stevens Creek For A Dispute Regarding The Payment Of Fees For Services To Certain Public Agencies

The City's commercial solid waste program requires franchised haulers to pay a franchise fee. However, previous audits of Stevens Creek and Allied Waste found that these haulers were not remitting the commercial solid waste fees for the school districts and other government agencies. Including penalties and interest, the audit found that in July 2005, Stevens Creek owed the City \$714,853 and Allied Waste owed the City about \$670,095 in unpaid franchise and AB 939 fees and late payment penalties plus interest.² At the conclusion of the audit, the City sent Allied Waste and Stevens Creek two demand letters for the monies owed.

Both Stevens Creek and Allied Waste disputed the audit's findings, claiming that these fees are not owed because they relate to solid waste collection and disposal services provided to state/public agencies located within the City.³ According to the City Attorney's Office, there is no requirement that public agencies be exempt from AB 939 fees. Further, franchised haulers are not exempt from franchise fees for solid waste services to these public agencies. In March 2006, the City signed separate tolling agreements with both Stevens Creek and Allied Waste and entered into settlement negotiations for the purpose of resolving the dispute.

We should note that since December 2005, according to the Allied Waste controller, it has been collecting franchise fees from school districts. However, it has not remitted these amounts to the City. The City Attorney's Office is in confidential settlement negotiations with Allied Waste and hopes to reach a settlement in a timely manner.⁴ Further, the City has not yet begun any negotiations with Stevens Creek in order to resolve its dispute.

² The audit was conducted by an ESD staff auditor who has since retired from the City, and ESD was unable to provide us with the records of this audit.

³ San Jose State Mission Trail Garbage Court case found that San Jose State University is a state agency and that state agencies do not have to use a City franchised hauler.

⁴ The audit period in dispute is from July 1, 2001 through June 30, 2004. The Tolling Agreement is to remain in place until terminated by 30-day written notice by either party and both parties agree not to initiate a lawsuit until the expiration of 30 days after written notice of termination. The haulers and the City agreed to hold the collection of these fees in abeyance from the term of the Tolling Agreement which is March 1, 2006 to the expiration of the 30-day notice period. No interest or penalties for non-payment of these fees during the term of the Agreement will be assessed.

We recommend that the City Attorney's Office propose to the City Council:

Recommendation #1

**A resolution to the City's dispute with Allied Waste to ensure that the monies that school districts have already paid to Allied Waste are paid to the City and reimbursed to the school districts in a timely manner including outstanding disputes with other franchise haulers.
(Priority 3)**

In 2007, The San Jose City Council Resolved To Exempt School Districts From Paying AB 939 Fees And Reimburse Them For Their Portion Of The Franchise Fees That They Pay To The Hauler And The Hauler Pays To The City⁵

In June 2007, the City Council passed Resolution 73879 which set AB 939 fees at \$0 for solid waste for any K-12 and adult education institutions supported by public funds provided they enter into an agreement with the City to promote recycling. In December 2007, the City executed an agreement with the San Jose Unified School District where the City agreed to reimburse the school district for the franchise fees in order to offset the cost of these fees that the haulers pass on to the schools. The agreement also provides that the schools use a City franchised hauler and submit quarterly reports to the City that include information on waste prevention, re-use, recycling, and other aspects of integrated waste management.

The City's Proposed Reimbursement Process For Franchise Fees For The School Districts Is Burdensome And May Require Significant Staff Time To Monitor

As stated above, the City intends to execute agreements with the 19 San Jose school districts and adult education institutions to *pass through* franchise fees. The AB 939 fees for school districts that have entered into this agreement is set to zero dollars. In our opinion, the pass through process is burdensome and could potentially require significant staff time.

According to the Municipal Code, "*Each person engaging in the business of collecting, transporting or disposing of commercial solid waste or commingled recyclables kept, accumulated or generated in the city shall pay a franchise fee to the city.*" Franchise fees are actually a fee imposed on the hauler. Haulers may or may not pass the fee on to the customer. The Municipal Code does not exempt any agency -- public or private -- from

⁵ The City would reimburse only that portion of the solid waste handling services that are attributable to the franchise fees paid to the City by the institution's hauler.

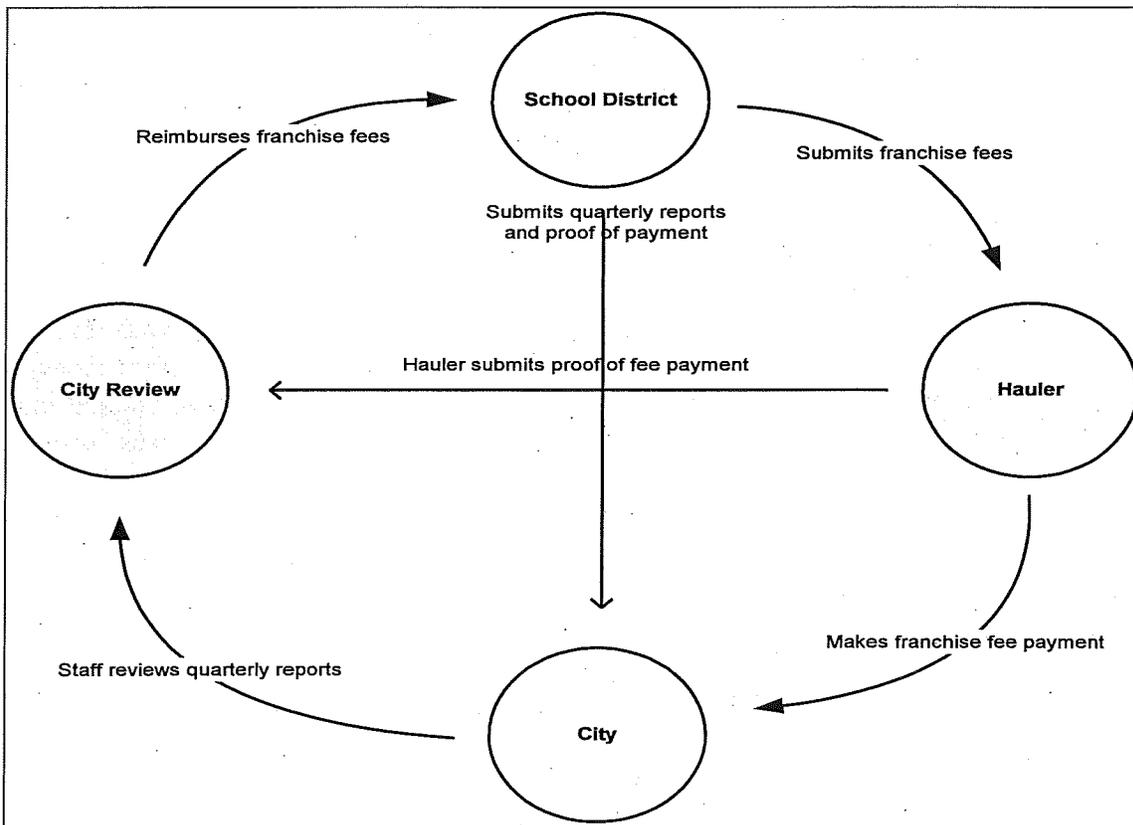
paying the franchise fees the hauler may have passed on to the customer. The City has established a reimbursement process rather than establishing exemptions to this Municipal Code provision.

The agreement between San Jose Unified School District and the City currently states:

- District has to submit quarterly reports to the City on its recycling and waste management program.
- City shall reimburse the district for solid waste handling costs attributable to franchise fees on a quarterly basis within 30 days after City's reasonable verification of the amounts due.

The reimbursement process requires that if the schools paid franchise fees to the haulers, then the City would reimburse that amount to the districts. The City would require the school district and the hauler to submit proof of payment to the City and after review would reimburse the school district for the franchise fees. The exhibit below illustrates this proposed reimbursement process.

Exhibit 5: City's Proposed Franchise Fee Reimbursement Process



Source: ESD.

In our opinion, this process is burdensome for the hauler, the school district, and the City.

Other Cities Do Not Charge Commercial Solid Waste Fees To Public Agencies

We surveyed two large California cities and the Sacramento Regional Solid Waste Authority. Specifically, we surveyed the City of San Diego and the City of Oakland. We found that the City of Oakland has a single hauler system where it charges the hauler a flat fee for doing business in the city. However, it exempts public agencies from paying any fees. We also found that the Sacramento Regional Solid Waste Authority exempts public agencies from paying franchise fees. Finally, the City of San Diego, which has a competitive hauler system, exempts public agencies from paying the fees.

We recommend that ESD in consultation with the City Attorney's Office:

Recommendation #2

Propose to City Council to either exempt school districts, set franchise and AB 939 fees associated with school districts at \$0, or otherwise simplify the City's current reimbursement process. (Priority 3)

The County Of Santa Clara Does Not Pay The Required AB 939 Fees

In 2001, the City entered into an agreement with the County of Santa Clara (County) to reimburse the County for all the costs attributable to franchise fees the County paid to the haulers. In accordance with the agreement, the Finance Department reimburses the County for these costs. However, even though the County's agreement does not exempt the County from paying the AB 939 fees, we found that Allied Waste has not collected AB 939 fees. Based on our review of a sample of monthly reports Allied Waste provided, we found that for one month alone the County should have paid the City about \$4,000 in AB 939 fees or about \$48,000 per year. Allied Waste does not bill the County for the AB 939 fees.

According to the City Attorney's Office, even though the City's position is that public agencies are not exempt from AB 939 fees, the City has set the fee for some public agencies at zero dollars.⁶ Finally, unlike the current and

⁶ These agreements are intended to promote diversion by K-12 and adult education institutions support by public funds.

proposed agreements with the public schools, we found that nothing in the current Franchise Fee agreement with the County requires the County to provide information on its recycling program or goals.

We recommend that ESD in consultation with the City Attorney's Office:

Recommendation #3

Propose to the City Council that the City's agreement with the County of Santa Clara be amended to clarify whether the County should pay the AB 939 fees, and consider including reporting requirements in return for the City reimbursement of the County's franchise fees. (Priority 3)

The Valley Transportation Authority (VTA) And The United States Postal Service (USPS) Have Refused To Pay Fees

According to the City's franchise agreement with Allied Waste, franchise fees are the responsibility of the franchisee – not the customer. Specifically, *“During the term of the commercial solid waste and recyclables collection franchise, franchisee (emphasis added) shall pay to the City franchise fees for the privilege of engaging in the business of collecting, transporting and disposing of commercial solid waste and recyclables kept, accumulated or generated in the City of San Jose.”*

Even though the franchise fees are imposed on the hauler, the haulers generally pass this fee on to their customers. We found that even though Allied Waste currently bills the VTA for the franchise fees and the AB 939 fees, the VTA does not pay these fees, and Allied Waste is not remitting these fees to the City.

Further, we also found that the VTA has not paid the AB 939 fees to the City. Moreover, with respect to VTA's non-payment of the AB 939 fees, Allied Waste should have provided documentation to the City supporting VTA's claim, including documentation showing that Allied Waste billed VTA for the AB 939 fees.⁷ Based on our review of the monthly reports, we found that Allied Waste did not submit this supporting documentation to City staff.⁸

⁷ Allied Waste provided the City Auditor's Office with sample invoices as part of the audit review.

⁸ According to the franchise agreement between Allied Waste and the City, for each month in which any generator fails or refuses to pay the AB 939 fees, the franchisee shall notify the City of the generator's name, address, the amount due for AB 939 fees, and account information, and shall provide documentation supporting the franchisee's claim (including documentation showing the franchisee billed the generator for the AB 939 fees).

According to the Allied Waste controller, Allied Waste keeps a record of how much the VTA would have to pay. Furthermore, Allied Waste's position is that since the VTA is a public agency it is exempt from paying the AB 939 and franchise fees.

Based on our six-month samples each for 2005-06 and 2006-07 and Allied Waste's records, it should have remitted about \$65,700 each year in franchise fees to the City and about \$12,700 each year in AB 939 fees related to the VTA account.

United States Postal Service (USPS)

We also found that the USPS has refused to pay the required AB 939 fees. The USPS submitted a letter to Stevens Creek claiming that, "*Due to the US Postal service is a state and federal agency they are not required to pay AB 939 charges as they have their own guild [sic] lines they are required to follow, which relieves them from these charges.*" According to the City Attorney's Office, federal law expressly waives any immunity to state and local solid waste requirements. Section 6961 of Title 42 Public Health and Welfare Code states "*each department, agency, and instrumentality of the executive, legislative, and judicial branches of the Federal Government . . . engaged in any activity resulting, or which may result, in the disposal or management of solid waste or hazardous waste shall be subject to, and comply with, all Federal, State, interstate, and local requirements . . . including reasonable service charges.*" Reasonable service charges include nondiscriminatory charges that are assessed in connection with a State, or local solid waste regulatory program. AB 939 fees pay for the cost of programs that promote meeting the State's solid waste diversion goals.

A review of one month's worth of hauling activity indicated the USPS should have paid about \$736. Extrapolating this over one year, the USPS should have paid about \$8,832.

Some Non-Profit Agencies Are Refusing To Pay AB 939 Fees

As part of the monthly reporting, haulers are required to provide the City with a list of generators who are not paying or refuse to pay AB 939 fees. Stevens Creek has informed the City of non-profit agencies who refuse to pay AB 939 fees. Some of the organizations on this list do not have an agreement with the City in which the City has agreed to waive AB 939 fees, and/or do not qualify under the Municipal Code as a non-profit reuser.⁹ For

⁹ According to the Municipal Code Section 9.10.1436, "*The [AB 939] fees imposed pursuant to section 9.10.1435 shall not apply to the residue generated by a nonprofit charitable reuser who has been granted an exception from such fees.*"

example, in 2005, the San Jose Job Corps Center provided a letter to Stevens Creek claiming exemption from the AB 939 fees. According to the Administrative Director of the San Jose Job Corps Center, *“The San Jose Job Corps chooses not to pay the 50 cent/yard fee, AB939 since we are a Federal Facility and should be exempt.”*

In our opinion, ESD staff should have pursued collecting these fees in a timely manner.

We recommend that ESD:

Recommendation #4

Work with the Finance Department to pursue collecting all unpaid franchise fees from the haulers and AB 939 fees from those agencies that should be paying the fees. (Priority 1)

Further, we recommend that ESD:

Recommendation #5

Require haulers to submit required documentation if a generator refuses to pay, and act on those reports in a timely manner. (Priority 3)

Finding II Improvements Are Needed To Better Enforce The City's Commercial Solid Waste Fee Provisions

We found that ESD staff needs to improve its current monitoring practices. Specifically, we found that

- ESD does not have written procedures to monitor commercial solid waste hauler fee collection and reporting;
- Allied Waste is not reporting its information by yardage making it difficult to verify whether appropriate fees have been applied;
- ESD staff allowed Stevens Creek to adjust at least \$50,000 in its fee remittance when its agreement specifically disallowed it; and
- ESD has not conducted required outreach efforts nor is the Division of Code Enforcement conducting regular agreement-required trainings for collection vehicle drivers.

In our opinion, ESD staff should develop procedures for collecting fees and penalties and interest. Furthermore, ESD should re-evaluate what kind of information and in what manner a hauler could provide that would make ESD's monitoring efforts more valuable and efficient. In addition, ESD should develop procedures to ensure that haulers are adequately and consistently monitored including 1) disallowing any unapproved adjustments that haulers make, and 2) reaffirming parameters for assessing penalties and interest. Finally, ESD should provide the haulers with the required outreach materials for distribution as stated in its agreement with each of the haulers and work with the Division of Code Enforcement to develop regular agreement-required training for collection vehicle drivers.

ESD Does Not Have Written Procedures To Monitor Commercial Solid Waste Hauler Fee Collection And Reporting

ESD does not have any written policies and procedures to monitor the commercial solid waste haulers' fee collection process. We found that each franchise manager reviews the monthly reports differently. One franchise manager simply reviews reports for discrepancies from one month to the next but the other manager tracks the remittances for the hauler over a year. Furthermore, ESD also does not have any procedures on how to collect AB 939 fees from solid waste generators that have refused to pay the fees. The franchise agreement currently states, "*FRANCHISEE shall bill, collect and remit to the CITY the Source Reduction and Recycling Fee (SRR fee) [AB 939] imposed by the CITY on solid waste generators for whom*

FRANCHISEE performs solid waste handling services For each month in which any generator fails or refuses to pay SRR fees to FRANCHISEE when such fees are due and payable, FRANCHISEE shall notify CITY of the generator's name, address, the amount due for SRR fees, and account information ... and shall provide documentation supporting FRANCHISEES claim."

The agreement and the Municipal Code are silent on which department and in what manner the City should pursue collecting these fees. The Finance Department staff told us that ESD was responsible for collecting any unpaid or underpaid fees, whereas ESD staff told us that the Finance Department was responsible for pursuing the collection. Aside from one instance where the Finance Department staff sent out demand letters to Allied Waste and Stevens Creek in 2005, we found no evidence that either ESD staff or the Finance Department ever tried to formally pursue collecting these unpaid fees from generators.

We recommend that ESD:

Recommendation #6

**Develop procedures for collecting fees and penalties and interest.
(Priority 3)**

Allied Waste Is Not Reporting Its Information By Yardage Making It Difficult To Verify Whether Appropriate Fees Have Been Applied

Per the agreement between the City and Allied Waste, the hauler is required to electronically submit monthly reports. These reports contain information which must include the following:

- a listing of each container size from which the hauler collected commercial solid waste and recycling;
- the number of collections of each listed container size;
- the total volume of solid waste and recycling; and
- the hauler's gross receipts for collection services, etc.

The waste haulers are required to submit these monthly reports so that the City can verify that the haulers are paying the appropriate amount of Franchise and AB 939 fees. However, we found that Allied Waste does not calculate fees based on the amount of cubic yards of solid waste collected. Instead, it uses total franchise fees and AB 939 fees billed for each customer and then calculates the cubic yardage. In other words, Allied Waste 'backs into' its total yardage from fees billed. This makes it

impossible for ESD's monitoring staff to validate that Allied Waste is paying the proper amount of franchise fees, because ESD lacks the information to do so. Furthermore, ESD does not receive any kind of back-up information which would support the fee amounts provided. Our review of Allied Waste's invoices found that it simply labels the fees as "Franchise - Local" and does not distinguish between whether the fees include both the Franchise and the AB 939 fees. In our opinion, there is no way for a customer or the City to determine which fees they have paid and the basis for the calculation of those fees.

Until 2005, ESD had a position for one Full Time Employee (FTE) auditor whose role was to monitor and verify hauler information and determine whether the appropriate fees were remitted to the City. Since that time, ESD has reassigned this position and, instead of hiring another full-time position, ESD told us that it has hired the services of a contractor with expertise in the solid waste industry to conduct regular audits of the haulers.

As mentioned above, as part of the monthly reporting, the haulers are required to provide data on the volume of garbage, container size, and tonnage. ESD not only uses this data for internal reporting purposes but also to provide its solid waste diversion results to the State of California. The integrity of this data is critical to this reporting and it would be in the City's best interest to review the accuracy of the information submitted. Based on our review of Allied Waste's source documents, we found that the information reported in these documents was also by total fees collected and not as information tracked by yardage. In general, the City's agreements with haulers do not require the haulers to report information by yardage, which makes it difficult to verify whether appropriate fees have been paid. Therefore, ESD's franchise managers do not have assurance that the information presented in the monthly reports is complete and accurate.

We recommend that ESD:

Recommendation #7

Re-evaluate what kind of information and in what manner a hauler could provide that would make ESD's monitoring efforts more valuable and efficient. (Priority 3)

ESD Staff Allowed Stevens Creek To Adjust At Least \$50,000 In Its Fee Remittance When Its Agreement Specifically Disallowed It

According to Stevens Creek's agreement with the City, "In the event FRANCHISEE believes that FRANCHISEE has paid franchise fees in excess of the fees due to CITY, FRANCHISEE may submit a request for refund to the Director of Finance on a form provided by said [ESD] Director. If proof of overpayment is satisfactory to the Director, the Director shall refund to FRANCHISEE any overpayment. FRANCHISEE shall not apply any overpayment as a credit against any SRR Fees [AB 939 fees], franchise fees or other amounts payable to City."

In June 2006, Stevens Creek adjusted its fee payment for more than a \$50,000 overpayment and about a \$29,000 underpayment. The underpayment was because Stevens Creek had not taken an appropriate deduction, and the overpayment was because it had double-counted certain customers. Per the agreement provisions, ESD staff should have never allowed Stevens Creek to make the adjustment without a formal application to the Director of ESD. Furthermore, the franchise manager was not aware that the agreement did not allow for these overpayment and underpayment adjustments and said that the hauler often made these kinds of adjustments. Finally, with regard to the underpayment, the franchise manager made the decision not to assess any penalties or interest because Stevens Creek, not City staff, had uncovered this error. Based on the City's agreement with Stevens Creek the Franchise Manager did not have the authority to waive these penalties. We found no evidence that the ESD Director ever approved this waiver.

We recommend that ESD:

Recommendation #8

Develop policies and procedures to ensure that haulers are adequately and consistently monitored, including:

- **Disallowing any unapproved adjustments the haulers make; and**
- **Reaffirming parameters for assessing penalties and interest. (Priority 2)**

ESD Has Not Conducted Required Outreach Efforts Nor Is The Division Of Code Enforcement Conducting Regular Agreement-Required Trainings For Collection Vehicle Drivers

The purpose of the AB 939 Fee program is to promote recycling and to reduce the amount of material that is deposited in the landfills. The AB 939 fees are to pay for staff costs associated with solid waste reduction and include outreach materials to educate customers on the benefits of recycling. Thus, the fee structure of the AB 939 fees and the franchise fees is set to encourage solid waste reduction and no fees are assessed on material that is recycled.

According to its agreement with Allied Waste, *“Twice per year...FRANCHISEE shall distribute public outreach materials to all of FRANCHISEE’S regular San Jose customers.”* The agreement also states the *“CITY will design and produce the outreach material at CITY’S cost and expense, and will deliver the outreach materials.”* Furthermore, the *“FRANCHISEE shall permit CITY staff to provide training for all of FRANCHISEE’S collection vehicle drivers with respect to the requirements of the San Jose Municipal Code regarding collection and transportation of materials... FRANCHISEE shall coordinate with CITY’S Division of Code Enforcement to schedule training sessions...on not less than twice-per-year basis.”*

We found that ESD staff has not provided the outreach material to the haulers on a regular basis, and the Division of Code Enforcement has not conducted the trainings. In our opinion, conducting outreach is not only required by the agreement, but needed, in order to meet the goal of reducing waste and increasing recycling. According to the California Integrated Waste Management Board, each year in California, more than 42 million tons of waste - enough to fill garbage trucks placed bumper to bumper stretching 1.25 times around the earth - is hauled to landfills. Nearly 60 percent of this paper, cardboard, plastic, food, and construction waste is generated by commercial, industrial, and institutional sources. According to the *Western City, July 2008* issue, *“Failing to educate employees adequately about on-site recycling is the most significant barrier to successful commercial recycling.”* Further, *“Programs that focus on greater involvement by businesses in reducing waste, reusing packaging and materials, and recycling can help put a big dent in minimizing the amount of disposed waste.”*

We found the City has not been taking full advantage of the contract provision requiring haulers to mail City-provided outreach materials. For example, in 2008, the City provided the haulers about 7,500 mailers to distribute to their customers. Instead of taking full advantage of the

Agreement's outreach provision, the City mailed out an additional 13,500 mailers using the City's Business License Tax database. In response to these mailers, the City received 550 responses from the business community via an on-line survey. According to the AB 939 legislation the fees are to be used to pay for promoting source reduction and recycling. Without conducting active outreach and education, ESD does not have the assurance that the City businesses have the awareness of the incentives to increase their recycling.

Finally, we found that the Division of Code Enforcement was unaware of the agreement provision and has not done the required training for the haulers. According to the Code Enforcement Administrator, although they have conducted a couple of trainings for the haulers at ESD staff's request, they currently do not have the staffing necessary to conduct the regular agreement-required trainings.

We recommend that ESD:

Recommendation #9

Provide the haulers with the required outreach materials for distribution as stated in its agreements with each of the haulers. (Priority 3)

Recommendation #10

Work with the Division of Code Enforcement to develop regular required training for collection vehicle drivers. (Priority 3)

Memorandum

TO: Sharon Winslow Erickson
City Auditor

FROM: John Stufflebean

SUBJECT: SEE BELOW

DATE: 08-29-08

Approved

Deanna Sauter

Date

9/2/08

SUBJECT: *The Administration's response to an Audit of the Commercial Solid Waste Franchise and AB939 Fee Collection Program of the Environmental Services Department*

BACKGROUND

The Environmental Services Department (ESD) has reviewed the *Audit of the Commercial Solid Waste Franchise and AB939 Fee Collection Program* and is generally in agreement with most of the findings of the audit and the recommendations made by the Auditor's Office.

ANALYSIS

Since April 2007, ESD has been evaluating the commercial solid waste franchise system and is moving forward to implement a complete redesign of this program. Major redesign components were presented to the Transportation and Environment Committee on August 18, 2008. One of the objectives of this process will be to implement a system that provides more effective tools for managing the franchised haulers' compliance and performance in providing solid waste and recycling services in accordance to their agreements with the City. Additionally, the new system will provide a permanent solution for the payment of fees by state agencies. Staff projects that the commercial solid waste system redesign will be fully implemented by July 2012.

Since March 2008, ESD has been working on developing internal procedures to more effectively manage the current franchise agreements. This includes clearly defining responsibilities and timelines for key reporting activities and developing process flow diagrams for better tracking of hauler revenue remitted to the City. Recently, the Commercial Solid Waste Division was re-organized to provide more consistent oversight in managing the franchise agreements. This effort has included the reassignment of a Staff Analyst to help with administering the commercial franchise agreements. ESD has initiated work with the Finance Department to identify and implement improvements to collection procedures for more effective fiscal monitoring and oversight. Part of that process has included providing read-only access to the Finance Department's Revenue Plus application to select ESD staff. This will help ESD better track the status of demand letters for late payments and penalties.

ESD's responses to the audit recommendations are detailed below:

Recommendation #1: *A resolution to the City's dispute with Allied Waste to ensure that the monies that school districts have already paid to Allied Waste are paid to the City and reimbursed to the school districts in a timely manner including outstanding disputes with other franchise haulers. (Priority #3)*

The Attorney's Office is currently negotiating a settlement agreement with Allied Waste Systems. Once a settlement agreement is reached with Allied, the Attorney's Office will begin negotiations with Stevens Creek Disposal and Recycling with the goal of achieving a similar outcome.

Recommendation #2: *Propose to City Council to either exempt school districts, set Franchise Fees and 939 Fees at \$0, or otherwise simplify the current reimbursement process. (Priority #3)*

ESD and the City Attorney's Office will develop alternatives for Council consideration that simplify the current reimbursement process of franchise fees paid by the haulers for service to School Districts in the City.

Recommendation #3: *Propose to the City Council that the City's agreement with the County of Santa Clara be amended to clarify whether the County should pay the AB 939 fees, and consider including reporting requirements in return for the City reimbursement of the County's franchise fees. (Priority #3)*

The Administration, in consultation with the City Attorney's Office, is evaluating this clarification and will bring a recommendation to Council for consideration.

Recommendation #4: *Work with Finance to pursue collecting all unpaid Franchise Fees from the haulers and AB939 fees from those agencies that should be paying the fees. (Priority #1)*

ESD, the Finance Department, and the City Attorney's Office will continue to pursue collecting all unpaid franchise fees from the haulers. In addition, ESD will identify those agencies that are not paying AB939 fees and work with Finance and the City Attorney's Office to collect this revenue. ESD and Finance will work to enhance existing monitoring and collection processes to make them more effective and efficient for monitoring and collecting AB939 and Franchise Fee Revenue.

To ensure that other Franchised Haulers are properly reporting collection activities from public agencies, and in response to the findings from this audit, ESD, through a contract with HF&H

Consulting, is initiating an audit of GreenWaste Recovery and GT Waste for this fiscal year. These two companies are the largest franchised haulers after Stevens Creek Disposal and Allied Waste whose franchise agreement compliance was just reviewed by the City Auditor. HF&H has conducted similar solid waste audits for local governments throughout California to ensure that all franchise, AB 939, or other fees remitted are accurate. The ESD audit scope will include verification that proper diversion targets were met and that franchise and AB939 fees were properly paid or avoided through eligible recycling programs.

Recommendation #5: *Require haulers to submit required documentation if a generator refuses to pay and act on those reports in a timely manner. (Priority #3)*

ESD is reviewing its current procedures and modifying them to ensure that generators that refuse to pay AB939 fees are identified and that the haulers have submitted the appropriate documentation. ESD and Finance are developing more effective processes and procedures for collecting un-remitted AB939 fees.

Recommendation #6: *Develop procedures for collecting fees, penalties and interest. (Priority #3)*

ESD is seeking input from the Finance Department to collaboratively develop a procedure for collecting outstanding fees, penalties, and interest.

Recommendation #7: *Re-evaluate what kind of information and in what manner a hauler could provide that would make ESD's monitoring efforts more valuable and efficient. (Priority #3)*

ESD is currently in the process of evaluating and developing recommendations for implementing a new city-wide commercial garbage and recycling collection system. It is anticipated that this new system will be easier to manage, by limiting the number of haulers to exclusive districts. Through these exclusive contracts, the City can set measurable and enforceable performance standards. Final system recommendations are anticipated to be considered by Council in December 2008. In the meantime, ESD is evaluating the current hauler reporting system, including what changes would be feasible to implement between now and the start of a new commercial system.

Recommendation #8: *Develop Policies and procedures to ensure that haulers are adequately and consistently monitored including: disallowing any unapproved adjustments the haulers make and reaffirming parameters for assessing penalties and interest. (Priority #2)*

ESD is developing policies and procedures to ensure that adjustments are approved in conjunction with the Finance Department. Additionally, ESD recently strengthened controls in the management of the franchises to ensure that these agreements are consistently and effectively monitored.

Recommendation #9: *Provide haulers with the required outreach materials for distribution as stated in its agreements with each hauler. (Priority #3)*

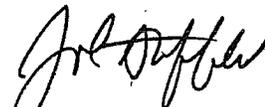
ESD recently hired staff to provide recycling technical assistance to the business community. Part of this responsibility will include developing outreach/educational materials and coordinating its distribution through the franchised haulers. It is important to note the limitations of the outreach distribution provisions in the hauler agreements. The outreach sent by the haulers goes to whoever receives the garbage bill, which is often not the most effective target audience. For example, in any case where there is a landlord or facility manager who pays the garbage bill on behalf of many tenants, like a large retail mall or an office complex, only the landlord or accounting staff will receive the outreach provided by the haulers. ESD is designing the new business recycling technical assistance program to target individual businesses directly which should result in a more robust outreach program.

Recommendation #10: *Work with the Division of Code Enforcement to develop regular required training for collection vehicle drivers. (Priority #3)*

ESD is working with Code Enforcement to improve and to more effectively utilize training sessions for collection vehicle drivers as provided in the commercial solid waste franchise agreements.

COORDINATION

This report has been coordinated with the City Attorney's Office and the Departments of Planning Building, and Code Enforcement, and Finance.



JOHN STUFFLEBEAN
Director, Environmental Services

APPENDIX A

DEFINITIONS OF PRIORITY 1, 2, AND 3 AUDIT RECOMMENDATIONS

The City of San Jose's City Policy Manual (6.1.2) defines the classification scheme applicable to audit recommendations and the appropriate corrective actions as follows:

Priority Class ¹	Description	Implementation Category	Implementation Action ³
1	Fraud or serious violations are being committed, significant fiscal or equivalent non-fiscal losses are occurring. ²	Priority	Immediate
2	A potential for incurring significant fiscal or equivalent fiscal or equivalent non-fiscal losses exists. ²	Priority	Within 60 days
3	Operation or administrative process will be improved.	General	60 days to one year

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- ¹ The City Auditor is responsible for assigning audit recommendation priority class numbers. A recommendation which clearly fits the description for more than one priority class shall be assigned the higher number.
 - ² For an audit recommendation to be considered related to a significant fiscal loss, it will usually be necessary for an actual loss of \$50,000 or more to be involved or for a potential loss (including unrealized revenue increases) of \$100,000 to be involved. Equivalent non-fiscal losses would include, but not be limited to, omission or commission of acts by or on behalf of the City which would be likely to expose the City to adverse criticism in the eyes of its citizens.
 - ³ The implementation time frame indicated for each priority class is intended as a guideline for establishing implementation target dates. While prioritizing recommendations is the responsibility of the City Auditor, determining implementation dates is the responsibility of the City Administration.