Lexington-Fayette Urban County Government
OFFICE OF INTERNAL AUDIT

MANAGEMENT ACTION PLAN PROGRESS REPORT

DATE: September 17, 2015

TO: Jim Gray, Mayor

CC: Sally Hamilton, Chief Administrative Officer
Glenn Brown, Deputy Chief Administrative Officer
Aldona Valicenti, Chief Information Officer
David Holmes, Commissioner of Environmental Quality & Public Works
William O'Mara, Commissioner of Finance & Administration
Janet Graham, Commissioner of Law
Tracey Thurman, Director of Waste Management
Phyllis Cooper, Director of Accounting
Susan Straub, Communications Director
Urban County Council Members
Internal Audit Board Members

FROM: Bruce Sahli, CIA, CFE, Director of Internal Audit
Teressa Gipson, CFE, Internal Auditor

RE: Material Recovery Facility (MRF) Collections Process MAPPR

EXECUTIVE SUMMARY

On January 24, 2014 the Office of Internal Audit issued the MRF Collections Process Audit. The 2014 report contained several findings related to the assignment of the MRF to a separate Enterprise Fund; the need for an exclusive management team to manage MRF operations; an accountant to oversee the financial activities; security issues noted; excessive amounts of overtime routinely incurred; deposit violations noted; issues noted by Risk Management not addressed; contractors providing outside services needed to be monitored; updated contract needed with BRRC and other affiliates; reports from BRRC for commodities sold contained discrepancies; production reports should be reinstated; and additional issues noted.

This review is provided for management information only. It is not an audit and no opinion is given regarding controls or procedures. The period of review included MRF collections from December 1, 2014 through March 15, 2015 and payroll activity from July 1, 2014 through March 15, 2015.

A summary of the findings from the original audit report and a summary of the results of our follow-up are provided in the table below. The original findings, management's original responses, and details of the results of this follow-up are contained in the **ORIGINAL AUDIT RESULTS AND FOLLOW-UP DETAILS** section of this report.

Finding	Summary of Original Finding	Follow-Up Results
Finding 1 High Priority	The MRF Should be Considered for Assignment to a Separate Enterprise Fund	In the June 2014 Environmental Quality Committee meeting the administration stated it has decided not to establish the MFR as a separate enterprise fund and explained the reasons why. This finding has been resolved.
Finding 2 High Priority	The MRF Operation Needs an Exclusive Management Team to Manage Its Operations	The MRF has a Plant Operations Manager who is in charge of running the day to day operations. A Safety Officer has been hired and he is in charge of safety compliance at the plant. This finding has been resolved.
Finding 3 High Priority	The MRF Needs an Accountant to Oversee its Financial Activities	An accountant was hired at the MRF and all previous financial issues were corrected. MRF year-end inventory needs to be provided to Accounting, and Accounting should confer with the external auditors on the proper reporting thereof. We still noted issues with reconciling the daily inventory count to the production reports. We recommend that MRF administration consider the use of a receivable program to track receivables instead of Excel spreadsheets.

Finding 4 High Priority	MRF Security Issues Noted	Security improvements were made including the re-keying of doors and a card scanner. This finding has been resolved.
Finding 5 High Priority	Excessive Amounts of Overtime Routinely Incurred by Certain MRF Employees	Overtime was significantly reduced by 53%. Overtime is being monitored; however, it has not been eliminated and is not projected to be eliminated. This finding has been resolved.
Finding 6 High Priority	CAO Policy #40 Deposit Violations Noted	The Division of Revenue started receiving and depositing checks for the MRF in approximately August 2014. These payments appear to be properly posted to the MRF liability account. This finding has been resolved.
Finding 7 High Priority	Issues Noted by Division of Risk Management Not Addressed	The Safety Officer for the MRF has worked with Risk Management to correct the outstanding issues. This finding has been resolved.
Finding 8 High Priority	MRF Contractors Providing Outside Services Should be Monitored for Compliance	Currently, a Labor Works employee in the on-site supervisory role is undergoing the required OSHA training. In the interim, a Labor Works manager who has the required OSHA training is providing assistance as needed. The MRF Plant Operations Manager is overseeing the contract. This finding has been resolved.
Finding 9 High Priority	Updated Contracts Needed With BRRC and Other Affiliates	LFUCG terminated its business relationship with BRRC on June 30, 2014. Agreements for a majority of affiliates have been received; however, the contracts have not been fully executed because they have not been signed by the Mayor and approved by Council.
Finding 10 High Priority	May and June 2013 Reports From BRRC for Commodities Sold Contained Discrepancies	LFUCG is no longer conducting business with BRRC, therefore, this finding has been resolved.

Finding 11 High Priority	Production Reports Should be Reinstated	Production reports were reinstated on October 28, 2013 and are being sent to the Plant Manager and to the Director. This finding has been resolved.
Finding 12 High Priority	Additional Issues Noted During the Audit	All voided manifests are maintained at the MRF. Management indicated that accurate reads of tonnage are being obtained. Since the process is being managed, management has decided not to install the electronic arm due to the anticipated expense of operating and replacing the arm when damaged. This finding has been resolved.

ORIGINAL AUDIT RESULTS AND FOLLOW-UP DETAILS

Original Finding #1: The MRF Should be Considered for Assignment to a Separate Enterprise Fund
Priority Rating: High

Condition:
The MRF is currently a section of the Division of Waste Management, and is therefore included in the Urban Services Fund, a governmental fund of LFUCG. However, in reality the MRF is a manufacturing operation that collects revenue generated from the sale of its recycled commodities to buyers on the open market, and is therefore better suited to be accounted for via an Enterprise Fund due to its business-type activity. The Governmental Accounting Standards Board (GASB) defines an Enterprise Fund as a proprietary fund type used to report an activity for which a fee is charged to external users for goods or services.

Effect:
Under the current reporting method it is difficult to determine if the MRF revenues are sufficient to cover its cost of operations since governmental funds do not report certain types of expenses (i.e. depreciation expense and bad debt expense) that are reported by enterprise funds, or to determine if the current fee structure at the MRF subsidizes other counties for using its recycling facility.

Recommendation:
Senior management should consider removing the MRF from the Urban Services Fund and having its financial activities reported through its own Enterprise Fund. It is possible to develop an operating and capital budget based on MRF's historical financial information for revenue and expenses from the previous three fiscal years (the MRF was upgraded in June 2010).

Director of Waste Management Response:
While accurately tracking annual expenditures at the MRF is very important in calculating our operating cost per ton and in gauging DWM's efforts toward more efficient operations, it is equally important to recognize that revenue from the sale of commodities is subject to wide fluctuations and, as such, is not a stable funding source for an ongoing operation. While we have enjoyed per ton prices in excess of $100 (average across all commodities) for several years, the commodities price have dipped significantly to the $60-$70 range this year. Other financial benefits include reduced landfill tipping fees and increased opportunities for automation and streamlined collection systems over the long term. The latter is quite significant and is a real benefit but very hard to measure on a year to year cost benefit analysis.

The MRF enterprise is a component of an overall waste management strategy to handle waste in an environmentally responsible manner, while pursuing efficiency in both the collection and resource management parts of our operation. As with other DWM management systems such as E-waste, composting, household hazardous waste and particularly landfill disposal, they are not self-funding operations. While the MRF operations comes the closest to meeting this standard the commodity revenue alone will not allow for a stable funding system.

Acting Commissioner of EQ&PW Response:
A decision regarding creation of a recycling enterprise fund should rest with the administration and council. Accurate accounting (revenues and expenses) is essential to assure that the fee structure is equitable between LFUCG and the affiliated MRF users.

Follow-Up Detail Results:
A presentation was made to the Environmental Quality and Public Works Committee in June 2014. The Commissioner of Finance and Administration indicated that the administration has decided not to pursue the audit recommendation to establish the MFR as a separate enterprise fund. The administration stated that the Government Finance Officers Association (GFOA) was consulted during the implementation of the MRF, and it was recommended that the MRF not be established as a self supporting fund. It was also stated in

the June 2014 Committee meeting that the MRF produces a commodity that is very volatile in price.

The original audit recommendation was that senior management should consider setting up the MRF as an Enterprise Fund. Public discussion and due consideration of this recommendation has occurred.

This finding has been resolved. No management response required.

<u>Original Finding #2:</u> The MRF Operation Needs an Exclusive Management Team to Manage Its Operations
Priority Rating: High

Condition:
The Director of the Division of Waste Management currently oversees more than 200 employees who collect recyclables, yard waste, and trash throughout the Urban County Government, as well as being responsible for the MRF operation. The MRF is a manufacturing operation with challenges unique to that type of environment, and in our opinion requires it own unique management team with extensive industry experience.

Effect:
As noted in other findings in this report there are many security, Occupational Safety and Health Administration (OSHA), administrative, operational, accounting and internal control issues at the MRF, many of which could have been prevented or at least detected sooner. Although a Program Manager Senior (the overall plant manager) was on hand at the MRF, given the organizational structure it appears that major decisions were deferred to upper management (i.e., the Division Director) who, given his many other responsibilities, did not always ensure the concerns were addressed in a timely fashion.

Recommendation:
A senior management individual (perhaps at the Deputy Director level) should be hired as soon as possible and assigned the task of correcting the problems and implementing the recommendations noted in this report and in other reports issued by the Division of Risk Management and OSHA. Going forward, this senior manager should be provided the authority to manage the MRF. The Director of Waste Management should be informed of the decisions made without being required to provide day-to-day input into those management decisions.

Director of Waste Management Response:
I agree with the recommendation for a Deputy Director for the Division, although that would require reclassification of the Director's position while it is vacant to allow the Deputy Director to have oversight over the Program Manager Senior positions in DWM.

I agree that the MRF, as referenced in the recommendation, is an intense manufacturing operation not typically found under direct government management. I do believe there are three recent changes that have either occurred or are underway that will improve the management and oversight over the MRF.

1. Contracting with an outside entity to manage floor operations.
2. A recently hired safety manager who is actively engaged with MRF operations.
3. Filling the Program Manager Senior position with a candidate who will be actively engaged with the management of the facility.

Acting Commissioner of EQ&PW Response:
The recruitment of a plant manager with extensive experience in an industrial manufacturing facility would, in my opinion, be a better outcome than hiring a deputy director or filling the Program Manager Sr. position utilizing the current position description.

The plant manager would:

- Report and maintain a full-time presence at the MRF. Past practice has sometimes had the Program Manager Sr. position reporting to the Byrd Thurman offices, with visits to the MRF as necessary. I am of the opinion that the lack of full-time presence by a plant manager driven by operation metrics is a contributing factor to inefficiencies at the facility.
- The plant manager should be given specific operational metrics in which to manage the day to day operations and otherwise have autonomy in the administration of his/her staff or budget. Considerable effort is necessary to establish those performance metrics initially and refine them as necessary in the future.

The Commissioner's office agrees that contracting with a new entity to manage MRF floor operations should result in improved efficiencies at the MRF.

The Commissioner's office is working to establish an enhanced safety program throughout the Division of Waste Management. The Risk Management report dated July 31, 2012 is currently under review with a goal of implementing near-term corrective action immediately.

<u>Follow-Up Detail Results:</u>
The MRF has a Plant Operations Manager and he is in charge of running the day to day operations. A Safety Officer has been hired and he is in charge of safety compliance at the plant. Additionally, the Safety Officer has been working with Risk Management to resolve the safety issues as noted in Finding #7. Prior to the end of fieldwork, the administration had advertised for a Plant Operations Manager. Taken as a whole, these steps appear to be sufficient to provide a management team capable of managing the MRF's operations.

This finding has been resolved. No management response required.

<u>Original Finding #3:</u> The MRF Needs an Accountant to Oversee its Financial Activities
Priority Rating: High

Condition:
The following accounting issues were noted during the course of the audit: 1) accounts receivable were not tracked throughout the fiscal year and no policy exists for NSF checks or late payment fees; 2) inventory was not reported to the Division of Accounting at fiscal year-end; 3)inventory was not reconciled to available production records; 4) affiliate payments (for other entities who bring their commodities to the MRF and share part of the sale proceeds) were deducted from revenue account 42512 rather than through an established liability account 24999; 5) as a result of item 4, affiliate payments were not always deducted from the proper fiscal year (i.e. June 2012 affiliate payments were deducted from 2013 recognized revenue) resulting in improper revenue recognition; 6) Nine out of 159 (5.7%) revenue transactions from fiscal years 2011, 2012 and 2013 were not properly accrued since some payments for shipments occurring in June were recorded as recognized revenue in the next fiscal year.

We brought items 2, 4, and 5 to the attention of management during fieldwork and steps have been taken to correct them, but many of these issues could have been avoided if an employee with a strong accounting background worked on-site at the MRF.

Effect:
At any given time, the LFUCG may not know the amount of payments due from commodity buyers, nor if the buyers' payments are past due. Additionally, if revenue is not properly recognized, a departure from generally accepted accounting principles exists. Although inventory is periodically counted to determine if a sale is warranted to create storage space for more recycled commodities, if inventory levels are linked to a

production report it can be maintained on a perpetual basis. Failure to report year-end inventory value to Accounting may be a violation of generally accepted accounting principles.

Recommendation:
An accountant should be hired for the MRF as soon as possible and given the task of implementing all accounting related recommendations included in this report. The accountant should make every effort to utilize any modules in PeopleSoft for Accounts Receivable tracking and immediately create term agreements with the buyers to establish time periods for payments and late fee charges, NSF charges, ownership of inventory, etc. We also recommend the MRF accountant report administratively to the MRF senior manager or the Director of Waste Management, but report operationally to the Director of Accounting.

Director of Waste Management Response:
I agree with the recommendation and believe that funds for an accountant should be included in the FY-2015 budget for DWM. An outside accountant has been hired to develop protocols and process to properly track the shipments, receivables and disbursements to outside haulers. The recommendations will be incorporated into the plan the accountant develops and PeopleSoft will be used where the applications are practical.

Acting Commissioner of EQ&PW Response:
The Commissioner's office agrees with the Internal Audit recommendation assuming that the recommendation is that while the accountant reports daily to offices located at the MRF, the accountant only receives work assignments and directives from the Department of Finance. For clarity, the current accountant is a contract employee, not a merit/non-merit position.

Follow-Up Detail Results:
The MRF hired an accountant who started in November 2014. The accountant has been instrumental in resolving the following issues noted in the prior audit:

1) **The accountant has devised a series of Excel spreadsheets to track accounts receivable transactions. A New Vendor Information Sheet has been devised which includes terms and conditions for payment. This vendor information will be sent to all vendors when shipping out materials for sale. All NSF checks are handled by the Division of Revenue and they automatically pursue collection on these checks. This portion of the finding has been resolved.**

The tracking of accounts receivable appears to be currently manageable using Excel spreadsheets. The administration may want to consider obtaining accounts receivable software at some point in the future to eliminate the manual receivables tracking process currently in use. This portion of the finding has been resolved.

2) The Director of Accounting indicated that the process for recording MRF ending inventory is still the same as in previous years (i.e., not reported). Subsequent discussion with the Commissioner of Finance & Administration has resulted in a decision to instruct MRF management to conduct a fiscal year-end physical inventory of recycled product that is ready for sale/delivery and to report the results of the physical inventory to the Director of Accounting.

   The Director of Accounting should confer with the external auditors on whether or not the results of the MRF physical inventory is material to the financial statements, and if so, how it should be reported.

3) Since the prior audit, the Plant Manager has reinstated the Daily Production Report to reflect total tonnage produced per hour. The Plant Manager also previously used a Daily Marketing Report to record the number of bales physically in the warehouse and loaded in trailers awaiting pickup by vendors (this report was in use during prior audit) for comparison against the Daily Production Report. However, there has been inconsistency in producing the Daily Marketing Reports because the Labor Works employee who normally completed the report has stopped working at the MRF. This has resulted in inconsistent reconciliation of physical inventory to the Daily Production Report. The Plant Manager has also drafted an SOP related to this process, but the SOP has not been approved or implemented.

   We recommend that the SOP guidelines be approved and implemented to provide for a consistent reconciliation between Daily Marketing Reports (physical inventory) and Daily Production Reports (production per book).

4) We determined that affiliate payments are being properly deducted from the liability account 24999 and the portion of revenue is being allocated to revenue account 42512. This portion of the finding has been resolved.

5) We pulled the FY 2015 revenue recognition activity log from PeopleSoft and noted that payments were posted and recognized as revenue for shipment of materials from May and June 2014. These payments were correctly

recognized as revenue in FY 2014. This portion of the finding has been resolved.

6) Shipments of recycled materials are being noted and booked by the accountant. The Division of Accounting posts to the liability account in PeopleSoft approximately 30 to 45 days after shipment, when payment has been received and the proceeds calculated by the accountant. This practice of revenue recognition by Accounting appears to comply with the current GASB guidelines. This portion of the finding has been resolved.

<u>Director of Waste Management Response:</u>
Plant Manager Barry Prater and Administrative Officer David Loney conducted the FY 2015 year-end physical inventory of baled commodities only at the end of the business day on June 30, 2015 and reported the information to the Division of Accounting. This resolves this portion of the finding. Please see the attached spreadsheet.

The attachment addresses the following:
1-Each commodity in baled form was counted by both Barry Prater and David Loney on June 30, 2015.
2-The count included the baled commodities on the floor as well as those located on partially loaded trailers in the yard.
3-They estimated the average weight of each commodity in pounds and tons. The average weight for each baled commodity was calculated by taking shipment weights in the month of June 2015 and dividing by the number of bales associated with that shipment weight.
4-The dollar value per pound or dollar value per ton for each commodity is based on June's pricing received for that commodity.
5-The total dollar value of ending inventory was calculated for each commodity by number of bales X average weight per baled x June 2015 dollar pricing per pound or ton, whichever is applicable.

Note: Dollar value is based on June prices for commodity sales. Mills and Brokers usually base prices for the entire month on market sheets distributed by the middle of the said month. In the case above, June prices were used as the July prices were not available for distribution until the middle of July.

David Loney provided a follow up on commodity prices to Accounting based on July prices, too. The prices are as follows:

Commodity	**July Average Pricing**
OCC	**$83.87 per ton**
SOW	**$35 per ton**
ONP	**$60.16 per ton**
Steel Cans	**$.06696 per pound**
Alum Cans	**$.5700 per pound**
PET	**$.1266 per pound**
NHDPE	**$.3900 per pound**
CHDPE	**$.2100 per pound**
Rigid Plastics	**$.0700 per pound**
# 3 through # 7 Rigid Plastics	**$.0400 per pound**

Although the finding is resolved, Internal Audit suggested that an accounts receivable software be considered in the future. David Loney contacted Computer Services regarding a software package.

On August 10, 2015 DWM staff (Eddie Dean, Damon Griggs, Richard Boone, Barry Prater, and David Loney) had a conference call with representatives from Mettler Toledo Scale to discuss their Accounts Receivable and Invoicing Modules of the Auto Scale software which DWM currently uses at the MRF. During this conference call, Mettler Toledo electronically presented how their AR and Invoicing modules interact with other Auto Scales' modules that the MRF currently uses. A follow-up meeting was conducted on September 1, 2015. The Division is moving forward with the software proposal and waiting on a quote from Mettler Toledo for customized forms. This will provide a software solution as recommended by Internal Audit.

Internal Audit also made the following recommendation: SOP guidelines be approved and implemented to provide for a consistent reconciliation between Daily Marketing Reports (physical inventory) and Daily Production Reports (production per book). Plant Manager Barry Prater has implemented guidelines for consistent reconciliation. This is resolved.

<u>Commissioner of EQ&PW Response:</u>
It would appear that Waste Management is now fully compliant with the audit finding.

<u>Original Finding #4:</u> MRF Security Issues Noted
Priority Rating: High

Condition:
During the audit several MRF employees expressed concerns over lax security measures. We were informed that several interior and exterior doors have never been rekeyed and there is no way to determine how many keys exist or who may possess them, including employees who no longer work at the MRF. We also noted that one door in the back of the plant is broken and cannot be locked.

The lower gate is secured with a pad lock having a combination code that is used by drivers needing access to the premises after hours to pick up drop loads ready for transportation. We also noted that cameras have been installed both outside the plant where the trucks are weighed as well as inside the plant floor. Additionally, a chain length fence surrounds the entire perimeter. The only vehicle access to the premises is through one of two gates: truck gate (mentioned above) and the all other vehicles gate (upper gate).

Effect:
The absence of accountability for plant keys is a significant concern. If the plant and administrative offices are not properly secured, items can be stolen from the facility. Of even greater concern is the risk that an unauthorized person could enter the plant after hours and fall into the recycling machinery, resulting in a catastrophic event that could subject the LFUCG to a lawsuit.

Recommendation:
MRF management should work with the Department of General Services to determine which doors need rekeyed and which doors may possibly need conversion to a card scan entry door. The door in the back of the plant should be repaired or replaced immediately. The lower gate used by drivers should be replaced with an electronic gate and each driver that needs access afterhours should be given an individual access code for entry. If possible, the gate should have memory capability to recall which code was used for entry.

<u>Director of Waste Management Response:</u>
Work orders were submitted in October with Fleet and Facilities Management to rekey the door locks and to repair the rear door. DWM management will explore the feasibility of an electronic gate and individual access code system.

<u>Acting Commissioner of EQ&PW Response:</u>
The Commissioner's office agrees with the recommendations of Internal Audit.

<u>Follow-Up Detail Results:</u>
We toured inside and outside the plant to note the improvements made, including the door at the rear of the plant and a card scanner used by employees at the front entrance. Through our review of work orders from the Division of Facilities Maintenance we were able to determine doors had been re-keyed. As noted in Original Finding #12 follow-Up Detail Results, management indicated that accurate reads of tonnage are being obtained. Since the process is now being effectively managed and accurate scale readings are now being obtained, management has decided not to install the electronic arm because of the possible increase in expense of operating and replacing the arm if damaged.

This finding has been resolved.

No management response required.

<u>Original Finding #5:</u> Excessive Amounts of Overtime Routinely Incurred by Certain MRF Employees
Priority Rating: High

Condition:
Over the past three calendar years (the scope of the audit) excessive amounts of overtime have been incurred by certain employees of the MRF. The table below includes an analysis:

Calendar Year	**# of employees analyzed and total MRF employees**	**% of OT to gross salary**	**Average hours OT worked per week**	**Total OT for MRF**	**Total OT for employees analyzed**
2011	5 of 16	26% to 41%	12-21 hrs	$104,774	$90,359
2012	7 of 19	27% to 38%	10-21 hrs	$140,470	$127,673
2013 through July 25, 2013	5 of 18	28% to 40%	13-21 hrs	$74,608	$65,957

During the audit we received an allegation stating that in 2013 there were two separate incidents where the production of recycled material was intentionally slowed down in order to incur additional overtime, and that senior MRF management was aware of the incidents but did not take corrective action. However, this would only account for a small portion of the overtime incurred in 2013.

It should also be noted that MRF's overtime budget for the past three fiscal years has been $50,000 each year, and each fiscal year the overtime budget has been significantly overspent. While this is an acceptable practice as long as the Division as a whole does not overspend its payroll budget, overtime in a specific section still warrants management oversight and control. It should also be noted that the Division did not overspend its overall payroll budget during any of the three fiscal years examined.

Effect:
While some overtime may be necessary, the amount of overtime incurred at the MRF should be investigated by upper management as it increases the amount of payroll costs, including fringe benefits paid by the LFUCG. In addition, given its unique operation and the type of manufacturing equipment housed within the MRF, if an employee consistently works extended hours five days a week and also works on Saturday to perform maintenance, accidents due to employee fatigue are more likely to occur. Management may also want to investigate whether the distribution of overtime at the MRF is equitable based on the skills and overtime work requests of its employees.

Recommendation:
Senior management should investigate the reasons for the overtime and develop solutions to eliminate excessive overtime. This could include introducing a second shift designed specifically to provide equipment maintenance, or perhaps staggering the shift of the current employees so everyone works a normal day without incurring excessive amounts of overtime.

Director of Waste Management Response:
The MRF has run without adequate staffing to provide maintenance and operational support for a number of years resulting in excessive overtime. An RFP has been issued and a respondent is under review to contract with an outside entity manage and staffing for floor operations related to maintenance, equipment operation and sorting activities should dramatically reduce the overtime. This should effectively eliminate the need for most staff overtime.

Acting Commissioner of EQ&PW Response:
The department concurs that excessive overtime should be addressed. The contract operations vendor noted in the division's response will provide the opportunity to drastically reduce overtime at the facility.

That being said, the department is currently focused on having a new management structure in place at the MRF so that the overtime cost reduction is not simply replaced with increased contract operations costs.

Over the next 60 days, the department expects to have resolved remaining questions with the contract operations vendor so that an operations contract can be submitted for council approval and mitigation of the excessive overtime can begin.

Follow-Up Detail Results:
The Plant Manager stated overtime is being monitored, but has not been eliminated due to the nature of the operation. We noted that the total overtime paid to all MRF employees from July 1, 2014 through March 15, 2015 (8.5 months) was $39,832. This is a 53% reduction from the $74,608 total overtime paid from January 1, 2013 through July 25, 2013 (approximately 7 months) as noted in the previous audit. In our opinion, the reduction in overtime noted during our review indicates a reasonable effort is being made to contain overtime costs.

This finding has been resolved. No management response required.

Original Finding #6: CAO Policy #40 Deposit Violations Noted
Priority Rating: High

Condition:
The following CAO Policy #40 violations were noted during the test of deposits: 1) the MRF lacks a segregation of duties over mail processing and deposits because the same employee opens the mail and also prepares the deposit; 2) deposits are not properly secured prior to deliver to the Division of Revenue; and 3) there is no mail log to record when a check is actually received in the mail, making it impossible to determine with certainty that deposits are being made in timely manner.

Effect:
Deposits are subject to misappropriation if a proper segregation of duties is not established and deposits are not secured. Management cannot determine if checks are held for a lengthy period of time before processing and depositing if a mail log does not exist.

Recommendation:
Mail should be opened and checks logged by an employee who is not responsible for making the deposit. A locking device such as a small safe should be obtained to secure payments not sent to the Division of Revenue on the same day they are received. This is

particularly important because some of the checks received from commodity buyers are for very substantial amounts.

__Director of Waste Management Response:__
An outside accountant has been hired to develop protocols and process to properly track the shipments, receivables and disbursements to outside haulers. The recommendations will be incorporated into the plan the accountant develops. A small safe to store deposits is being ordered.

__Acting Commissioner of EQ&PW Response:__
The department concurs with the division's response and also recommends that the action plan be a component of recommendations for Finding # 3.

__Follow-Up Detail Results:__
The MRF no longer receives and/or deposits money. The Division of Revenue started receiving and depositing checks from MRF customers in or around August 2014. The payments appear to be properly posted to the MRF accounts.

This finding has been resolved. No management response required.

__Original Finding #7:__ Issues Noted by Division of Risk Management Not Addressed
Priority Rating: High

Condition:
As a result of the initial walkthrough of the MRF we noted what appeared to be violations of safety rules and notified the Division of Risk Management. We were informed that Risk Management had spent a significant amount of time addressing safety issues at the MRF, and as recently as October 2012 had issued a report with several findings.

Upon our request, Division of Risk Management personnel re-inspected the MRF and issued another safety violations report in July 2013. The July 2013 report contained two new findings and noted that eleven of the twelve prior findings from the 2012 report were only partially addressed or had not been addressed at all.

Effect:
When safety violations or observations are brought to the attention of any Division, especially one with unique characteristics and challenges such as the MRF, every effort should be made to correct them in a timely manner. This can greatly reduce the potential for a catastrophic work place event that could subject the LFUCG to a lawsuit.

Recommendation:
The safety violations noted by the Division of Risk Management should be promptly corrected. Due to the fact eleven of the twelve safety violations noted in the 2012 report were only partially addressed and in some instances were not addressed at all, senior management should oversee the correction of these issues.

Director of Waste Management Response:
The Plant Manager and the DWM's new Safety Manager are addressing the items in the Risk Management report. They indicated that all items will be addressed by mid-February and a formal response will be sent.

Acting Commissioner of EQ&PW Response:
The department concurs with the division's response but currently believes that full resolution of all report recommendations by mid-February is not attainable.

Two Division of Waste Management employees who would have had key roles in the implementation of corrective actions resigned in mid-December 2013. With an acting division director and acting program manager assuming MRF daily operations in late December, the department believes that the division can begin implementation of corrective actions immediately and should issue progress reports to the department on a monthly basis.

Follow-Up Detail Results:
The Safety Officer for the MRF has worked with Risk Management to correct the outstanding issues. We were provided a detailed spreadsheet with all outstanding issues and the corrective action taken. It appears that all items had been resolved prior to the MRF roof being blown off in November 2014. There was an alarm system installed to warn drivers to stop in case they leave their tailgates up prior to exiting the tipping floor area. However, when the roof blew off, these alarms were damaged and need to be re-installed. As of the last day of fieldwork, the purchase orders were in process to complete these repairs.

This finding has been resolved. No management response required.

<u>Original Finding #8:</u> MRF Contractors Providing Outside Services Should be Monitored for Compliance
Priority Rating: High

Condition:
A significant amount of work at the MRF is performed by outside labor services. According to pages 27 and 28 of the temporary labor services contract, the vendor supplying day labor must have a permanent, full-time, on-site employee to act as supervisor over the temporary labor force. The contract states this person must have supervisory experience and skills necessary to manage up to 40 workers, and must also have certain qualifications. This person should also serve as the primary on-site contact/liaison for LFUCG personnel to facilitate day to day operations. Additionally, this person will be billed at $12.49 per hour as compared to $10.37 per hour for general labor. We tested twelve temporary labor service invoices from FY 2013 and only one included charges at a supervisor rate, indicating the vendor did not supply a supervisor as required.

Effect:
If a temporary labor supervisor isn't provided as required by the contract, other essential LFUCG personnel located at the MRF must then spend time supervising the temporary labor force rather than performing their other responsibilities. This is a potential breach of contract with the LFUCG that may also result in increased personnel costs for the LFUCG.

Recommendation:
The senior MRF manager recommended in Finding #2 should be given the task of overseeing contracts for the MRF to ensure appropriate compliance. In the absence of this provision, the Director of Waste Management should appoint this task to an existing employee. The Department of Law should be contacted about the potential breach of contract for advice on how to address this issue.

<u>Director of Waste Management Response:</u>
An RFP has been issued and a response is under review that will allow DWM to contract with an outside entity manage and staffing for floor operations related to maintenance, equipment operation. This business model of this company exclusively focused on the operations of MRFs and they are currently providing these services to many of the large MRFs across the United States. Securing their services will allow DWM management staff more time to focus on the oversight of the contract.

<u>**Acting Commissioner of EQ&PW Response:**</u>
The Department of Law has been contacted to investigate a potential breach of contract but it is the department's observation that such a claim could be compromised by what appears to be a cognizant failure by MRF management staff to enforce certain terms of the contract.

In conjunction with the response provided in Finding #5, the department expects to conclude negotiations with a new contract operations vendor within the next 60 days. Key to the success of this vendor is a revamped internal management structure designed to monitor contract performance and costs so that underperformance and excessive overtime can be mitigated.

<u>**Follow-Up Detail Results:**</u>
Labor Works is currently the temporary labor services provider for the MRF. The contract stipulates that an on-site supervisor with a 30 hour general industry OSHA certification be provided. Several employees with the OSHA certification have been placed at the MRF by Labor Works in the supervisory role, but were not a good fit for this unique industry. Since October 2014, Labor Works has been training an employee to assume the on-site supervisory role, and MRF management indicated this employee is doing well. Labor Works will now initiate OSHA training for this employee. In the interim, the Labor Works manager of the LFUCG contract has the required OSHA training and is providing assistance as needed. The Plant Manager is overseeing the contract with Labor Works.

This finding has been resolved. No management response required.

<u>Original Finding #9:</u> Updated Contracts Needed With BRRC and Other Affiliates
Priority Rating: High

Condition:
For several years, the MRF has employed the services of the Bluegrass Regional Recycling Corporation (BRRC) to act as a broker for commodities sales, excluding aluminum cans. BRRC manifests used at the MRF indicate the type and amount of commodity sold, and BRRC negotiates the price, typically on a monthly basis. BRRC receives payment from the buyer, deducts a $7 service fee for each ton sold on behalf of the LFUCG and affiliates, and then pays the LFUCG and affiliates their share of the revenue. In addition, multiple affiliates bring their recycled commodities directly to the MRF for processing and subsequent sale to buyers. LFUCG receives a $35 per ton processing fee from each affiliate as part of their revenue share.

Contracts either could not be located or otherwise do not exist between LFUCG and BRRC or the affiliates. It is our understanding discussions concerning the elimination of BRRC as a broker are occurring. However, even if BRRC is eliminated, affiliates will continue to bring their recyclables to the MRF for processing and the need for contracts with those affiliates will continue to exist.

Effect:
Properly executed contracts provide performance specifications, reduce potential misunderstandings between parties, and limit legal liabilities.

Recommendation:
If the MRF continues to use the broker services of the BRRC, a contract between the two entities should be established which outlines fees, charges, expectations concerning market prices, any other services offered by BRRC, and defines the legal duties of both the LFUCG and the BRRC. If the MRF eliminates the BRRC as broker, the accountant recommendation in Finding #3 will take on greater significance as the accountant will likely be needed to work with the Commodities Marketing Manager to manage the sale of aluminum cans and the other commodities.

Regardless of the decision concerning BRRC, contracts are needed with all current and future affiliates that define items such as fees charged by LFUCG, sharing in inventory losses resulting from fire or damage, penalties imposed by LFUCG should an affiliate load contain a disproportionate share of glass or trash, limit LFUCG's legal liabilities, etc.

Director of Waste Management Response:
A draft memorandum of agreement has been prepared and is being sent to the Department of Law for review. The MOA will address the issues mentioned in the recommendation above. The plan is to present the agreement to the outside haulers after the proper protocols have been established per the outside accountant's report.

Acting Commissioner of EQ&PW Response:
The department concurs with the division's recommendation. The Department of Law's review of the MOA is expected to be complete in the very near future. The schedule for completing the accounting protocols is 45 days after receipt of the MOA from Law.

<u>Follow-Up Detail Results:</u>
LFUCG terminated its business arrangement with BRRC on June 30, 2014. We noted that agreements with the following affiliates were on file at the MRF:

Republic Services of Kentucky, LLC - completed w/signature
Anderson County Fiscal Court - completed w/signature
City of Frankfort - completed w/signature
Winchester Municipal Utilities - completed w/signature
University of KY - completed w/signature
City of Versailles - completed w/signature
Legacy Carting, LLC (does business for several others) - completed w/signature
Jessamine County - completed w/signature
Madison County - completed w/signature

It appears that most of the contracts were signed between July and August of 2014. However, the contracts have not been executed by the Mayor as required by LFUCG Charter 5.04.

The affiliates Rumpke, Advanced Disposal, and ITS- Innovative Trash Service still do not have contracts with the MRF.

Contracts with Rumpke, Advanced Disposal, and ITS- Innovative Trash Service should be obtained. All MRF contracts should be executed by the Mayor as required by LFUCG Charter 5.04.

<u>Director of Waste Management Response:</u>
The MOUs were approved by Council on November 13, 2014 per Resolution 623-2014 which is attached.

All contracts, except Anderson County, have been signed and executed by the Mayor and are on file at the Council Clerk's Office. Anderson County opted out of their contract in lieu of their franchise agreement with Republic; therefore, we pay Republic for all materials received from Anderson County. A summary sheet is attached with a list of all signed contracts which have also been placed in a binder at the Materials Recovery Facility.

Advanced Disposal and ITS have minimal volume and are classified as non-paid affiliates. They are separated from citizen load on the monthly report only due to reporting requirements to the Commonwealth of Kentucky. This has now been resolved.

<u>Commissioner of EQ&PW Response:</u>
It appears that Waste Management is now fully compliant with the audit finding.

<u>Original Finding #10:</u> May and June 2013 Reports From BRRC for Commodities Sold Contained Discrepancies
Priority: High

Condition:
While reviewing May and June 2013 marketing reports generated by the BRRC to summarize activities, including the amount of revenue LFUCG and each affiliate received for the preceding month's shipments, we noted the broker fee received by BRRC was based on inbound tonnage for the LFUCG and all affiliates rather than outbound tonnage sold by BRRC resulting in an overpayment of broker fees to BRRC of $9,341 for LFUCG's portion.

We also noted that only 200 tons of glass (in May 2013) and 100 tons of glass (in June 2013) were charged back to affiliates at $15 per ton as part of the LFUCG processing fee when the total tons of glass was actually 651.78 tons and 462.49 tons, respectively. Upon inquiry, we discovered the May report was the first report where all affiliates were charged for glass shipments. Previously, only three affiliates were charged a processing fee for glass under the assumption no other affiliates had glass mixed in with their inbound loads, and no affiliates were charged for trash processing until the May 2013 report was issued.

Glass has a limited market and LFUCG currently pays to ship all glass to a vendor in Dayton, Ohio at a cost of $15 per ton, a practice started in January 2013. Prior to January 2013, LFUCG paid $10 per ton to ship about one-half of the glass to a vendor, and therefore a significant amount of glass accumulated on-site since only about one-half was shipped. MRF management decided to charge affiliates for only 200 and 100 tons respectively, in the first two "new" reports (May and June 2013) since this was the first time most affiliates were charged for glass shipments. The Director of Waste Management could not recall if he was informed of this decision. Affiliates were charged the full amount for their glass beginning in July 2013.

Effect:
LFUCG was bearing a larger burden of the cost for glass and trash than necessary.
The MRF was also overcharged broker fees of $9,341. BRRC refunded the MRF on the next BRRC report after we brought this to MRF management's attention.

Recommendation:
All future BRRC reports should be carefully analyzed for proper calculations and revenue sharing. Any decisions concerning charges to affiliates should be approved by senior management and properly documented.

Director of Waste Management Response:
A two deep review of the commodity transaction is being established with both the Commodity Marketing Manager and the Accountant being involved in the review.

Acting Commissioner of EQ&PW Response:
The department concurs with the division's response and also recommends that the action plan be expanded such that the recommended Plant Manager position (Finding # 2) has an accountable role in commodity transaction report accuracy.

Follow-Up Detail Results:
LFUCG is no longer conducting business with BRRC. Glass tonnage fees are being charged to affiliates.

This finding has been resolved. No management response required.

Original Finding #11: Production Reports Should be Reinstated
Priority Rating: High

Condition:
MRF personnel completed daily production reports using Excel and submitted them to the Division Director and others between February 16, 2010 and June 24, 2013 (the last date a production report was prepared and submitted). Beginning on June 25, 2013, the Program Manager Senior completely overhauled the report format. The employee responsible for completing and submitting the reports noticed issues with the new report format and on July 17, 2013, sent an email to the Program Manager Senior asking for assistance. On August 28, 2013, the Program Manager Senior sent an email stating corrections to the report had been made. On September 5, 2013 the employee responsible for completing and submitting the reports once again expressed concerns over the validity of the reports. On September 23, 2013 the Program Manager Senior sent another email stating additional corrections had been made. As of the end of field work, upper level management had not inquired as to why a production report hasn't been sent since June 24, 2013.

Between the issuance of the September 5, 2013 and September 23, 2013 emails, we met with the Commodities Marketing Manager, the Scale Operator, and the Public Service

Supervisor Senior (plant operations manager) to discuss the issues with the production reports. At that meeting, the Public Service Supervisor Senior instructed the Scale Operator to use the previous report format and scrap the overhauled report. Since an email was sent by the Program Manager Senior afterwards about using the overhauled production report, conflicting directives have been given to the employee.

Effect:
Given the unique characteristics of a manufacturing operation, productions goals should be established and every attempt made to reach those goals. Production goals for the MRF are 20 tons per hour of baled commodities, or 84% efficiency, which is considered normal. Without the production report, it would be difficult to determine if this goal is being met.

Recommendation:
A senior management individual (perhaps at the Deputy Director level) should be given the task of getting the production reports back on schedule. A decision is needed immediately on which report to use and this information should be provided to the employee responsible for completing and submitting the reports. The senior management individual (perhaps at the Deputy Director level) should also monitor the reports to make sure goals are set and are being met. Otherwise, the Director of Waste Management should assign this task to another employee.

Director of Waste Management Response:
Production reports were returned to their original format last month. Review will be part of the Resource Management's Program Manager Senior's responsibilities.

Acting Commissioner of EQ&PW Response:
The department concurs with the division's response regarding the production report format. The department concurs with the division's response regarding the review responsibility only as an interim measure.

As stated previously, the department recommends the hiring of a Plant Manager who possesses the skill set necessary to manage a manufacturing facility such as the MRF. The Program Manager Sr. referenced in Condition #11 has resigned and an acting Program Manager Sr. is currently in place as upper level management further evaluates the situation and develops an action plan moving forward.

The development of a firm schedule for completing the Plant Manager hiring process is difficult at this time due to the division director vacancy. It is the department's recommendation that recruitment of the division director come first so that the new director can play an active role in the selection of a Plant Manager. The advertisement for the vacant division director was posted January 15, 2014 and is scheduled to close February 16, 2014.

<u>Follow-Up Detail Results:</u>
Production reports were reinstated on October 28, 2013 and are being sent to the Plant Manager and the Director.

This finding has been resolved. No management response required.

<u>Original Finding #12:</u> Additional Issues Noted During the Audit
Priority: High

Condition:
During discussions with MRF employees, two additional items were noted that warrant being included in this report: 1) voided BRRC manifests are sent back to BRRC but no record of them is kept; and 2) trucks that have Radio Frequency Identification (RFID) don't always stay on the scale long enough for the weight to register in the computer.

Regarding the first issue, manifests are the primary source of information for shipment of commodities from the MRF. Currently, as noted in a previous finding, BRRC acts as the broker for LFUCG and all other affiliates for all commodities sold excluding aluminum cans. LFUCG uses its own manifest for aluminum can shipments. Manifests should be used in sequential order, and any unused manifests should be voided with a record of this action retained. We informed the Scale Operator of this issue during the audit, and a list of voided BRRC manifests is now being kept.

Regarding the second issue, the scale management system currently used at the MRF was updated in June 2010 and has the capability to read and upload the owner and weight of any RFID truck that drives across the scale, provided the driver stays on the scale long enough. A red and green light was installed that visually alerts the driver on when to stop and when to drive off the scale. However, drivers are moving off the scale before the light turns green.

Effect:
Shipments can be lost if manifests are not accounted for properly. The daily inbound and outbound tonnage, which is calculated using the weight of the trucks, can be incorrect.

Recommendation:
A copy of all voided manifests being sent back to BRRC should be retained at the MRF, along with any manifests voided by the LFUCG. An electronic arm should be installed on the scale that indicates when it is safe for the driver to move off the scale.

<u>Director of Waste Management Response:</u>
It is the intention of DWM management to internalize the services of the BRRC after the appropriate protocols have been established for managing the processes of shipping receivables and disbursements. This will address the issue of the voided manifests. DWM staff will explore the feasibility of installing an automated arm at the truck scale.

<u>Acting Commissioner of EQ&PW Response:</u>
The acting division director is pursuing Internal Audit's recommendations.

<u>Follow-up Details</u>
Since the business relationship with Bluegrass Regional Recycling Corporation (BRRC) ended on June 30, 2014, manifests have been maintained internally. We obtained a list of all manifest numbers and noted all voided manifests are maintained at the MRF.

We conducted a walkthrough of the scale operation. During our observation, trucks entered the gate and stopped on the scale. The Administrative Specialist communicates via speaker and informs the driver when they are cleared to move forward. Management indicated that accurate reads of tonnage are being obtained. Since the process is now being effectively managed and accurate scale readings are obtained, management has decided not to install the electronic arm because of the possible increase in expense of operating and replacing the arm if damaged.

This finding has been resolved. No management response required.

FY 2015 Physical Inventory taken by B. Prater and D. Loney on June 30, 2015 for the MRF
Baled Commodities Only

Commodity	Symbol	# of Bales	Estimated Average Weight Per Bale in Pounds	Estimated Average Weight Per Bale in Tons	$ Value per Pound based on June 2015 Pricing	$ Value per Ton based on June 2015 Pricing	$ Value of June 30 2015 Ending Inventory based on June 2015 Pricing
Cardboard--floor	OCC	1	1,686.00	0.843		$ 73.42100	$ 61.894
Cardboard--trailer	OCC	11	1,686.00	0.843		$ 73.42100	$ 680.833
Sorted Office Paper--floor	SOW	147	1,776.00	0.888		$ 35.00000	$ 4,568.760
Sorted Office Paper--trailer	SOW	0	1,776.00	0.888		$ 35.00000	$ -
Newspaper--floor	ONP	69	1,781.00	0.891		$ 60.94200	$ 3,744.551
Newspaper--trailer	ONP	0	1,781.00	0.891		$ 60.94200	$ -
Aluminum Cans--floor	UBC	49	952.00	0.476	$ 0.55000		$ 25,656.400
Aluminum Cans--trailer	UBC	0	952.00	0.476	$ 0.55000		$ -
Steel Food Cans--floor	SFC	13	2,193.00	1.097	$ 0.07545		$ 2,151.004
Steel Food Cans--trailer	SFC	0	2,193.00	1.097	$ 0.07545		$ -
Soda/Pop Bottles--floor	PETE	60	1,324.00	0.662	$ 0.12000		$ 9,532.800
Soda/Pop Bottles--trailer	PETE	0	1,324.00	0.662	$ 0.12000		$ -
Milk Jugs--floor	NHDPE	17	1,489.00	0.745	$ 0.37500		$ 9,492.375
Milk Jugs--trailer	NHDPE	0	1,489.00	0.745	$ 0.37500		$ -
Colored Jugs--floor	CHDPE	12	1,610.00	0.805	$ 0.25000		$ 4,830.000
Colored Jugs--trailer	CHDPE	0	1,610.00	0.805	$ 0.25000		$ -
LG, Rigid Plastics--floor	Rigid	46	1,388.00	0.694	$ 0.07000		$ 4,469.360
LG, Rigid Plastics--trailer	Rigid	0	1,388.00	0.694	$ 0.07000		$ -
# 3 thru #7 Plastics--floor	Rigid	22	1,427.00	0.714	$ 0.04000		$ 1,255.760
# 3 thru #7 Plastics--trailer	Rigid	0	1,427.00	0.714	$ 0.04000		$ -
					Total FY 2015 Ending Inventory $ Value--all commodities		**$ 66,443.737**

RESOLUTION NO. 623 2014

A RESOLUTION AUTHORIZING THE MAYOR, ON BEHALF OF THE URBAN COUNTY GOVERNMENT, TO EXECUTE STANDARDIZED MEMORANDA OF AGREEMENT WITH RECYCLING AGENCIES, FOR PROCESSED MATERIALS AT LFUCG'S MATERIALS RECOVERY FACILITY.

BE IT RESOLVED BY THE COUNCIL OF THE LEXINGTON-FAYETTE URBAN COUNTY GOVERNMENT:

Section 1 - That the Mayor, on behalf of the Lexington-Fayette Urban County Government, be and hereby is authorized to execute the standardized Memoranda of Agreement, which are attached hereto and incorporated herein by reference, with recycling agencies, for LFUCG's Materials Recovery Facility.

Section 2 - That this Resolution shall become effective on the date of its passage.

PASSED URBAN COUNTY COUNCIL: November 13, 2014

MAYOR

ATTEST:

CLERK OF URBAN COUNTY COUNCIL

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AFFILIATES SUMMARY PAGE

- ***RESOLUTION NO. 623-2014..***

*********All affiliates include Exhibit A & B**********

- *Central Kentucky Hauling………………………………………………………………*
- *City of Versailles…………………………………………………………………………*
- *City of Frankfort………………………………………………………………………....*
- *Franklin County Fiscal Court……………………………………………..........*
- *Jessamine County…………………………………………………………..............*
- *Legacy Carting, LLC………………………………………………………….............*
- *Madison County…………………………………………………………………………*
- *Republic Services……………………………………………………………………...*
- *Rumpke of Kentucky………………………………………………………………...*
- *University of Kentucky……………………………………...............................*
- *Winchester Municipal Utilities…………………………………………………….*
- *Woodford County Fiscal Court…………………………………………………….*