JEFFERSON WELLS
A Manpower Company

City of Houston

Annise D. Parker
City Controller

Solid Waste Management Department

Contract Compliance Review of Republic Waste Services of Texas, Ltd. and BFI Waste Systems of North America, Inc.

Report No. 06-08
April 2006

OFFICE OF THE CITY CONTROLLER
CITY OF HOUSTON
TEXAS

ANNISE D. PARKER

April 7, 2006

The Honorable Bill White, Mayor
City of Houston, Texas

SUBJECT: Solid Waste Management Department
Contract Compliance Review of Republic Waste Services of Texas, LTD.
and BFI Waste Systems of North America, Inc. (Phase 1 - Report No. 06-08)

Dear Mayor White:

In accordance with the City's contract with Jefferson Wells International (JWI), JWI has completed a contract compliance review of the Service Contract for Collecting and Transporting Residential Refuse, Heavy Trash, and Yard Waste between the City of Houston and Republic Waste Services of Texas, LTD. (Republic Waste) and of the Solid Waste Disposal Services Agreement between the City and BFI Waste Systems of North America, Inc. (BFI). The primary objectives of the engagement were to:

- Assess the level of compliance with the contractual terms and conditions of the Republic Waste collection and transportation agreement and the BFI disposal agreement.
- Determine whether fees paid separately by the City to Republic Waste and BFI under their respective agreements were paid according to the contractual terms and conditions.
- Review the reasonableness of the methodology utilized by Moriarty Leyendecker (of counsel to the City) to prepare an initial reimbursement request of identified overcharges resulting from actions taken by Republic Waste.

The report, attached for your review, identified significant deficiencies in the documentation that is contractually required to be maintained by Republic Waste to support the work they performed for the City and the waste disposal charges that are billed to the City's account.

Prior to commencing the review, Republic Waste management admitted to delivering non-City residential solid waste to the BFI landfill. These improper deliveries resulted in BFI charging the City for the disposal, which were overcharges to the City. JWI conducted procedures to determine the amount of the overcharge. Republic Waste proposed a method to estimate the potential overcharge in which Republic Waste electronic data and original hardcopy route sheets along with BFI generated delivery tickets would be utilized to specifically identify deliveries resulting in inappropriate disposal charges to the City's account at BFI. Due to limitations of available supporting documentation, JWI was unable to validate the reasonableness of the Republic Waste calculations and the actual amount of overcharges.

Additionally, the City retained the law firm of Moriarty Leyendecker, PC to determine the amount of overcharges to the City and to facilitate the negotiation of the recovery from Republic Waste. As a result of their review, JWI believes that the overcharge estimation of $2.0 million developed by the law

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firm is a reasonable estimate. JWI's review did not identify any other quantifiable scenarios that indicated potential overcharges were either less than or in excess of $2.0 million.

The results and recommendations identified during the review are included in the body of the report. Draft copies of the matters contained in the report were provided to department officials. The views of the responsible department officials as to actions being taken are appended to the report as Exhibit 1.

We appreciate the cooperation extended to the JWI engagement team by department and contractor personnel during the course of the review.

Respectfully submitted,

Annise D. Parker
City Controller

xc: City Council Members
Anthony Hall, Chief Administrative Officer
Michael Moore, Chief of Staff, Mayor's Office
Buck Buchanan, Director, Solid Waste Management Department
Judy Gray Johnson, Director, Finance and Administration Department

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April 7, 2006

Controller Annise D. Parker
City Controller
City of Houston
901 Bagby, 8th Floor
Houston, TX 77002

Dear Controller Parker:

We have completed our contract compliance review of the agreements between the City of Houston - Solid Waste Management Department and Republic Waste Services of Texas, LTD and BFI Waste Systems of North America, Inc., respectively, as outlined in our engagement letter dated December 13, 2005 under Contract No. 56545.

Our observations and recommendations noted during the performance of the review are presented in this report. Our procedures, which accomplished the project objectives, were performed through March 24, 2006 and have not been updated since that date. Our observations included in this report are the only matters that came to our attention based on the procedures performed.

All data used during this review was obtained from representatives of the Solid Waste Management Department or from the contracted service providers, Republic Waste Services and BFI Waste Systems. Our work does not constitute an audit conducted in accordance with generally accepted auditing standards, an examination of internal controls or other attestation or review services in accordance with standards established by the American Institute of Certified Public Accountants (AICPA). Accordingly, we do not express an opinion or any other form of assurance on the reporting or compliance of the Solid Waste Management Department.

Jefferson Wells is pleased to have assisted the City Controller, and we appreciate the cooperation received during this engagement from the Solid Waste Management Department as well as you office.

This report is intended solely for the information and use of the City, the Solid Waste Management Department and the City Controller's Office, and is not intended to be used for any other purpose.

Eric Bruce
Director, Internal Controls

Table of Contents

EXECUTIVE SUMMARY.....1

Engagement Objectives and Scope.....1

Background.....1

Results.....2

Summary of Key Recommendations.....4

RESULTS AND RECOMMENDATIONS.....6

EXHIBIT I: Views of Responsible Officials

EXECUTIVE SUMMARY

Engagement Objectives and Scope

Jefferson Wells completed a contract compliance review on the Service Contract for collecting and transporting Residential Refuse, Heavy Trash, and Yard Waste between the City of Houston ("the City or City") and Republic Waste Services of Texas, LTD ("Republic") and on the Solid Waste Disposal Services Agreement between the City and BFI Waste Systems of North America, Inc ("BFI").

The primary objectives of this review were to:

- Assess the level of compliance with the contractual terms and conditions of the Republic collection and transportation agreement and the BFI disposal agreement.
- Determine whether fees paid separately by the City to Republic and BFI under their respective agreements were paid according to the contractual terms and conditions.
- Review the reasonableness of the methodology utilized by Moriarty Leyendecker (of counsel to the City) to prepare an initial reimbursement request of identified overcharges resulting from actions taken by Republic.

The scope of services that were provided by Jefferson Wells included:

- Reviewing contractual terms to determine if fees paid by the City to Republic and BFI were paid according to established terms.
- Reviewing processes and procedures utilized by Republic and BFI for the recording and recordkeeping of activities associated with the collection, transporting and disposal of residential solid waste for the City.
- Reviewing documentation from Republic and additional supporting documentation from BFI to determine the validity of per-haul quantities delivered to the BFI McCarty Road Landfill ("the BFI landfill").
- Analyzing invoices and supporting documentation from BFI to document and quantify charges for waste disposal by Republic on City non-scheduled collection days.
- Reviewing the application of tare weights used for calculation of net waste quantities delivered by Republic and their subcontractor to the BFI landfill.

Background

The Agreement between the City and Republic was effective July 1, 2000 with a term of five (5) years ending on June 30, 2005. The Agreement provides for two (2) twelve-month extensions at the discretion of the City. The "not to exceed" contract value approved by the City for this Agreement is $56,826,603.27 and Republic has billed the City $42,495,792.59, or 75% of the total value, inception-to-date through November 30,

2005. At the time of this review the first twelve-month extension was in effect and Republic's work was ongoing. Republic Waste has subcontracted a portion of the collection agreement to a certified M/WBE contractor, A&T Environmental Services ("A&T"). A&T's subcontract has been in place since the inception of the primary collection agreement between the City and Republic.

The Agreement between the City and BFI was effective July 1, 1998. The Agreement, as currently amended, remains in effect through June 30, 2023, or until such time as the McCarty Road Landfill, Whispering Pines Landfill and Blue Ridge Landfill all close to delivery of City Waste, whichever date is sooner, unless sooner terminated under the Agreement. The "not to exceed" contract value approved by the City for this agreement is $154,000,000 and BFI has billed the City $66,395,667.27, or 43% of the total value, inception-to-date through November 30, 2005. At the time of this review, work under this agreement was ongoing.

Republic invoices the City monthly based on a contractually established rate per residential service unit times the number of residential service units collected, as approved in advance each month by the Solid Waste Management Department ("SWMD"). Republic does not invoice the City for specific volumes or weight of trash collected, except under certain special circumstances such as storm debris cleanup periods. The City in turn does not reimburse Republic for the disposal of residential waste collected – the disposal falls under the separate agreement between the City and BFI.

BFI invoices the City monthly based on contractually established rates for compacted (based on tonnage) and non-compacted (based on cubic yards) residential waste delivered to the BFI landfill. BFI invoices do not include any component for the collection or transportation of the waste being disposed of.

Results

1. **Assessment of the level of compliance with the contractual terms and conditions of the Republic collection and transportation agreement and the BFI disposal agreement**

   While internal controls employed by Republic were effective for generating accurate invoices for the work performed and for maintaining a consistent level of customer service in operating the routes contracted from the City, significant deficiencies were identified in the documentation that is contractually required to be maintained by Republic to support the work they performed for the City and the waste disposal charges that are billed to the City's account. Article XXXV of the City of Houston / Republic Waste contract requires that Republic maintain records to support the work performed for the City. While recordkeeping appeared to be adequate in recent months (May 2005-October 2005), significant recordkeeping deficiencies were identified for earlier months. Only limited supporting records for the first eighteen

months of the contract period were available to be presented to Jefferson Wells as requested to support our review of the work performed by Republic. For 2002-2004, better recordkeeping was maintained, but these records were not sufficient in detail or existence to allow us to conclusively identify the rate at which Republic may have collected non-City waste that was later billed to the City's account by BFI under the disposal agreement.

Further, the deficient recordkeeping over much of the period of the contract is a material weakness in Republic's internal control structure and is not in compliance with the Inspections, Reviews and Enforcement clause (Article XXXV) of the contract between the City of Houston and Republic Waste.

In the areas where detailed documentation was available for our review, we noted the following deficiencies/contract non-compliances in the agreement between the City and Republic:

- Documentation for Republic's subcontracted waste hauler, A&T Environmental Services, was not maintained to support all of A&T's activities.
- Residential refuse deliveries for the City by Republic and A&T were made to BFI on Wednesdays, Saturdays and Sundays, which are typically days in which residential refuse is not collected for City residents.

Additionally, we also identified the following deficiencies with the administration of the City of Houston / BFI disposal contract:

- Tare weights in the BFI truck scale system for Republic vehicles delivering waste to BFI were found to be incorrect.
- BFI scales used to weigh Republic vehicles delivering waste to BFI were not calibrated semi-annually as required in the City of Houston / BFI disposal contract.

2. Determination that fees paid by the City to Republic and BFI under their respective agreements were in accordance with the contractual terms and conditions

Prior to commencing our review, Republic admitted to delivering non-City residential solid waste to the BFI landfill. These improper deliveries resulted in BFI charging the City for the disposal, which were overcharges to the City. We found no evidence indicating that BFI knowingly overcharged the City. BFI merely charged the City's account for disposal of solid waste delivered by Republic as City waste in the normal course of daily operations. We employed procedures to determine the amount of the overcharge. Republic proposed a method to estimate the potential overcharge in which Republic electronic data and original hardcopy route sheets along with BFI-generated delivery tickets would be utilized to specifically identify deliveries resulting in inappropriate disposal charges to the City's account at BFI. Republic

used this methodology in performing their own review of internal records after being made aware of the allegations that they had improperly disposed of non-City waste on the City's account. Republic's internal review covered the period from May through October 2005. Republic calculated the rate of inappropriate disposal charges over this period and then extrapolated the calculations over the remainder of the contract period (July 2000 to April 2005) to develop their estimate of the overcharges to the City.

Due to limitations of available supporting documentation for the period to which Republic applied the rate as discussed in this summary and throughout this report, we were unable to validate the reasonableness of the calculations as they relate to the period July 2000 through April 2005. Additionally, due to the same limitations, we were unable to apply accepted auditing procedures to determine the actual amount of overcharges.

3. **Reasonableness of the methodology utilized by Moriarty Leyendecker**

As a result of allegations confirmed by Republic Waste that the City of Houston had been charged for disposal of residential solid waste that was collected by Republic Waste from non-City residences, the law firm of Moriarty Leyendecker, PC ("Moriarty") was retained by the City to determine the amount of overcharges to the City and to facilitate the negotiation of any recovery. As a result of our review, we believe that the overcharge estimation of $2,000,000 developed by Moriarty is a reasonable estimate. Although we believe that the Moriarty estimate has limitations and that there may be better methodologies available for developing a more accurate estimate, adequate supporting documentation from Republic was not available to allow us to conclusively validate a more accurate methodology. Therefore, our review did not identify any other quantifiable scenarios that indicated potential overcharges were either less than or in excess of $2,000,000.

Summary of Key Recommendations

The Solid Waste Management Department Should:

- Require Republic to fully comply with its Solid Waste Collection and Transportation Agreement regarding delivering only City waste to the designated City disposal facility, maintaining complete documentation of all records in support of solid waste that it collects and transports under the agreement, and implementing adequate internal controls to monitor and support the activities of its subcontractors.
- Require Republic to supply accurate, updated vehicle tare weights (weights of the vehicles weighed empty) on a periodic basis (to be mutually agreed upon by both parties) and to notify SWMD in a timely manner of all changes in assigned collection equipment so that updates to tare weights can be provided to BFI prior to any deliveries being made at the landfill. SWMD should require BFI, in turn, to maintain consistent, accurate records of vehicle tare weights provided by the City. SWMD

should assign primary responsibility for overseeing the maintenance of correct vehicle tare weights to a SWMD employee.

- Require BFI to fully comply with its Solid Waste Disposal Agreement regarding maintenance and documentation of scale calibrations on all scales used to weigh solid waste disposed of for the City.
- Incorporate a more thorough monitoring program for its contracted solid waste service providers, including enhanced monitoring of collection and disposal activities and incorporation of ongoing compliance reviews of both Republic's and BFI's internal controls related to documentation of routes serviced and deliveries made, and accuracy of quantity measurements including maintenance of up-to-date tare weights on all vehicles and monitoring of scale calibrations.

The Performance Review of SWMD that is currently underway will address specific internal controls and procedures employed by SWMD to monitor and administer the activities performed by all SWMD-assigned third-party service providers under contract to the City to collect and dispose of solid waste.

All information in this summary, along with details of the above-noted issues and other opportunities for improvement can be found in **Results and Recommendations** on page 6.

We sincerely appreciate the assistance and spirit of openness and cooperation that was exhibited by all parties during this review. Mr. Thomas (Buck) Buchanan and his entire staff in the Solid Waste Management Department cooperated fully in responding to our requests and providing information in a timely and professional manner. Republic and BFI both cooperated fully in regard to our requests for information and in making their management and staffs available to us to facilitate the completion of this review.

This report is intended solely for the information and use of the City of Houston, the Solid Waste Management Department and the Office of the City Controller, and is not intended to be used for any other purpose.

Respectfully Submitted,

Jefferson Wells	*April 7, 2006*
Jefferson Wells	Date

RESULTS AND RECOMMENDATIONS

1. Assessment of the level of compliance with the contractual terms and conditions and related fees of the Republic collection and transportation agreement and the BFI disposal agreement

a) Republic Vehicles Collecting Waste on City of Houston Routes

We reviewed deliveries made by Republic vehicles not on the current list of vehicles for which updated tare weights had been provided to SWMD as of 1/11/06 in order to determine if those deliveries represented legitimate charges for City waste. Our review identified thirty-two Republic vehicles that have made deliveries to the BFI landfill at some time during the contract period from July 2000 through December 2005 that are not included on the current list of vehicles with updated tare weights. We provided that list of vehicles to Republic and requested explanations for why the vehicles in question had not been included on the most current update. With the exception of several vehicles for which specific, written explanations were provided, we were only given a general verbal explanation that vehicles other than those typically assigned to service City routes were often used when assigned vehicles were inoperable or during periods of high volume. We were not provided with any further documentation or specific explanations for the use of those vehicles in support of the City contract. As such, we were unable to confirm the validity of the remaining deliveries with any degree of precision.

We also requested a listing of all vehicles used by Republic over the life of the City contract, including dates that those vehicles were assigned to City work. Republic was unable to provide a vehicle listing or register that included the dates of service; however, they did provide a current listing of all Republic vehicles used in the Houston market, both on City and non-City work.

In analyzing the deliveries made by the noted Republic vehicles we determined that the deliveries totaled over $3.3 million based on quantities that were received at the BFI landfill. We reduced the $3.3 million by the entire cost of deliveries made by Republic during the debris cleanup periods for Tropical Storm Allison, a tornado in late 2002, and Hurricane Rita. We also adjusted for deliveries made by vehicles for which Republic provided specific explanations of use that appeared reasonable. After the adjustments we calculated over $1.57 million in deliveries by vehicles not currently assigned to City work for which we could not obtain substantiated explanations for why the deliveries were made to the City account at BFI.

Our review of Republic records related to delivery tickets and route sheets revealed that there are periods of time (July 2000 through December 2001) for which significant portions of the supporting documentation was not available for

review. Even during the periods for which records are generally available, there are delivery tickets that cannot be matched with the corresponding route sheets in order to determine whether deliveries charged to the City were for City routes.

Results

Recordkeeping by Republic is not sufficient to be considered in full compliance with the Inspections, Reviews and Enforcement clause (Article XXXV) of the contract.

Recommendation

SWMD should require Republic to comply with the terms of the contract and, where necessary, to enhance its recordkeeping in regard to documentation related to deliveries and routes so that Republic will be able to objectively support all costs it directly (for collection and transportation) and indirectly (for disposal) generates through its operations under the contract with the City.

b) Deliveries by City of Houston-Contracted Solid Waste Haulers on Non-Scheduled Delivery Days

1) Republic Waste Services Sunday Deliveries

We reviewed all Republic Sunday deliveries (non-scheduled collection and delivery days) to the BFI landfill to determine the reasonableness of such deliveries that were billed to the City and noted:

- Republic made 406 deliveries to the landfill between July 2000 and December 2005.
- 237 of those deliveries were during storm debris cleanup periods approved by the Director of SWMD.
- Written documentation to support the remaining 169 deliveries could not be obtained from Republic.
- Republic provided a verbal explanation stating the reasons for Sunday deliveries to the BFI landfill, all of which appear to be reasonable based on consultation with Solid Waste Management Department management.
- The level of documentation maintained by Republic did not allow us to perform an independent verification of those explanations.
- Republic made non-storm debris cleanup Sunday deliveries from contract inception through December 2005. The lack of consistent recordkeeping related to those transactions impacted our ability to verify their validity.

Results

Republic internal controls over recordkeeping, particularly for the first eighteen (18) months of the contract period from July 2000 through December 2001, were deficient in regard to supporting documentation and formalized procedures. While Sunday collection and delivery may be necessary on an occasional basis (such as during formal debris cleanup events or for seasonal heavy volumes) there is not currently a mechanism in place to document those situations so that Republic can readily support the value to the City of working on Sundays.

2) **Republic Waste Services Wednesday and Saturday Deliveries**

We reviewed Wednesday and Saturday deliveries (not scheduled days for compacted waste collection) made to the BFI landfill by Republic to determine if a pattern of potentially improper deliveries existed. Our detailed review included the months of July 2002, July 2003, June 2005 and July 2005. (We were unable to perform scheduled detailed testing for two additional months in 2000 and 2001 as a result of unavailable supporting documentation. Republic advised that hardcopy records could not be located for the eighteen (18) months prior to January 2002.) Our review revealed:

- For July 2002, a significant number of delivery tickets obtained from the Republic electronic database did not have an associated paper route sheet maintained by Republic or a BFI landfill delivery ticket available for review. Many loads documented by delivery tickets in the Republic database that were delivered as City refuse did not have a route sheet showing a City route available to confirm where the refuse was collected. We estimate that between one-quarter and one-half of the deliveries on routes that could be identified as non-City were made to the BFI landfill on Wednesdays or Saturdays, which are not City scheduled collection days for compacted refuse.

- For July 2003 the results are similar to those noted for July 2002 in all respects. Again, we estimate that between one-quarter and one-half of the deliveries on routes that could be identified as non-City were made to the BFI landfill and Wednesdays or Saturdays.

- In the case of both July 2002 and July 2003, the Republic database information provided for our review was incomplete, as route data was not maintained in the database. A large number of hardcopy route sheets that identify the locations where refuse was collected by Republic vehicles were not available for review (representing approximately 60% of all BFI-generated delivery tickets). Only about 25% of all delivery tickets could be confirmed as City routes from the information available on Republic route sheets. For July 2002 in particular, a significant number of the

hardcopy delivery tickets from the BFI landfill were unavailable at Republic, thereby limiting our ability to confirm the existence of deliveries by Republic to BFI. In general, the information provided for these two months was not deemed reliable enough to allow us to draw any conclusions about the appropriateness of amounts of waste delivered by Republic to BFI.

- For June and July 2005 we re-performed some of the detailed testing of deliveries based on the Republic database and Republic hardcopy route sheets and BFI-generated delivery tickets that had been performed by Republic in the period just prior to the commencement of this review. In general, our analysis confirmed the results of the review performed by Republic in regard to noted deliveries of non-City waste to the BFI landfill. Our testing did not reveal any significant deviations from the results reached by Republic for those months. We were able to confirm that more than half of the deliveries identified as non-City waste during June and July 2005 occurred on Wednesdays or Saturdays.

- Given the results of our testing in July 2002, July 2003 and June and July 2005 it appears that, in the cases where we were able to confirm that non-City waste had been disposed of at the BFI landfill, there was a tendency for those deliveries to occur on Wednesdays or Saturdays when regular City compacted refuse routes were not scheduled to be run by Republic.

Results

Due to our lack of confidence in the completeness of Republic's data based on the detailed testing we performed in periods prior to 2005, including the unavailability of the majority of hardcopy documentation prior to January 2002, we are unable to make any precise projections of potential total improper deliveries to the BFI landfill based on our detailed review of delivery tickets and Republic route sheets.

3) **A&T (Republic Subcontractor) Sunday Deliveries**

We reviewed all A&T Sunday deliveries to the BFI landfill to determine the reasonableness of such deliveries that were billed to the City and noted:

- A&T made 442 deliveries to the landfill between July 2000 and December 2005.
- 157 of those deliveries were during storm debris cleanup periods approved by the Director of SWMD.
- Written documentation to support the remaining 285 deliveries could not be obtained from Republic or A&T. We requested explanations for these deliveries.

- A&T's explanation for the non-storm debris deliveries was that they were "carry-over activity" as a result of high trash volumes and that such activity occurs on a sporadic basis. A&T claimed to use Saturdays and Sundays to deliver staged containers collected during regular collection days to the landfill in order to maintain consistent customer service during the week.
- It was evident from the supporting documentation available at Republic, as well as the feedback that we received directly from A&T, that the level of documentation that would have allowed for verification of where trash being delivered to BFI on Sundays was collected was not available.

Results

Republic internal controls for monitoring A&T operations under their subcontract were deficient in regard to required supporting documentation and formalized procedures. From our testing it did not appear that Republic had specific knowledge of the fact that A&T was delivering City waste to BFI on Sundays outside of the approved storm debris cleanup periods. It also appears that there was little, if any, verification by Republic of the validity of A&T Sunday deliveries made to BFI based on the minimal level of documentation provided with A&T's monthly invoices to Republic and the documentation maintained by A&T.

Recommendation

SWMD should require Republic comply with all aspects of its contract by implementing internal controls and procedures to enhance Republic's ability to document special situations such as accommodating public holidays and cleanup of storm-debris that may necessitate waste collection and delivery on non-scheduled days. SWMD should require Republic to expand their month-end reports to include statistics and explanations for such events. This additional reporting, along with Republic maintaining complete documentation of the underlying delivery tickets and route sheets along with its electronic database of deliveries throughout the remainder of the contract period, would serve to more fully document the validity of all services being provided by Republic to the City.

SWMD should require Republic to implement internal controls and procedures to enhance their ability to monitor A&T's operations and costs. Included in those improvements should be more complete documentation of routes serviced for the City and inclusion of that information in invoices submitted to Republic by A&T. Exception reporting, wherein A&T would notify Republic of the necessity for collecting and delivering City waste on non-scheduled days, would also enable Republic to improve its monitoring of activity under their subcontract.

c) **BFI Waste Systems Maintenance of Tare Weights for City-Contracted Solid Waste Haulers**

We reviewed a sample of tare weights (weights of the vehicles weighed empty) for Republic and A&T vehicles that were assigned to City routes for selected months, primarily December 2001, July 2002, July 2003, June 2005 and July 2005. We compared the tare weights per individual BFI-generated delivery tickets (the stored tare weights) with a listing of tare weights maintained for those vehicles by the City of Houston. For that test we noted deviations in favor of the City ranging from 160 pounds to 8,260 pounds. The deviations in favor of BFI ranged from 80 pounds to 5,300 pounds.

We then compared the same sample of tare weights per the BFI delivery tickets with the tare weights on file at BFI that had been updated based on new vehicle weights provided by Republic on 1/11/06. We calculated similar weight variances for all vehicles tested and noted deviations between the original stored tare weights at BFI (per the delivery tickets) and the updated tare weights from 1/11/06.

For that test we noted deviations in favor of the City ranging from 600 pounds to 7,640 pounds. The deviations in favor of BFI ranged from 230 pounds to 8,630 pounds. Additionally, on 2/9/06 we compared a list of Republic vehicles that service City routes and had been weighed at a certified public scale on 1/11/06 with the records in BFI's TRUX (scale) system. We also compared the Republic and A&T vehicles maintained by SWMD in the Landfill Audit Database with the records provided by Republic and BFI.

We noted four vehicles (two Republic and two A&T) where the SWMD Landfill Audit Database had not been updated for the latest information. We confirmed that BFI had properly updated the TRUX system that contains the stored tare weights for all the Republic vehicles for which new tare weights were provided. However, we noted thirty-two (32) Republic vehicles that were not recently weighed and submitted to SWMD for which BFI was still maintaining tare weights based on old information. Since the stored tare weights for those thirty-two (32) Republic vehicles had not been updated, there was the potential that incorrect net weights were being generated if those vehicles were continuing to deliver waste to the BFI landfill.

Results

Our review of tare weights revealed a number of significant variances on a "same-vehicle" basis over a period of time. Since vehicle tare weights should not change significantly over time, we felt that the data being maintained on tare weights by Republic, BFI and SWMD was not being consistently maintained by all parties or errors in inputting vehicle numbers were occurring at BFI to drive the variances that were noted.

Recommendation

As a result of the degrees of variance noted between tare weights for the same vehicle over a period of time, SWMD should require that all Republic and A&T empty vehicle weights be recertified on an annual basis to minimize the potential of paying for incorrect quantities of waste being disposed of at the BFI McCarty Road Landfill.

SWMD should contact BFI immediately and advise BFI to remove or deactivate (and not allow deliveries by until recertified) all Republic and A&T vehicles for which an updated tare weight was not provided to them by SWMD based on Republic's list from 1/11/06. A certified tare weight should be required for any new vehicle added to the list of assigned vehicles servicing the City under contract.

d) Republic Waste Services Insurance Compliance

Our review of Republic's compliance with the insurance requirements of the Agreement as stated in Article XIII – Insurance revealed the following deficiencies:

- The Certificates of Insurance provided to SWMD and currently on file in the Department did not include the required Worker's Compensation coverage for the period 11/1/04 to the present or the required Excess Liability coverage for the period 11/1/05 to the present.

- A&T is required to have coverage meeting all of the requirements for Republic except for amount, which shall be commensurate with the amount of the subcontract, but in no case shall it be less than $600,000 per occurrence. Republic is to provide copies of such insurance certificates to the Director of SWMD. While A&T does have current General Liability insurance coverage meeting the established requirements, there is no evidence on file in the Department of the other required insurance types, namely: Worker's Compensation, Employer's Liability, Automobile Liability and Excess Liability. If such coverage has been maintained by A&T throughout the contract period, no evidence in the form of Certificates of Insurance documenting that coverage is available in the Department.

Results

Republic is not currently in compliance with the insurance requirements of the Agreement. Coverage for both Republic and A&T is deficient based on documentation on file in SWMD.

Recommendation:

SWMD should require Republic to provide the Worker's Compensation and Employer's Liability Insurance coverage to meet the minimum limits set out in the Agreement.

SWMD should require Republic to provide copies of Certificates of Insurance obtained by A&T for all required coverage not currently being met according to the Agreement between Republic and the City.

e) **BFI Waste Systems Scale Calibration Compliance**

The agreement between BFI and the City requires semi-annual scale calibrations on all scales used to weigh City solid waste being disposed of at the various disposal sites, including the McCarty Road Landfill. On 2/9/06 we reviewed the calibration records maintained by BFI at the landfill from the point where the BFI-owned scales were installed up through the most current calibration records. We reviewed the scale calibration records for all four of the scales in use at the landfill.

Our review revealed several significant time intervals between comprehensive calibrations, particularly on Scales A and B. The most significant periods of non-compliance were as follows:

Scale A (inbound) - 323 days between 12/2/99 and 10/20/00 and **1,379 days** between 10/20/00 and 7/30/04.

Scale B (inbound) - 240 days between 2/23/00 and 10/20/00; 224 days between 8/2/01 and 3/14/02; 236 days between 3/14/02 and 11/5/02; and **731 days** between 11/5/02 and 11/5/04.

Scale C (inbound EZ Tag) - While there were significant intervals between calibrations on Scale C (EZ tag lane) that scale was not used to weigh SWMD vehicles or Republic or A&T vehicles hauling solid waste under contract to the City. NOTE: SWMD is in the process of implementing use of the EZ Tag system on City-owned vehicles, so calibration of this scale will soon be an issue as well.

Scale D (outbound) - 392 days between 7/6/00 and 8/2/01; 460 days between 8/2/01 and 11/5/02 and **532 days** between 5/22/03 and 11/4/04.

Results

BFI was not in compliance with the semi-annual scale calibration requirements of the contract for significant portions of the contract from inception-to-date.

Recommendation

SWMD should require BFI to comply with the semi-annual scale calibration requirements of the contract. As of the Second Amendment to the Agreement with BFI dated January 1, 2006 BFI is required to provide on January 1 and July 1 of each year a certificate of calibration for each scale used to measure quantities of City Waste. The certificate of calibration shall be issued by an independent testing laboratory approved by the Director. The independent and approved testing laboratory shall provide test results to the Director at the same time that results are provided to BFI, but not later than 15 days after the scales are calibrated and tested. SWMD should designate a Department representative to monitor compliance with this requirement and to advise BFI if reporting of such is not timely

f) **BFI Waste Systems Insurance Compliance**

Our review of BFI compliance with the insurance requirements of the Agreement revealed the following deficiencies:

The Certificates of Insurance provided to SWMD and currently on file in the Department indicate that beginning with the renewal of coverage on 9/30/99, the Employer's Liability minimum coverage level provided was reduced from $2,500,000 Bodily Injury by Accident (each accident) / $2,500,000 Bodily Injury by Accident (policy limit) / $2,500,000 Bodily Injury by Disease (each employee), which are the contract minimum levels, to $1,000,000 / $1,000,000 / $1,000,000.

Beginning with the 5/1/00 renewal of Automobile Liability insurance coverage, the required Form MCS-90 endorsement has not been included with the Certificates of Insurance.

Results

The current Employer's Liability insurance in force is still not in compliance with the established minimum coverage limits. The current Automobile Liability insurance in force is deficient without the Form MCS-90 endorsement attached.

Recommendation:

SWMD should require BFI to update the Employer's Liability and Automobile Liability Insurance coverage to meet the minimum limits set out in the Agreement.

g) **BFI Waste Systems Minority/Women's Business Enterprise Vendor /Subcontractor Compliance**

The Agreement calls for BFI to make a good faith effort to award subcontracts or supply agreements in at least 11% of the value of the agreement to Minority and Women-owned Business Enterprises verified by the City's Affirmative Action & Contract Compliance ("AA&CC") Division. The Second Amendment to the Agreement dated 1/1/06 revised the MWBE goal to be 11% of the transportation component of the Agreement instead of the entire value of the Agreement.

On 2/14/06 we reviewed BFI's compliance with the stated goals with the City's Director of AA&CC. As of the most recent reporting month reviewed (January 2006), BFI's M/WBE percentage based on actual payments to subcontractors and suppliers is 4.87% against the goal of 11%.

Results

The adjustment taking into effect the revision based on the Second Amendment to the Agreement had not been input into the City's automated system for tracking M/WBE compliance percentages on the date of our review.

Recommendation

SWMD, in conjunction with AA&CC, should provide BFI with an updated dollar goal for compliance based on the revision in the Second Amendment to the Agreement. The revised overall goal should then be input into the City's tracking system.

h) **Review of Republic Waste Services Overcharge Calculation Methodology**

Republic admitted to improperly disposing of non-City waste on the City's account at the BFI landfill and supported this with an internal analysis. We obtained the analysis prepared internally by Republic, which covered the period May through October 2005, and discussed their methodology with members of Republic's management team. In theory, the methodology employed by Republic in estimating the potential amount of overcharges for deliveries of non-City solid waste to the BFI landfill was reasonable. The methodology involved matching Republic route sheets used to document the collection routes serviced by particular Republic vehicles on each day with delivery tickets generated by BFI for all deliveries to the BFI landfill. All City routes collected by Republic are identified by specific numerical route numbers. Using the BFI-generated delivery tickets (which indicate vehicle number, date and time of delivery, and gross and net tonnage and/or cubic yardage delivered) and comparing them to the Republic route sheets is a method for determining where the loads were collected prior to delivery to the landfill.

We visited the BFI landfill and reviewed the controls over the generation of delivery tickets and the maintenance of vehicle tare weights. The integrity of the calculations produced when the delivery tickets are generated appeared to be good. Controls over revising tare weights appear to be effective and functioning based on our observation of the system in use and our review of procedures with scale house supervision. There is also a system of cameras that constantly records the activity on the various scales and within the scale houses, including those of the scale operators.

Republic's method identified non-City deliveries made to the BFI landfill during the May through October 2005 time period, and included performing tonnage extrapolations back to contract inception based on those noted improper deliveries. The Republic projections provided to Jefferson Wells resulted in estimated total overcharges ranging from a low of $455,000 to a high of $867,000. We tested the Republic method's comparability against earlier months in the contract period while trying to identify the most efficient and economical method to independently estimate overcharges.

We attempted to replicate the testing that Republic performed by selecting several months from earlier in the contract period to further validate the soundness of their methodology and to form a basis for our planned tonnage extrapolations. We performed detailed testing in the months of June 2005 and July 2005 to re-confirm the improper deliveries that Republic noted in their review. We then selected four additional months (August 2000, December 2001, July 2002 and July 2003) for additional detailed testing. As noted previously, hardcopy documentation of Republic route sheets prior to January 2002 was unavailable and the documentation of delivery tickets from that period was incomplete. This rendered our review of the months selected for review in fiscal years 2001 and 2002 impossible to complete. Instead of selecting additional months in the later fiscal years of the contract period to review, we decided to focus on the detailed review of July 2002 and July 2003.

In general, we feel that Republic's methodology was sound and may have generated an accurate projection of potential overcharges. However, the information provided for these two months was not deemed reliable enough as to allow for any conclusions to be reached about the appropriateness of amounts of waste delivered by Republic to BFI throughout the contract period. The incomplete data for July 2002 and July 2003 coupled with the unavailability of most supporting documentation for the eighteen-month period prior to January 2002 gave us serious concerns about the integrity and consistency of the overall data being maintained by Republic. As a result of these limitations, we chose not to perform any additional tonnage extrapolations in order to project potential overcharges as a result of improper deliveries.

Results

Republic was unable to produce consistent data for our use in performing detailed testing procedures, which prevented us from identifying or validating Republic's overcharge estimates.

Recommendation

SWMD should enhance its current monitoring of Republic-collected routes as much as economically feasible. SWMD might consider augmenting its in-house monitoring activities by instituting ongoing compliance reviews of both Republic and BFI documentation such as route sheets and delivery tickets. While no single, economically-viable control would have prevented the improper deliveries made by Republic, increased vigilance and enhanced monitoring of all service providers involved in the collection and disposal of residential solid waste should improve SWMD's ability to detect and mitigate any future occurrences. Requiring Republic to develop and implement a process improvement plan incorporating improved document retention procedures that would allow for more complete verification of deliveries made by Republic and its subcontracted waste haulers would provide additional assurance of adherence to control documentation requirements.

2. Review of Moriarty Leyendecker, P.C., Recovery Estimates

We reviewed the reasonableness of the methodology utilized by Moriarty Leyendecker to prepare an initial reimbursement request of identified overcharges resulting from actions taken by Republic. The basis for the analysis was that Republic had admittedly been collecting and delivering non-City solid waste to the BFI landfill where it was being disposed of and charged against the City's account under the City's disposal agreement with BFI. It was SWMD's contention that Republic-collected waste quantities should not differ significantly from the monthly average quantities collected by SWMD on the routes it operates within the City. Based on the best available information at the time, Moriarty utilized a high-level analysis of monthly refuse collected by Republic on City routes on a per residential service unit basis and compared those quantities against average monthly refuse collected on the same basis by SWMD on the routes that it operates within the City. Monthly variances between the Republic quantities and the City quantities were calculated in order to project the amount of potential overcharges over the entire contract period. The prevailing contractual disposal rates in effect were applied to determine an overall variance in dollars. Moriarty generated a series of projected overcharge estimates, with the final projected overcharge amount settled upon by Republic and the City at $2.0 million.

Our review included a confirmation of the monthly collected waste by Republic and SWMD based on information gathered from Republic and SWMD operations and maintained by SWMD, a confirmation of the service units provided to Moriarty by

SWMD for Moriarty's use in performing its analysis of average collected pounds of refuse per service unit per month, and a verification of the BFI contracted landfill rates used for the analysis.

Results

As a result of our review, we believe that the overcharge estimation of $2,000,000 developed by Moriarty is a reasonable estimate. Although we believe that the Moriarty estimate has limitations and that there may be better methodologies available for developing a more accurate estimate, adequate supporting documentation from Republic was not available to allow us to conclusively validate a more accurate methodology. Therefore, our review did not identify any other quantifiable scenarios that indicated potential overcharges were either less than or in excess of $2,000,000.

EXHIBIT I

CITY OF HOUSTON
Solid Waste Management Department

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TO: Annise D. Parker
City Controller

FROM: Buck Buchanan

DATE: 04/06/06

SUBJECT: Department Response to Contract Compliance Review of Republic Waste Services of Texas, Ltd. And BFI Waste Systems of North America, Inc.

I am pleased to respond to the recommendations made by the audit team concerning the compliance review identified above. The response is keyed to the recommendation numbers contained in the draft report provided on April 5, 2006.

Recommendation 1. a). I partially agree with the recommendation that we should require documentation supporting the indirect cost for delivery of waste collected under our contract to the landfill. We will require RWS to maintain the documentation and will audit it as necessary. The amendment to our contract which is pending before City Council contains clauses that limit RWS's disposal to the volume of waste that this department collects (in pounds per year per customer – pro-rated if necessary). Even though the department believed an enforceable limit was included in the original contract form, ambiguities in the pertinent clauses prevented enforcement. The clauses in the amendment are unambiguous and enforceable. This limitation may obviate the need to continuously audit disposal deliveries made by RWS.

I have, however, no interest in the direct costs of collection and transportation incurred by RWS in its performance under our contract. They are not paid on a cost basis, but on a fixed cost per customer per month. We have excellent controls in place to verify and confirm the number of customers for which they receive payment.

Recommendation 1. b). In accordance with contract terms, RWS routinely provides notification when non-emergency work is performed on weekend days and Wednesdays. We will require RWS to expand the monthly activity report to more formally document non-emergency collections on those days, and provide a record of deliveries to the landfill on those days, even when the collection actually occurred on scheduled collection days.

Views of Responsible Officials

Recommendation 1. c). RWS, A&T and city vehicle tare weights are presently certified and are fixed in the BFI scale/billing system. No tare weight change will be allowed without joint certification by the city and BFI. In the unlikely event that routine tare weight checks reveal a need to re-certify the tare weight of any of these vehicles, representatives of the department and BFI will verify that the vehicle in question is truly unloaded and utilize a certified, calibrated truck scale to determine the actual empty weight of the vehicle.

BFI was notified, in March, to remove from the "authorized" list all RWS and A&T vehicles that had not had their tare weights recertified. Any new vehicle added to the "authorized" list has a certified tare weight ticket which accompanies any request to add a new vehicle. Any time a vehicle is taken out of service, BFI is instructed to remove that vehicle from the "authorized" list.

Council Members: Toni Lawrence Jarvis Johnson Anne Clutterbuck Ada Edwards Addie Wiseman M.J. Khan, P.E. Pam Holm Adrian Garcia Carol Alvarado Peter Brown Sue Lovell Shelley Sekula-Gibbs, M.D. Ronald C. Green Michael Berry Controller: Annise D. Parker

EXHIBIT I

Annise D. Parker, 04/06/06, page 2

Recommendation 1. d). We have requested that RWS update the insurance covered to comply with the limits specified in the contract document. An increase in the coverage limits for Employer's Liability Insurance is in process by RWS. RWS has chosen to utilize an alternative coverage for Workers' Compensation not contemplated in the contract document but authorized under the regulations of the State of Texas. Their attorney is working with the City Attorney regarding the current contract language and the possibility of accepting this type of coverage.

Recommendation 1. e). BFI has been instructed to comply with the calibration requirements set forth in the contract document. The scales at the BFI facilities were calibrated in January, 2006, and we have been provided with the calibration schedule which indicates they will also be in compliance in July, 2006.

Recommendation 1. f). BFI has been requested to provide the required Employers Liability minimum coverages and the Form MCS-90 endorsement. A recent change-of-command in their area offices has occurred, but the required coverages are expected in the next 1-2 weeks.

Recommendation 1. g). I will coordinate the recommended revisions with the Mayor's Affirmative Action Division.

Recommendation 1. h). We have a high confidence level in our monitoring of the collection and transportation elements of the RWS contract. We also have an excellent system of monitoring the timeliness and completeness of service deliveries under the contract. We know to a precise level the number of customers serviced, as this is the basis of payment to RWS. We will enhance our monitoring of RWS deliveries to the landfill to the extent practical and feasible. There is some comfort level in the enforceable restrictions contained in the contract amendment pending before council concerning the volumes of waste deliveries by RWS which we will pay for. In fact, in my opinion, this enforceable condition of the contract provides more safeguards against fraudulent delivery of waste to the landfill than those monitoring efforts we may be able to expend in the limits of economic feasibility.

(revised)

Views of Responsible Officials