

**TO:** James L. App, City Manager  
**FROM:** Doug Monn, Public Works Director  
**SUBJECT:** Pacific Waste Services  
Financial and Operational Audit  
**DATE:** August 2, 2011

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**NEEDS:** For the City Council to receive and file the auditor's report on Pacific Waste Services and to direct staff to negotiate terms of an amended contract with the landfill operator.

**FACTS:**

1. The City owns a Class III municipal solid waste landfill located near the intersection of Union Road and Highway 46.
2. The 145-acre facility has been in operation since 1970 and is permitted to dispose of non-hazardous waste. An estimated 32,000 tons of waste are buried each year in the landfill.
3. Pacific Waste Services has operated the City landfill for 12 years and the current contract extends through 2020.
4. Combined annual revenues are approximately \$1.2 million and City franchise fees are approximately \$305,000.
5. In November 2010, the City Council retained R3 Consulting Group to prepare a financial and operational audit of Pacific Waste Services.
6. The auditor submitted their findings in the form of a report dated July 2011.

**ANALYSIS AND**

**CONCLUSION:** The auditor's principal findings are:

1. Contract adherence was overall good, however; there were several areas of non-compliance, including failure to provide audited financial statements every 3 years, maintaining a \$50,000 performance bond, and regular checks of hazardous waste. Pacific Waste Services has since reinstated the required performance bond.
2. Pacific Waste Services gets a +2.5% guaranteed annual payment increase. This is detrimental to the City. If tonnage deposits continue to decline, the City projects negative cash flow within 2 years.
3. The operational review was overall positive with a recommendation that more should be done to plan future excavation areas so that soil is not handled twice.
4. The contract language between the City and Pacific Waste Services does not clearly define revenues subject to the franchise fees, expenses, and other key terms. Current contract language is also silent as to limits on expenses, rent, salaries, benefits, etc.

The auditor recommends that a future contract be put in place that eliminates a guaranteed payment increase, more clearly specifies the applicable franchise fee, better defines/limits expenses, profit sharing and profits, and updates the agreement terms. Should negotiations on such future contract language fail, the City could commission a valuation study for use in possible sale of the landfill.

**POLICY**

**REFERENCE:** Economic Strategy; 2009 Landfill Master Plan

**FISCAL IMPACT:** Negotiating terms of an amended contract with landfill operator will require administrative and legal support services, likely under \$30,000.

Solid waste is a General Fund service. City Council has allocated funds derived from the sale of right of way frontage to the State of California (Cal Trans) in FY 08/09 to offset preparation cost of the Landfill Master Plan and audit. Approximately \$140,000 remains to fund the contract renegotiation.

- OPTIONS:**
- a. Receive and file the auditor's report on Pacific Waste Services and direct staff to negotiate terms of an amended contract with the landfill operator.
  - c. Should negotiations fail, direct staff to proceed with a valuation study.
  - b. Amend, modify, or reject the above option.

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**ATTACHMENT:** Executive Summary of Auditor's Report

## Executive Summary

The major objectives of the review of Pacific Waste Services (PWS) were to:

- Determine if all required contract payments have been made;
- Determine if the allocation of revenues is in relatively the same proportion intended by the Agreement;
- Determine if PWS is in compliance with the major terms and conditions of the operating agreement (Agreement);
- Provide an assessment of PWS's operational performance specific to the Agreement; and
- Provide a general assessment of the effectiveness of PWS's operations and costs.

As part of our review we:

- Reviewed and analyzed documents provided to us by both the City and PWS;
- Conducted site visits of the landfill and scale house operations and observed operations;
- Interviewed management and staff; and
- Reviewed and analyzed various financial and operating data.

We also compared the findings from this review to those presented in the City's Landfill Master Plan. In those cases where the two reviews addressed similar issues we found the resulting findings to be generally consistent.

### Contractor Payments

- The Agreement does not clearly define "revenues" or "gross revenues" for purposes of establishing the basis upon which the City's payments are calculated. PWS does not include revenues from the sale of recovered materials (~\$300,000 total for 2006-2010) in the base it uses to calculate City payments<sup>1</sup>;
- PWS generally appears to have reasonable internal controls in place to track and monitor tonnages and revenues; and

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<sup>1</sup> PWS's position is that those revenues were not intended to be included in any revenue sharing with the City per Section 6 of the Agreement (Distribution of Revenues).

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- PWS's reported Gross Revenues, which serve as the basis for its payments to the City, were approximately \$23,000 less than those reported on its financial statements after supporting adjustments;

## Review of Distribution of Revenues

In the event that the average growth in gross revenues received from the operations at the landfill is two and a half percent (2.5%) per year or less, over three consecutive years, the Agreement provides for the City and Contractor meeting to make adjustments in the allocation of revenues to each party. Gross revenues at the landfill have been less than 2.5% for the past four years, and as discussed below under Review of Operating Agreement, unless something is changed it is very likely that the City will experience negative cash flow related to the landfill at some point over the remaining term of the Agreement.

## Contract Compliance

PWS is operating the landfill at a level consistent with industry standards, although there have been a number of regulatory issues. The Local Enforcement Agency has issued 10 notices of violation (NOV) and 26 areas of concern (AOC) since January 2002, although no NOV's have been received since 2006. Most of the NOV's have been related to exceeding the daily tonnage limit of 250 tons per day, which is a not uncommon NOV for landfills throughout the State. The maximum daily tonnage has since been increased to 450 tons per day. PWS also reported that a number of the AOC's were out of PWS's control, and various others were corrected immediately upon observation.

## Review of Operating Agreement

PWS is generally in compliance with the operational aspects of the contract with the exception of litter fencing and long-term planning.

With respect to litter, the Agreement requires that litter be controlled "*by constructing and maintaining movable fencing adjacent to areas in use...*" While PWS does not have movable fencing, the fencing it does use (T-posts and wire fencing) is adequate for controlling litter and well within industry standards.<sup>2</sup>

The issue of compliance with respect to long term planning relates to the appropriate planning of "*new waste disposal cells.*" While

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<sup>2</sup> PWS's contention is that the existing T-posts and wire fencing is "moveable" and that there has never been any fencing at the landfill other than T-post and wire fencing. Our position is that movable fencing is fencing that can be readily and repeatedly moved in order to adapt for shifting winds (i.e., fencing on movable skids).

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the basics of access and slope development (for drainage) have been established it is not clear that soil removal is effectively focused on the next area to be excavated and lined. If the solid is not first removed from the next liner area the City may end up having to hire a contractor to excavate soil that PWS could have removed as part of its daily operations.<sup>3</sup>

Overall impressions of the Agreement include:

- It has a longer term than most landfill contracts (20 years, with approximately 9 years remaining (July 31, 2020)), which puts the City at a significant disadvantage in terms of negotiating contract changes;
- The 2.5% annual payment increase is extremely detrimental to the City. Declining waste tonnages and revenues may soon put the City in a negative cash flow situation requiring subsidization of landfill operations; and
- The requirement that PWS is responsible for paying for and constructing the landfill liner system creates a strong incentive for PWS to conserve existing airspace and therefore, as discussed above, they appear to be doing a good job.

For purposes of assessing the impact to the City of potential future negative cash flow associated with the 2.5% annual payment increase three scenarios were evaluated:

1. **Waste tonnage continuing to decline at current rate (Worst Case Scenario)** – Under this scenario cash flow will drop below zero in 2012; By December 2016, the monthly deficit will surpass \$50,000 per month. Total projected deficit for the remaining term of the Agreement = \$4,399,000.
2. **Waste tonnage flattening at the current level** –Under this scenario the City would have to periodically subsidize PWS beginning with a deficit of just over \$10,000 in 2011. Total projected deficit for the remaining term of the Agreement = \$340,000.
3. **Waste tonnage increasing at 1% per year** – In this third scenario the first negative “hit” to the City is likely to occur in October 2011. Total projected deficit for the remaining term of the Agreement = \$161,000.

Note: PWS has identified a potential new source of landfill tonnage that could generate additional monthly tipping

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<sup>3</sup> In response to our draft report, PWS stated that existing excavation plans will be expanded to provide site development excavation planning and sequential landfill module development covering the next 20 years,

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fees of as much as \$40,000, which it has reported to the City

## Operational Review

PWS's operations are lean but functional. PWS is meeting the minimum requirements for regulatory and contractual compliance however some aspects of PWS's operations are not in line with industry standards<sup>4</sup>. While most of the equipment is generally older it is of the appropriate size, type and quantity to handle the inbound tonnage and perform most of the necessary site development projects. Staffing levels are also reasonable given the inbound tonnage. Observations include the following:

- Access roads were in good condition, litter was properly controlled and the wet-weather tipping pad was properly set up. Entrance signage however, should be updated to reflect a more professional status and provide clearer direction for facility users;
- Equipment operators are clearly skilled and work efficiently;
- The current waste cell was properly covered with soil and adequate tarps were available for use as alternative daily cover (ADC);
- The waste on the working face was properly segregated and very well compacted;
- There was relatively little differential settlement or broad settlement on the older landfill slopes indicating good waste compaction;
- Short-term planning (e.g., fill sequencing, access road placement, use of temporary soil stockpiles, etc.) was well organized and in-line with industry standards. Long-range planning, however, particularly in regard to future soil excavation areas, as previously discussed, requires attention to minimize expenses associated with future double-handling of soil.

## Cost Category Examination

A review of PWS's financial statements for fiscal years 2006 through 2010 found that:

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<sup>4</sup> As an example the secondary containment for the fuel tank consists of a soil berm with a piece of geosynthetic material held in place with random chunks of concrete.

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- PWS realized a total net income of approximately \$1.15 million<sup>5</sup>; and
- Revenues decreased by 28% while expense decreased by 18% although during that time there were significant increases in Salaries (~ \$162,000 (41%)) and Subcontractor expense (~\$285,000 (374%))<sup>6</sup>.

### Recommendations

- Upgrade entrance signage to reflect a more professional status and provide clearer direction for facility users<sup>7</sup>;
- Have PWS track soil used for daily and intermediate cover and reconcile that usage with periodic topographic maps to provide a more accurate cover soil ratio<sup>8</sup>;
- Require PWS to develop and implement a long-term excavation plan that focuses soil excavation in the appropriate area; and
- Consider options for reducing the declining revenue stream, including importing waste, increased tipping fee and renegotiating the revenue allocations set forth in the Agreement, as specifically provided in the Agreement (Section 6 (d)), so that the parties are receiving the intended relative proportions.

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<sup>5</sup> PWS reported cumulative net income of \$343,000 for the first five (5) years of the contract (2001 – 2005)

<sup>6</sup> PWS reported that the increase in both Salaries and Subcontractor expense was largely attributed to costs in contract year 2009/2010 attributed to the design and construction of a new landfill module (Module 3B).

<sup>7</sup> Since our on-site review was conducted PWS has upgraded signage at the scale house and on the routes to the active landfill and wood waste stockpile areas.

<sup>8</sup> In response to this recommendation in our draft report, PWS reported that it will prepare a topographic map using GPS surveying methods no later than January 1, 2012 that will be used, for among other things, determining soil volumes and refuse fill volumes to calculate refuse fill density and refuse to soil cover ratio. PWS also reported that it will provide a revised soil excavation plan by April 30, 2013 that will reflect site development over the next 20 years. Additionally, Module 3C base grading plan design will be completed by April 30, 2012.

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