

**DEPARTMENT OF ENVIRONMENTAL QUALITY AND OKLAHOMA TAX COMMISSION
WASTE TIRE RECYCLING INDEMNITY FUND
SPECIAL REPORT
FOR THE PERIOD JULY 1, 2001 THROUGH JUNE 30, 2003**

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STATE OF OKLAHOMA
OFFICE OF THE AUDITOR AND INSPECTOR

JEFF A. McMAHAN
State Auditor and Inspector

April 7, 2004

**TO THE EXECUTIVE DIRECTOR OF THE DEPARTMENT OF ENVIRONMENTAL QUALITY
AND
THE ADMINISTRATOR OF THE OKLAHOMA TAX COMMISSION**

Transmitted herewith is the Department of Environmental Quality and Oklahoma Tax Commission, Waste Tire Recycling Indemnity Fund Special Report for the period July 1, 2001 through June 30, 2003.

We wish to take this opportunity to express our appreciation for the assistance and cooperation extended to our office during the course of the review.

The Office of the State Auditor and Inspector is committed to serving the public interest by providing independent oversight and issuing reports that serve as a management tool to the state to ensure a government which is accountable to the people of the State of Oklahoma.

Sincerely,

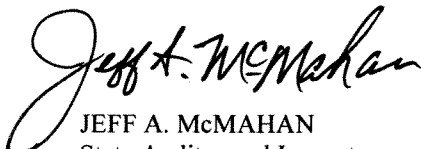

JEFF A. McMAHAN
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TABLE OF CONTENTS

	Page
Executive Summary	1
Background.....	3
Scope	4
Objective #1.....	5
Objective #2.....	7
Objective #3.....	10
Objective #4.....	11

Executive Summary

Determine whether the Waste Tire Recycling Indemnity Fund can be self-sustaining with the current rate structure.

Not self-sustaining

It appears the Waste Tire Recycling Indemnity Fund cannot be self-sustaining under the current rate structure.

Determine whether reimbursements to Frontier Recycling and the Four D Corporation were appropriate.

Not possible

Due to the nature of the program, it is not possible to determine whether compensation paid to these processors was appropriate.

Trucks not weighed as required

Each truck is to be weighed both gross (full) and tare (empty). Preferably, a truck should be weighed with the full trailer attached; the trailer should then be emptied, and the truck and trailer should be weighed again to establish tare weight. Frontier does not have a consistent method for weighing their trucks and trailers. Four D weighs the truck and full trailer, and enters a predetermined tare weight.

Scales not certified quarterly

According to DEQ policy, all scales are to be certified quarterly by the Oklahoma Department of Agriculture, Food, and Forestry or by an independent scale contractor. Of eight possible quarters, Frontier's (Borg Steel) scales and Four D's scales were not certified for three quarters.

Compensation high compared to tires collected

Based on the comparison of all processors' number of tires reported, the number of tons reported, and the compensation amounts received for FY 02 and FY 03, it appears Frontier's percent change in compensation is high when compared to its percent change in total tires.

Policies not enforced

DEQ did not enforce its policies regarding the weighing of vehicles and the quarterly certifying of scales.

Determine whether the increase in tire tonnage flowing through the system in FY 03 was legitimate.

Based on processors' reports

It appears the overall increase in tons collected and processed was legitimate.

Frontier stands out

When the number of tons for which compensation was paid to Frontier is compared to the number of tires collected, the tons appear excessive.

DEPARTMENT OF ENVIRONMENTAL QUALITY AND
OKLAHOMA TAX COMMISSION
WASTE TIRE RECYCLING INDEMNITY FUND
FOR THE PERIOD JULY 1, 2001 THROUGH JUNE 30, 2003

Determine whether there are other issues or concerns that should be addressed.

Monitoring of illegal tire dumps

No inspections are conducted by DEQ during the time tires are being reported as collected from illegal tire dumps, thus creating the potential for fraudulent reporting.

Inaccurate data

It is not possible, from records retained by OTC, to determine how many tires were sold or first registered in Oklahoma during FY 02 and FY 03, nor is it possible to determine whether the correct amount of waste tire fees was collected and remitted to the state.

Background

The Oklahoma Waste Tire Recycling Act (the Act), enacted in fiscal year 1990, was written to bring about the cleanup of existing waste tire dumps and to prevent the development of new dumps.

The Department of Environmental Quality and the Oklahoma Tax Commission are jointly responsible for the administration of the Act. The Department of Environmental Quality is responsible for permitting and certifying waste tire facilities. The Oklahoma Tax Commission is responsible for establishing and publicizing rules that pertain to the remittance of fees and the allocation of monies accruing to the Waste Tire Recycling Indemnity Fund (the Fund).

Deposits into the Fund include fees collected by both tire dealers and tag agents. Tire dealers collect \$1.00 per tire sold for tires with a rim diameter of 17½" or smaller; \$3.50 per tire sold for tires with a rim diameter larger than 17½"; and \$1.00 per tire sold for motorized cycles, such as motorcycles and motorized bicycles. The tire dealers are required to remit monthly to the Oklahoma Tax Commission 97.75% of the total fees collected. Tag agents collect fees on the tires of all vehicles when they are first registered in Oklahoma. The fees collected are the same as those collected by the tire dealers. However, the tag agents are allowed to retain \$1.00, rather than a percentage, of the fee collected for each vehicle.

Other deposits into the Fund include interest earned on the investment of money in the Fund.

Distribution of the money in the Fund is set by statute, as follows:

1. Four percent to the Oklahoma Tax Commission for administrative costs;
2. Four percent to the Oklahoma Department of Environmental Quality for administrative costs;
3. Ten percent of the remaining 92% (nine and two-tenths percent) to entities that manufacture products or derive energy from waste tires, up to 100% of their capital investment, at the rate of \$20 per ton of waste tires used. The actual monthly compensation to these entities is limited to a proportionate share of the funds available, based on the relative amount of each entity's capital investment.
4. The remaining 82.8% of the money in the fund is apportioned to processors, according to the percent of tires collected, transported, delivered, or processed, for:
 - a. Processing—\$49 per ton;
 - b. Collecting and/or transporting—\$48 per ton;
 - c. Conservation project—\$0.80 per tire 17 ½" or smaller; \$2.80 per tire larger than 17 ½";
 - d. Baling—\$0.50 per tire;
 - e. Energy or fuel recovery—\$29 per ton.
5. If the balance of the fund reaches \$3,000,000, the Oklahoma Tax Commission is authorized to award matching grants to public schools or institutions, state parks and recreation areas to reimburse them for purchasing and installing playground surfacing material made from waste tire material. The total matching grants awarded cannot exceed \$1,000,000.

**DEPARTMENT OF ENVIRONMENTAL QUALITY AND
OKLAHOMA TAX COMMISSION
WASTE TIRE RECYCLING INDEMNITY FUND
FOR THE PERIOD JULY 1, 2001 THROUGH JUNE 30, 2003**

Scope

Pursuant to the request of the management of the Department of Environmental Quality, the objectives of our audit were to determine:

1. Whether the Fund can be self-sustaining with the current rate structure.
2. Whether reimbursements to Frontier and the Four D Corporation were appropriate.
3. Whether the increase in tire tonnage flowing through the system in FY 03 was legitimate.
4. Whether there are other issues or concerns that should be addressed.

The audit period was July 1, 2001 through June 30, 2003.

Abbreviations

DEQ—Department of Environmental Quality
OTC—Oklahoma Tax Commission
Ag—Department of Agriculture, Food, and Forestry
OSF- Office of State Finance

DEPARTMENT OF ENVIRONMENTAL QUALITY AND
OKLAHOMA TAX COMMISSION
WASTE TIRE RECYCLING INDEMNITY FUND
FOR THE PERIOD JULY 1, 2001 THROUGH JUNE 30, 2003

OBJECTIVE #1 Determine whether the Waste Tire Recycling Indemnity Fund can be self-sustaining with the current rate structure.

Methodology The following procedures were performed:

- We researched the statutes to gain an understanding of the fees generated by the Fund and the distribution of money from the fund, as well as to determine statutory changes during the audit period that could have affected the Fund.
- We obtained from OTC a schedule of revenues and expenditures from the inception of the Fund.
- We calculated the maximum compensation per tire, and compared it to the revenue generated per tire.

Observations Upon researching the statutes, we found no guarantee that the Fund will be sufficient to pay all claims of processors in full. In fact, 27A O.S. §2-11-408.B. states:

If the Indemnity Fund contains insufficient funds in any month, then the Oklahoma Tax Commission shall apportion the payments among all of the qualifying applicants according to the percentage of tires collected, transported, delivered, or processed.

Also, the statutes do not prohibit the use of these funds for other purposes.

One reason the Fund may not be self-sustaining is that the program is based on the "honor system". Some of the problems noted with this system are:

- The actual number of tires delivered/collected in a specific load may easily be misstated, depending upon the volume of tires. The only assurance that the number is correct is a manifest that must be signed, under penalty of perjury, by both the dealer (land owner if collection is from an illegal dump), and the hauler/processor, certifying to the number of tires delivered/collected. However, there is no method by which to independently verify this number.
- The tire weight may easily be misstated. To determine the weight of the tires, the truck and trailer must be weighed gross (full) and tare (empty). However, there are various methods used by the processors for determining gross and tare weights, which could cause tire weight misstatements. While weight tickets are submitted as documentation, they do not identify specific trucks and trailers. Once again, there is no method by which to independently verify this number. Further details regarding this subject may be seen under Objective 2.

**DEPARTMENT OF ENVIRONMENTAL QUALITY AND
OKLAHOMA TAX COMMISSION
WASTE TIRE RECYCLING INDEMNITY FUND
FOR THE PERIOD JULY 1, 2001 THROUGH JUNE 30, 2003**

Upon analyzing the schedule of revenues and expenditures of the Fund, and upon researching the statutes, we noted the following items as contributing to the Fund's declining balance:

Withdrawal by Legislature (FY 99 and FY 00)	\$4,600,000
Funding for playgrounds (FY 02)	1,000,000
New reimbursement category (FY 02 and FY 03)	840,835
Decrease in revenue in FY 02	526,558
Rate increase (FY 02 and FY 03)	313,985
New processor (FY 03)	274,487
	\$7,555,865

While these items negatively impacted the Fund's ability to be self-sustaining, the principal financial obstacle appears to be that the compensation rate per tire can exceed the revenue generated per tire. The law allows payment for each tire up to three times (collection/transportation, processing, and use in manufacturing or energy/fuel recovery), in addition to allowing payment up to the full purchase price for equipment used in manufacturing items from processed tires or in energy/fuel recovery from processed tires.

The following tables illustrate compensation and revenue generated per tire:

Compensation to Processors and/or Users

<u>Car Tire</u>	<u>Amt/ton</u>	<u>Amt/lb</u>	<u>Lb/tire</u>	<u>Amt/tire</u>
collection and transportation	\$48.00	\$0.024	20	\$0.48
processing	\$49.00	\$0.025	20	\$0.49
capital outlay reimbursement	\$20.00	\$0.010	20	\$0.20
energy/fuel recovery	\$29.00	\$0.015	20	\$0.29
				\$1.46

<u>Truck Tire</u>	<u>Amt/ton</u>	<u>Amt/lb</u>	<u>Lb/tire</u>	<u>Amt/tire</u>
collection and transportation	\$48.00	\$0.024	115	\$2.76
processing	\$49.00	\$0.025	115	\$2.82
capital outlay reimbursement	\$20.00	\$0.010	115	\$1.15
energy/fuel recovery	\$29.00	\$0.015	115	\$1.67
				\$8.40

**DEPARTMENT OF ENVIRONMENTAL QUALITY AND
OKLAHOMA TAX COMMISSION
WASTE TIRE RECYCLING INDEMNITY FUND
FOR THE PERIOD JULY 1, 2001 THROUGH JUNE 30, 2003**

Revenue Generated per Tire

<u>Car Tire</u>	<u>Total fee/tire</u>	<u>% submitted to OTC</u>	<u>Total revenue/tire generated</u>
purchased from tire dealer	\$1.00	97.75%	\$0.98
registered with tag agent	\$0.80	100%	\$0.80
<u>Truck Tire</u>			
purchased from tire dealer	\$3.50	97.75%	\$3.42
registered with tag agent	\$3.30	100%	\$3.30

Conclusion

The Waste Tire Recycling Indemnity Fund cannot be self-sustaining under the “honor system” and/or the current rate structure.

Recommendation

A system of accountability is of paramount importance in any program operated with state funds. We recommend DEQ and OTC together establish a system of accountability to be followed both by the tire dealers and the processors.

If it is the intent of the Legislature to have a self-sustaining fund, they should reconsider the fees and the types and rates of compensation allowed and determine appropriate levels for each that will allow the Fund to continue on a self-sustaining basis.

We further recommend the Legislature consider empowering DEQ to perform a feasibility study whenever an application for a new processor is submitted to determine whether the Fund and/or the industry can sustain another processor.

OBJECTIVE #2

Determine whether reimbursements to Frontier and the Four D Corporation were appropriate.

Methodology

The following procedures were performed:

- We obtained from OTC all Request for Compensation forms, including supporting documentation, submitted during the audit period by these two processors.
- We visited both processors at their facilities.
- We obtained information from Ag’s Weights and Measures Division regarding the scales used by each of the two processors.

DEPARTMENT OF ENVIRONMENTAL QUALITY AND
OKLAHOMA TAX COMMISSION
WASTE TIRE RECYCLING INDEMNITY FUND
FOR THE PERIOD JULY 1, 2001 THROUGH JUNE 30, 2003

- We compared the number of tires reported, the number of tons reported, and the compensation amounts between FY 02 and FY 03 for all processors.

Observations

For the months of July 2001, November 2001, April 2002, June 2002, September 2002, October 2002, March 2003, and May 2003, we traced the number of car and truck tires reported on the Request for Compensation to manifests that were signed by the tire dealer/landowner and the hauler/processor. For those same months, we traced the net tire weight from the Request for Compensation to the scale printout that appeared on either the manifest or a separate weight ticket. While there were immaterial differences, it did not appear that the processors were over/underpaid by any significant amount.

Upon visiting the facilities, we noted the following:

- Frontier management stated their drivers may weigh the truck and trailer empty (tare weight—without tires) and return to weigh it loaded, or vice versa. However, there is no distinction as to gross or tare weight on the weight ticket.
- Four D management stated that they use a predetermined tare weight for trailers, and manually enter that weight into the scale keypad at the time of weighing a loaded truck. DEQ policy 252:515-21-32 (h) (3) (effective 6-1-03) states, "Stored tare weights shall not be used".

According to DEQ policy 252:520-21-3 (e) (effective 6-1-99), "...Weighing must be at scales tested and certified in accordance with Department of Agriculture requirements. Scales must be inspected at least quarterly by the State Department of Agriculture or an approved independent contractor." Based on review of the quarterly inspections and conversations with Ag officials, the following items were noted:

Frontier (*Frontier uses scales at the Borg Steel Corporation*)

- Borg Steel's vehicle scale was rejected on 1-15-02. However, according to Ag's records, it was repaired on the same day.
- One of Borg Steel's vehicle scales was rejected on 1-28-04 for weighing 90 pounds light.
- According to DEQ's records, Borg Steel's vehicle scales were not certified during the second and fourth quarters of FY 02 and the third quarter of FY 03.

Four D Corporation

- Four D's vehicle scale was certified on 2-21-02.
- Four D's vehicle scale was certified on 1-27-04.
- According to DEQ's records, Four D's vehicle scale was not certified for the first and second quarters of FY 02 and the fourth quarter of FY 03.

**DEPARTMENT OF ENVIRONMENTAL QUALITY AND
OKLAHOMA TAX COMMISSION
WASTE TIRE RECYCLING INDEMNITY FUND
FOR THE PERIOD JULY 1, 2001 THROUGH JUNE 30, 2003**

The following table summarizes the results of comparing the number of tires reported, the number of tons reported, and the compensation amounts between FY 02 and FY 03 for all processors.

<u>Processor</u>	<u>Change in total tires</u>	<u>Percent change in total tires</u>	<u>Change in total tons (collected)</u>	<u>Percent change in total tons (collected)</u>	<u>Change in compensation</u>	<u>Percent change in compensation</u>
Frontier	(74,484)	-20.06%	218	3.53%	\$36,969	6.34%
Safe Tire	(646,656)	-39.72%	(9,226)	-36.64%	(\$839,231)	-35.14%
Four D	(127,252)	-28.19%	(1,016)	-16.75%	(\$87,153)	-15.10%
Able	1,025,195	464.49%	14,691	408.00%	\$1,412,923	407.88%
Totals	176,803		4,667		\$523,508	

The only two processors whose results appear to be unusual are Able and Frontier. However, Able's large increase is likely due to the fact that the facility did not open until February 2002, operating only 5 months during FY 02, as compared with operating 12 months of FY 03. Therefore, the only processor's numbers that appear to be truly unusual are Frontier's. Since fewer tires were collected, an increase in tons collected appears to be unreasonable.

Conclusion

Due to the nature of the program, it is not possible to determine whether Frontier and Four D were appropriately compensated. However, the following matters were noted:

- Trucks were not weighed as required, both full and empty.
- Scales were not certified quarterly as required by DEQ policy.
- Frontier's percent change in compensation was high when compared to its percent change in total tires collected.
- Policies were not enforced by DEQ.

The largest obstacle in determining whether compensation paid to any processor is appropriate is the fact that the program operates entirely on the "honor system", with no possible method of verifying any data submitted.

Recommendation

We recommend DEQ exercise its authority to investigate any suspected noncompliance with the Waste Tire Recycling Act, and impose enforcement actions, if necessary.

Further, we recommend the Legislature consider amending the current statutorily-mandated compensation process to provide a greater level of accountability.

OBJECTIVE #3

Determine whether the increase in tire tonnage flowing through the system in FY 03 was legitimate.

Methodology

The following procedures were performed:

- We reviewed the analysis prepared by DEQ.
- We compiled an analysis of the tires that were in the system during FY 03.

Observations

According to DEQ management, there was an approximate increase of 10,000 tons of tires flowing through the processing system from FY 02 to FY 03. This figure was based on an analysis in which they compared the actual tons of tires (based on the weight tickets) reported on the Request for Compensation to tons of tires based on the following Rubber Manufacturers Association's (RMA) figures:

- scrap car tire—20 lbs;
- scrap truck tire—100 lbs. (DEQ increased the truck tire estimate to 115 lbs.)

Upon review of this analysis, we noted the following:

- The numbers of car and truck tires were obtained from spreadsheets submitted by the processors. These spreadsheets were tested and were found to be inaccurate.
- The "actual" tons were the number of tons collected during the period, not the number of tons for which compensation was paid.
- The "actual reimbursement" amount was calculated rather than actual.

Therefore, rather than relying on DEQ's analysis, we prepared a similar analysis in which the total tires reported, the total tons collected, the total tons processed and the requested compensation were scheduled from the Request for Compensation forms submitted by the processors. (Our analysis did not include any calculations based on RMA tire weights.) Based on our calculations, there was an increase of 4,667 tons collected between FY 02 and FY 03. Most of this increase appears to be due to Able operating during all of FY 03. However, Frontier's data appears to be inconsistent with that of the other processors. These data are presented in table format under Objective 2.

Conclusion

It appears that the increase in tons processed during FY 03 was legitimate. However, it also appears that the number of tons for which compensation was paid to Frontier is excessive when compared to the number of tires collected.

DEPARTMENT OF ENVIRONMENTAL QUALITY AND
OKLAHOMA TAX COMMISSION
WASTE TIRE RECYCLING INDEMNITY FUND
FOR THE PERIOD JULY 1, 2001 THROUGH JUNE 30, 2003

Recommendation We recommend DEQ obtain an explanation from Frontier Recycling as to why their tire weights appear to be greater than those of the other processors. We also recommend DEQ consider suspending payments to Frontier until a satisfactory explanation has been obtained.

Objective #4 Determine whether there are other issues or concerns that should be addressed.

Methodology The following procedures were performed:

- We reviewed the system for collecting tires from illegal dumps.
- We reviewed the records maintained by OTC that document the number of tires sold and the waste tire fees remitted.

Observations Before an illegal dump site appears on DEQ's Priority Cleanup List, a survey is performed to establish an estimate of the number of tires at the site. However, the number of tires collected from these dumps is not tracked by site; the processor must notify DEQ that all of the tires have been removed. This situation appears to lend itself to abuse because it would be possible to continue to claim compensation for tires collected from the site after it has been cleared.

To determine whether waste tire fees were being properly remitted by tire dealers, a report that listed the number of tires sold (car and truck) for every tire dealer in the state and their waste tire fees remitted to the OTC during FY 02 and FY 03 was requested from OTC. According to the report, approximately 52 million tires were sold in Oklahoma during this period, and several dealers had sold enormous numbers of tires per month. However, there was not a corresponding increase in the Fund's revenue. For example, according to the report provided, the largest number of tires sold by a dealer in a month was 2,668,300, but the amount remitted was only \$26,209.71. The following problems were noted:

- On the Waste Tire Report form submitted by the tire dealers, there is a line for the number of tires sold and a line for the passenger tire fees collected. The line for the number of tires sold has no decimal place, but the passenger tire fee line has a decimal place for cents. Based on a review of four Waste Tire Reports, chosen from those dealers for whom sales appeared to be excessive, we determined that the tire dealers had added two zeroes at the end of the number of tires sold, apparently under the assumption there was a decimal place on the number of tires line.
- There are no procedures to determine whether the amount remitted agrees with the amount due based on the number of tires reported.

A report was also requested for tag agents, listing the number of new cars registered and the fees remitted for the same time period. The same types of problems were noted.

**DEPARTMENT OF ENVIRONMENTAL QUALITY AND
OKLAHOMA TAX COMMISSION
WASTE TIRE RECYCLING INDEMNITY FUND
FOR THE PERIOD JULY 1, 2001 THROUGH JUNE 30, 2003**

Conclusion

No inspections are conducted during the time tires are being reported as collected from illegal tire dumps, thus creating the potential for fraudulent reporting.

It is not possible, from records retained by OTC, to determine how many tires were sold or first registered in Oklahoma during FY 02 and FY 03, nor is it possible to determine whether the correct amount of waste tire fees was collected and remitted to the state.

Recommendation

We recommend DEQ develop formal, written procedures to periodically survey illegal tire dumps to determine progress made in removal of tires. This would reduce the possibility compensation being paid for nonexistent tires.

We further recommend OTC redesign the Oklahoma Waste Tire Report to be more easily understandable, as well as develop procedures to ensure the fees remitted to the OTC correspond to the reported number of tires sold and/or first registered.