



South Bayside Waste Management Authority

Review of Allied Waste Industries' Final 2010 Transfer Station Compensation Application



September 15, 2011



HF&H Consultants, LLC

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September 15, 2011

Mr. Kevin McCarthy
Executive Director
South Bayside Waste Management Authority
610 Elm Street
San Carlos, CA 94070

Reference Number: S3804

Subject: Review of Allied Waste Industries' Final 2010 Transfer Station Compensation Application

Dear Mr. McCarthy:

This report documents HF&H Consultants, LLC's (HF&H) review of Allied Waste Industries' (Allied) Final 2010 Transfer Station Compensation Application (Application) to the South Bayside Waste Management Authority (SBWMA) for the operation of the SBWMA's Shoreway Environmental Center (Shoreway) located in San Carlos. Specifically, this report summarizes our audit of the reasonableness of Allied's reported 2010 revenue and operating expenses (see Table 1) and calculates the cumulative balancing account shortfall due to Allied (see Table 2) and reflects the negotiated revisions since the draft report dated July 22, 2011.

Adjustments and Results for 2010

Based on our review and of Allied's reported operating results for operations ending December 31, 2010, we recommend:

- 1) An \$8,923,000 increase to revenues resulting primarily from recognizing recycling material payments from Smurfit (the Authority's third-party recyclable material processor) and an increase in realized revenue from a minor reduction to Allied's diversion incentive payment;
- 2) A \$637,000 reduction to Allied's allowable operating expenses and profit;
- 3) A \$5,104,000 increase to material processing costs paid to Smurfit to process recyclable materials due to the shutdown and demolition of the MRF, which Allied did not include in their projections;

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Table 1
HF&H Adjusted Annual Revenue Requirement

Shoreway Environmental Center
 (\$000's Unless Otherwise Indicated)

	HF&H Adjusted FY2010	Per Allied Rate App	Net Adjs
A Revenue	37,128	28,205	8,923
Revenue Requirement			
Allied's Operating Expenses ¹	26,038	26,675	(637)
Smurift Recycling Processing Costs	5,104	-	5,104
B Total Revenue Requirement²	31,141	26,675	4,467
Operating Surplus/(Shortfall) (A - B)	5,987	1,530	4,457

¹ Includes operating costs, profit, and disposal

² Total revenue requirement does not include Franchise Fees, SBWMA management costs, or debt payments.

Variance to Projections from Last Year's Review (see Exhibit 3, Page 5)

Actual revenue (both from the gate and from the sale of recyclable materials) were a net \$824,000 greater than projected.

Actual revenue requirement, (i.e., allowable compensation), for the operation of the Shoreway facility were a net \$736,000 less than projected.

Section II of our report summarizes the variances in more detail.

Estimated Allied Compensation Balancing Account Balance

Since the start of the operating agreement in March 2000, Allied has received bi-monthly payments from the SBWMA. The per-ton payment amount is calculated to provide Allied with its allowable projected compensation; however, the payments are not intended to provide compensation greater than actual expenses and allowable profit. On an annual basis, HF&H reviews and determines Allied's actual compensation (actual and allowable expenses and profit). HF&H calculates the difference between Allied's actual compensation and the sum of the bi-monthly payments Allied actually received from the SBWMA during 2009 and 2010 (\$30,762,000 and \$26,531,000, respectively; Table 2, Line 10 on the next page). The cumulative balance owed Allied for operations through December 31, 2010 is \$1,988,000 (compared to the projected balance owed of \$2,213,000 estimated last year) and is summarized in Table 2, Line 19 and in Exhibit 1 included in the Executive Summary of this report.

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Additional detail regarding the anticipated cumulative balancing account due Allied at the end of the current Operating Agreement is provided in the Executive Summary of this report.

Table 2

Allied Cash Balances		2006	2007	2008	2009	2010	
1	Allied Reimbursable Expenses	28,950	29,909	31,107	29,486	26,038	
2	Third Amendment \$.90 per ton reduction 4/1/04-12/31/06	(444)					
3	Self Haul Penalty Adjustment	425	-				
4	2003 overpayment reimbursed in 2006 with interest	(423)					
5	Due from SBWMA prior yr under \$250,000	85		147			
6	Prior Period (over)/under Payment	-	(2,647)	-	2,132	600	
7	Reimbursable Expenses net of penalties and adjustments	28,592	27,263	31,254	31,618	26,638	
8	Incentive Payments	534	510	443	499	580	
9	Net Revenue Required	29,126	27,773	31,697	32,117	27,218	
10	SBWMA Payments to Allied	27,023	27,724	31,097	30,762	26,531	
11	Due (to) / from SBWMA from Operations	2,103	48	600	1,355	687	
12	Total Gate Fee and Commodity Revenues (excludes Smurfit)	35,506	37,197	37,163	31,540	28,736	
13	Revenues Sent to SBWMA	35,491	37,295	37,163	31,527	28,682	
14	Due (to) / from SBWMA from Cash Flow	(15)	98	-	(13)	(54)	
	Line						
15	Due (to)/ from SBWMA	2,088	147	600	1,342	634	
16	Interest Payment	44	-	-	5	8	Cumulative
17	Total Due (to)/from SBWMA	2,132	147	600	1,347	641	Balance Due
18	Payments Made	(2,132)	(147)	(600)			Allied
19	Balance Due (to)/ from SBWMA through 12/31/10	-	-	-	1,347	641	1,988

* * * *

HF&H appreciates the assistance provided by Allied management and staff during its review, and your direction. Should you have any questions, please call me at 925/977-6957.

Very truly yours,
 HF&H CONSULTANTS, LLC

Richard J. Simonson, CMC
 Vice President

cc: Marshall Moran, SBWMA
 Kevin Finn, Allied Waste Industries
 Rich Lanser, Allied Waste Industries
 HF&H Client Files

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Section I. Executive Summary

Reconciliation of Allied's Actual Compensation to Payments from the SBWMA

Since the start of the operating agreement in March 2000, Allied has received bi-monthly payments from the SBWMA. The per-ton payment amount is calculated to provide Allied with its allowable projected compensation; however, the payments are not to provide compensation greater than actual expenses and allowable profit. On an annual basis, HF&H reviews and determines Allied's actual compensation (actual and allowable expenses and profit). HF&H calculates the difference between Allied's allowed compensation and the sum of the bi-monthly payments Allied received from the SBWMA. The balance owed Allied for operations through December 31, 2010 is \$1,988,000 (compared to the projected balance owed of \$2,213,000 estimated last year) and is summarized in Exhibit 1, line 19.

Exhibit 1

<u>Allied Cash Balances</u>		<u>2006</u>	<u>2007</u>	<u>2008</u>	<u>2009</u>	<u>2010</u>	
1	Allied Reimbursable Expenses	28,950	29,909	31,107	29,486	26,038	
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19	Balance Due (to)/ from SBWMA through 12/31/10	-	-	-	1,347	641	1,988

Allied's Comments Regarding HF&H Current-Year Adjustments

HF&H, SBWMA, and Allied staff met on August 17 to discuss HF&H's recommended adjustments presented in our July 22, 2011 draft report (which was presented to the Board at the July 28, 2011 Board meeting). At that meeting, Allied staff took exception to several of HF&H's recommended adjustments in the July 22, 2011 draft report. While we were able to come to a mutually agreeable compromise on most items; there are several issues that remain. The results presented in this report reflect the adjustments based on HF&H and SBWMA staff's interpretations of the Agreement; however, Allied is not in agreement with all of our adjustments. These adjustments and Allied's concerns are described below. **Where applicable, we have noted and provided an update based on meetings with Allied management subsequent to the presentation of the draft report to the Board on July 28, 2011.**

Reconciliation of Post-2010 Expenses Not Yet Known

Allied's 2010 reported expenses included approximately \$8,700 in a projected liability for the future (i.e., past December 31, 2010) settlement of workers compensation claims on accidents that occurred during the contract period (i.e., through 12/31/10). Allied's workers compensation insurance is self-funded and establishes a reserve. The reserve is subsequently reconciled to the actual costs incurred (subject to a \$250,000 cap). Such adjustments can be made up to two years from the date of the claim. Therefore, it is unknown at this time what the total cost of claims that occurred in 2009 and 2010 will be; the final costs may be higher or lower.

Update since the July 22, 2011 draft report: Allied's final compensation (detailed in this report) includes actual workers compensation claim reserves through August 2011. Actual claims will be higher or lower than what has been projected; however, the parties have agreed that this is a fixed amount which will not be reconciled based on actual results.

Pre-Paid Vehicle Licenses

Allied's 2010 operating costs included the accelerated expensing of vehicle license fees for vehicles that were manufactured in 2000 or prior. The state bills, and Allied pays, the vehicle license fees one-time per year; however, historically such expenses are divided into 12 equal payments and booked over a 12-month period. The vehicle license fees paid in 2010 cover anywhere from 1 to 11 months of calendar year 2011 (depending which month in 2010 the vehicle license is due). Allied's application has included the full 12-month fee even though the vehicle was only used to operate the Shoreway facility for something less than the full 12-months. We do not believe the methodology for spreading such costs over the 12-month period should change during the last year of the agreement by accelerating the depreciation. Allied is not in agreement with our position. Cost to Allied is approximately \$10,000 for the year ending December 31, 2010. Although the SBWMA has essentially paid for these vehicles through the compensated depreciation expense, Allied will have the use of these vehicles in other operations or will have the full benefit from the proceeds from any sale of these vehicles with nothing coming back to the SBWMA.

Update since the July 22, 2011 draft report: Allied has agreed to allow this adjustment.

Corporate Overhead

In accordance with the Operating Agreement, Allied's allowable overhead expense is the lesser of: 1) 3.5% of the revenue received at the Transfer Station and MRF or 2) the cap amount of \$1,385,000 (adjusted annually by the change in CPI). Allied's calculation was based on receiving 100% of the capped amount provided for in the Operating Agreement; however, during both years, 3.5% of the projected revenue at the Shoreway Facility is less than the cap amount (after including Smurfit commodity revenues per a negotiated agreement between the Executive Director and Allied Management with the Board's approval). Allied is not in agreement with our revised calculations. Allied believes the agreement was to calculate Overhead expense to equal the Cap, not whichever is less. The 2010 Cap is \$1,384,309 and our recommended adjustment compensates Allied \$1,319,770. This is the same objection Allied raised during last year's rate review but the Board approved the staff recommendation to pay the lesser of 3.5% or the cap. Cost to Allied is \$64,817.

Update since the July 22, 2011 draft report: Allied continues to disagree with this adjustment.

Safety Incentive Program

During the 4th quarter of 2009, Allied's General Manager doubled the monthly safety incentive payments payable to those collection drivers which maintain a safe driving/accident record during the previous month; however, such an increase was not discussed with nor approved by the SBWMA's Executive Director, as required. HF&H has reduced Allied's allowable safety incentive program expenses for 2010 to the projected amounts which would have been paid prior to the General Manager doubling the incentive payment amount (similar to the adjustment made last year to Allied's allowable 2009 expenses). Allied believes the increased incentive payments lead to fewer accidents and workers' compensation claims during that time period and should therefore be an allowable expense; however, total claims costs have continued to rise. Cost to Allied is approximately \$36,000 for the year ending December 31, 2010.

Update since the July 22, 2011 draft report: Allied continues to disagree with this adjustment.

Bridge Repair Costs

Our adjustments include decreasing Allied's allowable insurance expense by \$47,000 to remove bridge repair costs resulting from an accident at the Transfer Station by a transfer driver. Staff feels that the accident was a result of driver negligence and should be denied, based on the contract criteria of "reasonable and necessary".

Update since the July 22, 2011 draft report: Allied has agreed to allow this adjustment.

Transfer Station Diversion Update

The transfer station facility recovers materials through: (1) a floor-sort program; and (2) transfer of plant materials and commercial organics for processing. These programs have had the desired effect (as

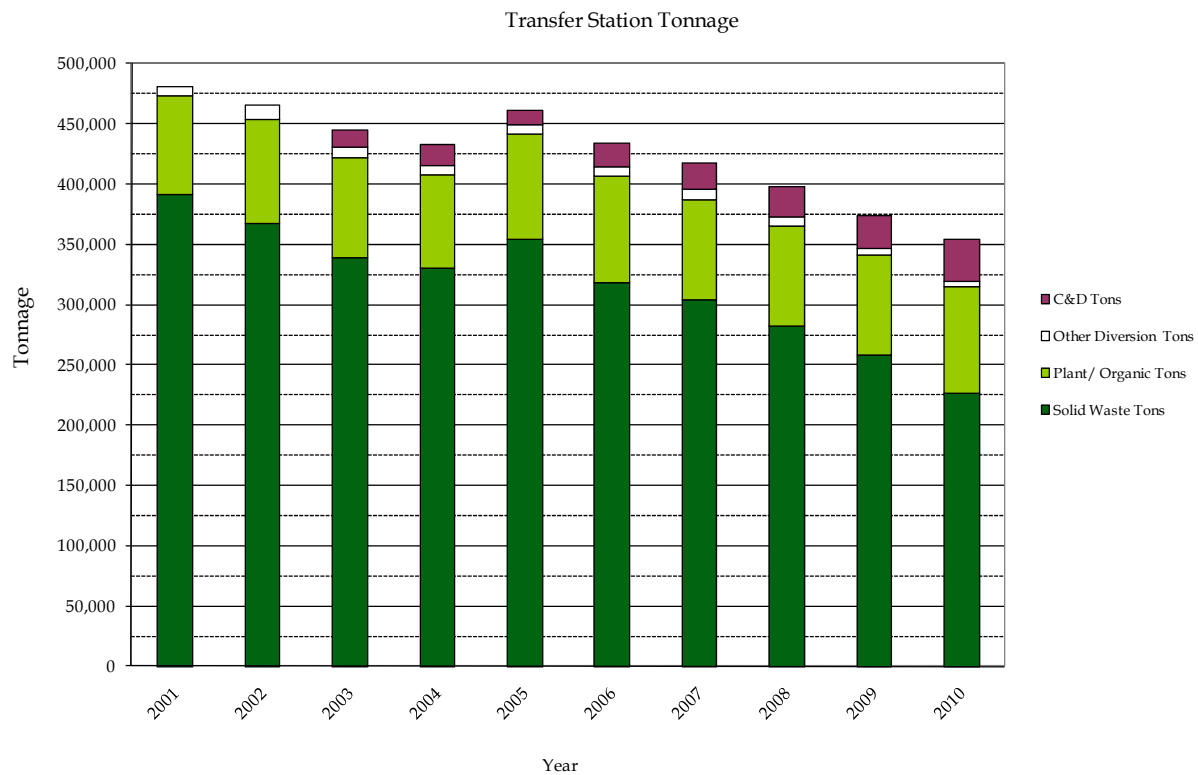
illustrated in Exhibit 2). Over time, solid waste tons as a percent of total waste disposed have decreased, while tons diverted have increased.

Exhibit 2

<u>Year</u>	<u>Solid Waste Tons</u>	<u>Plant/ Organic Tons</u>	<u>C & D Tons¹</u>	<u>Other Diversion Tons²</u>	<u>Total Tons</u>	<u>% Diversion</u>
2001	391,465	81,779		7,626	480,869	18.59%
2002	367,003	86,589		11,798	465,390	21.14%
2003	339,218	83,000	13,768	8,541	444,527	23.69%
2004	330,379	77,397	17,078	7,623	432,477	23.61%
2005	354,674	86,706	12,266	8,084	461,729	23.19%
2006	318,170	88,931	19,624	7,526	434,251	26.73%
2007	303,665	83,456	22,137	8,674	417,931	27.34%
2008	281,812	83,540	25,865	7,185	398,402	29.26%
2009	258,199	82,883	27,093	5,285	373,460	30.86%
2010	226,563	87,853	34,800	4,677	353,893	35.98%

¹ Note: Beginning in 2003, Allied began tracking C&D separately

² Other diversion includes metals, batteries, aggregates, tires, carpet and e-waste



Section II. Variance Analysis

This section documents our analyses of the Shoreway Facility revenue and expense variances between the 2010 projected results (as estimated during last year's review) to the 2010 actual results.

Projected 2010 Results versus Actual 2010 Results Variance Analysis

Summarized below is HF&H's variance analysis comparing the actual 2010 results to 2010 projected results during last year's review.

Exhibit 3				
South Bayside Waste Management Authority				
Shoreway Facility Variance Analysis (2010 Projected vs. 2010 Actual)				
(\$000's Unless Otherwise Indicated)				
	Projected FY 2010	Actual FY 2010	Variance	% Change
Gate Revenues	28,271	28,508	237	0.8%
Material Sales Revenues	<u>8,574</u>	<u>9,200</u>	<u>626</u>	7.3%
Total Revenues	36,845	37,708	863	2.3%
Less: Incentives	<u>(541)</u>	<u>(580)</u>	<u>(39)</u>	7.2%
Net Revenues	<u>36,304</u>	<u>37,128</u>	<u>824</u>	2.3%
Operating Costs Eligible for Profit	12,406	11,970	(437)	-3.5%
Operating Ratio	1,227	1,184	(43)	-3.5%
Pass-Through Expenses ¹	<u>19,465</u>	<u>19,209</u>	<u>(257)</u>	-1.3%
Annual Revenue Requirement	<u>33,098</u>	<u>32,362</u>	<u>(736)</u>	-2.2%
Surplus/(Deficit)	<u>3,206</u>	<u>4,766</u>	<u>1,560</u>	

¹ Excluding SBWMA management costs

The variances shown in Exhibit 3 result from the following:

Revenues

Actual 2010 Net Revenues were \$824,000 (2.3%) greater than projected, a result of the following:

- Transfer station gate revenues were \$237,000 (0.8%), greater than projected, as a result of slightly greater than anticipated tons from Allied's franchised and non-franchised Builders' Debris Box Service (BDDBS) and solid waste yards brought to the facility by the general public;

partially offset by, less than anticipated tons green waste yards brought to the facility by the general public and slightly less tons from Allied's franchised collection operations;

- Recyclable material sales revenue were \$626,000 (7.3%), greater than projected, resulting from a 5.6% increase in the total recyclable material tons collected and processed, as well as, a 3.6% increase in the average revenue per ton received from the sale of the recyclable materials.
- Allied's revenue sharing incentive was \$39,000 (7.2%), greater than projected; primarily due to a greater than anticipated diversion incentive payment due Allied for exceeding the floor sort diversion level reached in previous years.

Operating Costs Eligible for Profit

Actual Operating Costs Eligible for Profit was \$437,000 (3.5%) less than projected last year. The major variances are primarily the result of the following:

- ⊕ Direct Labor expenses were \$124,000 (2.2%) less than projected primarily due to: 1) less than anticipated outside labor expenses; 2) slightly less health care premium expense; and 3) less than anticipated holiday and sick payouts during the last quarter of 2010;
- ⊕ Maintenance and Other expenses were \$139,000 (3.6%) less than expected resulting from: 1) less than expected cost of fuel, oils, lubricants, and tires; 2) less than expected parts expenses; partially offset by greater than anticipated truck rental and outside repair costs.
- ⊕ Operating Insurance expenses were \$133,000 (16.4%) less than projected due to the actual cost to cover workers' compensation claims (i.e., cost related to doctor visits, surgeries, physical therapy, prescriptions, etc.) were less than the reserve amounts initially set up by the third-party insurance adjuster (including credits to reserves post-2010);
- ⊕ G&A expenses were \$59,000 (8.0%) less than projected, primarily resulting from less than anticipated legal and other consulting/professional fees ; and,
- ⊕ Corporate and Regional Overhead expenses were \$18,000 (1.4%) greater than projected as a result of higher than projected Gate Fee revenue and commodity sales revenue, discussed above in the revenue section. Overhead costs, in accordance with the Operating Agreement, are based on 3.5% of revenues at the Shoreway Facility. Note: 2010 Overhead calculation was calculated assuming Allied processed and marketed all of the recyclable materials including material sold by Smurfit, in accordance with the agreement between the SBWMA Executive Director and Allied Management and approved by the SBWMA Board of Directors.

Profit

Allied's operating profit was \$43,000 (3.5%) less than projected due to the less than projected operating costs eligible for profit, described above.

Pass-Through Expenses

Pass-through Expenses were \$257,000 (1.1%) less than projected last year, as a result of:

- Actual Disposal expenses that were \$381,000 (2.9%) less than projected as a result of: 1) fewer yard waste tons delivered to Newby Island and delivered to Bio-Fuel Systems at a cheaper rate; 2) less than anticipated costs for the handling of metals, batteries, tires, e-waste, and carpet); and,
- ⊕ Actual Smurfit Recyclable Material Processing costs were \$261,000 (5.4%) greater than projected, as a result of the greater than anticipated recyclable material tons processed by Smurfit (this increase costs was more than offset by the additional revenue received from the sale of these materials); and,
- ⊕ Actual Franchise Fee costs were \$125,000 (9.3%) less than projected as a result of a calculation error in last year's projections (in accordance with the Operating Agreement, franchise fees paid to the City of San Carlos are calculated as 4.76% of gross revenue); and,
- Actual Permit Fees were \$11,000 (260.2%) less than projected.

Section III. Allied Compensation Process

The April 2005 Operating Agreement between Allied and the SBWMA describes the process for Allied's compensation.

Allied projects the revenues and expenses of the Shoreway Facility based upon actual results, trends, and management's plans. Rates are determined to reimburse Allied for its reasonable operating expenses and profit (calculated using a 91% operating ratio). The operating ratio is applied to Allied's reasonable and necessary expenses, exclusive of certain pass-through expenses (e.g., disposal fees, franchise fees, lease payments, and the SBWMA budget). Variances between Allied's actual revenues and its revenue requirement (i.e., allowable compensation) are recorded and carried forward to future periods in a balancing account.

After preparing the Application, Allied presents it to the SBWMA. The SBWMA requests its consultant (HF&H) to determine the reasonableness of the Application and its consistency with the regulation requirements of the Operating Agreement. The consultant summarizes the results of its findings in a report to the SBWMA Board for consideration. If necessary, the Board determines the amount of any gate fee rate adjustments, based upon the report of its consultant and other available data, in order to fully compensate Allied for their projected operating expenses. This year's review is reconciling Allied's actual 2010 revenues and expenses and calculating the surplus/shortfall of Allied's balancing account with the SBWMA.

Section IV. Scope of Review

Scope of Review

The scope of HF&H's review of the Application included:

- Reviewing the mathematical accuracy and logical consistency of the rate application;
- Obtaining supporting schedules from Allied that present actual and projected operational data and financial results of operations;
- Reconciling the above schedules to Allied's audited financial statements and other records;
- Reviewing capital additions and replacements for accuracy and reasonableness;
- Comparing the year ending December 31, 2010 results of operations, projected during last year's rate review, to actual results;
- Identifying appropriate adjustments; and,
- Calculating Allied's compensation shortfall or surplus as of December 31, 2010, if any, in accordance with the Operating Agreement.

Limitations

Our review did not comprise an audit of Allied's financial statements to express an opinion regarding the financial statements taken as a whole. For 2010, Hood & Strong performed such an audit.

Section V. Findings and Recommendations

Exhibit 4 shows the results of HF&H's review of the Application and our recommended adjustments to the operating results reported by Allied. We briefly describe our adjustments on the following pages.

Allied's 2010 Operating Results		Exhibit 4
As Adjusted By HF&H (\$000's Unless Otherwise Indicated)		
		Actual <u>YE 2010</u>
Revenue Projected By Allied		
1.	Gate Revenues	28,572
2.	Material Sales Revenues	164
	Less: Incentive Adjustments	<u>(531)</u>
3.	Total Net Revenue Projected By Allied	28,205
<u>HF&H Recommended Revenue Adjustments</u>		
4.	Transfer Station Revenue Adjustment	-
5.	Recyclable Materials Revenue Adjustment	<u>8,971</u>
6.	Total Revenue Adjustments	8,971
<u>HF&H Recommended Incentive Adjustments</u>		
7.	Minimum Profit Adjustment	(51)
8.	Adjust Tonnage Diversion Incentive	<u>3</u>
9.	Total Incentive Adjustments	(48)
10. Total Adjusted Revenue (Line 3 + Line 6 + Line 9)		37,128
11. Operating Expenses Projected By Allied		
HF&H Operating Expense Adjustments		
12.	Direct Labor	(244)
13.	Direct Fixed	(7)
14.	Direct Maintenance	(114)
15.	Indirect Maintenance	-
16.	Supervisory Expense	-
17.	Other Expense	-
18.	Insurance	(148)
19.	General and Administrative	(1)
20.	Overhead	<u>(65)</u>
21.	Adjusted Operating Expenses	11,970
22. Operating Ratio Projected by Allied		
23.	Profit Adjustments due to Expense Adjs Above	<u>(57)</u>
24.	Adjusted Operating Ratio	1,184
25. Pass Through Expenses Projected By Allied (excl. SBWMA budget)		
<u>HF&H Recommended Pass Through Expenses Adjustments</u>		
26.	Disposal Expense	-
27.	Smurfit Processing	<u>5,104</u>
28.	Adjusted Pass Through Expenses	19,209
29. Total Revenue Requirement (Line 21 + Line 24 + Line 28)		32,362
30. Current Year Surplus / Deficit (Line 10 - Line 29)		4,766

Adjustments to Allied Actual and Projected Revenues

Net Revenue Adjustment

For the year ending December 31, 2010, we recommend increasing projected revenue by \$8,971,000 (Exhibit 4, Line 5), to include the commodity sales revenue from the off-site processing of recyclable materials during the demolition and reconstruction of the MRF. Allied was not responsible for the processing nor marketing of the materials they collected; however, we have included the sales figures to provide the Authority with a complete picture of the financial performance of the Shoreway facility during 2010.

Adjustments to Allied Revenue Related Incentives

The Operating Agreement provides incentives for Allied to increase the volume of materials diverted from the landfill. These incentives are comprised of a revenue sharing incentive (Section 5.05 of the Operating Agreement) and a tonnage incentive related to the “Floor Sorting” and “Bunker” programs (Section 5.05 of the Operating Agreement).

Minimum Profit Guarantee

Allied calculated that it was due \$504,000 in 2010, for revenue-sharing incentive payments, based on the revenues received from the sale of recyclable materials above \$4,500,000, up to the agreed-upon maximum profit level. Because Allied was not responsible for processing recyclable materials in 2010 (due to the demolition and reconstruction of the MRF); and, therefore would not have the opportunity to receive the previously agreed-upon revenue-sharing incentive payment, the parties agreed to provide Allied with a payment in lieu of the revenue-share incentive payment. The in lieu payment would be additional profit; however, the amount, when added to their operating profit, could not exceed 90% of their maximum allowable profit in accordance with the Operating Agreement.

Allied included an additional profit amount to provide the agreed-upon minimum profit level that Allied would have experienced had they continued to process and market recyclable materials instead of having them processed by a third-party during the re-construction of the MRF.

Based on our analysis of the contracted limit on Allied’s annual profit, we recommend increasing (thereby decreasing revenues available for operations) Allied’s net revenue sharing amount by \$51,000 (Exhibit 4, Line 7).

Tonnage Diversion Incentive

Allied calculated that it was due \$27,500 in the tonnage diversion incentive in 2010. Per our analyses, Allied’s 2010 calculation was based on reaching the previous year’s diversion level rather than the highest level reached during the term of the agreement, which occurred in 2003. Allied diverted 39,083 tons through the floor-sort program in 2010, which qualified them for the incentive for reaching 80% of

the highest level achieved, 37,977 tons in 2003. Based on our calculations using the 2003 benchmark for the calculation, Allied is due \$25,000 for the tonnage incentive; therefore, we recommend decreasing the incentive payment, thereby increasing revenues available for operations, by \$2,500 (Exhibit 4, Line 8).

Adjustments to Allied's Actual and Projected Operating Expenses

We recommend the following adjustments to Allied's actual and projected expenses, as described below.

Direct Labor

We recommend decreasing Direct Labor expense by a net \$244,000 (Exhibit 4, Line 12) as a result of the following:

- A decrease of \$103,000, for the labor-related component of the transportation and processing of plant material at Newby Island (in accordance with the First Amendment to the Agreement). As part of Allied's annual rate application, they calculate the difference between their actual costs to transport and process plant materials at their Newby Island Processing Facility and remove any excess expenses greater than \$26.00 per ton (adjusted annually by the change in CPI). In this case, Allied did not remove enough; and,
- A decrease of \$92,000 to remove January 2011 health care premiums paid by Allied for employees employed by the new operator. Subsequent to Allied submitting their Application and their request to receive payment for such costs from the Authority (through this Application process it has been determined that the new operator, SBR, has also paid for TBT January coverage of their employees. Therefore, Allied is seeking a credit back from the Teamster's Benefit Trust for this duplicate payment ; and,
- A decrease of \$45,000, to remove Allied's over accrual of estimated expenses incurred during 2010 but an invoice had not yet been received. Vendors typically send invoices 2-3 weeks after services/products have been requested or received. In order to ensure they would be compensated for expenses that were incurred but not yet paid as of December 31, 2010, Allied estimated what those costs would be. HF&H reviewed subsequent payments during January, February, and March 2011 and found allied had overstated the expenses; and,
- A decrease of \$2,500 to remove costs associated with additional volume of material left on the transfer station floor on December 31, 2010. Allied's application did remove \$2,000 to provide a credit for 4-hours of the drivers pay to account for the additional volume left in the transfer station on the final day; however, the parties agreed the credit should be increased additional \$2,500 to account for services required but not provided.

Direct Fixed

We recommend decreasing Direct Fixed costs (i.e., vehicle depreciation) by \$7,000 (Exhibit 4, Line 13), to correct a calculation error in Allied's allowable sales tax reimbursement on leased equipment from a related-party.

Direct Maintenance

We recommend decreasing Direct Maintenance expense by a net \$114,000 (Exhibit 4, Line 14), due to the following:

- A decrease of \$104,000 for the vehicle-related component of the transportation and processing of plant material at Newby Island (in accordance with the First Amendment to the Agreement). As part of Allied's annual rate application, they calculate the difference between their actual costs to transport and processing plant materials at their Newby Island Processing Facility and remove any excess expenses greater than \$26.00 per ton (adjusted annually by the change in CPI). In this case, Allied did not remove enough; and,
- A decrease of \$10,000, to remove the 2011 portion of the accelerated expensing of vehicle license fees. Allied's 2010 operating costs included the accelerated expensing of vehicle license fees for vehicles that were manufactured in 2000 or prior. The state bills, and Allied pays, the vehicle license fees one-time per year; however, historically such expenses are divided into 12 equal payments and booked over a 12-month period. The vehicle license fees paid in 2010 cover anywhere from 1 to 11 months of calendar year 2011 (depending which month in 2010 the vehicle license is due). Allied's application has included the full 12-month fee even though the vehicle was only used to operate the Shoreway facility for something less than the full 12-months. We do not believe the methodology for spreading such costs over the 12-month period should change during the last year of the agreement by accelerating the depreciation. **Allied has agreed to allow this adjustment;** and,

Indirect Maintenance

HF&H reviewed and does not recommend any adjustment to Allied's reported Indirect Maintenance expenses for 2010 (Exhibit 4, Line 15).

Supervisory

HF&H reviewed and does not recommend any adjustment to Allied's reported and projected Supervisory expenses for 2010 (Exhibit 4, Line 16).

Other Expense

HF&H reviewed and does not recommend any adjustment to Allied's reported and projected Other expenses for 2010 (Exhibit 4, Line 17).

Insurance

We recommend decreasing Allied's reported Insurance expense by \$148,000 (Exhibit 4, Line 18) to: 1) remove doubling of safety incentive payments to Transfer Station drivers without prior approval by the Executive Director; 2) remove the cost to repair damage caused to the new Transfer Station bridge due to the negligence of a transfer driver; and, 3) reduce actual workers compensation reserve amounts to reflect the actual results through August 2011.

General and Administrative (G&A)

We recommend decreasing General and Administrative expenses by a net \$1,000 (Exhibit 4, Line 19), to remove additional non-allowable charitable contributions not already removed by Allied.

Overhead

HF&H recommends decreasing Overhead expenses by \$65,000 (Exhibit 4, Line 20), resulting from a recalculation of Allied's allowable overhead expense, calculated in accordance with the Operating Agreement. In accordance with the Operating Agreement, Allied's allowable overhead expense is the lesser of: 1) 3.5% of the revenue received at the Transfer Station and MRF or 2) the cap amount of \$1,385,000 (adjusted annually by the change in CPI). Allied's calculation was based on receiving 100% of the capped amount provided for in the Operating Agreement; however, during both years, 3.5% of the projected revenue at the Shoreway Facility is less than the Cap (after including Smurfit commodity revenues per the Board's approval). **Allied is not in agreement with our revised calculations. Allied believes the agreement was to calculate Overhead expense to equal the Cap, not whichever is less. The 2010 Cap is \$1,384,309 and our recommended adjustment compensates Allied \$1,319,770. This is the same objection Allied raised during last year's rate review but the Board approved the staff recommendation to pay the lesser of 3.5% or the cap.**

Adjustments to Operating Ratio (Profit)

HF&H recommends decreasing Allied's profit by \$57,000 (Exhibit 4, Line 23), due to the respective net recommended reductions to Allied's Operating Expenses Eligible for Profit, described above.

Adjustments to Pass-Through Expenses (excluding SBWMA management costs)

Disposal Costs

HF&H reviewed and does not recommend any adjustment to Allied's reported Disposal Costs expenses for 2010 (Exhibit 4, Line 26).

Smurfit Processing (Off-Site Recyclable Material Processing Services)

Based on discussions with SBWMA staff and the third-party agreement with Smurfit (the third-party contractor that is processing recyclable materials while the MRF is be constructed) the actual processing costs for 2010 were \$5,104,000 (Exhibit 4, Line 31). Allied was not responsible for the processing nor marketing of the materials they collected; however, we have included the processing costs (and revenue; see revenue discussion above) to provide the Authority with a complete picture of the financial performance of the Shoreway facility during 2010.

Cumulative Operating Surplus/ (Shortfall) before Accounting for SBWMA Management Costs

HF&H calculated that the surplus or shortfall from operations (before accounting for the SBWMA management costs) during the period of January 2010 to December 2010 is a \$4,766,000 surplus (Exhibit 4, Line 30).