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February 11, 2016

Farouk Fakira, Finance Manager  
SBWMA/RethinkWaste  
610 Elm Street, Suite 202  
San Carlos, CA 94070

**Subject: Financial Systems Audit of 2015 Collection Services and Facility Operations Contractors Project**

Dear Mr. Fakira:

R3 Consulting Group, Inc. (R3) is pleased to submit our our attached Statement of Qualifications; Work Proposal; List of Staff, Hourly Rates & Cost Proposal; and Implementation Schedule for the above referenced project to the South Bayside Waste Management Authority (RethinkWaste).

## Firm Background and Qualifications

Established in 2002, R3 is a solid waste management consulting firm that has been in business for 14 years. ***We work exclusively for municipal agencies responsible for solid waste management*** – we do not work for private solid waste management service providers. One of R3's core services is assisting public agencies, like RethinkWaste, that manage private sector service providers with a review of the rates, finances and operations of those service providers. We believe that our qualifications and ability to conduct a high-quality review for RethinkWaste is most effectively demonstrated by our repeated selection to conduct detailed and complex financial audits and rate analyses for jurisdictions throughout California. Those projects include:

- Our current and past detailed rate review projects for the City of San Jose;
- Our hauler tonnage and fee audits conducted annually for the past five years for the cities of Citrus Heights, Elk Grove, Rancho Cordova and Sacramento and Sacramento County;
- Our current financial audit of the City of Fresno's contracted transfer station operator; and
- Our recent detailed rate reviews for the cities of San Francisco and Fresno.

These and other projects conducted by R3 – most notably, our more than two dozen contractor compliance reviews and billing and fee audits that have involved many of the same type of review and analysis required to successfully complete this engagement – have included:

- Reconciling revenues;
- Assessing the accuracy of customer billings for both standard and extra services;

- Verifying the accuracy of contractor compensation;
- Assessing the accuracy of material sales and CRV revenues;
- Reviewing and assessing scale house practices and data tracking and reporting procedures; and
- Testing tonnage and revenue weight ticket source data.

R3 also gained considerable insight into both Recology's and SBR's monthly, quarterly and annual reports and internal controls as part of conducting the 2013 and 2014 Review of Collection Services and Facility Operations Reports, Tonnage, Data and Customer Service Systems Auditing Project for RethinkWaste, as well as the 2014 Financial Reviews. As part of that project, we also reviewed SBR's scale house operations and associated data tracking and reporting procedures.

## Project Team

The project team for this engagement will be me and Emily Morse. I became a principal at R3 after serving in municipal management for eight years at the City of El Cerrito; I have considerable experience with solid waste operational and financial analyses. Emily Morse is an Associate Analyst at R3 and is qualified to support me on this project.

\* \* \* \* \*

We appreciate the opportunity to submit a proposal to RethinkWaste. If you have any questions about our proposal, or need any additional information, please don't hesitate to call me at (510) 292-0853 or email at [gschultz@r3cgi.com](mailto:gschultz@r3cgi.com).

Sincerely,

### **R3 CONSULTING GROUP**



Garth Schultz | Principal

### **Attachments:**

- Attachment 1 – Statement of Qualifications
- Attachment 2 – Work Proposal
- Attachment 3 – List of Staff, Hourly Rates & Cost Proposal
- Attachment 4 – Implementation Schedule

## Statement of Qualifications

The major tasks of this engagement are discussed below, along with a summary of R3's related experience and qualifications.

### Annual Revenue Reconciliation for 2015

The objective of this task is to determine if Recology has accurately calculated each Member Agency's revenue surplus/shortfall for its franchised services. Among the tasks that need to be completed are: confirming that Recology's billings are consistent with the approved rate schedules; confirming that reported revenues tie to accounting records; verifying net revenue calculations and adjustments; and verifying that Contractor's Compensation ties to each Member Agency's approved compensation.

R3 routinely reconciles revenues and expenses among various franchised and non-franchised operations, among specific franchised services, and among multiple jurisdictions as part of our contract compliance reviews, billing and fee audits, and detailed rate reviews that we have conducted for dozens of jurisdictions. Our prior contractor compliance reviews for the cities of Fairfield and Downey both involved reconciling billed revenues to approved rate schedules and associated accounting records and reports. Similar revenue reconciliations are common tasks as part of our detailed rate review projects to assure that billed revenues are consistent with approved rate schedules, and that they are also accurately assigned to the appropriate jurisdictions.

### Revenue Reconciliation: Revenue Billed to Customers for Attachment Q – Unscheduled Services

Section 11.03 of the Franchise Agreement provides for Recology to retain 100% of the revenue collected for the provision of unscheduled/intermittent services (outlined in Attachment Q of the Franchise Agreement), with the exception of revenues for a certain threshold of customers subscribing to backyard service, and also with the exception of any Member Agency fees associated with Attachment Q revenue. The objectives of this task are to determine if Recology has charged appropriate rates for Attachment Q services, that the revenue reported for the Attachment Q services is accurate, and that none of this revenue includes revenue for base services. As with the Annual Revenue Reconciliation above, this task includes confirming that Recology's billings for Unscheduled Services are consistent with the approved rate schedules, and that reported revenues tie to accounting records. In accordance with the franchise agreements, Recology only retains backyard service revenues once the total number of residential accounts subscribing to backyard service exceeds 20% of all residential customers within each Member Agency, and a determination needs to be made as to whether Recology has exceeded this minimum threshold in any of the Member Agencies.

R3 routinely conducts billing audits to assure that customers are billed the correct rates for the service levels provided. Our contract compliance reviews and billing and fee audits include reconciliation of the billed rates to the approved rate schedules. We have provided the same or similar services to those required for the successful completion of this task to many jurisdictions, including the cities of Citrus Heights, Cotati, Dublin, Fairfield, Fresno, Petaluma, Pomona, Redlands, Sacramento, Salinas, San Bernardino, San Leandro, Santa Barbara, Windsor and Woodland, and counties of El Dorado, Napa and Plumas, and the Yuba-Sutter Regional Waste Management Authority.

## Audit of Facility Operations Contractor (SBR)

The objective of this task is to determine if SBR has accurately accounted for and remitted all gate revenue collected from self-haul loads to RethinkWaste and accurately accounted for all recyclable material commodity revenue. This task includes confirming that the public revenue transferred to RethinkWaste ties to accounting records, that the reported gross commodity revenue ties to accounting records, and that payment by SBR to SEC Buyback Center customers, and associated reimbursements by RethinkWaste, ties to accounting records and other related supporting documentation. Also included in this task is a review of scale house procedures and testing of weight tickets to determine the accuracy of recorded route and material type information.

R3 regularly reviews scale house and recyclable material processing operations and associated policies and procedures as part of our Operational and Performance Reviews and various Detailed Rate Reviews. As part of our 2013 and 2014 Review of Collection Services and Facility Operations Reports, Tonnage, Data and Customer Service Systems Auditing Project for RethinkWaste, R3 reviewed SBR's scale house operations and associated data tracking and reporting procedures. We have a sound understanding of CRV program related revenues and payments and OBM commodity pricing, as well as recyclable material sales revenue tracking, reporting and reconciliation. We have provided the same or similar services to those required for this task to jurisdictions including the Yuba-Sutter Regional Waste Management Authority, Del Norte Solid Waste Management Authority, the cities of Paso Robles, Salinas, and Woodland, and other cities and counties.

# Work Proposal

## Project Approach

R3 takes an organized, systematic, and comprehensive approach when conducting audits of the type RethinkWaste is requesting. Upon authorization to proceed, R3 will develop a Financial Audit Work Plan. This Work Plan will be based on our proposed Scope of Work provided below and the implementation schedule provided in Section 5. The objective of the Work Plan is to describe all aspects of the detailed review to ensure that all required tasks are accounted for and to provide a specific “road map” for the review process. Once the Work Plan has been completed, each task will be assigned to a specific project team member with a specific schedule and work product.

Work paper documentation guidelines will also be established to ensure consistent supporting documentation of all required tasks. The Project Manager will monitor Work Plan progress relative to the established schedule and make any necessary adjustments to complete the required tasks in a timely manner. Preliminary draft task deliverables will be reviewed by the Project Manager and other team members prior to submittal to RethinkWaste. The results of the audit will be documented in our work papers, including all analyses conducted in support of the audit and copies of all supporting documentation. R3 project staff will be available to discuss and respond to questions or other issues related to the audit throughout the process, and will provide status updates on a bi-weekly basis (or more frequently if requested) throughout the duration of the project.

## Scope of Work

The project tasks below have been organized to correspond directly with the services requested in RethinkWaste’s prior RFP for the 2014 financial systems audit, which R3 performed. The RethinkWaste Member Agencies covered by this audit include:

- Atherton;
- Belmont;
- Burlingame;
- East Palo Alto;
- Foster City;
- Hillsborough;
- Menlo Park;
- Redwood City;
- San Carlos;
- San Mateo;
- West Bay Sanitary District; and
- County of San Mateo.

### Task 1 Kick-off Meetings and Data Requests

Upon receiving “Authorization to Proceed” from RethinkWaste staff, R3 will schedule kick-off meetings with RethinkWaste and contractor staff. Prior to the meetings, R3 will schedule a conference call with RethinkWaste staff. R3 anticipates attending one kick-off meeting at SBR’s facility and one kick-off meeting at Recology’s office. The kick-off meetings will allow the R3 project team, RethinkWaste staff, and contractor staff to discuss the Financial Audit Work Plan, project goals and objectives, deliverable due dates, and also address the findings and recommendations from last year’s audit. For the kick-off meetings, R3 will provide meeting agendas, as well as separate requests for information to be issued to each of the contractors.

In addition to the in-person kick-off meetings, R3 project team members will be available to provide status updates via conference call throughout the duration of the project.

## **Task 2      Audit of Collection Service Contractor (Recology)**

For Task 2, the R3 project team will conduct an audit of Recology's annual revenue reconciliation for 2015, submitted in accordance with Section 11.03 and Attachment K of Recology's Franchise Agreement for Collection Services with San Mateo County. This audit will include determining if Recology has accurately calculated each Member Agencies revenue surplus/shortfall for its franchised services, confirming that Recology's billings are consistent with the approved rate schedules and that reported revenues tie to accounting records, verifying net revenue calculations and adjustments, and verifying that Contractor's Compensation ties to each Member Agency's approved compensation. R3 will also confirm that Recology billed and retained the correct amounts for Attachment Q unscheduled services, review how additional cart fees are reported, and verify that revenue for the first 20% of backyard service in each Member Agency is accurately documented.

For each subtask below, R3 will request and verify Recology data for all RethinkWaste Member Agencies. All Task 2 subtasks will involve working closely with Recology to determine the source documentation and reporting process for each data category, and then verifying the mathematical accuracy and logical consistency of the company's reported values.

### **Task 2.1      Annual Revenue Reconciliation for 2015**

Task 2.1.1 – R3 will confirm that the residential and commercial revenue amounts reported as billed (by Member Agency) for calendar year 2015 ties to the accounting records, including unbilled and deferred revenue adjustments.

Task 2.1.2 – R3 will verify the following annual amounts and data reported in the Revenue Reconciliation, and will verify that the calculations used to derive the amounts and data are properly reported for each Member Agency:

1. Billed Revenue;
2. Collection Expense;
3. Member Agency Fees (will also confirm that fees are properly calculated and paid for each Member Agency); and
4. Disposal expense and tonnage data.

Task 2.1.3 – R3 will verify the calculation of net revenue retained by Recology (i.e., gross revenue billed, as adjusted, less agency fees paid less disposal expense paid equals net revenue) in total and by Member Agency.

Task 2.1.4 – R3 will compare all values in the 2015 Revenue Reconciliation to the 2015 Annual Report and explain any variances.

Task 2.1.5 – R3 will review and validate all adjustments in the Revenue Reconciliation, and explain all adjustments in the event that Recology's explanation in the report needs further clarification.

Task 2.1.6 – R3 will review and perform tests to verify that the rates billed to residential and commercial customers tie to approved rate schedules for each Member Agency.

Task 2.1.7 – R3 will verify that the net surplus or shortfall balance owed to/from Recology by Member Agency is accurate.

Task 2.1.8 – R3 will verify the Contractor's Compensation ties to their approved compensation by Member Agency.

Task 2.1.9 – R3 will explain all unusual adjustments in the Revenue Reconciliation.

**Task 2.2 Revenue Reconciliation: Revenue Billed to Customers for Attachment Q – Unscheduled Services**

Task 2.2.1 – R3 will confirm that the amount of Attachment Q revenue reported as billed by Member Agency ties to the accounting records for each different type of charge.

Task 2.2.2 – R3 will explain how the additional cart fees charged by some Member Agencies (Atherton, Hillsborough, and County) are reported in the revenue and excluded from cost (these surcharges have no corresponding cost).

Task 2.2.3 – R3 will verify that the credit for the first 20% of residential backyard service customers is accurately reported. (Resolution No. 6178 amended the Recology Franchise Agreement to state that: “Each Agency shall retain the revenue for the first twenty (20) percent of Backyard Service Customers that subscribe to this service.”)

Task 2.2.4 – R3 will report any issues or concerns on how Attachment Q services are calculated and reported by Recology for both the revenue calculation and the cost calculation, and explain how each is separately reported.

**Task 3 Audit of Facility Operations Contractor (SBR)**

For Task 3, the R3 project team will conduct a financial audit of South Bay Recycling (SBR), RethinkWaste’s Facility Operations Contractor. Task 3 subtasks will involve coordinating with SBR to determine the source documentation and data tracking process for each reporting category. This will include determining how 2015 public revenues, commodity revenues, SEC buyback center payments, and weight ticket information (including route number and material types) are recorded using SBR’s “PC Scales” tracking system, and then verifying the mathematical accuracy and logical consistency of the company’s reported values. In addition, R3 will conduct an in-depth review of scale house procedures as compared to the SBR Facility Procedure Manual, and test weight tickets to verify that SBR’s procedures are effective and accurate.

**Task 3.1 Verify Public Revenue**

R3 will verify that the 2015 public revenue transferred monthly to RethinkWaste ties to the accounting records.

**Task 3.2 Verify Commodity Revenue**

R3 will verify that the gross 2015 commodity revenue as reported on their December monthly report ties to the accounting records. R3 will not verify the allocated amount attributed to RethinkWaste as this is done by RethinkWaste.

**Task 3.3 Verify SEC Buyback Center Payments**

R3 will verify that amount of payments to SEC Buyback Center customers by SBR and reimbursed by RethinkWaste ties to accounting records.

**Task 3.4 Review Scale House Procedures**

R3 will review the procedures at the scale house to help ensure all public revenue is being properly accounted for and all franchised volume is being properly recorded. R3 will review documented procedures (i.e., the SBR Facility Procedure Manual), verify that procedures are being followed, and review the training methods for scale house personnel, procedures for measurement of public loads, and scale house security measures. R3 will note any deviation, request an explanation from SBR and determine/quantify the impact on reporting practices. R3 will also review the procedures on validating and making changes to tare weights. R3 will monitor the scale house activities to verify the scale house is being operated in accordance with the contract with RethinkWaste, as it relates to the data that is



required to be included in SBR's monthly, quarterly, and annual reports. As a result of this task, R3 will recommend improvements to scale house procedures as appropriate.

**Task 3.5 Test Weight Tickets**

R3 will select enough weight tickets and measured public tickets to verify the stated procedures are being followed. Such testing will include: verifying the collection route stated on the weight ticket ties to the information from Recology's daily dispatch log; verifying the type of material listed on the weight ticket ties to the information from Recology's daily dispatch log which will state the assigned route and material type (i.e., is the assigned vehicle collecting solid waste, recyclable materials, or organic materials).

**Task 4 Draft and Final Reports**

**Task 4.1 Draft Report**

Based on the results of Tasks 1 through 3 above, R3 will prepare a draft report of preliminary findings and recommendations. As part of the draft report, R3 will:

- Provide explanation of the auditing process and data analyzed;
- Provide charts to summarize findings (with particular attention paid to Recology);
- Provide detailed support of findings and recommendations;
- Include the monetary impact of all findings and recommendations; and
- Obtain feedback from the contractors as to their agreement or disagreement with the findings, and their explanation of specific findings if warranted.

**Task 4.2 Meet with RethinkWaste/Contractors**

RethinkWaste will review the draft report of preliminary findings and provide suggested edits to the report. R3 will attend one (1) in-person meeting with RethinkWaste/contractors to review the findings (if requested), and conduct additional conference calls as necessary. R3 will conduct additional analysis specific to Tasks 2 and 3 above based on feedback from RethinkWaste and the contractors, if necessary.



**Task 4.3 Final Report and Board Meeting**

Based on the feedback received from the contractors and/or RethinkWaste staff, R3 will prepare a Final Report. R3 staff will also attend one (1) RethinkWaste Board meeting to be available to answer any questions from RethinkWaste staff and/or Board members.



## Attachment 3 | List of Staff, Hourly Rates & Cost Proposal

### List of Staff

Garth Schultz	Principal   Project Manager	
Emily Morse	Associate Analyst   Project Analyst	

### Hourly Rates

R3 2016 BILLING RATES AND CHARGES	
Category	Hourly Rate
Principal / Project Manager	\$190 per hour
Senior Project Manager	\$185 per hour
Project Manager	\$170 per hour
Senior Project Analyst	\$140 - 160 per hour
Project Analyst	\$125 - 140 per hour
Associate Analyst	\$100 - 125 per hour
Administrative Support	\$75 - 95 per hour
REIMBURSABLE COSTS (Included in hourly rates)	
Consultants/Subcontractors	Direct cost
Lodging and meals	Direct cost
Travel — Private or company car	\$0.54 per mile
Travel — Other	Direct cost
Delivery and other expenses	Direct cost

### Payments

Unless otherwise agreed in writing, fees will be billed monthly at the first of each month for the preceding month and will be payable within 30 days of the date of the invoice.

# Cost Proposal

R3 will complete our proposed work scope for a total not-to-exceed budget of **\$35,743** as shown in the table below. This amount includes all overhead costs and expenses for all tasks. R3 reserves the right to allocate staffing hours as needed to ensure successful completion of this project.

Task	R3 Consulting Group		Cost	Hours
	Garth Schultz (Principal)	Emily Morse (Associate Analyst)		
	\$ 190	\$ 120		
<b>1 Kick-Off Meetings and Data Requests</b>				
<b>Task 1 Subtotal</b>	<b>10</b>	<b>10</b>	<b>\$ 3,100</b>	<b>20</b>
<b>2 Audit of Collection Services Contractor (Recology)</b>				
2.1 Annual Revenue Reconciliation	40	20	\$ 10,000	60
2.2 Revenue Reconciliation – Attachment Q	10	10	\$ 3,100	20
<b>Task 2 Subtotal</b>	<b>50</b>	<b>30</b>	<b>\$ 13,100</b>	<b>80</b>
<b>3 Audit of Facility Operations Contractor (SBR)</b>				
3.1 Verify Public Revenue	10	10	\$ 3,100	20
3.2 Verify Commodity Revenue	10	10	\$ 3,100	20
3.3 Verify SEC Buyback Center Payments	10	10	\$ 3,100	20
3.4 Review Scale House Procedures	10	10	\$ 3,100	20
3.5 Test Weight Tickets	10	10	\$ 3,100	20
<b>Task 3 Subtotal</b>	<b>50</b>	<b>50</b>	<b>\$ 15,500</b>	<b>100</b>
<b>4 Draft and Final Reports</b>				
4.1 Draft Report	10	5	\$ 2,500	15
4.2 Meet with RethinkWaste/Contractors	15	5	\$ 3,450	20
4.3 Final Report and Board Meeting	20	5	\$ 4,400	25
<b>Task 4 Subtotal</b>	<b>45</b>	<b>15</b>	<b>\$ 10,350</b>	<b>60</b>
	<b>Total Hours</b>	<b>155</b>	<b>105</b>	<b>260</b>
	<b>Total Cost</b>	<b>\$ 29,450</b>	<b>\$ 12,600</b>	<b>\$ 42,050</b>
			<b>15% Discount</b>	<b>\$ 6,308</b>
			<b>Final Budget</b>	<b>\$ 35,743</b>

## Implementation Schedule

Our projected implementation schedule for this engagement is provided in the table below. To effectively manage this engagement and provide the City with immediate access to a decision maker, Garth Schultz, a Principal with R3, will serve as Project Manager.

He will be actively involved in all phases of the project and will maintain ongoing contact with RethinkWaste staff. Mr. Schultz will monitor progress relative to the work scope and established schedule below and make any necessary adjustments to complete the required tasks in a timely manner.

Task #	Description	Projected Date of Completion
<b><i>"Authorization to Proceed" received from RethinkWaste</i></b>		<b>March 28, 2016</b>
<b>Task 1</b>	Kick-off Meetings and Data Requests	Week of April 4, 2016
<b><i>All required supporting documentation received from contractors</i></b>		<b>April 6, 2016</b>
<b>Task 2</b>	<b>Audit of Collection Service Contractor (Recology)</b>	April – May 2016 (Tasks 2 and 3 completed concurrently)
Task 2.1	Annual Revenue Reconciliation for 2015	
Task 2.2	Revenue Reconciliation: Revenue Billed to Customers for Attachment Q – Unscheduled Services	
<b>Task 3</b>	<b>Audit of Facility Operations Contractor (SBR)</b>	Biweekly status updates provided to RethinkWaste, and correspondence with contractors conducted as necessary.
Task 3.1	Verify Public Revenue	
Task 3.2	Verify Commodity Revenue	
Task 3.3	Verify SEC Buyback Center Payments	
Task 3.4	Review Scale House Procedures	
Task 3.5	Test Weight Tickets	
<b>Task 4</b>	<b>Draft and Final Reports</b>	(see subtasks below)
Task 4.1	Draft Report	May 18, 2016
Task 4.2	Meet with RethinkWaste/Contractors	Week of May 23, 2016
<b><i>Receive comments on Draft Report from RethinkWaste/contractors</i></b>		<b>May 27, 2016</b>
Task 4.3	Final Report	June 10, 2016
<b><i>RethinkWaste Board meeting</i></b>		<b>As scheduled by RethinkWaste</b>

The projected implementation schedule provided here is dependent on timely receipt of data and comments from RethinkWaste and the contractors. If R3 becomes aware of any delays that potentially affect any of the completion dates listed here, R3 will immediately notify RethinkWaste staff and work towards resolving the delays.