

COUNTY AUDIT DEPARTMENT

REPORT # 365

An Audit of:

COVANTA AGREEMENT - ENERGY RECOVERY SERVICES

JUNE 11, 2019



Pat Frank INTEGRITY. TRANSPARENCY. ACCOUNTABILITY.

CLERK OF COURT & COMPTROLLER • HILLSBOROUGH COUNTY, FLORIDA



June 11, 2019

The Honorable Lesley “Les” Miller, Jr., Chairman
The Honorable Ken Hagan
The Honorable Pat Kemp
The Honorable Sandra L. Murman
The Honorable Kimberly Overman
The Honorable Mariella Smith
The Honorable Stacy R. White

Dear Chairman Miller and Commissioners:

The Audit Team performed an audit of the Covanta Agreement - Energy Recovery Services (Audit Report # 365, dated June 11, 2019). Responses to the Audit Team’s recommendations were received from the Director of Solid Waste Management and have been included in the Report after each audit comment and recommendation.

The purpose of this Report is to furnish management independent, objective analysis, recommendations, counsel, and information concerning the activities reviewed. It is not an appraisal or rating of management.

Although the Audit Team exercised due professional care in the performance of this audit, this should not be construed to mean that unreported noncompliance or irregularities do not exist. The deterrence of fraud and/or employee abuse is the responsibility of management. Audit procedures alone, even when carried out with professional care, do not guarantee that fraud or abuse will be detected.

The Audit Team appreciates the cooperation and professional courtesies extended to the auditors by the Director and personnel of Solid Waste Management and Public Utilities during this audit.

Sincerely,

Heidi Pinner, CIA, CISA, CFE, CRMA
Director of County Audit

CC: Mike Merrill, County Administrator
Lucia Garsys, Chief Development & Infrastructure Administrator
John Lyons, Infrastructure Services Administrator
George Cassady, Director, Public Utilities
Kimberly Byer, Division Director, Solid Waste Management
Nate Johnson, Executive Manager, Solid Waste Management
Kevin Brickey, Management & Budget Office
Dan Klein, Chief of Staff, Clerk of Court and Comptroller
Rick VanArsdall, Chief Deputy, Clerk to the Board

TABLE OF CONTENTS

EXECUTIVE SUMMARY..... 1

 BACKGROUND INFORMATION 1

 OBJECTIVE 1

 SCOPE 1

 OVERALL EVALUATION 1

 OPINION 2

 AUDITED BY 2

AUDIT COMMENTS & RECOMMENDATIONS 3

EXECUTIVE SUMMARY

BACKGROUND INFORMATION

The Solid Waste Management Division oversees waste collection, disposal, and recycling in Hillsborough County. The Division contracts with private companies for curbside residential and commercial service and operates several centers throughout the county that accept waste, household hazardous waste, and yard waste. Solid Waste also runs an innovative waste-to-energy plant known as the Hillsborough County Resource Recovery Facility (the Facility).

The Facility, operating as Covanta Hillsborough, Inc., began operation in October 1987 and expanded in 2009 to increase its processing capacity. The Facility now processes up to 1,800 tons of solid waste per day and generates up to 46.5 megawatts of renewable energy. Hillsborough County owns the Facility, supplies the waste processed, and sells the electricity generated by the Facility. Covanta staffs and operates the Facility and receives 10% of all electricity revenue. The County has also contracted with an engineering firm, CDM Smith, to provide consulting to Solid Waste Management regarding operations of the Facility. The Facility maintains emission control equipment in compliance with the United States Environmental Protection Agency's Clean Air Act.

OBJECTIVE

The objective of the audit was to determine whether or not adequate controls are in place to ensure that the Covanta Agreement is appropriately monitored.

SCOPE

The audit was conducted in conformance with the *Generally Accepted Government Auditing Standards* and the *International Standards for the Professional Practice of Internal Auditing*. These Standards require that County Audit plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for the audit comments and conclusions based on the audit objectives. County Audit believes that the evidence obtained provides this reasonable basis.

The Audit Team reviewed the County's contract agreement with Covanta and the related controls to ensure compliance with the agreement.

OVERALL EVALUATION

The employees of Solid Waste Management, as well as Public Utilities, were responsive to the Audit Team's inquiries and provided the information requested in a timely manner. The Audit Team encountered knowledgeable and dedicated employees during the course of the audit.

The following table summarizes the audit comments and corresponding cross references to the page number where the audit comment details can be found in this Report.

AUDIT COMMENT	CONCLUSION OF OBJECTIVE	PAGE
1	Invoices for contract services were generally in compliance with the Covanta contract. <ul style="list-style-type: none"> • Invoices were calculated properly. • Rates paid to Covanta were appropriate. • <i>Some invoices did not have evidence of all approvals or adequate support.</i> • <i>Credits for metal recovery sales were not received timely from Covanta.</i> 	3
2	Covanta was in compliance with the performance guarantee requirements of the contract. <ul style="list-style-type: none"> • <i>The Process Residue Quality guarantee is not currently tracked and may no longer be applicable.</i> 	6

OPINION

The overall control environment relative to managing the Covanta Agreement is at the formal (defined) maturity level. This is an average control rating and means that control awareness exists and controls are defined and in place. There are reviews and monitoring processes currently used that rely on the diligence of employees from Covanta and the County. Addressing the opportunities identified in this Report will further enhance the overall control structure and provide increased consistency and assurance.

The exit conference was held on May 8, 2019.

Other minor concerns not included in this Report were communicated to management and/or corrected during fieldwork.

AUDITED BY

Heidi Pinner, CIA, CISA, CFE, CRMA, Director of County Audit
 Ben Everett, CPA, CIA, CFE, Audit Manager
 Greg McCullough, CPA, CIA, CFE, Senior Internal Auditor
 Matthew Demler, Internal Auditor II

AUDIT COMMENTS & RECOMMENDATIONS

AUDIT COMMENT 1

Invoices for contract services are in compliance with the Covanta contract. An opportunity exists to improve controls related to invoice processing.

The objective was to determine whether or not invoices for contract services are in compliance with the Covanta contract and are sufficiently supported.

Analysis and Testing of Invoices

Incorporated in the contract between the County and Covanta are agreements to reimburse Covanta for certain expenses incurred and for the operation and maintenance of the waste to energy Facility. There are 4 types of invoices which are processed for the Covanta contract on a monthly basis.

1. Reimbursement of Reagents – This is one of two invoice types related to general expenses that Covanta incurs during their normal operation of the Facility. These invoices are for the County to reimburse Covanta for the cost of reagent substances which are used in the process of converting solid waste to energy within the Facility.
2. Pass-through charges – This is the second of two invoice types related to general expenses that Covanta incurs during their normal operation of the Facility. These invoices are for reimbursement of various expenses that have been incurred by Covanta, known as pass-through charges.
3. Electrical Revenue Fee – This is one of two invoice types for the operation of the Facility and related to the revenue share Covanta receives. This electrical revenue fee is calculated as 10% of the total monthly electrical revenue produced from operation of the Facility.
4. Operating Fee - This is the second of two invoice types for the operation of the Facility and related to the revenue share Covanta receives. This operating fee is calculated based on the total amount of waste processed through the Facility, with a credit for scrap metal recovered and recycled as a byproduct of the waste incinerated. Of the metals recovered, there are ferrous and non-ferrous metals which are sold by Covanta to third party vendors with the revenue being split between the County and Covanta. Metal recovery revenue is received from Covanta by the County as credit memos and is deducted from the monthly operating fee.

All monthly invoices are to be paid to Covanta within 30 days of receipt. Credit memos for revenues (net of related expenses) from the sale of ferrous or non-ferrous metals are to be issued by Covanta to the County within 30 days of when Covanta receives payment from its third party vendors. The market value of scrap metal may vary each month. Therefore, Covanta may sometimes opt to delay selling metals until market rates are more favorable.

For the reagent and pass-through charges, Covanta provides supporting documentation which details each line item included in the invoice. For the electrical revenue fee and operating fee invoices, the Contract Manager is responsible for creating an invoice and determining the amount that must be remitted to Covanta on a monthly basis. These invoices are compiled based on support from various data sources, including internal and external reports.

The Audit Team obtained a listing of all invoices paid for fiscal year 2018. From this list, the Audit Team selected 4 invoices for the month of July 2018, 1 of each of the different invoice types, for testing in order to verify that invoices:

- Were properly calculated.
- Were properly supported, including complete and accurate documentation in order to justify the monthly amounts being remitted to Covanta.
- Had evidence of review and approval.
- Were paid to Covanta in a timely manner.
- Reflected rates in compliance with the rates outlined in the contract.

Results of Testing

The Audit Team obtained and reviewed each selected invoice and supporting documentation and determined that:

- All invoices were calculated properly.
- Three (75%) of the invoices included adequate support to recalculate the total amount paid to Covanta. One (1) invoice, the Operating Fee invoice, did not include all support necessary to verify the amount paid to Covanta was accurate. The Audit Team inquired of the Contract Manager about the variance and was able to identify the data that was missing. Missing data required to support the calculation was related to the credits received for the metals recovery revenue. After the missing set of data was provided to the Audit Team, the invoice calculation was able to be verified.
- Two (50%) of the invoices selected did not have evidence of all reviews and approvals prior to payment.
- All invoices were paid to Covanta in a timely manner (within 30 days). However, Covanta receives revenues from the sale of ferrous and non-ferrous metals recycled. The contract stipulates that the County shall, within 30 days of receipt by Covanta, receive 60% of the revenue generated from the sales of non-ferrous metal and 50% of the revenue from the sale of ferrous metals. During the review of the Operating Fee invoice, the audit team identified multiple credits received by Covanta for the sale of metals dating back to December 2017. These credits were not received by the County until August 2018.
- All invoices reflected rates in compliance with the contract.

RECOMMENDATION

In an effort to strengthen controls over contract invoice review, management should consider:

1. Including complete and accurate supporting documentation with invoice files when recalculating and verifying invoice payments to Covanta.
2. Including evidence of all reviews and approvals on all Covanta invoices, prior to being paid.
3. Ensuring credits for the sale of ferrous and non-ferrous metals are provided to the County from Covanta within 30 days of receipt by Covanta, as agreed upon in the Covanta contract.

CLIENT RESPONSE:

Concur

CORRECTIVE ACTION PLAN:

Solid Waste Staff will coordinate with PUD-Fiscal to develop Standard Operating Procedures (SOP) for the processing of all types of Covanta invoices. The SOP's will document an approval process from point of origin to final submission for payments, with a full implementation date of June 2020.

Effective June 2019 Solid Waste Staff has directed Covanta not to hold payments but to process ferrous/non-ferrous payments individually as they are received.

TARGET COMPLETION DATE:

June, 2020.

AUDIT COMMENT 2

Covanta was in compliance with the performance guarantee requirements in the contract. An opportunity exists to improve monitoring of the performance guarantees.

The objective was to determine whether or not Covanta was in compliance with the performance guarantees in the contract.

Analysis and Testing of Guarantee Items

The County's contract with Covanta includes a schedule of performance guarantees. Covanta provides an annual report to Solid Waste Management that indicates whether each guarantee was met. The Audit Team selected 5 of the performance guarantee items from the contract for testing and determined what internal controls and processes were in place to ensure Covanta met these guarantees. The Audit Team also obtained a copy of the most recent annual Covanta performance guarantee report and information on the timing of the issuance of the report. The Audit Team reviewed the annual report, inquired with management and with the CDM Smith engineering consultant to determine whether Covanta met each of the performance guarantees selected. At the time of testing, the most recent annual performance guarantee report available from Covanta was for the fiscal year ended September 30, 2017.

Results of Testing

The Audit Team confirmed that Covanta met 4 of the 5 guarantees tested for the fiscal year ended September 30, 2017. For the one performance guarantee not achieved, excess usage of natural gas, Covanta had provided a credit to reimburse the County in accordance with the terms of the contract.

All five of the performance guarantees have monthly monitoring controls in place. For 4 of the 5 performance guarantees tested, the Contract Manager relies on data and calculations provided by Covanta without a means to independently verify the result. While this places a heavy reliance on the accuracy of the contractor's data, there were several mitigating controls observed by the Audit Team to reduce the associated risk, including:

- A revenue sharing arrangement in the contract which provides a financial incentive to Covanta to accurately report the data.
- Use of a Solid Waste employee to read meters for internal sale of electricity and to review reagent invoices and supporting documents such as bills of lading.
- Use of the independent engineer CDM Smith to review reasonableness of plant data on the plant monthly operations report.
- Use of external meter data from Tampa Electric Company (TECO).

The Audit Team also observed that the contract with Covanta comprises a lengthy series of documents and amendments that date back to the 1980's. This collection of contract items is difficult to navigate and increases the risks related to accountability, clarity and knowledge retention (in the event of staff turnover or attrition). In December 2015, CDM Smith, the independent engineer for the Facility, prepared a summary document of the Covanta contract documents. It includes a list describing the amendments and modifications to the design, construction, operation and management agreements for the Facility. However, this summary document has not been updated since that time.

Testing of Items Not On Annual Performance Guarantee Summary

In addition to the 5 guarantees selected for testing, the Audit Team identified 4 other performance guarantee items listed on the contract schedule that were not tracked on the most recent annual performance guarantee summary. The Audit Team inquired of the Contract Manager to determine why these were not tracked on the annual Covanta performance guarantee summary of actual results.

Results of Testing

One item not included was the Reagent Consumption Guarantee for urea. Ammonia is now used as a substitute for urea (and ammonia is tracked on the annual summary). Therefore, the performance guarantee for urea was removed from the contract guarantee schedule by amendment number 1 to the Extension Operations and Management Agreement.

Two other items not included are capacity guarantees for the Project and Expansion components of the Facility. The guarantees for the components are expressed as a daily capacity and were put in place for testing purposes if or when there is a need to perform testing.

The one remaining item was the Process Residue Quality guarantee. Per the Contract Manager, this item is no longer required by the Department of Environmental Protection but the item has not been removed from the Contract.

RECOMMENDATION

Management should consider:

1. Compiling the various updates, amendments and revisions for the Agreement into a single, consolidated document that details the existing contract terms and conditions. Doing so will allow management to ensure there is clarity for the existing contract relationship, continuity of the contract management role and will also aid in future contract revisions and/or renewals.
2. Researching the requirement for the Process Residue Quality guarantee and determining whether or not to modify the contract to remove the guarantee or require the contractor to include and track it on the annual Covanta performance guarantee summary report.

CLIENT RESPONSE:

Concur

CORRECTIVE ACTION PLAN:

The Process Residue Quality guarantee that are no longer applicable and therefore not tracked will [be]clarified in the updated contract. Staff will coordinate with The County Attorney's Office and our Consulting Engineer to formulate a plan to compile various updates, amendments and revisions for the Agreement into a single contract document.

TARGET COMPLETION DATE:

June, 2020.