



City of Chattanooga

INTERNAL AUDIT

City Hall

Chattanooga, Tennessee 37402

Stan Sewell
Director

Ron Littlefield
Mayor

November 3, 2011

Mayor and City Council
City of Chattanooga
Chattanooga, TN 37402

RE: Fleet/Garage Parts Contract, Audit #11-05

Dear Mayor Littlefield and City Council Members:

Attached is the Internal Audit Division's report on the Fleet Services Division garage parts contract.

We thank the management and staff of Lee-Smith, Inc., Fleet Services, Purchasing and the Finance Department for their cooperation and assistance during this audit.

Sincerely,

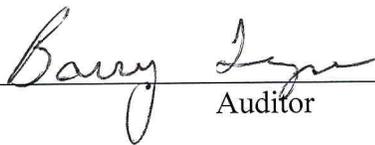
A handwritten signature in blue ink, appearing to be "S. Sewell", written over a horizontal line.

Stan Sewell, CPA, CGFM
Director of Internal Audit

cc: Dan Johnson, Chief of Staff
Audit Committee Members
Dan Thornton, Director, General Services
Brian Kiesche, Manager, Fleet Services
Artie Prichard, Purchasing

**GENERAL SERVICES DEPARTMENT
FLEET/GARAGE PARTS CONTRACT
AUDIT 11-05
August 17, 2011**

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Auditor



Audit Director

**FLEET/GARAGE PARTS CONTRACT
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INTRODUCTION

The City of Chattanooga executed blanket contracts/purchase orders with Lee-Smith, Inc. (Lee-Smith) for heavy duty vehicle parts (P.O. 505134) and light duty vehicle parts (P.O. 505161). The contracts were originally executed on August 25, 2010 for a period of one year, with an option to renew for four additional years. The first renewal has been exercised for the year ending August 24, 2012. Each contract has specific prices for approximately 150 commonly used vehicle parts that were the basis for awarding the contract, along with agreement to sell remaining purchases at fifteen percent above the cost to Lee-Smith.

STATISTICS

For the period August 25, 2010 – August 3, 2011 expenditures on the vehicle parts contracts were as follows:

• Heavy Duty Vehicle Parts	\$ 748,230
• Light Duty Vehicle Parts	<u>1,595,344</u>
Total Expenditures	<u>\$2,343,574</u>

STATEMENT OF OBJECTIVES

This audit was conducted in accordance with the Internal Audit Division's 2011 Audit Agenda. The objectives of this audit were to determine if:

1. Lee-Smith is selling the City catalog items at a markup of fifteen percent over their cost;
2. Lee-Smith is following contract terms related to parts contracted to be sold at static pricing;
3. City employees are purchasing appropriate part items from Lee-Smith;
4. The City has procedures in place to properly oversee the contracts with Lee-Smith.

STATEMENT OF SCOPE

The audit is based on the terms of the contracts between the City and Lee-Smith, with the audit covering the period beginning August 25, 2010 and ending August 3, 2011.

STATEMENT OF METHODOLOGY

We reviewed the contracts between Lee-Smith and the City for pertinent facts related to our audit. We met with personnel of Lee-Smith to discuss expectations for the audit. We obtained records from Lee-Smith and City personnel, performing tests to ensure contract terms were followed. We compared pricing for purchases contracted for static pricing, as well as proving correct invoice pricing on items contracted at cost plus 15% from records obtained from Lee-Smith.

To achieve the audit's objectives, reliance was placed on computer-processed data contained in both the Lee-Smith and City financial systems. The City's financial system was previously determined to be reliable and no additional work was necessary. Data from the Lee-Smith system was determined to be reliable based upon tests of pricing data against vendor invoices paid by Lee-Smith.

STATEMENT OF AUDITING STANDARDS

We conducted this performance audit in accordance with generally accepted government auditing standards. Those standards require we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

AUDIT CONCLUSIONS

Based upon the test work performed and the audit findings noted below, we conclude:

1. Lee-Smith is selling catalog items to the City at a markup of fifteen percent over their cost;
2. Lee-Smith has not met contract terms related to parts contracted to be sold with static pricing;
3. City employees are purchasing items from Lee Smith, Inc. that are not motorized vehicle parts, including items covered under blanket contracts with other vendors;
4. The City does not have procedures in place to properly check/oversee the contracts with Lee-Smith, Inc.

While the findings discussed below may not, individually or in the aggregate, significantly impair the operations of the Fleet Maintenance Division, they do present risks that can be more effectively controlled.

NON-COMPLIANCE WITH STATIC PRICING CLAUSE

The contracts for both light duty and heavy duty vehicle parts were awarded based on the pricing for approximately 150 parts on each contract. The contract required pricing on these parts to be held static for one year, with the pricing renegotiated on those parts prior to contract renewal for the upcoming contract year. We compared the prices quoted for those parts to actual prices charged for the items. Some prices for items in each contract vary significantly from the amounts in the bids, resulting in the City expending greater funds than necessary. Also, the static priced parts are comingled with invoicing for the remaining items of the contract, priced at dealer cost plus 15%, resulting in the Fleet Division being unable to properly track pricing on invoices.

RECOMMENDATION 1

We recommend the City Fleet Division require Lee-Smith provide billing of static priced items on a separate invoice, enabling the City to ensure proper pricing is charged for those parts. We further recommend researching the possibility of electronic invoicing, allowing purchases to be uploaded into the accounting system and pricing checked automatically.

AUDITEE RESPONSE

Fleet Services agrees that dual billings for each type of transaction would be the best practice for the way that this contract is structured. We initially requested it from the vendor, however, the vendor didn't agree to this term until recently.

We also agree that an electronic version would streamline this task. We will institute a meeting between the vendor's technical staff and our IS department to determine if it is possible at this time. If not, it could be placed as a condition of award for the next contract.

RECOMMENDATION 2

We further recommend the City Fleet Division demand repayment of amounts overcharged to-date. Upon request, Internal Audit will assist the Division in calculations of overcharges.

AUDITEE RESPONSE

We agree, and will request assistance at the appropriate time.

FREIGHT ON RUSH ORDERS

Freight is currently charged by Lee-Smith on immediate need parts (hotshot orders) in violation of the contract. The bid specification (included as part of contract) states “all items must be quoted F.O.B. destination”. Bid specification section IV (1) states “All parts are to be delivered. All deliveries, including stocked and non-stocked parts, should be included in the parts price discounts.” Bid specification Section IV (2) states “Non-stocked immediate need parts (Hot Shot) should have a two hour maximum.” The bid response from Lee-Smith says, in part; “Our markup proposal does include all proprietary, non aftermarket parts, as well as aftermarket.”

The practice of allowing Lee-Smith to add freight charges over the agreed upon 15% markup unnecessarily increases the cost of operations of Fleet Services. Further, this procedure is unfair to other bidders, who would have assumed all freight was included in the markup over cost they quoted.

RECOMMENDATION 3

We recommend City Fleet Services work with the Purchasing Department to inform Lee-Smith of their non-compliance of this contract term, and take appropriate action.

AUDITEE RESPONSE

We agree we should not pay shipping charges for normal parts deliveries.

Fleet Services does occasionally request overnight shipments for emergency equipment replacement parts for critical machinery. The overnight freight charges are the current industry standard, and are less costly than the cost of idle work crews because their equipment is down. Out of service equipment also affects ISO ratings for the Fire Department. After much scrutiny and discussion about this subject, we have tightened the rules concerning shipping going forward, and feel it will resolve this issue.

AUDITOR COMMENT

Our finding and recommendation was not intended to suggest immediate need parts should not be ordered. On the contrary, we point out the contract excludes freight payments for most parts purchased by the City under this contract, including non-stocked immediate need parts.

INVOICING BY LEE-SMITH

The City receives a large quantity of invoices from Lee-Smith daily, most containing billing for only a few parts. Processing this large number of invoices greatly increases the amount of work required of the Finance Department, increasing costs by necessitating the coding and processing of the many invoices.

RECOMMENDATION 4

We recommend the City Fleet Services and Finance departments work with Lee-Smith to provide two daily invoices for each contract, one for static priced parts, and another for cost-plus contract purchases.

AUDITEE RESPONSE

Per a request from Finance, this practice has already been instituted.

PURCHASE OF NON-PART SUPPLIES FROM LEE-SMITH

Items not vehicle-related are being purchased from Lee-Smith under the parts purchase contracts, some at higher prices than available under other City blanket contracts. In one instance, printer cartridges were purchased for \$90.45 from Lee-Smith that were available on a blanket contract at \$9.07. Other items, such as restroom mats, pieces of lumber and truck seat upholstery have been purchased through the parts contracts.

RECOMMENDATION 5

We recommend the City Fleet Division use the City's parts contract for part purchases only, as well as take steps to identify all blanket contracts in place, taking advantage of those that are applicable.

AUDITEE RESPONSE

We agree, and understand some future enhancements by Purchasing and IS will soon make these contracts available for review by everyone.

RECOMMENDATION 6

We recommend the City Purchasing Department, working with IS, move the webpage listing blanket contracts on the City intranet to a location allowing easy access by all employees, such as under the Purchasing tab on the main page.

AUDITEE RESPONSE (Purchasing)

We agree.

INCONSISTENT USE OF WARRANTY CLAUSE IN CONTRACT

Both parts contracts with Lee-Smith have a clause providing if parts fail within one year of purchase the part will be replaced at no cost to the City. Parts are frequently

purchased without checking the date that part was last replaced on a piece of machinery. Not taking advantage of the contract warranty clause increases the cost of City garage operations.

RECOMMENDATION 7

We recommend the City Fleet Maintenance Department implement a policy to use the vehicle repair history to verify warranties on parts with costs exceeding \$25 have not expired prior to the replacement of the part.

AUDITEE RESPONSE

We agree. We will institute this at the recommended level. We will perform further study to determine if \$25 is the correct base level.

PARTS RETURN POLICIES

Many contracts for items that are inventoried allow purchasers to return a percentage of annual purchases for full credit to the supplier, the credit being used in exchange for useful parts. A similar clause in these contracts would lower Fleet Services operating cost by providing the opportunity to replace parts that have become obsolete due to changes in equipment being used by the City. Such a provision would allow the City to receive greater value than selling the parts at surplus auction.

RECOMMENDATION 8

We recommend the City Purchasing Department explore the possibility of adding return clauses into future large contracts for items that are inventoried, and the products of intended use, such as vehicle parts, are subject to obsolescence.

AUDITEE RESPONSE (Purchasing)

We agree.

PROCEDURE MANUALS

The procedures manuals related to parts procurement are outdated and affected personnel do not have a copy. New employees have no guidance on policy, procedures, or the basic operations of the garage.

RECOMMENDATION 9

We recommend the City Fleet Services Department update the policy and procedures manual for parts management and provide it to employees who would benefit from its

use.

AUDITEE RESPONSE

We agree.

PARTS IN BID NOT PURCHASED

The Fleet Services light-duty and heavy-duty equipment parts contracts were based on the pricing of 150 frequently used parts. Purchasing required the bid specifications state bids could be the brand listed, or a part of equivalent quality. However, in some cases, Fleet Services does not use the brand of parts quoted in the bid, buying other branded parts at a higher price. Fleet Services states the quoted parts are not of equivalent quality, or in some instances, a particular brand must be used to preserve equipment warranties. There does not appear to have been proper consideration, by either Purchasing or Fleet Services management, to the parts and the associated quality of the equivalent parts in the bid that was accepted.

RECOMMENDATION 10

In the future, we recommend City Fleet Services not agree to accept bids based on items they cannot, or will not, use.

AUDITEE RESPONSE

We agree.

RECOMMENDATION 11

We also recommend the Purchasing Department work with all departments to ensure that specifications provided potential bidders meet the needs of the departments that will purchase the goods.

AUDITEE RESPONSE (Purchasing)

Purchasing works with the buying departments to develop purchasing specifications. We will be diligent in the future to ensure the specifications meet the needs of the buying department.