



Performance Audit

Vehicle Maintenance Contract Monitoring

Durham County Internal Audit Department

February 3, 2014



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February 3, 2014

Lee Worsley,
Interim County Manager,

Dear Mr. Worsley,

The Internal Audit Department has completed its audit of vehicle maintenance contract monitoring. The audit focused on whether effective monitoring would result in savings and what additional controls should be established for vehicle maintenance contracts awarded in fiscal year 2015 and beyond.

Audit results demonstrated that contract monitoring could benefit the County by reducing maintenance costs associated with overpriced parts and labor. Additionally, contract terms should be clearer, including specifics regarding (1) labor standards that will be applied and (2) material and parts expenses for preventative maintenance procedures.

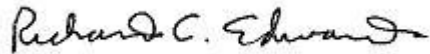
Fleet management was designed to be conducted non-centrally by Departmental fleet representatives having responsibility for its fleet. Representatives approved work on its departmental fleet and approved payment of invoices. They did not monitor labor, parts, and material costs because they were not aware they should to the extent necessary to assure costs were in line with contract provisions. This report suggests centralized monitoring of labor costs.

Our recommendations include (1) establishing a monitoring process especially for labor and parts expenses, (2) clarifying language in future contracts to assure standard labor manuals are used as the basis of labor costs, (3) clarifying language in future contracts to identify specific labor, parts and material covered in the negotiated price for preventative maintenance services.

The recommendation to monitor labor charges comes with a cost. The labor standards manual and effort to closely monitor the cost of fleet repairs may cost additional dollars but our findings demonstrate it would be cost effective.

Brian Welch conducted the primary analysis for this audit. Special thanks to Carolyn Louis, Quality Control and Contract Specialist, Department of General Services, for her dedicated effort in analyzing the raw data which was the basis of this audit report.

Sincerely,

A handwritten signature in black ink that reads "Richard C. Edwards". The signature is written in a cursive style with a prominent initial "R".

Richard Edwards,
Internal Audit Director

CC: Motiryo Keambiroiro, Director of General Services
Audit Oversight Committee
Marqueta Welton, Deputy County Manager

Introduction

The Audit Oversight Committee approved this audit in the fiscal year 2014 Annual Audit Plan. The audit follows-up on the ongoing effort to more effectively monitor County contracts. Additionally, there have been discussions over the past several years regarding the source and options for vehicle repair.

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

Performance audits are defined as audits that provide findings or conclusions based on an evaluation of sufficient, appropriate evidence against stated criteria. Performance audits provide objective analysis to assist management and those charged with governance and oversight in using the information to improve program performance and operations, reduce costs, facilitate decision making by parties with responsibility to oversee or initiate corrective action, and contribute to public accountability.¹

Audit Objectives, Scope

Fieldwork for the audit engagement was conducted between July 23, 2013, and October 8, 2013. The objectives of our audit were to answer the following questions:

1. Are contract monitoring procedures adequate to reasonably assure that wasteful spending on repairs is avoided?
2. Are revisions needed in the contract monitoring process to enhance controls to assure service providers compliance with contract terms?
3. Are revisions or additional considerations needed to improve future contract terms so as to assure better compliance and to more reasonably respond to contract expectations?

Methodology

Our methodology was determined by the County's legal representative's opinion of options for our conclusion. Our choices were (1) that the service providers overcharged for their services, or (2) the County did not administer and monitor contracts appropriately resulting in unnecessary costs. The County's legal representative advised that the second option was more viable because the contracts had been in force for about seven years in one instance and about eight years in the other, and County representatives had not demanded provider adherence to contract terms. Therefore, it was more appropriate to address the lack of appropriate monitoring. Overcharges would require efforts to collect them and the legal arguments to collecting may not have favored the County because of the long term nature of the contract term omissions without intervention by County representatives.

¹ Comptroller General of the United States, *Government Auditing Standards*, Washington D.C: U.S. Governmental Accountability Office, 2011, p.17.

Because of the above advice, we felt County management would be better served by internal audit demonstrating that contract monitoring is beneficial to achieve expected savings and assurance of contractor compliance and service delivery.

We did not undertake to demonstrate the extent to which savings could have been achieved. The audit resources necessary to achieve that objective would have been out of proportion to the results because the savings are not retroactive. Instead, internal audit's objective was to demonstrate that savings can be achieved in the future if appropriate monitoring is conducted. We believe we provide enough evidence to substantiate this conclusion in the findings section of this report.

To answer our objectives, we:

1. Reviewed Speight's and Hendrick's repair contracts.
2. Reviewed invoices to determine if information required by contract terms were included in invoices.
3. Compared labor charges to standard labor hours for repairs as estimated by "Motor Labor Guide Manual." We then calculated labor charge differences based upon information obtained in the labor manual.
4. Calculated the differences in the price of parts as shown on the invoice with the allowable mark-up. Contract terms allow for a mark-up of 45% above the price the contractor paid for the part. We chose ten parts for each service provider for this exercise and asked them to provide documentation to show what they paid for the specific item. That price was compared to the price charged to the County.
5. Reviewed invoices and contracts to determine if terms were clear and precise.

For our audit fieldwork designed to determine if labor charges were in line with contract terms, we selected invoices that included maintenance service beyond preventative maintenance and inspections. Preventative maintenance costs are set under the contract terms; therefore, labor charges associated with that service has been determined. The invoices we chose to review included labor charges that fell under the general schedule for labor. The contract labor rate is \$55 per hour of labor. To compare labor standard hours to the invoiced labor cost, we simply converted the labor charges to time and compared that time with the standard. For other audit observances such as clarity of terms, we reviewed all invoices, including those with preventative maintenance service.

Background

The County has contracted with two providers to conduct maintenance of its vehicles as needed. The contract includes provisions for regular preventative maintenance such as tire rotations, tune-ups and inspections, as well as more extensive repairs as required. The contracts have been in force since 2005, originally for a two year period and then by annual amendments. The County has approximately 483 vehicles, 289 of which are Sheriff's Office vehicles that are serviced under the contracts. Not all of the 483 vehicles use these contract services. For example, EMS has capability for maintaining its vehicles. The County spent approximately \$277,009 for labor, parts and materials in fiscal year 2013 under these two contracts. Approximately 1,246 invoices were submitted that year.

The contract agreements contain clauses for labor, material, and preventative maintenance. For example, the latest contract amendments, the agreement calls for (1) labor rates of \$55 per hour, (2) parts mark-up of no more than 45% of the price the provider paid for the part, and (3) a flat rate for shop supplies not to exceed 7 percent of labor cost or \$14 per invoice, among other stipulations.

The framers of the contract included clauses that would facilitate contract monitoring. The contracts included language that required the contractor to provide the number of hours to perform a repair and the net cost of parts required in conducting repairs with each invoice. These two pieces of information, if used appropriately, could provide the checks to determine if the contractor was adhering to contract terms and that the County was not being overcharged for these contracted repair services.

The vehicle maintenance operation was designed to be non-centrally operated. Each department with vehicles was responsible for obtaining required services and approving provider reimbursement. The departments designated a Departmental Fleet representative to handle the administrative tasks associated with this process.

Findings and Conclusions

Summary

Departmental fleet representatives did not monitor the contracts to the extent necessary to assure the provider complied with contract terms or to the extent necessary to determine if reimbursements were in accordance with contract terms. Two aspects of billing, the number of labor hours to conduct a specific repair and the net costs of the parts used in repairs, were not obtained by representatives as required by the contract. Therefore, information vital to contract monitoring was not available for that purpose. The contract terms called for contractors to provide that information with each invoice; however, they did not provide the information nor did County representatives require it. Additionally, the contract is not clear regarding the labor standard to use for labor hours reporting as well as for material and parts used in preventative maintenance.

This report demonstrates that if these weaknesses were addressed, savings would result. To benefit from potential savings, we recommend a process be set up for obtaining the necessary data and monitoring the contract on a reasonable basis. Additionally, we recommend clarifying contract terms in follow-up contracts in regards to labor hour standards and material costs for preventative maintenance.

The weaknesses above are in some ways related to the organization of the vehicle repair program. The program was designed to be non-centrally operated. Each department head designated representatives to administer the program. The representatives were not aware of the contract terms which required information be submitted for the purpose of contract monitoring. Even if they had been aware of the contract provision, each representative would have needed monitoring tools in the form of industry labor standards to implement monitoring.

Labor charges and parts costs could have been lessened

Monitoring of labor charges could have lessened the cost of repairs. We found \$3,693.72 that could have been saved on 88 invoices.² Our review and comparison of labor hours charged for repairs with a labor hour manual resulted in this determination. As a result of our analysis, we believe a monitoring program directed at labor hour costs would result in savings and if not actual savings, deter contractors from charging hours that are not in line with industry standards.

Contract terms are not complied with. Contract terms call for the contractor to provide with each billing invoice, the number of hours to conduct specific items of repairs and to provide net pricing information. The contractors do not provide this information as required by the contract and the information was not requested by departmental fleet representatives. We discussed this with representatives of six of the 14 departments that use the repair services. When asked why they did not obtain the required information and monitor contracts accordingly, each said they were not aware of the provision. Several said even if they knew of the contract requirement they did not have the tools to monitor the labor hour requirement.

We agree that they did not have the tools to monitor the labor hour requirement. Monitoring of labor hours requires a labor hour guide, preferable the identical guide used by the provider. These guides can cost several hundred dollars and more depending upon the conveniences one wants attached. We do not believe it would be cost effective for all department representatives to obtain a manual; therefore, we believe it would benefit the County to create a centralized location to monitor repair labor hours, to some degree, before invoices are submitted for payment. Departmental representatives can hold the provider responsible for submitting the necessary data as required and can monitor the material and parts costs by applying the agreed upon mark-up to the invoice amount.

Mark-ups for parts costs exceeded terms of the contract. Instead of the allowable 45% parts mark-up allowed by contract terms, the average mark-up was 73 percent for one contractor. We requested from each provider the net price of ten specific parts along with documentation. One provider provided copies for nine of the parts, including invoices. One provider provided an electronic copy of ten parts prices but did not provide supporting invoices.³

For those parts for which we obtained invoices, the total amount charged to the County was \$960.73. The service provider's cost for these parts was \$561.34. The terms of the contract would have allowed the contractor to markup this price \$252.60. Instead parts were marked-up \$399.39 or \$146.79 more than the contract terms allow. This is a mark-up of 58 percent more than terms allow.

² We did not review all 1190 invoices. Our methodology was to select any random invoice and determine if discrepancies existed between labor charged and the labor manual. We repeated that method until we had 88 discrepancies or what we believed was a sufficient number to demonstrate that savings could be achieved with appropriate monitoring.

³The provider that provided the electronic information said backup invoices were available to support the printout. We did not insist upon obtaining them because we had enough evidence from the other provider to demonstrate that overcharges occurred and that adequate monitoring would have detected those occurrences.

Again, we did not review the entire universe of parts; however, we believe with our analysis of nine parts, the effort to monitor parts prices would result in savings either by asking for price corrections or by deterring overpricing. As such, we recommend that users of the contracts insist upon obtaining net parts prices and monitor them for compliance with contract terms.

Contract terms are not always clear

Contract terms were unclear in two areas. It was vague as to whether (1) the contract included a standard for labor hours and (2) if parts or material such as motor oil or filters used in the preventative maintenance procedures are intended to be included in the negotiated prices for those services.

Standards for labor hours were not specified. The contracts require the service providers to use best practices in fleet management but it does not specifically state that an expectation exists for the providers to use standard labor guides or manuals. The three most common manuals are Chilton's, AllData, and Mitchell's. One of the County's providers uses AllData. These manuals provide shop employees with the time it takes to complete a specific repair and is used to estimate and charge for labor.

The contract term that required providers to submit labor hour data with each invoice is useful if it is going to be used as a monitoring tool. To appropriately monitor the contract, the contract should specify which labor guide it will use and then hold the contractor responsible for providing the information in accordance with contract terms. The County will need to have access to a manual in order to conduct its monitoring processes.

Terms are not clear regarding materials used for preventative maintenance services.

Contracts terms call for routine preventative maintenance procedures to be conducted at periodic intervals. The contract term specifies the service should cost \$62.50. The contracts include a list of specific items to be inspected and maintained during the preventative maintenance procedures. The confusion lies in whether the costs of parts and materials for the preventative maintenance procedures are intended to be included in the costs negotiated and included in the contract terms.

For example, the contracts specifically states that the provider should "inspect critical components (hoses, belts, etc.) and replace any worn or damaged components." It is unclear if the contract terms intend for replacement of worn and damaged parts to be included in the \$62.50 fee, the contracted price for the services. Another example is oil changes. It is unclear if the \$62.50 preventative maintenance allowance includes the oil and filter or if these materials were to be charged separately. In some instances such costs were included in the \$62.50 preventative maintenance cost and in some instances it was not included. We believe the terms of the contract should be clear regarding these costs and will include that in our recommendations.

Recommendation

This report includes several recommendations to assure that service providers comply with contract terms regarding labor and material used for County vehicle maintenance and upkeep. The responses from the departmental fleet representatives regarding these recommendations

indicated they were in favor of them and that they will implement them. The specific recommendations are:

1. Establish an effective and efficient contract monitoring program that focuses on labor, materials, and parts charges. This monitoring program should include a written policies and procedures document.
2. Include language in future contracts to clearly indicate that industry standards are to be used for determining labor hour costs.
3. Clarify language in future contracts that clearly identify what material and parts costs are to be included in preventative maintenance services such as oil changes.
4. Hold service providers accountable for providing all data required in contract terms.

Implementation of recommendations

On January 15th the County Manager announced a program to implement the recommendation to...“establish an effective and efficient contract monitoring program that focuses on labor, materials, and parts charges. The implementation program as explained during the announcement is as follows:

1. User departments, upon receipt of a vendor invoice, will verify that work was satisfactorily completed.
2. User departments will forward invoices for verified satisfactory work to a central location in the General Services Department for cost monitoring.
3. The monitoring representative will determine if labor and pricing information is correct and forward accurate invoices to the Accounts Payable Division in the Finance Department for payment.
4. The monitoring representative will be return incorrect or invoices requiring clarify to the vendor for necessary correction and clarification.

The manager emphasized that all of the above will take place without delay so the “payment to vendor” contract terms will be adhered to. Those terms require payment in 30 days.

In addition to the above monitoring steps, the service contracts will be re-bid in the upcoming contract cycle to implement the recommendations to clarify language in the contracts.