



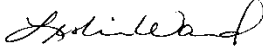
CITY OF ATLANTA

LESLIE WARD
City Auditor
lward1@atlantaga.gov

AMANDA NOBLE
Deputy City Auditor
anoble@atlantaga.gov

CITY AUDITOR'S OFFICE
68 MITCHELL STREET SW, SUITE 12100
ATLANTA, GEORGIA 30303-0312
(404) 330-6452
FAX: (404) 658-6077

AUDIT COMMITTEE
Marion Cameron, CPA, Chair
Cheryl Allen, PhD, CPA
Daniel Ebersole

TO: Managed Competition Independent Review Board
FROM: Leslie Ward, City Auditor 
DATE: May 6, 2016

SUBJECT: Managed Competition Cost Proposal Review: Fleet Services

The purpose of this memo is to communicate the results from our performance audit of the cost portion of the city employees' Fleet Parts Managed Competition Proposal dated March 8, 2016. The Mayor's Office asked us in mid-March 2016 to review the employees' cost proposal. The proposal estimates service costs, savings due to process improvements, and new revenue streams over the next five years if city employees continue to provide the service. The objective of this audit was to answer the following question:

- Are the five-year estimates of service costs, process improvement savings, and revenue streams presented in the city's managed competition proposal reasonable?

Background

Managed competition provides a way for the city to make an informed decision whether to continue to provide a service in-house or to outsource to a private vendor. The Mayor's Blue Ribbon Commission on Waste and Efficiency in Government recommended in June 2014 that the city pilot a managed competition program; in April 2015, the Huron Consulting report identified fleet services as an area of opportunity. With the goals of ensuring a legal and replicable process that is fair to all parties and achieving cost-savings and operational improvements by fiscal year 2017, the Mayor's Office provided affected employees internal and external resources to develop a five-year proposal to stock and manage city vehicle replacement parts storerooms. Simultaneously, the city solicited proposals from external vendors for the same service. An evaluation committee consisting of city representatives is reviewing external proposals to recommend the most responsible and responsive private vendor proposal and the Managed Competition Independent Review Board will compare the vendor and the employee proposals. The board will then recommend the service-delivery option that it considers best for the city.

The employees' cost proposal covers three areas (see Exhibit 1):

- Estimated Service Costs
- Estimated Impact of Process Improvements
- Estimated Impact of New Revenue Streams

The estimated service costs cover personnel (salaries, benefits, and bonuses), supplies (parts), interfund/interdepartmental (fuel and maintenance costs for eight service trucks), and debt service (to replace aging service trucks over a pre-determined timeline). The estimated impact of process improvements evaluates processes that could be implemented to achieve cost-savings, while the estimated impact of new revenue streams are new opportunities the proposal team identified that could generate revenue to offset costs.

Exhibit 1 Managed Competition Cost Proposal from City Employees

City of Atlanta



Fleet Parts Managed Competition Cost Proposal

	Employee Cost and Service Level Proposal					
	Year 1	Year 2	Year 3	Year 4	Year 5	Total
Estimated Service Costs						-
Personnel	924,211	939,211	954,211	954,211	954,211	4,726,055
Supplies	4,235,683	4,235,683	4,235,683	4,235,683	4,235,683	21,178,415
Interfund/Interdepartmental	40,000	40,000	40,000	40,000	40,000	200,000
Debt Service	10,000	10,000	10,000	10,000	10,000	50,000
Sub-total	5,209,894	5,224,894	5,239,894	5,239,894	5,239,894	26,154,470
Estimated Impact of Process Improvements:						
Renegotiate Contracts / Usage	(338,855)	(423,568)	(423,568)	(423,568)	(423,568)	(2,033,128)
New Initiative - Hydraulic Hose Repair Program	(28,000)	(28,000)	(28,000)	(28,000)	(28,000)	(140,000)
New Initiative - Battery Recharge Program	(50,000)	(50,000)	(50,000)	(50,000)	(50,000)	(250,000)
New Initiative - Warranty Tracking and Usage	(84,714)	(84,714)	(84,714)	(84,714)	(84,714)	(423,568)
Sub-total	(501,568)	(586,282)	(586,282)	(586,282)	(586,282)	(2,846,696)
Estimated Impact of New Revenue Streams:						
Used Tire Re-sell	(5,000)	(5,000)	(5,000)	(5,000)	(5,000)	(25,000)
Obsolete Part Surplus	(5,000)	(5,000)	(5,000)	(5,000)	(5,000)	(25,000)
Sub-total	(10,000)	(10,000)	(10,000)	(10,000)	(10,000)	(50,000)
Estimated Total Service Costs	4,698,326	4,628,612	4,643,612	4,643,612	4,643,612	23,257,774

Source: Final Proposal Submittal by Employees, March 2016

Methodology

We conducted this audit in accordance with generally accepted government auditing standards. Our audit methods included:

- interviewing representatives of the employees' proposal team, the Mayor's Office, and the team's consultant to understand the bases and methods of cost, savings, and revenue estimates
- analyzing Oracle data and budget projections to evaluate total personnel costs
- reviewing financial and procurement data to assess whether supply estimates were accurate and included all relevant accounts
- analyzing fleet services records, Carfax data, and the Energy Information Administration's fuel cost projections to estimate fuel and maintenance costs for eight vehicles over the five-year period
- identifying best practices associated with useful life of fleet trucks to assess whether the proposed fleet replacement cycle is most economical
- reviewing documents provided by the employees' proposal team to evaluate the possible cost-saving implications associated with the current and new process initiatives

Generally accepted government auditing standards require that 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 objective. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

Proposal Could Underestimate Total Costs; Magnitude of Cost Savings is Uncertain

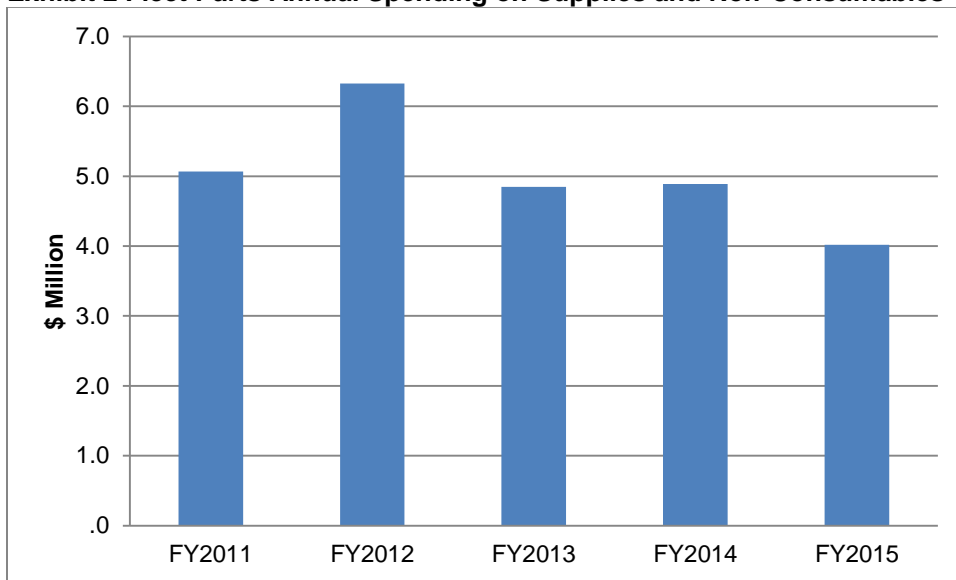
The employees' cost proposal could underestimate total costs over the five years by not incorporating potential annual increases for employee benefits. Estimated supply costs are uncertain; supply costs account for 81% of the employees' cost proposal and have varied considerably over the past few years. While fleet parts can take steps to control shrinkage and obsolescence, supply costs are largely outside of its control. We agree that cost savings due to process improvements are possible, but are unable to validate the estimated magnitude presented in the proposal.

Estimated personnel costs are reasonable for year one, but the subsequent years do not consider annual increases for benefits. Personnel costs include salaries and benefits – retirement, health insurance, and group life insurance – paid by the city. We verified current employees' salaries and most recent benefit rates. While estimated personnel costs appear reasonable in the first year, the proposal includes no increases in personnel costs over the five years, which appears to be an unreasonable assumption. The city's Office of Budget and Fiscal Policy project a 6% increase in pension costs and a 4% increase in health insurance costs from fiscal year 2016 to fiscal year 2017. The proposal estimates supervisor salaries at the maximum of the range and the manager and storekeeper salaries at the midpoint, which is higher than all current salaries, but includes no cost-of-living or merit increases over the five years. Nor does the proposal include potential overtime costs; 14 of 15 employees are eligible

for overtime. Depending on the staffing model chosen, overtime could be required to meet operating needs. We estimate that 8.1 storeroom staff would be required to keep at least one person on duty in each of the four locations for the weekly operating hours described in the city’s request for proposal. The employees’ proposal identifies seven supervisors and seven storekeepers to operate six locations. If the intent is to have a supervisor and storekeeper on duty together, the unit would likely incur overtime. The request for proposal also requires staffing in emergencies as determined by the city, such as inclement weather, which could result in overtime.

Annual supply costs have varied, making them difficult to project. The proposal estimates \$4.2 million per year for supplies and excludes a growth rate. The proposal team estimated costs based on purchase orders for fiscal year 2015. According to the adjusted trial balance, fleet parts spending on supplies and non-consumables in fiscal year 2015 was \$4 million, a five-year low. The average annual supply cost over the past five years was \$5 million (see Exhibit 2). The total amount spent on supplies each year ranged from \$4.0 to \$6.3 million, suggesting variation in annual operational needs not reflected in the employees’ proposal, or that annual spending was influenced by other factors. We were unable to determine a growth rate from the city data, but applying the Federal Reserve’s projected inflation rate would increase supply costs by about 8% over the five years. Because supplies account for 81% of the employees’ cost proposal, changes in estimated supply cost have a big effect on the overall cost proposal.

Exhibit 2 Fleet Parts Annual Spending on Supplies and Non-Consumables



Source: Oracle Financials, adjusted trial balances for fiscal years 2011 through 2015

Fuel and maintenance costs appear to be overestimated. Interfund and interdepartmental service costs included in the proposal represent fuel and maintenance costs for eight vehicles. The unit is currently assigned seven vehicles; the proposal calls for an additional vehicle so that one truck will be assigned to the manager and one to each of the seven supervisors. The proposal estimates \$5,000 per vehicle per year for fuel and maintenance, which was obtained using the average annual fuel and maintenance costs for 1998-2014 half-ton pickup trucks in

the city's fleet and rounding up. Average annual fuel and maintenance costs for the unit's current seven vehicles, however, was \$2,287, in part because the vehicles see relatively little use. The vehicles were driven an average of just under 6,000 miles per year. Even adjusting annual estimates for inflation and using worst case fuel price forecasts from the Energy Information Administration, total fuel and maintenance costs for these vehicles appear to be overestimated.

Debt service costs are reasonable, but rely on overextending useful vehicle life. Debt service costs included in the proposal represent repayment of proceeds to be obtained from Georgia Municipal Association's Master Lease and Option Agreement to replace vehicles assigned to Parts locations. The proposal estimates \$25,000 to replace each vehicle by using the average purchase price of 2015 Ford F-150s (\$24,893) and rounding up. The proposal plans to replace one vehicle every 2 ½ years with the first replacement beginning in year 0. Fleet replacement at this pace will take 17 ½ years, overextending the life for each vehicle. The average age of the trucks is currently 10 years. Our calculation of debt service costs shows the proposal provides a reasonable estimate for debt service costs for replacing vehicles. The unit could likely reduce overall vehicle costs by reducing the number of vehicles assigned and replacing current vehicles every 1 ½ years.

We could not independently validate the proposal team's estimated process improvement savings. The employees' cost proposal estimates \$2.8 million in savings due to process improvements. Over \$2 million (71.4%) of the estimate is from an initiative to renegotiate parts contracts with vendors. Based on industry knowledge, the proposal team's consultant concluded that the city could save 8% to 10% on parts by reducing the number of contracts and changing the basis to "cost-plus," in which the vendor charges the city its price for the part plus a pre-determined mark-up. We did not assess whether this plan is consistent with the city's procurement code. According to the proposal team, the Department of Procurement has approved the strategy in concept. The proposal team estimated an additional 2% annual savings on parts could be achieved by an initiative to better manage warranties. This estimate is based on employees' working knowledge of warranties. We verified that the current IT system, AssetWorks, has warranty tracking capabilities that fleet parts does not currently use. While we agree that cost savings are likely possible, we could not independently verify the bases of the estimates. Also, to the extent that supply costs are over- or underestimated, these savings are also over- or underestimated.

The proposal team also estimated potential savings from repairing hydraulic hoses in-house and from recharging batteries. The proposal team estimated a \$70 saving for each hose based on current costs and volume of repairs. For the battery recharge initiative, the proposal team estimated a 50% recovery of their documented \$100,000 annual spending on batteries by recharging replaced batteries to full functionality for re-use. These programs would require a small investment in equipment.

We could not independently validate estimated revenues. The proposal team estimated new revenue to partially offset costs from selling used tires and returning obsolete parts to the vendor. The proposal team estimated selling 1,000 used tires per year at \$5 per tire based on quoted prices from four vendors from \$3-\$10. Fleet parts does not have an agreement in

place and expects to sell used tires on the city's existing auction website. The proposal team estimated recovering 10% of \$50,000 in obsolete parts each year, assuming full credit for return of unused parts within six months and partial credit for unused parts returned within twelve months. It could be difficult to achieve flexible return policies with vendors while also reducing supply costs through contract negotiation. The consultant did not assist with either new revenue stream initiative.

We shared the draft report with the Mayor's Office on May 4, 2016, and have incorporated their comments. We appreciate staff's courtesy and cooperation throughout the audit. If you have questions you may call Amanda Noble at 404/330-6750, or you may reach me at 404/330-6804.

Cc:
Mayor Kasim Reed
City Council President Ceasar C. Mitchell
Members of the City Council