

March 6, 2019

Honorable Mayor and Members of City Council

Subject: Audit to Assess the Potential Overcharging of Auto Parts Supplies

The attached report contains results of our audit titled, “Audit to Assess the Potential Overcharging of Auto Parts Supplies.” Our area of focus was a concern raised by a competitor who asserted the Contractor was charging the City for parts more than its cost and possibly violating contract provisions. The competitor also questioned the feasibility of the Contractor performing the parts operation function for the City while charging a low management fee. Our report was unable to confirm, due to restrictions, whether the Contractor included a mark-up cost on parts and supplies purchased through their distribution center. However, we did find that the contractual terms need to be updated and invoice processing needs to be enhanced. As such, we made four recommendations based on the work performed. We appreciate the courtesies and cooperation of the City administration and corresponding departments that were extended to us during our audit.

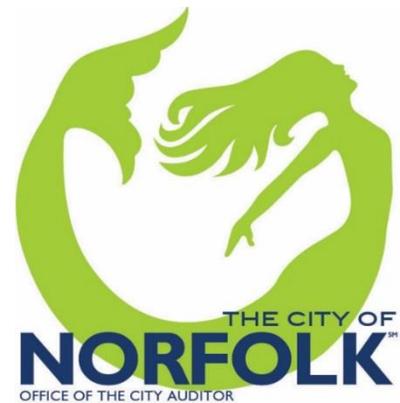
Respectfully submitted,

Tammie Dantzler

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Audit to Assess the Potential Overcharging of Auto Parts Supplies

March 6, 2019



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BACKGROUND

Genuine Parts Company (GPS), DBA NAPA Auto Parts (Contractor), is currently the City of Norfolk's (City) parts operations vendor. On July 1, 2015, the City entered into a five-year, five-month term contract, ending November 30, 2020. Per the contract, the Contractor provides staffing, management, aftermarket and original equipment, manufacturer's maintenance and repair parts, which may include lubricants and specified tires necessary to support City vehicles and equipment. In the contract, the City agreed to pay the Contractor's product costs monthly as well as a monthly management service fee of \$25,500. The Contractor's product cost is the actual cost paid by NAPA for parts purchased. Therefore, the City receives parts from NAPA with no markup. Between July 1, 2015, and October 31, 2017, the City paid approximately \$4.4 million for parts and \$714 thousand in management service fees.

OBJECTIVES

The audit was conducted to address concerns raised by a competitor, through the City Attorney's Office, indicating that the Contractor was charging the City for parts more than its cost and possibly violating contract provisions. The competitor also questioned the feasibility of NAPA performing the parts operation function for the City while charging a low management fee. Therefore, we amended the City Auditor's FY 2017 annual audit plan to perform this audit. The audit objective was to determine if prices the City paid NAPA for parts were at cost, as per the contract, or at a markup, which violates the terms of the contract. Specifically, we focused our audit efforts on ascertaining if the Contractor was complying with the provisions of the contract regarding pricing and transparency of pricing to include all applicable charges.

SCOPE

The audit covered processes and procedures within the terms and conditions of the contract from July 1, 2015, through November 30, 2020, as well as the Contractor's vendor invoices to verify the product cost the vendor paid to purchase the parts.

METHODOLOGY

We reviewed the contract to gain an understanding of the terms and conditions between the City and the Contractor to assess compliance with provisions. Also, we obtained transactional information from the Advantage Financial Management System (AFMS) General Ledger Detailed Expenditure Report (804C) for December 2016 and used Audit Command Language (ACL), a data analysis extraction tool, to statistically generate a sample of 37 invoices. We subsequently selected ten additional transactions to review, for a total of 47, based on the varying transaction amounts within the sample. Based on our sample, we requested and received invoices from the Contractor and City's Fleet Management Division to reconcile the original prices NAPA paid to their vendors for the parts to ensure the parts were provided to the City at cost without any markup.

We also performed the following to accomplish the audit objective:

- met with the concerned auto parts provider's representatives that raised the concern of the City being overcharged for auto parts supplies to gather an understanding of the potential issues;
- met with the City Attorney's Office to discuss the raised concern from a procurement and contractual basis;
- reviewed the Invitation for Bid and the contract between the City and NAPA to assess the terms;
- conducted a tour of the NAPA store within Fleet Management to obtain an understanding of how Fleet Management purchases auto parts supplies from the NAPA store;
- traced invoices in the City's financial system to ensure accuracy of payments;
- obtained a written certification from NAPA as to the accuracy of invoices provided;
- discussed with Fleet Management Mechanics and assessed the quality and timeliness of them receiving parts from NAPA;
- documented the process Fleet Management uses for tracking returned parts to determine possible quality issues involving parts; and



- interviewed the Fleet Director from a neighboring city to inquire whether similar issues were the reason why they were no longer using the contractor for their parts operations function.

GOVERNMENT AUDITING STANDARDS

We obtained an understanding of internal control that was significant within the context of the audit objective. We assessed whether internal control was properly designed and implemented and performed procedures to obtain sufficient evidence to support the effectiveness of those controls. We further assessed the information in the FASTER¹ database system and the data reviewed from the AFMS as reliable and determined that the data could answer the audit objective. The extent of our assessment was dependent on the expected importance of the data to the final report, strengths or weaknesses of any corroborating evidence, and anticipated level of risk in using the data. We assessed the level of risk from using the data to be low.

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

CONCLUSION

Based on the work performed, we were unable to confirm the cost of the six sample transactions that were purchased by NAPA through their Richmond Distribution Center, as NAPA deemed the pricing data was confidential and proprietary business information. Because of this restriction, we did not have sufficient evidence to validate whether the auto parts supplies included a mark-up cost. The number of transactions that were processed through a distribution center was 13% (six of the sampled 47). As such, for the remaining 41 sampled transactions NAPA purchased through vendors, the vendors invoice prices matched the prices the City paid. However, because we did not confirm the invoice prices with the applicable suppliers our conclusion is qualified to this extent.

We did note some opportunities for improvement to process invoices. Our test work noted that a uniform method for entering invoices into the City's financial system was not in place which caused a check to be processed twice, then later cancelled.

CONTRACT PROVISIONS:

STATEMENT OF CONDITION: During the audit, we were unable to adequately determine whether the Contractor was marking-up the cost of the auto parts supplies sold to the City for the parts purchased through their distribution center, because they stated the evidence needed to validate the actual product cost was considered propriety and confidential information.

CRITERIA: The contract stipulates prices include all applicable charges such as packaging, shipping, duties, customs, tariffs, and any other fees.

CAUSE: The contract is silent on the supporting documentation the vendor is required to provide to validate the Contractor's product cost to ensure compliance with the contract provisions.

EFFECT OF CONDITION: We were unable to confirm \$211.00 (1%) total product cost for six of the sampled 47 transactions (\$35,906), because NAPA purchased the auto parts supplies through their distribution center.

¹ FASTER is the system used by Fleet Management to generate invoices for auto parts supplies requested from the vendor as well as maintaining records for the services performed on each vehicle.

RECOMMENDATION: The current contract should be amended to include a requirement to have available for review, on a monthly or quarterly basis, supporting documentation of NAPA's product costs that includes all applicable charges such as packaging, shipping, duties, customs, tariffs, and any other fees.

DEPARTMENT OF FINANCE RESPONSE:

The Department of Finance (Finance) will work with the vendor to attempt to amend the existing contract to include a requirement that the vendor give access to supporting documentation that supports the vendor's product costs to the City on a periodic basis.

ESTIMATED COMPLETION DATE:

Finance will attempt to complete this with the current vendor by June 30, 2019.

INVOICE PROCESSING:

STATEMENT OF CONDITION: We noted two payments were processed for the same amount on the same billing statement two days apart. Precisely, on July 12, 2016, the June 2016 billing statement was entered into the City's financial system to process for payment. Then, on July 14, 2016, the same billing statement for the same amount was processed for payment again.

CRITERIA: The City's AFMS is designed to detect duplicates when identical invoice numbers are entered into the system.

CAUSE: NAPA's invoices do not have a numbering scheme. All of their invoices are identified by date and year. However, it appears Fleet Management has not established a mechanism to ensure uniformity when entering these types of invoices to ensure that duplicates are detected and rejected before a check is processed.

EFFECT OF CONDITION: A check for an overpayment of \$250,884.92 was processed then later canceled by the City's Accounts Payable Division.

RECOMMENDATION: Fleet Management must establish a uniform method for entering NAPA invoices into AFMS such as the first three letters of the month and two-digit year (Jun18) for June 2018 billing statement.

GENERAL SERVICES RESPONSE:

The July 2016 NAPA duplicate invoice payment request was attributed to the urgency to ensure fiscal year compliance with year-end closeout and Period 13 processing. Once Fleet Management identified the error, Finance worked with Fleet to correct the line amount, cancel the duplicate payment request and process the payment in the appropriate fiscal year (FY 2016). While there was a duplicate payment request entered in the system, the vendor was not paid twice as only one check was processed.

In an effort to avoid a future occurrence, per the above recommendation, Fleet Management will implement a uniform method for AFMS invoice submission. Fleet Management will utilize the first three letters of the month and two-digit year of each invoice as a unique identifier.

ESTIMATED COMPLETION DATE:

Fleet Management will begin utilizing the uniform method for NAPA AFMS invoice submissions immediately upon the receipt of the next invoice (February 2019).

OTHER IMPROVEMENT OPPORTUNITIES:

During the audit, we noted an opportunity for Fleet Management to improve internal controls of invoice processing. Therefore, we recommend management develop processes and procedures to ensure the following when processing payments within the City's financial and accounting system:

- a. Enter each invoice separately in AFMS to provide an accurate accounting of each transaction for adequate reconciliation purposes.
- b. Develop a mechanism to capture the actual date invoices are received to monitor invoice processing time and timeliness of payment.

GENERAL SERVICES RESPONSE:

Please see corresponding responses for each of the above bullet letters below:

- a. Fleet Management will enter each invoice separately in AFMS.
- b. Fleet Management's level one processor will capture the invoice received date via an excel spreadsheet. Invoicing processing time and payment will be monitored by management.

ESTIMATED COMPLETION DATE:

Fleet Management will enter invoices separately and track invoice received dates and monitor processing time and payments beginning in February 2019.