

Review of the Vehicle Rental Fund –
Methodology used to
Calculate Fleet Services Operating &
Maintenance Rates

Report of Audit 04/05-XX-02

January 6, 2005



MEMORANDUM NO. 05-12

DATE: January 6, 2005

TO: Director of Parking and Fleet Services/John Hoelzle
Director of Finance/Terry Sharp

SUBJECT: *Review of the Vehicle Rental Fund – Methodology used to Calculate Fleet Services Operating & Maintenance Rates*

Enclosed is the “subject” Final Report of Audit.

Allyson C. Love
Director, Office of Management and Budget

Attachment - Final Report of Audit

c: City Commission
City Manager/George Gretsas
Assistant City Manager/Kathleen Gunn
Assistant City Manager/Stephen Scott
Chief of Police/Bruce Roberts

ACL/cs

REPORT OF AUDIT NO. 04/05-XX-02

DATE: October 29, 2004

TO: Director of Parking and Fleet Services/John Hoelzle
Director of Finance/Terry Sharp

FROM: Director, Office of Management and Budget/Allyson C. Love

SUBJECT: *Review of the Vehicle Rental Fund - Methodology used to Calculate Fleet Services Operating & Maintenance Rates*

BACKGROUND

The City of Fort Lauderdale (City) former Administrative Services Department operated a Fleet Services internal service fund known as the Vehicle Rental Fund. The purpose of an internal service fund is to provide services to other funds/departments of the primary government on a cost reimbursement basis. According to the Fiscal Year (FY) 2003-2004 Annual Fleet Plan, the City has 1,379 vehicles/equipment distributed throughout the user departments, as follows:

<u>Department</u>	<u>Count</u>
Police	558
Public Services	415
Parks & Recreation	224
Fire	84
Planning & Economic Development	61
Administrative Services	37
Total Fleet	<u>1,379</u>

The Fleet Manager prepares a Fleet Plan as an integral part of the annual budget process based upon input from the various departments and personal observations/intuition concerning Fleet Operating and Maintenance (O&M) cost behaviors. The vehicles/equipment are organized into classes by grouping vehicles similar in terms of model/design and use characteristics. The user departments are assessed monthly charges for O&M expenses and a replacement reserve. The monthly O&M charge covers usual repair and preventive maintenance for all vehicles and equipment in the Fleet inventory. The monthly replacement reserve is intended to accumulate

REPORT OF AUDIT NO. 04/05-XX-02

resources to cover repurchase of the vehicles/equipment at the end of their useful lives.

The Fleet Manager develops budgeted O&M rates based upon a subjective evaluation of a number of causal factors that affect life cycle maintenance costs, including use patterns, age of vehicles, and the availability of manufacturer's warranty. The guiding principle integral to this entire process is whatever rate is set for each class, the total O&M departmental charges must, in conjunction with other Fleet revenues, contribute enough resources to the Vehicle Rental Fund to align/balance with budgeted/anticipated expenditures for each fiscal year. Repair services have been outsourced to First Vehicle Services, Inc. (herein "Contractor"), who operates out of City-owned facilities behind the Public Safety building located at 1300 West Broward Boulevard in Fort Lauderdale. Most repair work is completed by the Contractor; however, some body work and certain specialized repairs are subcontracted out.

SCOPE

The overall objective of our review was to determine if the methodology used to develop the O&M rates results in an equitable distribution of Fleet maintenance costs and an accurate system to charge departments, the consumers of fleet services, back directly for the actual services they consume. We reviewed FY 2002 and FY 2003 O&M interdepartmental charges and underlying support documents during the months of January and February 2004, according to generally accepted government auditing standards.

OVERALL EVALUATION

Fleet Services does not have written policies and procedures for its current methodology for allocating O&M costs which is inherently flawed since it is based on a budget allocation process, opposed to actual consumption by user departments. A direct charge-back method for O&M is more theoretically sound and eliminates the possibility of interdepartmental cross-subsidization, which results when one department pays for O&M through the budget allocation, which may be more or less than their actual consumption of Fleet O&M services. Thus, one department underpays, while another overpays. A direct cost allocation method would assure annual O&M charges for each department would reflect/tie to their actual consumption of Fleet O&M and improve cost control. Furthermore, a

REPORT OF AUDIT NO. 04/05-XX-02

physical inventory of vehicles and equipment is not conducted to confirm the actual existence of these assets (vehicles).

FINDING 1

The City's unwritten methodology used to allocate Fleet Services O&M costs to user departments lacks objectivity and is based on a budget allocation process, opposed to charging user departments of fleet services for the actual services consumed, resulting in interdepartmental cross-subsidization (one department underpays, while another overpays).

The methodology used to allocate Fleet O&M charges should be objective, promote cost awareness and better manage fleet assets. Charging fleet users for the costs of the specific vehicles and services they actually utilize is imperative to manage these costs.

The current methodology to allocate O&M to the user departments is based upon the Fleet Manager's budgeted class rates and is highly subjective. Actual O&M costs are billed to the City by the Contractor and are not distributed to the departments directly. Thus, the amount a particular department pays for O&M through the budget allocation may be more or less than their actual consumption of Fleet O&M services. This methodology often results in one department involuntarily subsidizing another. As shown in the table below, for example, the Police Department in FY 2002 and FY 2003 contributed \$861,487 more in monthly O&M than they consumed in O&M services. Conversely, Public Services contributed \$781,403 less in O&M relative to their consumption.

Department	FY 02 Paid	FY 03 Paid	Total Paid	FY 02 Consumed	FY 03 Consumed	Total Consumed	Over(Under) Paid
Police	\$1,041,155	\$1,179,255	\$2,220,410	\$618,950	\$739,973	\$1,358,923	\$861,487
Fire	695,293	712,685	1,407,978	628,789	898,776	1,527,565	(119,587)
Admin. Services	120,525	94,275	214,800	97,966	100,600	198,566	16,234
Parks & Rec.	559,260	590,385	1,149,645	440,089	387,484	827,573	322,072
PED	78,925	75,900	154,825	45,527	66,643	112,170	42,655
Public Services	1,341,550	1,340,625	2,682,175	1,709,496	1,754,082	3,463,578	(781,403)
Total	\$3,836,708	\$3,993,125	\$7,829,833	\$3,540,817	\$3,947,558	\$7,488,375	\$341,458

The current indirect cost allocation method does not promote cost awareness and is dysfunctional in terms of motivating department managers to use Fleet Services efficiently. The methodology was inherited by the Fleet Services Manager and was never questioned or critically evaluated in terms of promoting cost effective usage of fleet services.

REPORT OF AUDIT NO. 04/05-XX-02

Charging for actual consumption of Fleet O&M and providing a detailed billing to management of user departments will significantly enhance O&M cost control and Contractor accountability. Furthermore, the accuracy of enterprise fund user fees could be improved by using the direct charge-back method.

RECOMMENDATION 1

The Director of Parking and Fleet Services should develop in writing and implement a methodology/system that is equitable and accurate in charging user departments for Fleet O&M charges directly for actual consumption of services¹, which will promote cost effectiveness and better manage Fleet assets.

Management Comment. Management concurred in principle and offered the following alternative: “Fleet Services does not consider it feasible to charge directly for each month’s current, actual consumption of services since it would require a considerable increase in personnel and a major modification of software and billing procedures. On average, the City’s contracted maintenance provider, First Vehicle Services, generates approximately 1,500 repair orders each month for the approximately 1,400 pieces of equipment in the fleet. In addition, a large number of invoices are generated for work that is subcontracted out for specialized services. To handle this amount of billing paperwork in-house, on a monthly basis, would not be possible with current resources. In addition, this method would not provide all the fleet vehicle and equipment user departments an accurate method to prepare their annual fleet budget in April of each year because the amount of repairs would vary from year-to-year, and in any given year they could easily overrun their vehicle repair and maintenance budgets.

As an alternative, Fleet Services is proposing to implement the procedure outlined immediately below for the next budget year (FY 05/06). The proposed system will distribute direct and indirect costs in a more equitable manner (based on a department’s actual previous consumption) and encourage fleet users to more efficiently utilize resources in order to reduce their operating expenses. The proposed system will also continue to provide averaged monthly O&M payments that are much more manageable from a

¹The National Association of Fleet Administrators recently published “Cost Allocation Guidelines” representing industry best practice for the Direct Charge-Back System.

REPORT OF AUDIT NO. 04/05-XX-02

budgeting perspective. Expenses for major repairs (e.g. damaged engines, heavy duty truck transmissions, tracks on beach tractors, etc.), if required, will be covered by the established O&M charges and not directly billed on a monthly basis. The proposed system also avoids the complications of trying to synchronize billing cycles to make sure that incurred charges are passed on to the using department in the same month that the repair was completed.

NEW PROCEDURE

1. Fleet Services proposes to produce a cost analysis evaluation summary by January 2005 that summarizes life to date costs by vehicle class for all equipment in the Fleet. This summary will cover the cost of all repairs (parts & labor) less accident.
2. An average, direct monthly O&M cost will then be calculated for each vehicle Class based on lifetime repair costs. This monthly O&M rate, by vehicle Class, will be billed to each department, month by month, for the entire fiscal year.
3. Total annual O&M revenue calculated from the monthly figures will be compared to the proposed budget for Fleet Services for the next fiscal year.
4. The difference between these two figures is the indirect expenses that will be allocated among all departments on a monthly basis. The allocation will be proportional to the share of direct O&M repair expenses incurred by each department during calendar year 2004. Use of calendar year 2004 data will enable Fleet Services to bring the calculated cost as close as possible to the beginning of the budget process and the upcoming new fiscal year.
5. Beginning in FY 05/06, each department using Fleet vehicles will receive a monthly bill for the indirect charges in addition to the monthly bill for the direct O&M charges as noted in item #2 above.
6. The Finance and Information Technology Services Departments will be requested by Fleet Services to assist in this new fleet billing procedural change that should be implemented in time for the beginning of FY 05/06. Since all City departments will have to be told how to budget for this change in April 2005 Fleet Services will have to have a commitment by Finance and Information Systems to

REPORT OF AUDIT NO. 04/05-XX-02

accomplish the required changes to this entire new charge back system before April 2005. If they have other priorities, this new billing system may not be accomplished in time for implementation by October 1, 2005.” **Estimated completion date April 30, 2005.**

FINDING 2

The City’s internal financial controls were not effective to prevent and detect posting errors, including a duplicate posting of the monthly Fleet Services O&M journal entry.

Internal financial accounting controls are designed to prevent and detect duplicate postings. Distinct tracking of O&M in a dedicated object code provides enhanced cost control.

During our review of monthly O&M charges allocated to user departments the following errors occurred.

- O&M charge for October 2002 was posted twice in the amount of \$393,600 and there was no O&M charge posted for November 2002.
- 13 Monthly postings of O&M charges for FY2001/2002 (two in September 2002 \$397,920 and \$393,600) resulted in a \$393,600 overcharge.

The Finance Department did not have an operating procedure in place to verify that all monthly interfaces from Fleet Services were properly accounted for in order to prevent missing or duplicate entries. Furthermore, monthly O&M charges are commingled with replacement reserve in subobject 4373. A report provided for subobject 4373 did not separately identify the monthly O&M charges for FY2002 and FY2003 because replacement reserve and O&M charges were posted to the same subobject 4373; thus, could not be isolated electronically. No history of the data supporting the monthly Vehicle Rental Detail Report is saved electronically.

Proper accounting for each and all Fleet Services monthly postings will assure the reliability/accuracy of the O&M charges allocated to the user departments and recognized as revenue in the vehicle rental fund. Furthermore, tracking O&M charges in a unique subobject code will promote cost awareness and assist in the detection of errors.

REPORT OF AUDIT NO. 04/05-XX-02

RECOMMENDATIONS AND MANAGEMENT COMMENTS

The *Director of Finance* should require the *Controller* to:

Recommendation 2. *Develop a written operating procedure and create a checklist to verify all Fleet monthly interfaces are accounted for to prevent missing or duplicate entries.*

Management Comment. *Management concurred with the finding and recommendation and stated:* “The interface process involves staff from Fleet, Information Systems, and Finance. We are setting a meeting to discuss the current procedures and potential improvements to that process for the latter part of January. Depending upon the option, we commit to developing the appropriate operating procedure with division of responsibilities among the three departments no later than March 1, 2005. **Estimated completion date March 1, 2005.**”

Recommendation 3. *Create a new object code for monthly O&M charges, which are currently commingled with replacement reserve and other Fleet charges in subobject 4373. All future journal entries and preformatted coding on all other source documents should also be updated to reflect the new subobject code.*

Management Comment. *Management concurred with the recommendation and stated:* “Interestingly, the current accounting structure does separate the O&M Charges from the replacement charges on the revenue side. We agree with the recommendation but will need to develop the details of changing the interface file to ensure that the expenditures hit the new subobject code. We will also explore whether it makes sense to implement this accounting change at the beginning of the new fiscal year (October 1, 2005). We will develop our implementation schedule and recommendation no later than March 1, 2005.” **Estimated completion date March 1, 2005.**”

The *Director of Parking and Fleet Services* should:

Recommendation 4. *Consult with the Manager of Tech. Strategy from the Information Systems Department to update the processing procedures*

REPORT OF AUDIT NO. 04/05-XX-02

for the monthly Vehicle Rental Detail Report to include creation of a history file for the O&M charges separate from the replacement reserve charge.

Management Comment. *Management concurred with the finding and recommendation and stated:* “Fleet Services concurs with this recommendation since it would eliminate referring to hard copies of billed information to determine the cumulative collection of replacement funds for any given vehicle. It would also be most useful when determining the life-to-date replacement fees paid when fleet vehicles are totaled, so that required information can be provided to Risk Management in a timely manner. In addition, it would also provide a historical record for study and identification of O&M repair charge trends. Fleet Services will submit a request to the Director of the Information Technology Services Department to implement a revised billing program by the end of the second quarter FY 04/05.” **Estimated completion date March 31, 2005.**

FINDING 3

Fleet Services does not conduct annual physical inventory of Fleet Vehicles and Equipment to verify the accuracy of Fleet inventory records.

An annual physical inventory of Fleet vehicles and equipment confirms the actual existence of these assets.

According to the Fleet Services Manager, an annual physical count of Fleet vehicles and equipment has never been done. A bill is sent showing how much each department has been charged for each vehicle in their fleet and department managers are supposed to verify fleet counts and should notify Fleet Services if they were charged for a vehicle they no longer had.

Independent physical counts assist in the detection of inventory errors and may reveal situations where Fleet assets cannot be located, are no longer in existence and/or are being used inappropriately.

RECOMMENDATION 5

The Director of Parking and Fleet Services should establish a procedure and conduct at minimum an annual Fleet inventory physical count, to

REPORT OF AUDIT NO. 04/05-XX-02

verify the existence of Fleet assets and assure the accuracy of Fleet inventory records. Furthermore, document results of physical inventory and maintain on file for audit purposes.

MANAGEMENT COMMENT

Management concurred with the finding and recommendation and stated: “Fleet Services concurs with this recommendation and will coordinate an annual audit of all vehicles/equipment. An inventory list will be sent to each department in January and a schedule will be established with the department liaison that will be identified by each user department, to audit each department’s fleet during February and March. Estimated completion of this fleet audit is the end of the second quarter of FY 04/05.” **Estimated completion date March 31, 2005.**

FINDING 4

The Unrestricted Net Assets in the Vehicle Rental Fund during fiscal years 2002 and 2003 rose from \$13,578,482 to \$16,277,165, a \$2,698,683 or 19.9% increase from the prior fiscal year end and no written policy exists to determine the adequacy of this growing unrestricted balance.

The adequacy of the unrestricted net asset balance in the vehicle rental fund should be periodically evaluated.

The unrestricted net asset balance in the Vehicle Rental Fund is growing at a rate of 15.1 to 19.9% annually and may be excessive based upon average replacement expenditures (**Schedule**).

The growing unrestricted net asset balance was never objectively analyzed/forecast in terms of actual use characteristics. Additionally, no policy and procedure exists to perform an evaluation of the adequacy of the unrestricted net asset balance.

Proper planning, forecasting, and management of the unrestricted fund balance will ensure sufficient resources accumulate and fully align with Fleet Services’ actual revenue and expenditure patterns.

REPORT OF AUDIT NO. 04/05-XX-02

RECOMMENDATION 6

The Director of Parking and Fleet Services, in conjunction with the City Controller, should develop a written policy and procedure to measure/evaluate annually the adequacy of the unrestricted net asset balance. Moreover, the procedure should address how over/under funding will be corrected/resolved.

MANAGEMENT COMMENT

Management concurred with the finding and recommendation and stated:
“Fleet Services concurs with this recommendation and will contact the City Comptroller to establish an adequate procedure. Estimated completion for development of a written policy is the end of the third quarter of FY 04/05.”
Estimated completion date June 31, 2005.

EVALUATION OF MANAGEMENT COMMENTS

Management comments provided and actions taken and/or planned are considered responsive to the recommendations.

**City of Fort Lauderdale-Internal Audit Office
Analysis of Unrestricted Net Assets Relative to Average Annual Replacement Costs**

Schedule

				9/30/2001 Actual	\$ Increase	% Increase	9/30/2002 Actual	\$ Increase	% Increase	9/30/2003 Actual	9/30/2004 Actual
Unrestricted Net Assets				\$ 11,792,820	\$ 1,785,662	15.1%	\$ 13,578,482	\$ 2,698,683	19.9%	\$ 16,277,165	
Replacement Reserve Revenues & Proceeds - Actual Sales				\$ 6,171,809			\$ 7,641,160			\$ 7,290,822	\$ 7,855,230
Less: Replacement Expenditures (excludes year-end encumbrances)				(4,774,034)			(6,347,143)			(6,310,018)	(5,004,345)
Net Effect on Unrestricted Net Assets				\$ 1,397,775			\$ 1,294,017			\$ 980,804	\$ 2,850,885
				Replacement Expenditures	Unrestricted Net Assets	% Increase					
	Actual	9/30/2001		\$ 4,774,034	\$ 11,792,820						
	Actual	9/30/2002		6,347,143	13,578,482	15.1%					
	Actual	9/30/2003		6,310,018	16,277,165	19.9%					
	Estimated	9/30/2004		5,004,345	18,735,017	15.1%	Estimated Unrestricted Net Assets @ 15.1% Increase				
		Total		\$ 22,435,540							
Estimated Unrestricted FY2004 Net Assets				18,735,017							
Average Replacement Expenditures FY2001-04				5,608,885							
Unrestricted Net Assets/Average Expenditures				3.34	*Years						
*Note:											
The estimated 9/30/04 fund balance would cover 3.34 years of average replacement expenditures, which on the surface appears more than adequate; however, without a policy guideline or an industry accepted benchmark to follow, it is purely speculative.											