
OFFICE OF THE CITY AUDITOR

AUDIT OF THE EFFICIENCY AND EFFECTIVENESS OF THE SALVAGE YARD

**Thomas M. Taylor, CPA
City Auditor**

Prepared by:

Theresa A. Hampden, CPA
Audit Manager

David Henley, CPA
Auditor

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Memorandum



CITY OF DALLAS

September 20, 2002

Honorable Mayor and Members of the City Council
City of Dallas

We have conducted an audit of the efficiency and effectiveness of the Salvage Yard, which is operated by the Support Services and Inventory Management Division of the Equipment and Building Services Department.

In our opinion, the Salvage Yard is operating efficiently and effectively. The Salvage Yard provides both direct and indirect cost savings to the Equipment and Building Services Support Services Division. Salvage Yard assets are adequately safeguarded with a combination of inventory controls and premises safeguards. Additionally, Salvage Yard customers seem to be satisfied with its services. However, the City's environmental plan could be more coordinated, documentation of associated control records could be improved, and interdepartmental activities and processes could be coordinated more efficiently and effectively. These concerns are noted and discussed in the *Opportunities for Improvement* section of this report.

We appreciate the cooperation of City staff during our examination.

Thomas M. Taylor

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City Auditor

c: Teodoro J. Benavides, City Manager

AUDIT OF THE EFFICIENCY AND EFFECTIVENESS OF THE SALVAGE YARD

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INTRODUCTION

Authorization

We have conducted an audit of the efficiency and effectiveness of the Salvage Yard, which is operated by the Support Services and Inventory Management Division of the Equipment and Building Services Department (EBS). This audit was conducted under the authority of Chapter IX, Section 2 of the Dallas City Charter and in accordance with the Annual Audit Plan approved by the City Council.

Scope and Methodology

Our examination was conducted in accordance with generally accepted government auditing standards and, accordingly, included tests of the accounting and related records and other audit procedures that we considered necessary in the circumstances. Our audit covered the period October 1, 1999, to February 28, 2002.

The objectives of our audit were to determine whether:

- The Salvage Yard procedures for receiving, storing, and stripping both wrecked and surplus City vehicles are efficient and effective.
- The savings from salvaging parts at least offsets the total cost of operating the Salvage Yard.
- The policy for identifying vehicles to be salvaged is effective.
- Salvage Yard customers are satisfied with the services provided.
- Appropriate performance measures exist and provide useful information to management.
- The Salvage Yard is in compliance with specific state and federal environmental regulations.
- The environmental plan for the Salvage Yard is consistent with a sufficiently comprehensive Citywide environmental plan.

To achieve our audit objectives, we:

- Identified cost savings and auction revenues associated with vehicles that were stripped and sold for scrap.
- Interviewed managers of the EBS garages to determine their opinion of the service provided.
- Conducted site visits.

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- Surveyed other Texas cities regarding their Salvage Yard operations.
- Interviewed numerous staff from various divisions of EBS that provided fleet vehicle support.
- Examined various inventory and accounting records.
- Researched environmental regulations that pertain to the operation of the Salvage Yard and Service Centers of the City.
- Interviewed officials from the Texas Department of Transportation and Texas Natural Resources Conservation Commission on operating issues.

Overall Conclusion

In our opinion, the Salvage Yard is operating efficiently and effectively. The Salvage Yard provides both direct and indirect cost savings to the EBS Support Services Division. Salvage Yard assets are adequately safeguarded with a combination of inventory controls and premises safeguards. Additionally, Salvage Yard customers seem to be satisfied with its services. However, the City's environmental plan could be more coordinated, documentation of associated control records could be improved, and interdepartmental activities and processes could be coordinated more efficiently and effectively. These concerns are noted and discussed in the *Opportunities for Improvement* section of this report.

Background

The Salvage Yard supplies City garages with usable parts from wrecked and surplus fleet vehicles. It is located at the Southeast Service Center, immediately adjacent to the Body Shop, which is its biggest customer. It also supplies parts to commercial garages and auto dealers that provide contracted repair service on City vehicles. The vehicles remain in the Salvage Yard until about sixty-five percent of their usable value has been removed, then the stripped shell is sold at a scrap auction held in an adjacent area. The Salvage Yard is replenished with wrecked City vehicles when estimators determine that it would cost more than the vehicle is worth to repair the damage, and/or the value of remaining parts is greater than the amount that could be received for the vehicle at auction. Non-wrecked vehicles that have exceeded their service lives are also salvaged when EBS managers determine that there is sufficient demand for the parts.

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There are five employees primarily assigned to the Salvage Yard. A Manager III provides limited administrative oversight. Two mechanics and a storekeeper devote all of their time to the Salvage Yard. The supervisor and the manager have other responsibilities in addition to the Salvage Yard. The supervisor also oversees the Heavy Shop Storeroom at the Southeast Service Center. The Salvage Yard manager orders all parts catalogs, identifies inventory needs for new vehicles, and is responsible for the Heavy Shop Storeroom, the Make Ready Storeroom, and the Central Tire Shop. The manager closed

the Central Warehouse and is returning the remaining inventory for credit and/or auction.

The Salvage Yard is surrounded by a six-foot cyclone fence, which is topped with razor wire on all sides facing public areas. The facility is locked each night. The mechanics remove and safeguard all usable high-value parts that can be easily and quickly removed. There are two main inventory accounting controls to help track vehicles and removed parts. First, the supervisor inspects each vehicle when it is received and he notes any missing or damaged parts. Next, each part issued from that vehicle is recorded in the regular EBS parts inventory system. These two inventory records provide the basis for periodic comparisons with the vehicles physically stored in the Salvage Yard. The manager will periodically identify what parts were available when the vehicle was received, record the parts that were issued, and then inspect the vehicle to determine whether additional parts are missing. This periodic verification process is a deterrent to unauthorized removal of parts.

Salvage Yard mechanics remove individual parts or even entire parts assemblies based on requests received from the garages. Parts are picked up and delivered to the garages by a contracted courier, usually on the same day if the request is received early enough. The storekeeper updates inventory records for all parts pulled and delivered to the service garages. There is no direct cash outlay for these parts as there is for new parts purchased from a dealer or old parts purchased from a commercial salvage yard. The part is listed on the garage work order at a zero dollar amount. The Salvage Yard staff enters each part's cash savings value in their inventory records. This statistic serves as a comparative performance measure for the Salvage Yard operations, allowing Salvage Yard staff to

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determine which types of vehicles provide the most cost savings. It is important to note that only non-safety related parts are pulled. Safety items, such as brakes, are always purchased new.

The Salvage Yard serves a vital function by providing a ready inventory of spare parts for fleet vehicles. This function is especially critical after the closure of the EBS centralized parts warehouse. Garage managers and mechanics both consistently reported that they could get key parts from the Salvage Yard more quickly than from outside parts vendors.

The Salvage Yard provides both direct and indirect cost savings. The direct cost savings are the result of using vehicle parts the City already owns rather than buying additional parts. The indirect cost savings are the result of reduced labor and reduced fleet vehicle downtime.

The direct cost savings reported by the Salvage Yard are understated since the Salvage Yard will issue complete parts assemblies and parts that dealers generally do not. The value reported for those assemblies does not reflect the cost of staff time saved. Staff time is saved because mechanics do not have to diagnose and replace the individual part within the assembly. The direct cost savings reported by the Salvage Yard are measures of the cash that would have been paid if a new or rebuilt part were purchased. The cost savings values are assigned at sixty percent of the City's price agreement cost of that part for engine and wearable parts and one hundred percent of the cost for other, non-wearable parts. This valuation is an accurate indication of savings for small individual parts that are quickly removed or replaced. However, major parts assemblies such as engines or doors contain many individual parts that dealers will commonly sell individually. The value assigned to such an assembly is often the direct cost of only the most expensive single part; thus, the direct value of the entire assembly is understated.

There are two main indirect cost savings achieved by pulling entire parts assemblies from Salvage Yard vehicles. The first is the time saved because the mechanic is not required to diagnose the problem that is causing the assembly to fail. The second is the time saved because the mechanic does not have to disassemble the component to replace the broken part and

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then reassemble the component before installing it. In some cases, such reassembly requires expensive specialized tools that City garages do not have, and the garage would be required to send the vehicle or component out to a vendor for repair or rebuilding. This outsourcing would delay and extend downtime on the affected vehicle.

Delays in the delivery of parts from outside vendors also extend vehicle downtime.

Garage managers reported that vendors keep very limited inventories on hand and order more frequently from off-site warehouses.

Such delays can add one or more

days to the expected delivery date, keeping the vehicle in the garage. There are many indirect costs associated with these delays for the customer departments, such as overtime pay or purchased services. Garage managers report that delivery from the Salvage Yard is very rapid, often occurring on the same day. The greatest time savings was reported by the Body Shop supervisor, who told us that he achieved additional time savings on body parts because he did not have to repaint them or add decals.

The measured cost savings recorded in fiscal year 2000-2001 were \$306,729. The measured cost savings in the current fiscal year, through May 31, 2002, were \$297,634. The annual cost of operating the Salvage Yard is \$231,475.

The Salvage Yard staff performed a major cleanup of the facility in response to a December 5, 2001, environmental inspection conducted by City storm water inspectors. The staff quickly remedied many of the hazards identified and have started the process to obtain an operating permit that will bring the Salvage Yard into compliance with state and federal storm water regulations.

OPPORTUNITIES FOR IMPROVEMENT

We identified certain policies, practices, and procedures that could be improved. Our audit was not designed or intended to be a detailed study of every relevant system, procedure, and transaction. Accordingly, the opportunities for improvement presented in this report may not be all-inclusive of areas where improvement may be needed.

1. City procedures for salvage auctions provide opportunities to conceal the identity of stolen vehicles.

One method used to hide the identity of a stolen vehicle is a “VIN switch.” The VIN is the Vehicle Identification Number that is affixed to vehicles when they are manufactured, as required by federal law. It is stamped or placed on several locations on the vehicle body. The VIN is also listed on the vehicle title and registration papers, which are used by state officials to certify both the ownership and operating safety of the vehicle.

Individuals will often attend vehicle auctions like those held by the City to dispose of surplus or stripped vehicles. The individual’s primary objective is to get a legal operating title along with the matching VIN plates. The vehicle buyer then applies for and obtains a legal title in his/her name and switches the VIN plates from the scrapped vehicle with those from a similar stolen vehicle. The stolen vehicle then effectively takes on the identity of the scrapped vehicle for most purposes. Only a detailed examination of the switched plates or a comparison of those plates to VIN numbers hidden on other parts of the vehicle body will identify this switch. Most law enforcement officers will not perform such an examination unless they have reason to suspect the vehicle is stolen.

Current City auction procedures do not effectively prevent “VIN switches.” We found the following.

- A. Titles to auctioned salvaged vehicles do not show the purchased item as a “Salvaged Vehicle.” The City currently holds auctions of scrapped or surplus City vehicles three to four times a year, depending on the number of vehicles available from EBS. A contracted auctioneer conducts the vehicle auctions under the supervision of the City Sales Agent. The Cost Accounting section of the Office of Financial Services (OFS) maintains custody of the titles to all City vehicles. When vehicles are auctioned, OFS personnel record the odometer readings on the titles, sign them, and deliver the titles to the auctioneer to send to the buyers. These steps are required under Chapter 501 of the Texas Transportation Code. However, that law also allows the owners of damaged or scrapped vehicles (the City) to exchange the regular operating title of the vehicle for one of two types of salvaged vehicle titles. One salvaged vehicle title may be obtained for damaged vehicles whose repair cost equals seventy-five percent of the vehicle’s value before the accident. The second salvaged vehicle title is called a “nonrepairable motor vehicle” title. This title is for damaged vehicles whose repair costs equals ninety-five percent of the

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vehicle's value before the accident. A salvage title would significantly reduce the funds that could be received for a VIN-switched vehicle. This drop in value is great enough to generally deter an attempt to VIN switch on all but the most valuable vehicles.

- B. The Dallas Police Department (DPD) does not monitor salvaged vehicles from EBS for possible VIN switching. The DPD Auto Theft Unit (ATU) maintains, at the DPD Auto Pound, a squad of detectives who routinely survey commercial salvage yards for stolen VIN plates. The detectives will examine the car body to get the VIN number from another spot. Each week, the detectives also survey Auto Pound auction vehicles that are likely candidates for a VIN switch. They photograph the vehicle, record the VIN numbers from both sources, and enter the VIN numbers into a database of suspect VIN numbers. Periodically, one of the detectives will compare the database with the state registry of operating vehicles. If the detective finds a match for one of their suspect VIN numbers, then it is very likely that the number has been put on a stolen car. The ATU will either investigate or notify other authorities. However, the ATU does not currently examine any salvage or surplus City vehicles prior to the periodic equipment or scrap auctions held at EBS facilities.

We recommend that the Director of EBS:

- A. Coordinate with the OFS to exchange the regular operating title for a salvage title as soon as a vehicle is transferred from the active City fleet to the Salvage Yard.
- B. Notify the DPD ATU about impending scrap or equipment auctions so that the detectives may examine the vehicles for likely VIN switches and add the VINs and photographs of these vehicles to their database.

Management's Response:

- A. EBS concurs in part given that not all equipment is or will become salvage. As an example, a sanitation vehicle will have the loader unit stripped for parts and if possible the cab chassis and engine will be kept intact and sold as such. EBS evaluates and makes strategic decisions on whether a piece of equipment is or should become salvage in order to maximize the financial return. However, in order to ensure that we are timelier in obtaining salvage titles, the following procedure has been adopted. Upon arrival, equipment will immediately be evaluated and if determined that it is or will become salvage, a salvage title will be requested. Additionally, since Purchasing and other departments also use the salvage yard to store miscellaneous equipment such as mowers and tractors prior to auctioning them off, EBS will provide them with a copy of this recommendation in case it is applicable.
- B. EBS concurs and will notify the DPD ATU 30 to 45 days prior to each sale.

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2. The City's environmental program is not coordinated.

Environmental Protection Agency regulations require permits for certain facilities that have storm water discharges associated with industrial activities. Salvage Yards are generally classified under two Standard Industrial Classification (SIC) Codes: one for used motor vehicle parts and one for scrap and related materials. Both of these operations are among the SICs that require both a permit and a Storm Water Pollution Prevention Plan (SWPPP) under both federal and state regulations.

The City's Public Works storm water inspection team performed an inspection of the Salvage Yard in December 2001 and found neither a current permit nor a SWPPP. The inspectors also found several other minor violations of the Clean Water Act. Since then, the Salvage Yard staff cleaned up the housekeeping and storage issues, and a consultant has been hired to develop an SWPPP and to apply for a storm water permit for the Salvage Yard.

The storm water inspections were made in response to a City Council member's request. It was the first Citywide assessment of risks under the storm water regulations. Prior to this inspection, department directors made all environmental assessments. EBS management had historically reported that their initial risk assessment was based on its knowledge of hazardous waste regulations rather than storm water regulations. Due to limited expertise and a lack of resources within other City departments, it appears that there may be similar situations of gaps in environmental compliance for other City departments.

There are several major federal and state environmental laws affecting the management of hazardous waste, as well as the contamination of air, surface water, ground water, and storm water. These laws have different regulations but enforcement can sometimes be interrelated. For example, both storm water and hazardous waste regulations require both a permit and a pollution prevention plan. However, each law is sufficiently different in scope and enforcement that compliance steps for one law can create environmental hazards under another law. Thus, it is vital that compliance efforts under different environmental laws be coordinated.

Currently, the City's response to each major environmental law is divided among the various departments. Environmental and Health Services administers compliance with the Clean Air Act. The main compliance efforts for the Clean Water Act are centered in Water Utilities and Public Works departments. There are compliance efforts under hazardous waste regulations in the EBS, Fire, and Property Management departments. Many environmental officers in those departments focus on their specific laws and are unaware of changes in other environmental laws. There is a need for those officers to meet regularly to advise each other about each other's specific compliance efforts and identify both conflicting compliance efforts and possible gaps in compliance.

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We recommend that the Director of EBS confer with the City Manager to develop a more coordinated Citywide environmental effort to minimize conflicts in City compliance efforts, identify gaps in compliance, and fill the “information void” for those persons that need the additional data.

Management’s Response:

In FY 2000-2001 the City Manager created the Office of Environmental Management, a division of Environmental and Health Services, for the purpose of coordinating all of the City’s environmental initiatives.

Additionally, EBS has also undertaken further efforts in order to enhance compliance on environmental issues and Best Management Practices relative to all the Service Centers and the Salvage Yard. These efforts include (1) engaging in dialogue and working closely with Public Works’ Storm Water Management Division and (2) requesting through the budget process three positions dedicated to prevention and remediation of environmental issues. Also, the SWPPP has been written, once our review is complete the Notice of Intent (application) will be submitted to TCEQ, (Texas Commission on Environmental Quality, formerly TNRCC), which will occur within 30 days.

3. Random inventory checks are not documented and conducted regularly.

The Salvage Yard manager conducts periodic comparisons of inventory records for parts shown as issued from a specific vehicle with that vehicle. These comparisons are made to determine whether missing parts were not initially documented as missing when the car was received, were not documented when issued, or were improperly removed. The manager asks the Salvage Yard supervisor to investigate and explain instances of identified missing parts. The Salvage Yard manager stated that he performs these checks several times a year; however, he did not keep the associated notes/documentation.

Administrative Directive 6-1, Section 4.2.1 requires departments to conduct periodic inventory checks to deter employee theft. Checks should be unannounced, performed frequently, and documented to provide assurance that the control is in place and operating as designed.

We recommend that the Director of EBS require the Salvage Yard manager to conduct inventory checks at least quarterly, document the results, and expand the test if reasonable explanations/support are not provided for missing parts. The documentation should be retained in accordance with department record retention policies.

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Management's Response:

EBS concurs, although this was being done informally, the procedures are being rewritten to formally implement the recommended process and will be completed in the first quarter of FY 2002-2003.

4. Documents transferring vehicles to the Salvage Yard are not properly authorized.

Currently, the fleet manager and the Salvage Yard manager orally agree on which vehicles to transfer to the Salvage Yard. The Salvage Yard manager then writes and circulates a memo that documents and initiates the transfer. That memo also serves as the authorizing document. The fleet manager does not sign or initial the memo. Thus, the authorization is not properly approved. This procedure was developed over time as the most convenient method for all parties concerned.

Administrative Directive 6-1, Section 4.2.1 requires department directors to establish and maintain adequate internal controls for all personal property charged to that department. Such controls should include accurate and complete documentation of the authorization of all transfers or disposals of that property.

We recommend that the Director of EBS require the fleet manager to initiate and properly authorize the transfer of vehicles to the Salvage Yard. The documentation should be retained in accordance with department record retention policies.

Management's Response:

EBS concurs and the process has been formalized to be in compliance with AD 6-1.

5. Vehicles transferred from the active vehicle fleet to the Salvage Yard are not properly shown in the City's fixed asset records.

We reviewed documentation for five vehicles transferred from the active fleet to the Salvage Yard. We noted that EBS managers did reflect the transfer of vehicles from the active fleet to the Salvage Yard in their inventory records (GEMS 2000). However, EBS personnel did not notify the Fixed Asset Accountant in the City Controller's Office. Thus, the Resource Fixed Asset records for these vehicles are unreliable with regard to the asset value and location of the vehicles.

Administrative Directive 6-1, Section 4.2.12 requires departmental property coordinators to advise the OFS of the decision to cannibalize any fixed assets by completing the necessary disposition form (FXA-104). Form FXA-104 must show the disposition code

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as "N" (for nonrepairable, used for parts). The form should be accompanied by a statement of the circumstances, such as the memo referred to in the previous finding.

We recommend that the Director of EBS require the fleet manager to comply with Administrative Directive 6-1, Section 4.2.12 regarding vehicles transferred to the Salvage Yard, reconcile EBS' GEMS 2000 inventory records to the General Fixed Asset Group, and submit documentation to correct General Fixed Asset Group balances.

Management's Response:

EBS concurs and will initiate submitting a disposition form FXA-104 on all vehicles transferred to the Salvage Yard for parts utilization within 30 days and research past Salvage Yard transfers and complete documentation for submission to the Fixed Asset Accountant in the City Controller's within the first quarter of FY 2002-2003.