



**Program Evaluation and Audit**

***Metro Transit***

***Bus Tire Lease Contract Review***

12 December 2007

# INTRODUCTION

## Background

Metro Transit operates a fleet of about 864 buses for daily transit operations. Individual buses can travel up to about 5,000 miles per month. Most buses have six tires, two on the front and four on the rear. Articulated buses have 10 tires, two in front, four in the middle and four in the rear. Bus tires have averaged about 14.6 million miles per month from January through June 2007.

Metro Transit entered into a five year contract to lease bus tires and pay for on-site tire repair services from Goodyear Tire and Rubber Company (Goodyear) under the terms and conditions of Council contract 02P113 (Contract). Lease payments are based upon miles traveled and the size of tire used. Over 90 percent of all mileage is invoiced at \$.003531 per tire mile. Tire repair service is contracted at a flat monthly rate beginning at \$27,800 per month in 2003 and increasing to \$30,000 per month in 2007. Total payments cannot exceed \$5.3 million during the contract period from January 1, 2003 through December 31, 2007.

## Assurances

This review was conducted in conformance with Government Auditing Standards and the Standards of the Institute of Internal Auditors. Findings are reported to auditee senior management, the Regional Administrator and the Audit Committee of the Council.

## Scope

This review was conducted to assure that Metro Transit is paying the proper amounts as stated in Appendix B to the contract, that the ceiling expense has not been exceeded and that services contracted for are being provided in an acceptable manner.

## Methodology

To gain an understanding of Contract provisions, invoicing and payment procedures and mileage calculations, the following methods of inquiry were used:

- Personnel in Maintenance, Accounting, Bus Operations and Procurement Departments were interviewed in addition to Goodyear service representatives (Goodyear Reps).
- Goodyear invoices were analyzed.
- The Contract between Metro Transit and Goodyear was reviewed.
- Minnesota Department of Revenue sales tax regulations were reviewed.

# OBSERVATIONS

Program Evaluation & Audit (Audit) reviewed the scope of work required of the Goodyear Reps under the Contract with the Maintenance Manager at each of Metro Transit's five garages. In addition, Audit interviewed the Goodyear Reps at each garage and the roaming Goodyear supervisor to determine actual practices. As a result of these discussions and interviews, Audit has determined that Goodyear is not complying with the following Contract requirements:

## Contract Requirements

### *Tire Regrooving*

New Metro Transit buses arrive with all new tires, whereas, the current fleet is equipped with new tires on the front wheels and regrooved and recapped tires on the rear wheels. When the groove in the tread on the front tire becomes too shallow, the groove is deepened by the Goodyear Rep. This process is referred to as "regrooving," and its purpose is to provide a channel through which water can be wicked away from the tire. Exhibit A, Section 7.4 of the Contract states that "all tires regrooved shall be regrooved in a zigzag configuration. The Contractor shall provide zigzag tire regrooving equipment deemed necessary by the Contractor. The costs of retreading, regrooving and repairing tires shall be borne by the Contractor and are included in the monthly tire services rate." In addition, Section 4.1(b) states that "the monthly service fee for tire maintenance services shall include all tire service labor, materials, supplies, parts, equipment and tools necessary to provide the services identified in this contract." However, since early in the contract term, all tire regrooving has been done using the straight line configuration.

A November 18, 2003 letter from the Goodyear Technical Center in Akron, Ohio, to Metro Transit, states, "Goodyear has conducted several studies to verify which is the best regrooving design – straight or zig zag. Bottom line, it seems the results did not change, they all are comparable in performance and traction. ... Goodyear prefers the straight four grooves. Much easier for the tire service personnel to handle and much more economical in time spent regrooving." Subsequent to this letter, Metro Transit personnel stated that they conducted their own research which verified the accuracy of the Goodyear statements; however, no records exist to support such Council research. Metro Transit then approved a move from zig-zag to a straight line regrooving configuration. However, no documentation of this authorization could be located and the Contract was never amended to reflect this change.

A Metro Transit maintenance manager also spoke with a representative of Michelin Tire Company to obtain a second opinion. Michelin agreed with Goodyear that there is no difference in traction from zig-zag to straight line regrooving. According to both firms, it is industry practice to regroove in the straight line configuration. As a result, there was insufficient demand for zig-zag regrooving equipment and the sole firm that manufactured the equipment stopped doing so.

Even though the straight line method is "more economical in time spent regrooving," Goodyear initially incurred the same cost, for there was no change in the amount of labor allocated to the Contract. The time saved on regrooving has been used to accomplish other tasks including (i) re-torquing wheels within 100 to 150 miles of the initial torquing whenever a replacement tire has been placed on a wheel, (ii) recording pre-fill rather than post-fill tire air pressure on the monthly air pressure/tire depth reports and (iii) testing the thickness of the powder paint on newly painted wheels received from the Goodyear painting subcontractor. In early 2007, Goodyear added a half time position at no extra charge to assist in accomplishing these tasks.

### ***Goodyear Reports***

The Contract calls for Goodyear to provide the Council with the following reports:

- An annual physical inventory of all leased and non-leased tires upon the anniversary date of start of service. The report shall include the inventory date, bus number, location of the tire on the bus, tire manufacturer name, tire serial or brand number, tread depth, accumulated mileage as of last report and garage location and shall be sent to the Metro Transit Assistant Director of Equipment Maintenance and the Council's Internal Auditor.
- Monthly reports by tire group showing original tread and retread accumulated mileage for tires removed from service during the month.
- Quarterly reports of scrapped tires permanently removed from service to include the date the tire was scrapped, tire manufacturer name, tire serial or brand number and accumulated mileage.

No Metro Transit personnel or anyone for the Council's Audit department has received any of these reports since the contract began in January 2003. However, Goodyear was able to provide the required reports dating to the contract's commencement when requested by Audit.

### ***Tool Calibration***

Exhibit A, Section 8.1(k) of the Contract specifies that torque wrenches are to be calibrated quarterly and impact wrenches and air gauges weekly. None of these devices had been calibrated to these intervals prior to the Auditor's inquiry. Records of torque wrench calibrations disclosed that each of the torque wrenches at the five garages was calibrated only three times during the five year life of the contract. The first calibration for all five was 19 months after the contract start date and thereafter, the shortest time between calibrations at any of the five garages was 10 months. The contract calls for calibration of torque wrenches every three months. The most recent calibrations for all the garages were in October 2007, subsequent to Audit's inquiry.

Subsequent to discussions with the Goodyear Rep Supervisor, a program was put in place to assure quarterly torque wrench and weekly air gauge calibration. Both Metro Transit and Goodyear personnel concurred that there is no need to calibrate the impact wrenches.

## **Invoices and Payments**

In addition to the differences between Contract requirements and actual practice stated above, Audit's review of Goodyear invoices and Council payments disclosed the following:

### ***Sales Tax***

The Contract includes the material cost of the leased tires and the material and labor cost for wheel painting as well as the labor cost of providing six service representatives who assure an adequate supply of spare tires, mount and dismount all tires, balance the front tires, maintain proper air pressure and tire tread depth, repair punctures and flats, regroove tires, dispose of scrapped tires and provide training regarding abnormal tire wear.

Audit reviewed the Minnesota Department of Revenue web site for information on sales tax for bus tire repair services. This search and a discussion with a Senior Revenue Tax Specialist at the Department of Revenue disclosed that the guidance most closely associated with Metro Transit operations is reflected in Revenue Notice #93-21, "Sales and Use Tax – Automotive Repair, Paint and Body Shops – Labor, Parts and Supplies" as modified and effective January 1, 2002. This

guidance states that, "Repair labor performed by service stations, body shops, garages, paint shops and automotive dealers is not taxable if it is separately stated on the bill or invoice." Goodyear submits a separate invoice for tire leasing (materials) and another for the monthly service charge (labor). Materials and labor are separately identified. Therefore, the monthly tire service charge should not be taxable.

Goodyear has included sales tax on every invoice for monthly repair services and the Council has paid such sales tax. Over the course of the five year contract that will expire on December 31, 2007, the Council will have paid a total of about \$108,000 in Minnesota sales tax for repair labor that is exempt from such tax. In addition, Goodyear also held the previous five year tire leasing and repair contract for the period January 1, 1998 through December 31, 2002 and a review of some of those invoices also disclosed that Goodyear had invoiced and Metro Transit had paid sales tax on monthly charges for repair service.

During the course of the review, Audit advised Metro Transit of this situation and other observations it had made. Metro Transit management personnel subsequently notified Goodyear and Goodyear agreed that the monthly repair service invoices should not include Minnesota State sales tax, stating,

... I have reviewed with our tax department the question you asked related to The Goodyear Tire & Rubber Company charging tax on the labor portion of the services Goodyear provides to Metro Transit. Based upon your feedback and our tax department's review, it appears that your understanding is accurate in that State Tax should not be charged to Metro Transit for service. ... Current tax structure allows The Goodyear Tire & Rubber Company to recoup from the State of Minnesota taxes paid within the last 36 months; therefore, our credit to Metro Transit will correspond with the State taxes paid within this timeframe. ... we will pursue the appropriate credits from the State of Minnesota and we will in turn credit your account by \$67,206.17.

Metro Transit received a credit memo from Goodyear on October 31, 2007 in the amount stated above to resolve past tax paid. In addition, Metro transit will be reviewing contract language for the five year contract to be awarded beginning January 1, 2008 to assure that sales tax is neither invoiced by the contractor or paid by Metro Transit in the future.

### ***Goodyear Invoices and Council Payments***

Audit sampled invoices received and payments made to Goodyear for tire leasing and services under the Contract. Exhibit A to the Contract states the rates that apply to each category for each year of the five year Contract. In each instance, the correct rates were applied and the invoices were adequately reviewed by Metro Transit. The tire miles invoiced were also verified to the actual mileage data that Metro Transit submits to Goodyear each month.

The contract has a ceiling amount of \$5.3 million and it appeared that payments could exceed that amount if not closely monitored. Metro Transit was advised of this possibility and Audit believes the risk of overpayment is low. In addition, Members of ATU Local 1005 were on strike from March 4, 2004 through April 18, 2004. During that time, Goodyear Reps did not work. Therefore, no monthly service charge was incurred by Metro Transit. A review of Goodyear invoices and Metro Transit payments for that period disclosed that Goodyear did not invoice Metro Transit for service during the strike period.

## CONCLUSIONS

*1. Payments made by the Council under the Contract accurately reflect contract requirements.*

The monthly bus mileage submitted by Metro Transit to Goodyear was subsequently accurately reflected on the Goodyear invoice. In addition, the appropriate contract rates for tire miles, powder wheel painting and monthly repair services were used by Goodyear in its invoices to the Council. Finally, the Council was not invoiced for tire repair services during the period of the 2004 ATU strike.

*2. Metro Transit and Goodyear agreed to change from zig-zag to straight line tire regrooving; however, no documentation was found to support this decision and the contract has never been amended to reflect this change.*

The contract states that “all tires regrooved shall be regrooved in a zigzag configuration” (Exhibit A, Section 7.4) and that “the monthly service fee for tire maintenance services shall include all tire service labor, materials, supplies, parts, equipment and tools necessary to provide the services identified in this contract” [Exhibit A, Section 4.1(b)]. Two of Metro Transit’s five garages are equipped with zigzag regrooving equipment; however, tires at all the garages are regrooved in a straight line configuration.

Based upon Goodyear studies and Metro Transit research, the change from zig-zag to straight line regrooving was agreed to in November 2003; however, no documentation of this authorization could be located and the Contract was never amended to reflect this change. Even though the straight line method is “more economical in time spent regrooving,” Goodyear incurred the same cost, for there was no change in the amount of labor allocated to the Contract and the time saved on regrooving has been used to accomplish other tasks.

*3. Although they have the data, Goodyear has not complied with the reporting requirements stated in Appendix A to the Contract and those requirements may not be applicable considering Metro Transit no longer purchases any of its tires.*

Goodyear is required to provide an annual inventory report, a quarterly scrap tire report and a monthly report of mileage by tire group for tires removed from service. Until the Goodyear Regional Supervisor was contacted, none of these reports had been submitted to the Council at any time during the period of the Contract. However, upon special request by the Auditor, Goodyear was able to provide all the reports desired.

Metro Transit personnel stated that since all tires are leased (including those that come with newly purchases buses), the need for the required reports has been lost. However, that does not negate the lack of contract compliance by Goodyear or the need of Metro Transit to maintain the tire lease contract in a manner that reflects current requirements.

*4. Goodyear has not complied with the tool calibration requirements stated in Appendix A to the Contract.*

Exhibit A, Section 8.1(k) of the Contract specifies that torque wrenches are to be calibrated quarterly and impact wrenches and air gauges weekly. None of these devices had been calibrated to these intervals prior to the Auditor’s inquiry. Torque wrenches were only calibrated three times during the five year life of the contract when they should have been calibrated 20 times. Impact wrenches and air gauges were not calibrated at all.

Subsequent to discussions with the Goodyear Rep Supervisor, a program was put in place to assure quarterly torque wrench and weekly air gauge calibration. Both Metro Transit and Goodyear personnel concurred that there is no need to calibrate the impact wrenches.

*5. The Council has paid sales tax on tax exempt tire repair services.*

The contact with Goodyear includes provisions for tire leasing, wheel painting and a monthly repair service fee. Discussions with a Minnesota Department of Revenue Senior Revenue Tax Specialist disclosed the guidance regarding taxable services most closely associated with Metro Transit operations is reflected in Revenue Notice #93-21, "Sales and Use Tax – Automotive Repair, Paint and Body Shops – Labor, Parts and Supplies" as modified and effective January 1, 2002. This guidance states that, "Repair labor performed by service stations, body shops, garages, paint shops and automotive dealers is not taxable if it is separately stated on the bill or invoice."

Goodyear invoices separately for tire leasing and for the monthly repair services, and therefore, it appears that the monthly tire repair service charge should not be taxable. Over the five year period of the Contract such sales tax amounts to about \$108,000. . In addition, Goodyear also held the previous five year tire leasing and repair contract for the period January 1, 1998 through December 31, 2002 and a review of some of those invoices also disclosed that Goodyear had invoiced and Metro Transit had paid sales tax on monthly charges for repair service.

Goodyear subsequently agreed that they should not have charged sales tax on the labor portion of the contract and has submitted a credit memo to Metro Transit to reimburse the Council for over \$67,000 in taxes paid over the most recent 36 month period.

# RECOMMENDATIONS

Program Evaluation and Audit recommendations are categorized according to the level of risk they pose for the Council. The categories are:

- **Essential** – Steps must be taken to avoid the emergence of critical risks to the Council or to add great value to the Council and its programs. Essential recommendations are tracked through the Audit Database and status is reported twice annually to the Council’s Audit Committee.
- **Significant** – Adds value to programs or initiatives of the Council, but is not necessary to avoid major control risks or other critical risk exposures. Significant recommendations are also tracked with status reports to the Council’s Audit Committee.
- **Considerations** – Recommendation would be beneficial, but may be subject to being set aside in favor of higher priority activities for the Council, or may require collaboration with another program area or division. Considerations are not tracked or reported. Their implementation is solely at the hands of management.
- **Verbal Recommendation** – An issue was found that bears mentioning, but is not sufficient to constitute a control risk or other repercussions to warrant inclusion in the written report. Verbal recommendations are documented in the file, but are not tracked or reported regularly.

**1. (Significant) Metro Transit should develop procedures to identify procurements that both contain product and service elements and include explicit contract language regarding the Minnesota State Sales Tax exempt status of the service labor provided.**

Without clear guidance to employees based upon explicit contract language, it easily becomes routine to accept and process invoices from one vendor the same way as those from another vendor even when the contracts or purchase orders differ regarding the tax status of products and services procured. Determining the tax status in the proposal stage of the procurement and including appropriate language in the subsequent contract provides notification and clarification to both the vendor when it prepares its invoice and internal personnel when the invoice is processed for payment.

It was found that Goodyear included sales tax on every invoice for exempt repair services and the Council has paid such tax. Over the course of the five year Contract that will expire on December 31, 2007, the Council will have paid about \$108,000 in Minnesota sales tax for exempt repair labor. In addition, Goodyear also held the previous five year tire leasing and repair contract for the period January 1, 1998 through December 31, 2002 and invoiced the Council under that contract in a similar fashion.

***Management Response:** The Bus Maintenance Department made changes to the next tire service contract that will allow the Council to avoid paying sales tax on tire service labor in the future. The next tire service contractor will be required to list non-taxable repair labor separately from parts and supplies. This is the method recommended in Minnesota tax statutes. The current tire service contract does not require the contractor to list repair labor separately from parts and supplies, and as a result the sales tax was applied to the entire service invoice. Bus Maintenance staff will meet with the tire service contractor prior to the execution of the next tire service contract to ensure that the invoice changes are understood and complied with. This meeting will also include discussions of air gauge and torque wrench calibrations (item #3 below) and tire information reporting requirements (item #4 below).*



**2. (Significant) Metro Transit should review the process leading to the change from zig-zag to straight line regrooving and implement controls to assure that when changes are made in practice that the contract is amended and that written records are maintained to support such changes.**

Exhibit A, Section 7.4 of the Contract states that “all tires regrooved shall be regrooved in a zigzag configuration. The Contractor shall provide zigzag tire regrooving equipment deemed necessary by the Contractor. The costs of retreading, regrooving and repairing tires shall be borne by the Contractor and are included in the monthly tire services rate.” In addition, Section 4.1(b) states that “the monthly service fee for tire maintenance services shall include all tire service labor, materials, supplies, parts, equipment and tools necessary to provide the services identified in this contract.”

A November 18, 2003 letter from the Goodyear Technical Center in Akron, Ohio, to Metro Transit, states, “Goodyear has conducted several studies to verify which is the best regrooving design – straight or zig zag. Bottom line, it seems the results did not change, they all are comparable in performance and traction. ... Goodyear prefers the straight four grooves. Much easier for the tire service personnel to handle and much more economical in time spent regrooving.” Subsequent to this letter, Metro Transit, having conducted its own review of zig-zag/straight line regrooving, agreed with Goodyear to change from the zig-zag to the straight line configuration. However, the Contract was never amended to reflect this change, nor was documentation available to support Metro Transit’s review and acceptance of Goodyear’s claim.

***Management Response:** The request to change the re-grooved tire tread design was thoroughly researched before acceptance, although the research was not documented. Subsequent research confirmed the original conclusion that it made good business sense to accept this change. The Bus Maintenance Department will establish and implement a procedure for responding to proposed changes to departmental contracts. This procedure will include proper documentation, consideration of financial and operational impacts and review by other departments as appropriate.*

**3. (Significant) Metro Transit should periodically review Goodyear Rep records to be assured that torque wrenches and air gauges are calibrated according to Contract requirements.**

Exhibit A, Section 8.1(k) of the Contract specifies that torque wrenches are to be calibrated quarterly and impact wrenches and air gauges weekly. None of these devices had been calibrated to these intervals. Torque wrenches were only calibrated three times during the five year life of the contract; the shortest interval between calibrations being 10 months. Impact wrenches and air gauges were not calibrated at all.

Subsequent to discussions with the Goodyear Rep Supervisor, a program was put in place to assure quarterly torque wrench and weekly air gauge calibration. Both Metro Transit and Goodyear personnel concurred that there is no need to calibrate the impact wrenches.

***Management Response:** The Bus Maintenance Department changed the requirement for air gauge accuracy in the next tire service contract. The new language reads “Air gauges must be checked against a master gauge no less than weekly, and gauges found to be more than 3% out of calibration must be removed from service. The Contractor must take the necessary steps to ensure that the master gauge is accurate.” Bus Maintenance staff will request that the tire service contractor provide documentation of their method of ensuring the master air gauge is accurate. Bus Maintenance staff will also request that quarterly torque wrench calibration records be sent to the Assistant Director of Maintenance for review.*

- 4. (Consideration) Metro Transit should review the reporting requirements of the contract to determine if they are still valid for inclusion in the new five year contract to begin in January 2008. Metro Transit should also consider initiating a process whereby periodic reports required under the Contract from Goodyear are received in a timely manner and that records are retained for the required time periods.**

Goodyear is required to provide an annual inventory report, a quarterly scrap tire report and a monthly report of mileage by tire group for tires removed from service. Until the Goodyear Regional Supervisor was contacted, none of these reports had been submitted to the Council at any time during the period of the Contract. However, Goodyear did provide the reports when requested to by the Auditor.

Since Metro Transit did not receive and therefore did not use the required reports, they may not be needed. A new five year contract will be executed as of January 2008 and if the current reports are not used by Metro Transit or if other reports would assist Metro Transit in fulfilling its mission, it would be appropriate to change the contractor reporting requirements accordingly.

*Management Response: The Bus Maintenance Department made several changes regarding the record-keeping requirements listed in the next tire service contract. These changes are:*

- ***Increasing the time allowed for delivering the annual tire inventory from 30 to 45 days.*** This change does not have a negative impact on the Council, but it allows more time for the tire contractor to assemble a very large amount of data.
- ***Specifying that the results of the annual inventory are due on the tire contract service anniversary date.*** This change is a clarification to the existing contract language, which didn't specify when the annual tire inventory information was due.
- ***Requiring that information on non-leased tires shall be tracked separately from information on leased tires.*** In the event that a new contractor is selected to provide tire service on the Council's buses, this change will allow run-out tires to be tracked separately from tires provided by the new contractor. Since run-out tires will likely have a different serial number system from that used on the new contractor's tires, this change will also allow the new contractor to format those two sets of data more easily.
- ***Committing the Council to providing mileage and bus number information to the tire service contractor by the tenth day of each month.*** The Council has been doing this for several years, so this represents no practical change in Council procedures. This change resulted from a potential tire service contractor's request for a clarification on the timing of the delivery of this data to the contractor.

*In addition, Bus Maintenance staff will monitor the tire contractor to ensure compliance with the reporting requirements. The specified timetable for delivery of the required reports will be discussed with the tire service contractor to ensure that the requirements are understood and complied with.*