

Agenda Report

TO: City Council **DATE:** August 30, 1999
FROM: Cynthia J. Kurtz, City Manager
SUBJECT: Review of Prior Tow Operator Selection and Audit Process

RECOMMENDATION:

This report is for information only.

BACKGROUND:

At the Council meeting of August 16, 1999, the City Council asked staff to respond to issues raised by the three current tow operators relating to both the initial process regarding the selection of the tow operators and the subsequent audit of their financial records. Below is a recap of the requested information.

Selection Process

The Pasadena Police Department has an on-going need for vehicle impound and storage services arising from such infractions as illegal parking, public nuisance, and the need to preserve evidence in criminal cases. Historically, the City has contracted with one or more towing agencies to provide these services. Under these contractual relationships, the towing services receive compensation through impound and storage fees, approved by the City, which are charged to vehicle owners.

In January 1997, the City Council, acting on the recommendation of the City Manager, established a non-exclusive franchise for vehicle impound and storage services. The impetus for the franchise was an amendment to the California Vehicle Code that established a mandatory thirty-day impound for vehicles operated by unlicensed drivers. One of the effects of this new regulation was to increase the amount of revenue available to towing and storage operators. The combination of existing revenues plus the additional revenue available as a result of the thirty-day impound, was deemed sufficient to warrant the establishment of a franchise.

While considering the possibility of establishing a franchise for Police towing services, staff contacted other cities to determine whether any had similar regulations. The cities of Southgate and Downey had established non-exclusive towing franchises worth \$330,000 and \$130,000 respectively, and the City of Montebello had recently concluded an exclusive arrangement that was to provide that city \$200,000 annually. (Of note is the fact that subsequent to establishment of this exclusive arrangement, Montebello put the franchise back out to bid because the franchisee failed to pay the full franchise fee. Montebello's new franchise fee is based on the number of cars impounded and released and is expected to provide \$100,000 per year in revenue to the City.)

Based on the information available at the time, staff determined that a franchise fee of \$150,000 in the aggregate, to be shared equally by the successful bidders was appropriate. As an example, if three respondents were awarded franchises, as was the case, each would be required to pay \$50,000. Staff's recommendation to establish a non-exclusive franchise, as opposed to an exclusive, was based primarily on the fact that the City had been using three local businesses to perform these services and an exclusive franchise would negatively impact two of these local operators. The following process took place culminating in signed contracts with S.N. Ward & Son, Johnnies and Masters. These agreements became effective on April 6, 1998.

Calendar of Events

RFP Process

- 10/14/97 RFP's were mailed to prospective tow companies and clearly stated that the franchise fee established by City Council was \$150,000, to be shared equally amongst the successful bidders.
- 10/21/97 Meeting held between Police Department and potential applicants to discuss RFP. Tow companies represented were Johnnies, Masters, Wards, Gordys, McVey and Helms & Hill.
- 11/14/97 Return deadline for RFP's. Five tow companies respond (Ward's, Johnnies, Masters, American and McVey).
- 11/20/97 Tow companies inspected. Ward's, Johnnies & Masters meet requirements. American and McVey fail to meet certain criteria.
- 12/02/97 Police and Finance staff review returned RFP's and inspection results.
- 01/12/97 Agenda Report submitted to the City Council with a resolution of intent to award a non-exclusive franchise for police towing services and to set a date of public hearings for that purpose.
- 01/26/98 Agenda Report submitted to the City Council and a public hearing was held. No public comment in opposition was made. Council authorized the City Attorney to prepare ordinance awarding such franchises.
- 02/09/98 Ordinance Fact Sheet from City Attorney to City Council.
- 03/30/98 Awarded contracts and delivered to tow companies for signatures. Contracts were executed and returned without comment.
- 04/06/98 Contracts become effective.

Initiation of Complaint

- 05/18/98 Letter received by Lt. Uribe from Alfred Moses, attorney representing Wards, Masters and Johnnies, objecting to the annual franchise fee of \$50,000 per company citing no substantial increase in revenues.
- 05/28/98 Commander Hiltz responds to Mr. Moses in a letter disputing claims made by Moses on behalf of his three clients and instituting change to a more equitable rotation of calls for service.
- 08/25/98 The towing operators and their attorney, Mr. Moses, met with Chief Melekian, Commander Hiltz and Lieutenant Uribe at PPD to further discuss disagreement over franchise amount.
- 10/08/98 Chief receives letter from Mr. Moses with operating expense figures from tow companies as agreed.
- 10/14/98 Chief responds in a letter to Mr. Moses reasserting the estimated revenues and refers him to Director of Finance.
- 10/27/98 Mr. Moses responds by letter to the Chief and agrees operators will pay half of the quarterly fee due and proposes new fee structure based on prior year actuals, rather than going out with new RFP.
- 12/11/98 Agreement drafted by Mr. Moses and signed by Director of Finance to perform informal audit, suspend collection activities, and pay two good faith payments of \$6,250 each by certain dates. It is also noted that if actual revenues approximate \$200,000 per operator per year, the City plans to keep current franchise fee; but if substantially lower, would recommend revising the fee structure. Subsequently, a list of items to be provided by the tow operators in order to perform the informal audit was forwarded to Mr. Moses.
- 1/25/99 Mr. Moses responded in a letter that the list of requested items exceeded what was necessary to perform the informal audit.
- 2/9/99 Tow operator, Mr. Moses, Finance Director and City Manager meet to review issues and decide to proceed with audit using reduced amount of information.
- 2/16/99 The Department of Finance reduces the amount of information requested from each tow operator.
- 4/15/99 Audit concluded, findings support that revenues of approximately \$200,000 per operator were attained.
- 7/14/99 Tow operators notified of audit findings as well as franchise agreements extended on a month to month basis, new RFP to be issued allowing bidders to proposal alternate fee structure.

Audit Process

When the Department of Finance first agreed to audit the towing operators, a full-scale audit strategy was developed, including the following objectives:

- Document general information about the franchisee's normal business operations;
- Document a typical service call transaction
- Review internal controls
- Sample 20 receipts from the franchisee
- Sample 15 impound cases from the Police Department
- Examine accounting records (both revenues and expenses)
- Analyze towing activity prior to and following the establishment of the franchise

After a letter was sent to each towing operator on January 11, 1999, requesting them to make available the related business records, their attorney responded by letter on January 25, 1999, that our request for information far exceeded the parameters envisioned by the agreement for an informal audit. Records initially requested included:

- Financial statements
- Trail balances
- Income tax returns
- Bank statements and reconciliations
- General ledger detail
- Subsidiary receipt ledgers or receipt books
- Towing service logs
- Towing rate schedule

The operators, through their attorney, felt that the audit should involve towing revenues only as a means to resolve the differences between the City and the operators. Staff agreed to look at only tow revenues related to the franchise agreement and to ignore all other revenues, such as AAA, commercial transport, and automotive repair. The City limited the requested records to towing service logs, impound reports, and receipts related to City-referred towing only. While agreeing to this modified scope, City staff still felt that a comprehensive review of expenses was necessary in order to determine the actual overhead and profit related to their towing operations. According to the towing franchise agreements, the City has access to and the right to audit the contractor's records including the above items requested.

In planning the audit, City staff visited each franchisee at their business location to assess their operations including file maintenance and organization of records to be reviewed during the audit. Only one operator had a tracking system that was consistently utilized and neatly organized. The other franchisees either were not able to readily present the records needed without sorting through boxes in storage at another location, or the records themselves were not suitable for auditing purposes, such as stacks of card files with no organization and loose leaf logs. One of the operators suggested using the franchisee selected to represent all three since they had the best

records. It was, therefore, decided to perform the audit field work with this operator and expand the audit to the other franchisees if necessary.

Sample Selection

A random sample size of 50 service calls was determined to be sufficient. This number would statistically support a moderate level of control risk for a tolerable and allowable risk of over-reliance. The sample was taken from monthly rotational dispatch logs maintained by the Police Department and involved three different types of logs: regular impound, 30-day impound, and next-up tow. The first dispatch record of each month for each type of service was selected as well as an additional item from either regular impound or 30-day impound, whichever had more. Of those selected, only 43 items were located in the towing operator's records.

For each sample item selected, the following steps were performed:

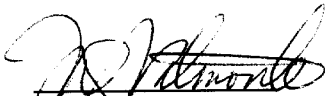
- Locate the item by date and type of service on the towing operator's log
- Determine if release had been made and, if so, pull associated receipt
- Re-calculate revenue collected to verify correct fees were received
- If vehicle was disposed of, verify assigned trade-in value
- If release had not been made, verify actual vehicle was in storage

It was determined that approximately 3,000 tows occur per year, which equated to about 1,000 per operator since they are referred by the City on a rotational basis. These figures were similar to the numbers originally estimated by the Police Department during the development of the franchise fee Request for Proposal.

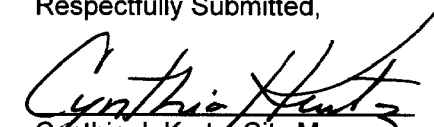
Results

Based on the sample pulled, actual revenue exceeded the \$200,000 agreed upon amount. Each sample item was analyzed according to the number of days held and revenues received. Revenue was made up of the standard \$15 per day storage plus \$75 flat impound rate if released or the amount received from sending the vehicle to junk if abandoned by the owner. It was also noted that additional revenue was included such as a hazmat fee of \$35 for certain calls and lien charges to cover lien application fees and overhead incurred to physically inspect the vehicle for the required paperwork involved. These lien fees were \$50 for most cars or \$100 for those over \$40,000 in value which require additional advertising to process the lien. A detailed explanation of how these results were reached is shown in Attachment A.


Prepared By:


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Senior Internal Auditor

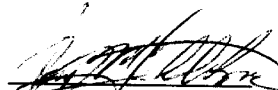
Respectfully Submitted,


Cynthia J. Kurtz, City Manager

and


Steve Mermell
Purchasing Administrator

Approved By:


Jay M. Goldstone
Director of Finance