



A REPORT
TO THE
ARIZONA LEGISLATURE

Performance Audit Division

Performance Audit

Arizona Department of Transportation

Motor Vehicle Division—
State Revenue Collection Functions

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REPORT NO. 04 – 09



Debra K. Davenport
Auditor General

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STATE OF ARIZONA
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AUDITOR GENERAL

WILLIAM THOMSON
DEPUTY AUDITOR GENERAL

September 27, 2004

Members of the Arizona Legislature

The Honorable Janet Napolitano, Governor

Mr. Victor M. Mendez, Director
Arizona Department of Transportation

Transmitted herewith is a report of the Auditor General, A Performance Audit and Sunset Review of the Arizona Department of Transportation, Motor Vehicle Division—State Revenue Collection Functions. This report is in response to a November 20, 2002, resolution of the Joint Legislative Audit Committee. The performance audit was conducted as part of the sunset review process prescribed in Arizona Revised Statutes §41-2951 et seq. I am also transmitting with this report a copy of the Report Highlights for this audit to provide a quick summary for your convenience.

As outlined in its response, the Arizona Department of Transportation agrees with all of the findings and plans to implement all of the recommendations.

My staff and I will be pleased to discuss or clarify items in the report.

This report will be released to the public on September 28, 2004.

Sincerely,

Debbie Davenport
Auditor General

Enclosure

SUMMARY

The Office of the Auditor General has conducted a performance audit and sunset review of the Arizona Department of Transportation, Motor Vehicle Division (MVD) pursuant to a November 20, 2002, resolution of the Joint Legislative Audit Committee. This audit was conducted as part of the sunset review process prescribed in Arizona Revised Statutes (A.R.S.) §41-2951 et seq and is the first in a series of three reports on the Motor Vehicle Division. This report focused on several MVD functions that produce or affect the revenue generated for the State. The second report will focus on the security of MVD information systems and the status and performance of ServiceArizona, the e-government program that MVD implemented in November 1997. The third report will be an analysis of the 12 statutory sunset factors.

MVD, one of several divisions within the Arizona Department of Transportation (ADOT), provides a number of services to the public, including issuing driver's licenses, vehicle titles, and permits. In addition, it enforces commercial transportation laws and agreements through driver testing and licensing, as well as through its ports of entry where commercial vehicles are checked for compliance with weight, size, and safety laws, including hazardous materials requirements. In providing these services, MVD collects significant revenues on the State's behalf. These revenue collections, which ADOT reports totaled more than \$1.56 billion for fiscal year 2004, include the vehicle license tax, gas and use fuel taxes, motor carrier taxes, and motor vehicle registration fees. Only the Department of Revenue collects more revenues for the State than MVD.

[MVD can improve the cost-effectiveness of its vehicle registration compliance program \(see pages 11 through 18\)](#)

MVD should take various steps to improve the cost-effectiveness of its recently established vehicle registration compliance program. In fiscal year 2002, the Legislature provided MVD with funding to increase its vehicle registration compliance

efforts. This funding was allocated for 15 new peace officers using existing MVD positions and for other activities to help enforce Arizona's vehicle registration laws. ADOT reports that Arizona's vehicle license tax (VLT), collected through vehicle registrations, provided \$695.3 million in fiscal year 2004 to fund state highways and roadways and other government expenses in counties, cities, and towns. However, some state residents may avoid paying this tax by driving with out-of-state license plates or expired Arizona license plates. Auditor analysis of the overall costs and revenues of MVD's three enforcement efforts found that using automated letters has been the most cost-effective approach.

- **Automated letter**—MVD developed a software application that automatically sends letters to new Arizona residents who have applied for a driver's license, but have not registered a vehicle. From October 2002 through June 2003, MVD generated over an estimated \$797,000 in vehicle license tax revenue from this approach at a cost of slightly over \$13,700.
- **Citizen tips**—MVD follows up on leads or tips regarding unregistered vehicles received from citizens via MVD's telephone hotline. In fiscal year 2003, MVD staff who pursued these leads opened approximately 2,900 cases and generated over an estimated \$187,000 in vehicle license tax revenue at an approximate cost of \$63,000.
- **Peace officers**—MVD peace officers identify and pursue potential registration violators through a variety of sources, including employer parking lot sweeps or personal sightings of unregistered vehicles. Officers then issue letters, warnings, or citations to achieve compliance. In fiscal year 2003, MVD's officers opened approximately 8,500 cases and generated over an estimated \$588,000 in vehicle license tax revenue at an approximate cost of \$427,600.

MVD should build on the success of its automated letter approach by using its title and registration system to automatically send letters to vehicle owners who do not renew their vehicle registrations. California uses a similar method to help obtain compliance with vehicle registration requirements. Specifically, the California Department of Motor Vehicles sends up to three delinquent notices at 30, 60, and 90 days past registration to nonrenewing vehicle title holders.

Improvements are also needed to help ensure that MVD accurately determines and reports the revenues generated from its enforcement efforts. When the Legislature provided MVD with additional enforcement funding, it also directed it to measure the return on investment for its enforcement program and remit 50 percent of the increased revenue generated from enforcement activities to the General Fund. In response to this requirement, MVD determined that the return on investment should consist of both direct and indirect revenue. Direct revenue results when vehicle

owners register their vehicles in response to an enforcement action. Indirect revenue results from other members of the public registering their out-of-compliance vehicles after learning of the enforcement program. Auditor analysis of data from MVD's database determined that direct VLT revenue is overstated by an estimated \$233,000 for fiscal year 2003. This overstatement of revenue is caused by computer programming errors. MVD needs to correct these errors so that direct VLT revenue is more accurately stated. With regard to indirect revenue, the formula MVD adopted for estimating this revenue and to serve as a basis for remitting a portion of this revenue to the General Fund does not produce valid results. Developing a better formula would likely be difficult and costly, and it is not clear that the program, which is relatively small, can be expected to have much of an indirect effect. Thus, MVD should eliminate the indirect revenue measure as part of its calculation of the return on investment for its enforcement program and as a basis for remitting a portion of this revenue to the General Fund.

MVD should improve fuel tax refunds processing (see pages 19 through 25)

MVD needs to improve its processes for reviewing and issuing fuel tax refunds to help ensure that claimants receive accurate amounts. Arizona taxes gasoline and diesel fuel purchases so that drivers partially compensate the State for the use of its highways. Arizona collects these taxes at the storage facility, not from the end-user. According to statute, some suppliers and users are eligible for tax refunds because they do not use the fuel on public roadways. For example, operators of farm construction equipment used off the highway may be eligible for a tax refund. During fiscal year 2003, MVD collected nearly \$649 million in fuel taxes and provided more than 6,600 refunds totaling over \$23 million.

Work done for this audit, as well as internal reviews conducted by ADOT's Office of Audit and Analysis—Revenue Audit, shows that some refund amounts are incorrect or are not supported by sufficient documentation. For example, as of May 2004, ADOT auditors identified errors ranging from \$8 to more than \$5,800 in 7 of the 16 refunds audited during fiscal year 2004. ADOT auditors also used to conduct prepayment reviews of refunds over \$25,000 that often identified errors. This effort identified errors in 7 of 18 refunds referred for review in fiscal year 2001, preventing nearly \$700,000 in inaccurately determined refunds from being paid. However, few such reviews have occurred since fiscal year 2001 because of concerns about the timeliness of the reviews and the lack of requirements specifying the claim types that should be referred for review.

MVD should take several steps to improve its processing and review of fuel tax refunds. These steps include updating and implementing additional refund

processing procedures to ensure these procedures adequately detail how claims should be reviewed, processed, and issued; and that they specify the supporting documentation needed to show that required activities were properly performed. MVD should also improve its oversight of refund claim processing to help ensure the appropriateness and accuracy of refunds, including incorporating two levels of supervisory approval to authorize a refund payment. Finally, MVD should provide better instructions to taxpayers on how to file claims and require taxpayers to provide better documentation to support refund claims.

MVD should examine its fees (see pages 27 through 34)

MVD should continue with its efforts to examine the fees it assesses and the amounts charged. Based on auditors' review of statutes and administrative rules, MVD has authority to assess over 350 different fees for the various services it provides. According to MVD reports, fees assessed by MVD generated over \$150 million for the State in fiscal year 2003. However, until recently, MVD did not have a process in place to periodically review these fees. Some fees appear outdated or too low to cover the cost of providing the associated service. For example, vehicle title fees have remained at \$4 for over 30 years and may not reflect processing costs. Although MVD does not have specific cost data, one MVD manager estimated that a title transaction involves about 20 minutes of a customer service representative's time. If so, the current \$4 fee may not cover the average costs of the customer service representative's salary and benefits, not to mention overhead costs or the additional costs for preparing the title.

Further, a number of MVD's fees are low when compared with those in other states. Additionally, MVD lacks authority to charge a fee for one service—a Level I vehicle title inspection, which verifies vehicle identity prior to registration. In fiscal year 2003, MVD reports that it performed nearly 277,000 of these inspections which, in some cases, required staff travel time in addition to the inspection time.

In January 2004, MVD formed an internal working group to begin reviewing its fees. In addition to staffing the working group with key personnel from ADOT and MVD, MVD plans to solicit input from the Joint Legislative Budget Committee and the Governor's Office of Strategic Planning and Budgeting. According to an MVD official, as of April 2004, this working group has identified some of the fees it plans to review. The working group has also begun to benchmark these fees and transactions to similar transactions in the state of Washington.

In addition to these steps, the working group should develop or follow a structured approach to systematically evaluate and review MVD's fees, possibly using an

approach that has been developed in Mississippi.¹ This approach would allow the group to systematically review its fees by considering whether the fee is needed, its purpose, and whether it should be set at a level to recover its costs. Additionally, the working group will need to develop and collect basic cost, revenue, and transaction data and information related to fees and the services associated with the fees. This information is not readily available at MVD. To reduce the resource requirements for developing cost data, MVD should develop cost data only for the fees it prioritizes for review.

MVD should better protect registration renewal fees (see pages 35 through 38)

MVD can help prevent the loss or theft of state monies by making a number of changes to its vehicle registration renew-by-mail procedures. Currently, MVD receives over \$15.7 million a month in mail-in vehicle registration payments. Through March of fiscal year 2004, MVD also processed an average of nearly 3,900 renewals daily, resulting in deposits of between \$639,000 and \$918,000 each day. To better protect these monies, MVD should restrict employee access to the monies; immediately endorse and deposit these monies upon receipt, either by processing registration renewals the same day they are received or by storing monies in a secure place while using a receipt for processing; and track receipts through the registration renewal process. Finally, to ensure consistency, MVD should document these policies and procedures, and periodically request a procedural review from ADOT's internal audit group.

Other pertinent information (see pages 39 through 41)

As part of the audit, auditors gathered information regarding ADOT's efforts to reconcile MVD's cash-clearing account. This account is the initial point of deposit for most of the revenue that MVD collects. These monies are then distributed to various funds. MVD's inability to accurately reconcile this account with the State's accounting system has been a long-standing problem. However, ADOT and MVD have made significant progress in reconciling this account by adding resources, improving reconciliation processes, and accounting for a \$9.5 million unreconcilable difference between the two systems that was identified by a 1997 ADOT internal audit report. As a result of these efforts, from April through November 2003, the monthly differences have been narrowed to less than \$11,000.

¹ Mississippi Joint Legislative Committee on Performance Evaluation and Expenditure Review. *State Agency Fees: FY 2001 Collections and Potential New Fee Revenues*. Jackson, Miss.: Dec. 2002.

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INTRODUCTION & BACKGROUND

The Office of the Auditor General has conducted a performance audit and sunset review of the Arizona Department of Transportation, Motor Vehicle Division pursuant to a November 20, 2002, resolution of the Joint Legislative Audit Committee. This audit was conducted as part of the sunset review process prescribed in Arizona Revised Statutes (A.R.S.) §41-2951 et seq and is the first in a series of three reports on the Motor Vehicle Division. This report focused on several MVD functions that produce or affect the revenue generated for the State. The second report will focus on the security of MVD information systems and the status and performance of ServiceArizona, the e-government program that MVD implemented in November 1997. The third report will be an analysis of the 12 statutory sunset factors.

MVD programs and staffing

The Arizona Department of Transportation (ADOT) was formed in 1974 and consists of six operating divisions, including the Motor Vehicle Division (MVD). While most of ADOT focuses on highway transportation planning, construction, and maintenance, MVD's mission is unique within the Department. Specifically, MVD defines its mission as "supporting Arizona through licensing, vehicle credentialing, revenue collection, safety programs, and by promoting compliance with transportation laws." As such, MVD provides a variety of services to Arizona citizens. These include issuing driver's licenses, vehicle titles, and vehicle registrations; enforcing commercial transportation laws and agreements through driver testing and licensing; and collecting significant state tax revenues, including the vehicle license and fuel taxes. As of July 8, 2004, MVD reported a total of 1,894 positions funded with

MVD—Fiscal Year 2003 Activity

Customers served: (In field offices)	4.73 million
Type of transaction:	
Driver's licenses issued	1.04 million
Vehicle registrations	3.99 million
Vehicles weighed at ports	4.64 million
Vehicle inspections	311,500
Method of transaction:	
Field offices	5.74 million
Internet	1.76 million
Renew-by-Mail registrations	988,100

Source: Auditor General staff summary of unaudited Arizona Department of Transportation, Motor Vehicle Division fiscal year 2004 Strategic Plan and various MVD reports.

state-appropriated monies.¹ As of this date, MVD reported that 1,576 positions were filled, while 318 were vacant. MVD employees work in the following three programs:

- **Customer Services (1,223 filled positions; 212 vacancies)**—The Customer Services program consists of the following:
 - **Customer Service (880 filled positions; 136 vacancies)**—Within this subprogram, MVD has 60 field offices established throughout the State that provide a variety of services to the public. These services include issuing driver's licenses, vehicle registrations, permits, and vehicle titles, and collecting driver's license and vehicle registration fees.
 - **Motor Carrier and Tax Services (73 filled positions; 28 vacancies)**—Responsibilities of the Motor Carrier and Tax Services subprogram include collecting gasoline and use fuel taxes, and issuing fuel tax refunds to eligible claimants, helping to assure motor carrier safety by overseeing the medical reviews of commercial and noncommercial drivers, registering interstate motor carriers, and issuing commercial driver's licenses.
 - **Competitive Government Partnerships (81 filled positions; 12 vacancies)**—According to MVD, this subprogram oversees 488 contractors that have agreements to provide MVD services to the public and businesses, such as vehicle titles and registrations, driver's license exams, and vehicle inspections. Additionally, this subprogram oversees transactions conducted via the Internet through a dedicated Web site; licenses and oversees 424 professional driving schools, traffic survival schools, and driver education programs; and licenses the over 3,800 motor vehicle dealers in the State. Finally, Competitive Government Partnerships provides record sales to 87 commercial and 150 government agencies/departments, and oversees the Renew-by-Mail Unit, which processes vehicle registration renewals.
 - **Division Operational Support Services (189 filled positions; 36 vacancies)**—Responsibilities of this subprogram include MVD policies and rule writing, public information call center operations, records management, and the Division's technical training.
- **Motor Vehicle Enforcement Services (214 filled positions; 87 vacancies)**—The Motor Vehicle Enforcement program enforces transportation-related laws and regulations at both mobile and fixed port-of-entry check points. Currently, MVD maintains 22 ports of entry on highways at Arizona's borders. Port operations include enforcing commercial vehicle compliance with weight, size, and safety laws, including hazardous materials requirements. In addition, this program enforces vehicle registration compliance, conducts vehicle inspections to verify vehicle identification numbers against ownership documentation and the vehicle, and helps to identify stolen vehicles.

¹ This total does not include an additional 47 positions funded with federal or nonappropriated monies.

- **Motor Vehicle Support Services (139 filled positions; 19 vacancies)**—Support Services consists of the following:
 - **Director’s Office (11 filled positions; 2 vacancies)**—The Director’s Office provides leadership and assistance in legislative, government, public information, and community relations, information systems support, and organizational development.
 - **Executive Hearing Office (23 filled positions; no vacancies)**—The Executive Hearing Office conducts administrative hearings on issues such as DUI offenses, motor vehicle titles, dealer licenses, and motor carrier safety.
 - **Office of Special Investigations (36 filled positions; 4 vacancies)**—This Office investigates title and driver’s license fraud and employee misconduct.
 - **Executive Services Group (69 filled positions; 13 vacancies)**—This Group provides various support services to the Division, including budgeting, purchasing, personnel services, facility management, procurement, and strategic planning.

MVD revenue collections and distributions

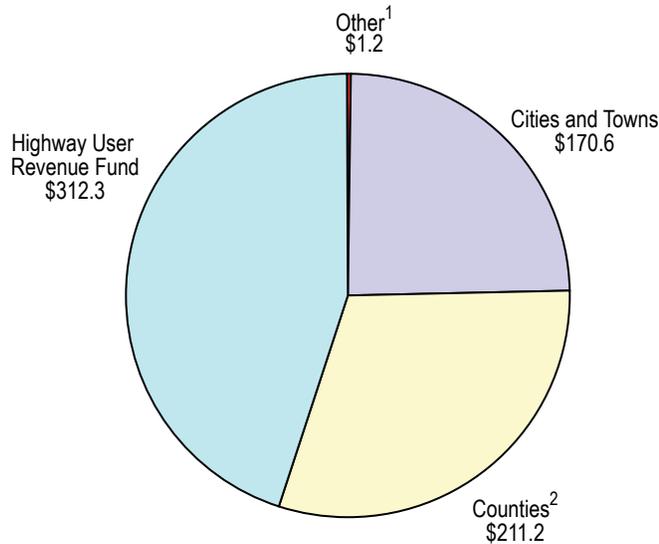
In performing its duties, MVD collects a variety of taxes and fees. These include gasoline fuel taxes, vehicle license taxes, fees for the registration and operation of motor vehicles, and driver’s license and other miscellaneous fees. In fact, only the Department of Revenue collects more taxes and fees for the State than MVD. For fiscal year 2004, ADOT reported that MVD collected over \$1.56 billion in revenues. Of this total, MVD collected \$695.3 million in Vehicle License Tax (VLT) revenues. VLT is an annual license tax imposed on registered vehicles and is based on the vehicle’s assessed value. Counties, cities, and towns receive almost 55 percent of the collected VLT monies for highway maintenance and general government expenses, while approximately 45 percent (\$312.3 million for fiscal year 2004) of VLT revenues are deposited into the Highway User Revenue Fund (HURF). See Figure 1 on page 4 for the Vehicle License Tax Distributions for fiscal year 2004. In addition to the VLT revenues, MVD deposits additional fees and taxes into HURF to help meet Arizona’s street and highway needs. As illustrated in Figure 2 (see page 5), the additional fees and taxes include:

- **Gas and Use Fuel Taxes (\$642.5 million)**—Arizona taxes those who purchase gasoline in the State at \$0.18 per gallon. The purchase of other use fuels, which includes all other gases and liquids used to propel motor vehicles, such as diesel fuel, is taxed at \$0.26 per gallon.

MVD is second only to the Department of Revenue in revenue collection.

**Figure 1: Vehicle License Tax Distribution, in Millions
Year Ended June 30, 2004
(Unaudited)**

Vehicle License Taxes Collected = \$695.3 Million



¹ Consists of \$0.4 million to the State Highway Fund and \$0.8 million to the State General Fund for school aid.

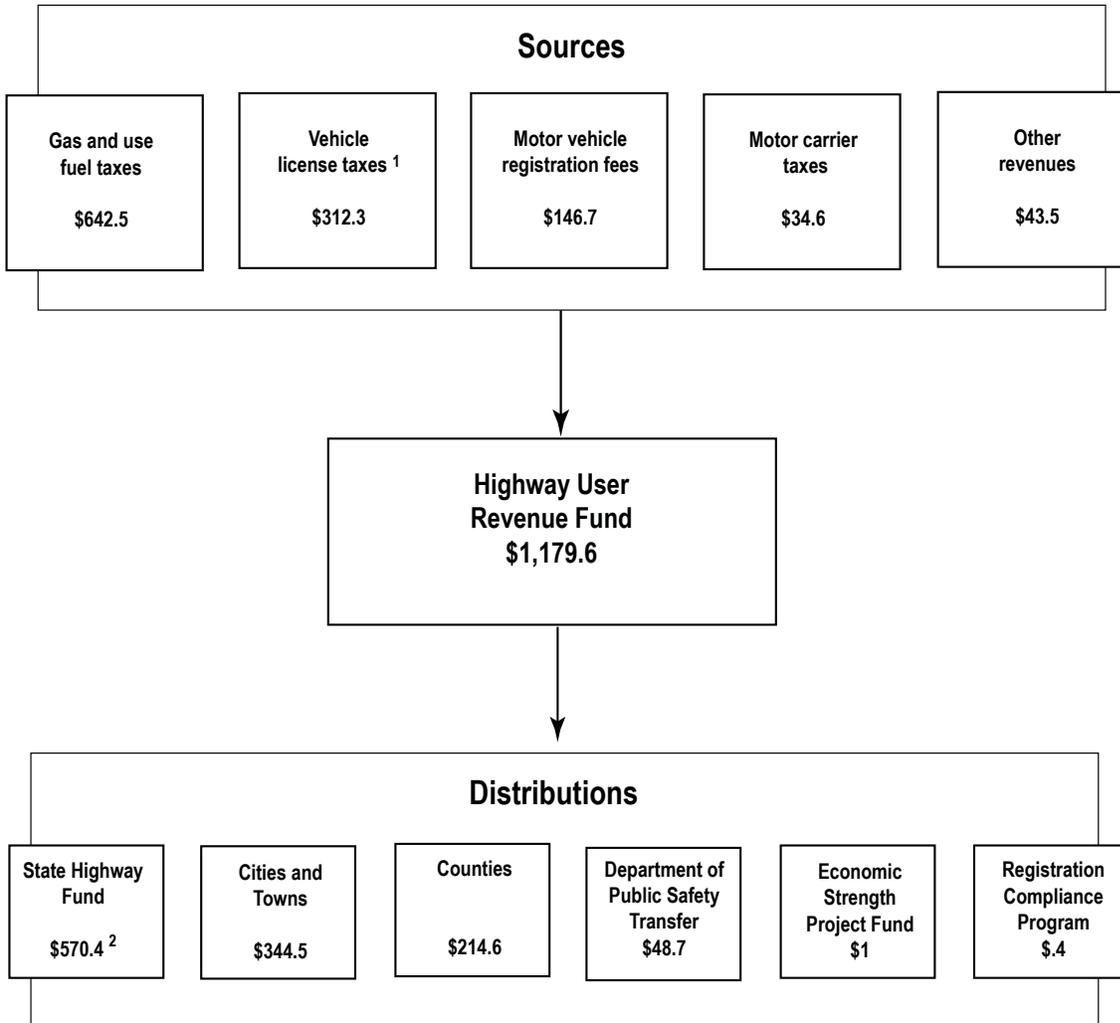
² Includes \$40.6 million to counties specifically for highway purposes.

Source: Auditor General staff analysis of the Department's *Vehicle License Tax Distribution* for the year ended June 30, 2004, and A.R.S. §§28-5801 and 5808.

- **Motor Vehicle Registration Fees (\$146.7 million)**—In addition to the vehicle license tax, Arizona charges registration fees for both commercial and noncommercial vehicles, as well as nonresident permit fees and registration penalties.
- **Motor Carrier Taxes (\$34.6 million)**—These taxes are imposed on commercial carriers based on vehicle weight.
- **Other User Fee Revenues (\$43.5 million)**—Other user fee revenues include fees for titles, driver's licenses, oversize/overweight permits, and inquiries and fuel permits, as well as highway fines, fuel tax penalties, investment interest, and other miscellaneous fees.

Based on statutory formulas and as illustrated in Figure 2 (see page 5), distribution from HURF is made to the State Highway Fund; Arizona cities, towns, and counties;

Figure 2: Sources and Distributions of Highway User Revenue Fund Monies, in Millions
Year Ended June 30, 2004
(Unaudited)



¹ Portion of vehicle license taxes distributed to the Highway User Revenue Fund.

² Includes \$86.7 million distributed to Maricopa and Pima Counties for controlled access.

Source: Auditor General staff analysis of the Department's *Highway User Revenue Fund Revenue Trend by Category, Distributions to Cities, Towns, and Counties*; and other information provided by the Department of Transportation for the year ended June 30, 2004.

and other entities. According to Arizona's Constitution, HURF monies can be used only for costs associated with highways or streets. Acceptable expenditures include administering laws, acquiring right of way, and making payments on highway and street bonds. Costs associated with construction, maintenance, repair, and roadside development can also be supported by HURF monies. Additional programs or agencies that receive distributions from HURF include the Economic Strength Project Fund, which provides monies for projects recommended by the Commerce and Economic Development Commission and that are approved by the Transportation Board; the Arizona Department of Public Safety, which uses HURF monies to help fund highway patrol costs; and MVD's Registration Compliance Program, which uses HURF monies to enforce compliance with state vehicle license tax and registration laws.

MVD's operating budget

The majority of the Motor Vehicle Division's operating budget consists of monies appropriated from the State Highway Fund. Table 1 (see page 7) illustrates MVD's actual revenues and expenditures for fiscal years 2002 through 2004. As shown, MVD's operating revenues for fiscal year 2003 were \$83.3 million and increased to \$87.3 million for fiscal year 2004. This represents a 4.8 percent increase in operating revenues from fiscal year 2003. MVD had operating expenditures of \$81 million in fiscal year 2003, while its expenditures increased to \$85.1 million in fiscal year 2004, for a 5.1 percent increase in operating expenditures. According to an MVD official, most of this increase in expenditures results from increased employee health and retirement benefits, as well as replenishing its inventory of license plates due to increased demand for these plates during fiscal year 2004. MVD's largest expenses are personal services and related benefits, which accounted for 73 percent of the total operating expenditures for fiscal year 2004.

Audit scope and methodology

This audit focused on MVD functions that produce or affect the revenue generated for the State, including MVD's enforcement of vehicle registration laws, processes for reviewing and issuing fuel tax refunds to eligible claimants, appropriateness of amounts currently charged for fees, processing of mail-in vehicle registration renewals, and efforts to reconcile its cash-clearing account. This report includes findings and recommendations in the following four areas:

- MVD needs to take various steps to improve the cost-effectiveness of its recently implemented vehicle registration compliance program and to correct errors in the calculations of its revenues from these enforcement efforts.

Table 1: Motor Vehicle Division Operations
Statement of Revenues, Expenditures, and Changes in Fund Balance, in Thousands ¹
Years Ended June 30, 2002 through 2004
(Unaudited)

	2002	2003	2004
Revenues:			
State Highway Fund ²	\$72,879.8	\$77,014.6	\$81,912.0
Motor vehicle licenses, title, and registration fees	3,478.0	2,840.6	2,416.3
Charges for services ³	2,391.4	2,796.2	2,522.3
Highway User Revenue Fund ⁴		648.2	383.3
Other			55.7
Total revenues	<u>78,749.2</u>	<u>83,299.6</u>	<u>87,289.6</u>
Expenditures and operating transfers out:			
Personal services and related benefits	56,209.7	63,129.9	62,194.2
Professional and outside services	867.8	912.7	2,235.3 ⁵
Travel	394.0	321.0	252.3
Other operating	15,566.3	16,128.6	18,017.4
Equipment	2,615.0	484.5	2,414.6
Total expenditures	<u>75,652.8</u>	<u>80,976.7</u>	<u>85,113.8</u>
Operating transfers out	<u>1,122.3</u>	<u>124.8</u>	<u>107.7</u>
Total expenditures and operating transfers out	<u>76,775.1</u>	<u>81,101.5</u>	<u>85,221.5</u>
Excess of revenues over expenditures and transfers out	<u>\$ 1,974.1</u>	<u>\$ 2,198.1</u>	<u>\$ 2,068.1</u>

¹ This table includes only revenues and expenditures relating to the Motor Vehicle Division operating budget.

² Consists of the Division's portion of State Highway Fund monies used to pay for its operations. The State Highway Fund receives monies from the Highway User Revenue Fund, and fuel and motor carrier taxes.

³ Consists of fees collected in accordance with A.R.S. §28-4151 for the reinstatement of motor vehicle registration and license plates. This amount consists of only the portion used for division operations.

⁴ Consists of the Division's portion of Highway User Revenue Fund (HURF) monies used to pay for its operations. The HURF receives gasoline and use fuel taxes, motor carrier taxes, motor vehicle registration fees, and other miscellaneous fees. See Figure 2, page 5 for sources and distributions of HURF monies.

⁵ Amount includes purchase of license plates from the Arizona Correctional Industries. The Division indicates that the large increase for fiscal year 2004 resulted from increased demand for license plates and the Division replenishing its inventory at fiscal year end.

Source: Auditor General Staff analysis of financial information provided by the Arizona Department of Transportation and Arizona Financial Information System (AFIS) *Revenues and Expenditures by Fund, Program, Organization, and Object* report for the years ended June 30, 2002, 2003, and 2004.

- MVD needs to pursue various improvements to its fuel tax refunds process to better ensure that submitted refund claims are valid and accurate.
- While MVD generates significant revenues by assessing hundreds of fees, MVD's internal working group should develop or follow a structured approach to review the appropriateness and necessity of the hundreds of fees it assesses.
- MVD needs to employ stronger cash-handling procedures to adequately safeguard vehicle registration renewal payments.

In addition, this report includes other pertinent information regarding the lack of current and timely reconciliations of MVD's cash-clearing account.

Auditors used a number of methods to obtain information about the Division's programs and study the issues addressed in this report. These methods included interviewing ADOT and MVD management and staff; and reviewing statutes, administrative rules, MVD procedures, policy memos, and ADOT/MVD's strategic plans for fiscal years 2003 and 2004.

Auditors also used the following specific methods:

- To assess the effectiveness of MVD's vehicle registration enforcement efforts and validity of reported revenues associated with these efforts, auditors analyzed data on fiscal year 2003 vehicle registration compliance cases from MVD's Registration Compliance System. In addition, auditors interviewed representatives from five states and the United Kingdom to discuss enforcement methods, automated enforcement techniques, and the measurement of indirect revenue from direct enforcement efforts.¹ Auditors also reviewed studies of vehicle tax evasion and enforcement.^{2,3}
- To evaluate the accuracy of MVD's fuel tax refund processing, auditors observed the processing of fuel tax refunds and examined 44 internal audits and reviews performed by ADOT's Office of Audit and Analysis—Revenue Audit in fiscal years 2001 through 2004. Auditors also evaluated refund forms and instructions from eight states and analyzed fuel tax refund audits from Washington and Tennessee.⁴ Further, auditors reviewed a Federal Highway Administration report related to fuel tax evasion.⁵

¹ Auditors interviewed representatives from either the state agency or the state audit organization in five states: California, Colorado, Kentucky, Utah, and Wyoming. Utah and Kentucky were selected because they had conducted a recent audit of vehicle registration evasion in their states, while California, Colorado, and Wyoming were selected because they are Western states with similar vehicle license taxes to those of Arizona. Additionally, auditors interviewed representatives from the United Kingdom Comptroller and Auditor General because they conducted a comprehensive study of vehicle registration compliance for years 2002-2003.

² The Council of State Governments and the Council of Governors' Policy Advisors. *Road Fund Tax Evasion: A State Perspective*. Lexington, KY:1996.

³ Office of the Utah Legislative Auditor General. *A Performance Audit of Unregistered Passenger Vehicles in Utah*. Utah.: Oct. 2001.

⁴ Auditors reviewed refund claim forms from California, Florida, Idaho, Missouri, North Carolina, Tennessee, Texas, and Washington.

⁵ U.S. Department of Transportation, Federal Highway Administration. *Fuel Tax Evasion: The Joint Federal/State Motor Fuel Tax Compliance Project*. June 1992.

- To evaluate MVD's current fee structure and to determine whether fees cover the costs of the associated services, auditors identified over 350 fees assessed and collected by MVD and the amounts of these fees through a review of statutes and administrative rules and compared a sample of MVD's fees to similar fees in six other states.¹ Auditors also reviewed several studies and literature describing best practices in setting government fees and sources of potential new fee revenues.^{2,3,4}
- To evaluate MVD's processes and cash-handling procedures for mail-in vehicle registration renewals, auditors observed the cash-handling practices of MVD's Renew-by-Mail Unit. Auditors also reviewed the contract between MVD and Arizona Correctional Industries for the processing of license plate tabs, MVD volume and revenue collection reports for fiscal year 2003 and the first 9 months of fiscal year 2004, and internal control requirements published in the *State of Arizona Accounting Manual*.
- To develop information on the lack of current and timely reconciliations of the MVD cash-clearing account, auditors reviewed the reconciliations performed by MVD from July 2003 through November 2003 and a journal entry prepared to account for an unreconcilable difference. Auditors also reviewed the June 1997 ADOT internal audit report; a management letter from Deloitte and Touche, LLP, ADOT's external auditor, dated November 15, 2002; and a July 2001 United States General Accounting Office report.⁵

This audit was conducted in accordance with government auditing standards.

The Auditor General and staff express appreciation to the director and staff of the Arizona Department of Transportation and the Motor Vehicle Division director and staff for their cooperation and assistance throughout this audit.

1 Auditors compared Arizona's fees to similar transaction fees in California, Colorado, Nevada, New Mexico, Texas, and Utah. These states were selected because of their geographic and demographic similarity to Arizona.

2 Zodrow, George R. *State Sales and Income Taxes: an Economic Analysis*. College Station: Texas A&M University Press, 1999.

3 Fisher, Ronald C. *State and Local Public Finance*. Chicago: Irwin, 1996.

4 Mississippi Joint Legislative Committee on Performance Evaluation and Expenditure Review. *State Agency Fees: FY 2001 Collections and Potential New Fee Revenues*. Jackson, Miss.: Dec. 2002.

5 United States General Accounting Office, Financial Management: *Improvements in Air Force Fund Balance with Treasury Reconciliation Process*, GAO-01-847. Washington, D.C.: July 2001.

FINDING 1

MVD can improve the cost-effectiveness of its vehicle registration compliance program

MVD should take various steps to improve the cost-effectiveness of its recently established vehicle registration compliance program. First, MVD should develop an automated delinquency letter to contact Arizona residents with expired vehicle registrations. MVD should also improve its systems for enforcement case-tracking, to correct revenue-reporting errors and better direct enforcement officers' efforts. Finally, MVD should discontinue using its indirect revenue measure as part of the calculation of the return on investment for its enforcement program and as a basis for remitting a portion of this revenue to the General Fund because this measure does not produce valid results, and a more appropriate measurement is too costly to develop.

Vehicle license tax and enforcement

The vehicle license tax (VLT), collected through vehicle registrations, represents a significant source of revenues for state and local governments. For fiscal year 2004, MVD collected \$695.3 million in VLT revenue. The Highway User Revenue Fund receives approximately 45 percent of these monies for highway construction and maintenance and distributes the remaining 55 percent to local governments for both highway and general government expenses. Arizona's VLT is based on a combination of the manufacturer's price of the vehicle when new, the age of the vehicle, and the tax rate adopted by the Legislature. Vehicle license taxes averaged \$158 per vehicle in fiscal year 2003, but can be as high as \$1,000 or more for a new, high-priced vehicle.

Some Arizona residents may avoid paying Arizona's VLT by driving with license plates from other states or with expired Arizona license plates. In 1996, the Council of State Governments, a national nonprofit organization serving all three branches of state governments, summarized evasion rate studies from both the general literature

Over \$695 million in VLT revenue was received during fiscal year 2004.

and specific states.¹ At that time, based on a survey of state revenue administrators, the Council reported that revenue gains of 4.7 percent could be achieved if vehicle tax evasion were eliminated. While the Council cited a study that estimated Arizona's evasion rate at between 4.8 and 7 percent, the study was conducted in 1984, and auditors did not identify a more recent study of Arizona's evasion rate.² In a 2001 study by Utah's legislative auditor general, Utah's evasion rate was estimated at 3.8 percent.³ However, both the Council of State Governments and Utah's Auditor General suggested that complete elimination of vehicle registration evasion is unlikely.

Beginning in July 2002, the Legislature appropriated nearly \$1.3 million to MVD to increase its vehicle registration compliance efforts. These appropriated monies were allocated for 15 new peace officers using existing MVD positions, associated training and vehicle operating expenditures, and one-time expenditures, such as computer programming and equipment. With this funding, MVD hired a new group of enforcement officers, resumed its automated letter system for new residents, and publicized registration laws through limited television, radio, and billboard advertisements featuring a well-known actor. While the advertisements did not publicize the already existing MVD telephone hotline, which takes citizen tips on potential violators, news coverage of MVD's enforcement activities publicized the citizen hotline. Prior to these efforts, according to MVD officials, MVD's enforcement of vehicle registration laws varied with budget resources and agency priorities, but typically consisted of a few officers who pursued registration cases along with other enforcement duties.

In providing this funding, the Legislature also directed that MVD remit 50 percent of increased vehicle license tax collections resulting from the enforcement program to the State General Fund (Laws 2002, Ch. 328, §24) .

MVD can improve cost-effectiveness of enforcement efforts

MVD should increase its reliance on automated methods to identify and pursue vehicle registration law violators. Information from MVD case data shows that automated and administrative methods may be more cost-effective than officers' casework. As a result, MVD should develop a second automated method to enforce compliance with Arizona's vehicle registration laws.

¹ The Council of State Governments and the Council of Governors' Policy Advisory. *Road Fund Tax Evasion: A State Perspective*. Lexington, KY:1996.

² Market Opinion Research, *Estimates of Revenue Loss Arising from Vehicle Registrations*. Detroit, Mich:Dec.1984.

³ Office of the Utah Legislative Auditor General. *A Performance Audit of Unregistered Passenger Vehicles in Utah*. Utah. Oct. 2001.

Table 2: Direct Vehicle License Tax Revenue Estimates and Related Costs by Vehicle Registration Enforcement Method
Fiscal Year 2003

Enforcement Method ¹	OAG Estimated Revenue ²	Approximate Cost ³
Automated letter to new residents	\$797,112	\$ 13,700
Administratively pursued lead from a citizen's report	187,679	63,000
Peace officer cases	588,764	427,600

¹ Because the enforcement methods involving automated letters to new residents and peace officers were not fully operational during July through September 2002, annual revenues and costs for these enforcement methods are likely to be higher in fiscal year 2004.

² The estimated revenues presented in this table reflect auditors' analysis of enforcement cases and application of estimation techniques to account for errors found in a random sample of 239 compliance cases.

³ Additional fiscal year 2003 costs for the registration compliance program included expenditures for advertising, computer programming, and office supplies.

Source: Auditor General staff analysis of fiscal year 2003 enforcement cases included in MVD's Registration Compliance System and salary and expenditure information provided by the MVD Budget Office.

MVD automated method most cost-effective—MVD primarily relies on three enforcement methods to enforce vehicle registration laws. These methods are letters to new Arizona residents, pursuit of leads from citizens, and peace officer efforts. Auditor analysis of the overall costs and revenues of these enforcement methods found that cases pursued through the new-resident letter or through citizen tips are more cost-effective than officer cases. Table 2 illustrates the revenues and costs for these enforcement methods. Specifically:

- Automated letters to new residents**—MVD developed a software application that generates letters to be sent to new residents who applied for a driver's license but did not register a vehicle. This system automatically sends a letter to the name and address on the driver's license record and informs the person of Arizona's vehicle registration laws. While not all people moving to the State need to register a vehicle, MVD reports that from October 2002 through June 2003, of the average of 3,900 persons who received these letters each month, nearly one-sixth registered a vehicle within 60 days of receiving the letter. For the 9 months in fiscal year 2003 that the letters were operational, MVD generated over an estimated \$797,000 in VLT revenue from this enforcement approach, whereas the postage and computer processing costs to send these letters totaled slightly over \$13,700, since letter initiation and handling is fully automated. If a vehicle is not registered in response to the letter, these cases may become leads for peace officers.

New resident letters most cost-effective enforcement method.

Citizens can provide tips on unregistered vehicles.

- **Leads from citizen calls (hotline) and letters**—MVD follows up on citizen tips regarding unregistered vehicles via the efforts of two administrative assistants. When MVD receives a tip, the assistants will determine whether the vehicle is unregistered, and identify a mailing address for the individual if not provided by the caller. If it appears the person may be in violation of Arizona's vehicle registration laws, and if an address is identified, the assistants will initiate an automated letter informing the recipient of applicable registration laws. Due to news coverage of MVD's enforcement activities, which also publicized the citizen hotline, calls from the public increased. According to MVD reports, citizen tips increased from approximately 2,000 in fiscal year 2002 to over 17,000 in fiscal year 2003. The MVD staff who pursue citizen tips opened approximately 2,900 cases in fiscal year 2003 and generated over an estimated \$187,000 in VLT revenue. The costs for this effort totaled an estimated \$63,000 for fiscal year 2003, which included the two staff's salary and employee-related expenditures.
- **Peace Officers**—Although authorized 15 peace officers, as of April 2004, MVD reported that it employed 11 officers to enforce vehicle registration laws and had 4 vacant positions. These officers pursue leads from a variety of sources, including sweeps of large employer parking lots or personal sightings of unregistered vehicles. Officers' actions may include warnings placed on vehicles, visits to a potential violator's residence or workplace, citations, or license plate removal. MVD's officers opened approximately 8,500 cases in fiscal year 2003 and generated over an estimated \$588,000 in VLT revenue. The fiscal year 2003 cost for officer salaries, employee-related expenditures, and vehicle operating costs was approximately \$427,600.

MVD should develop additional automated letter—To increase cost-effectiveness, MVD should develop an additional software application to contact persons with expired Arizona vehicle registrations. Similar to the letters sent to new residents, MVD should use data from its title and registration system to send letters to vehicle owners who have expired Arizona vehicle registrations. Currently, when a vehicle owner receives the registration renewal, there is no MVD followup if registration does not occur. For vehicle registrations that expired in September 2003, at 60 days after expiration, more than 59,000 out of 258,000 vehicle owners eligible to renew that month had not renewed their registrations. At 90 days after the September expiration, more than 50,000 of the vehicles still had not been registered. Although some registrations would not be renewed because the vehicle owner sold the vehicle or moved out of Arizona, the number of nonrenewals is substantial.

Based on this incidence of nonrenewal, it would cost an estimated \$18,900 per month (\$226,500 annually) in postage and computer processing fees if MVD sent a single letter to the vehicle owner at 60 days' delinquency or an estimated \$16,100 per month (\$192,900 annually) at 90 days' delinquency. As is the case with MVD automated letters to new residents, revenues from letters to residents with expired registrations have the potential to greatly exceed monthly expenditures. For example,

MVD does not follow up when Arizona vehicle registrations expire.

based on the 2003 average VLT of \$158 per vehicle, the estimated monthly costs of sending a single letter at 60 days past expiration can be recovered by 120 registration renewals.

Other jurisdictions contacted use a similar method to obtain compliance with vehicle registration requirements. For example, the California Department of Motor Vehicles (DMV) uses a system of automated notices to pursue nonrenewing vehicle title holders instead of relying on department peace officers. A spokesman for the California DMV indicated that the use of delinquent notices and collections efforts is the primary means of compliance enforcement other than citations issued by law enforcement officers. California sends up to three delinquent notices, at 30, 60, and 90 days past the expiration of the vehicle registration. According to the spokesman, the California DMV discontinued using DMV-employed peace officers to pursue unregistered vehicle owners many years ago.

California relies on delinquency notices.

According to MVD management, it has identified monies from its fiscal year 2005 lump sum appropriation that it plans to use to fund the development and implementation of a second automated letter. MVD estimates it will cost approximately \$52,000 to develop this additional enforcement method.

Enforcement revenues less than reported

MVD needs to improve its reporting of vehicle registration enforcement case information to ensure accurate remittance of revenues to the General Fund and accurate information on case success. Fiscal year 2003 VLT revenues resulting from MVD's three direct enforcement efforts are overstated by an estimated \$233,000. MVD should correct the computer programming errors that have resulted in inaccurate revenue reporting. MVD should also make system improvements to allow cost analysis of its enforcement efforts.

Direct revenues overstated—For fiscal year 2003, MVD reported \$1.95 million in vehicle registration enforcement revenues, consisting of VLT and fee revenue, but these revenues are overstated. Accurate reporting of revenues is important because, by statute, MVD is required to remit 50 percent of increased vehicle license tax collections because of its vehicle registration enforcement program to the General Fund. However, auditor analysis of data from MVD's Registration Compliance System, which tracks vehicle registration enforcement cases and associated revenues, determined that VLT enforcement revenues are overstated by an estimated \$233,000.

This estimated reporting error is caused by faulty logic in the computer programs used to attribute monies to specific enforcement cases, and MVD should correct these logic problems. Specifically, MVD's computer program automatically counts

the most recent VLT revenue on record for the vehicle, even if the revenue was received months before the case opened or if the vehicle had never been in violation. For example, if an officer opens a case on a vehicle that is later determined to be actually registered, the program still attributes this revenue to the case. In addition, the computer program counted approximately \$95,000 of revenues more than once. Most of this error occurred in the automated database letters to new residents because when letters are sent to a husband and wife, for example, two cases are opened. If one vehicle is later registered, the revenues are attributed to both cases, counting the revenue twice.

MVD should determine case costs—In addition to correcting the programming problems, MVD should evaluate the cost-effectiveness of its cases. While MVD maintains a database of vehicle registration enforcement cases, limitations in this database prevent analysis of the costs associated with pursuing the different types of cases. For example, MVD has not conducted an analysis to determine the cost-effectiveness of pursuing out-of-state versus expired Arizona vehicle registration cases; or the cost-effectiveness of its different enforcement methods, such as parking lot sweeps, issuing warnings, or issuing citations. The current system does not track the number and extent of activities associated with each method, including peace officer time and resources spent on a case. This lack of information prevents cost comparison of case types or enforcement methods. In order for MVD to actively direct its enforcement staff activities to the most cost-effective enforcement methods, MVD should either make the necessary improvements to the enforcement database to allow for the tracking and analysis of case costs and activities or periodically conduct valid studies to determine case cost and effectiveness.

MVD should discontinue using indirect revenue measurement

The indirect revenue formula adopted by MVD to measure and remit monies generated from its vehicle registration enforcement program does not produce valid results and should not be used as a basis for remitting monies to the General Fund. Specifically, this formula does not produce valid results because it is not closely tied to enforcement efforts and actually measures a variety of factors, including more pervasive economic conditions. Indirect revenues result from potential evaders who register vehicles after seeing or hearing about an enforcement action against others. When the Legislature appropriated monies for MVD's expanded enforcement efforts, it directed MVD to measure the return on investment for its enforcement program and remit half of the increased revenues generated from enforcement activities to the General Fund. According to MVD, it was generally understood that in addition to direct revenues resulting from enforcement efforts, indirect revenues would result because of the public knowing about the enforcement program. Therefore, MVD and

Costs of enforcement methods not tracked or analyzed.

Indirect revenue formula does not produce valid results.

ADOT developed a formula to calculate indirect revenue. Based on the formula, MVD remitted over \$5 million from indirect revenues to the General Fund for the first two quarters of fiscal year 2003. However, as shown in Table 3, the formula has resulted in indirect revenue amounts that represented increased noncompliance from enforcement activities. For example, even though MVD generated direct revenues of \$214,000 in May 2003, the formula estimated that indirect revenues were a negative \$7.9 million.

Table 3: MVD-Prepared Schedule of Direct and Indirect Revenues (Rounded to nearest thousand) July 2002 through June 2003

Month	Direct Revenues Received	Indirect Revenues Estimated
July 2002	\$ 15,000	\$ 1,696,000
August	13,000	970,000
September	30,000	380,000
October	265,000	3,399,000
November	166,000	4,124,000
December	210,000	320,000
January 2003	228,000	(4,361,000)
February	170,000	(7,829,000)
March	187,000	(8,212,000)
April	216,000	(2,769,000)
May	214,000	(7,913,000)
June	240,000	(873,000)

Direct Revenues—Represent actual registration enforcement revenues received from vehicle owners registering their vehicles in response to MVD automated new resident letters or letters, warnings, or other actions by peace officers or administrative staff.

Indirect Revenues—Represent estimated registration revenues that may be received from other vehicle owners registering their vehicles because they saw or heard about the direct enforcement efforts. These amounts are estimated by taking the difference between a month's registration revenues this year and last year and adjusting it for several factors.

Source: Motor Vehicle Division Strategic Plan FY2003, Director's Update, June 2003.

These results are caused by the fact that instead of measuring the impact of enforcement efforts, the formula primarily measures how much VLT revenues change from year to year. The formula compares each month's total VLT revenues to the same month in the prior year, makes several adjustments, and then labels the difference "indirect revenue." Many factors can influence annual VLT collections, such as the growth in the number of vehicles, the public's ability and willingness to pay their VLT, the number of biennial registrations compared to annual registrations, and the general state of the economy that impacts the dollar value of vehicles. These factors can overwhelm or hide any indirect revenue effect that the formula might also capture.

MVD should discontinue using the indirect revenue measure as part of its calculation of the return on investment of its vehicle registration enforcement program and as a basis for remitting a portion of this revenue to the General Fund. Developing a better

measure will be difficult and may be very costly because it will be resource-intensive to design and implement. After searching for a similar measure in Arizona's government, other states and governments, and through a literature review, auditors were unable to find a measure of indirect revenue. Further, it is not clear whether Arizona's program, which is relatively small, can be expected to have a very large indirect effect. Much of what the program does—such as following up on citizen tips or checking the parking lots of major employers—is not very visible to the general public. Without a broader public awareness of its program, it would be difficult to produce a significant change in the number of people who are out of compliance.

Recommendations

1. MVD should develop an additional software application to send delinquency letters to Arizona residents who do not renew their vehicle registrations.
2. MVD should ensure that revenues from its vehicle registration enforcement efforts are correctly reported by addressing the programming errors that allow revenues to be erroneously attributed to cases.
3. MVD management should either modify its Registration Compliance System to track the enforcement activity for each case or periodically conduct valid studies of registration enforcement cases so that management can determine the cost-effectiveness of the various case types and enforcement methods and direct officer activities to those cases and methods.
4. MVD should discontinue using the indirect revenue measure as part of its calculation of the return on investment of its vehicle registration enforcement program and as a basis for remitting a portion of this revenue to the General Fund.

FINDING 2

MVD should improve fuel tax refunds processing

MVD needs to improve its fuel tax refunds process to help ensure that eligible claimants receive accurate refunds. Because Arizona collects its fuel taxes when fuel is distributed from the storage facility, some suppliers and users may be eligible for refunds of this tax based on certain uses of the fuel that are tax-exempt. However, the MVD unit responsible for processing refund claims lacks adequate procedures and oversight to process these refunds, sometimes resulting in inaccurate fuel tax refunds. As a result, MVD should take several steps to improve the fuel tax refunds process.

Some fuel uses eligible for tax refunds

Arizona taxes purchasers of gasoline and diesel fuel to partially compensate the State for the use of its highways. While all states tax gasoline and diesel fuel purchasing, Arizona is one of several states that require its \$0.26 per gallon diesel (use fuel) tax and \$0.18 per gallon gasoline (motor fuel) tax to be paid as fuel exits the distribution terminal or storage facility. With this approach, Arizona collects the tax early and from fewer taxpayers, which provides for greater scrutiny of the taxes collected. However, MVD must subsequently provide refunds to suppliers and users who have paid the tax but used the fuel in ways that are tax-exempt. During fiscal year 2003, MVD collected nearly \$649 million in gross fuel tax receipts (diesel and gasoline) and provided over 6,600 refunds totaling over \$23 million to taxpayers for ten different types of fuel tax refunds. Table 4 illustrates the categories that statute

Table 4: Fuel Tax Refunds
Fiscal Year 2003
(Unaudited)

Off-highway use	\$10,261,152
Tax differential	5,299,898
Export fuel	2,675,039
Tax report/other	1,712,000
Native-American fuel	1,084,070
IFTA (International Fuel Tax Agreement)	888,014
Tax rebate for Arizona fuel purchases used elsewhere	772,367
Government fuel	442,200
Idle time fuel	191,755
Aviation	<u>12,698</u>
Total fuel tax refunds	\$23,339,193

Source: Auditor General staff analysis of detail reports prepared for the Motor Vehicle Division's Strategic Plan, FY 2003, director's update, June 2003.

exempts from paying the fuel taxes, as well as the fiscal year 2003 fuel tax refund amounts for each category. These uses include:

- **Off-Highway Use**—Fuel used by vehicles or other equipment off the highway. Potential uses that qualify include agriculture, construction operations, or vehicles not designed or used primarily for transportation of people or property.
- **Tax Differential**—Vendors such as gas stations, who pay the diesel fuel tax rate of \$0.26 per gallon, but sell it to light-class motor vehicles, such as passenger cars, with an \$0.18 per gallon tax, can claim a refund for the \$0.08 per gallon difference.
- **Export Fuel**—Fuel purchased by licensed suppliers who can show proof that they exported the fuel across state lines.
- **Tax Report/Other**—Amounts refunded for overpayments, credit balances for motor and use fuels, and exempt payers of underground storage tank taxes.
- **Native American Fuel**—Fuel sold within a reservation to an enrolled member of the Native American tribe living on the reservation and fuel used on state highways for governmental purposes if the motor vehicle is leased to or owned by and operated for the sole benefit of a Native American tribe.

Some fuel tax refunds inaccurate

MVD has inaccurately determined some of the fuel tax (diesel and gasoline) refunds it has made. For example, Arizona Department of Transportation (ADOT) auditors have identified inaccurate refund amounts both in audits of payments made to claimants and in prepayment reviews of other claims. Additionally, MVD has issued fuel tax refunds without adequate supporting documentation to support the refund claim. Finally, other weaknesses in the refunds process increase the potential for fraud.

Refunds issued inaccurately—Based on auditor reviews of refunds issued by MVD in fiscal year 2003, as well as 44 refund audits or reviews conducted by ADOT's Office of Audit and Analysis—Revenue Audit (Revenue Audit) in fiscal years 2001 through 2004, several refunds were inaccurately determined. These errors include cases where MVD had already issued the refund, as well as high dollar amount refunds where a final review by ADOT Revenue Audit caught the error prior to issuing the refund. However, this final review has gone largely unused since 2001, greatly reducing its usefulness as a safeguard against incorrect payments. Specifically:

- **ADOT auditors identified inaccurate refunds**—While ADOT Revenue Audit has infrequently performed audits of refunds, during fiscal year 2004, Revenue Audit

planned to randomly select 45 refunds to audit. As of May 2004, Revenue Audit had completed 16 of these 45 refund audits and identified errors in 7 of them. These errors, which included both over- and underpayments, ranged from \$8 to more than \$5,800.

- **Final review process also identified errors, but now is little used**—Prior to September 2001, Revenue Audit reviewed high dollar claims that were referred to it prior to payment. These reviews identified inaccuracies that could have resulted in hundreds of thousands of dollars in erroneous payments. Specifically, Revenue Audit established guidelines for referring claims over \$25,000 and other unusual claims to Revenue Audit for review. Revenue Audit reviewed 18 referred refund claims during fiscal year 2001 and identified errors in 7 of them. This effort prevented nearly \$700,000 in inaccurately determined refunds from being paid. For example, one company filed a refund claim after the filing time limit expired and also claimed a false exemption. This same company filed another refund claim for taxes paid to the Navajo Nation. For July and August 2001, only four claims had been referred to and reviewed by Revenue Audit prior to payment. Review of these four claims totaling over \$310,000 identified claim errors of over \$122,000, including two companies that claimed refunds for payments previously received. The refund amounts for these four claims were subsequently reduced. Since that time, MVD had not referred additional refund claims for review through August 2003. According to an MVD official, MVD has not continued to submit refund claims to ADOT Revenue Audit for review because of concerns regarding the timeliness of reviews, the lack of requirements specifying the types of claims that should be referred for review, and a change in management for the MVD unit that processes refunds.

Refunds may be approved without adequate documentation—

Documentation claimants submitted may be inadequate to support the refund claim's validity and ensure correct processing. Based on auditor review of nine refund claims paid in fiscal years 2003 and 2004, auditors identified examples of claims paid without required supporting documentation, such as current equipment lists to substantiate off-highway use of fuel. For example, MVD issued refund payments totaling over \$18,600 to two companies without having required equipment lists on file. Additionally, based on auditor review of 21 Revenue Audit reviews of refunds, four refund claims filed in fiscal year 2001 that requested exemptions for taxes paid in Arizona on fuel exported to another state did not include documentation from the other states to show receipt of the fuel. Finally, in some cases, claimants are not required to provide documentation supporting the stated use that qualified for a refund. For example, for gas stations requesting the \$0.08 cent differential allowed when diesel fuel is sold to light-class motor vehicles, the vendor is not required to support the claim by submitting sales receipts or other records, although the vendor is required to maintain these records. These fuel tax refunds represented nearly 23 percent of the fuel tax monies refunded in fiscal year 2003.

Some refunds lack adequate supporting documentation.

Potential for fraud increased—Inadequately supported and reviewed refund claims increase the potential for fraud or tax evasion. Studies by the Federal Highway Administration and The Council of State Governments indicate that substantial revenue is lost nation-wide because of fuel tax evasion.^{1, 2} Additionally, according to the Federal Highway Administration study, examining taxpayer records is fundamental to reducing fuel tax evasion. To counteract fuel tax evasion and fraud, MVD organized a fuel tax evasion unit in fiscal year 2002. In addition to other responsibilities, this unit combats fraudulent tax reporting. However, only two refund claims have been referred to this unit for review from inception through March 2004 because MVD lacks guidelines specifying the criteria under which potentially falsified refund claims will be referred to this unit.

MVD should develop better refund process

MVD needs to take several steps to help ensure that refunds are valid and accurately processed. These include updating its procedures for refund processing, improving oversight of the refunds process, requiring adequate documentation to substantiate claims, and better guiding taxpayers by revising its claim forms and instructions. All of these procedures are used in a number of other states that auditors contacted.

MVD should update procedures for processing refunds—MVD should update its current procedures and implement additional, written operational procedures to guide refund processing. Although MVD has refund processing procedures, these procedures do not reflect the current process since some of the procedures are no longer relevant and certain statutes referred to in the procedures have been repealed or changed. Further, MVD's procedures do not specify requirements for various steps in the processing of refund claims including specifying all of the documents required to substantiate a claim, the process for assessing the validity of a claim, the process to confirm authorized claim signatures, and the levels of review required for different claim amounts. Therefore, MVD should update its procedures and establish additional procedures that document and describe these various steps. Once MVD develops and implements these procedures, it should ensure all staff involved in the processing of fuel tax refund claims are trained on these procedures.

Improved oversight needed—MVD should improve its oversight of fuel tax refunds claim processing. MVD currently lacks oversight procedures for the staff who process the refund claims and review the appropriateness and accuracy of these claims. For example, according to an MVD supervisor, current supervisory oversight focuses on the mathematical accuracy of the refund calculation and data entry, not on the validity of the claim. Further, MVD should establish two supervisory levels to

Updated procedures needed for processing refunds.

¹ The Council of State Governments and the Council of Governor's Policy Advisors. *Road Fund Tax Evasion: A State Perspective*. Lexington, KY: 1996.

² U.S. Department of Transportation, Federal Highway Administration. *Fuel Tax Evasion: The Joint Federal/State Motor Fuel Tax Compliance Project*. June 1992.

approve refunds based on the refund amount to help ensure refund accuracy and appropriateness prior to payment. For example, according to a manager with the Texas State Comptroller's Office, two processing staff must review and approve claims of approximately \$1,000, while supervisory review is required for claims over \$10,000. According to an official with Washington's Department of Licensing, a manager must approve claims over \$5,000, and two signatures are needed for those over \$10,000. Supervisory responsibility should include review of data input summaries, as well as compliance reviews of individual refunds, to ensure unit procedures are followed, claim documentation requirements are met, and calculations are accurate.

Refund review and authorization needed prior to payment.

Improved oversight should also include a defined role for ADOT's Office of Audit and Analysis and MVD's Fuel Tax Evasion Unit. Audits of refund payments have been inconsistently performed and MVD does not require the Refund Unit's supervisor to periodically audit completed transactions in detail. While MVD planned 35 compliance reviews of refund payments during fiscal year 2003, only one review was conducted. Management attributed the incomplete reviews to limited personnel. However, during the audit, MVD assigned a staff person to the Refund Unit who will review claims for validity prior to payment.

In addition, ADOT's Office of Audit and Analysis should implement a plan to audit an adequate number of high-dollar refunds and a random sample of other refunds annually. Other states conduct such audits. For example, according to an official with the Washington Department of Licensing, field auditors are required to annually conduct refund claim audits, in addition to other audits of suppliers and interstate truckers. Further, the Tennessee Department of Revenue, Petroleum Tax Division conducts field audits of a sample of refunds and for other refunds if a claim appears questionable. MVD could also refer questionable refund claims to its Fuel Tax Evasion Unit for field review. Because questionable claims should be consistently referred for review, MVD should identify criteria for referring a refund claim to its Fuel Tax Evasion Unit.

Audits of refund claims should occur annually.

MVD should require adequate claim substantiation—Similar to other states, MVD should strengthen taxpayer requirements to support refund claims. The ADOT director currently has statutory authority to require any documentation deemed necessary to support a refund claim. Particularly important is better documentation to support off-highway fuel tax refunds as these refunds represent one of the largest categories of refunds MVD issues. For example, Texas and Tennessee require off-highway users of fuel to maintain documentation showing the fuel dispensed from the bulk storage tank to the equipment. In addition, Texas completes a field audit on receipt of a company's initial claim to ensure the equipment listing is accurate. In contrast, MVD does not conduct such a check.

Additionally, gasoline vendors applying for the \$0.08 differential refund could be asked to submit documentation to substantiate their sales at the lower price. As mentioned previously, statute already requires vendors to maintain this documentation.

MVD should improve taxpayer instructions—MVD could also assist Arizona taxpayers by providing better claim forms and instructions. While MVD has informational booklets and Web site information that answers some questions regarding fuel tax refunds, MVD's current forms do not provide line-by-line instructions for the user. Additionally, the forms lack information defining eligibility for fuel tax refunds and do not detail requirements for submitting supporting documentation.

MVD should provide clear and comprehensive forms and instructions to better assist taxpayers and potentially reduce filing errors. Auditor review of eight other states' refund forms and instructions shows that these states better explain how to complete refund claims.¹ For example, states such as California and Idaho include line-by-line instructions for the completion of claim forms. Additionally, California's and Idaho's forms are more comprehensive, instructing the user about exemptions, filing periods, and necessary signatures to support the refund claim.

¹ Auditors reviewed refund claim forms from California, Florida, Idaho, Missouri, North Carolina, Tennessee, Texas, and Washington. Similar to Arizona, these states, except for Texas, collect fuel taxes at the distribution storage facility. Texas is in the process of converting to that point of taxation.

Recommendations

1. MVD should update its current procedures and implement additional, written procedures that document the steps and requirements for processing, validating, reviewing, and issuing fuel tax refund claims.
2. Once it has updated its procedures and implemented additional procedures, MVD should ensure that all staff involved in the processing and review of fuel tax refund claims are trained on the procedures.
3. To help ensure appropriate oversight and monitoring of the refunds process, MVD should establish and implement procedures requiring:
 - a. Two levels of refund approval based on the refund amount;
 - b. Supervisory review of the accuracy and validity of all refunds before they are issued and requiring that questionable refund claims be referred to its Tax Evasion Unit for review; and
 - c. Independent audits by ADOT's Office of Audit and Analysis of a random sample of refund claims annually based on a systematic audit plan.
4. MVD should strengthen the requirements that stipulate the documentation taxpayers must maintain to support refund claims and the documentation taxpayers must submit with their refund claims.
5. MVD should develop more comprehensive forms and instructions for taxpayer claims to assist taxpayers in the filing of claims and help ensure that MVD has all required information to process and verify refund claims.

FINDING 3

MVD should examine its fees

While fees assessed by MVD generate significant revenue for the State, MVD should continue with its recently initiated process to examine these fees to ensure they are necessary and sufficient to cover its costs. According to MVD reports, MVD generated over \$150 million in fiscal year 2003 through fees and assesses over 350 different fees. MVD has not reviewed these fees to determine whether, for example, some might no longer be appropriate or might be set too low to cover the cost of providing the associated service. However, in January 2004, MVD established a working group to evaluate its fees. Using a structured process that considers both cost and other information and collects needed cost data for analysis would enhance this working group's efforts. Additionally, using such an approach could result in useful recommendations for legislative consideration.

MVD generated over \$150 million in fiscal year 2003 through fees.

Purpose of fees

At all levels of government, the assessment of fees serves a variety of purposes, including recovering the costs of providing a service, generating revenue, and reducing the demand for services. Specifically, according to a Texas A&M University study on state sales and income taxes, fees are generally considered to be an appropriate tool for recovering the cost of providing a specific service to an individual.¹ Additionally, according to literature, user fees can be based on the costs of providing the associated service, including operating and capital costs.²

¹ Zodrow, George R. *State Sales and Income Taxes: an Economic Analysis*. College Station: Texas A&M University Press, 1999.

² Fisher, Ronald C. *State and Local Public Finance*. Chicago: Irwin, 1996.

Some MVD fees may be unnecessary or inappropriately established

Until recently, MVD did not have a process in place to periodically review the over 350 fees it charges, and there are several reasons to question whether some fees are needed or appropriate. For example, some fees are outdated or are too low, and might not cover the cost of the services provided. In addition, MVD provides one service without charging any fee.

MVD has historically lacked process to review fees—Despite responsibility for assessing and collecting hundreds of fees, MVD has not reviewed the necessity or adequacy of these fees. Based on auditors' review of statutes and administrative rules, MVD currently has the authority to assess over 350 fees. As illustrated in Table 5 (see page 29), MVD charges these fees to provide a variety of services including vehicle title and registrations, specialized license plates, and driver's licenses. Statute either establishes a fee or requires the ADOT director or his designee to establish the fee in administrative rule. Based on auditors' review, approximately 86 percent of MVD's fees are established by statute, with the remaining fees established in administrative rule. Additionally, statute also either specifies the fee amount, establishes a maximum fee amount that MVD can assess, or requires the director to establish a fee that covers all or part of the cost of providing the service.

MVD has not conducted a comprehensive review of the necessity or appropriateness of its fees. However, in January 2004, MVD established an internal working group consisting of personnel from ADOT and MVD specializing in budgeting and purchasing, finance, revenue, and economics to begin reviewing its fees. MVD also indicated it plans to solicit input from the Joint Legislative Budget Committee and Governor's Office of Strategic Planning and Budgeting. This initial working group plans to determine what should be done to evaluate the fees. In the next phase, MVD plans to have its staff analyze the fees.

Some fees may be too low or unnecessary—Because MVD's fees have not been reviewed and updated for many years, some common fees assessed by MVD may be too low or may not be needed. Specifically:

- **Amounts of some fees outdated**—Changes to the over 300 fees established in statute have been infrequent. Specifically, the Legislature has revised approximately 20 fees since 1997. As a result, fees may no longer be adequate because of inflation and the increasing costs of providing services. This is particularly true for fees that have remained unchanged for periods of 30 or more years. For example, vehicle title fees have remained at \$4 for more than 30 years. Adjusting this fee for inflation using a U.S. Bureau of Labor Statistics formula yields a value of \$18.29 in 2003.

Some fees have not been revised for 30 or more years.

**Table 5: Common MVD Fees
Fiscal Year 2003**

Type of Fee/Specific Fee	Purpose	Fee Amount or Range	Statute Establishing Fee
Certificates of Title and Registration			
Vehicle inspection	Identify the vehicle	\$ 0 to 50	A.R.S. §28-2011
Level I		0	
Level II		20	
Level III		50	
Certificate of title	Identify the owner of a vehicle	4	A.R.S. §28-2003
Registration of motor vehicle	Register the vehicle with the State	8	A.R.S. §28-2003
License Plates			
License plate	Provide a license plate to a registered owner of a vehicle	0	A.R.S. §28-2351
Honored military license plate Ex: Pearl Harbor survivor license plate	Provide a special license plate to a registered owner of a vehicle	25	A.R.S. §28-2455
Pearl Harbor survivor license plate renewal	Annually renew an honored military license plate	5	A.R.S. §28-2455
Motor Vehicle Driver's Licenses			
Class D Driver's License (with a written test)	Authorize an individual to drive a motor vehicle	10	A.R.S. §28-3002
Class D Driver's License (no test required)	Authorize an individual to drive a motor vehicle	10 to 25	A.R.S. §28-3002
Age 50 or older		10	
Age 45 to 49		15	
Age 40 to 44		20	
Age 39 or younger		25	
Class M Driver's License	Authorize an individual to drive a motor vehicle	10 to 25	A.R.S. §28-3002
Age 50 or older		10	
Age 45 to 49		15	
Age 40 to 44		20	
Age 39 or younger		25	
Highway Use Fees			
46 different fees	Charge for commercial motor vehicle based on the age and weight of the vehicle	50 to 2,217	A.R.S. §28-5471

Source: Auditor General staff analysis of common MVD fees established by Arizona Revised Statutes.

Arizona's fees are lower than similar fees in other states.

Additionally, the \$4 fee may not reflect the costs for MVD to process and issue a vehicle title. Although MVD does not have specific cost information, one MVD manager estimated that a title transaction requires about 20 minutes of a customer service representative's time. If so, the current \$4 fee may not cover the average costs of the customer service representative's salary and benefits, not to mention overhead costs or the additional costs for preparing the title. According to MVD reports, MVD issued more than 2.5 million titles in fiscal year 2003, yielding more than \$9.8 million in revenue. If this fee were increased 50 percent to \$6, it could generate an additional \$5 million annually.

- **Costly to collect very small fees**—Some fee amounts are so low that MVD might not recover its costs to collect them. Auditors' review found that over 90 statutorily required fees are set at \$10 or less. More than 40 of these fees are \$5 or less, and 4 of these fees are only \$1. For example, MVD charges a \$1 fee for such services as issuing a one-trip registration permit, a temporary registration fee for a commercial truck, or a title for a vehicle repossessed by the seller.
- **Fees lower than other states' fees**—Although a few fees may be comparable to those of other states, the fees that MVD can charge for some common transactions are generally lower than the fees charged by other states for comparable transactions.¹ Based on auditor review of MVD transactions, auditors selected six common transactions for comparison to similar transactions in other states. As illustrated in Table 6 (see page 31), while Arizona's fees for duplicate registrations are comparable with fees in other states, the fees for duplicate licenses are significantly lower than those of other states.

One service not covered by a fee—While the Legislature established three levels of vehicle title inspections to verify the vehicle identification prior to registration, MVD has authority to assess fees only for the second and third levels of inspections.² MVD does not have statutory authority to assess a fee for Level I vehicle title inspections. In fiscal year 2003, MVD reports providing nearly 277,000 of these Level 1 inspections. In many cases, these inspections require staff travel time to inspect vehicles at offsite locations, in addition to the time required to conduct the actual inspection and process the paperwork.

¹ California, Colorado, Nevada, New Mexico, Texas, and Utah were selected for comparison based on their geographic and demographic similarity to Arizona.

² Level I inspections consist of visual confirmation of a vehicle's identification number. When information is insufficient for a Level I inspection, MVD performs a Level II inspection, which confirms the vehicle's identity through a search of the vehicle for a confidential vehicle identification number. Level III inspections are similar to Level II inspections, but require a search of the vehicle to find the more confidential vehicle identification numbers.

Table 6: Comparison of Selected State Fees
As of May 2004

	Arizona	California	Colorado	Nevada	New Mexico	Texas	Utah
Automobile title	\$4	\$15	\$9.50	\$20	\$ 3.50	\$28 ^a	\$ 6
Motorcycle title	4	15	9.50	20	3.50	28 ^a	6
Duplicate title	4	15	8.20	20	15.00	2	6
Duplicate registration	4	15	2.20 ^a	5	3.50	5.30 ^a	4
Duplicate plate	5	15	5.54 ^a	10.50	15.50	5.30 ^a	5
Duplicate driver's license	4	19	8.10 or 15.60 ^{a,b}	16.25	16.50	10	13

^a Represents minimum fees charged in these states.

^b \$8.10 applies to those aged 60 and older, while \$15.60 fee applies to those aged 21 to 59.

Source: Auditor General staff review of motor vehicle fees for Arizona and other states.

MVD's working group should establish a fee-setting process

MVD's newly formed working group should continue with its efforts to assess the necessity and appropriateness of its fees. To facilitate this review of its fees, MVD's working group should develop a uniform process to systematically evaluate and review its fees, possibly using a model developed in Mississippi. MVD should also develop and collect the data and information needed to analyze the costs of providing the services associated with the fees it reviews. Finally, once it completes its analysis and review, MVD should recommend appropriate fee revisions for legislative consideration.

MVD should systematically review fees—MVD's recently established working group should ensure that fees are set at appropriate levels and reviewed periodically. According to an MVD official, as of April 2004, this working group has identified some of the fees it plans to review based on the frequency of the associated transaction. These include vehicle title and registration fees. Additionally, the group has begun to benchmark these fees and transactions to similar transactions in Washington. In addition to focusing on high-volume transactions, the group should identify and review any fees that, given their size and frequency of use, do not appear to be cost-effective to collect or potentially unnecessary.

MVD should follow structured approach to review fees.

For the fees it reviews, MVD should either follow or develop a structured approach to evaluate, establish, and review its fees. Such an approach has been developed by the Joint Legislative Committee on Performance Evaluation and Expenditure Review (PEER) in Mississippi.¹ As illustrated in Figure 3 (see page 33), PEER's decision model for state government fee-setting is systematic, consistent with the literature on fees reviewed during this audit, and would be appropriate for Arizona's MVD to follow. Following such a model would allow MVD's working group to systematically review its fees by determining whether the fee is needed, its purpose, and whether it should be set at a level to recover its costs.

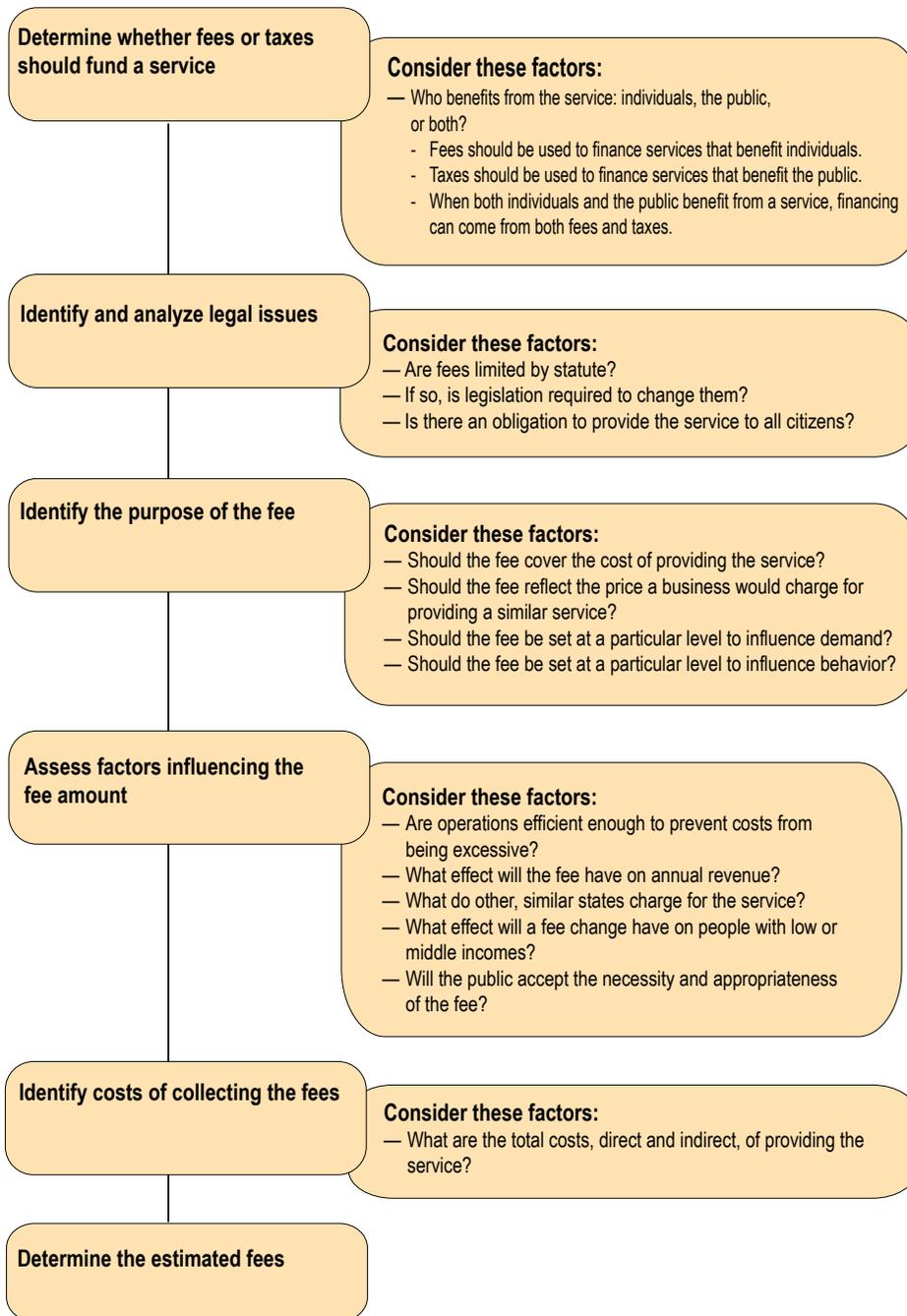
Cost data and other information needed—In addition, MVD needs to develop and collect basic cost and other information related to its fees and the services associated with the fees. While a fee review requires substantial information on specific service costs, this information is not readily available at MVD. MVD maintains some revenue and transaction data that may be useful for its fee review and analysis. However, MVD lacks sufficient service cost data and information to accurately determine the costs of the services associated with its fees. Therefore, MVD should begin to collect the cost, revenue, and transaction data and information needed to appropriately review and analyze its fees. To manage the impact of this work on its limited resources, MVD should undertake to collect this data and information only on the fees that it selects for review and analysis.

MVD should collect cost and transaction data needed for fee review.

Legislative action needed to revise most fees—Once MVD has completed the review and analysis of its fees, and has developed specific recommendations to change fee amounts, legislative action will be needed. While MVD can change the small number of fees that are established in administrative rule, those established in statute require legislative action. However, fees established in statute can be difficult to revise because, under Arizona's Constitution, the approval of two-thirds of the Senate and two-thirds of the House (a supermajority of the Legislature) is required to increase a statutory fee. Nonetheless, based on its research and analysis, MVD should recommend appropriate fee revisions for legislative consideration.

¹ Mississippi Joint Legislative Committee on Performance Evaluation and Expenditure Review. *State Agency Fees: FY 2001 Collections and Potential New Fee Revenues*. Jackson, Miss.: Dec. 2002.

Figure 3: Mississippi Joint Legislative Committee on Performance Evaluation and Expenditure Review
Structured Fee-Setting Process
Developed for State Government



Source: Auditor General staff analysis of fee-setting model included in the *State Agency Fees: FY2001 Collections and Potential New Fee Revenues* report prepared by the Mississippi Joint Legislative Committee on Performance Evaluation and Expenditure Review.

Recommendations

1. MVD should continue with its recently initiated process to evaluate its fees. MVD's newly formed working group should use a systematic approach that includes the following steps:
 - a. Identify fees that are not cost-effective to collect or that are no longer needed;
 - b. Evaluate fees that represent a significant amount of revenue or a relatively large number of transactions;
 - c. Perform a fee-by-fee analysis of the selected fees using a structured approach for determining the costs of the services;
 - d. Recommend appropriate fee changes to the Legislature.
2. For those fees that the working group analyzes, MVD should collect the necessary cost, revenue, and transaction data and information on the actual cost of services provided and associated fees charged.

FINDING 4

MVD should better protect registration renewal fees

Despite receiving over \$15.7 million a month in mail-in vehicle registration renewals, the Motor Vehicle Division (MVD) lacks adequate controls to protect these monies. Through March of fiscal year 2004, MVD processed an average of nearly 3,900 mail-in registration renewals and deposited between \$639,000 and \$918,000 each day. MVD should take steps to protect these payments, including restricting employee access to these monies, immediately endorsing and depositing checks and money orders upon receipt, and tracking receipts through the registration renewal process.

Vehicle registration renewals

Mail-in registration is the most common approach used by Arizona residents to renew their vehicle registrations. Through March of fiscal year 2004, more than 34 percent of registration renewals were received via the mail, while nearly 31 percent of renewals were processed by MVD field offices and drop boxes, and 27 percent were from Internet transactions.¹ The remaining 8 percent of registration renewals were handled by third-party administrators and fleet transactions.

MVD has a Renew-by-Mail Unit to process mail-in registration renewals. According to MVD reports, this unit processes approximately 83,000 mail-in registration renewals and deposits an average of over \$15.7 million each month. During the audit, MVD officials reported that the Renew-by-Mail Unit was anywhere from 6 to 10 days behind in processing registration renewals. As of February 4, 2004, MVD reported a 6 and-a-half day backlog in processing mail-in registration renewals. Based on this reported backlog and the average daily deposits for the first 9 months of fiscal year 2004, MVD could have as much as \$4.76 million in mail-in vehicle registration renewal payments at its processing facility on a given day.

MVD receives over \$15.7 million monthly in mail-in registration renewals.

¹ These vehicle registration renewal figures do not include renewal transactions completed with other transactions, such as lost plates or change of address.

MVD does not adequately safeguard registration renewal payments

MVD lacks adequate policies and procedures to protect vehicle registration renewal monies processed by its Renew-by-Mail Unit. Specifically, this unit does not use appropriate procedures in all areas of its cash-handling process. For example, the unit allows unnecessary access to vehicle registration renewal monies, does not endorse checks and money orders immediately upon receipt, and does not track these monies through the registration renewal process. MVD should take action to correct these problems, and also document and regularly review its cash-handling policies and procedures.

Insufficient procedures over check processing—MVD's current procedures for processing registration renewal payments fail to sufficiently protect state monies during processing. The current process proceeds as follows: First, MVD's processing unit has a mailroom clerk who opens, bundles, and places the day's mail in bins in the mailroom. This mail is left in an unsecured area for up to 10 days until it is distributed to customer service representatives for processing. Once these representatives verify that the appropriate fee and documents have been submitted, the payment and renewal documentation is bundled and forwarded to another area for data entry into the MVD title and registration system. After this, a deposit clerk verifies, endorses, and prepares these monies for deposit. This process has the following weaknesses:

- **Access to receipts not restricted**—MVD does not adequately restrict access to registration renewal payments. In addition to the 29 employees in the Renew-by-Mail Unit, staff uninvolved with processing also have easy access to vehicle registration renewal payments. Specifically, the janitorial staff and employees in other units at the MVD field office also have access to the unendorsed checks and money orders. By failing to limit employee access to checks and money orders, MVD increases the potential for loss or theft.

MVD can reduce unnecessary access to these monies by strengthening its control over monies stored in the mailroom, the processing area, and individual processing workstations. First, MVD should limit mailroom access to necessary staff. Second, MVD should securely store all registration renewal payments by retaining all checks and money orders in an adequate physical facility (fireproof safe, locking filing cabinet) until ready for processing. Additionally, checks should not be left unattended and unsecured at workstations, but should be stored in a locking physical facility when left unattended. By retaining all registration renewal payments in an acceptable physical facility, MVD will be in compliance with the *State of Arizona Accounting Manual* and diminish the risk of loss or theft of state monies.

Too many people have access to registration payments.

- **Checks not endorsed immediately**—MVD does not safeguard its checks and money orders through restrictive endorsement until the very end of the registration renewal process. According to an MVD supervisor, it takes approximately 1 day to process the vehicle registration renewal payments. However, these payments are not endorsed for several days due to the processing unit's backlog. Additionally, during the actual registration renewal process, at least five employees handle these checks as part of their normal job function, making it more difficult to trace potentially lost or stolen payments.

Restrictively endorsing a check helps prevent unauthorized individuals from depositing the money. The *State of Arizona Accounting Manual* requires that all checks and money orders be immediately restrictively endorsed, and payments received must be deposited on a timely (daily) basis. As such, MVD should consider two options to better protect these monies and comply with state requirements. Specifically, if MVD could reduce its processing backlog, it could process, restrictively endorse, and deposit registration renewals the same day they are received. However, until the backlog can be reduced, the other option is for MVD to prepare a receipt noting the check information and payment amount and attach this receipt to the accompanying registration renewal documentation. Payments would then be placed in a safe or locking cabinet during processing. Once the customer service representatives verify that the payment amount and associated documentation are complete and accurate, MVD could then deposit these monies. Either one of these procedures would better safeguard receipts and minimize employee access to these monies during processing.

- **Receipts not tracked**—Throughout the registration renewal process, MVD fails to track vehicle registration renewal monies. Specifically, MVD does not have a mechanism in place to help ensure that all registration renewal payments received are processed. When mail is initially received and bundled, the unit does not prepare a mail log. Further, the unit does not track the distribution of these registration renewal payments throughout processing.

To again better safeguard these monies, MVD should assign a unique identifier to each mail bundle and create a daily mail log documenting the total count for the corresponding bundle. The *State of Arizona Accounting Manual* requires that mail logs be prepared for all receipts received through the mail. MVD should also use a batch log to document each item distributed to the different processing clerks. The mail log and processor batch logs could be used to track renewals if the deposit receipts and title and registration data do not reconcile. These additional safeguards would decrease the potential for loss and theft and ensure that each payment received is processed.

MVD should better track mail-in registration payments.

Document cash-handling procedures—Once MVD institutes these changes, it should document policies and procedures governing registration renewal payments. Specifically, MVD should document policies for handling cash and cash-like receipts. These policies and procedures should incorporate the recommended changes to the Renew-by-Mail Unit's cash-handling process and define employee responsibilities for each step in the process. Additionally, to help ensure it establishes and adheres to appropriate cash-handling policies and procedures, MVD should periodically request a procedural review from ADOT's Office of Audit and Analysis, which conducts internal audits of ADOT functions. Such a review analyzes an organization's processes and looks for internal control weaknesses. By regularly reviewing its internal controls, MVD can ensure its procedures effectively safeguard state monies.

Recommendations

1. MVD should establish and maintain the following processes and procedures to better safeguard registration renewal monies:
 - a. Store registration renewal payments in an adequate physical facility, such as a safe or locking storage cabinet, and limit access to necessary employees;
 - b. Limit mailroom access to necessary employees;
 - c. Immediately endorse all checks and money orders upon receipt by processing registration renewals the same day they are received, or generate a record of money received, such as a receipt, to accompany registration renewal documentation during processing;
 - d. Create and use a daily mailroom log that documents the number of envelopes for each bundle of mail;
 - e. Create and use a batch worksheet that tracks the distribution of mail before and during processing;
 - f. Develop and implement policies and procedures for handling cash and cash-like receipts that incorporate the recommended changes made in this report and define employee responsibilities for each step in the cash-handling process; and
 - g. Periodically request a procedural review from ADOT's Office of Audit and Analysis to ensure it establishes and adheres to appropriate cash-handling policies and procedures.

OTHER PERTINENT INFORMATION

As part of this audit, auditors gathered other pertinent information regarding ADOT and MVD efforts to reconcile the MVD cash-clearing account accurately and in a timely manner. MVD deposits most of the revenue that it collects into a cash-clearing account. Accurate reconciliation of the monies deposited into the account with amounts shown in the State Accounting System is critical to ensure the accurate distribution of these monies to various funds, including HURF. However, reconciling the cash-clearing account with other records has been a long-standing problem. While ADOT and MVD have made significant progress in improving the timeliness and accuracy of its reconciliations, some differences continue.

Reconciling MVD's cash-clearing account critical—MVD's Revenue Accounting Unit has the responsibility for reconciling the cash-clearing account. Routinely performing reconciliations provides an effective mechanism to help ensure that all monies received are deposited and to review account activity. Additionally, the *State of Arizona Accounting Manual* requires all agencies to reconcile their internal records to the State Accounting System (AFIS). To comply with this requirement, MVD must reconcile daily transactions reflected in its cash-clearing account on its TARGATS system to AFIS. MVD uses its TARGATS system to record daily transactions, including monies collected from its 60 field offices. However, reconciling cash balances recorded in AFIS and TARGATS is complex due to the massive volume of transactions MVD processes, including the need for manual transactions, because TARGATS is inadequate for current processing needs.

Reconciling cash account has been a long-standing problem—Multiple internal and external audit reports have identified the lack of current and accurate reconciliations as a long-standing problem. For example, in a June 1997 internal audit report, ADOT auditors concluded that periodic reconciliations, a key control to ensuring the clearing account's accuracy, were not required by MVD policies or performed. Additionally, in the Arizona Department of Transportation's (ADOT) fiscal year 2002 management letter, ADOT's external auditors indicated that as of June 30, 2002, MVD was 17 months behind schedule in reconciling the cash balance between its TARGATS system and AFIS.

Multiple audits have identified inaccurate and untimely reconciliations as a long-standing problem.

In addition, various audit reports identified a significant cash difference between MVD's cash-clearing account on its TARGATS system and AFIS. In the 1997 internal audit report, ADOT's auditors indicated that an attempted reconciliation of the cash-clearing account to AFIS at December 31, 1995, reflected an unidentified difference of approximately \$10 million. Further, in the fiscal year 2002 management letter, ADOT's external auditors reported that while MVD staff do not know the exact nature of this difference, they believe that MVD may have over-distributed collections to HURF, other state agencies, or cities and counties. However, according to MVD officials, because this cash difference occurred many years ago, MVD does not have any documentation to indicate what may have caused this difference between the two systems.

Steps taken to improve reconciliation timeliness—In response to the recommendations made in the various audit reports, MVD has allocated additional resources to performing reconciliations and improved its reconciliation procedures, while ADOT has accounted for a \$9.5 million unreconcilable difference. Specifically:

- **Added additional resources**—MVD allocated additional resources to help become current with the reconciliation of the cash-clearing account. In the fall of 2002, MVD devoted one full-time person to completing the clearing account reconciliation. With the help of this new staff person and some temporary staff, MVD has made progress in becoming current with the reconciliations. Prior to this time, MVD did not have a specific employee assigned to perform this function, but had assigned it to a staff person who had many other responsibilities.
- **Reviewing and improving reconciliation process**—MVD is reviewing its current reconciliation process and establishing improved procedures. Specifically, in July 2003, MVD staff identified several improvements to the reconciliation process and is in the process of developing reconciliation procedures. Also, according to MVD officials, MVD has implemented computer-based improvements to facilitate data flow and eliminate accidental data modification. Prior to these improvements, the reconciliation process required manual data entry, which increased the likelihood of errors.

In addition to these efforts, MVD has established the following guidelines and goals:

- **Accuracy of reconciliations**—MVD established a short-term guideline to reconcile within +/- \$25,000 for each monthly reconciliation. As illustrated in Table 7, (see page 41), since April 2003, MVD monthly reconciliations have produced monthly differences between AFIS and TARGATS totaling less than \$11,000. These differences are well within MVD's stated goal to reconcile the account to within \$25,000. However, monthly reconciliations still result in differences. Specifically, according to the November 2003 reconciliation, MVD has accumulated a difference of nearly \$788,000 in its cash-clearing account

MVD has improved its reconciliations.

from July 2000 through October 2003. According to an MVD official, after the unit becomes current with the reconciliations, MVD staff will begin to research and resolve these accumulated differences in the cash-clearing account.

- **Defining “current”**—MVD defined current as having the reconciliation prepared 2 months after the end of the month. For example, the March 2004 reconciliation would be considered current if reconciled before the end of May 2004. As of March 2004, MVD was only 3 months behind in its reconciliations. However, MVD has established a long-term goal to reconcile the cash-clearing account 3 weeks after the end of the month.
- **Accounting for cash difference**—According to ADOT officials, in consultation with an Attorney General representative, ADOT has accounted for a \$9.5 million unreconcilable difference between TARGATS and AFIS. In July 2003, ADOT management recorded a \$9.5 million accounting entry to resolve that part of the reconciling difference in the cash balance between AFIS and TARGATS.

Table 7: Cash Balance Unreconciled Differences Between the MVD System and the State’s General Fund Ledger September 2002 through November 2003

Month	Unreconciled Difference
September 2002	\$(325,766)
October	297,342
November	(79,705)
December	(6,670)
January 2003	217,677
February	(6,260)
March	53,489
April	(4,006)
May	(7,393)
June	2,334
July	10,524
August	(5,604)
September	(3,081)
October	6,387
November	(26)

Source: Auditor General staff analysis of the Arizona Department of Transportation Motor Vehicle Division cash-clearing account reconciliation as of November 2003.

AGENCY RESPONSE



Arizona Department of Transportation
Office of the Director

208 South Seventeenth Avenue Phoenix, Arizona 85007-3213

Janet Napolitano
Governor

Victor M. Mendez
Director

September 20, 2004

Debra Brisk
Deputy Director

Debbie Davenport
Auditor General
2910 North 44th Street
Phoenix, Arizona 85008

Dear Ms. Davenport:

The Arizona Department of Transportation extends its thanks to you and your staff for the professionalism displayed during the performance audit and Sunset review of the Arizona Department of Transportation, Motor Vehicle Division.

In response to the audit, the Department plans to implement the recommendations as follows:

Finding #1 Vehicle Registration Compliance Program

1. **Auditor General Recommendation:** MVD should develop an additional software application to send delinquency letters to Arizona residents who do not renew their vehicle registrations.

Motor Vehicle Division Response: The finding of the Auditor General is agreed to, and the recommendation will be implemented.

The program was originally established to focus on new Arizona residents not complying with state registration laws. One of the tools we have provided to the public over the years is a 1-800 line that can be used to report possible non-compliance. Many of the leads we receive are related to automobiles with out-of-state plates driven by Arizona residents. The program, as originally designed, has proven successful; we agree that expanding the target population at this time would be beneficial.

2. **Auditor General Recommendation:** MVD should ensure that revenues from its vehicle registration enforcement efforts are correctly reported by addressing the programming errors that allow revenues to be erroneously attributed to cases.

Motor Vehicle Division Response: The finding of the Auditor General is agreed to, and the recommendation will be implemented.



By continuous monitoring of measures associated with the Registration Compliance Program, MVD has discovered the need for, and implemented, changes to the automated tracking system over time. The findings presented by the Auditor General will also be implemented.

3. **Auditor General Recommendation:** MVD management should either modify its Registration Compliance System to track the enforcement activity for each case or periodically conduct valid studies of registration enforcement cases so that management can determine the cost-effectiveness of the various case types and enforcement methods and direct officer activities to those cases and methods.

Motor Vehicle Division Response: The finding of the Auditor General is agreed to, and the recommendation will be implemented.

4. **Auditor General Recommendation:** MVD should discontinue using the indirect revenue measure as part of its calculation of the return on investment of its vehicle registration enforcement program and as a basis for remitting a portion of this revenue to the General Fund.

Motor Vehicle Division Response: The finding of the Auditor General is agreed to, and the recommendation will be implemented.

Finding #2 MVD should improve fuel tax refunds processing

1. **Auditor General Recommendation:** MVD should update its current procedures and implement additional, written procedures that document the steps and requirements for processing, validating, reviewing, and issuing fuel tax refund claims.

Motor Vehicle Division Response: The finding of the Auditor General is agreed to, and the recommendation will be implemented.

The Division is already working on evaluating current policies and procedures as well as related system issues. We expect this implementation will be lengthy due to various issues including reprogramming enhancements for TARGATS and filling critical positions.

2. **Auditor General Recommendation:** Once it has updated its procedures and implemented additional procedures, MVD should ensure that all staff involved in the processing and review of fuel tax refund claims are trained on the procedures.

Motor Vehicle Division Response: The finding of the Auditor General is agreed to, and the recommendation will be implemented.

The Motor Vehicle Division has already started work on this recommendation, and is currently conducting some training.

3. **Auditor General Recommendation:** To help ensure appropriate oversight and monitoring of the refunds process, MVD should establish and implement procedures requiring:
 - a. Two levels of refund approval based on the refund amount;

- b. Supervisory review of the accuracy and validity of all refunds before they are issued and requiring that questionable refund claims be referred to its Tax Evasion Unit for review; and
- c. Independent audits by ADOT's Office of Audit and Analysis of a random sample of refund claims annually based on a systematic audit plan.

Motor Vehicle Division Response: The finding of the Auditor General is agreed to, and the recommendations will be implemented.

4. **Auditor General Recommendation:** MVD should strengthen the requirements that stipulate the documentation taxpayers must maintain to support refund claims and the documentation taxpayers must submit with their refund claims.

Motor Vehicle Division Response: The finding of the Auditor General is agreed to, and the recommendation will be implemented.

The Division has encountered some issues in the past relative to at least one refund type, diesel differential.

5. **Auditor General Recommendation:** MVD should develop more comprehensive forms and instructions for taxpayer claims to assist taxpayers in the filing of claims and help ensure that MVD has all required information to process and verify refund claims.

Motor Vehicle Division Response: The finding of the Auditor General is agreed to, and the recommendation will be implemented.

In the past, forms had more detailed instructions. The Division will go back to providing the detail.

Finding #3 MVD should examine its fees

1. **Auditor General Recommendation:** MVD should continue with its recently initiated process to evaluate its fees. MVD's newly formed working group should use a systematic approach that includes the following steps:
 - a. Identify fees that are not cost-effective to collect or that are no longer needed;
 - b. Evaluate fees that represent a significant amount of revenue or a relatively large number of transactions;
 - c. Perform a fee-by-fee analysis of the selected fees using a structured approach for determining the costs of the services;
 - d. Recommend appropriate fees changes to the Legislature.

Motor Vehicle Division Response: The finding of the Auditor General is agreed to, and the recommendation will be implemented.

The Motor Vehicle Division has formed a working team to study fees. The team has started working on those fees that generate the most revenue. The Division anticipates that the analysis of these selected fees will take some time. At this time, it is unknown when the appropriate level for these fees will be determined so that a recommendation can be made.

The ultimate goal of collecting fees is to cover specific costs. Many existing fees have dollar amounts specified in statute, which means that legislation must be proposed and passed before fee amounts may be raised to address increases in associated costs. Therefore, it may be recommended that statutory fees not indicate a specific dollar amount in the future. The Division will research other ways of dealing with fees, including changing the setting of fees by statute to Administrative Rule; establishing "up-to" caps rather than a specific amount; using language that allows fees to be set that cover specific costs; and adopting an automatic adjustment tied to some type of indicator.

2. **Auditor General Recommendation:** For those fees that the working group analyzes, MVD should collect the necessary cost, revenue, and transaction data and information on the actual cost of services provided and associated fees charged.

Motor Vehicle Division Response: The finding of the Auditor General is agreed to, and the recommendation will be implemented.

That is exactly what the working team on fees plans to do.

Finding #4 MVD should better protect registration renewal fees

1. **Auditor General Recommendation:** MVD should establish and maintain the following processes and procedures to better safeguard registration renewal monies:
 - a. Store registration renewal payments in an adequate physical facility, such as a safe or locking storage cabinet, and limit access to necessary employees;
 - b. Limit mailroom access to necessary employees;
 - c. Immediately endorse all checks and money orders upon receipt by processing registration renewals the same day they are received, or generate a record of money received, such as a receipt, to accompany registration renewal documentation during processing;
 - d. Create and use a daily mailroom log that documents the number of envelopes for each bundle of mail;
 - e. Create and use a batch worksheet that tracks the distribution of mail before and during processing;
 - f. Develop and implement policies and procedures for handling cash and cash-like receipts that incorporate the recommended changes made in this report and define employee responsibilities for each step in the cash-handling process; and

- g. Periodically request a procedural review from ADOT's Office of Audit and Analysis to ensure it establishes and adheres to appropriate cash-handling policies and procedures.

Motor Vehicle Division Response: The finding of the Auditor General is agreed to, and the recommendation will be implemented.

Registration renewals will be stored in a locked cabinet. Locks have already been installed, thereby limiting access to the mailroom. On item "c" the Division opts for the first alternative, which coincides with the program's goal to process registration renewals the day they are received. The Division will pursue the second alternative in item "c", generating a record of money received, if the first alternative cannot be achieved; however, this would require an additional staff person.

Sincerely,

Victor M. Mendez
Director

VMM:cg

Performance Audit Division reports issued within the last 24 months

02-09	Arizona Health Care Cost Containment System—Sunset Factors	03-07	Arizona Board for Charter Schools
02-10	Department of Economic Security—Division of Children, Youth and Families, Child Protective Services	03-08	Arizona Department of Commerce
02-11	Department of Health Services—Health Start Program	03-09	Department of Economic Security—Division of Children, Youth and Families Child Protective Services—Caseloads and Training
02-12	HB2003 Children’s Behavioral Health Services Monies	04-L1	Letter Report—Arizona Board of Medical Examiners
02-13	Department of Health Services—Office of Long Term Care	04-L2	Letter Report—Gila County Transportation Excise Tax
03-L1	Competitive Electric Metering, Meter Reading, and Billing and Collections	04-01	Arizona Tourism and Sports Authority
03-01	Government Information Technology Agency—State-wide Technology Contracting Issues	04-02	Department of Economic Security—Welfare Programs
03-02	Registrar of Contractors	04-03	Behavioral Health Services’ HB2003 Funding for Adults with Serious Mental Illness
03-03	Water Infrastructure Finance Authority	04-04	Department of Emergency and Military Affairs and State Emergency Council
03-04	State Board of Funeral Directors and Embalmers	04-05	Department of Environmental Quality—Water Quality Division
03-05	Department of Economic Security—Child Protective Services—Foster Care Placement Stability and Foster Parent Communication	04-06	Department of Environmental Quality—Waste Programs Division
03-06	Arizona Board of Appraisal	04-07	Department of Environmental Quality—Air Quality Division
		04-08	Department of Environmental Quality—Sunset Factors

Future Performance Audit Division reports

Arizona Department of Transportation, Motor Vehicle Division—Information Security and E-government Services

Arizona Department of Transportation, Motor Vehicle Division—Sunset Factors