



A REPORT
TO THE
ARIZONA LEGISLATURE

Performance Audit Division

Performance Audit and Sunset Review

Arizona Department of Environmental Quality— Vehicle Emissions Inspection Program

Department Has Reduced Some Program Fees, but Can Improve Its Fee-Setting Process, Continue to Improve Contract Monitoring, and Use Results of Effectiveness Study to Make Program Improvements

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Auditor General

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October 1, 2015

Members of the Arizona Legislature

The Honorable Doug Ducey, Governor

Mr. Misael Cabrera, Director
Arizona Department of Environmental Quality

Transmitted herewith is a report of the Auditor General, *A Performance Audit and Sunset Review of the Arizona Department of Environmental Quality—Vehicle Emissions Inspection Program*. This report is in response to an October 3, 2013, resolution of the Joint Legislative Audit Committee and was conducted as part of the sunset review process prescribed in Arizona Revised Statutes §41-2951 et seq. I am also transmitting within 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 Environmental Quality agrees with all of the findings and plans to implement or implement in a different manner all of the recommendations.

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

Sincerely,

Debbie Davenport
Auditor General

Attachment



REPORT HIGHLIGHTS PERFORMANCE AUDIT

Department has reduced some program fees, but can improve its fee-setting process

Our Conclusion

The State of Arizona established the Vehicle Emissions Inspection Program (Program) in 1976 to reduce vehicle emissions and improve air quality, and the Arizona Department of Environmental Quality (Department) is responsible for the Program. The Department assesses program fees to cover the costs of the vehicle emissions testing services it provides to motorists and fleet owners. Although program fees have historically been higher than needed to pay for program costs, the Department reduced some fees in fiscal year 2015 to better align fee revenue with program costs, and it should continue its efforts to establish fees that better reflect program costs. Additionally, the Department should continue with plans to improve program contract monitoring and use the results of its planned effectiveness study to improve the Program's effectiveness and efficiency.

Unless a vehicle falls into an exempted category, all vehicles in the Phoenix and Tucson areas are required to pass a vehicle emissions inspection test prior to being registered with the Arizona Department of Transportation—Motor Vehicle Division. The Department contracts with a vendor to perform the majority of vehicle emissions inspection tests. In fiscal year 2015, the contractor initially tested more than 1.5 million vehicles. Additionally, Arizona law allows fleet owners, such as car dealerships and city governments, to self-test their own vehicles for emissions compliance. The Program issues permits to vehicle fleet locations and licenses inspectors to allow fleet owners to perform a vehicle emissions inspection test on their own vehicles.

Department assesses various program fees—Statute requires the Department to set fees to pay for the full cost of administering the Program and, as such, the Department charges different fees for the different services it provides. Specifically, motorists pay a fee for each vehicle emissions inspection test the contractor performs. Additionally, under certain circumstances, vehicle owners can pay a fee for a certificate of waiver, which allows the vehicle to be registered for one registration cycle without passing emissions testing. Further, fleet owners pay a fee to purchase a certificate of inspection, which a licensed fleet inspector assigns to a vehicle after the vehicle has passed a vehicle emissions inspection test that inspector administered.

Department has reduced some fees, but customers pay inequitable rates for some services—Although program revenues have historically exceeded program costs, in fiscal year 2015, the Department began charging reduced fees for two contractor-performed tests in the Phoenix area, which represent approximately 86 percent of the total tests that the contractor performs in the Phoenix area. According to the Department, the reduction in fees for these two tests was the first in a series of steps it had planned to take to revise program fees. However, the Department's fiscal year 2015 fee revenue of \$30.4 million was still approximately 22 percent more than the Program's total costs. Additionally, some program fees are too low to cover the Department's contractor costs for providing the associated service, while other fees result in customers paying different rates for the same program services.

Department should establish fees to more equitably recover program costs—Consistent with best practices, the Department should continue with its efforts to establish fees that better reflect the costs of program services and ensure that each fee equitably contributes toward the Program's costs. Best practices for government fee setting developed by several government and professional organizations state that user fees should be determined based on the costs of providing a service. Additionally, best practices suggest government agencies should generally limit subsidizing services provided to one group of users with fees charged to another group of users.



2015

Recommendations

To help ensure program fees better reflect program costs, the Department should:

- Ensure its operations are as efficient as possible to help reduce program costs;

- Develop and implement a method for determining and tracking program costs;
- After developing this cost methodology, determine the appropriate fees to charge for each program service and set program fees accordingly; and
- Consider the impact that proposed fee changes may have on affected customers and obtain their input when developing the proposed fees. If proposed fees are significantly higher, the Department might consider increasing fees gradually.

Department should continue to improve program contract monitoring and use results of effectiveness study to make program improvements

In the Sunset Factors section of the report, we also identified the following two areas for program improvement:

Department should continue improving program contract monitoring—Contract monitoring is important to ensure that the vehicle emissions inspection contractor implements the Program as agreed upon in the contract and provides all stipulated services. Additionally, beginning in fiscal year 2015, the contractor was assigned responsibilities that the Program previously performed. Our Office’s 2007 audit (see Report No. 07-12) found that the Department had not verified or monitored contractor compliance with contract provisions or federal requirements. The report recommended that the Department expand its contract monitoring activities.

By the time of this audit, the Program had not completed implementing these recommendations. The Department and Program have since taken steps in fiscal year 2015 to address these previous recommendations and improve contract monitoring. The Department should continue with its plans to identify important monitoring activities, such as monitoring the contractor’s complaint-handling processes, and develop and implement a contract monitoring plan that includes these activities and helps to ensure contractor compliance with contractual and federal requirements.

Department should use results of effectiveness study to improve the Program’s effectiveness and efficiency—The Department is statutorily required to determine the effects of vehicle emissions on air quality, although statute does not specify how frequently the Department should make such a determination. Additionally, the Department has statutory authority to contract for effectiveness studies for the purpose of analyzing the costs and benefits of pollution reduction measures and to evaluate the results of any testing program required by statutes.

Conducting an effectiveness study will likely provide useful information on program operations that the Department could use to improve program effectiveness and efficiency. In July 2015, the Department procured and established a contract with a consultant for an effectiveness study to be completed by December 2015. After the study is completed, the Department should use the study’s results to identify and implement program changes to improve the Program’s effectiveness and efficiency.

Recommendations

The Department should:

- Continue with its plans to identify important program contract monitoring activities, and develop and implement a contract monitoring plan that includes these activities;
- Develop and implement policies and procedures to further detail and formalize how program staff should implement the contract-monitoring plan; and
- Use the results of a planned effectiveness study to identify and implement program changes to improve the Program’s effectiveness and efficiency.

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INTRODUCTION

Scope and Objectives

The Office of the Auditor General (Office) has conducted a performance audit and sunset review of the Arizona Department of Environmental Quality (Department)—Vehicle Emissions Inspection Program (Program) pursuant to an October 3, 2013, 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. This audit addresses the Department's fee-setting practices for the Program and includes responses to the statutory sunset factors.

Program responsible for controlling vehicle-related emissions

Program history

The State of Arizona established the Program in 1976 to reduce vehicle emissions and improve air quality. At that time, the Program was limited to the Phoenix and Tucson areas, where higher vehicle populations reduced air quality, but the Program's boundaries have changed over time.¹ At program inception, the Legislature established vehicle emissions inspection programs in the Phoenix and Tucson areas to test for carbon monoxide and hydrocarbon emissions.²

In 1982, provisions of the Federal Clean Air Act (Act) required the State to continue implementing vehicle emissions inspection programs in the Phoenix and Tucson areas. Specifically, the Phoenix and Tucson areas were not able to meet National Ambient Air Quality Standards established by the U.S. Environmental Protection Agency (EPA) as part of its implementation of the Act, and the EPA classified these areas as out of compliance with the carbon monoxide standard. As a result, the EPA required the State to include the Program in its State Implementation Plan, which described how the State planned to meet pollutant standards established by the EPA (see textbox for more information).

The Clean Air Act and State Implementation Plans

The Act's purpose is to regulate air pollution from stationary and mobile sources. As required by the Act, the EPA has established acceptable levels of pollution in the air for six common pollutants, including carbon monoxide and ozone. The EPA requires states that do not meet these standards to develop and implement a State Implementation Plan, which describes how the state will meet the standards.

Source: Auditor General staff summary of EPA documents.

In 1995, the Legislature modified the Program's requirements in the Phoenix area to test for nitrogen oxides (NO_x), which, according to the EPA and the National Aeronautics and Space Administration, contribute to the creation of

¹ As of July 2015, A.R.S. §49-541 requires emissions testing in Area A, which includes parts of Maricopa, Pinal, and Yavapai Counties, and in Area B, which includes parts of Pima County. This report will refer to Area A as the Phoenix area and Area B as the Tucson area. Other areas in the State are not required to perform testing and, according to the Department, local governments do not elect to require emissions testing.

² According to the EPA Web site, it is important to control carbon monoxide levels in the air, as carbon monoxide can cause harmful health effects by reducing oxygen delivery to the body's organs (like the heart and brain) and tissues.

ozone.¹ In 1998, the EPA classified the Phoenix area as out of compliance with the federal ozone standard. Although the State had been testing for NOx in the Phoenix area since 1995, the EPA's formal classification of the Phoenix area as out of compliance with the ozone standard required the State to continue to include the additional vehicle emissions inspection testing requirements for NOx in the State Implementation Plan for the Phoenix area.

Figure 1 shows the Phoenix and Tucson testing areas' boundaries as of April 2015. No vehicle emissions inspection testing is required outside of the Phoenix and Tucson areas.

**Figure 1: Phoenix and Tucson area testing boundaries
As of April 2015**



Source: Auditor General staff analysis of program boundaries as identified in A.R.S. §49-541(1-2) and information from the Department's Web site.

¹ According to the EPA Web site, NOx can cause airway inflammation and ozone is harmful to the lungs.

Program provisions

The Program operates within the Air Quality Division of the Arizona Department of Environmental Quality (Department) and is overseen by the governor-appointed department director. The Program is responsible for identifying vehicles that emit higher levels of pollution than the acceptable standards established by the EPA. Unless a vehicle falls into an exempted category, all vehicles in the Phoenix and Tucson areas are required to pass a vehicle emissions inspection test prior to being registered with the Arizona Department of Transportation—Motor Vehicle Division. The Department contracts with a vendor to perform the majority of vehicle emissions inspection tests.

Vehicles requiring testing—According to the Program's Web site, unless the vehicle falls into an exempted category, all vehicles model years 1967 and newer and registered in the Phoenix or Tucson areas are required to receive a test annually or biennially. Testing requirements vary depending on a vehicle's age and engine type. For example, on-board diagnostic (OBD) testing is required for vehicle model years 1996 and newer, whereas transient load tests are performed on gasoline vehicles model years 1967 through 1980.¹ Statute exempts some vehicles from testing, including:

- Vehicles manufactured prior to 1967;
- Vehicles that are the current model year and the prior 4 model years (except for alternative fuel vehicles); and
- Golf carts.

Failing vehicles—In accordance with statute, the owner of a vehicle failing an initial vehicle emissions inspection test has several options. First, the owner can have the vehicle repaired and receive one free retest within 60 days of the initial test. A vehicle failing the second time may receive further repairs and be tested again, but the owner may have to pay another testing fee. Additionally, the owner may choose to remove the failed vehicle from operation. Finally, if certain requirements are met, the owner can apply for a once-in-a-vehicle-lifetime certificate of waiver. This waiver allows the vehicle to be registered for one registration cycle without passing emissions testing. The Department may grant a waiver when a failed vehicle meets all of the following requirements:

- The malfunction was diagnosed during testing and the vehicle received a tune-up following the initial failure;
- The vehicle failed the contractor's emissions test at least two times;
- The vehicle does not emit more than two times the applicable emission standard;
- The vehicle does not have a faulty catalytic converter; and

¹ For detailed descriptions of the tests and testing requirements, see Appendix A, pages a-1 through a-2.

- Additional repair costs to reduce emissions levels would exceed the maximum repair cost limits established in department rules.

Testing performed at contractor facilities—The Department has contracted with an independent company to perform the majority of vehicle emissions inspection tests. The Department has contracted with the same vendor since 1991, and, as of June 2015, the contractor operated 18 testing locations—15 locations in the Phoenix area and 3 in the Tucson area. At these testing locations, the contractor tests gasoline and diesel vehicles, and performs several different types of tests. For example, the contractor provides OBD tests, in which the contractor uses equipment to read the vehicle’s on-board computer to assess emissions outputs. Additionally, the contractor performs loaded cruise tests, in which an inspector runs a vehicle on a machine similar to a treadmill at various speeds while measuring tailpipe emissions for hydrocarbons and carbon monoxide. For the vehicles that are required to receive tests, the Program maintains records of vehicles tested by the contractor. The testing statistics for fiscal years 2014 and 2015, according to program data, are listed in Table 1.

Table 1: Total vehicles initially tested by contractor and vehicles that failed by testing location Fiscal years 2014 and 2015

Testing location	Number of vehicles initially tested	Number of vehicles that failed initial test	Percent of vehicles that failed the initial test
Fiscal year 2014			
Phoenix area	1,209,032	145,152	12.0%
Tucson area	319,556	35,551	11.1
Fiscal year 2015			
Phoenix area	1,204,905	86,514	7.2%
Tucson area	313,399	23,704	7.6

Source: Auditor General staff analysis of information compiled by the contractor.

The contractor’s testing locations also include waiver lanes, which are testing lanes used for the purpose of conducting emissions inspection tests for and issuing waivers to vehicle owners that qualify for them if the owner has applied for such a waiver. Although program staff have historically performed these waiver responsibilities, the contractor has assumed the duty of operating waiver lanes and issuing waivers to motorists. Specifically, beginning in fiscal year 2015, the contractor began operating waiver lanes, and has established a waiver lane at three contractor stations—two in the Phoenix area and one in the Tucson area—where motorists can apply for and receive a once-in-a-vehicle-lifetime waiver.

Fleet vehicles may self-test—Arizona law allows fleet owners, such as car dealerships and city governments, to self-test their own vehicles for emissions compliance. The Program issues permits to vehicle fleet locations and licenses inspectors that enable fleet owners to perform a vehicle emissions inspection test on their own vehicles instead of taking each vehicle owned to a contractor testing location. Fleet owners must have at least 25 vehicles and apply for and receive a permit prior to self-testing their vehicles. However, participation in

the fleet program is voluntary for fleet owners. Additionally, all fleet locations that participate in the fleet program are required to have a licensed inspector who meets certain requirements specified in department rule, such as passing a test administered by the Department with a score of 80 percent or higher and being able to demonstrate that he/she can properly administer an emissions test.

Each fleet vehicle that receives and passes a vehicle emissions inspection test should receive a Certificate of Inspection (COI). A permitted fleet location must purchase COIs from the Department in packs of 25 at a cost of \$11.50 per certificate, for a total of \$287.50 per pack. An inspector will assign a COI to a vehicle when the vehicle has passed a vehicle emissions inspection test that inspector administered. For tracking and verification purposes, the inspector is required to complete a program form to report vehicle information, such as the vehicle identification number and the test results. According to department documents, as of July 2015, there were 185 licensed fleet locations in the Phoenix area and 39 in the Tucson area. Additionally, there were approximately 830 licensed fleet inspectors in the State. In fiscal year 2015, nearly 98,000 COIs were purchased from the Program, resulting in revenue of more than \$1.1 million.

Organization and staffing

As of July 2015, the Program had 26 full-time equivalent positions, including 9 vacant positions. Prior to July 2015, the Program comprised five units including a unit to oversee Phoenix operations, a unit to oversee Tucson operations, a unit for administration and business operations, a support and evaluation unit, and a compliance unit to assess contractor compliance with laws and rules. However, according to the Department, because the Program shifted some responsibilities, such as issuing waivers, to the contractor and in an effort to streamline operations, as of August 2015 it is in the process of modifying the Program's organizational structure. Specifically, the Department reported that it is in the process of reorganizing the Program into two units—one in Phoenix and one in Tucson—and program staff in both units will be trained to perform various contract monitoring and fleet program oversight duties, such as conducting scheduled and unscheduled audits and inspections of contractor and fleet inspection stations, reviewing monthly reports submitted by the contractor and fleet permittees, and monitoring the contractor's waiver issuance activities. In addition, according to the Department, the reorganization eliminated or reclassified several supervisory positions, and both units will report to one program manager, who will also supervise two administrative support staff. Program staff estimated the changes will be finalized in October 2015.

Budget

The Program's revenues consist primarily of emissions inspection program fees. Specifically, A.R.S. §49-543 authorizes the department director to set and alter fees to pay for the Program's full costs. In addition, A.R.S. §49-543(F) states that all fees shall be deposited into the Emissions Inspection Fund (Fund). Further, A.R.S. §49-544 states that the Fund is subject to legislative appropriation and that monies in the Fund may be used for (1) enforcement of the provisions related to fleet emissions inspections, exemptions, and certificates of waiver; (2) payment of contractual charges to independent contractors; (3) costs to the State of administering the emissions inspection services

performed by the independent contractor, including inspection station auditing, contractor training and certification, and motorist assistance; (4) funding the State's portion of the catalytic converter program costs; and (5) other costs of administering and enforcing the Program.¹ As shown in Table 2 (see page 7), during fiscal year 2015, the Program's revenues totaled more than \$30 million, a decrease of nearly \$8.4 million from its fiscal year 2014 revenues. The decreased revenue during fiscal year 2015 resulted from the Department reducing some program fees at the beginning of fiscal year 2015 to better align fees with program costs. See Finding 1, pages 10 through 11, for more information on the decrease in the Program's fee revenues.

Consistent with statute, the Legislature appropriates fund monies each year to the Department to pay for program costs. As shown in Table 2, during fiscal year 2015, the Program's expenditures and transfers totaled more than \$33 million, with nearly \$22 million, or 67 percent, going toward professional and outside services, primarily to pay the contractor for conducting emissions inspection tests. Additionally, the Legislature has authorized several appropriations and transfers from the Fund to various other funds and programs. For example, as shown in Table 2, the Legislature transferred \$10 million in fiscal year 2013 and approximately \$191,000 in fiscal year 2014 to the State General Fund. Additionally, the Legislature appropriated approximately \$5 million in fiscal year 2014 and \$6.8 million in fiscal year 2015 to the Automation Projects Fund.² Further, the Legislature authorized the Department to use fund monies for the Department's Safe Drinking Water Program, and the Department spent approximately \$1.7 million in fiscal year 2013 and nearly \$1.4 million in fiscal year 2015 on this program. Finally, according to the Department, it spent approximately \$1.2 million annually in fiscal years 2013 and 2014 and approximately \$1.4 million in fiscal year 2015 to pay for the Department's Travel Reduction Program, which helps to reduce vehicle emissions by requiring employers to assist their employees with the use of alternatives to single-occupant-vehicle commuting.

¹ A.R.S. §49-474.03(E) states that a county with a population of more than 1,200,000 persons shall operate and administer a program to replace catalytic converters on motor vehicles that fail to meet emissions standards because of the catalytic converter system failure if that failure is not the result of tampering.

² These transfers to the Automation Projects Fund were for the MyDEQ project. MyDEQ is an online customer service portal, and although still under construction, it is intended to allow the Department's regulated entities to conduct many of their transactions with the Department online, including paying annual fees, applying for or renewing coverage under general permits, and submitting monitoring data.

Table 2: Schedule of revenues, expenditures, and changes in fund balance
Fiscal years 2013 through 2015
(In thousands)
(Unaudited)

	2013	2014	2015
Revenues			
Emissions inspection program fees	\$ 39,807.6	\$ 38,601.6	\$ 30,247.8
Investment earnings	113.6	98.4	105.4
Other	6.0	57.4	6.1
Total revenues	<u>39,927.2</u>	<u>38,757.4</u>	<u>30,359.3</u>
Expenditures and transfers			
Personal services and related benefits	1,809.6	1,833.3	1,350.5
Professional and outside services	22,123.5	22,224.8	21,918.0
Travel	39.8	51.2	51.4
Aid to organizations and individuals	1,217.3	1,220.3	1,405.3
Other operating	174.9	215.9	153.8
Equipment		4.9	11.0
Total program expenditures	<u>25,365.1</u>	<u>25,550.4</u>	<u>24,890.0</u>
Safe Drinking Water Program expenditures ¹	1,724.4		1,367.7
Transfers to the Automation Projects Fund		5,000.0	6,800.0
Transfers to the State General Fund	10,000.0	191.2	
Total expenditures and transfers	<u>37,089.5</u>	<u>30,741.6</u>	<u>33,057.7</u>
Net change in fund balance	2,837.7	8,015.8	(2,698.4)
Fund balance, beginning of year	9,163.0	12,000.7	20,016.5
Fund balance, end of year	<u>\$ 12,000.7</u>	<u>\$ 20,016.5</u>	<u>\$ 17,318.1</u>

¹ Laws 2012, Ch. 303, §9 authorized the Department to use up to \$1.8 million in fiscal year 2013 from the Emissions Inspection Fund for the Department's Safe Drinking Water Program. In addition, Laws 2014, Ch. 13, §11 authorized the Department to use up to \$1.8 million in fiscal year 2015 from the Emissions Inspection Fund for the Department's Safe Drinking Water Program. The expenditures listed are the Department's expenditures from the Emissions Inspection Fund for the Safe Drinking Water program.

Source: Auditor General staff analysis of department-prepared financial information for fiscal years 2013 through 2015.

FINDING 1

The Arizona Department of Environmental Quality (Department)—Vehicle Emissions Inspection Program (Program) has reduced some program fees, but should better align its fee-setting process with best practices. The Department assesses different fees to pay its costs for the various program services it provides to motorists and fleet owners, such as vehicle emissions inspection tests, waivers, and certificates of inspection (COIs). Although program fees have historically been higher than needed to pay for program costs, the Department reduced some fees in fiscal year 2015 to better align fee revenue with the costs of running the Program, and it plans to take additional steps to revise program fees in the future. However, some of the Program's fees are not set high enough to recover the Program's costs of providing the service; and the Program's various fees recover different amounts to pay for some of the Program's costs even though these costs do not vary depending on the service provided. Therefore, consistent with best practices for establishing fees, the Department should continue its efforts to establish fees that better reflect program costs.

Department has reduced some program fees, but can improve its fee-setting process

Department assesses program fees for services it provides to motorists and fleet owners

The Department charges different fees for the different services it provides within the Program. Specifically, Arizona Revised Statutes (A.R.S.) §49-543 requires the Department to set fees to pay for the full cost of administering the Program and, as such, the Department charges fees for the following services:

- **Vehicle emissions inspection tests**—As stated in the Introduction (see page 4), the Department contracts with an independent company to perform the majority of vehicle emissions inspection tests. The contractor operates 15 testing locations in the Phoenix area and 3 testing locations in the Tucson area.¹ Motorists pay a fee for each vehicle emissions inspection test the contractor performs. In the Phoenix area, the fee varies depending on the type of vehicle emissions inspection test performed. For example, in the Phoenix area, motorists pay \$20 for an on-board diagnostic (OBD) test, and \$28 for a heavy-duty diesel test. In the Tucson area, motorists pay \$12.25 for all tests performed (see Appendix A, pages a-1 through a-2, for detailed descriptions of the tests).
- **Waivers**—Motorists pay \$15 for each waiver.² As stated in the Introduction (see pages 3 through 4), vehicle owners can apply for a once-in-a-vehicle-lifetime certificate of waiver, which allows the vehicle to be registered for one registration cycle without passing emissions testing.
- **Exemptions**—Motorists pay \$9.50 for each exemption issued. Motorists can be exempted from vehicle emissions inspection test requirements if the vehicle is out of the State at the time a test is required or if a motorist is an active duty military member stationed outside of the State.³

¹ As of July 2015, A.R.S. §49-541 requires emissions testing in Area A, which includes parts of Maricopa, Pinal, and Yavapai Counties, and in Area B, which includes parts of Pima County. This report will refer to Area A as the Phoenix area and Area B as the Tucson area. Other areas in the State are not required to perform testing and, according to the Department, local governments do not elect to require emissions testing

² If a motorist seeks a waiver following a paid test, the waiver fee will take the place of a free retest and no additional test fee will be charged to the motorist. However, if a motorist requests a waiver after receiving a free retest, the contractor will charge the motorist the normal test fee, as well as the waiver fee.

³ Other vehicles may be exempted from vehicle emissions inspection testing requirements and would not be required to pay a \$9.50 fee. The vehicles that qualify for exemption with no fee include vehicles of the newest 5 model years, vehicles model years 1966 and older, and golf carts.

- **Certificates of Inspection**—Fleet owners pay \$11.50 for each certificate of inspection (COI), purchased in packs of 25 COIs. As stated in the Introduction (see page 5), an inspector will assign a COI to a vehicle after the vehicle has passed a vehicle emissions inspection test that the inspector administered.

The Program pays the contractor a set fee for each initial vehicle emissions inspection test performed. As a result, the fee collected for each vehicle emissions inspection test covers both the contractor and the Department's costs for conducting and administering vehicle emissions inspection tests. Conversely, the Department retains the full amount of the fee charged for each waiver to pay its costs to administer these services. Specifically, although the contractor issues waivers under the contract, the Department does not pay the contractor a specific amount for each waiver as it does for other tests. Additionally, because program staff provide COIs and issues exemptions, and the contractor does not provide services related to these, the Department retains the entire amount of each fee collected for COIs and exemptions to pay for its costs to administer these services. As previously discussed (see Introduction, page 6), during fiscal year 2015, the Program's revenues totaled more than \$30 million and its expenditures and transfers totaled more than \$33 million.¹

Department has reduced some fees, but customers pay inequitable rates for some services

The Department has reduced some fees, impacting more than a million motorists, to better align fee revenue with the Program's operating costs, but some program fees do not cover the costs of the associated service and other fees result in motorists paying inequitable rates for the same services. Although the Program's revenues have been higher than what is needed to pay for the Program's costs, in fiscal year 2015, the Department reduced some program fees to begin to address this issue. However, a gap between program revenues and costs still exists. Additionally, some program fees may be too low to cover the cost of providing the associated service while other fees result in customers paying different rates for the same program services.

Program revenues have historically exceeded program costs—Program fees have historically been higher than needed to pay for program costs. A.R.S. §49-543 requires the department director to set the Program's fees to pay for the full costs of the Program. Prior to fiscal year 2015, the Department collected substantially more fee revenue than it cost to operate the Program. Specifically, the Office of the Auditor General's 2007 performance audit of the Program (see Report No. 07-12), reported that the contractor planned to lower its Phoenix area fees in 2009, but that the Department had not yet determined whether it would lower the fees it charged to customers. However, the Department did not lower its fees at that time, which resulted in it collecting more fee revenue than needed to cover the Program's costs. For example, in fiscal year 2014, the Program collected approximately \$38.6 million from program fees—51 percent more than the Program's total cost, including required payments to the contractor.

¹ The Program's fiscal year 2015 expenditures included an expenditure approved by the Legislature of nearly \$1.4 million for the Department's Safe Drinking Water Program (see page 6 for more information).

Due to the large year-end fund balances that have accumulated since fiscal year 2009, as mentioned in the Introduction (see page 6), since fiscal year 2013, the Legislature has transferred and appropriated more than \$25 million from the Emissions Inspection Fund (Fund) to various other funds and programs, including the State General Fund (approximately \$10.2 million), the Automation Projects Fund (\$11.8 million), and the Department's Safe Drinking Water Program (approximately \$3.1 million).¹ The transfers to the Automation Projects Fund were to pay for the development of MyDEQ, an online customer service portal the Department is developing. Although MyDEQ is still under construction, it is intended to allow the Department's regulated entities to conduct many of their transactions with the Department online, including paying annual fees, applying for or renewing permit coverage, and submitting monitoring data. Additionally, the Legislature authorized the Department to use monies in the Emissions Inspection Fund to help pay the Department's costs of operating the Safe Drinking Water Program, which, according to the Department, helps to ensure the delivery of safe drinking water to the citizens of Arizona.

Finally, according to the Department, it has used program fee revenues for travel reduction programs in Maricopa, Pima, and Pinal Counties to help reduce vehicle emissions by requiring employers to assist their employees with the use of alternatives to single-occupant-vehicle commuting. Specifically, the Department reported that in fiscal years 2013 through 2015, it has used approximately \$3.8 million in program fee revenue to pay for the Travel Reduction Program.

Department has reduced some program fees, but gap still exists—In fiscal year 2015, the Department took steps to better align program fee revenue with program costs. Specifically, as of July 1, 2014, the Department began charging reduced fees for OBD and transient load tests in the Phoenix area, impacting more than a million motorists or approximately 86 percent of the total tests the contractor performed in the Phoenix area in fiscal year 2015. The Department lowered the fee it charges for these emissions tests from \$27.75 to \$20. All other fees the Department charges remained the same. According to the Department, the reduction in fees for these two emissions tests was the first in a series of steps it had planned to take to revise program fees. Although the Department has narrowed the gap between program revenues and costs, the Department's fiscal year 2015 fee revenue of \$30.4 million was still approximately 22 percent more than the Program's total costs.

According to the Department, it sets program fees higher than program costs primarily to pay for legislative appropriations to the Safe Drinking Water Program and the Automation Projects Fund for the development of MyDEQ. In addition, as explained in the next paragraph, the Department has not set some of its specific program fees at a sufficient level to cover its contractor costs for those specific services. Further, the Department has set other program fees higher than program costs, subsidizing the services for which the fees are not set at a sufficient level. Therefore, because the Department has not appropriately set program fees to cover the costs of providing services, this has led to it collecting more revenue than needed to cover program costs.

Department fees inconsistently cover costs of associated services—Despite these fee reductions, the Department's program fees inequitably cover the costs of associated services. For example, as shown in Table 3 (see page 12), some of the

¹ Laws 2012, Ch. 303, §9 authorized the Department to use up to \$1.8 million in fiscal year 2013 from the Fund for the Department's Safe Drinking Water Program. In addition, Laws 2014, Ch. 13, §11 authorized the Department to use up to \$1.8 million in fiscal year 2015 from the Fund for the Department's Safe Drinking Water Program. The Department's expenditures from the Fund for the Safe Drinking Water Program during these years were approximately \$3.1 million.

Table 3: Service fees customers pay in the Phoenix and Tucson areas and the amount the Department pays the contractor to conduct vehicle emissions inspection tests As of July 1, 2014

Vehicle emissions inspection service	Amount customers pay	Amount Department pays the contractor	Surplus (or deficit) available for administrative costs
Phoenix area			
On-board diagnostic	\$20.00	\$13.85	\$ 6.15
Transient load (IM147)	20.00	13.85	6.15
Loaded cruise	19.00	13.85	5.15
Idle inspection	19.00	13.85	5.15
Light-duty diesel	19.00	13.85	5.15
Heavy-duty diesel	28.00	23.50	4.50
Waiver	15.00	N/A ²	15.00
Certificate of inspection (COI)	11.50	N/A ¹	11.50
Exemption	9.50	N/A ¹	9.50
Tucson area			
On-board diagnostic	\$12.25	\$13.85	\$ (1.60)
Loaded cruise	12.25	10.85	1.40
Idle inspection	12.25	10.85	1.40
Light-duty diesel	12.25	10.85	1.40
Heavy-duty diesel	12.25	23.50	(11.25)
Waiver	15.00	N/A ²	15.00
Certificate of inspection (COI)	11.50	N/A ¹	11.50
Exemption	9.50	N/A ¹	9.50

¹ Program staff provide COIs and exemptions. Therefore, the Department retains the entire fee for these services.

² Although the contractor issues waivers under the contract, the Department does not pay the contractor a specific amount for each waiver as it does for other tests. Instead, the Department retains the full amount of the fee charged to the customer for each waiver.

Source: Auditor General staff summary of information provided by program staff.

Department's program fees for specific services do not cover its contractor costs for those services. Specifically, although the Department pays its contractor \$23.50 for performing each heavy-duty diesel test in both the Phoenix and Tucson areas, Tucson area customers only pay \$12.25 for a heavy-duty diesel test. Phoenix area customers pay \$28 for this same test. As a result, the Department subsidizes the cost of providing heavy-duty diesel and other emissions tests in the Tucson area with fees charged to other customers. However, for fiscal year 2015, the total amount in contractor costs that was not covered by the associated program fee was less than \$400,000, which represents approximately 1 percent of the Program's total fee revenue and 4 percent of the revenues available for administrative costs.

Additionally, the Department's fees include different amounts to pay for its administrative costs even though the Program's administrative costs do not vary based on the service provided. Specifically, as shown in Table 3, the portion of program fees available to cover the Program's administrative costs varies from fee to fee. For example, the portion of the fee available to cover the Program's administrative costs for heavy-duty diesel tests in the Phoenix area is

\$4.50, whereas the corresponding portion of the OBD test fee in the Phoenix area provides \$6.15 toward administrative costs. Additionally, some program fees do not contribute any revenues toward the Program's administrative costs. However, according to the Department, the Program's administrative costs do not vary by the type of service provided—in other words, the Department's administrative costs for providing a waiver, an exemption, a COI, or any type of vehicle emissions inspection test are generally the same. As a result, depending on the service obtained and the associated fee, some customers pay for a greater portion of the Program's administrative costs than other customers.¹

Department should establish fees to more equitably recover program costs

Consistent with best practices, the Department should continue with its efforts to establish fees that better reflect the costs of program services and ensure that each fee equitably contributes toward the Program's administrative costs. Best practices for government fee setting developed by several government and professional organizations state that user fees should be determined based on the costs of providing a service.² Additionally, best practices suggest government agencies should generally limit subsidizing services provided to one group of users with fees charged to another group of users.^{3,4,5}

Therefore, to help ensure its fees better reflect the associated costs of program services, to avoid some customers paying fees to subsidize the services provided to other customers, and to help ensure administrative costs are more equitably distributed, the Department should take the following steps:

- Ensure its operations are as efficient as possible to reduce program costs;
- Develop and implement a method for determining and tracking program costs, and create policies and procedures for using this method; and
- After developing this cost methodology, determine the appropriate fees to charge for each program service, including ensuring administrative costs are more equitably distributed between motorists, and set program fees accordingly; and

¹ As previously mentioned, the Department has set its fees to recover more revenue than needed to pay for the Program's costs in part to pay for transfers to the Automation Projects Fund and the Department's Safe Drinking Water Program. As a result, these customers also pay a greater portion of these transfer costs.

² Auditors reviewed fee-setting guidelines from the Arizona State Agency Fee Commission, the Government Finance Officers Association, the Mississippi Joint Legislative Committee on Performance Evaluation and Expenditure Review, the U.S. Government Accountability Office, and the U.S. Office of Management and Budget (see Appendix B, page b-2, for specific citations).

³ Best practices suggest that subsidizing services for one group of users may be appropriate when the government wants to influence behavior, or when a certain group's usage provides benefits to the public. For example, an agency might subsidize community mental health services for lower-income individuals by charging higher-income individuals higher rates in an effort to avoid incurring the much higher costs of institutionalization at a later date.

⁴ Arizona State Agency Fee Commission. (2012). *Arizona State Agency Fee Commission report*. Phoenix, AZ.

⁵ Joint Legislative Committee on Performance Evaluation and Expenditure Review. (2002). *State agency fees: FY 2001 collections and potential new fee revenues*. Jackson, MS.

- Consider the effect the proposed fee changes may have on the affected customers and obtain their input when reviewing the fees. If proposed fees are significantly higher, the Department might consider increasing fees gradually.

As previously mentioned, the Department reported that it plans to take additional steps to revise its program fees. Specifically, according to the Department, it plans to take an incremental approach to revising program fees to not only help ensure that it can continue to pay for the costs of the Program, but that it can continue to use program fee revenues to help pay for the Safe Drinking Water Program and the Travel Reduction Program if so required. Additionally, if the EPA adopts a more stringent ozone standard, the Department may be required to expand the Program to other parts of the State, which would require a broader assessment of program costs and fees (see sunset factor 10, page 23 for more information on the proposed change to the ozone standard). However, in taking an incremental approach, the Department should be able to follow the four recommendations outlined above.

Recommendations:

- 1.1 To help ensure program fees better reflect program costs, to avoid some customers paying fees to subsidize the services provided to other customers, and to help ensure administrative costs are more equitably distributed among all customers, consistent with fee-setting models outlined in best practices, the Department should take the following steps:
 - a. Ensure its operations are as efficient as possible to help ensure program costs are as low as possible;
 - b. Develop and implement a method for determining and tracking program costs, and create policies and procedures for using this method;
 - c. After developing this cost methodology, determine the appropriate fees to charge for each program service, including ensuring administrative costs are more equitably distributed between motorists, and set program fees accordingly; and
 - d. Consider the effect that proposed fee changes may have on affected customers and obtain their input when developing the proposed fees. If proposed fees are significantly higher, the Department might consider increasing fees gradually.

SUNSET FACTORS

Sunset factor analysis

In accordance with Arizona Revised Statutes (A.R.S.) §41-2954, the Legislature should consider the following factors in determining whether to continue or terminate the Arizona Department of Environmental Quality (Department)—Vehicle Emissions Inspection Program (Program). Auditors' analysis of the sunset factors found good performance by the Program with regard to many of these factors. However, this analysis includes recommendations for the Department to:

- Continue with its plans to identify important contract monitoring activities, develop and implement a contract monitoring plan, and provide contract monitoring training to its staff (see Sunset Factor 2, pages 17 through 19);
- Use the results of a planned program effectiveness study to improve the effectiveness and efficiency of the Program (see Sunset Factor 2, page 19); and
- Develop and implement formal complaint-handling policies and procedures; monitor the contractor's complaint-handling process; and review complaints to identify and address trends (see Sunset Factor 6, pages 20 through 21).

1. The objective and purpose in establishing the Program and the extent to which the objective and purpose are met by private enterprises in other states.

The Department oversees the Program to test vehicle-related pollution in the State and has contracted with a vendor to administer the majority of the Program. Specifically, the Program's objective and purpose is to test vehicles in the State to (1) ensure that vehicles in the Phoenix and Tucson areas comply with emissions standards and (2) determine the effect of vehicle-related pollution on air quality standards established by the U.S. Environmental Protection Agency (EPA).¹ The Program is also an EPA-required component of the State Implementation Plan, which is required by the EPA and details how the State plans to meet federal air quality standards. The Program operates within the Department's Air Quality Division.

The Department has contracted with a vendor to perform vehicle emissions inspection tests, collect and track vehicle testing data, and issue waivers for qualifying vehicles. Additionally, the Program allows public and private fleets to self-test their vehicles. The contractor performs the vast majority of vehicle tests the Program oversees. The only testing component of the Program that the contractor does not operate is the fleet component, which is operated by the Department and consists of licensing fleet locations and inspectors to perform inspections of fleet vehicles.

Auditors found that other states use private enterprise to some extent to implement their vehicle emissions inspection programs. Specifically, auditors identified seven states with similar air quality issues as Arizona, i.e., states that did not meet the national requirement for ozone.^{2,3} Like Arizona, all seven states have a program that allows fleet owners to self-test their vehicles. Additionally, similar to Arizona, all seven states use private enterprise as part of their vehicle emissions inspection programs. However, the extent to which these other states use private enterprise varies. Based on the information provided by other states, auditors

¹ As of July 2015, A.R.S. §49-541 requires emissions testing in Area A, which includes parts of Maricopa, Pinal, and Yavapai Counties, and in Area B, which includes parts of Pima County. This report will refer to Area A as the Phoenix area and Area B as the Tucson area. Other areas in the State are not required to perform testing and, according to the Department, local governments do not elect to require emissions testing.

² The seven states auditors identified were California, Colorado, Georgia, Louisiana, Missouri, Texas, and Wisconsin. See Appendix B, page b-2, for details on how auditors identified these states.

³ According to the EPA Web site, the Clean Air Act established national ambient air quality standards (NAAQS) for acceptable levels of ground level ozone present in the air. As of July 2015, the NAAQS for ozone is 0.075 parts per million. Additionally, according to the EPA Web site, ozone is harmful to the lungs.

identified three main approaches for using private enterprise to administer a vehicle emissions inspection program:

- **Single contractor**—Consists of using a single contractor to perform all tests, except for tests performed by fleet owners on their vehicles. The states that use this approach include Arizona and Colorado.
- **Licensing individually owned facilities**—Consists of the state licensing or certifying individually owned and operated facilities to perform tests. The states that use this approach include California, Georgia, Louisiana, Missouri, and Texas.
- **Combination**—Consists of a single contractor selecting and overseeing individually owned and operated facilities to perform tests. Wisconsin uses this approach.

2. The extent to which the Program has met its statutory objective and purpose and the efficiency with which it has operated.

The Program has generally met its statutory objective to test vehicles and help ensure vehicles in the Phoenix and Tucson areas comply with emissions standards, but it can make improvements in two areas. Specifically, to meet the Program's statutory objective, the Department has:

- Established a vehicle emissions inspection program in the Phoenix and Tucson areas that meets federal requirements and has contracted with a vendor to operate the Program. The vendor has 18 testing locations—15 locations in the Phoenix area and 3 in the Tucson area. Additionally, the Department has established a program to allow fleet owners with 25 or more vehicles to obtain permits to self-test vehicles;
- Submitted a State Implementation Plan describing vehicle emissions testing elements that satisfies EPA requirements; and
- Implemented performance measures aimed at increasing the Program's effectiveness and efficiency. For example, the Department reported increased program effectiveness and efficiency based on the following performance measure:
 - **50 percent reduction in initial vehicle fail rates**—This measure addresses the number of vehicles that initially fail a vehicle emissions inspection test when first administered. The Department reported that reducing the number of initially failing vehicles helps to reduce the amount of pollutants in the air by addressing polluting vehicles at the testing location instead of having a polluting car continue to operate until the motorist can address the problem. According to the Department, its baseline performance for this measure was an initial failure rate of 13.23 percent for all cars tested in the Phoenix and Tucson areas. The Department's goal was to reduce this initial fail rate by 50 percent over 5 years—in other words, to have 6.62 percent of cars failing initial tests by fiscal year 2017. The Department reported that the Program has made progress toward its goal over the last 2 fiscal years. Specifically, the Department reported that the initial failure rate was 7.48 percent for fiscal year 2015.

According to the Department, the reduction in the initial failures rate partially resulted from implementing a gas cap replacement program in April 2014. Specifically, a vehicle emissions inspection test often includes a functional test of the gas cap to ensure that the gas cap holds pressure and that fumes do not escape from the gas tank. A leaking gas cap would lead to a failed vehicle emissions inspection test. As part of the gas cap replacement program, the contractor provides free gas caps to customers who otherwise would have failed an initial emissions inspection test solely based on a leaking gas cap. Providing the gas cap allows the car to pass the vehicle emissions inspection test. As a result, the Department does not include these vehicles in its initial failure rate and, thus, the rate has decreased.

According to the Department, the gas cap replacement program benefits motorists because they do not have to drive to an automotive store, purchase a gas cap, and then return to a testing station for a retest.¹ The contractor incurs all costs associated with the gas cap replacement program. However, the contractor benefits from providing the gas caps by not having to incur the costs of providing a free retest for cars that would have otherwise failed an initial emissions inspection test solely based on a leaking gas cap. As of June 30, 2015, the Department reported that the contractor had spent approximately \$444,000 on gas caps and gas cap gift cards during the first full year of implementing the gas cap replacement program. Approximately 50,000 motorists have received a gas cap and approximately 3,000 motorists have received a gas cap gift card, allowing motorists who would have otherwise failed the emissions test to pass. The Department reported that the program has reduced the overall initial emissions testing failure rate by approximately 45 percent.

Although the Department has generally met its statutory objective to perform emissions tests on vehicles in the Phoenix and Tucson areas, auditors identified three areas for improvement. One of these areas—the Department’s process for setting program fees—was discussed in Finding 1 (see pages 9 through 14). The second and third areas are presented here:

- **Department should continue with plans to improve program contract monitoring—** Despite the importance of contract monitoring, the Department has not yet implemented prior Office of the Auditor General recommendations to develop and implement a program contract monitoring plan. Contract monitoring is important to ensure that the vehicle emissions inspection contractor implements the Program as agreed upon in the contract and provides all stipulated services. Additionally, beginning in fiscal year 2015, the contractor was assigned responsibilities that the Program previously performed. Specifically, the Program previously operated waiver lanes by ensuring repairs to the vehicle had been made, administering the appropriate vehicle emissions inspection test for the vehicle, ensuring the vehicle did not exceed more than twice the acceptable emissions standard, and assigning waiver certificates to vehicles that failed vehicle emissions inspections tests. In fiscal year 2015, the Department shifted these responsibilities to the contractor.

¹ Additionally, in the event that the contractor does not have a gas cap for a particular vehicle, the contractor provides the motorist with a \$5 gift card for the purchase of a gas cap. However, after purchasing a new gas cap, the vehicle owner must return to the contractor station for a retest.

However, the Office of the Auditor General's 2007 audit (see Report No. 07-12) found that the Department had not verified or monitored contractor compliance with contract provisions or federal requirements. The report recommended that the Department expand its contract monitoring activities by:

- Periodically evaluating contractor quality assurance and quality control procedures;
- Verifying the contractor's compliance with its surveillance schedule and audit plan;
- Reviewing and ensuring that the contractor conducts other internal audits required by the contract, such as audits of management controls, program performance, effectiveness of equipment maintenance, and quality control activities;
- Developing an annual contract monitoring plan to help ensure more effective, efficient, and comprehensive coverage of its monitoring activities; and
- Assessing whether its employees needed additional training in specific contract monitoring activities and provide this training.

As of February 2010, the Department had begun to work on the contract monitoring plan and reported that it would complete the plan within 3 months. Additionally, the Department had begun to implement other contract monitoring recommendations. However, by the time of this audit, the Program had not completed implementing these recommendations. According to program staff, because of staff turnover and management changes, the contract monitoring plan was not completed.

The Department and Program have since taken steps in fiscal year 2015 to address these previous recommendations and improve contract monitoring. Specifically, the Department has assigned program staff to review and summarize the most important goods and services that the contractor is obligated to provide and that require program oversight and monitoring. Additionally, consistent with the Office of the Auditor General's recommendations, after identifying areas requiring oversight and monitoring, the Program reported that it plans to develop a contract monitoring plan including tools that will facilitate oversight, and that these tools will likely consist of contract monitoring checklists.

Therefore, the Department should continue with its plans to identify important monitoring activities, such as monitoring the contractor's complaint-handling processes, and develop and implement a contract monitoring plan that includes these activities and helps to ensure contractor compliance with contractual and federal requirements. The contract monitoring plan should also include corrective action follow-up procedures in the event the contractor has not complied with contractual and/or federal requirements, and sample contract-monitoring documentation, such as checklists. Additionally, the Department should develop and implement policies and procedures to further detail and formalize how program staff should implement the contract monitoring plan. Finally, the Department should develop and provide training based on its contract

monitoring plan, identified monitoring activities, and policies and procedures to help ensure its staff effectively conduct contract oversight and monitoring activities.

- **Department should use results of effectiveness study to improve the Program's effectiveness and efficiency**—According to A.R.S. §49-542(A), the Department is statutorily required to determine the effects of vehicle emissions on air quality, although statute does not specify how frequently the Department should make such a determination. Additionally, according to A.R.S. §49-553(C), the Department has statutory authority to contract for effectiveness studies for the purpose of analyzing the costs and benefits of carbon monoxide reduction measures and to evaluate the results of any testing program required by statutes, including the testing program designed to reduce ozone pollution in the Phoenix area. However, the Department has not conducted an effectiveness study of its vehicle emissions testing program since 2007.

Conducting an effectiveness study likely will provide useful information on program operations that the Department could use to improve program effectiveness and efficiency. For example, Colorado performed an effectiveness study specifically to identify how to reduce emissions testing requirements for motorists (see Sunset Factor 11, page 24, for more information on the Colorado program). As a result of the study, Colorado was able to reduce the scope of its testing program for motorists and continue operating a program that should effectively address pollution issues.

In July 2015, the Department procured and established a contract with a consultant for an effectiveness study to be completed by December 2015. After the study is complete, the Department should use the effectiveness study's results to identify and implement program changes to improve the Program's effectiveness and efficiency.

3. The extent to which the Program serves the entire State rather than specific interests.

The Program operates in the Phoenix and Tucson areas. See Figure 1, page 2, for the Program's geographic boundaries. No testing is performed outside of the Phoenix and Tucson areas.

Although the State is required to have a vehicle emissions inspection program only in specific areas within the State, the Program serves the entire State by helping Arizona comply with federal requirements to have a vehicle emissions inspection program to address vehicle-related air quality issues. Specifically, as previously mentioned (see Introduction, pages 1 through 2), the State was out of compliance for air quality standards for carbon monoxide and ozone, and therefore was required to include an emissions inspection program within its State Implementation Plan, which details how the State intends to achieve national air quality standards. Although the State attained the national air quality standard for carbon monoxide in Tucson in 2000, it is required to continue including a vehicle emissions inspection program in the State Implementation Plan and to continue implementing the Program until it can demonstrate that it could maintain compliance without the Program and receive approval from the EPA to discontinue the Program. Similarly, as of 2012, the Phoenix area does not comply with the national air quality standard for ozone and must continue to include the Phoenix-area vehicle emissions inspection program in the State Implementation Plan and continue implementing

the Program until it can demonstrate compliance and receive approval from the EPA to discontinue the Program.

4. The extent to which rules adopted by the Program are consistent with the legislative mandate.

General Counsel for the Office of the Auditor General has analyzed the Program's rule-making statutes and believes that the Program has established all of the rules required by statute and that established rules are consistent with statute.

5. The extent to which the Program has encouraged input from the public before adopting its rules and the extent to which it has informed the public as to its actions and their expected impact on the public.

Although the Department has not pursued any rulemaking activity specific to the Program since 2008, the Department has encouraged input from the public before adopting its rules and has informed the public as to its actions and their expected impact on the public. Specifically, the Office of the Auditor General's September 2013 sunset factor report of the Department of Environmental Quality (see Report No. 13-10) indicated that the Department reported it regularly solicited input from stakeholders, attempted to work toward a consensus on rule changes before it began the formal rule-making process, and used its e-mail listserv to notify stakeholders of its rule-making activities.

In addition to its proposed rules, the Department is required to inform the public of existing rules and policies. Specifically, A.R.S. §41-1091.01 requires the Department to post on its Web site the full text of each rule and substantive policy statement currently in use or the Web site address and location of the full text of each rule currently in use, and a notice that the substantive policy statement is advisory only. The Program is in compliance with the requirements of A.R.S. §41-1091.01 to publish its rules and substantive policies on its Web site.

6. The extent to which the Program has been able to investigate and resolve complaints that are within its jurisdiction.

Although statute does not require the Department to investigate or resolve program complaints, it has established processes to address program-related complaints but can take steps to improve these processes. Both the contractor and the Department can receive and resolve complaints. Specifically:

- **Contractor's complaint process**—According to the contractor, the majority of the complaints it receives pertain to lost items such as money or other items left behind at an inspection station. Complaints about vehicle damage are the second most common complaint received. The contractor has established a formal complaint-handling policy that involves attempting to resolve the complaint at the inspection station level first before the customer submits a formal complaint to an area manager who is a contractor employee and who may be in charge of several inspection stations. In the event that a customer desires to submit a formal complaint, the contractor provides

a comment form to do so. At this point, the customer can choose to complete the form and submit it at the inspection station or forward the completed form to the Department. In the event that the Department receives one of these completed complaint forms, the Department reported that it will forward these to the contractor and then follow up on the complaint resolution. The contract states that a contractor employee must contact a customer within 72 hours after a formal complaint has been submitted.

- **Department's complaint process**—Although the Department has a formal complaint procedure for complaints involving potential violations of environmental law, statute, or rule, the Department does not have a formal process for handling other types of complaints, including those related to the Program. According to program staff, the majority of program complaints the Department receives are related to difficulties with registering vehicles with the Arizona Department of Transportation—Motor Vehicle Division (MVD), which the Department states is usually due to delayed communication between the contractor's computer system and that of MVD. Other common complaints the Department receives pertain to having to wait too long for an inspection or vehicle damage. However, customers may contact the Department to lodge a complaint regarding the contractor, or any program-related issue. Program staff indicated that the Department receives complaints through its Web site and over the phone. Additionally, program staff reported that they attempt to respond to the complainant within 5 days, and depending on the complaint's severity may enter the complaint into the Department's complaint-tracking database. However, the Department has not established a formal policy or procedures for documenting, processing, or tracking program complaints not related to violations of environmental law, statute, or rule.

Because the Department lacks a formal complaint process for program complaints not related to potential violations of environmental law, statute, or rule, the Department should develop and implement formal complaint-handling policies and procedures to help ensure that program complaints are appropriately handled, tracked, and documented. The Department could model these policies and procedures after its process for complaints involving potential violations of environmental law, statute, or rule. Additionally, as part of its implementation of a contract monitoring plan that includes important contract monitoring activities (see pages 17 through 19 for more information on the Department's planned implementation of a contract monitoring plan), the Department should monitor the contractor's handling of complaints to help ensure it adheres to contract requirements. Finally, the Department should track the types of complaints it receives, and it should review the types of complaints it and the contractor receive to identify potential trends in complaints that may indicate an issue, and take steps to address the identified issue as necessary. For example, if several complaints are received regarding long wait times, this could indicate that the Department should work with the contractor to adhere to the wait time requirements specified in the contract.

7. The extent to which the Attorney General or any other applicable agency of state government has the authority to prosecute actions under the enabling legislation.

According to A.R.S. §49-103(B), the Attorney General is the Department's legal adviser and, as such, may prosecute certain enforcement actions for the Department and thus the Program.

In some situations, the Department and the Attorney General will work together to investigate allegations of criminal violations involving the Program. For example, in 2014, an investigation by the Arizona Attorney General's Office and the Department revealed that an emissions repair facility manager took payments from undercover investigators for emissions repairs. However, instead of performing the necessary vehicle repairs, the emissions repair facility manager installed an electronic override device that would allow the vehicle to falsely pass a vehicle emissions inspection test. Following an investigation, the Attorney General prosecuted the emissions repair facility manager and the manager pleaded guilty to illegally conducting an enterprise based on fraudulently using electronic devices to generate false results during a vehicle emissions inspection test. On March 19, 2015, the emissions repair facility manager was sentenced to 9 months in jail and ordered to pay \$10,000 to the Attorney General's Anti-Racketeering Fund.

8. The extent to which the Program has addressed deficiencies in its enabling statutes that prevent it from fulfilling its statutory mandate.

According to the Department, there are no deficiencies in the Program's enabling statutes that prevent it from fulfilling its statutory mandate. However, some minor changes were made to the Program in 2014 that, according to the Program, were not significant but were necessary to keep pace with the normal evolution of program technology and to more clearly express the requirements of the federal Clean Air Act, such as those involving on-board diagnostic (OBD) systems and testing requirements. For example, Laws 2014, Ch. 89, revised A.R.S. §49-542(F) to require vehicles to take and pass an OBD test if the vehicle is equipped with OBD equipment. Additionally, Laws 2014, Ch. 99, revised A.R.S. §49-542.05, which changed when alternative fuel vehicles are tested.

9. The extent to which changes are necessary in the laws of the Program to adequately comply with the factors listed in the sunset law.

This performance audit did not identify any needed changes to the Program's statutes.

10. The extent to which the termination of the Program would significantly affect the public health, safety, or welfare.

Termination of the Program could negatively impact the State because the EPA requires the Program and could penalize the State if the Program were terminated without the EPA's approval. As discussed in the Introduction (see pages 1 through 2), the Program was originally implemented to address carbon monoxide concerns in both the Phoenix and Tucson areas, and it was later expanded in the Phoenix area to also address ozone pollution. Because the Phoenix area is out of compliance with ozone standards, the State is required by federal law to develop a State Implementation Plan that includes a vehicle emissions testing program and details the State's plans for addressing ozone levels in the Phoenix area. In the event that a state does not comply with the EPA requirements, or in the event that the EPA determines that a state's actions are insufficient, there are a number of actions that could be taken. First, the EPA could prevent the State from receiving monies for highway improvement projects, as long as prohibiting the project did not impact safety. Second, a citizen could bring a lawsuit against the State to force it to comply with

federal law. Finally, if the State chose not to have a vehicle emissions testing program, the EPA would be required to assume responsibility for vehicle emissions testing and develop a federal implementation plan in which the federal government would determine the ways in which compliance with air quality standards would be achieved.

However, the State may have opportunities to modify the Program to reduce testing requirements for motorists. Specifically, as a result of performing a study to determine its vehicle emissions inspection program's effectiveness, Colorado was able to reduce the level of regulation for motorists and continue operating a program that should effectively address pollution issues. Therefore, to determine if the State could modify the Program, the Department should use the results of a planned program effectiveness study that should be completed by December 2015 to determine whether any program revisions can be made (see Sunset Factor 2, page 19, for more details).

In addition, the Department may have an opportunity to phase out part of the Program. Specifically, in 2000, the EPA classified the Tucson area as compliant with the carbon monoxide standard. However, federal regulations require a state to have a maintenance plan for a period of 20 years after it has achieved compliance with the air quality standard for a pollutant. After 20 years, in order to phase out a vehicle emissions inspection program, a state must provide evidence that it can continue to attain the air quality standard without a vehicle emissions inspection program. Since the Department has not conducted an effectiveness study since 2007, it may have difficulty determining whether the Program in the Tucson area is necessary to demonstrate continued compliance for carbon monoxide standards, or if compliance could be maintained without the Program in the Tucson area. Therefore, the Program should review the results of the planned effectiveness study that should be completed by December 2015 to determine if the results provide evidence that the Program can be phased out in Tucson (see Sunset Factor 2, page 19, for further details).

Program staff indicated that obtaining the EPA's permission to alter the state implementation plan is a difficult and lengthy process. For example, according to the Department, the entire process of requesting an exemption for motorcycles took 11 years—from 2002 when the Arizona Legislature passed a bill requiring the Department to request the EPA exempt motorcycles from testing requirements to 2013 when the EPA approved the exemption. Further, the EPA is proposing a more stringent ozone standard that could result in the EPA requiring modification of program requirements in the Tucson area to test for oxides of nitrogen, similar to Phoenix area testing requirements. Specifically, if the EPA sets the new standard at a low enough level, the entire State could be out of compliance for ozone.¹ As a result, the Department would need to continue implementing the Program in Tucson, and may have to consider expanding it to other parts of the State. However, the EPA will not issue the new standard until November 2015.

11. The extent to which the level of the regulation exercised by the Program compares to other states and is appropriate and whether less or more stringent levels of regulation would be appropriate.

This audit found that the level of regulation the Program exercises is similar to comparable states and is generally appropriate. Federal regulations require a vehicle emissions inspection

¹ Vehicle emissions testing would be required in the entire State if the EPA establishes the new ozone standard at 0.065 ozone parts per million, which is a standard the EPA has proposed as of August 2015.

program for different levels of air quality noncompliance. However, even with fairly prescriptive requirements, states have the ability to determine factors such as the types of cars to be inspected, the extent of exemptions, and the types of tests to be administered. For example, auditors identified seven states with similar air quality issues as Arizona and found differences in the extent to which other states allowed new cars to be exempt from testing requirements.¹ The states with the fewest model years exempted were Louisiana and Texas, which exempt only cars 2 model years old or newer from testing. The state with the most model years exempted is Colorado, which exempts cars up to 7 model years old. In comparison, Arizona exempts vehicles that are 5 model years old or newer.

Another main difference auditors found between the states was the types of vehicle emissions inspection tests performed. For example, Louisiana performs only on-board diagnostic (OBD) testing, which is where the inspector connects the vehicle to a machine that reads information from the vehicle computer system to determine the vehicle's emissions output. Colorado, on the other hand, performs OBD testing for vehicles 8 to 11 model years old and performs a tailpipe test for older vehicles, during which the inspector connects an emissions reader to the tailpipe of a vehicle to measure the emission output. In comparison, Arizona performs OBD testing for nondiesel vehicles model year 1996 or newer and varying types of tailpipe tests for vehicles model years 1967 to 1995, including idle inspections, loaded cruise inspections, and transient load inspections (see Appendix A, pages a-1 through a-2, for detailed descriptions of the tests).

Some states, such as Texas and Colorado, have performed effectiveness studies on their vehicle emissions inspection programs and, as previously mentioned, Colorado specifically performed an analysis to determine how it could reduce regulations for motorists. Colorado used the EPA-required modeling software to predict how different regulatory requirements would impact the emissions reductions benefits the state would receive. The result was that Colorado allowed more model years to be exempt from emissions testing requirements while still receiving the same emissions benefits to satisfy EPA requirements. Similarly, the Department may be able to lessen the vehicle emissions testing requirements for vehicles but to determine this, it needs to review the results from its planned effectiveness study and determine if it can revise or potentially lessen requirements while maintaining sufficient emissions reductions to satisfy EPA requirements (see Sunset Factor 2, page 19, for further information).

12. The extent to which the Program has used private contractors in the performance of its duties as compared to other states and how more effective use of private contractors could be accomplished.

The Program accomplishes most of its duties by contracting with a private vendor, as mentioned in Sunset Factor 1 (see pages 15 through 16), and could potentially use private contractors to perform additional program duties. For example, Texas uses a private contractor to perform a fee analysis to determine whether fee revenue from the vehicle emissions inspection program was sufficient to cover its program's costs. Additionally, Texas uses a private contractor to conduct program evaluations of its vehicle emissions

¹ The seven states auditors identified were California, Colorado, Georgia, Louisiana, Missouri, Texas, and Wisconsin. See Appendix B for details on how auditors identified these states.

inspection programs by assessing the emissions reductions the program achieved based on data collected during inspection and repair of vehicles, as required by the EPA. Additionally, Wisconsin uses a private contractor to oversee the independently owned and operated facilities that perform vehicle emissions inspection tests. Specifically, the private contractor in Wisconsin is responsible for selecting which facilities can participate in the vehicle emissions inspection program, licensing the inspectors at the facilities to perform vehicle emissions inspection tests, and auditing the facilities to ensure they adhere to testing requirements.

In July 2015, during this audit, the Department procured and established a contract with a consultant for an effectiveness study to be completed by December 2015. Additionally, although the Department could contract with a private consultant to conduct an analysis of the Department's program fees, similar to Texas, it could also conduct this analysis itself. This audit did not identify any other opportunities for the use of private contractors.

Recommendations:

1. The Department should continue with its plans to identify important program contract monitoring activities, and develop and implement a contract monitoring plan that includes these activities and helps to ensure contractor compliance with contractual and federal requirements. The contract monitoring plan should also include corrective action follow-up procedures in the event the contractor has not complied with contractual and/or federal requirements, and sample contract-monitoring documentation (see Sunset Factor 2, pages 17 through 19).
2. The Department should develop and implement policies and procedures to further detail and formalize how program staff should implement the contract monitoring plan (see Sunset Factor 2, pages 17 through 19).
3. The Department should develop and provide contract monitoring training based on its contract monitoring plan, identified contract monitoring activities, and policies and procedures to help ensure its staff effectively conduct contract oversight and monitoring activities (see Sunset Factor 2, pages 17 through 19).
4. The Department should use the results of a planned effectiveness study to identify and implement program changes to improve the Program's effectiveness and efficiency (see Sunset Factor 2, page 19).
5. The Department should develop and implement a formal complaint-handling process that ensures program complaints are appropriately handled, tracked, and documented (see Sunset Factor 6, pages 20 through 21).
6. The Department should monitor the program contractor's complaint-handling process to help ensure it adheres to contract requirements (see Sunset Factor 6, pages 20 through 21).
7. The Department should track the types of program complaints it receives, and it should review the types of complaints it and the program contractor receive to identify potential trends in

complaints that may indicate an issue, and take steps to address the identified issue as necessary (see Sunset Factor 6, pages 20 through 21).

APPENDIX A

This appendix lists the types of vehicle emissions inspection tests performed as part of the Vehicle Emissions Inspection Program and provides a brief description for each test type.

Vehicle emissions inspection tests

Types of vehicle emissions inspection tests and descriptions:

- **Idle inspection**—Used annually for 1967 to 1980 light-duty gas engines and 1967 to current heavy-duty gas engines in the Phoenix area and 1967 to 1995 light-duty and heavy-duty gas vehicles in the Tucson area. The vehicle is tested at idle. This inspection measures emissions while a vehicle is idled within 100 rpm (revolutions per minute) of the manufacturer's specified idle setting once readings have stabilized, or at the end of 90 seconds.
- **Loaded cruise**—Used annually for 1967 to 1980 light-duty gas engines and 1967 and newer heavy-duty gas engines in the Phoenix area and all 1981 to 1995 gas vehicles in the Tucson area. The vehicle is operated on a dynamometer, an apparatus for measuring mechanical power, at various loads and speeds of approximately 22 to 40 miles per hour (depending on vehicle class) while the tailpipe emissions are measured until the readings for hydrocarbons (HC) and carbon monoxide (CO) have stabilized, or at the end of 90 seconds.
- **On-board diagnostic (OBD)**—Used biennially in the Phoenix area and annually in the Tucson area on 1996 and newer light-duty vehicles only. Engine operating data is accessed by connecting directly to a computer in the vehicle that continuously monitors engine emissions control systems operation. The OBD test can identify problems before they lead to engine damage and emissions system failure.
- **Transient load (IM147)**—An enhanced test used biennially for most 1981 through 1995 gasoline-powered vehicles in the Phoenix area. In this test, the vehicle is driven on rollers, called a dynamometer, at varying speeds to simulate urban driving. The exhaust is continuously measured for 147 seconds and hydrocarbons (HC), carbon monoxide (CO), carbon dioxide (CO₂), and nitrous oxides (NO_x) emissions are shown in grams per mile.
- **Diesel**—Diesel vehicles are tested annually in the Phoenix and Tucson areas for opacity (smoke density). The test uses an opacity meter, which is an instrument that measures the percentage of exhaust opacity. Light-duty diesel vehicles in the Phoenix area and all Tucson-area diesel vehicles are tested under load on a dynamometer. In the Phoenix area, heavy-duty diesel vehicles are tested using a procedure called “snap acceleration” or “snap idle,” which consists of measuring the opacity of three, wide-open throttle, no-load accelerations from idle to maximum

governed engine speed with the transmissions in neutral. The average opacity for the three accelerations cannot exceed the standard for the engine model year.

- **Functional gas cap**—Visual and functional inspection conducted for vehicles both in the Phoenix and Tucson areas in conjunction with other tests and ensures that gas fumes will not escape from the gas tank.

APPENDIX B

Methodology

This appendix provides information on the methods auditors used to meet the audit objectives.

This performance audit was conducted in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

The Auditor General and staff express appreciation to the Arizona Department of Environmental Quality (Department) Director and staff for their cooperation and assistance throughout the audit.

Auditors used various methods to study the issues addressed in this report. These methods included reviewing applicable federal and state laws and rules, department policies and procedures, and other information obtained from department staff and the Department's Web site; gathering information on the Department's goals, performance measures, strategic plan, staff and vacancies, and revenue and expenditures; reviewing the Department's contract with a private vendor to administer vehicle emissions inspection tests for the Vehicle Emissions Inspection Program (Program); interviewing department staff; interviewing officials within the U.S. Environmental Protection Agency (EPA) Region 9 office, which oversees EPA's programs in Arizona, California, Hawaii, and Nevada; and reviewing previous Office of the Auditor General audits of the Program (Report Nos. 88-11 and 07-12).

Additionally, auditors used the following specific methods to meet the audit objectives:

- To assess the appropriateness of the Department's program fees, auditors reconciled the Department's fiscal years 2013 through 2014 cash flow reports for the Emissions Inspection Fund to the fiscal years 2013 through 2014 State of Arizona Annual Financial Reports; compared the Department's fiscal years 2014 through 2015 program revenue to the Program's fiscal years 2014 through 2015 program expenditures; compared the Department's consumer fees for each test to the amount the Department pays the contractor for each test; and compared the Department's fiscal year 2015 testing projections to department data on the actual numbers of tests performed in fiscal year 2013. Additionally, auditors reviewed best practices for fee setting from the Arizona State Agency Fee Commission, the Government Finance Officers Association, the Mississippi Joint Legislative Committee on Performance Evaluation and Expenditure Review, the U.S. Government Accountability Office, and the U.S. Office of Management and Budget.^{1,2,3,4,5}
- To assess the Program's activities in relation to other states, auditors contacted staff at state agencies responsible for overseeing vehicle emissions inspection programs in seven states with similar air quality issues as Arizona and reviewed state agency Web sites and/or state

¹ Arizona State Agency Fee Commission. (2012). *Arizona State Agency Fee Commission report*. Phoenix, AZ.

² Michel, R.G. (2004). *Cost analysis and activity-based costing for government*. Chicago, IL: Government Finance Officers Association.

³ Joint Legislative Committee on Performance Evaluation and Expenditure Review. (2002). *State agency fees: FY 2001 collections and potential new fee revenues*. Jackson, MS.

⁴ U.S. Government Accountability Office. (2008). *Federal user fees: a design guide*. Washington, DC.

⁵ U.S. Office of Management and Budget. (1993) *OMB Circular No. A-25 Revised*. Washington, DC.

statutes and regulations from the seven states.¹ To identify the seven states with similar air quality issues, auditors identified other states that the EPA has classified as out of compliance with the federal ozone standard.

- To assess the extent to which the Program has encouraged input from the public before adopting its rules and the extent to which it has informed the public as to its actions and their expected impact on the public, auditors reviewed the Arizona Administrative Register.
- To obtain information used in the Introduction section of the report, auditors compiled and analyzed unaudited financial information on the Program for fiscal years 2013 through 2015 provided by department staff. In addition, auditors reviewed information from the Program's organizational chart and compiled and analyzed unaudited information on the vehicle emissions inspections tests the contractor performed in fiscal years 2014 through 2015.
- Auditors' work on internal controls included assessing the Department's fee-setting process for program fees, the Program's contract monitoring activities, and the Program's complaint-handling processes. Auditors' conclusions on these internal controls are reported in Finding 1, Sunset Factor 2, and Sunset Factor 6.

¹ Auditors identified other states that the EPA has classified as out of compliance with the federal ozone standard to a similar extent as Arizona. The seven states identified were California, Colorado, Georgia, Louisiana, Missouri, Texas, and Wisconsin.

AGENCY RESPONSE



Douglas A. Ducey
Governor

ARIZONA DEPARTMENT OF ENVIRONMENTAL QUALITY



Misael Cabrera
Director

September 28, 2015

Debra K. Davenport, CPA
Auditor General
Office of the Auditor General
2910 North 44th Street, Suite 410
Phoenix, Arizona 85018

Re: Response to Draft *Performance Audit and Sunset Review of the Arizona Department of Environmental Quality – Vehicle Emissions Inspection Program*

Dear Ms. Davenport,

This document provides the Arizona Department of Environmental Quality's (ADEQ's) draft response to the September 21, 2015 revised preliminary report draft of the *Performance Audit and Sunset Review of the Arizona Department of Environmental Quality – Vehicle Emissions Inspection Program*.

Prior to the Auditor General's review of the Vehicle Emissions Inspections Program, ADEQ had already begun voluntarily reducing the fees charged for the service provided to more than one million motorists in Maricopa County by more than 25 percent. To our knowledge this is the first time in the last ten years that a state agency has reduced its fees and revenues without prompting. We believe that through efforts such as our lean transformation we will continue to provide our service faster, better and cheaper, allowing us to provide increased value for lesser costs. ADEQ is committed to finding additional efficiencies and expects to make additional fee reductions in this program through a thoughtful, step-based approach.

Overall, ADEQ has chosen a path that seeks to balance the needs of the economy, environment and community. We begin by drawing feedback from representatives of each group. By taking an inclusive approach we are able to better identify the manifest values in each group helping us to solve the underlying problems and create victories for each group. A great example of this is the implementation of our gas cap replacement program.

As noted in the report (see page 19), ADEQ worked closely with its contractor, Gordon Darby Arizona Testing, Inc. (Gordon Darby) to develop and implement a plan to replace leaking gas caps at the time that Gordon Darby tested the faulty gas cap. Prior to implementing this plan, a vehicle owner would fail the emissions test, be sent to purchase a new gas cap at an off-campus store, and be encouraged to return to the testing station after the gas cap had been replaced. As long as the vehicle owner returned for a retest within 60 days, the retest would be free to the motorist.

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ADEQ and its partner found that this problem maximized the worst possible outcomes for the environment (air quality), the community (vehicle owner), and the contractor (economy). After the failed emissions test the vehicle owner could operate the vehicle for up to 60 days, all the while leaking extra air pollution into the environment from the faulty gas cap. Upon return the vehicle owner would have to wait in line for the free retest, wasting their valuable time. When the vehicle owner finally received the retest, Gordon Darby was providing a service to the motorist for no fee, incurring extra cost for the rework.

Through careful analysis it was determined that Gordon Darby could stock more than 90 percent of the gas caps at its testing locations. If a vehicle failed the gas cap test, the motorist only needed to provide consent and a new gas cap would be immediately installed on the vehicle. Gordon Darby would then provide the motorist with a passing grade completing the process. This solution saves air pollution emissions into the environment, saves the vehicle owner the extra time spent procuring a gas cap and waiting for a retest, and saves Gordon Darby money as a free retest isn't performed, lowering the cost to do business. As a result, Gordon Darby provides this service to Arizona motorists for no extra charge to the vehicle owner or the State.

In Fiscal Year 2015, the gas cap replacement program was used by more than 50,000 motorists, reducing initial failure rates by 45 percent. We anticipate similar results this fiscal year.

Throughout the audit process we have appreciated the cooperation, diligence and hard work of the Auditor General's staff in completing this performance audit. Their work has been diligent, thoughtful and thorough. The consideration of our feedback and information throughout the process has resulted in an improved report and recommendations that ADEQ has determined it can implement. Already our staff is hard at work developing plans for response and we look forward to providing updates on our activities soon. Our direct responses to the findings are attached to this document.

In the spirit of identifying opportunities for additional efficiency, ADEQ would like to request that the Legislature align the sunset audit of the Vehicle Emissions Inspections Program with the Department's sunset audit. The 2013 sunset audit of ADEQ included a thorough analysis of the entire Department's budget, including the funds associated with the Vehicle Emissions Inspections Program. The 2015 audit of the Vehicle Emissions Inspections Program appears to have covered the same ground. If the two audits can be combined, the state has the opportunity to reduce the amount of duplicate effort and save taxpayer resources that could be used for other purposes, allowing the State to provide more value for less cost.

If you have questions, please contact Eric Massey, ADEQ's Air Quality Division Director, at (602) 771-2288.

Sincerely,

Misael Cabrera
Director

RESPONSE TO FINDINGS

Finding #1: The Department has reduced some program fees, but can improve its fee setting process.

Recommendation #1.1: To help ensure program fees better reflect program costs, to avoid some customers paying fees to subsidize the services provided to other customers, and to help ensure administrative costs are more equitably distributed among all customers, consistent with fee-setting models outlined in best practices, the Department should take the following steps:

- a. Ensure its operations are efficient as possible to help ensure programs costs are as low as possible;

Response: The finding of the Auditor General is agreed to and the audit recommendation will be implemented.

- b. Develop and implement a method for determining and tracking program costs, and create policies and procedures for using this method; and

Response: The finding of the Auditor General is agreed to and the audit recommendation will be implemented.

- c. After developing this cost methodology, determine the appropriate fees to charge for each program service, including ensuring administrative costs are more equitably distributed between motorists, and set program fees accordingly; and

Response: The finding of the Auditor General is agreed to and the audit recommendation will be implemented.

- d. Consider the effect that proposed fee change may have on affected customers and obtain their input when developing the proposed fees. If proposed fees are significantly higher, the Department might consider increasing fees gradually.

Response: The finding of the Auditor General is agreed to and a different method of dealing with the finding will be implemented.

RESPONSE TO GENERAL RECOMMENDATIONS

Recommendation#1: The Department should continue with its plans to identify important program contract monitoring activities and develop and implement a contract monitoring plan that includes these activities and helps to ensure contractor compliance with contractual and federal requirements. The contract monitoring plan should also include corrective action follow-up procedures in the event the contractor has not complied with contractual or federal requirements, and sample contract-monitoring documentation.

Response: The finding of the Auditor General is agreed to and the audit recommendation will be implemented.

Recommendation #2: The Department should develop and implement policies and procedures to further detail and formalize how program staff should implement the contract monitoring plan.

Response: The finding of the Auditor General is agreed to and the audit recommendation will be implemented.

Recommendation #3: The Department should develop and provide contract monitoring training based on its contract monitoring plan, identified contract monitoring activities and policies and procedures to help ensure its staff effectively conduct contract oversight and monitoring activities.

Response: The finding of the Auditor General is agreed to and the audit recommendation will be implemented.

Recommendation #4: The Department should use the results of a planned effectiveness study to identify and implement program changes to improve the Program's effectiveness and efficiency.

Response: The finding of the Auditor General is agreed to and the audit recommendation will be implemented.

Recommendation #5: The Department should develop and implement a formal complaint handling process that ensures program complaints are appropriately handled, tracked, and documented.

Response: The finding of the Auditor General is agreed to and the audit recommendation will be implemented.

Recommendation #6: The Department should monitor the program contractor's complaint handling process to ensure it adheres to contract requirements.

Response: The finding of the Auditor General is agreed to and the audit recommendation will be implemented.

Recommendation #7: The Department should track the type of program complaints it receives, and it should review the types of complaints it and the program contractor receive to identify potential trends in complaints that may indicate an issue, and take steps to address the identified issue as necessary.

Response: The finding of the Auditor General is agreed to and the audit recommendation will be implemented.

Performance Audit Division reports issued within the last 12 months

14-107	Arizona Department of Child Safety—Children Support Services—Emergency and Residential Placements
14-108	Arizona Department of Administration—Arizona State Purchasing Cooperative Program
15-101	Arizona Department of Child Safety—Child Abuse or Neglect Reports, Substantiation Rate, and Office of Child Welfare Investigations
15-102	Arizona Department of Administration—State-wide Procurement
15-103	Arizona Medical Board—Licensing and Registration Processes
15-104	Arizona Department of Transportation—Motor Vehicle Division
15-105	Arizona Department of Revenue—Use of Information Technology
15-CR1	Independent Review—Arizona's Child Safety System and the Arizona Department of Child Safety
15-CR1SUPP	Supplemental Report to the Independent Review—Arizona's Child Safety System and the Arizona Department of Child Safety
15-106	Arizona State Retirement System
15-CR2	Independent Operational Review of the Arizona State Retirement System's Investment Strategies, Alternative Asset Investment Procedures, and Fees Paid to External Investment Managers
15-107	Arizona Sports and Tourism Authority
15-108	Arizona Department of Administration—Personnel Reform Implementation
15-109	Arizona Department of Administration—Sunset Factors
15-110	Arizona Foster Care Review Board
15-111	Public Safety Personnel Retirement System
15-CR3	Independent Operational Review of the Public Safety Personnel Retirement System Investment Strategies, Alternative Asset Investment Procedures, and Fees Paid to External Investment Managers
15-112	Arizona Commerce Authority
15-113	Arizona Department of Transportation—Transportation Revenues
15-114	Arizona Department of Transportation—Sunset Factors
15-115	Arizona Radiation Regulatory Agency, Arizona Radiation Regulatory Hearing Board, and Medical Radiologic Technology Board of Examiners
15-116	Arizona Department of Revenue—Security of Taxpayer Information
15-117	Arizona Department of Revenue—Sunset Factors
15-118	Arizona Department of Child Safety—Child Safety, Removal, and Risk Assessment Practices

Future Performance Audit Division reports

Information Briefs:

- Alternatives to Traditional Defined Benefit Plans
- A Comparison of Arizona's Two State Retirement Systems