

**REPORT
 HIGHLIGHTS**
 PERFORMANCE AUDIT

Subject

In FY 2004, the Motor Vehicle Division (MVD) collected over \$1.56 billion in taxes and fees. Only the Department of Revenue collects more revenues for the State. This audit examined several MVD functions related to its revenue collection role.

Our Conclusion

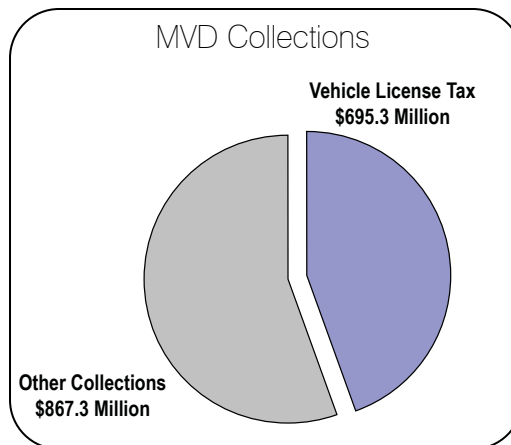
MVD can improve the cost-effectiveness of its vehicle registration compliance program. MVD also needs to improve its fuel tax refund process so that taxpayers receive accurate refunds. MVD collects hundreds of different fees. Its internal working group should follow a structured approach to review the amount and necessity of its fees. MVD also needs stronger cash-handling procedures and safeguards for its Renew-by-Mail Unit.



2004

Cost-Effectiveness of Vehicle Registration Compliance Program Can Be Improved

The vehicle license tax (VLT), which vehicle owners pay with their registrations, is a significant source of revenue for state and local governments. MVD collected \$695.3 million in VLT in FY 2004, which represents approximately 44 percent of its total collections.



Because of the significant amount of tax revenue involved, obtaining taxpayer compliance with the vehicle registration requirements is important. However, a 1984 study, the most recent study auditors could find, concluded that owners of between 4.8 percent and 7 percent of the vehicles in Arizona evade the vehicle license tax.

Beginning in July 2002, the Legislature provided MVD nearly \$1.3 million to increase VLT enforcement. MVD has used this money to:

- Send an automated letter to new residents.
- Publicize vehicle registration requirements.
- Hire peace officers.

Vehicle License Tax
 Fiscal Year 2004

- \$695.3 million—Collections
- \$158—Average tax per vehicle (FY 2003)
- 45 percent—Used for *state* highway construction and maintenance
- 55 percent—Used for *local* government general expenses and highway maintenance

Automated letter is most cost-effective—

MVD developed a software application to automatically send a letter to new residents who applied for a driver's license but did not register a vehicle. Between October 2002 and June 2003, an average of 3,900 people received these letters each month. Nearly one-sixth of them registered a vehicle within 60 days of receiving the letter.

The second most cost-effective method of enforcement was citizen tips. MVD has a hotline citizens can call to report potential vehicle registration evaders. Two MVD administrative assistants receive hotline calls, and in FY 2003, they opened about 2,900 cases. They then send automated letters informing these people of the need to register their vehicles.

The least cost-effective method was MVD peace officers who conducted sweeps of large employers' parking lots or made personal sightings at various locations. In FY 2003, MVD's officers opened about 8,500 cases.

Cost-Effectiveness of Collection Methods Fiscal Year 2003

Automated letter

- Cost—\$13,700
- Estimated revenue—\$797,112
- Dollars collected for each dollar spent = \$58.18

Hotline tips

- Cost—\$63,000
- Estimated revenue—\$187,679
- Dollars collected for each dollar spent = \$2.98

Peace officers

- Cost—\$427,600
- Estimated revenue—\$588,764
- Dollars collected for each dollar spent = \$1.38

MVD should develop an automated letter for expired registrations—

MVD currently does not follow up when an owner does not renew the vehicle registration. In September 2003, owners had not registered over 59,000 out of 258,000 vehicles within 60 days after the registrations expired. After 90 days, more than 50,000 vehicles still had not been registered. Using this rate of nonrenewal as a guide, it would cost MVD about \$19,000 per month to send a single letter to each vehicle owner whose registration was 60 days delinquent. However, if only approximately 120 vehicles were registered because of these letters, the letters would pay for themselves.

Other jurisdictions send letters to persons who do not renew. For example, California's Department of Motor Vehicles discontinued using peace officers many years ago and instead sends a series of letters at 30, 60, and 90 days past the expiration of the vehicle registration.

Revenues from enforcement efforts are lower than reported—

MVD's enforcement

efforts have generated significant revenues. MVD reported revenues of \$1.95 million in FY 2003, consisting of both VLT and fee revenue. However, auditors determined that VLT revenues are overstated by an estimated \$233,000. The overstatement is the result of computer programming errors.

MVD's measurement of indirect revenue is also inaccurate—

When the Legislature appropriated money to expand MVD's enforcement efforts, it directed MVD to measure the return on investment for the enforcement program and remit half of the increased revenues from enforcement efforts to the General Fund. In addition to measuring the revenues resulting directly from the automated letter, hotline tips, and peace officers, MVD adopted a formula to measure "indirect revenues." These are revenues that come from people who decide to register vehicles after seeing or hearing about enforcement actions against others.

However, MVD's indirect revenue formula, which serves as a basis for remitting a portion of this revenue to the General Fund, does not produce valid results. For example, the formula's results indicate that the enforcement program has actually worsened compliance.

Recommendations

MVD should:

- Develop an additional software application to send automated letters to owners not renewing vehicle registrations.
- Address programming errors so that revenues are correctly reported.
- Discontinue using the indirect revenue measure as a basis for remitting a portion of this revenue to the General Fund.

MVD Should Improve Fuel Tax Refunds Process

Arizona taxes fuel as it leaves the terminal or storage facility for distribution to retailers. The tax per gallon of diesel is \$0.26 and the tax per gallon of gasoline is \$0.18. Some suppliers and users are entitled to refunds of the taxes they paid because they used the fuel in tax-exempt

ways. For example, fuel used by vehicles off the highway for farming and construction is tax-exempt. In FY 2003, MVD collected almost \$649 million in fuel taxes and provided over 6,600 refunds totaling over \$23 million.

Some fuel tax refunds are inaccurate—

Over the years, reviews by the Arizona Department of Transportation's (ADOT) Revenue Audit Unit have found errors in fuel tax refunds. For example, as of May 2004, the Revenue Audit Unit audited 16 refunds in FY 2004 and found errors in 7 of them. These errors include over- and underpayments ranging from \$8 to over \$5,800.

The Revenue Audit Unit also established guidelines for reviewing refund claims over \$25,000 and other unusual claims prior to payment, and these reviews identified inaccuracies that could have resulted in hundreds of thousands of dollars in erroneous payments. However, according to an MVD official, these reviews have largely been discontinued because of concerns regarding the timeliness of reviews and the lack of requirements specifying the types of claims that should be referred for review.

Finally, documentation claimants submitted was sometimes inadequate to support the claims and in some cases, is

not required. For example, a gas station requesting the 8 cent per gallon differential when selling diesel fuel to light-class vehicles does not have to provide copies of the sales receipts, even though it is already required to maintain them.

MVD needs a better refund process—

MVD needs to update and implement additional procedures for processing refunds. Some procedures are no longer relevant and some statutes referred to in the procedures have been repealed. In addition, the procedures are missing basic guidance, such as prescribing the documents needed to support a claim, describing how to decide if a claim is valid, or the process for confirming authorized claim signatures.

MVD should also require:

- Additional supervisory approval for large tax refunds. Some states require additional supervisory review for claims over a set amount.
- Audits of high dollar refunds and a random sample of other refunds.
- Taxpayer submission of more stringent documentation to support refund claims.

Recommendations

MVD should:

- Update and implement additional procedures for processing fuel tax refunds.
- Develop and implement procedures for overseeing the fuel tax refund process.
- Require more stringent documentation from taxpayers to support refunds.

MVD Should Examine Its Fees

In FY 2003, MVD reported generating over \$150 million by assessing more than 350 different fees. MVD charges fees for a variety of services that it provides, such as vehicle and title registrations, specialized license plates, and driver's licenses. However, some fees are outdated and so low that they may not cover the cost of the service. For example, vehicle title fees have remained at \$4 for over 30 years. If adjusted for

inflation, this fee should have been \$18.29 in 2003.

In addition, some fees may not cover MVD's costs to perform the service. Again, using title fees as an example, an MVD manager estimated that it takes 20 minutes to process a title application. If so, the \$4 fee may not cover the average salary and benefit costs of the MVD customer service representatives, much

less the overhead or other costs of preparing the title.

Finally, our review found that MVD fees are generally lower than those of other states.

MVD should develop a structured approach to review fees—In January 2004, MVD established an internal working group to begin reviewing its fees. This group should use a systematic

approach to review fees, including collecting basic cost, revenue, and transaction data for the fees it analyzes. It should decide:

- Whether a fee is needed,
- Its purpose,
- Whether it should be increased to recover costs, and
- Whether it requires a change in statute or rule.

Recommendations

MVD should:

- Continue its evaluation of its fees.
- Collect data on the costs of services, the revenue collected, and the number of transactions involved for the fees it analyzes.

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MVD Needs To Better Protect Registration Renewal Fees

Vehicle owners mail MVD over \$15.7 million a month to renew their vehicle registrations. As of February 2004 and based on its reported backlog for processing registration renewals, MVD could have had as much as \$4.76 million in renewal payments at its processing facility on any given day.

However, MVD does not adequately protect these monies. It does not:

- Adequately restrict access to the unendorsed checks and money orders.

- Endorse checks and money orders upon receipt, as required by the state accounting manual.
- Prepare a mail log and track the monies through the process.

MVD can address each of these deficiencies by limiting access to payments, endorsing checks immediately, and tracking payments through the process. Once it has done this, MVD should establish written policies covering payment processing procedures.

Recommendations

MVD should:

- Better safeguard registration renewal monies.