



REPORT OF
THE
STATE AUDITOR

**Highway Users Tax Fund
Revenue Collection and Distribution**

**Performance Audit
June 2004**

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Members of the Legislative Audit Committee:

This report contains the results of a performance audit of the collection and distribution of revenues designated by statutes to the Highway Users Tax Fund. The audit was conducted pursuant to Section 2-3-103, C.R.S., which authorizes the State Auditor to conduct audits of all departments, institutions, and agencies of state government. The report presents our findings, conclusions, and recommendations, and the responses of the Department of Revenue, the Department of Transportation, the Judicial Department, and the Office of the State Treasurer.

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Authority, Purpose, and Scope

This performance audit was conducted under the authority of Section 2-3-103, C.R.S., which authorizes the Office of the State Auditor to conduct performance audits of all departments, institutions, and agencies of state government. The audit focused on the Department of Revenue, the Department of Transportation, the Judicial Department, and the Office of the State Treasurer and their respective roles in the collection and distribution of revenue designated by statutes to the Highway Users Tax Fund. The audit work, performed from December 2003 through April 2004, was conducted in accordance with generally accepted government auditing standards.

We acknowledge the assistance and cooperation extended by management and staff at the Department of Revenue, the Department of Transportation, the Judicial Department, and the Office of the State Treasurer.

Background

The Highway Users Tax Fund (HUTF or the Fund) was created to account for and govern the use of state highway revenue. By statute, all moneys in the Fund are to be used for construction, improvement, repair, maintenance, and safety purposes on the state highway system, the county highway system, the city street systems, and on other public roads and highways of the state. The single largest source of revenue to the Fund is the motor fuel tax. Together with motor vehicle license and registration fees, these two sources represent approximately 94 percent of total HUTF revenue each year. In Fiscal Year 2003 almost \$736 million in revenue was deposited into the Fund.

Several state agencies are statutorily responsible for critical aspects of the collection and distribution of revenue for the Highway Users Tax Fund. The Department of Revenue and the Judicial Department are responsible for collecting revenue. The Departments of Revenue and Transportation are responsible for providing information used in the Fund distribution formula. The actual distribution of the Fund is the responsibility of the Office of the State Treasurer (Treasury) which distributes funds to the Department of Transportation, the counties, and the municipalities on a monthly basis.

Summary of Audit Findings

Fund Revenue

We reviewed the policies and procedures governing the collection of Highway Users Tax Fund revenue. We found:

- **Revenues earmarked for the Fund are not being maximized.** Department of Revenue staff review fewer than 1 percent of all problem tax returns and transactions. Consequently, we estimate that the Department did not collect more than \$1.6 million in revenue which should have been deposited into the HUTF. Timely and accurate reviews of fuel distributor tax returns and transactions is critical not only for generating revenues but also for improving customer service and increasing public confidence in the processes associated with fuel tax payment and collection.
- **Penalties prescribed in statute have not been assessed.** Statutes detail the specific penalty amounts for each type of motor fuel tax filing infraction as well as the mathematical formulas for calculating the exact penalty amounts. However, Department of Revenue staff have miscalculated and failed to assess statutorily-required penalties. For 64 penalty assessments, issued during the period January 2001 through March 2004, we found that approximately \$360,000 in penalties were not assessed by staff.

Fund Distribution

We reviewed the policies and procedures governing the distribution of HUTF dollars to the recipient entities and found:

- **Statutory clarification is needed to ensure all revenues are being distributed as intended.** By statute, fuel tax revenue deposited into the Fund is to be allocated through two distinct streams and the amount of highway funds received by state and local entities differs significantly depending upon how revenues are allocated between the two streams. Statutes require the first 7 cents per gallon of fuel tax of every gallon sold to be allocated to the first distribution stream. The first distribution stream is currently apportioned at 65 percent to the Department of Transportation, 26 percent to Colorado counties, and 9 percent to about 270 municipalities throughout the state. The second distribution stream is comprised of revenue from fuel taxes, in excess of four cents per gallon. That is, the second stream consists of the next 15 cents of the 22 cents per gallon gasoline tax and the next 13.5 cents of the 20.5 cents per gallon special fuels tax. The second distribution stream is apportioned at 60 percent to CDOT, 22 percent to the counties, and 18 percent to the municipalities.

We found that the Treasury allocates fuel tax revenue among the two distribution streams in accordance with statute. However, it is unclear whether the Treasury's treatment of other HUTF revenue sources is consistent with statutory intent. Although statutes clearly define the specific stream into which fuel taxes are to flow, the statutes are unclear as to which stream is to receive other miscellaneous revenues. Currently, the Treasury distributes these unassigned, miscellaneous revenues to the first stream. Statutory clarification would eliminate any perception of bias or inequity in the distribution of the Fund and would ensure that all Fund revenue is distributed in accordance with statutory intent.

- **Motor vehicle registration information used in the HUTF distribution formula is not always accurate.** Motor vehicle registration information is a vital component of the HUTF distribution formula and has a direct impact on the funding distributed to local entities. We found problems with inaccurate information and duplicative data sources, error-prone manual data entry, and a lack of procedures for resolving data discrepancies. The lack of controls over information has affected the accuracy of the distributions. For example, we compared the data actually used for the Fiscal Year 2003 HUTF distribution with the data that should have been used. We found a number of errors including overpayments to one county in the amount of \$11,506 and to one municipality in the amount of \$5,763. For the same period we found one county was underpaid \$3,643 and another received \$48,854 less than it should have.
- **The Department of Transportation lacks adequate internal controls to ensure the information submitted to Treasury for use in the HUTF distribution formula is accurate.** The Department is statutorily responsible for annually submitting information on both the number of lane miles and the number of bridge deck square feet for local jurisdictions. We found that Department staff often change lane mile information submitted by local governments without adequately documenting the reasons for the changes, and the manual processes used to submit bridge deck information have resulted in data errors. Additionally the bridge deck data itself is from a different time period than all other statutorily-required data used in the HUTF distribution formula.
- **Errors in monthly Fund distributions are not always corrected.** Staff from the Office of the State Treasurer exercise discretion in determining whether to correct distribution errors. Additionally, when corrections are made, there are no standards, guidelines, or criteria used to determine the form corrections will take. For Fiscal Years 2001 and 2002 we identified about \$3 million in errors, and while some were corrected, others were not. Specifically, Treasury made corrections for underpayments to the cities of Aurora and Centennial and for an overpayment to Elbert County and a corresponding underpayment to El Paso County. However, the Treasury did not correct another error in the payments to Elbert and El Paso Counties and to Lake and La Plata Counties.

RECOMMENDATION LOCATOR

Rec. No.	Page No.	Recommendation Summary	Agency Addressed	Agency Response	Implementation Date
1	20	Improve review of motor fuel tax returns by evaluating and modifying edit reports and prioritizing staff workload.	Department of Revenue	Agree	July 2004
2	24	Ensure compliance with statutory penalties for fuel taxes by assessing penalties accurately and collecting penalties due.	Department of Revenue	Agree	July 2004
3	25	Determine the most efficient way to maximize interest earned for the Highway Users Tax Fund through timely and frequent transfers of revenues.	Office of the State Treasurer	Agree	Fiscal Year 2005
			Department of Revenue	Agree	Fiscal Year 2005
			Judicial Department	Agree	Fiscal Year 2005
4	30	Determine the intended distribution for miscellaneous revenue from the HUTF and seek statutory change as appropriate.	Office of the State Treasurer	Agree	2005 Legislative Session
5	34	Improve the efficiency and effectiveness of the motor vehicle registration certification process by eliminating duplicative steps, implementing and distributing procedures to verify registration information, and working with the State Treasurer's Office to adopt standard procedures for correcting errors.	Department of Revenue	Agree	January 2005
6	37	Increase the accuracy and accountability of lane mile information by maintaining documentation to support changes.	Department of Transportation	Agree	July 2004

RECOMMENDATION LOCATOR

Rec. No.	Page No.	Recommendation Summary	Agency Addressed	Agency Response	Implementation Date
7	39	Improve the accuracy and reliability of bridge deck information by ensuring information is reviewed prior to submission and providing data for the same time period as other required data submissions.	Department of Transportation	Agree	June 2004
8	43	Ensure the accuracy of HUTF distributions by adopting policies and procedures for correcting errors, working with other Departments when errors occur, documenting ways errors are to be corrected and notifying local governments of errors found.	Office of the State Treasurer	Agree	December 2004

Highway Users Tax Fund

Overview

Background

The Highway Users Tax Fund (the Fund or HUTF) was statutorily created in 1953 to account for state highway revenue. According to Section 43-4-204, C.R.S., all moneys in the HUTF are appropriated for:

The acquisition of rights-of-way for, and the construction, engineering, safety, reconstruction, improvement, repair, maintenance, and administration of, the state highway system, the county highway systems, the city street systems, and other public roads and highways of the state. . .

Since its creation, revenue from motor fuel excise taxes, annual vehicle license and registration fees, and passenger-mile taxes on vehicles have been credited to the Fund. Over time however, additional revenue sources, such as court fines from traffic infractions and specialty license plate fees have been statutorily earmarked for the Fund.

The single largest source of Fund revenue is the motor fuel tax, which is currently set at 22 cents per gallon. The table on the following page shows the Fund's various revenue sources and the dollar amounts of each for Fiscal Years 2002 and 2003. As the table indicates, in both fiscal years, fuel taxes and motor vehicle license and registration fees were the largest revenue sources to the Fund. Together, these two sources represented about 94 percent of total Fund revenues in each year.

Highway Users Tax Fund Revenue		
Fiscal Years 2002 and 2003		
(In Millions)		
Revenue Source	2002	2003
Motor Fuel Excise Tax	\$544.6	\$542.0
Motor Vehicle License and Registration Fees	151.4	151.0
Drivers' License Fees	23.4	21.1
Court Fines and Fees	7.5	7.6
Motor Vehicle Penalty Assessments	5.7	6.7
Miscellaneous Fees ¹	6.6	6.9
Passenger Mile Tax	.6	.6
TOTALS	\$739.8	\$735.9
Source: Office of the State Auditor analysis of COFRS and Office of the State Treasurer data.		
¹ Miscellaneous fees include specialty license plate fees, motorist insurance identification database, and interest earned on the Fund.		

Agencies with HUTF Responsibilities

Several state agencies have statutory responsibility for the revenue collection and distribution processes related to the Highway Users Tax Fund. Specifically, statutes charge the Department of Revenue and Judicial Department with the collection of revenue that is deposited into the Fund. In addition, the Departments of Revenue and Transportation are charged with compiling and providing information for use in the HUTF distribution formula. The Highway Users Tax Fund is statutorily located within the Office of the State Treasurer which has overall responsibility for administering the Fund. The Office of the State Treasurer is responsible for apportioning money from the Fund according to the statutory distribution formula and for obtaining the necessary information from the Departments of Transportation and Revenue for use in the monthly allocations. In the following sections we describe in greater detail the roles of the various state agencies in the HUTF process.

Office of the State Treasurer

The Office of the State Treasurer (Treasury) manages the Highway Users Tax Fund and is responsible for the annual calculations used to determine monthly distributions from the Fund to the recipient entities.

Judicial Department

A portion of various court fines related to highway traffic infractions, such as fines for Driving Under the Influence (DUI), are deposited in the Highway Users Tax Fund, per Section 42-1-217, C.R.S. The State's county courts collect the applicable fines and transfer them to the State Court Administrator's Office (SCAO) located within the Judicial Department. As part of its duties as the central accounting office for the courts, the SCAO is responsible for depositing this revenue into the HUTF.

Department of Revenue

Within the Department of Revenue (Revenue or DOR) two divisions have responsibilities related to the Highway Users Tax Fund. These are the:

Motor Carrier Services Division - operates 10 ports of entry and 10 mobile port units in the State. The Division registers interstate motor carriers and collects the associated registration fees. The Division also collects the passenger mile tax and the fuel taxes from fuel distributors, the latter being the primary source of HUTF revenue. Additionally, the Ports of Entry Program within the Motor Carrier Services Division is funded by the Highway Users Tax Fund.

Motor Vehicle Division - oversees the State's programs for licensing drivers and titling and registering intrastate and other motor vehicles. The Division is also responsible for collecting all taxes and fees assessed on motor vehicles in Colorado. By statute, the Department must annually certify to the Treasury the number of vehicles registered in each county and municipality. The Motor Vehicle Division uses the Colorado State Titling and Registration System (CSTARS) to record this information, and statutes require that this information annually be certified by the clerk and recorder in each county. After the information is certified, the Division sends it to Treasury for input into the HUTF distribution formula.

Department of Transportation

In addition to receiving the largest portion of HUTF revenue each year, the Colorado Department of Transportation (CDOT) annually provides Treasury with data on jurisdictional roadway mileage and statewide bridge deck square footage. These data are statutory components in the HUTF distribution formula for the county and municipality allocations.

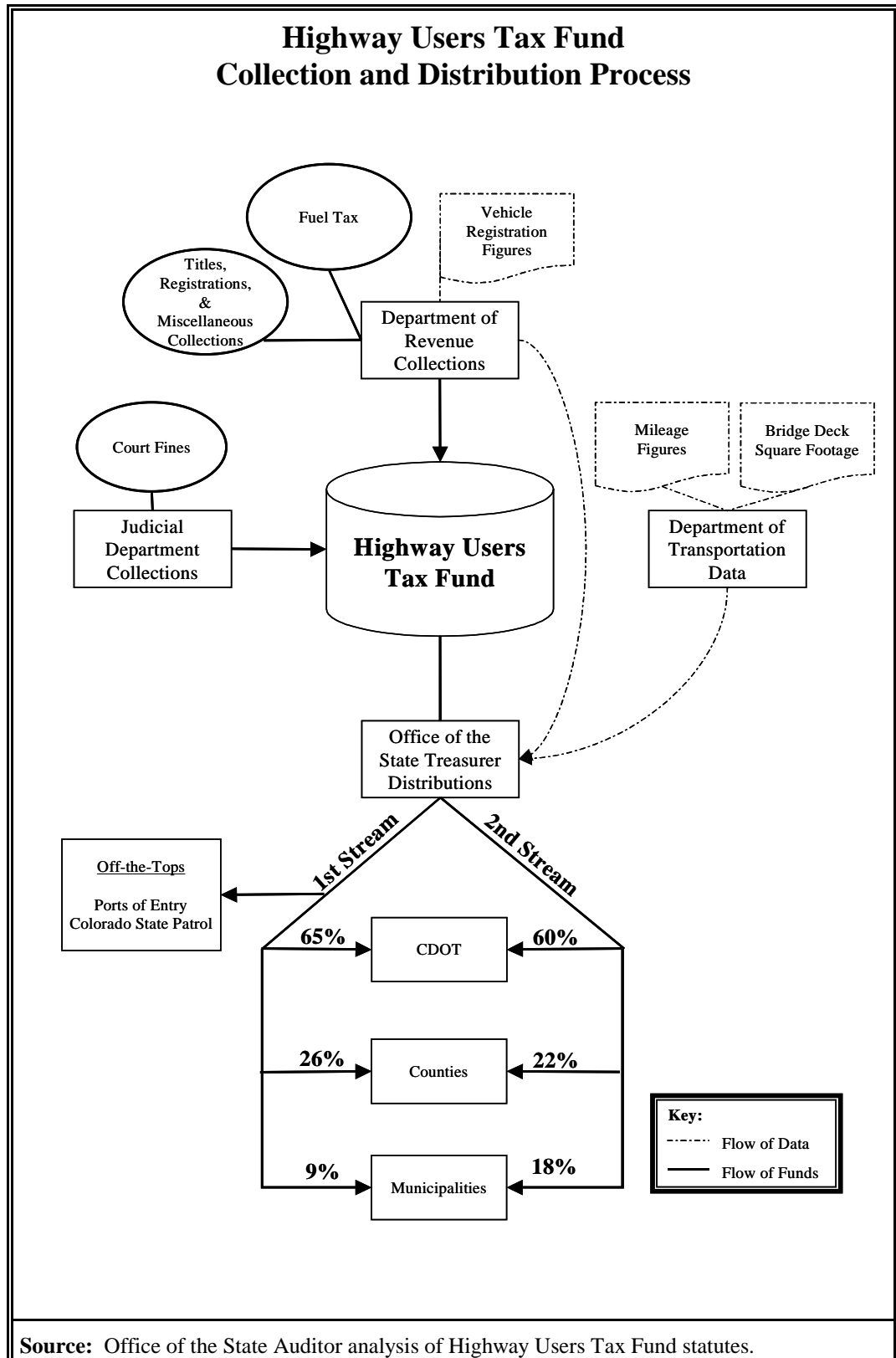
The HUTF Formula

Statutes governing the Highway Users Tax Fund prescribe the revenue collection and distribution process. Revenue flows into the Fund based on statutorily-set timetables and amounts. Moneys flow out of the Fund for distribution to the recipient entities, also based on a formula prescribed in statute. In the following sections, we provide a brief description of the HUTF distribution formula. In subsequent report chapters, we provide details about the revenue and information flowing into the Fund.

As the chart on the next page illustrates, after certain “off the top” allocations, there are two distinct revenue distribution streams within the HUTF:

First Stream. The source of revenue for the first distribution stream is the first 7 cents of the excise tax on motor fuel. The first stream also includes miscellaneous collections from motor vehicles, drivers’ licenses, and court fines. The first distribution is currently apportioned at 65 percent to CDOT, 26 percent to 62 of 64 Colorado counties, and 9 percent to about 270 municipalities throughout the State. (Note: The Cities and Counties of Denver and Broomfield are statutorily classified as municipalities for purposes of the HUTF distribution.)

Second Stream. The second distribution stream is comprised of revenue from fuel taxes in excess of 7 cents per gallon. That is, the second stream consists of the next 15 cents of the 22 cents per gallon gasoline tax and the next 13.5 cents of the 20.5 cent per gallon special fuels tax. The second stream also includes miscellaneous revenue from a portion of drivers’ license fees and motor vehicle registrations. The second distribution stream is apportioned at 60 percent to CDOT, 22 percent to the counties, and 18 percent to the municipalities.



Fund Distributions

Currently, the Departments of Public Safety and Revenue also receive a portion of HUTF revenue. However, as discussed below, the majority of the revenue is distributed to the Department of Transportation, counties, and municipalities within the State. Statutes governing the Highway Users Tax Fund are specific regarding the ways in which the Fund is to be distributed. In the initial distribution established in 1953, after funding was provided to the Colorado State Patrol, 65 percent of the Fund was apportioned the Department of Transportation, 30 percent to the counties, and 5 percent to the municipalities. Over time and through numerous legislative changes, the distribution became more involved, as described in the following sections.

Off-the-Top

The first distributions from the Highway Users Tax Fund are commonly referred to as the “off-the-top” appropriations because they are made before any other appropriations from the HUTF. The General Assembly annually makes the off-the-top appropriations for highway-related functions of state government as required by Section 43-4-201, C.R.S. Historically, the General Assembly made these statutory distributions as needed to various state agencies such as the Office of Transportation Safety, the Department of Labor and Employment for the oil inspection program, and the Department of Corrections for costs related to the production of license plates. Beginning in Fiscal Year 1996, however, the majority of the off-the-top distributions were phased out.

Currently the off-the-top appropriations are limited to the Department of Public Safety for the Colorado State Patrol and to the Department of Revenue for the Ports of Entry Program and the Motor Vehicle Division. By statute, the distributions to these two Departments cannot increase more than 6 percent annually. In Fiscal Year 2003 approximately \$88 million or 12 percent of the total Highway Users Tax Fund was appropriated for off-the-top distributions.

Department of Transportation

The portion of the Highway Users Tax Fund that is distributed to the Department of Transportation—plus interest, other miscellaneous fees, and federal reimbursements—constitutes the State Highway Fund. The State Highway Fund is to be used primarily for the maintenance of the state highway system and for matching available federal highway construction dollars. In Fiscal Year 2003, CDOT received 65 percent or about \$125 million of the first distribution stream and 60 percent or about \$273 million of the second stream. Total HUTF moneys

received by CDOT—about \$398 million—accounted for approximately 45 percent of the total revenue in the State Highway Fund.

Counties

Colorado counties receive 26 percent of the first distribution stream and 22 percent of the second stream. In Fiscal Year 2003 the counties received a total of about \$50 million of the first distribution stream and about \$100 million of the second stream, for a total distribution of about \$150 million. Statutes further divide the counties' share of the Fund into three distribution tiers.

- The first \$69.7 million of the counties' share is allocated in the same percentage as the allocation made in Fiscal Year 1988.
- The next \$17 million (\$69.7 to \$86.7 million) is allocated to 17 counties according to specifications in the HUTF statutes.
- The third tier, or all revenue in excess of \$86.7 million, is allocated on the basis of four factors: rural vehicle registrations - 15 percent; countywide vehicle registrations - 15 percent; square feet of bridge decking - 10 percent, and lane miles, adjusted for terrain type and surface type - 60 percent. The data used to establish this third tier of the county distribution are compiled and submitted to the Treasury by the Departments of Revenue and Transportation.

Municipalities

Municipalities receive 9 percent of the first distribution stream and 18 percent of the second distribution stream. In Fiscal Year 2003, the municipalities received a total of about \$17 million from the first stream and about \$82 million from the second stream, for a total distribution of about \$99 million. Statutes also allocate the local share of the Fund between the municipalities as follows:

- 80 percent on the basis of the number of urban motor vehicle registrations, adjusted to reflect the increased standards and costs of construction resulting from the concentration of vehicles in municipalities. (Note: Factors used to adjust the vehicle registrations are different for the first and second distribution streams. This allows for additional funding to municipalities with a higher concentration of motor vehicles.)
- 20 percent on the basis of the mileage of open, used and maintained streets.

As previously noted, both Denver and Broomfield are statutorily classified as municipalities for purposes of the HUTF distribution.

Distribution Amounts

The following table shows HUTF distribution amounts for Fiscal Years 2001 through 2003 and the portion of the total funds received by each category of recipient.

Total HUTF Distributions						
Fiscal Years 2001 through Fiscal Year 2003						
(In Millions)						
Recipient	2001	Percent of Total	2002	Percent of Total	2003	Percent of Total
Off-the-Top ¹	\$ 74.6	10%	\$ 82.1	11%	\$ 88.0	12%
Department of Transportation	396.3	55%	404.6	55%	398.4	54%
Counties	149.6	21%	152.7	21%	150.2	20%
Municipalities	97.9	14%	100.4	13%	99.3	14%
TOTAL	\$718.4	100%	\$739.8	100%	\$735.9	100%
Source: Office of the State Treasurer.						
¹ Off-the-top distributions include those to the Departments of Public Safety and Revenue, various Long Bill appropriations including capital construction, and other legislative distributions.						

Audit Scope and Methodology

Our performance audit focused on the processes used to collect revenues for the Highway Users Tax Fund, the data used to determine distributions from the Fund, and the processes used to make monthly distributions from the Fund. We interviewed staff, reviewed documentation, and analyzed data from the Judicial Department, the Departments of Revenue and Transportation, and the Office of the State Treasurer. We also contacted various county clerks and local public works departments' staff for information on motor vehicle registrations and lane mile and bridge deck measures. Audit work was conducted from December 2003 through April 2004. We would like to acknowledge the management and staff at each of the state agencies, as well as the local government staff, for their efforts and cooperation during the audit.

Fund Revenue

Chapter 1

Overview

For the Highway Users Tax Fund (HUTF or the Fund) to effectively finance state and local governments' highway construction, maintenance, and repair projects, revenue must be assessed, collected, and deposited in an accurate, complete, and timely fashion. The importance of the timely and accurate collection and deposit of revenue into the Fund is clear from the extensive statutory requirements established by the General Assembly. In this chapter we discuss several issues related to the Fund's revenue inflows. The policies and practices of two state departments—Revenue, which is responsible for collecting about 99 percent of the Fund's moneys, and to a lesser extent, Judicial which accounts for about 1 percent—are evaluated. We make recommendations aimed at enhancing revenue collections in several areas. Most importantly, we found that weaknesses in the Department of Revenue's controls over fuel tax collections and penalty assessments have resulted in significantly fewer dollars being collected for the Fund than should be the case.

Motor Fuel Taxes

As previously noted, over 70 percent of Highway Users Tax Fund revenue derives from excise taxes on motor fuels. Therefore, the need for adequate controls in this area is particularly important. Motor fuel excise taxes are collected at the wholesale level on gasoline and on "special fuels" which include 19 different types of fuel, such as diesel and kerosene. Fuel taxes are imposed on licensed distributors who acquire fuel for storage and subsequent sale. The tax is based on the quantity of gallons sold by the distributor, less a small percentage for shrinkage and collection costs. By statute, the tax shall be paid only once upon the same gasoline and must be paid by the third time the gasoline is sold from one distributor to another. The current tax rate for gasoline is 22 cents per gallon, and the special fuel tax rate is 20.5 cents per gallon. The total taxable gallons and tax receipts for motor fuels in Fiscal Years 2002 and 2003 are shown in the following table.

Department of Revenue Gallons of Fuel and Fuel Tax Revenue Fiscal Years 2002 and 2003			
Fuel Type		2002	2003
Gasoline	Gallons	2,027,227,277	2,017,510,141
	Receipts	\$445,990,001	\$443,852,231
Special Fuels	Gallons	480,801,634	478,497,000
	Receipts	\$98,564,335	\$98,091,885
TOTALS	Gallons	2,508,028,911	2,496,007,141
	Receipts	\$544,554,336	\$541,944,116
Source: Office of the State Auditor analysis of Department of Revenue 2003 Annual Report data.			

Fuel Distributors

By statute, Colorado's licensed fuel distributors are required to file monthly fuel tax returns with the Department of Revenue. Section 39-27-101(7)(a), C.R.S., defines a distributor as:

- C A gasoline or special fuel broker and any person who sells special fuel to another distributor, broker, or vendor, and any vendor of liquified petroleum gases;
- C Any person who acquires gasoline or special fuel from a supplier, importer, blender, or another distributor for the subsequent sale and distribution by tank cars, tank trucks, or both; or
- C Any person who refines, manufactures, produces, compounds, blends, or imports special fuel or gasoline.

The monthly fuel tax returns are to include all of the transactions or fuel sales the distributor made during the previous month. Fuel distributor tax returns and taxes owed are due the 25th day following the end of the reporting month. For example, the return and the tax for July are due by August 25th. Both gasoline and special fuel taxes are reported on the distributor's monthly return. Licensees file one report per person or firm. Electronic filing is required for all filers with an average of 20 or more transactions each month.

The majority of fuel distributors file their tax returns electronically using the Colorado Fuel Tracking System (COFTS or the System), a Web-based system maintained by a private contractor for the Department. Distributors enter information into the System concerning their fuel transactions, and the System then calculates the total amount of tax due and provides distributors with a form to remit to the Department with their tax payments. If problems exist with distributors' tax returns, such as late or amended filings, COFTS generates an error/edit. For example, if a return is filed after the 25th day of the month in which it is due, the System will generate an edit. The System will also generate edits if discrepancies exist within the individual transactions reported on the returns. Problems with transactions can include fuel sales to an unlicensed distributor or taxable fuel transactions incorrectly reported as tax exempt. Staff of the Motor Carrier Services Division within the Department are responsible for reviewing the COFTS edits. In some cases, an edit may indicate the Department needs to take further action such as assessing and collecting additional taxes, penalties, and interest. In other cases, staff will eliminate problems or clarify discrepancies.

Motor Carrier Services Division

The Department of Revenue's Motor Carrier Services Division is responsible for administering the Colorado fuel excise tax program. As part of their duties, Division staff review four fuel tax edit reports generated by COFTS each month. The four edit reports are for late filings, amended returns, exempt sales, and variances. When staff review edit reports and validate problems with tax returns, tax payments, or transactions, they are authorized to issue the taxpayer an assessment or a refund. Assessments can include taxes owed, penalties, and interest, all of which should result in additional revenue to the State for deposit into the HUTF.

Few Problem Tax Returns Are Reviewed

By statute, the Department of Revenue is charged not only with collecting taxes but also with ensuring the correct amount of taxes are assessed and paid. As such, the Department has the statutory authority and responsibility to conduct audits and reviews to determine compliance with tax laws, to assess additional taxes and penalties when taxpayers have not paid a sufficient amount of taxes, and to issue refunds when taxpayers have overpaid. We identified weaknesses in the Division's review of fuel tax returns and transactions that raise concerns about the frequency and completeness of this process. Overall, staff reviewed fewer than 1 percent of all problem tax returns and transactions. We found that the lack of adequate review has resulted in revenue earmarked for the Fund being uncollected. On the basis of our audit, we estimate that the Department did not collect more than \$1.6 million in

revenue for the HUTF in a one year period. It is also likely the Department failed to identify and refund overpayments to taxpayers.

We reviewed Division fuel tax records for the four-month period from November 2002 through February 2003 to determine whether all taxes due were being assessed and collected. Our audit work included a review of COFTS edits generated during this period to determine whether staff use the edits to follow-up on tax returns and transactions that have been identified as problematic. We found that during these four months, approximately 400 fuel distributors filed 1,530 tax returns. These 1,530 tax returns reported information for almost 850,000 individual transactions or fuel sales. From these, COFTS generated approximately 13,600 HUTF-related edits. Of this total number, Division staff could provide evidence of their review in only 127 cases, or less than 1 percent.

The 127 edits reviewed by staff resulted in the issuance of six assessments totaling \$7,832, or an average assessment of \$1,305. Using these data, we calculated the percentage of edits that result in assessments. We also calculated a dollar value associated with the assessments, based on the average assessment amount established in the sample we reviewed. From our calculations, we estimate that more than \$1.6 million in additional fuel tax revenue could have been collected had Division staff reviewed all of the problem tax returns and transactions identified by COFTS during a one-year period. It is important to note that at the same time revenues are due to the State, the State owes some taxpayers refunds. Therefore, although an additional \$1.6 million was due in taxes, the net effect or the additional HUTF moneys available for distribution could have been less. We attempted to determine the total number and dollar amount of taxpayer refunds resulting from the edit reviews. We were unable to arrive at a reliable figure due to data discrepancies at the Department. Specifically, fuel tax refund data provided by Motor Carrier Services Division staff differed from that provided by the staff within the Department's Accounting and Financial Services Section.

Weaknesses Exist

In addition to the lack of regular, comprehensive reviews of fuel tax return data, our conclusion that the Division does not have adequate controls to ensure accurate fuel tax assessment and collections was based on the following:

- C **Data to track review activities and results are lacking.** The Division does not routinely compile, maintain, or review data needed to determine the status of edit reviews and the extent of backlogs. Neither is the Division able to provide easily accessible information on the numbers of edits reviewed and the outcomes of the reviews (including refunds, taxes, penalties, and interest

assessed and collected). The Division also does not keep data on the most frequent or easily addressed edits, edits with the greatest potential for uncollected revenue, or edits indicating taxpayers who have recurring infractions. These types of data are important in order for the Division to monitor its performance and make modifications in its processes or to take other corrective actions.

- C **Supervisory review appears minimal.** Division staff told us they turn over their completed edit reviews to a supervisor for additional scrutiny. Although we found evidence that a supervisor initials the reviews, we question whether the reviews are thorough with regard to accuracy, completeness, or timeliness. We found no evidence that supervisors identify or correct errors or return the edit reviews to staff for additional clarification. Without such review, decisions on the part of individual staff can appear arbitrary or unfounded, thus reducing taxpayer confidence. The lack of review also raises questions about the reliability of the process and leaves the process vulnerable to fraud. In addition, lack of supervisory review can result in individual performance problems and overall workload issues going unaddressed.
- C **Standard procedures for referring cases for audit do not exist.** From time to time, Division staff refer cases to the Department's Field Audit Section for further investigation. Staff told us they make referrals when they believe a problem or concern with a fuel distributor requires investigation beyond their individual authority or the Division's resources. During our audit, we requested information on the number of cases referred for audit and the outcomes of these referrals. Division staff provided us with limited documentation on the number of referrals, the reasons for referrals, the outcomes of the referrals, and whether they conducted any follow-up with Field Audit staff.

Streamline Process and Conduct Reviews

Edit checks are the cornerstone of the Department's ability to ensure the accuracy of the fuel tax returns and, consequently, the fuel taxes collected. However, the current process is unnecessarily labor intensive and time consuming. In addition, the volume of edits is greater than the time available for staff to dispense with them. We estimate that staff take about 15 minutes on average to review an edit. Given the volume of edits—almost 3,400, each month—it would take more than 5 staff working 40 hours per week to complete all of the reviews. Currently, there are 2 to 3 staff trained and available to conduct the reviews, in addition to carrying out other

duties. The Department should examine ways to reduce the number of edits and streamline the process, including:

- C **Evaluating and modifying edits and edit reports.** Department staff worked with the COFTS contractor to set up the edit reports and review process when the System was implemented in January 2001. The Department has not thoroughly evaluated the System since that time. Department staff should evaluate the current edits, taking a risk-based approach, and determine which edit reports and individual edits are more or less likely to result in refunds or additional tax payments and then work with the contractor to modify the current report formats. Department management has indicated that staff do prioritize their reviews based on those edits most likely to generate additional revenue. However, the Department did not provide any documentation such as standard procedures or guidelines or evidence of systematic evaluations prioritizing certain edit reports or types of individual edits.
- C **Evaluating workload.** The Department should evaluate the workload and expertise of the Motor Carrier Services staff and determine the most cost-effective method of allocating staffing resources for this task. Possibly, it would be more efficient to assign one staff full-time responsibility and accountability for reviewing edits, rather than the 2 to 3 staff who currently have part-time responsibility for this activity.

The Division's review of tax return and transaction edits is critical because of the potential for reviews to generate additional revenues for the Fund. However, timely, accurate, and comprehensive review has additional benefits such as timely issuance of refunds to taxpayers who overpay, improvements in customer service by updating information such as address and name changes in a timely fashion, and greater public confidence in the processes associated with fuel tax collections.

Recommendation No. 1:

The Department of Revenue should improve the collection of fuel distributor taxes by streamlining the edit report review process. This should include:

- a. Working with the COFTS contractor to evaluate and modify edits and edit reports, possibly prioritizing potentially revenue-generating edits and reducing other edits that must be reviewed.

- b. Prioritizing staff workload by developing a risk-based approach for reviewing edit reports and/or reviewing a sample of edits each month.
- c. Implementing procedures for supervisory review of the completed edit reports and for referring edits to the Field Audit Section for further investigation, when appropriate, and following up on referrals.

Department of Revenue Response:

Agree. To be implemented July 1, 2004. Upon a thorough review of the audit report, we have determined that very strong steps must be taken to ensure that this problem is not repeated in the future. Therefore, the fuel tax collection function will be transferred back to the Taxpayer Services Division (TPS) of the department, where it resided until a 1996 department reorganization.

The Taxpayer Services Division (TPS) has a number of staff members with strong experience working with the fuel tax programs. Because they are part of a large tax collection system with sound knowledge of Colorado's tax laws and a high degree of experience, TPS is better suited to oversee the fuel tax collection program. TPS will ensure that a risk-based approach is utilized to identify and review edits that could result in additional tax revenue or refunds due to the taxpayer and will ensure the appropriate follow-up of referrals to audit. In addition, TPS will ensure that the process includes appropriate supervisory review at all stages.

Fuel Tax Assessments

When Motor Carrier Services staff review the Colorado Fuel Tracking System edit reports, they may determine that a fuel distributor owes additional fuel tax, interest, and/or penalties. In the case of penalties, statutes outline the specific dollar amount to be applied for each type of infraction and provide the mathematical formulas for calculating the penalty amounts. For example:

- C **Filing/paying late or failure to file/pay.** The penalty for both gasoline and special fuel distributors is 10 percent of the tax due or \$30, whichever is greater, plus a penalty of 0.5 percent per month until paid, not to exceed 18 percent in the aggregate.
- C **Filing an incorrect or fraudulent tax return.** The penalty for gasoline distributors is 30 percent of the additional tax due plus interest from the due date until paid. For special fuels distributors, the penalty for filing an

incorrect or negligent tax return is 25 percent of the additional tax due plus penalty interest of 0.5 percent per month until paid, not to exceed 18 percent in the aggregate.

Staff collect the additional revenue by issuing fuel assessments for the tax, penalty, and/or interest. From January 2001 through March 2004, the Fuel Unit issued 64 HUTF-related assessments to 55 different fuel distributors. These assessments resulted in approximately \$800,000 in additional revenue to the HUTF.

Penalties Not Applied

We reviewed the penalties calculated on the 64 assessments issued from January 2001 through March 2004. Because it is possible to have multiple penalties for different reporting infractions on a single assessment, some of the 64 assessments included multiple penalties. Others had one or none. We determined that 153 penalties were calculated for the 64 assessments. On the basis of our review, we found that staff use discretion in applying penalties, even though no discretion is authorized under statute. Consequently, we estimate that for the period reviewed approximately \$360,000 in penalties were not assessed that should have been. For the 153 penalties calculated on the 64 assessments we reviewed, we found:

- C **Staff erroneously calculated the statutorily-required penalty in 81, or more than one-half, of the 153 penalties.** As a result, we estimate the State did not receive approximately \$120,000 in HUTF revenue owed by fuel distributors during the three-year period in our review. For example, in Calendar Year 2003, staff issued an assessment to a fuel distributor for incorrectly claiming tax exempt special fuel sales on multiple monthly tax returns. Staff caught the reporting errors and calculated the additional taxes and penalties owed for each monthly infraction. However, staff applied the wrong penalty for this violation. Consequently, \$13,000 in penalties was applied when a \$30,000 penalty should have been. Division staff are aware of the statutory penalties; their training manual includes a summary of the applicable statutes. Additionally, we found there was only limited higher level review of penalty assessments, leaving the Department open to challenges of arbitrary or capricious administration of penalties and increasing the risk for fraud.

- C **Staff did not apply the penalties in almost 60 percent of cases.** Staff dismissed penalties totaling about \$240,000. Examples of the penalties which were dismissed included a \$1,100 penalty to one fuel distributor for “filing an incorrect tax return.” Staff indicated on the assessment that the account was in “good standing” and therefore, staff dismissed the penalty.

In another example, a large fuel distributor committed the same filing infraction—filing an incorrect tax return—three times in three consecutive months. Staff identified the infraction each month and calculated the appropriate assessment for additional fuel taxes, interest, and penalties. However, staff dismissed the penalties prior to sending the assessments to the fuel distributor in all three cases. Similarly, a different fuel distributor committed the same filing infraction during the same three months. Staff again identified the infractions and calculated the appropriate assessments. However, the penalty was dismissed on two of the three assessments.

Statutes do not provide staff the discretion to reduce or dismiss penalties related to fuel taxes. According to statutes, only the Executive Director of the Department has the authority to waive penalties. Taxpayers must be notified of assessments and formally protest the assessment in order for a waiver to be considered.

- C **Staff misapply or miscalculate penalties.** For example, in Calendar Year 2003, staff issued a fuel assessment to a taxpayer containing two separate penalties for filing the March 2003 and May 2003 gasoline tax returns late. Statutes detail a penalty amount of 10 percent of the tax owed plus a 0.5 percent penalty for each month, until paid, for all late filing infractions. However, staff did not use the same formula to calculate the total amount due in both instances. In March, staff correctly applied a 10 percent penalty based on the total tax due. However, in May, staff applied a 10 percent penalty based on only a portion of the tax due and, as a result, the May 2003 penalty calculation of \$220 was about \$43,000 less than it should have been. In total, we found that 7 of the 153 penalties (5 percent) were miscalculated.

It is important to note that the revenue losses we identified relate only to the 64 HUTF-associated assessments the Division issued during the period January 2001 through March 2004. If staff had reviewed more edit reports and identified more filing infractions as described in the preceding issue, it is likely more assessments and penalties would have been issued and significantly more revenue would have been collected for deposit into the HUTF.

Collection of fuel taxes is important to the State because these moneys fund the construction and repair of roads and highways. Statutes provide extensive detail on fuel taxes and on penalties for failure to pay or failure to pay in full. The Department is responsible for applying these statutes and for minimizing the risk of errors, irregularities, and fraud. The Department should take steps to ensure that penalties are assessed as specified in statute or take steps to request statutory change, if appropriate. Furthermore, the Department should remedy the past erroneous assessments we identified in this report by collecting the taxes due the State.

Recommendation No. 2:

The Department of Revenue should ensure compliance with statutory penalties for fuel taxes by assessing penalties accurately based on the type of infraction and collecting the penalties due.

Department of Revenue Response:

Agree. To be implemented July 1, 2004. The Taxpayer Services Division (TPS) will immediately ensure that all penalties are assessed in accordance with the provisions of Statute. In addition, TPS will review the details of penalty assessment errors identified by the state auditors, and recalculate and assess penalties where appropriate.

Transfer of Fees and Fines

The Judicial Department, counties and the Department of Revenue collect fines and fees that are deposited into the HUTF. Statutes vary between these entities regarding the time frame in which revenues are to be transmitted and deposited into the Fund. Section 42-2-217, C.R.S., requires that revenue collected by the Judicial Department be transmitted to the Treasury within 10 days after receipt by the courts. By contrast, Section 42-1-214, C.R.S., requires that dollars collected at the county level be transmitted to the Department of Revenue on a monthly basis, and Section 43-4-203, C.R.S., states that revenues collected from motor fuel taxes, annual registration fees and passenger mile taxes be deposited into the Fund as soon as received. The Department of Revenue is the agency ultimately responsible for the collection of these taxes and fees. The different time frames specified in statutes for collection and subsequent deposit of fees and taxes into the HUTF raise questions about the benefits to the State in terms of interest income that could be derived from more timely deposits.

In reviewing the Judicial Department's compliance with statutory timeframes, we found that the transfer of funds does not occur within the prescribed 10-day time frame. Colorado's courts do not operate directly on the State's central accounting system. Rather, court fines are accounted for on a statewide case management system known as the Integrated Colorado On-line Network (ICON). As the central administrative body for the Judicial Department, the Office of the State Court Administrator (SCAO) is responsible for the collection of fines from each of the individual courts for subsequent input into the State's accounting system. On a

monthly basis, the courts transfer the funds they have collected to the SCAO. The State Court Administrator's Office then deposits the revenue into the various state funds, including the Highway Users Tax Fund.

As previously mentioned, counties are statutorily required to transfer revenue to the Department on a monthly basis. According to Department staff, counties transfer HUTF revenues at various times throughout the month, with larger counties transferring funds as frequently as daily. Once these revenues are transferred to the Department, staff report that all motor vehicle registrations and other fees are deposited into the HUTF on a daily basis.

Although statutes differ regarding revenue deposit time frames, we believe the State should maximize the interest accrued on the Fund by ensuring revenues collected are deposited into HUTF as frequently as possible. We believe the Treasury should work with the Judicial Department and the Department of Revenue to determine whether funds collected by these agencies are being transferred as frequently as possible. If statutory change is needed, the Treasury should make recommendations as appropriate.

Recommendation No. 3:

The Office of the State Treasurer should work with both the Judicial Department and Department of Revenue to determine the most efficient way to maximize interest earned for the Highway Users Tax Fund through timely and frequent transfers of revenues collected at the local level.

Office of the State Treasurer Response:

Agree. To be implemented Fiscal Year 2005. The Treasury will initiate meetings with both the Department of Revenue and with the Judicial Department to identify means to speed up the deposit of HUTF revenues so as to maximize interest earnings. Meetings will be scheduled in the first quarter of Fiscal Year 2005.

Department of Revenue Response:

Agree. To be implemented immediately. The Department will work with the Treasury to increase HUTF interest earnings through efficient transfers of monies collected by the Department.

Judicial Department Response:

Agree. Implementation date as determined by the Office of the State Treasurer. The Judicial Department will work with the Office of the State Treasurer to determine the most efficient way to maximize interest earned for the Highway Users Tax Fund.

Fund Distribution

Chapter 2

Overview

In Chapter 1 we presented issues regarding the collection of Highway Users Tax Fund (HUTF or the Fund) revenues. In this chapter we discuss issues related to the distribution of moneys from the HUTF. As described earlier in this report, the total percentage each category of recipient—Department of Transportation, counties, and municipalities—receives from the Fund’s two streams is prescribed in statute. However, for the 62 counties and the approximately 270 municipalities receiving HUTF moneys, additional calculations are necessary to determine the exact monthly portion each will receive of the total statutory percentage. Motor vehicle registration, highway lane mile, and bridge deck information are used in the HUTF distribution formula to calculate these individual shares of the larger percentage distribution. The Departments of Revenue and Transportation are both statutorily responsible for collecting these data and for ensuring their reliability and accuracy. The Office of the State Treasurer (Treasury) is responsible for ensuring that funds are allocated according to the statutorily-prescribed formula. In this chapter, we identify weaknesses in the processes for determining the portions of HUTF moneys each recipient receives. Overall, we concluded that greater controls and clarification are needed to ensure statutory intent is met with regard to Fund distributions.

Revenue Distribution Streams

Section 43-4-205, C.R.S., requires that fuel tax revenue deposited in the Highway Users Tax Fund be allocated into two separate distribution streams on the basis of the amount of the fuel tax collected. The first 7 cents per gallon of fuel tax of every gallon sold is to be allocated to the first distribution stream. Everything over the first 7 cents per gallon collected is to be deposited into the second distribution stream. We found that the Treasury allocates fuel tax revenue among the two distribution streams in accordance with statute. However, it is unclear whether the Treasury’s treatment of other HUTF revenue sources is consistent with statutory intent.

In addition to fuel tax, the Highway Users Tax Fund includes a portion of revenue from sources such as:

- Motor vehicle titles and registration fees
- Motor vehicle penalty assessments
- Driver's license fees
- Judicial collections
- Excess Motorist Insurance Identification Database fees
- Excess driver's license revocation fees
- Interest earned on the Fund

These miscellaneous revenue sources represented approximately 20 percent of the Fund in Fiscal Year 2003, or about \$146.9 million. The Treasury has assigned these miscellaneous revenues to the first distribution stream. However, we did not find any statutory citation directing these particular revenues be allocated to the first stream. In fact, statutes do not mandate deposit of these revenues in either stream; statutes only mandate their deposit into the Fund. For example, Section 42-1-217, C.R.S., directs that certain court fines related to traffic infractions be deposited in the Highway Users Tax Fund. The statute merely references the Fund by name and does not reference to the section of the HUTF statutes that outlines the two distribution streams. Therefore, there is no clear direction as to whether these miscellaneous revenues (approximately \$146.9 million in Fiscal Year 2003) should be distributed in the first or second stream. We found this ambiguity in many of the statutes for various funds and revenue sources that are to be credited to the HUTF.

Distributions Vary

The amount of highway funds the Department of Transportation, the counties, and the municipalities receive is significantly affected depending upon the stream into which revenues are included. As the table on the following page shows, this is because the percentage of the HUTF distributed to each category of recipient differs whether the revenue comes from the first or the second distribution stream.

Highway Users Tax Fund Distribution Percentages by Stream		
	1st Stream	2nd Stream
CDOT	65%	60%
Counties	26%	22%
Municipalities	9%	18%
TOTAL	100%	100%
Source: Office of the State Auditor analysis of HUTF statutes.		
Note: Percentages are based on the portion of distributions made subsequent to “off-the-top” distributions.		

As the table shows, the percentages for CDOT and the counties are reduced in the second distribution by 5 and 4 percent, respectively. However, the municipalities’ share is increased by 9 percent in the second stream. The percentage differences between the first and second distribution streams translate into significant dollar differences for the recipient entities.

For example, if all of the Fiscal Year 2003 miscellaneous revenue of \$146.9 million had been deposited into the second distribution stream rather than the first, the municipalities would have realized an increase of \$13.2 million in their total share of the HUTF. By contrast, the Department of Transportation and the counties would have experienced an overall decrease in their total HUTF distributions of \$7.4 and \$5.8 million, respectively. We recognize that the General Assembly may not intend for all of the revenue in question to go to the second stream and that other variations, including maintaining the status quo, could be more appropriate. However, shifting even a portion of the miscellaneous revenue would affect each recipient’s share of the distribution. For example, if only the Judicial Department’s collections were included in the second stream rather than in the first, municipalities would have received a total of about \$683,000 more in Fiscal Year 2003.

Statutory Clarification

The original Highway Users Tax Fund statutes provided for a distribution ratio of 65:30:5 to the State Highway Department (CDOT), the counties, and the municipalities, respectively. In 1965, the ratio was changed to 65:26:9. Both of these ratios addressed the distribution of the Fund in its entirety. In 1981, statutes were changed again; this time, the Fund was divided into two distinct parts—the first

and second streams—and the distribution ratios between them differed. One part or stream was based on the first 7 cents of fuel tax (ratio of 65:26:9) and the second stream was established with amounts over 7 cents of fuel tax and a distribution ratio of 60:22:18. The 1981 statutory change addressed only the distribution of fuel tax revenue and did not earmark the distribution of the other revenue sources to either of the two Fund streams. In the absence of any specific statutory direction, the Treasury has distributed the miscellaneous revenue according to the 1965 statutory ratios and deposited them into the first distribution stream.

The lack of specific statutory requirements for the distribution of these miscellaneous funds appears to have been an oversight. We found no documentation indicating that either a legislative or executive branch decision was made to direct these revenues to one or the other of the two streams. Legislative and executive branch staff we questioned about this issue also had no historical knowledge of the decision-making involved in the assignment of these particular revenues to the HUTF. Statutes governing some sources of HUTF revenue, such as certain driver's license fees, do specifically direct that these fees be distributed through a particular stream. Other statutes, such as those that establish fines for defacing property, merely reference to the Highway Users Tax Fund in its entirety as the point of deposit.

While the evidence we reviewed does not indicate that the Treasury has erred in its assignment of the miscellaneous revenue to the first distribution stream, we recommend that statutes be clarified as to the distribution of miscellaneous revenue. In addition, in the future statutes should clearly assign to either the first or second stream any new revenue sources designated for the Fund.

State and local entities have significant interest regarding the amount of highway funding available to them. As we have shown, the stream through which revenues flow will impact the total funding available to the Department of Transportation, counties, and municipalities. Clear statutory direction would eliminate any perception of impropriety, bias, or inequity in the distribution of the Fund. Moreover, it would provide assurances that all Fund revenues are being distributed in accordance with statutory intent.

Recommendation No. 4:

The Office of the State Treasurer should work with the General Assembly to determine the intended distribution of miscellaneous revenue from the Highway Users Tax Fund and seek statutory change as appropriate.

Office of the State Treasurer Response:

Agree. To be implemented during the 2005 Session of the General Assembly. The Treasury will work with the General Assembly to see if it desires to change or clarify the intended distribution of the miscellaneous revenue within the HUTF.

Motor Vehicle Registration Data

Motor vehicle registration information is used in the HUTF distribution formula as a measure to indicate the use of roadways and of the corresponding roadway needs of local governments, and this data has a direct impact on the amount of funding distributed to local entities. Therefore, this information needs to be accurately reported and input into the distribution formula. The Department of Revenue's Title and Registration Section is responsible for annually compiling and reporting vehicle registration information to the Treasury as described in Section 43-4-207 (2)(e), C.R.S.:

Upon receipt of the information certified by the respective county clerk and recorders, the department of revenue shall tabulate the total number of all motor vehicle licenses issued during the preceding calendar year to persons residing within the limits of the respective counties in the entire state and within the limits of each city or incorporated town within the respective counties On or before May 1 of each year, the department of revenue shall certify to the state treasurer the percentage of motor vehicle registrations for each county as provided in this paragraph (e).

As described below, we found that the Department of Revenue needs to strengthen its oversight and administration of this data to ensure distributions from the HUTF are based on accurate and reliable information.

Certification Process

We reviewed the processes for certifying and submitting motor vehicle registration information used in the HUTF distribution formula. Our analyses involved reviewing Colorado State Titling and Registration System (CSTARS) electronic reports maintained by the Department of Revenue, individual county motor vehicle registration forms prepared by the Department and reviewed by the counties, and the

methods employed by the Treasury to input motor vehicle registration information into the distribution formula. We found problems in the following three areas:

- C **Inefficient/duplicative data verification and reporting activities.** Although the Department of Revenue is responsible for submitting motor vehicle registration information to the Treasury, statutes include county governments in the data verification and reporting process. Specifically, statutes require that motor vehicle registration information must first be certified by the clerk and recorder in each county before it is submitted by DOR to the Treasury. Currently, Department of Revenue staff prepare individual motor vehicle registration verification forms for each county to review. The forms contain a summary of county-supplied registration information available through CSTARTS and therefore easily accessible to each county. The Department submits both the electronic summary reports and the county-reviewed hard-copy documents to the Treasury. We believe the Department's practice of submitting two sets of motor vehicle registration information is inefficient and unnecessary. In addition, submitting two sets of data often results in discrepancies and inconsistencies, as described below.

- C **Error prone manual data entry.** When Department of Revenue staff manually transfer data from CSTARTS onto the individual county verification forms, they make errors. In the Calendar Year 2002 registration data used for the Fiscal Year 2004 distribution, we found 13 errors on a total of 62 county forms (21 percent). For the Calendar Year 2001 data used for the Fiscal Year 2003 HUTF distribution, we found 16 errors on a total of 62 forms (26 percent). Errors include omitting city registrations from overall county totals, miscalculations of total registration figures, and simple transcription errors. Errors we identified in Calendar Year 2002 data were as follows:
 - C Registrations for Montezuma County were understated by 684.
 - C Registrations for Granada in Prowers County were overstated by 5,294.
 - C Registrations for Routt County were understated by 595.

The above errors were caught by county staff before being entered into the distribution formula. However, if motor vehicle registration information is misreported and errors are undetected, HUTF distributions to counties and municipalities are not accurate. That is, some counties and municipalities will receive a larger share of the Fund than they are due and others will receive a smaller share. Furthermore, when motor vehicle registration totals for municipalities are reported incorrectly, it affects not only the municipalities' distributions but distributions to the counties within which the municipalities are located as well.

- C **Lack of procedures for resolving discrepancies.** In reviewing the hard copy verification forms, we found that county clerk and recorders often change the registration information and/or calculations sent to them by Department staff. Department of Revenue staff never review the county forms, resolve discrepancies, or make corrections before forwarding the forms to the Treasury. As a result, Treasury staff frequently identify discrepancies in the two sets of data (electronic summary reports and hard copy forms) submitted by DOR. When this occurs, Treasury staff told us they typically defer to the hard copy information because they believe it to be more accurate. The lack of a clear process for correcting errors and resolving discrepancies raises questions about the Department of Revenue's process for "certifying" motor vehicle registration information.

Inaccurate Distributions

As previously stated, when inaccurate motor vehicle registration information is used in the HUTF distribution formula, inaccurate distributions to the counties and municipalities result. For example, we compared the data actually used for the Fiscal Year 2003 HUTF distribution with the CSTARS data that should have been used. We found a number of errors. Some examples include:

- **Overpayments** - One county received \$11,506 more than it should have and one municipality was overpaid \$5,763.
- **Underpayments** - One county was underpaid \$3,643 and another received \$8,854 less than it should have.

This audit is not the first to identify errors in the motor vehicle registration data entered into the HUTF distribution formula. In the Office of the State Auditor's Fiscal Year 2003 Statewide Audit, errors were identified in the HUTF distribution for the City of Aurora. As reported in that audit, Aurora received an underpayment of \$215,000 due to an oversight by the Department of Revenue in adjusting the number of vehicle registrations. Correspondingly, all other municipalities received an aggregate overpayment of \$215,000. The Treasury corrected this distribution error in May of Fiscal Year 2003 by paying the City of Aurora the amount it should have been paid throughout the fiscal year. Another error was identified by the City of Centennial for its Fiscal Year 2003 distribution. In this case, Centennial was underpaid about \$1.4 million. After the error was identified, the Treasury corrected the error by reducing the September 2003 HUTF payments to all other municipalities and increasing Centennial's payment by \$1.4 million.

Strengthen Certification Process

The Department of Revenue has not adequately fulfilled its statutory responsibility to certify motor vehicle registration information used in the HUTF distribution process. To ensure motor vehicle registration information is accurate and reliable, the Department needs to overhaul current practices and implement a sound, efficient process. To improve accuracy, the Department should review and reconcile data before submitting it to the Treasury. To increase efficiency, the Department should determine the accuracy of different data sources and submit a single accurate report. To streamline the process for soliciting county input, the Department should eliminate the Department-prepared verification forms and allow counties to directly submit copies of their CSTARS reports. Prior to the statutory deadline, the Department should notify the county clerks and recorders of the data requirements and of the process for reporting changes or resolving discrepancies. Finally, the Department needs to adopt standard procedures for the Treasury to use when questions arise.

Recommendation No. 5:

The Department of Revenue should improve the efficiency and effectiveness of the motor vehicle registration certification process to ensure the accuracy of the data used in the Highway Users Tax Fund distribution by:

- a. Eliminating duplicative steps and reducing manual errors by allowing counties to annually submit motor vehicle registration information directly to the Department.
- b. Implementing and distributing procedures, including formats and time lines, for county clerks and recorders to use in verifying their respective registration information.
- c. Submitting a single comprehensive report to the Office of the State Treasurer.
- d. Working with the Office of the State Treasurer to adopt standard procedures for identifying and correcting errors found in the data submitted.

Department of Revenue Response:

Agree. To be implemented January 2005.

- a. The Department agrees with this recommendation. The Titles and Registrations Section will develop and implement a process for counties to certify motor vehicle registration information directly to the Department, including providing for county access to the CSTARs data necessary for their certification.
- b. The Department will develop guidelines to facilitate the certification of motor vehicle registration information by county clerks, including formats, content, and timelines.
- c. Upon receiving the various certifications, the Department will provide one report to the Office of the State Treasurer including the Department's tabulation of county-certified motor vehicle registration data as well as Department calculations required by C.R.S. 43-4-208(4).
- d. The Department will take the lead in establishing a working group comprised of representatives from the Office of the State Treasurer, County Motor Vehicle Office, Motor Vehicle IT section and the Titles and Registrations Section. This working group's mission will be to develop an error resolution process and ensure that it is workable for all entities, as well as effective in capturing complete and accurate information needs to distribute the correct percentages of HUTF moneys to the respective jurisdictions.

Highway Lane Mile Information

In addition to motor vehicle registrations, the number of lane miles of open, used, and maintained roads is used to calculate HUTF distributions to municipalities and counties. The Colorado Department of Transportation (CDOT) is responsible for providing lane mile information to the Treasury on an annual basis. Statutes prescribe that prior to July 1st of each year, CDOT shall certify to the Treasury the lane mile figures as of December 31st of the preceding year. The Treasury is to then use the lane mile figures as one basis for the current fiscal year's distributions.

The Department's Division of Transportation Development's Geographic Information System Section (GIS) is responsible for compiling the lane mile information. In November of each year, GIS staff send each local jurisdiction information about the roads in their respective locales, including road miles, the length of each road, surface type, width, and class of road. This information is generated from the Geographic Information System which contains a current status of the public roadway system for each jurisdiction. Statutes require local entities to provide road

inventory changes to CDOT staff who then review the information and submit a final report to the Treasury by June of each year. Currently 331 local jurisdictions are involved in this process and submit changes either electronically or in hard copy form.

We found that CDOT could make improvements to this annual process to ensure the reliability of the information submitted to the Treasury. We conducted a file review of 25 road inventory reports from both municipalities and counties. We found that Department staff change lane mile information supplied by local governments before submitting it to the Treasury. Specifically:

- C For 6 of the 10 counties we reviewed, CDOT staff changed lane mile information that had been submitted by the counties. These changes resulted in about a \$200 increase in HUTF moneys to two counties and about a \$1,360 decrease in HUTF moneys to four counties.
- Staff changed information provided by 6 of the 15 municipalities in our review. These changes resulted in an increase of about \$2,980 in funds to four municipalities and a decrease of \$3,420 for two municipalities.

Although the amounts in these cases are small, the lack of supporting documentation explaining the reasons for the changes made to lane mile information is a concern.

Documentation Needed

The lack of documentation raises questions about the sources and accuracy of the data used to override local government information. Department staff attribute some changes to work conducted by staff in the field and the remainder to errors discovered while they are entering local changes. Staff conduct fieldwork to determine the accuracy of the information reported from the local entities. Department staff told us that the fieldwork reports are maintained in the appropriate local government entity's file folder. Staff also indicated that errors are usually discussed with local representatives before they are corrected, but discussions are not always documented in the file. We found no fieldwork reports or other documentation to support the changes made to lane mile information in 12 of the 25 files we reviewed. In addition, although staff told us they do discuss changes with local government personnel for all but the most obvious of errors, we found no evidence that Department staff routinely notify local government entities of the changes they have made. Feedback is important to ensure potential disputes are resolved prior to the submission of information and the distribution of HUTF moneys. We do not question the authority of the Department of Transportation to make changes in local governments' lane mile information used in the HUTF

formula. However, the Department has a statutory responsibility to certify or attest to the accuracy of the information prior to submitting it to the Treasury.

Department instructional materials state that “when someone makes a change independently, due to a change reported by another city or county, it is helpful when they indicate the change on the log sheet.” The instructional materials note that such documentation can prevent duplication of effort and reduce staff time spent researching the reasons for changes when questions arise. Currently, Department staff do not always following this guideline. We believe the Department should take steps to ensure adequate documentation is maintained whenever lane mile information is changed.

Recommendation No. 6:

The Department of Transportation should increase the accuracy of and accountability for the lane mile information submitted to Office of the State Treasurer by maintaining documentation to support any changes made to road inventory information submitted by local entities.

Department of Transportation Response:

Agree. To be implemented July 1, 2004. The Colorado Department of Transportation (CDOT) recognized this problem two years ago and began taking steps prior to the audit to meet this goal. CDOT’s new electronic reporting software, used on a limited basis in 2003 and for all updates in 2004, automatically tracks all changes requested. Detailed data are gathered for major changes. Minor changes to existing segments are also documented, including information on the item changed, the old value and the new value.

Where local government staff use the CDOT-provided electronic reporting software, CDOT staff review all requested changes before they are posted to the master database. Where such changes are rejected or modified by CDOT staff, a record providing the reasons for the action is written in a reconciliation log that will be shared with the affected local governments.

Further changes planned:

- C For those jurisdictions reporting via paper, CDOT will enter all the changes as requested. Corrections will be made post-entry so that data for the reconciliation log are available for all jurisdictions and all changes.

- C Fieldwork reports will be retained and filed with the appropriate jurisdiction. Note that the lack of a report could mean that there were no major changes that required field checking.

Bridge Deck Information

Within the Department of Transportation, the Bridge Management Section is responsible for compiling information regarding the number of bridge deck square feet that is input into the HUTF distribution formula. Bridge deck information is relevant to the HUTF distribution only for the county portion of the allocation and only as applied to the third tier of the distribution. Specifically, Section 43-4-207(2)(b)(IV), C.R.S., states that “ten percent shall be allocated to counties in proportion to the square feet of bridge deck for bridges greater than twenty feet in length in each county, as certified by the department of transportation.” As described earlier in this report, by statute the third tier is revenue available to the counties in excess of \$86.7 million. In Fiscal Year 2003 a total of \$66.2 million was distributed to the counties through the third tier.

The Department of Transportation maintains a bridge management system called PONTIS which contains information on the type and length of every bridge and the structure and surface of every bridge in the State. Information in the system is also maintained for federal reporting purposes. Department staff annually query the system and submit the bridge deck information to the Treasury for use in the HUTF distribution formula.

We reviewed the Department's process for compiling bridge deck information and found the need for improvement. We found that the manual process used by CDOT staff to reorder some bridge data for consistency with the Treasury's reporting format increases the likelihood for errors. Because information contained in the PONTIS system is arranged for federal reporting requirements, CDOT staff must manually reorder the data for four counties to meet Treasury's HUTF formatting. These four counties, Elbert, El Paso, Lake, and La Plata, are placed in a different alphabetical order by the federal government. For the Fiscal Year 2002 distribution, CDOT staff transposed bridge deck measures for Elbert and El Paso Counties. This resulted in a \$328,471 overpayment to Elbert County and a corresponding underpayment to El Paso County. Also, for the 2002 distribution, data were transposed for Lake and La Plata Counties resulting in a misallocation of \$76,000. Neither of these errors was caught by CDOT staff. Rather, the Elbert and El Paso error was undetected until a review conducted by the Legislative Council. Our current audit identified the Lake and La Plata County error.

We also found that Department staff provide bridge deck data for a different time period than is required by statute for all other information input into the HUTF distribution formula. Staff pull the bridge deck data from PONTIS on a real time basis. By contrast, statutes specify that the three other types of data used to calculate the county portion of the Fund are from the preceding year. Consequently, the time period representing bridge deck information is inconsistent with all other time-specific information used in the formula. To ensure consistency, we suggest that the Department consider utilizing the same procedures as outlined in statute for other HUTF data submissions.

To improve the accuracy and reliability of the HUTF distribution process, the Department should ensure bridge deck data submitted to the Treasury is accurate by adopting an internal review process prior to submitting the data for input into the HUTF formula. Particular attention should be paid to areas in which data errors have occurred in the past. The Department should also consider providing bridge deck data similar to the time frame of all other data entered into the HUTF formula.

Recommendation No. 7:

The Department of Transportation should improve the accuracy and reliability of the bridge deck information submitted to the Office of the State Treasurer for use in the HUTF distribution formula by:

- a. Ensuring bridge deck information is reviewed prior to submission to the Office of the State Treasurer.
- b. Providing bridge deck data for the same time frame as other statutorily required HUTF data submissions.

Department of Transportation Response:

Agree. To be implemented June 1, 2004. The Colorado Department of Transportation (CDOT) is taking the following steps to ensure that these data are accurate for this year's report, and that the process is improved in future years:

- C CDOT staff have developed a process to validate bridge deck information. The new information will be compared to previous years to make sure that any major changes can be explained by construction activity, jurisdiction transfers, etc. and are not processing or reporting errors.

- C The Geographic Information System (GIS) Section worked with CDOT's Staff Bridge to make sure the data reported are for 12/31/03, and will assure that this is the case in future years.
- C As CDOT implements our new database next year, we will use automated techniques to access the bridge database directly and match jurisdictions based on Federal Information Processing Standards (FIPS) jurisdiction codes, rather than relying on sort order to match the bridge data to the mileage data for each jurisdiction.

Distribution Errors

Each month, the Treasury distributes HUTF moneys to the recipient entities. The total average monthly distributions for Fiscal Year 2003 were:

- C \$33 million to the Department of Transportation.
- C \$13 million to the counties.
- C \$8 million to the municipalities.

As noted in this report, errors have occurred in the monthly distributions. They may result from data entry mistakes or from the use of incorrect data in the distribution's calculations. Errors may originate at either the Treasury or at the Departments of Revenue or Transportation, which are both responsible for providing data used in the formula. We found that when errors do occur, Treasury staff exercise discretion in determining whether to correct the erroneous distributions. In addition, we found that when corrections are made, Treasury does not have standards, guidelines, or criteria for use in determining the manner in which corrections will occur.

As part of our audit, we reviewed the HUTF distribution process for Fiscal Years 2001 through 2003. We reviewed documentation regarding recent errors in the distributions, including any remedial actions taken by the Treasury. We found that the Treasury sometimes does not correct errors. As shown in the five examples below, the Treasury corrected erroneous distributions in three cases, but in two other cases took no action to adjust or correct subsequent distributions:

Corrected Distributions

- **The City of Aurora.** Aurora was underpaid approximately \$215,000 from July 2002 through April 2003. The error occurred because the Department of Revenue provided incorrect motor vehicle registration data to the Treasury. In May 2003, the Treasury reimbursed Aurora and reduced the amount paid to all other municipalities, in aggregate, by \$215,000.
- **Elbert and El Paso Counties.** From July 2002 through June 2003 Elbert County was overpaid by approximately \$970,000 and El Paso was underpaid the corresponding amount. This error resulted when staff at the Treasury transposed the number of motor vehicle registrations between the two counties. In September 2003 the Treasury reimbursed El Paso County. Beginning in January 2004 and continuing through December 2006, a portion of Elbert County's monthly distribution is to be reduced about \$27,000 per month until the overpayment of \$970,000 has been recaptured from the county.
- **City of Centennial.** Centennial was underpaid approximately \$1.4 million from July 2002 through June 2003. The error occurred because the Department of Revenue provided incorrect motor vehicle registration data. In September 2003, as a result of an Attorney General's opinion issued at the request of the Department of Local Affairs, the Treasury reimbursed Centennial the correct amount. That same month, the Treasury reduced the amount paid to all other municipalities, in aggregate, by \$1.4 million.

Uncorrected Distributions

- **Elbert and El Paso Counties.** Similar to the error described above, a transposition of data resulted in an \$328,000 overpayment to Elbert County and a corresponding underpayment to El Paso County. In this case, Department of Transportation staff mistakenly switched bridge deck square footage data for the two counties for the period of July 2001 through June 2002. To date, the Treasury has not corrected this error, and staff indicated the error will not be corrected until updated bridge deck information is provided by CDOT.
- **Lake and La Plata Counties.** In another case of data transposition, Lake County received about \$76,000 less than it should have and La Plata County received \$76,000 more from July 2001 through June 2002. Department of Transportation staff transposed the bridge deck square footage figures for these two counties in their data submission to the Treasury. To date,

Treasury has not corrected this error. Again, staff told us they will not correct the error until CDOT provides new information.

Following the error in the distribution to the City of Centennial, the Department of Local Affairs, on behalf of that city, requested an opinion from the State Attorney General's Office regarding whether the Treasury has an obligation to recalculate and remedy incorrect HUTF distributions. The opinion concluded that statutes awarding benefits must be followed exactly and that the recipient has a statutory entitlement to the HUTF revenue based on the distribution formula. Furthermore, because the Treasury has a responsibility to calculate the distribution under Section 43-4-205, C.R.S., the error in the distribution should be corrected, even when the error was not made by the Treasury.

Correct Errors

The errors we detail above totaled approximately \$3 million. Two of the five underpayments were reimbursed to the appropriate recipient in a subsequent fiscal year. A third was repaid in the same fiscal year. The Treasury gave one county three years to reimburse the Fund for an overpayment, while it required that two overpayments be reimbursed during the same fiscal year in which the errors occurred. More significantly, for two of the errors, the Treasury has taken no corrective action.

Treasury staff explained that they do not believe the Office of the State Treasurer has the authority to make changes to data which has been certified as correct by the agencies statutorily responsible for collecting, certifying, and submitting it. Consequently, Treasury staff told us they will not correct information unless they make the error or until they receive changes from the responsible agency. As noted in the preceding section, two of the three errors staff corrected were the result of data mistakes made at the Department of Revenue.

We believe the Treasury should have some flexibility in determining the ways in which errors are corrected. Factors such as the amount of over and under payments and the time frames in which errors occurred are reasonable considerations in establishing repayment schedules. Not all counties and municipalities have the same ability to repay large sums in a single payment. However, local governments that were underpaid should not go unreimbursed for extended periods. To-date, the Treasury has not adopted policies and procedures or a methodology for correcting errors in the distribution of HUTF revenue or sought legislative guidance in this area. We believe the Treasury should develop procedures and criteria for use in correcting distribution errors. In addition, the rationale for the ways in which errors are corrected should be documented and conveyed to the local governments.

In contrast with the flexibility we believe the Treasury should have in determining the ways it corrects errors, we believe there should be no question that the Treasury will indeed make corrections. Because the HUTF is statutorily established within the Treasury, we believe that Treasury has the primary responsibility to ensure its correct distribution. To this end, the Treasury should take the necessary steps to correct errors, provide feedback to the agencies responsible for the errors, and notify local entities of the errors and the corrections to be made. To provide additional scrutiny over the accuracy of distributions and to increase local government understanding of the Highway Users Tax Fund, the Treasury should consider using its Web site to regularly publish distribution information. Fund recipients could then review the information used to determine their portion of the HUTF revenues and report any anomalies to the Treasury.

Recommendation No. 8:

The Office of the State Treasurer should ensure the accuracy of the Highway Users Tax Fund distributions by:

- a. Adopting policies and procedures for correcting errors.
- b. Working with the Departments of Revenue and Transportation when errors occur in the data provided by either Department.
- c. Documenting the ways in which specific errors will be corrected, including the methods to be used to recapture overpayments and to reimburse for underpayments. Additionally, uncorrected errors addressed in this audit report should be addressed.
- d. Notifying local governments of the errors found and the mechanisms to be used in correcting errors.

Office of the State Treasurer Response:

Agree. To be implemented by December 31, 2004. The Treasury will:

- a. Develop a written policy for correcting errors when they are discovered.
- b. Work with the departments that provide it with information whenever errors are identified. In cases where the error is contained in the data submitted to Treasury, however, the Treasury is statutorily unable to

change the amounts distributed unless the certifying department concurs that an error occurred and formally corrects the data submitted.

- c. Develop a written policy outlining the methods used to recapture overpayments and to reimburse for underpayments. Additionally, in July 2004, Treasury will begin working with the counties involved in the uncorrected errors addressed in this audit to rectify over and under payments.
 - d. Develop a written policy for notifying local governments of errors found that will incorporate the methods used to recapture overpayments and to reimburse underpayments noted above.
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