

Performance Audit: Motor Fuel Tax (HB 1247)

*Prepared for the Committee on Legislative Research
by the Oversight Division*

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TABLE OF CONTENTS

COMMITTEE ON LEGISLATIVE RESEARCH	ii
LETTER OF TRANSMITTAL	iv
INTRODUCTION, BACKGROUND	page 1
OBJECTIVES	page 3
SCOPE, METHODOLOGY	page 4
FINDINGS/RECOMMENDATIONS/AGENCY RESPONSES	
#1 HB 1247 Tax Revenue Used For Administrative Purposes .	page 5
#2 Revenue & Expenditures Not Separately Accounted For .	page 7
#3 Documentation Not Maintained To Justify Expenditures ..	page 8
#4 15 Year Plan Amended Without Approval	page 11
#5 Accounting System Not Clear and Efficient	page 13
#6 Transient Employer Laws Not Followed	page 14
#7 Projected Construction Expenditures Exceed Revenues ..	page 15
#8 Internal Controls May Not Be Sufficient	page 15
CONCLUSION	page 16

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Members of the Committee on Legislative Research:

Pursuant to your resolution of June, 1994, we have concluded our program audit of House Bill 1247 relating to certain motor fuel tax increases. Our audit was conducted in accordance with generally accepted government auditing standards as they relate to program and performance audits. We did not examine departmental financial statements and do not express an opinion on them.

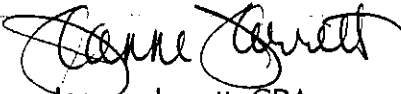
Overall we found the program to be progressing effectively with completion of projects on the 15-year road and bridge plan. We did however note several areas for improvement in segregating the income and expenditures related to the program from other revenues and expenditures in order to comply with legislative intent and current law.

The Department of Highway and Transportation appears to have spent some of the revenue from the program on administrative expenses contrary to the language in House Bill 1247. Due to the nature of DH&T's accounting records, they have not monitored expenditures to make sure that HB 1247 tax revenues were spent only on road construction. We estimate as much as \$6,000,000 of the revenues from the tax increase have been spent for administrative purposes.

Most agencies which request appropriations from highway funds have not maintained documentation to justify their requests as related directly to the state's road and highway system even though a 1987 performance audit issued by the Oversight Division, State Highway Department Fund and Other Funds Related to Highway Maintenance and Construction, specifically listed findings and recommendations in this area. In fact, one agency is admittedly spending highway funds disproportionate to their related services while another agency had not completed a study to determine what funding source was appropriate in several years. We recommend the Committee re-visit this issue when time allows.

The Department of Highway and Transportation has not followed all state laws in their contracting procedures. This has resulted in possible exposure to employment tax liabilities for private contractors' work.

The accompanying report includes our comments on internal controls, compliance with legal requirements, management practices, program performance and related areas. We hope this information is helpful and can be used in a constructive manner for the betterment of the state program to which it relates.



Jeanne Jarrett, CPA
Director

Introduction

The Joint Committee on Legislative Research directed the Oversight Division to perform a program audit of HB 1247, which was Truly Agreed to and Finally Passed during the 86th General Assembly Second Regular Session and signed into law by the Governor. HB 1247 provides for three two-cent increases in the motor fuel tax. The General Assembly has the option of putting the scheduled motor fuel tax increase in 1996 to a vote of the people for implementation or repeal. This audit provides them with information that will be useful in determining if they should exercise this option. The audit also informs the General Assembly of whether the tax money is being used efficiently and effectively, administered as authorized or required by law and used as intended by law.

Background

HB 1247 contains provisions for three two-cent tax increases. The first tax increase was effective April 1, 1992 and increased the state motor fuel tax from eleven cents to thirteen cents per gallon of motor fuel sold. The second became effective April 1, 1994 and increased the state tax from thirteen cents to fifteen cents per gallon, and the final increase will raise the tax to seventeen cents per gallon on April 1, 1996. Prior to HB 1247, Proposition A was passed which increased the motor fuel tax from seven cents to eleven cents per gallon, effective June 1, 1987.

HB 1247 limits the increase or decrease in appropriations from the prior year out of the highway fund to the percentage increase or decrease in total state revenues paid or transferred into the fund from the prior year. However, the Highway and Transportation Commission and Department of Highway and Transportation are not subject to this limitation. According to the bill, for fiscal year 1993 the base year for appropriations was fiscal year 1987; however, the increase or decrease in revenues was compared to fiscal year 1992. The state agencies that have received appropriations out of the highway fund during fiscal years 1992, 1993 and 1994 include the Department of Highway and Transportation (DH&T), State Auditor's Office

(SAO), State Treasurer's Office (STO), Office of Administration (OA), Department of Economic Development (DED), Department of Health (DOH), Department of Public Safety (DPS) and Department of Revenue (DOR). The bill does not allow the DH&T to use any of the tax increase for administrative expenses.

Historically, the highway fund has not earned its own interest. The interest is credited to the general revenue fund. HB 1247 allows for interest earned by the highway fund, exceeding the amount earned in fiscal year 1991, to be credited to the highway fund. However, due to declining interest rates, as of June 30, 1994 the interest had not yet exceeded the 1991 amount.

The General Assembly may elect to place before the voters the question of whether the tax increase scheduled for April 1, 1996 shall be implemented or repealed. As stated in section 142.009, RSMo Supp. 1993, reasons for taking the tax increase to a vote of the people would include changes in the Federal Surface Transportation Act no longer making the tax money necessary to match federal funds, not using revenues for the purposes specified in the 15 Year (1992-2007) Road and Bridge Program adopted by the DH&T on January 6, 1992 or any other reason deemed appropriate by the General Assembly.

The 15 Year (1992-2007) Road and Bridge Program includes not only 1992 road and bridge construction projects added from the HB 1247 tax increase, but also Proposition A construction projects. The purpose of this is to expedite the Prop. A projects with the HB 1247 tax increase. When Prop. A projects are completed, the Prop. A tax plus the HB 1247 tax will be used to complete the projects added with the 15 year program. Page two of the 15 Year (1992-2007) Road and Bridge Program states "The first five to six years will complete Proposition A." Through August, 1994, contracts for approximately 60% of the Proposition A construction projects have been awarded and approximately 2.5% of the additional HB 1247 projects have been awarded.

The construction expenditures are not necessarily proportional between highway districts. According to DH&T funds are committed for 15 year projects as they are ready for construction. In other words, the districts are on a first come, first serve basis. For example, through June 30, 1994 approximately \$54,000,000 was spent on 15 year program projects, of

which approximately \$20,600,000 was spent in district eight and approximately \$6,700,000 was spent in districts one and four combined.

The 15 Year (1992-2007) Road and Bridge Program does not include a time line for completion of the construction projects. A separate document, the Highway Right of Way and Construction Program, is updated annually and includes all of the construction projects with the years they are scheduled for letting. The DH&T's goal is to have all of the projects included in the 15 year program under contract by the year 2007. Therefore, the projects will not necessarily be completed by the year 2007.

Objectives

The objectives of the audit are to inform the General Assembly as to whether the revenue from the tax increase is being used efficiently and effectively, administered as authorized or required by law and conforms with statutory intent. The focus of the Oversight Division centered on ten main objectives to determine if:

- ▶ DH&T is properly monitoring the 15 Year (1992-2007) Road and Bridge Program and the program is progressing as planned.
- ▶ revenue collected by DOR is properly recorded in DH&T's accounting records.
- ▶ the two cent tax increases are not being used by DH&T for administrative purposes.
- ▶ the "cap" on appropriations out of the highway fund is being calculated correctly.
- ▶ DOR's management controls are adequate in processing fuel tax returns and depositing tax receipts, and a sample of fuel tax returns were properly recorded in the fuel tax report.
- ▶ interstate fuel tax (IFTA) collections and refunds are processed properly by the Highway Reciprocity Commission.
- ▶ motor fuel tax collections are being properly distributed to cities and counties.
- ▶ fiscal note information submitted by DOR to Oversight Division was accurate.
- ▶ calculation by STO for highway fund interest was correct and interest

- ▶ should be deposited into the highway fund.
- ▶ agencies receiving appropriations out of the highway fund have documentation to support the funding sources in their budgets.

Scope

The scope of the audit concentrated on the changes in the Missouri statutes by House Bill 1247, which was effective April 1, 1992. The main areas considered in the audit were the additional motor fuel tax increase, appropriations out of the highway fund, interest earned by the highway fund and construction related to the 15 Year (1992-2007) Road and Bridge Program.

Methodology

The Oversight Division conducted the audit in accordance with Government Auditing Standards issued by the Comptroller General of the United States as those standards relate to performance audits. The methodology used by the Oversight Division included tests of samples of transactions and evaluating management controls to the extent necessary to fulfill our audit objectives. Our main efforts concentrated on the following procedures:

- ▶ Selecting a sample of construction expenditures and evaluating management controls in processing and recording the transactions.
- ▶ Tracing DOR's revenue transmittals to revenue recorded by DH&T.
- ▶ Calculating tax increase revenues used for administration by DH&T.
- ▶ Recalculating OA's cap on appropriations out of the highway fund to various state agencies.
- ▶ Examining a sample of motor fuel and interstate fuel tax returns from DOR to evaluate processing of returns and management controls.
- ▶ Recalculating total motor fuel tax distributed to cities and counties and confirming tax receipts with a sample of cities and counties .

- ▶ Questioning state agencies on their support for highway fund appropriations.
- ▶ Recalculating gallons estimates used in the HB 1247 fiscal note.
- ▶ Recalculating interest earned by the highway fund.

Findings

Recommendations

Agency Responses

FINDING #1: The Department of Highway and Transportation has expended a portion of the HB 1247 tax revenue for administrative purposes, perhaps as much as \$6,000,000, even though the bill expressly prohibited such use.

House Bill 1247 states that "...any funds raised as a result of increased taxation...shall not be used for administrative purposes or administrative expenses of the highways and transportation department." The bill does not include a definition of "administrative purposes or administrative expenses." However, based on Oversight's understanding of the legislative intent of the bill, administrative expenses and purposes were intended to include any personal services and activities not related to construction of roads and bridges. The DH&T defines administration as costs not associated with road construction. For example, the Department does not consider engineering costs to be administration. DH&T has not been monitoring their expenditures to determine if the tax increase has been used for administration. Oversight Division compared percentage increases in highway fund revenues, excluding the HB 1247 tax increase, to administrative expenditures of the DH&T to determine an allowable growth rate of administrative expenditures. Based on calculations for fiscal years 1992, 1993 and 1994, Oversight determined that the DH&T's increase in administrative expenditures exceeded the growth in revenues excluding the tax increase by \$5,904,332 in fiscal year 1993.

House Bill 1247 does not restrict other state agencies from using the motor

fuel tax increase on administration. The calculation of the highway fund appropriations to other state agencies is based on the increase in total highway fund revenue from the prior year, which includes the HB 1247 tax increase.

RECOMMENDATION TO FINDING #1

The DH&T should set up separate subaccounts or a spreadsheet to monitor their HB 1247 construction expenditures. Pursuant to the recommendation to finding #2, the subaccounts or spreadsheet could account for the expenditures coming out of only the revenue from the HB 1247 tax increase. These subaccounts or spreadsheet would be restricted to only construction of roads and bridges, as indicated in the 15 Year (1992-2007) Road and Bridge Program. If the intent of the legislation is to restrict the use of the tax increase to only construction and no administration at all, the law would need to be amended to require the HB 1247 tax increase be deducted from total highway fund revenues before calculating the appropriations to other state agencies.

Agency Response to Finding #1

Department of Highway and Transportation:

DH&T disagrees that a portion of HB 1247 tax revenue has been spent for administrative purposes.

Between April 1992 and April 1994, the fuel tax received from HB 1247 amounted to \$146.2 million. Of that, \$109.6 million came to DH&T to be spent on activities related to construction of roads and bridges. DH&T has spent \$257 million to match federal dollars and \$265 million to pay for 100 percent state-funded projects, for a total highway and bridge projects expenditure of \$522 million. This far exceeds the \$109.6 million in revenue received from HB 1247.

Our main point of disagreement appears to center on the definition of administrative costs. Completion of a highway or bridge project cannot be accomplished without the integral activities of design engineering, right-of-way acquisition, and construction inspection. Actual construction is but one component of bringing a project to reality. These are not administrative costs.

Oversight's Comment:

DH&T's expenditures stated above are likely funded from HB 1247 revenues as well as other funding sources such as Proposition A revenues, motor vehicle license revenues, motor vehicle sales tax and the original motor fuel taxes. The theory that HB 1247 revenues are dedicated solely to road & bridge construction based on the state's total of road & bridge construction exceeding the amount of HB 1247 proceeds is misleading based on finding #2.

FINDING #2: The DH&T has not separately accounted for the revenues and expenditures related to the HB 1247 tax increase.

According to HB 1247, "...if revenues...are not being used for the purposes outlined in the 15 Year Road and Bridge Program...the general assembly may...vote to place before the voters the issue of whether the increases in tax ...shall be implemented or repealed." Because the various revenues received by the highway fund are not matched with individual expenditures, and the HB 1247 tax increase is combined with the other motor fuel taxes, it is difficult to determine from the highway fund's financial statement how individual revenues are being used.

RECOMMENDATION TO FINDING #2

If the intent of the legislation is to restrict the use of the HB 1247 tax increase to construction, Oversight recommends that DH&T begin immediately to track the HB 1247 revenues and expenditures separately, for example, using separate subaccounts or a spreadsheet. The level of construction expenditures prior to the HB 1247 tax increase could not decrease from year to year.

Agency Response to Finding #2

Department of Highway and Transportation:

DH&T agrees that improvements may be appropriate in our system of tracking HB 1247 revenues and expenditures.

FINDING #3: Some state agencies do not maintain proper documentation to justify their expenditures of HB 1247 revenue.

Based on correspondence with state agencies receiving appropriations from the highway fund, it appears that several agencies either cannot justify using highway funding to support their activities or they have not done a study recent enough to know what funding source is appropriate.

For fiscal year 1994 the State Treasurer's Office (STO) received approximately 24% of their total appropriation from the highway fund. This percentage has been approximately the same since 1985. Because the STO is in charge of investing state deposits and investments, it would appear to be more equitable to allocate their funding based on interest earned by each fund. Currently, the interest earned by the highway fund is deposited in the general revenue fund because the interest on its investments has not exceeded the 1991 interest (Section 226.200.7, RSMo Supp. 1993).

The Department of Revenue (DOR) indicated that their annual budget is based on the previous year's appropriation plus any new decision items approved by the General Assembly. According to the State Auditor's Office (SAO) management recommendations letter for the DOR's Division of Administration for two fiscal years ended June 30, 1984, the appropriation splits among funds were based on 1967 appropriations. The SAO's recommendation was for the DOR to conduct a review of their activities and request appropriations accordingly. The DOR stated that they did a review in 1987 based on the SAO's recommendation and submitted the results to Office of Administration, Division of Budget and Planning. DOR was not able to supply us with information regarding any budget studies since 1987.

The Department of Public Safety - Highway Patrol stated that they have not done any time studies to determine if their personal services out of the highway fund are completely highway related.

The SAO's level of highway funding was apparently established several decades ago and is based upon the ratio of highway funds to the total state budget.

There may be other state agencies such as Office of Administration, Department of Economic Development and Department of Health that have not done studies to determine if their highway funding is appropriate; however, the Oversight Division did not pursue this area any further for purposes of this audit.

In 1987 the Oversight Division conducted a performance audit of the state highway department fund (SHDF) and reported a finding stating "Activities funded with SHDF funds are not necessarily highway related. Some state agencies which use SHDF funds cannot show a direct relationship between SHDF expenditures and highway related activities. Therefore, additional monies could be made available for maintenance and construction of state roads."

RECOMMENDATION TO FINDING #3

Oversight recommends that all state agencies receiving highway fund appropriations be required to perform internal studies with existing personnel to determine that their appropriations are coming from the correct funds. These studies should be done every other fiscal year as part of the budget process. It is also recommended that the Joint Committee on Legislative Research consider further research on these appropriations to determine that the activities supported by the highway fund are used for the purposes specified in sections 30(a) and 30(b) of article IV of the Constitution of Missouri.

Agency Responses to Finding #3

State Treasurer's Office:

The State Treasurer's Office (STO) will be proposing legislation during FY 95 to fund its operational costs directly from interest received on state investments. Since the STO is responsible for investing and accounting for state funds and distributing related interest earnings and receipts, it is felt this proposed funding strategy will result in an equitable distribution of STO operational costs to the state funds that directly benefit from the investment function.

Department of Revenue:

The Department of Revenue concurs with the Oversight Division's recommendation. A two year audit plan will be developed by the Internal Audit Bureau that will verify SHDF funding. Audit outcomes will be communicated directly to the Office of Administration, Division of Budget and Planning.

Department of Public Safety - Highway Patrol:

Budget requests submitted by the Patrol are based upon our (DPS) judgment of the proper allocation by fund source. Generally speaking, highway funds are requested for activities/programs related to traffic enforcement and highway safety, while funding for other activities/programs is requested from general revenue, federal and other funds.

According to the Constitution of Missouri, the ultimate authority/responsibility to review Patrol budget requests lies with the General Assembly. The Patrol understandably makes the assumption that the General Assembly considers all relevant constitutional and statutory provisions regarding the use of state funds when it appropriates funds.

The State Auditor stated in our last audit in 1990 that approximately \$1,255,371 in salaries paid to personnel in the Patrol's Division of Drug and Crime Control from highway funds should be from other funds since they perform essentially nonhighway-related activities. However, since that time the General Assembly has switched amounts from general revenue to highway funds.

State Auditor's Office:

The State Auditor's Office use of Highway Funds to pay for the audit of highway related activities in other state agencies and counties is appropriate.

We (SAO) have conducted such studies twice in the last ten years. Both times the studies indicated that we expend more to audit highway funds than we receive in highway appropriations. Since we have not asked for any substantive increase in highway funding, and our audit efforts continue to be proportionately consistent, there is little benefit to expending resources on in-depth studies. Before we would ask for any increase in highway funding, we would certainly thoroughly study our expenditure of highway related activities to ensure that such an increase was warranted.

FINDING #4: The date of the 15 Year (1992-2007) Road and Bridge Program obtained from the DH&T does not correspond to HB 1247, and the DH&T has amended the program without legislative approval.

House Bill 1247 refers to the 15 Year (1992-2007) Road and Bridge Program as being adopted by the Highway and Transportation Department on 1-6-92. The actual program book is dated 1-3-92.

House Bill 1247 does not allow for changes in the 15 Year (1992-2007) Road and Bridge Program as it was originally adopted. Some of the miles and number of bridges listed in the 15 Year (1992-2007) Road and Bridge Program will not be completed exactly as shown on page two of the program. This is the result of errors and inaccurate estimates when the program was originally put together. For example, 19,600 miles of low type resurfacing are indicated on page two of the program as being added to the Proposition A projects; however, according to the DH&T, this is an error because it includes Proposition A projects. Only 9,800 miles will be done in addition to Proposition A miles. Five of the 494 bridges will not be strengthened because the DH&T determined that the bridges are not wide enough for two-way traffic, so there is no reason to strengthen them for two-way traffic. On the other hand, 675 miles of pavement replacement are

planned to be completed as opposed to 338 as shown in the program book. Also, instead of 1,597 miles of high type resurfacing, 6,195 miles plan to be completed.

Oversight also found an instance where a project was added to the Highway Right of Way and Construction Program and given as high of priority as projects in the 15 Year (1992-2007) Road and Bridge Program because of the urgent need to strengthen a bridge.

RECOMMENDATION TO FINDING #4

Currently HB 1247 does not allow for amendments to the 15 Year (1992-2007) Road and Bridge Program. Oversight recommends a legislative change to allow for the DH&T to amend the 15 Year (1992-2007) Road and Bridge Program to adjust for changes in estimates, etc. with the approval of the legislature. Another option would be to require legislative approval of the program, along with the tax increase, every three years since the DH&T can only predict with any degree of certainty projects for the next three years. The program book could then be updated every three years. The updated program book could also include a time line for starting and completing the projects. These recommendations would allow for an accurate document to exist for the legislature and the taxpayers indicating how the tax increase from HB 1247 will be used.

Agency Response to Finding #4

Department of Highway and Transportation:

The Missouri Constitution (Article IV, Section 30(b)) grants full discretion and control (including amendments) over the location, relocation, establishment, acquisition, and construction and maintenance of state highways and bridges to the Missouri Highway and Transportation Commission (MHTC). For this purpose, the funds in the State Road Fund "stand appropriated without legislative action". Therefore, legislative action to allow changes to the 15 year plan is not necessary.

Although the Legislature does not have control over project approval, the Legislature does control the amount of funding. In recognition of this fact, Section

1 of HB 1247 (Section 142.009) provides that the General Assembly may place the fuel tax increases enacted under HB 1247 before the voters for approval or rejection if the General Assembly is of the opinion that those revenues are not being used for the purposes outlined in the 15 Year Road and Bridge Program. Although the General Assembly has the power to do so with or without provisions of Section 1, the control over funding must not be confused with control over project selection in order to avoid any constitutional problems.

For these reasons, we believe the discretion granted to the MHTC under the Constitution clearly allows MHTC to make changes in the program as needs and priorities (which are identified with public involvement) change, without legislative approval. If the General Assembly is subsequently dissatisfied with the program, the General Assembly may repeal funding for the program or submit the funding issue to the voters for consideration.

FINDING #5: The DH&T's accounting system does not provide a clear and efficient trail of the history of transactions.

The accounting system of the DH&T is not fully computerized. The parts of the system that are computerized are not fully integrated. A fully integrated computer system could run the construction project ledgers, cash receipts and disbursements and financial reports from the same database. This would result in greater efficiency in reconciling reports and provide a clear, permanent record of accounting transactions.

RECOMMENDATION TO FINDING #5

Oversight recommends the DH&T research what software is compatible to their needs and what the costs are. They may want to start by contacting other states.

Agency Response to Finding #5

Department of Highway and Transportation:

We concur that our current accounting system is not fully automated. The

department has a long-range Information Strategy Plan that was approved by the Highway and Transportation Commission at its November, 1993 meeting. There are numerous needs in the department for automation which have been prioritized and will be implemented based on this priority. A new accounting system is included in this long-range plan.

FINDING #6: The DH&T is not following Missouri transient employer laws in regard to contracting with out-of-state construction companies. Their procedures do not include obtaining proof of registration with some other state agencies.

In Oversight's sample of eighty construction expenditure transactions, eight were for contractor payments. Oversight was unable to obtain from an out-of-state contractor included in the sample a certificate of registration in Missouri for the payment of Missouri withholding tax, unemployment tax and adequate workers' compensation insurance to be in compliance with Section 285.234, RSMo Supp. 1993. Oversight contacted the contractor and the DH&T for this information.

RECOMMENDATION TO FINDING #6

Oversight recommends the DH&T implement a policy to require a copy of the certificate of registration from the contractor before approving the contractor to be eligible to bid on Missouri jobs. This will enable the DH&T to avoid potential tax liabilities for the out-of-state contractor's state employment tax liabilities.

Agency Response to Finding #6

Department of Highway and Transportation:

DH&T concurs with the finding and has changed procedures by including the necessary special provisions in all contracts to insure compliance with Missouri transient employer laws.

FINDING #7: Total construction expenditures projected by the DH&T exceed projected revenues.

The total projected construction expenditures per the supporting documentation for the 1993 Highway Right of Way and Construction Program through the year 2007 are \$12,711,143,000. Total revenues projected through the year 2007 are \$10,257,000,000, which includes state and federal revenues. Therefore, based on the projections, it does not appear that there will be adequate funding to complete all of the construction projects.

RECOMMENDATION TO FINDING #7

Oversight recommends that the DH&T consider whether they will have adequate funding to complete the projects included in the 15 Year (1992-2007) Road and Bridge Program to determine if the projects can be completed more efficiently or the fund balances can absorb the difference to avoid another tax increase.

Agency Response to Finding #7

Department of Highway and Transportation:

DH&T agrees with this recommendation to the finding. A review of the 15 Year Plan is currently underway. The department intends to perform annual reviews throughout the remainder of the plan.

FINDING #8: DH&T's internal accounting controls may not be sufficient to protect the agency against errors or irregularities.

Oversight examined a sample of eighty construction expenditure transactions. Of this sample, three were for hourly time sheets. An instance was noted where a crew report for an hourly time sheet for maintenance was prepared and approved by the same person. This defeats the purpose of having an approval done.

RECOMMENDATION TO FINDING #8

In order to follow good internal control procedures, someone other than the preparer of a document should approve it.

Agency Response to Finding #8

Department of Highway and Transportation:

We agree that someone other than the preparer of a document should approve it and our current accounting procedures require it.

Conclusion

The Oversight Division's program audit related to HB 1247 is intended to provide the General Assembly with information in determining if the motor fuel tax increase scheduled to go into effect April 1, 1996 should be voted by the people for implementation or repeal. The audit also informs the General Assembly as to whether the tax money is being used efficiently and effectively, administered as authorized or required by law and whether the uses conform with statutory intent. Our primary audit areas centered on the collection of the motor fuel tax, appropriations out of the highway fund, interest earned by the highway fund and construction related to the 15 Year (1992-2007) Road and Bridge Program.

We considered all of the findings previously mentioned to be significant in relation to HB 1247. With respect to the items tested, the only non-compliance issues related to HB 1247 or deficiencies in management controls that we noted are included in the previously mentioned findings. With respect to the items not tested, nothing came to our attention that caused us to believe that the agencies affected did not comply with HB 1247.