



PERFORMANCE AUDIT REPORT 100-Hour Audit

**Motor Fuel Tax Refunds:
Determining Whether the Adjustments Made to
Refund Claims Were Handled Correctly**

**A Report to the Legislative Post Audit Committee
By the Legislative Division of Post Audit
State of Kansas
June 2003**

Legislative Post Audit Committee

Legislative Division of Post Audit

THE LEGISLATIVE POST Audit Committee and its audit agency, the Legislative Division of Post Audit, are the audit arm of Kansas government. The programs and activities of State government now cost about \$9 billion a year. As legislators and administrators try increasingly to allocate tax dollars effectively and make government work more efficiently, they need information to evaluate the work of governmental agencies. The audit work performed by Legislative Post Audit helps provide that information.

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June 11, 2003

To: Members, Legislative Post Audit Committee

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This report contains the findings, conclusions, and recommendations from our completed performance audit, *Motor Fuel Tax Refunds: Determining Whether the Adjustments Made to Refund Claims Were Handled Correctly (100-hour audit)*.

The report includes several recommendations to the Department of Revenue to ensure that it processes and pays motor fuel tax refund claims accurately. We would be happy to discuss these recommendations or any other items in the report with any legislative committees, individual legislators, or other State officials.

Barbara J. Hinton
Legislative Post Auditor

EXECUTIVE SUMMARY

LEGISLATIVE DIVISION OF POST AUDIT

Overview of Motor Vehicle Tax Refunds

Taxes imposed on the distribution and sales of motor fuels such as gasoline, gasohol, and diesel have increased 3 times in the past 4 years, and will again increase July 1, 2003. As a result, motor fuel tax collections have steadily increased to almost \$382 million in fiscal year 2002 and most likely will continue to rise. page 2

Taxpayers can request a refund of the motor fuel tax if they've paid \$25 or more in taxes and the fuel has been used for school buses or off-road uses such as farming, boating, or lawn mowing. To claim a refund, individuals or businesses must have a motor fuel refund permit. When taxpayers first apply for motor fuel refund permits, and each time they submit a refund claim, the Department sends them a new motor fuel tax claim card to use the next time they file. These cards have the fuel tax rates pre-printed on them for the taxpayer to calculate their refund. Each year for the past 6 years, between \$6 and \$7 million in motor fuel tax refunds has been paid to taxpayers claiming refunds. page 2

Did the Department of Revenue Appropriately Handle Corrections To the Motor Fuels Tax Rate When Taxpayers Submitted Outdated Refund Forms?

In all, 37% of the motor fuel refund claims we reviewed were paid inaccurately. We identified problems with 21 of the 57 refund claims we reviewed: The Department underpaid 14 claims (for a total of \$353) and overpaid 6 claims (for a total of \$533). The Department refunded nearly \$59,000 to one company, but we couldn't tell whether that amount was justified. page 4

For some refund claims, Department staff made errors trying to correct claim cards that had outdated tax rates, or they simply didn't correct errors on the cards. The Department pre-prints the tax rates on the claim cards that taxpayers use to file their refund claims. In the past few years tax rates have increased, and the rates on these cards will often be outdated. Taxpayers have up to a year after they buy fuel to claim a refund and because they use the rates on the pre-printed cards to calculate their claim, the amount they ask for will often be understated. page 5

In our sample, many taxpayers submitted their refund claims on cards that had outdated tax rates. Here's a summary of the problems we identified with how the Department handled these claims:

- ! For 7 claims, Department staff correctly adjusted the tax rates, but incorrectly reduced the number of gallons the taxpayer claimed. Of these claims, 6 taxpayers were underpaid a total of \$66 and one was overpaid by 18 cents. Department staff told us these errors happened because staff who processed claims had misunderstood training about how to manually adjust claims submitted after the Department's electronic payments system was shut down at the end of the year. These adjustments were supposed to be made to only a limited number of claims, not to all claim cards with old tax rates.
- ! For 8 claims, Department staff didn't update the tax rate to the current rate and simply processed the claims at the lower tax rate. If the rates had been updated, these 8 taxpayers would have received a total of nearly \$288 in additional refunds. Department staff told us they made a "business decision" to process claims without updating the tax rates because their staff had become too busy to change them.
- ! For 4 claims, the Department didn't fix errors that taxpayers had made, such as claiming gasoline on the "diesel" line item which has a higher tax rate. Such errors caused these 4 taxpayers to be overpaid by a total of nearly \$38.

In two cases, the documentation submitted didn't fully support taxpayers' refund claims, but the Department still refunded the full amounts. State law requires taxpayers to submit original fuel invoices with their refund claims.

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In one case, a school district claimed it had purchased and used 4,905 gallons of fuel, but the invoices submitted showed it had purchased only 2,439 gallons. The Department should have refunded the district \$549, not the \$1,045 the district claimed.

In the other case, a large corporation didn't submit original invoices for its refund claim of nearly \$59,000. Instead, it submitted a list it had generated itself as proof that it had purchased slightly more than \$583,000 in fuel. This listing didn't include the date of purchase, the number of gallons, type of fuel, or whether tax had been paid. All this information is required by State law. In response to an inquiry by the Department for original invoices, the company sent a handful of invoices. We reviewed those, and found that about \$1,080 of the slightly more than \$6,600 in purchases shown on the invoices was for such things as dyed diesel, gasoline, and fuel delivery charges - none of these costs are eligible for a diesel tax refund.

Department staff told us they didn't require the company to submit original invoices because they were operating under the assumption there was an exception to the State law requiring taxpayers to submit original invoices with their claims. Department officials also told us they have allowed such exceptions for several taxpayers who purchase large amounts of fuel for non-highway purposes, but they couldn't tell us which

taxpayers had been granted such exceptions. Further, the State law they cited as justification for not requiring original invoices, K.S.A. 49-3456, simply allows fuel distributors the option of using automated procedures to create invoices. It doesn't allow taxpayers to generate proof of their own fuel purchases and then submit that proof with their motor fuel tax refund claim.

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This audit was conducted by Laurel Murdie and Katrin Osterhaus. Leo Hafner was the audit manager. If you need any additional information about the audit's findings, please contact Ms. Murdie at the Division's offices. Our address is: Legislative Division of Post Audit, 800 SW Jackson Street, Suite 1200, Topeka, Kansas 66612. You also may call us at (785) 296-3792, or contact us via the Internet at LPA@lpa.state.ks.us.

Motor Fuel Tax Refunds: Determining Whether the Adjustments Made to Refund Claims Were Handled Correctly

The State imposes a tax on motor vehicle fuels sold in Kansas to help finance the construction and repair of Kansas highways. State law (K.S.A. 79-3453) allows anyone who buys motor-vehicle fuel for a non-highway use—such as for agricultural purposes—to file a claim with the Department of Revenue for a refund of the fuel tax they paid.

Motor fuel tax rates have increased each year for the past 3 years. These yearly rate increases can make it more difficult to ensure that the claims taxpayers submit—and the refunds they receive—are correct. Here's why:

- ! depending on when someone buys fuel and how often they file a claim, the invoices they submit could be for fuel purchased at 2 different tax rates.
- ! because tax rates have increased several years in a row, the claim cards people use to request their refunds don't always show the most up-to-date tax rates. As a result, taxpayers may inadvertently report that refunds are owed to them based on the wrong tax rates.

When this audit was requested, legislative concerns were being raised that the adjustments Department staff made when taxpayers submitted refund claims on out-dated forms were inaccurate, resulting in taxpayers receiving a smaller refund than they were owed. This 100-hour audit addressed those concerns by answering the following question:

Did the Department of Revenue appropriately handle corrections to the motor fuels tax rate when taxpayers submitted outdated refund forms?

To answer this question, we reviewed laws and regulations related to motor fuel tax refunds, interviewed Department officials about their processing procedures, and reviewed a sample of motor fuel refund claims submitted during fiscal year 2003.

A copy of the scope statement the Legislative Post Audit Committee approved for this audit is included in *Appendix A*. In conducting this audit, we followed all applicable government auditing standards. Our findings begin on page 4, following a brief overview of the motor fuel refund program.

Overview of Motor Fuel Tax Refunds

In Kansas, taxes are imposed on the distribution and sales of various motor fuels to generate revenue for highway construction and maintenance. Those include taxes on gasoline and gasohol, diesel fuel, liquid petroleum, and compressed natural gas. *Table OV-1* shows the tax rates imposed on each fuel type since July 1, 1999.

Table OV-1 Kansas Motor Fuel Tax Rates from July 1, 1999 to Present			
Effective Date	Gasoline and Gasohol	Diesel (a)	LP and compressed natural gas
July 1 1999 to June 30 2001 (FY 2000 and FY 2001)	\$.20	\$.22	\$.19
July 1, 2001 to June 30, 2002 (FY 2002)	\$.21	\$.23	\$.20
July 1, 2002 to June 30, 2003 (FY 2003)	\$.23	\$.25	\$.22
Starting July 1, 2003 (FY 2004)	\$.24	\$.26	\$.23
(a) Dyed diesel or "ruby diesel" is purchased tax-free and therefore can't be claimed for refund			

Tax collections on motor fuel sales increased from \$308.6 million in fiscal year 1997 to \$381.6 million in fiscal year 2002, and can be expected to grow in future years because of the increased tax rates. Of the \$5.6 billion in taxes collected during fiscal year 2002, motor fuels represents about 6.8%.

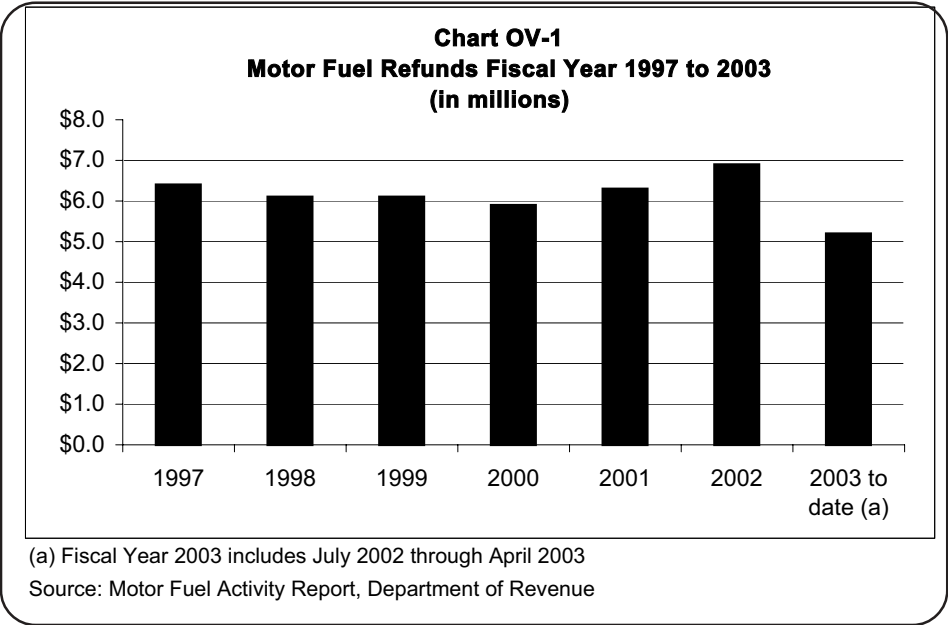
Taxpayers can request a refund of the tax imposed on motor-vehicle or special-use fuels if they've paid \$25 or more in fuel taxes and if the fuel has been used for school buses or any purpose other than driving on public highways. Eligible uses could include such things as fuel used for farming, boating, or lawn mowing.

To qualify for a refund, individuals or businesses must first apply for and receive a motor fuel refund permit from the Department of Revenue. New permit holders receive their permit card, a refund claim card, and instructions on how to complete the claim card.

To claim a refund, the fuel purchaser sends a refund claim card and the original receipts to the Department of Revenue. Once the permit holder uses the claim card to request a refund, the refund is

processed and a new claim card is sent to the permit holder along with the refund.

Over the past 6 years, total motor fuel tax refunds have fluctuated between \$6 million and \$7 million annually. That information is illustrated in *Chart OV-1*. The Division receives about 7,000 claims for motor fuel tax refunds each year.



**Dept. of Revenue - Division of Tax Operations
AT A GLANCE**

Authority: Created by K.S.A. 75-5102 through 75-5104
Staffing: The Division has 535 full-time-equivalent positions.
Budget: The Division administers and enforces most Kansas State taxes, such as individual and corporate; retail sales and use; inheritance; minerals; controlled substances; excise taxes, and motor fuels taxes. Most of the Division's funding comes from the State General Fund. For the most recent year, the Division took in and spent close to \$28 million, as shown below.

FY 2002 Expenditures			Sources for Funding for Expenditures	
<u>Type</u>	<u>Amount</u>	<u>% of Total</u>		
Salaries & Wages	\$18,889,256	68.1%	Vehicles Operating Fund	\$3,180,659 11%
Other Operating Expenditures	\$6,222,593	22.4%	Other Funds	\$3,285,056 12%
Other Assistance	\$2,619,962	9.4%	State General Fund	\$21,288,018 77%
Non-reportable	\$21,922	0.1%		
Total Expenses:	\$27,753,733	100%	Total Funding:	\$27,753,733

Source: *The Governor's Budget Report*, Vol. 2, FY 2003, and Dept. of Revenue budget office.

Did the Department of Revenue Appropriately Handle Corrections to the Motor Fuels Tax Rate When Taxpayers Submitted Outdated Refund Forms?

In all, more than one-third of the motor fuel refund claims we reviewed were paid incorrectly. The refunds paid incorrectly ranged from a few cents to several hundred dollars; some taxpayers were overpaid, and others underpaid. In most cases, Department staff made errors trying to correct outdated tax rates on the refund claim cards taxpayers submitted, or simply didn't correct the errors on those cards. In 2 cases, the documentation submitted didn't fully support the claim submitted, but the Department paid the full refund anyway. This included one claim by a large corporation that didn't submit any original invoices to support its claim, as required by law. We noted numerous problems with this claim and the Department's handling of it. These and related findings are discussed in more detail below.

In All, 37% of the Motor Fuel Refunds Claims We Reviewed Were Paid Incorrectly

The Department's written policies for processing motor fuel tax refund claims call for its staff to verify that:

- ! taxpayers' refund claims were submitted within one year of the date they purchased the fuel used for non-highway purposes.
- ! the claim isn't for "dyed" diesel. This type of diesel, which is artificially colored, is sold exclusively for non-highway use, so the buyer doesn't pay any tax on it.
- ! the taxpayer has claimed no more gallons of fuel for non-highway use than are shown on the original fuel invoices submitted with the claim. (There's essentially no way for the Department to know how much of the fuel purchased actually was used for non-highway purposes.)

To determine whether Department staff had made appropriate adjustments to taxpayers' refund claims and otherwise handled refund claims appropriately, we selected a random sample of 60 motor fuel refund claims filed during fiscal year 2003. Department staff could not locate the claim forms or supporting documentation for 3 of those claims, so we were only able to review records for 57 refund claims.

We identified problems with 21 of the 57 refund claims we reviewed. As shown in *Table I-1* on the next page, the Department

underpaid taxpayers on 14 claims, and overpaid taxpayers on 6. In addition, as described later in this report, we couldn't tell whether the Department had refunded the correct amount for a large corporation that claimed a refund. More detailed information about each of the claims we reviewed is summarized in *Appendix B*.

Table I-1	
For 14 claims in our sample, taxpayers were underpaid a total of \$353.	
Largest amount underpaid...	\$ 195
Smallest amount underpaid...	\$ 3
Average amount underpaid...	\$ 25
For 6 claims in our sample, taxpayers were overpaid a total of \$533.	
Largest amount overpaid...	\$ 495
Smallest amount overpaid...	18 ¢
Average amount overpaid	\$ 89

Source: LPA analysis of a sample of motor fuel refund claims made during fiscal year 2003.

For Some Refund Claims, Department Staff Made Errors Trying To Correct Claim Cards That Had Outdated Tax Rates, or They Simply Didn't Correct Errors on the Cards

When taxpayers first apply for motor fuel refund permits, and each time thereafter when their refund claims are processed, the Department sends them a new claim card to use the next time they file. These cards have the fuel tax rates pre-printed on them.

If rates go up before the next filing deadline, the rates on the card will be wrong. Because taxpayers use these rates to calculate the amount of refund they are owed, and because they have up to a year after they buy fuel to claim the tax refund, the amount of refund they ask for will often be understated on the claim card they send in. When claim cards were submitted with outdated rates, Department staff often tried to correct the claims as they came in.

In our sample of 57 claims we noted that 33 taxpayers (58%) had submitted their claims on cards that had outdated tax rates. Here are some examples of the problems we identified with the Department's handling of these refund claims:

- ! **For 7 claims in our sample, Department staff correctly adjusted the tax rates up, but offset that increase by reducing the number of gallons the taxpayers had claimed.** Department officials told us this happened because the staff who processed claims had misunderstood training about how to manually adjust claims submitted after the Department's electronic payment system was shut down at the end of the year. These adjustments were supposed to be made to only a limited number of claims, not to all claims. The example on the following page illustrates this problem.

	Gallons	Tax rate	Tax Refund Amount
Claim as submitted by taxpayer...	1,000	.20 ¢	\$ 200.00
Claim as changed by the Department...	952	.21 ¢	\$ 199.92
Claim if correctly processed...	1,000 (gallons are unchanged)	.21 ¢ (rate updated)	\$ 210.00 (\$10.00 additional)

In all, the Department underpaid 6 of these taxpayers about \$66 in total. Supervisory staff had not reviewed a sample of the adjustments these employees made to ensure that they were accurate and appropriate. Department officials became aware of and remedied this problem in late December 2002, when a taxpayer questioned the adjustments that had been made to the number of gallons he'd claimed.

- ! **For 8 claims in our sample, Department staff didn't update the tax rate to the current rate and simply processed the fuel refund claim at the lower tax rate.** If the rates on these claims had been updated, these 8 taxpayers would have received nearly \$288 in total additional refunds. Department officials told us they made a "business decision" to process claims without updating the tax rates because their staff had become too busy to change them.
- ! **For 4 claims in our sample, the Department didn't fix errors that taxpayers had made.** In one case, the taxpayer had claimed 2 fuel types—gasoline and diesel—all on the line item that allows claims for taxes paid on diesel fuel. The Department processed the taxpayer's claim as submitted, overpaying by \$31 because it refunded 25 cents of tax per gallon on all 4,748 gallons claimed, rather than paying 23 cents for gasoline claimed, and 25 cents for diesel fuel.

In Two Cases, the Documentation Submitted Didn't Fully Support Taxpayers' Refund Claims, but the Department Still Refunded the Full Amounts

To obtain a refund, State law requires taxpayers to submit original fuel invoices with their claims. Department procedures also require its staff to verify that the taxpayer has claimed no more gallons of fuel for non-highway use than are shown on those original invoices. In our sample, we found 2 claims—both for substantial refunds—that weren't fully supported by original invoices, but for which the Department refunded the full amounts.

In one case, a school district claimed it had purchased and used 4,905 gallons of fuel, but the invoices it submitted totaled only 2,439 gallons. Based on this documentation, the Department should have refunded the district \$549, not the \$1,045 the district claimed.

In the other case, a large corporation didn't submit original invoices for its refund claim. This claim involved a large corporation that submitted a request for a fuel tax refund of nearly \$59,000, claiming it had used about 253,000 gallons of diesel fuel for non-highway purposes during the first part of 2002.

However, we noted numerous problems with this claim:

- ! **except for a handful of invoices, the company submitted no documentation from the fuel distributors or retailers that it had purchased fuel from.** K.S.A. 79-3458 requires taxpayers claiming a fuel tax refund to attach the original fuel invoices to their claims. These invoices must be prepared by a licensed fuel distributor or retailer.
- ! **this company submitted a list it had generated itself as proof of the fuel purchases it had made.** That list consisted of about 500 line items for the first 7 months of 2002, with a dollar amount for each line, totaling slightly more than \$583,000. However, this list didn't show the types of information the law requires be submitted with the claim, including the date of purchase, the total gallons of fuel purchased, the type of fuel purchased, and whether the tax had been paid on that fuel. Further, more than 330 line items had no fuel distributor or retailer name listed, and some of the names were those of individual persons, not licensed fuel distributors or retailers.
- ! **the few original invoices the company submitted showed it had paid slightly more than \$6,600 to one fuel distributor, about \$1,080 of which was for dyed diesel, gasoline and fuel delivery charges—none of these costs were eligible for this diesel fuel tax refund.** This raised questions about how much of the \$583,000 the company showed on its self-generated list of fuel purchases actually were payments for fuel that was eligible for a refund.

We also identified several problems with the way the Department handled this claim:

- ! **The Department shouldn't have paid this claim as it was submitted.** Based on the information the company submitted, the Department paid the nearly \$59,000 refund the company had asked for. Although it's possible the company purchased as much diesel fuel as it claimed during the year, the information it submitted didn't comply with State law and didn't support its claim.

! **Department staff told us they didn't require the company to submit original invoices because they were operating under the assumption there was an exception to the statutory requirement that taxpayers submit original fuel invoices.** However, the State law they cited—K.S.A. 79-3456—simply allows fuel distributors the option of using automated procedures to generate fuel invoices. It doesn't allow taxpayers to generate proof of their own fuel purchases. Department staff indicated these “exceptions” were granted on a case-by-case basis; they couldn't tell us which companies had been granted an exception.

Department officials also said it would be unreasonable to expect large companies with lots of fuel purchases to submit original invoices for each purchase with their refund claims. We agree this could be onerous for both the companies and Department staff. However, some reasonable alternatives to individual, original invoices could give companies greater flexibility while still minimizing the risks involved. These alternatives include that:

- ! *the Department could allow taxpayers purchasing and using large amounts of fuel for non-highway purposes to submit itemized lists from their distributors or retailers, instead of individual invoices for each purchase.* This option would likely not require a change in State law, and could benefit those taxpayers that buy a lot of fuel from just a few distributors or retailers.
- ! *the Department could allow taxpayers purchasing and using large amounts of fuel for non-highway purposes to submit a self-generated list of the fuel purchases, and then require them to submit original invoices for a random sample of those purchases.* This option would require a change in the law that requires taxpayers to submit original invoices (K.S.A. 79-3458).

Under this option, the Department could pre-approve which taxpayers would be given this option (i.e., potentially limiting it only to those taxpayers who can demonstrate they buy fuel from a lot of different distributors and retailers across the State), as well as the format and content of the information taxpayers would be required to submit. At minimum, the information submitted should include the date of each purchase, the total gallons of fuel purchased, the type of fuel purchased, whether tax had been paid on each fuel type, and the names of each distributor and retailer for each purchase.

Conclusion The problems we identified with motor fuel tax refund claims generally didn't involve large over or under-payments. However, taxpayers and others expect the Department to process and pay these claims accurately. In addition, we noted that for claims made for substantial amounts, the risk of overpayment is especially high because the Department has allowed informal exceptions to the State law requiring original fuel invoices. The Department can address all these problems by implementing and following better procedures, and by training and supervising staff processing these refund claims.

- Recommendations**
1. **To correct problems caused by taxpayers submitting motor fuel refund claim cards with outdated tax rates**, the Department should take one of the following actions:
 - a. **continue to send motor fuel refund claim cards with pre-printed tax rates, but also include instructions that outline all fuel tax rates and any recent changes to those rates**, as well as an alert to the taxpayer that claims cards may not include the most up-to-date tax rates and that the Department may need to adjust claims if calculated incorrectly.
 - b. **require taxpayers to categorize their fuel purchases by amount, type, and date purchased, not by tax rate.** Rather than sending out motor fuel tax refund claim cards with pre-printed rates, the Department would only need to verify that the taxpayer has enough invoices to support the gallons claimed, and the Department's payment system would calculate the refund.
 2. **To ensure that Department staff refund motor fuel refund claims correctly**, Department officials should:
 - a. **Train staff** to follow Department procedures for paying claims.
 - b. **Supervise staff.** At minimum, have supervisory staff regularly pull and test a small sample of claims for accuracy.
 3. **To ensure that the Department follows current State law and refunds the correct amount to taxpayers with substantial motor fuel refund claims**, the Department should

adopt one of the alternatives outlined on page 8. Those alternatives include:

- a. allowing taxpayers purchasing and using large amounts of fuel for non-highway purposes to submit itemized lists from their distributors or retailers, instead of individual invoices for each purchase. This option likely would not require a change in State law.
 - b. allowing taxpayers purchasing and using large amounts of fuel for non-highway purposes to submit a self-generated list of the fuel purchases, and require them to submit original invoices for a random sample of those purchases. This alternative likely would require K.S.A. 79-3458 to be amended.
4. **For those claims that our audit showed to be paid in error, the Department should take steps necessary to correct them,** including refunding correct amounts to those taxpayers who were underpaid, and withholding amounts from future refund claims filed by taxpayers who were overpaid.

APPENDIX A

Scope Statement

This appendix contains the scope statement that has been authorized by the Chair of the Legislative Post Audit Committee on Wednesday, January 22, 2003. The requesting Legislator was Representative Pyle.

SCOPE STATEMENT

Motor Fuel Tax Refunds: Determining Whether the Adjustments Made to Refund Claims Were Handled Correctly

Under State law (K.S.A. 79-3453), anyone who buys motor-vehicle fuel but doesn't use it to operate a vehicle on public highways—such as for agricultural purposes—is entitled to a refund of the motor fuels tax paid. To claim the refund, the person has to get a permit, needs to file a claim within a year of the purchase date, and must submit original invoices showing the gallons of fuel they bought.

Motor fuel tax rates increased from 20¢ to 21¢ on July 1, 2001, and to 23¢ on July 1, 2002. They'll increase again on July 1, 2003. These yearly rate increases can make it more difficult to ensure that the claims taxpayers submit—and the refunds they receive—are correct. Here's why:

- **depending on when someone buys fuel and how often they file a claim, the invoices they submit could be for fuel purchased at 2 different tax rates.**
- **because tax rates have increased several years in a row, the claim cards people use to request a refund don't always show the most up-to-date tax rates. As a result, they may inadvertently show that refunds are owed to them based on the wrong rates.**

Department of Revenue officials have indicated that, if a person files a fuel tax refund that's incorrect or that doesn't include original invoices, their common practice is to send that claim back to the taxpayer to correct before processing the refund through the computer. However, because of the large number of incorrect motor fuel refund claims that have come in, Department staff have been making some of those adjustments themselves, entering "corrected" information into the computer that shows how many gallons of fuel were purchased at which tax rate.

Legislative concerns have been raised that the adjustments Department staff have made when taxpayers submitted motor fuel tax refund claims on out-dated forms were inaccurate, resulting in taxpayers receiving less refund than they are owed. A 100-hour performance audit would address this concern by answering the following question:

1. **Did the Department of Revenue appropriately handle corrections to the motor fuels tax rate when taxpayers submitted outdated refund forms?** To answer this question, we would interview Department staff and review any relevant policies, procedures, and other Department records to determine how changes should be made when the fuel tax refund claim a taxpayer submits contains the wrong tax rate. For a sample of motor fuel tax refund requests that taxpayers filed using outdated forms, we would determine what corrections Department staff had made, whether they were appropriate, and whether they resulted in the taxpayer receiving the correct tax refund. We would perform other testwork as needed.

Estimated time: 100 hours

APPENDIX B

Information About 21 of the 57 Claims the Department Paid Incorrectly

Sample #	Original Claim Amount	Department Refund	Refund Should have Been	Difference	Reason claim was paid incorrectly
3	\$326.55	\$326.55	\$342.55	\$16.00	Gallons adjusted inappropriately
9	\$165.07	\$165.07	\$163.07	-\$2.00	Didn't fix taxpayer's errors
11	\$114.03	\$114.03	\$119.29	\$5.26	Didn't adjust rate and refund when it should have
12	\$266.20	\$266.11	\$265.93	-\$0.18	Gallons adjusted inappropriately
15	\$452.18	\$452.18	\$476.00	\$23.82	Didn't adjust rate and refund when it should have
17	\$674.52	\$674.52	\$691.35	\$16.83	Didn't adjust rate and refund when it should have
21	\$270.27	\$270.27	\$278.67	\$8.40	Gallons adjusted inappropriately
24	\$59.60	\$59.64	\$62.58	\$2.94	Gallons adjusted inappropriately
29	\$179.60	\$179.55	\$197.16	\$17.61	Gallons adjusted inappropriately
30	\$263.36	\$264.27	\$271.69	\$7.42	Didn't adjust rate and refund when it should have
31	\$176.80	\$176.82	\$193.54	\$16.72	Gallons adjusted inappropriately
36	\$80.00	\$80.01	\$84.00	\$3.99	Gallons adjusted inappropriately
37	\$626.29	\$626.29	\$621.97	-\$4.32	Didn't fix taxpayer's errors
38	\$199.71	\$199.71	\$209.16	\$9.45	Didn't adjust rate and refund when it should have
39	\$1,044.53	\$1,044.53	\$549.05	-\$495.48	Documentation not sufficient to back up the refund
41	\$5,228.16	\$5,228.16	\$5,423.38	\$195.22	Didn't adjust rate and refund when it should have
45	\$1,187.00	\$1,187.00	\$1,156.03	-\$30.97	Didn't fix taxpayer's errors
48	\$58,995.00	\$58,994.59	unknown	unknown	Documentation not sufficient to back up the refund
53	\$416.43	\$416.43	\$441.73	\$25.30	Didn't adjust rate and refund when it should have
55	\$103.00	\$108.15	\$112.45	\$4.30	Didn't adjust rate and refund when it should have
57	\$61.00	\$64.47	\$64.05	-\$0.42	Didn't fix taxpayer's errors

APPENDIX C

Agency Response

On June 3rd, we provided a copy of the draft audit report to the Revenue. The Department's response is included as this Appendix.



K A N S A S

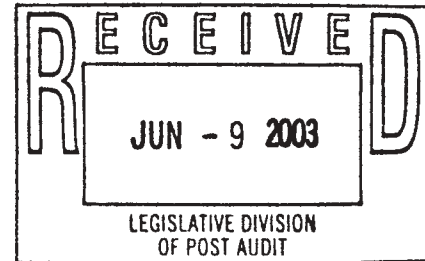
JOAN WAGNON, SECRETARY

DEPARTMENT OF REVENUE
OFFICE OF THE SECRETARY

KATHLEEN SEBELIUS, GOVERNOR

June 9, 2003

Ms. Barbara Hinton,
Legislative Post Auditor
Legislative Division of Post Audit
800 SW Jackson, Suite 1300
Topeka, Kansas 66612



Dear Ms. Hinton:

Thank you for the opportunity to respond to the draft audit report, *Motor Fuel Tax Refunds: Determining Whether the Adjustments Made to Refund Claims Were Handled Correctly*. We find the results of your testwork and the accompanying recommendations very instructive.

The processes that we employ to remit motor fuel tax refunds provide adequate control in most cases. The taxpayer receives a prompt refund that is accurate within a few dollars almost every time. With staff cutbacks that have been necessitated over the past few years, we lack the necessary manpower to provide an exhaustive audit and supervisory review over every claim submitted. The risk of an error occurring that would have a material impact on the taxpayer's refund is not great enough to warrant transferring personnel resources away from other key tax processes that impose even greater challenges and risks.

That being said, your audit has correctly identified several problems that can and will be corrected within a few short months. We plan to implement your suggestions for changing our existing processes or implement alternative improvements that we may derive from our own internal review.

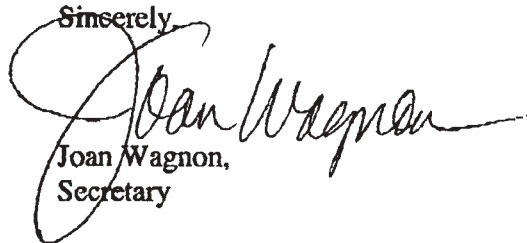
The Department disagrees with the conclusion that the risk of overpayment is especially high because the Department has allowed informal exceptions to the State law requiring original fuel invoices. The informal exceptions allowed are due to changes in technology, and are handled on a case by case basis. Statutes may need to be revised and internal processes updated to meet today's technology. We are encouraged that implementation of the recommendations below will alleviate that concern.

DOCKING STATE OFFICE BUILDING, 915 SW HARRISON ST., TOPEKA, KS 66612-1588
Voice 785-296-3081 Fax 785-296-7928 <http://www.ksrevenue.org/>

KDOR responses to LPA recommendations:

1. **Agreed.** To correct problems caused by taxpayers submitting motor fuel refund claim cards with outdated tax rates, the Department of Revenue will revise our claim card instructions for increased clarity. Inevitably, some claims are received that are computed using the wrong rate. In our new instructions we will indicate that tax rates on claim cards may become invalid if a fuel tax rate change occurs, as well as indicate that their claim may be adjusted due to the rate change.
2. **Agreed.** We will reevaluate the key controls in our process for paying claims and have supervisory staff regularly conduct testwork to keep material errors from occurring.
3. **KDOR agrees with recommendation (b).** We believe K.S.A. 79-3458 should be clarified in accordance with today's technologies, as well as to allow alternative methods of fuel receipt justification at the Director's discretion. Any reengineering of verification controls will include the possibility of auditing customers whose refund claims exceed pre-defined risk tolerance levels.
4. **KDOR plans to refund the additional amount due to the customer on the seven refunds in the auditors' sample that exceed \$15.00.** We do not plan to seek reimbursement from taxpayers in the auditors' sample who received overages.

Sincerely,



Joan Wagnon,
Secretary