



MICHIGAN

OFFICE OF THE AUDITOR GENERAL

AUDIT REPORT

PERFORMANCE AUDIT
OF THE

MOTOR VEHICLE TITLE AND REGISTRATION PROCESS

DEPARTMENT OF STATE

January 2015



Doug A. Ringler, CPA, CIA
AUDITOR GENERAL

The auditor general shall conduct post audits of financial transactions and accounts of the state and of all branches, departments, offices, boards, commissions, agencies, authorities and institutions of the state established by this constitution or by law, and performance post audits thereof.

– Article IV, Section 53 of the Michigan Constitution

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Report Summary

Performance Audit

Motor Vehicle Title and Registration Process

Department of State

Report Number:
231-0200-14

Released:
January 2015

The Department of State's responsibilities include administering and enforcing various sections within the Michigan Vehicle Code (Act 300, P.A. 1949, as amended) pertaining to the titling and registration of vehicles and the collection of related taxes and fees. The Department's mission is to deliver modern, efficient, cost-effective, and convenient service to the citizens of Michigan. The Department's executive officer, the Secretary of State, is an elected official who serves no more than two four-year terms.

Audit Objective	Audit Conclusion		
Objective 1: To assess the effectiveness of the Department's efforts in collecting taxes and fees when processing motor vehicle title and registration transactions.	Moderately effective		
Findings Related to This Audit Objective	Material Condition	Reportable Condition	Agency Preliminary Response
The Department did not always accurately prorate gross vehicle weight registration fees. We noted inconsistencies between the number of registered months recorded by the Department and our recalculation of registered months for 2,261 (14%) of the 15,846 registration transactions processed by the Department during April 2014. For 35 (70%) of 50 selected registration transactions from the 2,261 transactions, the Department overcharged or undercharged customers for the registration fees (<u>Finding 1</u>).	X		Agrees
The Department, in conjunction with the Department of Treasury, needs to strengthen its procedures to verify the reasonableness of use tax collected for motor vehicle title transactions. We estimated that the State may have forgone between \$9.2 million and \$36.5 million per year in motor vehicle use tax, based on sample results (<u>Finding 2</u>).		X	Partially agrees
The Department had not established a sufficient process to ensure the accuracy of new vehicle registration fee categories reported by dealers and manufacturers. The Department may have charged inaccurate registration fees to at least 18,363 and as many as 81,583 customers from May 2013 through April 2014, based on sample results (<u>Finding 3</u>).		X	Partially agrees

Audit Objective			Audit Conclusion
Objective 2: To assess the effectiveness of the Department's efforts to ensure that motor vehicle registration applications were accompanied by proof of insurance.			Moderately effective
Findings Related to This Audit Objective	Material Condition	Reportable Condition	Agency Preliminary Response
The Department did not verify the completeness of Electronic Insurance Verification (EIV) Program data, thereby limiting some customers from renewing vehicle registrations on-line or with self-service kiosks (<u>Finding 4</u>).		X	Agrees
The Department should investigate the feasibility and cost-effectiveness of implementing a Web-based insurance verification system to assist the Department in verifying proper insurance of motor vehicles in real time. A Web-based insurance verification system would also help reduce data integrity errors and protect the confidentiality of insurance information (<u>Finding 5</u>).		X	Disagrees

Audit Objective			Audit Conclusion
Objective 3: To assess the effectiveness of the Department's efforts in monitoring business entities participating in the Michigan Electronic Filing System (MiEFS) Program.			Moderately effective
Finding Related to This Audit Objective	Material Condition	Reportable Condition	Agency Preliminary Response
The Department did not sufficiently and timely monitor transactions and inquiries recorded by MiEFS Program participants. This resulted in potential errors to customer fees and access to confidential data (<u>Finding 6</u>).		X	Agrees

A copy of the full report can be obtained by calling 517.334.8050 or by visiting our Web site at:
<http://audgen.michigan.gov>

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Doug A. Ringler, CPA, CIA
Auditor General

January 16, 2015

The Honorable Ruth Johnson
Secretary of State
Richard H. Austin Building
Lansing, Michigan

Dear Secretary Johnson:

This is our report on the performance audit of the Motor Vehicle Title and Registration Process, Department of State.

This report contains our report summary; a description; our audit objectives, scope, and methodology and agency responses and prior audit follow-up; comments, findings, recommendations, and agency preliminary responses; and a glossary of abbreviations and terms.

Our comments, findings, and recommendations are organized by audit objective. The agency preliminary responses were taken from the agency's response at the end of our audit fieldwork. The *Michigan Compiled Laws* and administrative procedures require that the audited agency develop a plan to comply with the audit recommendations and submit it within 60 days after release of the audit report to the Office of Internal Audit Services, State Budget Office. Within 30 days of receipt, the Office of Internal Audit Services is required to review the plan and either accept the plan as final or contact the agency to take additional steps to finalize the plan.

We appreciate the courtesy and cooperation extended to us during this audit.

Sincerely,

A handwritten signature in black ink that reads "Doug Ringler".

Doug Ringler
Auditor General

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GLOSSARY

Glossary of Abbreviations and Terms

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Description

The Department of State's responsibilities include administering and enforcing various sections within the Michigan Vehicle Code (Act 300, P.A. 1949, as amended) pertaining to the titling and registration of vehicles and the collection of related taxes and fees. The Department's mission* is to deliver modern, efficient, cost-effective, and convenient service to the citizens of Michigan. The Department's executive officer, the Secretary of State, is an elected official who serves no more than two four-year terms.

During fiscal year 2013, the Department collected \$2.2 billion in taxes and fees. Of this amount, the Department collected \$1.0 billion in sales and use tax* on motor vehicles and \$1.0 billion in motor vehicle title and registration fees. A portion of the sales and use tax revenue collected by the Department is distributed to the School Aid Fund for use by the Michigan Department of Education in accordance with the Michigan Constitution, and the remaining amount is distributed to the State's General Fund, which is further allocated by the Department of Treasury. Revenue from motor vehicle title and registration fees collected by the Department is used to fund the Department's operations and the operations of certain other State departments. The Department expended \$196.9 million during fiscal year 2013 for its operations.

As of June 30, 2014, the Department had 131 branch offices, including 1 mobile branch office, and 1,579 employees, including 930 employees working in branch offices.

* See glossary at end of report for definition.

Audit Objectives, Scope, and Methodology and Agency Responses and Prior Audit Follow-Up

Audit Objectives

Our performance audit* of the Motor Vehicle Title and Registration Process, Department of State, had the following objectives:

1. To assess the effectiveness* of the Department's efforts in collecting taxes and fees when processing motor vehicle title and registration transactions.
2. To assess the effectiveness of the Department's efforts to ensure that motor vehicle registration applications were accompanied by proof of insurance.
3. To assess the effectiveness of the Department's efforts in monitoring business entities participating in the Michigan Electronic Filing System (MiEFS) Program*.

Audit Scope

Our audit scope was to examine the motor vehicle title and registration process and related records of the Department of State. We conducted this performance audit in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives. Our audit procedures, which included a preliminary survey, audit fieldwork, report preparation, analysis of agency responses, and quality assurance, generally covered the period October 1, 2011 through June 30, 2014.

Audit Methodology

We conducted a preliminary survey of the Department's operations as they pertained to its motor vehicle title and registration process in order to establish our audit objectives and methodology. Our preliminary survey included:

- Reviewing applicable laws, regulations, policies, and procedures.
- Reviewing MiEFS Program agreements and standards.

* See glossary at end of report for definition.

- Interviewing Department management and other employees.
- Observing daily activities related to processing motor vehicle title and registration transactions.
- Obtaining an understanding of the information systems used to process transactions.
- Conducting on-line research of best practices.

To accomplish our first objective, we:

- Obtained an understanding of sales and use tax requirements for motor vehicles.
- Obtained an understanding of the Department's processes for referring certain tax-related transactions to the Department of Treasury.
- Reviewed the Department's processes for identifying and correcting errors in motor vehicle title and registration transactions.
- Reviewed a judgmental selection of 50 commercial vehicle registrations processed during April 2014 to determine if gross vehicle weight* (GVW) registration fees were accurate. Because we judgmentally selected the items to test, our testing results may not apply proportionately to the entire population (Finding 1).
- Reviewed a statistical sample of used motor vehicle title transactions related to vehicles less than 10 years old and processed during April 2014 to assess the reasonableness of the reported purchase price. We projected the results of our testing to the population using a statistical method, and we projected these results on an annual basis using nonstatistical methods (Finding 2).
- Reviewed a statistical sample of 43 transactions and 2 additional nonstatistically selected transactions of new motor vehicle registration transactions processed during the period May 1, 2013 through April 30, 2014 to determine the accuracy of taxes and fees charged. We statistically projected the results of our testing from our statistical sample (Finding 3). We did not identify any errors within our nonstatistical sample.

* See glossary at end of report for definition.

- Reviewed a statistical sample of 43 used motor vehicle registration transactions processed during the period May 1, 2013 through April 30, 2014 to determine the accuracy of taxes and fees charged. We projected the results of our testing to the population using a statistical method.
- Reviewed a judgmental selection of 25 added fee invoice* transactions processed during the period October 1, 2011 through March 31, 2014 to determine if the invoice amounts were accurately calculated. Because we judgmentally selected the items to test, our testing results may not apply proportionately to the entire population.
- Reviewed judgmental selection of 28 customer fee change transactions and 20 sales tax credit transactions processed during the period October 1, 2011 through March 31, 2014 to determine the accuracy of fees and tax credits. Because we judgmentally selected the items to test, our testing results may not apply proportionately to the entire population.
- Reviewed a judgmental selection of 29 refund transactions processed during the period October 1, 2011 through April 4, 2014 to determine the accuracy of refunds. Because we judgmentally selected the items to test, our testing results may not apply proportionately to the entire population.

The Department was unable to provide us with a complete population of used motor vehicle title transactions, which included purchase price information, because the purchase price was stored in its mainframe system for a period of only 180 days. Also, the Department was unable to provide us with a complete population of motor vehicle registration transactions for our audit period because of the extensive resources needed to extract this data from its mainframe system. However, as noted in previous paragraphs, we obtained a population of April 2014 motor vehicle title transactions, which included purchase price information, and a population of motor vehicle registration transactions processed by the Department during the period May 1, 2013 through April 30, 2014 and tested samples of transactions from these populations.

* See glossary at end of report for definition.

To accomplish our second objective, we:

- Obtained an understanding of the Department's processes related to obtaining and maintaining Electronic Insurance Verification (EIV) Program* data reported by insurance companies and authorized third parties.
- Compared a list of insurance companies authorized to insure private passenger vehicles in Michigan to the insurance companies submitting electronic insurance data to the Department.
- Obtained an understanding of the Department's processes for conducting periodic insurance certificate surveys to verify the validity of the paper proofs of insurance directly with insurance companies.
- Reviewed a random sample of motor vehicle registration renewal transactions for vehicles not included in the Department's EIV Program data to determine if proof of insurance was obtained.
- Reviewed best practices related to electronic insurance verification and conducted on-line research of insurance verification programs of other states.

To accomplish our third objective, we:

- Obtained an understanding of the criteria for participating in the MiEFS Program.
- Reviewed a random sample of business entities to determine if they met the eligibility requirements for participating in the MiEFS Program.
- Reviewed the Department's process for reviewing transactions processed by participants in the MiEFS Program and for following up on errors.
- Obtained a download of the Department's MiEFS Program error database and analyzed errors by business entity and type.
- Reviewed the Department's process for monitoring on-line queries of driver and vehicle records performed by MiEFS Program participants.
- Reviewed the Department's process for monitoring the submission of inventory reports related to saleable items (e.g., license plates) assigned to MiEFS Program participants.

* See glossary at end of report for definition.

We based our audit conclusions on our audit efforts as described in the preceding paragraphs and the resulting material condition* and reportable conditions* noted in the comments, findings, recommendations, and agency preliminary responses section. The material condition is more severe than the reportable conditions and could impair management's ability to operate effectively or could adversely affect the judgment of an interested person concerning the effectiveness and efficiency of the Department's motor vehicle title and registration process.

When selecting activities or programs for audit, we direct our efforts based on risk and opportunities to improve the operations of State government. Consequently, we prepare our performance audit reports on an exception basis.

Agency Responses and Prior Audit Follow-Up

Our audit report contains 6 findings and 6 corresponding recommendations. The Department's preliminary response indicates that it agrees with 3, partially agrees with 2, and disagrees with 1 of the recommendations.

The agency preliminary response that follows each recommendation in our report was taken from the agency's written comments and oral discussion at the end of our audit fieldwork. Section 18.1462 of the *Michigan Compiled Laws* and the State of Michigan Financial Management Guide (Part VII, Chapter 4, Section 100) require the Department to develop a plan to comply with the audit recommendations and submit it within 60 days after release of the audit report to the Office of Internal Audit Services, State Budget Office. Within 30 days of receipt, the Office of Internal Audit Services is required to review the plan and either accept the plan as final or contact the agency to take additional steps to finalize the plan.

We released our prior performance audit of Cash Receipts and Branch Office Customer Service, Department of State (231-0200-08), in May 2009. Within the scope of this audit, we followed up 2 of the 6 prior audit recommendations. The Department substantially complied with 1 of the 2 recommendations. We repeated the other prior audit recommendation in Finding 3 of this audit report.

* See glossary at end of report for definition.

COMMENTS, FINDINGS, RECOMMENDATIONS, AND AGENCY PRELIMINARY RESPONSES

EFFECTIVENESS OF EFFORTS IN COLLECTING TAXES AND FEES WHEN PROCESSING MOTOR VEHICLE TITLE AND REGISTRATION TRANSACTIONS

COMMENT

Audit Objective: To assess the effectiveness of the Department of State's efforts in collecting taxes and fees when processing motor vehicle title and registration transactions.

Audit Conclusion: Moderately effective.

Factors leading to this conclusion included:

- The material condition related to the proration of gross vehicle weight (GVW) registrations and the reportable conditions related to verifying use tax and ensuring the accuracy of vehicle registration fee categories.
- The cumulative amount of customer overcharges and undercharges identified and projected were not quantitatively material in relation to the \$2.0 billion in taxes and fees collected by the Department for motor vehicle title and registration transactions.
- The impact of undercharged taxes and fees on the operations of the Department and other State departments that rely on revenue from taxes and fees collected by the Department.
- The impact of overcharged taxes and fees on customers.

FINDING

1. GVW Registration Fees

The Department did not always accurately prorate GVW registration fees. As a result, the Department charged inaccurate registration fees to some customers.

The Michigan Vehicle Code (Act 300, P.A. 1949, as amended) requires the Department to charge vehicle registration fees on commercial vehicles based on the vehicle's elected GVW. Section 257.802 of the *Michigan Compiled Laws* (a section of the Michigan Vehicle Code) provides that the Department may, upon

request, issue GVW registrations for three or more months for vehicles with an elected GVW of 24,000 pounds or greater and charge a prorated registration fee.

The Department processed 15,846 GVW registration transactions during April 2014 and collected \$5.4 million for these transactions. We compared the number of registered months recorded by the Department in its Branch Office System* (BOS) to our recalculation of the actual number of registered months issued for each transaction. We noted inconsistencies for 2,261 (14%) of the 15,846 registration transactions. Our review of a judgmental selection of 50 of these transactions disclosed that the Department incorrectly calculated prorated registration fees for 35 (70%) of the transactions. As a result, the Department overcharged 24 customers by a total of \$10,488 and undercharged 11 customers by a total of \$16,891. The 24 customers were overcharged from \$123 (33%) to \$1,818 (58%), with an average overcharge of \$437, and the 11 customers were undercharged from \$241 (17%) to \$2,412 (125%), with an average undercharge of \$1,536.

For example, the Department processed a GVW registration renewal in April 2014 with an October 2015 expiration date but then charged the customer a prorated 8-month registration fee. Therefore, the customer paid for the cost of an 8-month registration that was valid for 18 months, resulting in an undercharge of \$2,412. In another transaction, the Department processed a new GVW registration transaction in April 2014 with an expiration date of the last day of February 2015 but then charged the customer a 12-month nonprorated registration fee. However, the Department could have charged the customer a prorated 10-month registration fee and saved the customer \$520 (2 months of the 12-month registration fee).

The Department's procedures contained unclear guidance related to prorating GVW registration fees. Also, although Department procedures provided examples of GVW transactions that will result in the best value to the customer, the Department informed us that because the Michigan Vehicle Code provides that a prorated GVW registration is available upon request, the Department is not obligated to offer a prorated registration, which may provide the best value to each customer.

* See glossary at end of report for definition.

We identified various programming anomalies within the Department's BOS that required the branch clerk to override key data fields used to prorate GVW registrations. For example, BOS often generated different expiration dates than those originally entered by a branch clerk, resulting in improperly extending the customer's expiration date unless identified and corrected by the branch clerk. Upon our notification of the system weaknesses to the Department, the Department submitted a service request to the Department of Technology, Management, and Budget (DTMB) to address the BOS programming anomalies.

RECOMMENDATION

We recommend that the Department always accurately prorate GVW registration fees.

AGENCY PRELIMINARY RESPONSE

The Department provided us with the following response:

The Department agrees with the audit finding in the assertion of inaccurate calculation of prorated GVW registration fees. The Department also validated that certain anomalies exist within its information technology system resulting in inaccurate calculation of prorated GVW registration fees. As a result of the Department examination, a Remedy Ticket was submitted to DTMB to investigate and address the apparent anomalies occurring within BOS when calculating prorated GVW registration fees. The Department escalated the Remedy Ticket to a high priority to determine why the anomalies are occurring and the appropriate action to resolve them. DTMB has identified the software programming error and is developing a plan for correcting the software. Additionally, Department internal staff began reviewing prorated GVW registration fee transactions more closely on fee edit reports following the determination of a potential BOS programming issue. This enhanced review will continue until the BOS programming issue is resolved.

FINDING

2. Motor Vehicle Use Tax Collections

The Department, in conjunction with the Department of Treasury, needs to strengthen its procedures to verify the reasonableness of use tax collected for motor vehicle title transactions. We estimated that the State may have forgone the collection of \$9.2 million to \$36.5 million per year in revenue from motor vehicle use tax because of underreporting of motor vehicle retail values.

Section 205.179 of the *Michigan Compiled Laws* (a section of the Streamlined Sales and Use Tax Revenue Equalization Act, Act 175, P.A. 2004) requires the Department to collect use tax at a rate of 6% of the retail dollar value, as determined by the Department of Treasury, before the transfer of ownership of a motor vehicle from someone other than a licensed Michigan vehicle dealer. The Department of Treasury, which is responsible for administering and enforcing laws related to use tax, has issued General Sales and Use Tax Rules within the *Michigan Administrative Code*. These rules provide that the base price to be used in computing use tax shall not be less than a vehicle's retail dollar value as listed in any recognized guide for use or appraisal purposes.

We obtained a population of motor vehicle title transactions related to vehicles less than 10 years old and processed by the Department during April 2014, which involved the collection of \$3.2 million in use tax. We used a statistical sampling methodology to select a sample of used motor vehicle title transactions from this population. To evaluate the retail price used in computing use tax for our sampled items, we utilized processes sanctioned by the Department of Treasury through its General Sales and Use Tax Rules within the *Michigan Administrative Code*.

Based on our sample results, we estimate that the Department may have forgone the collection of use tax revenue ranging from \$762,696 to \$3,043,488 in April 2014. If the used motor vehicle title transactions processed during April are reflective of a typical month for the Department, we estimated that the Department could have collected additional use tax revenue ranging from \$9.2 million to \$36.5 million per year if it strengthened its procedures for verifying the reasonableness of motor vehicle use tax.

Our review of the Web sites of other states noted that several state motor vehicle administrators have established procedures related to the collection of tax on vehicle title transactions between private parties, including the establishment of minimum taxable values, the use of recognized appraisal guides, and/or requirements for a notarized bill of sale at the time of the title transaction.

According to Section 205.28 of the *Michigan Compiled Laws*, certain aspects of tax auditing and collection are protected, nonpublic data. As a result, we have omitted detailed information regarding our review of the Department of State and Department of Treasury's procedures related to the enforcement of motor vehicle use tax and key assumptions and detailed information related to our audit sampling methodology and results. We have separately reported the results of our review to the Department and the Department of Treasury in accordance with generally accepted government auditing standards.

RECOMMENDATION

We recommend that the Department, in conjunction with the Department of Treasury, strengthen its procedures to verify the reasonableness of use tax collected for motor vehicle title transactions.

AGENCY PRELIMINARY RESPONSE

The Department provided the following response:

The Department partially agrees with the finding. The Department does agree that it should report use tax transactions to the Department of Treasury. It is the Department's opinion that tax determination is under the purview of the Department of Treasury. The Department will work with the Department of Treasury to determine any appropriate steps to increase the effective collection of tax.

FINDING

3. Vehicle Registration Fee Categories

The Department had not established a sufficient process to ensure the accuracy of new vehicle registration fee categories reported by dealers and manufacturers. As a result, the Department may have charged inaccurate registration fees to at least

18,363 and as many as 81,583 customers during the period May 1, 2013 through April 30, 2014.

Section 257.801 of the *Michigan Compiled Laws* (a section of the Michigan Vehicle Code) requires the Department to charge vehicle registration fees for vehicles weighing less than 8,000 pounds with a model year of 1984 or newer by converting the vehicle's base price to a fee category. A vehicle's base price is determined based on the manufacturer's suggested retail price (MSRP). If the MSRP is unavailable, the vehicle's base price shall be determined based on the purchase price of the vehicle. Department procedures require the submission of an RD-108 form when dealers and manufacturers register new vehicles with the Department, which includes the reporting of the vehicle's fee category in accordance with these statutory requirements.

We obtained a population of vehicle registration transactions processed by the Department during the period May 1, 2013 through April 30, 2014, which consisted of 268,607 vehicle registration transactions for new (previously untitled) vehicles. We selected a random sample of 45 transactions from this population and compared the reported fee categories to MSRP information published by the National Automobile Dealers Association (NADA). We noted that the fee categories reported by dealers and manufacturers were not reasonable for 8 (18%) of the 45 transactions tested. As a result, the Department overcharged 3 customers and undercharged 5 customers for vehicle registration fees. Based on the calculation of vehicle registration fees for a 12-month period, we calculated differences in the registration fees charged ranging from an undercharge of \$20 to an overcharge of \$20 each for two customers, with an average undercharge and overcharge of 7% and 13%, respectively.

The fee category remains with a vehicle record for the life of the vehicle. Therefore, these differences will continue to occur each year the customer renews the vehicle registration unless the Department corrects the fee category. For example, for one vehicle, the incorrect fee category would result in overcharging the customer \$82 (10%) over a five-year period if the customer owned the vehicle during this time period. Based on our sample results, we are 95% confident that the fee categories were not accurate for at least 18,363 but not more than 81,583 of the 268,607 new vehicle transactions processed by the Department during the period May 1, 2013 through April 30, 2014.

The Department informed us that it relies on dealers and manufacturers to report correct fee categories when registering new vehicles, and it does not check the fee categories reported against MSRP information.

We noted a similar condition in our prior audit. In response to the prior audit, the Department stated that it agreed and was implementing a new automated information system that would systematically calculate fees based on an analysis of the vehicle identification number (VIN). However, the Department had not yet implemented the new system.

RECOMMENDATION

We again recommend that the Department establish a sufficient process to ensure the accuracy of new vehicle registration fee categories reported by dealers and manufacturers.

AGENCY PRELIMINARY RESPONSE

The Department provided the following response:

The Department partially agrees with this audit finding. The Department continues to support and is actively pursuing an automated VIN based program for providing vehicle MSRP information. The Department has selected an enhanced VIN edit package that will be used to establish the registration fee categories, alleviating some of the variation that currently exists. However, as noted, the data supporting the VIN based system still relies on the manufacturers providing the underlining information.

EFFECTIVENESS OF EFFORTS TO ENSURE MOTOR VEHICLE REGISTRATION APPLICATIONS WERE ACCOMPANIED BY PROOF OF INSURANCE

COMMENT

Audit Objective: To assess the effectiveness of the Department's efforts to ensure that motor vehicle registration applications were accompanied by proof of insurance.

Audit Conclusion: Moderately effective.

Factors leading to this conclusion included:

- The reportable conditions related to ensuring completeness of Electronic Insurance Verification (EIV) Program data and investigating the implementation of a Web-based insurance verification system.
- The Department's processes to include periodic verifications of the existence of proper insurance directly with insurance companies.
- The impact of incomplete and inconsistent use of EIV Program data on the Department's ability to prevent uninsured motorists from registering their vehicles.
- The risk of fraud associated with paper certificates of insurance.

FINDING

4. Completeness of EIV Program Data

The Department did not verify the completeness of EIV Program data. As a result, some customers may have been prevented from utilizing the Department's on-line and self-service kiosk systems when renewing their vehicle registrations. Also, the Department could not reduce its reliance on paper certificates of insurance, which are more susceptible to fraud, when processing motor vehicle registration renewal transactions.

The Insurance Code of 1956 (Act 218, P.A. 1956, as amended) requires automobile insurers writing policies for Michigan residents to provide insurance policy information for private passenger nonfleet automobiles in the format and time line required by the Department. The policy information shall include the insurer's name, the named insured, the named insured's address, the policy number, and the VIN. The Insurance Code of 1956 also requires the Department to provide this policy information to the Department of Community Health (DCH) to assist DCH in increasing third party liability collections from automobile insurers for Medicaid beneficiaries. The Insurance Code of 1956 and the Michigan Vehicle Code provide that the Department accept the transmission of an insured vehicle's VIN as proof of vehicle insurance for motor vehicle registration purposes.

The Department requires insurance providers to electronically transmit the policy information, known as EIV Program data, on the first and fifteenth of every month. Insurers must submit an EIV Program user work sheet and enroll as an authorized reporter to transmit the data electronically to the Department. Insurers can contract with third party reporters to submit their data. When the data is submitted, an automated process immediately directs the data directly to DCH. DCH removes all policy information except for the VIN from the data before sending the data to the Department. Therefore, the Department obtains only the VIN and does not actually obtain the other required policy information. If a customer's VIN is included in the EIV Program data at the time of registration renewal, the customer can renew the vehicle registration on-line or through a self-service kiosk.

Our review of the Department's processes related to the EIV Program data submission process disclosed:

- a. The Department did not verify whether all companies licensed to insure personal automobiles in Michigan submitted EIV Program data. Although the Department periodically verified that all authorized reporters submitted data, it did not verify whether the data submissions included information from all insurance companies because it did not obtain the insurer's name in the data it obtained from DCH.

The Department informed us that it believed that the insurer's name is considered policy information and that the Department would need a court order to obtain this information from DCH because of confidentiality requirements. Section 500.3101a(3) of the *Michigan Compiled Laws* (a section of the Insurance Code of 1956) provides that policy information submitted by an insurer and received by the Department is confidential, is not subject to the Freedom of Information Act, and shall not be disclosed to any person except DCH or pursuant to a court order in connection with a claim or fraud investigation or prosecution.

While the law prevents the Department from disclosing policy information to anyone other than DCH, it does not appear to preclude the Department from summarizing the policy information by insurer's name to assist in verifying the completeness of the EIV Program data.

- b. The Department did not verify whether all companies licensed to insure personal automobiles in Michigan had enrolled as authorized reporters of EIV Program data. We compared an April 2014 list of automobile insurers licensed to issue policies for Michigan residents published by the Department of Insurance and Financial Services (DIFS) to the Department's list of authorized reporters. We noted that the Department did not have sufficient documentation to support whether 21 (19%) of 110 companies had enrolled as authorized reporters of EIV Program data or had contracted with a third party to submit their data.

The Department informed us that it receives a list of licensed insurance companies from DIFS each year to identify which companies should be reporting. However, the Department did not document its process for reviewing the list. Also, we noted that the most recent list that the Department obtained from DIFS was based on 2011 information.

RECOMMENDATION

We recommend that the Department verify the completeness of EIV Program data.

AGENCY PRELIMINARY RESPONSE

The Department provided the following response:

The Department agrees to continue its ongoing effort to ensure that all insurance companies required to report personal coverage are sending the required policy information. The Department believes investing in reprogramming its existing program would not bring significant cost-benefit for the State. The Department is investigating other national reporting systems that could better meet the needs of the Department and the companies writing policies in Michigan for the future.

FINDING

5. Web-Based Insurance Verification System

The Department should investigate the feasibility and cost-effectiveness of implementing a Web-based insurance verification system. A Web-based insurance verification system would assist the Department in verifying that motor vehicles are properly insured at the time of registration renewal in real time. It would also help

reduce data integrity errors, which may cause customers to be mistakenly identified as uninsured, and protect the confidentiality of insurance information.

According to the Insurance Industry Committee on Motor Vehicle Administration (IICMVA), the effectiveness of automobile liability insurance reporting (ALIR) systems, whereby insurance companies submit periodic data files to state motor vehicle departments, has been adversely affected by data integrity issues, such as the reporting of incorrect VINs and the timeliness of reporting. Also, ALIR systems can be costly to implement and maintain by state jurisdictions and insurance companies. Some of these costs may be passed on to consumers in the form of higher premiums or other costs if consumers are mistakenly identified as uninsured. According to the IICMVA, evidence suggests that state ALIR systems have not effectively met their main objective: to identify and track uninsured motorists. Therefore, the IICMVA strongly supports a Web-based system as a method for state agencies to use when verifying evidence of automobile liability insurance. Using Web services technology, each insurance company is responsible for maintaining a Web portal or service through which on-line insurance verification can take place and for maintaining the data necessary to verify automobile liability insurance for event-based situations, including vehicle registration, traffic stops, and accidents.

Although the Department's ALIR system, known as the EIV Program, was designed to and does comply with current legislative requirements, our review of the system noted the following factors that could support moving to a real-time Web-based insurance verification system:

- a. Insurance companies are required to submit data on the first and fifteenth of each month and, therefore, the data may be outdated at the time the Department processes a vehicle registration renewal transaction.
- b. The Department accepts paper certificates of insurance if a customer's VIN is not included in the EIV Program data at the time of registration. However, the Department has determined through its random insurance verification reviews for the quarter ended May 2014 that paper certificates of insurance submitted by customers were fraudulent or invalid in 11.0% of the transactions processed through the mail and 5.4% of the transactions processed through branch offices.

According to the IICMVA, an on-line inquiry approach to insurance verification provides many benefits, including:

- Jurisdictions can incorporate on-line verification systems into their license plate renewal programs.
- There is no need to exchange massive amounts of data that is rarely, if ever, referenced, let alone 100% accurate and/or timely.
- The confidentiality of insurance information is protected within the confines of each insurance carrier's information technology environment.
- The matching limitations and data integrity issues of current state reporting programs is minimized or reduced.

According to the American Association of Motor Vehicle Administrators, as of August 2013, 8 states had adopted on-line verification, a real-time Web-based service to confirm in-force insurance. Our review of the Web sites of these 8 states noted that the programs of 6 of these states were operational.

The Department informed us that it was aware of the IICMVA recommendation, and it was watching the progress of other states that are developing these on-line verification systems. In September 2013, the Secretary of State, in conjunction with the Michigan Department of State Police, DIFS, insurance industry leaders, and prosecutors, established the Fighting Auto Insurance Rip-Offs (FAIR) Task Force to address the emerging problem of fraudulent insurance certificates in Michigan. One of the FAIR Task Force's recommendations, included in its September 2014 report, was to move to an on-line verification system based on industry and State agency technological capability.

While we recognize that implementing an on-line verification system would be a long-term project, that it would require the collaboration of several State agencies and members of the insurance industry, and that legislative changes would be necessary, we believe the potential benefits are substantial enough to warrant moving forward with investigating the feasibility and cost effectiveness of a new on-line system.

RECOMMENDATION

We recommend that the Department investigate the feasibility and cost-effectiveness of implementing a Web-based insurance verification system.

AGENCY PRELIMINARY RESPONSE

The Department provided the following response:

The Department disagrees with the recommendation. The reason for the disagreement is that the Auditor General is repeating a recommendation that was already made by the FAIR Task Force, and the Department does not believe it is a reportable condition when a recommendation already was established and was supported by the Department.

EFFECTIVENESS OF EFFORTS IN MONITORING BUSINESS ENTITIES PARTICIPATING IN THE MiEFS PROGRAM

COMMENT

Background: The Department's Michigan Electronic Filing System (MiEFS) Program allows participating automotive-related businesses to process their vehicle transactions electronically through a computerized vehicle registration* (CVR) without having to take the transaction to the local Department branch office. As of June 30, 2014, 485 business entities were participating in the MiEFS Program. Business entities include licensed Michigan dealers, rental fleet companies, and vehicle title service companies based both in Michigan and out of the State.

Audit Objective: To assess the effectiveness of the Department's efforts in monitoring business entities participating in the MiEFS Program.

Audit Conclusion: **Moderately effective.**

* See glossary at end of report for definition.

Factors leading to this conclusion included:

- The reportable condition related to the Department's efforts in monitoring transactions and inquiries recorded by MiEFS Program participants.
- The over 1.4 million motor vehicle title transactions processed through the MiEFS Program during the period October 1, 2011 through April 30, 2014.
- The Department's other monitoring procedures, including ensuring that business entities met the criteria for participation, reviewing on-line inquiries, and following up on discrepancies identified in quarterly inventory reports.
- The impact of uncorrected transaction errors by MiEFS Program participants on customers.
- The impact of insufficient and untimely monitoring of transactions and inquiries on the Department's ability to ensure that MiEFS Program transactions are processed in an accurate, timely, and secure manner.

FINDING

6. MiEFS Program Monitoring

The Department did not sufficiently and timely monitor transactions and inquiries recorded by MiEFS Program participants. As a result, the Department could not ensure that participants had processed motor vehicle title and registration transactions in accordance with MiEFS Program standards, which could include errors that impact customers, such as incorrect fees, and inappropriate access to personal information.

The Department requires authorized businesses participating in the MiEFS Program to comply with MiEFS Program standards. The MiEFS Program standards outline various prohibited practices that could result in the Department temporarily suspending or removing the participant from the MiEFS Program. The MiEFS Program standards also provide that the Department will conduct periodic reviews of participants to evaluate the participants' performance and compliance with program standards.

Our review of the Department's monitoring of MiEFS Program participants disclosed:

- a. The Department did not always identify MiEFS Program transaction errors in a timely manner. As a result, the Department was not able to notify MiEFS Program participants of errors so that participants could make timely corrections.

MiEFS Program standards require participants to mail transaction documentation to the Department within two days of processing the transaction. The Department reviews a selection of each participant's transaction documentation for compliance with program standards and records transaction errors, including missing documentation, in its MiEFS Program error database. Our review of the 31,185 errors recorded by the Department for MiEFS Program transactions processed from October 1, 2011 through April 30, 2014 disclosed that the Department did not review and input 8,497 (27%) errors into its MiEFS Program error database until more than 60 days after the transaction date. On average, the Department did not review and input these errors until 127 days after the transaction date, ranging from 61 days to 410 days. We noted that 3,780 (44%) of the 8,497 errors were related to fee discrepancies that could require the participant to process a refund to the customer.

The Department informed us that it scans approximately 7,000 documents submitted by MiEFS Program participants each day and that the delays in reviewing and inputting errors were primarily the result of ongoing problems with its scanning application system, which the Department used to scan and index all MiEFS Program transaction documents prior to review.

- b. The Department did not review all stand-alone inquiries processed by MiEFS Program participants to ensure that participants accessed only Department records needed in connection with the sale of a vehicle. As a result, the Department could not ensure that all MiEFS Program participants had complied with the federal Driver's Privacy Protection Act* (DPPA) and related Michigan driver privacy laws, which restrict disclosure of individuals' personal information to authorized recipients.

* See glossary at end of report for definition.

MiEFS Program standards provide that when processing a stand-alone inquiry, an inquiry of the Department's mainframe system that is completed outside the normal transaction processing, participants must enter the customer's name and the reason for the inquiry into CVR. The Department conducts periodic reviews of stand-alone inquiries to verify whether the participant performed the inquiry in connection with the sale of a vehicle. MiEFS Program standards provide that noncompliance with DPPA could result in immediate termination from the MiEFS Program.

The Department informed us that its standard procedure was to review all stand-alone inquiries twice a year for inquiries processed during the previous six months. Our review of the Department's summary reports related to its review of stand-alone inquiries processed from July 1, 2011 through May 31, 2014 disclosed that the Department did not review inquiries processed during 11 (31%) of the 35 applicable months.

The Department informed us that because of resource issues, it was not able to audit the stand-alone inquiries. When the Department eventually conducted the reviews, it reviewed only the previous 6 months and did not go back and review all of the months since the last review.

RECOMMENDATION

We recommend that the Department sufficiently and timely monitor transactions and inquiries recorded by MiEFS Program participants.

AGENCY PRELIMINARY RESPONSE

The Department provided the following response:

The Department agrees with the audit finding. New procedures have since been implemented to ensure that all applicable time frames are included in its reviews to ensure customer fees and data access are appropriately covered.

GLOSSARY

Glossary of Abbreviations and Terms

added fee invoice	An invoice issued to a customer after the discovery that the customer was undercharged when the customer initially paid the fee.
ALIR	automobile liability insurance reporting.
Branch Office System (BOS)	The automated information system used to process cash receipt transactions, primarily at the Department's branch offices.
computerized vehicle registration (CVR)	An electronic vehicle registration system used by business entities participating in the MiEFS Program.
DCH	Department of Community Health.
DIFS	Department of Insurance and Financial Services.
Driver's Privacy Protection Act (DPPA)	Federal law (Title 18, Section 2721 of the <i>United States Code</i>) that prohibits the release and use of certain personal information from State motor vehicle records.
DTMB	Department of Technology, Management, and Budget.
effectiveness	Success in achieving mission and goals.
Electronic Insurance Verification (EIV) Program	A program whereby all insurers issuing policies for private passenger nonfleet automobiles in Michigan are required to report electronic insurance policy information to the Department.
FAIR	Fighting Auto Insurance Rip-Offs.

gross vehicle weight (GVW)	The empty weight of a vehicle or combination of vehicles, fully equipped for service, plus the weight of the maximum load that the owner has elected to carry on such vehicle or combination of vehicles; also known as elected gross vehicle weight.
IICMVA	Insurance Industry Committee on Motor Vehicle Administration.
material condition	A matter that, in the auditor's judgment, is more severe than a reportable condition and could impair the ability of management to operate a program in an effective and efficient manner and/or could adversely affect the judgment of an interested person concerning the effectiveness and efficiency of the program.
Michigan Electronic Filing System (MiEFS) Program	A program that allows qualified automotive-related businesses to process motor vehicle title and registration transactions for customers electronically instead of taking the transaction to a local Department branch office.
mission	The main purpose of a program or an entity or the reason that the program or the entity was established.
MSRP	manufacturer's suggested retail price.
performance audit	An audit that provides findings or conclusions based on an evaluation of sufficient, appropriate evidence against criteria. Performance audits provide objective analysis to assist management and those charged with governance and oversight in using the information to improve program performance and operations, reduce costs, facilitate decision making by parties with responsibility to oversee or initiate corrective action, and contribute to public accountability.

reportable condition	A matter that, in the auditor's judgment, is less severe than a material condition and falls within any of the following categories: an opportunity for improvement within the context of the audit objectives; a deficiency in internal control that is significant within the context of the audit objectives; all instances of fraud; illegal acts unless they are inconsequential within the context of the audit objectives; significant violations of provisions of contracts or grant agreements; and significant abuse that has occurred or is likely to have occurred.
use tax	A specific excise tax levied under the Use Tax Act (Act 94, P.A. 1937, as amended) and administered by the Department of Treasury for the privilege of using, storing, or consuming tangible personal property in the State of Michigan.
VIN	vehicle identification number.

