

California State Auditor

B U R E A U O F S T A T E A U D I T S

Department of Motor Vehicles:

**Overstated Costs for Registration
Information Have Resulted in
Inequitable Charges to Customers**



July 1997
96116

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July 2, 1997

96116

The Governor of California
President pro Tempore of the Senate
Speaker of the Assembly
State Capitol
Sacramento, California 95814

Dear Governor and Legislative Leaders:

As requested by the Joint Legislative Audit Committee, the Bureau of State Audits presents its audit report concerning the costs related to the fees the Department of Motor Vehicles (department) charges for vehicle registration information. This report concludes that in fiscal year 1989-90, the department overstated its costs for providing registration and licensing information and has used these costs to establish inequitable fees. Further, because it has not reassessed its costs or revised its fee schedule during the last seven years, the department cannot ensure that its current fees are fair or that they cover the department's costs to deliver information. The report also identifies a few instances when the department did not comply with the law when providing registration and licensing information.

Respectfully submitted,

KURT R. SJOBERG
State Auditor

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Summary

Results in Brief

In fiscal year 1989-90, the Department of Motor Vehicles (department) overstated its costs for providing information to customers. This miscalculation resulted in the department's charging unreasonable, inequitable fees for information services products. Further, because it has not reassessed its costs or revised its fee schedule during the last seven years, the department cannot ensure that its current fees are fair or that they cover the department's costs to deliver registration and licensing information.




Audit Highlights . . .

Our review of fees charged for providing information products revealed that the department:

- Used flawed methods that resulted in overstated costs and higher-than-necessary fees.*
- Has subsidized its costs of providing information to government customers through fees charged to private entities.*
- Generated \$16.5 million annually in profits from sales to private entities purchasing less than one-third of all information products.*

The department fulfills a variety of responsibilities in addition to supplying customers with registration information. These responsibilities include regulating the issuance and retention of driver's licenses, protecting the public interest in vehicle and vessel ownership, and providing personal identification services to drivers and nondrivers. While carrying out these functions, the department acquires and compiles registration and licensing information in its database. The California Vehicle Code allows the department to sell this information but requires it to charge fees that are sufficient to at least cover the cost of providing the information. The department's Office of Information Services (OIS), now called the Information Services Branch, has been the unit primarily responsible for managing the delivery of this information to customers.

Our review focused on the department's process for establishing the fees it charges for registration and licensing information and on whether the department bases those fees upon actual costs. During our review, we noted the following issues that have affected the fees the department charges its customers:

- The department used flawed methods in fiscal year 1989-90 to calculate its costs to create and maintain its database. As a result, the department significantly overestimated its costs to provide registration and licensing information to its customers. Because the department overstated these costs, the fees the department charged some customers were higher than necessary. Moreover, because the department has not updated this calculation of costs or its fee schedule, the department cannot assure the fairness of its fees, nor can it properly identify or manage product profitability.
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- After determining its costs to create and maintain the database, the department did not equitably distribute those costs to all products sold by OIS. Specifically, the department allocated the costs to only three of six products that should have received a proportionate share; therefore, the costs for three of the information products are too high while the costs for the other three are too low. The department thus cannot assure that the fees it established for the various products fairly represent the department's cost of providing these products to customers.
- The department did not retain all of the support for the data it used to calculate unit costs in fiscal year 1989-90, so we reviewed the volume data the department compiled for fiscal year 1995-96. Because we found errors in this current volume data, we question the reliability of the 1989-90 information.
- The department's paying customers are subsidizing its costs to provide registration and licensing information to government entities. Although the California Vehicle Code, Section 1811, requires the department to charge fees sufficient to cover its costs of providing information to its customers, Section 1812 of the same code specifically prohibits the department from charging certain entities, including the State and the federal government, for information obtained from the department's records. The department therefore structured its fee schedule so that the prices paid by individuals and private entities would cover total costs.

In addition we also estimate that, over the past six fiscal years, the department has generated an average profit of \$16.5 million per year from sales of registration and licensing information. Also, in fiscal year 1995-96, the department generated a profit from sales to individuals and private entities that purchased less than one-third of the information the department provided to all of its customers.

Further, we identified a few instances in which the department did not comply with the law when providing registration and licensing information. For example, the department released confidential residence addresses without obtaining the required written assurance that the information would be limited to statistical research and reporting purposes and that the customer would not use the information to contact any person. When it does not comply with the law, the department cannot be sure that customers are fully aware of the restrictions the law imposes on the use of such confidential information,

and the department jeopardizes individuals' privacy. In another instance, we found that, contrary to the requirements of the law, the department also provided information to some customers without ensuring that the fees charged would cover related costs. When this occurs, the department must subsidize these costs by charging other customers more than necessary or by using taxpayers' money.

Recommendations

To establish reasonable and equitable fees for its registration and licensing information the department should take the following actions:

- Using guidelines similar to those described in Appendix B, update its cost calculations and compile reliable volume data to use in its calculation of unit costs. The department should also implement a system to track and report the number and type of records provided to private and government entities.
- Reassess and update its costs periodically to ensure that the costs represent current activities, and modify the fee schedule when necessary.

In addition, the Legislature should consider whether it is reasonable for paying customers to continue subsidizing the department's costs of providing information to government entities.

After assessing and updating its unit cost calculations, the department should establish fees that cover costs and provide for a reasonable profit margin.

Further, to ensure that it protects the confidential information in its records, the department should make certain that it complies with applicable laws before releasing any information.

Finally, the department should adhere to its fee schedule when charging customers for registration information.

Agency Comments

Although the Business, Transportation and Housing Agency is implementing some of our recommendations, it believes that the tone of the report is not consistent with the relative

significance of the audit findings and that we did not consider all the information the department provided. Further, the agency states that implementing our recommendations could increase taxes and fees charged to the public and could result in increased profits for information vendors and insurance companies.

Introduction

Background

The Department of Motor Vehicles (department) fulfills the following responsibilities:

- Protecting the public interest in vehicle and vessel ownership.
- Providing various revenue collection services for state and local agencies.
- Regulating the issuance and retention of driver's licenses.
- Providing personal identification services to drivers and nondrivers.
- Licensing and regulating occupations and businesses related to the manufacture, transport, sale, and disposal of vehicles.
- Licensing and regulating occupations and businesses related to driving instruction.
- Providing information from driver's licenses as well as vehicle and vessel registration records to individuals and to private and government entities.

During fiscal year 1995-96, the department had eight divisions that each consisted of multiple sections or units. Providing support services to the department itself were the Executive, Administration, the Program and Policy Administration, and the Information Systems divisions. The Investigations and Occupational Licensing, Headquarters Operations, Field Operations, and Drivers Safety divisions supplied the department's approximately 40 customer products. New and renewal vehicle registration, transfers of title, and original and duplicate driver's licenses are among these products. The department generates its products by performing such services as registering vehicles and vessels, licensing drivers, and licensing vehicle-related occupations.

While performing these services, the department compiles information, such as data from driver's licenses and from

vehicle and vessel registration, and provides or sells the information to individuals as well as government and private entities. The Information Services Branch, called the Office of Information Services (OIS), before fiscal year 1996-97, is primarily responsible for managing the delivery of this registration and licensing information. Government entities requesting information from the department's records include the courts, law enforcement agencies, and taxing agencies. Private entities include financial institutions, insurance companies, attorneys, and consumer reporting agencies. These private entities generally ask for vehicle ownership information, driver status, traffic accident and conviction history, for data to assist with statistical research and reporting, and for information related to warranties, emissions or product recalls, and vehicle safety.

Laws Restrict the Release of Information

Legislation enacted in 1990 made residence addresses in any of the department's records confidential and restricted the disclosure of this information only to those individuals or entities that meet certain criteria. As a result, the department must evaluate those who request data and limit the release or sale of residence address information to "authorized entities," or requesters who meet the law's criteria. Although the 1990 legislation does not apply to the courts, law enforcement agencies, or other governmental agencies that ask for information, the law affects private entities requesting information from the department. Specifically, the law requires a private entity to establish, among other things, that it has a legitimate business need for the information. In addition, the legislation restricts how private entities can use information obtained from the department's records. For example, the law does not allow vehicle manufacturers or its agents that obtain residence address information for safety, warranty, or product recalls to use the information for direct marketing or solicitation.

The Department Uses a Cost Model To Determine Fees for Its Products

At the end of each fiscal year, the department uses a cost allocation model to determine its costs of providing certain revenue-generating products and operating several of its sections or units. The department designed its model to assign

to these products, sections, and units a portion of its overall operational costs incurred during the fiscal year. For example, in fiscal year 1995-96, the department used the cost model to allocate costs to 40 products, including driver's licenses and vehicle and vessel registrations. In addition, the cost model distributed costs to several sections or units, including OIS. The cost model is part of the department's overall costing system, which is the department's collection of financial and nonfinancial data about its activities. If properly applied, the system should accurately assign costs to products and provide management with information to evaluate its products and operation effectively.

The Department Last Calculated Its Information Delivery Costs in Fiscal Year 1989-90

The last fiscal year in which the department tried to determine its total costs for providing registration and licensing information to customers was fiscal year 1989-90. In addition to identifying the direct, indirect, and overhead costs that it allocated to OIS through the cost model, the department identified additional costs associated with creating and maintaining records in its database, and the department allocated a portion of those costs to OIS. The department then developed methodologies to assign these costs to the specific products sold by OIS. The California Vehicle Code, Section 1811, requires the department to charge for copies of all or any part of records it sells, a fee sufficient to pay at least the entire actual cost of providing the information. Therefore, the department used the costs it identified for the various products that OIS sold to establish the fees it continues to charge customers for registration and licensing information.

Scope and Methodology

At the request of the Joint Legislative Audit Committee, we reviewed the costs associated with the fees that the department charges authorized entities for vehicle registration information. Specifically, we were to determine the following:

- How the department established its charges for registration information and whether the department has based those charges upon the actual cost of providing the information.

- Whether the department has an adequate accounting system and data to ascertain the actual expense of providing registration information and, to the extent possible, to determine the department's true expenses for providing this information.

To establish whether the department complied with relevant laws and regulations, we researched policies concerning the recovery of costs associated with services provided by state departments and examined state laws covering retrieval of costs for information sold.

To determine how the department established the fees it charges for registration information and whether it bases those charges on actual costs, we reviewed the unit costs that the department calculated in fiscal year 1989-90. Because the department did not retain some of the supporting documentation for the costs included in the calculation, we limited our review to an analysis of the methodology the department used to calculate its unit costs.

In addition, to assess whether the department currently has an adequate cost accounting system and data that will allow it to determine its actual expenses for providing registration and licensing information, we analyzed the cost model that the department used during fiscal year 1995-96 to assign its costs to its various divisions, sections, and units, including OIS. We focused our review on the department's allocation of costs to OIS to determine if that allocation resulted in reasonable, equitable charges to OIS. Furthermore, we reviewed expenditure records to ensure that the costs included in the model could be traced to the department's accounting records. Finally, we reviewed the revenues the department received from the sale of registration and licensing information, and we compared those revenues to the related costs.

When reviewing the department's fiscal year 1995-96 cost model and supporting data, we identified issues regarding the method the department uses to assign expenditures from other divisions to its Investigation Units and the way the department allocated certain expenditures incurred by its Program and Policy Administration Division. Although these expenditures may not change significantly the costs allocated to OIS, the expenditures could affect costs allocated to other units or divisions and thus affect the fees charged for other products that the department sells. We cover these issues in a separate letter addressed to the department that we have included as Appendix A in this report.

Chapter 1

The Department of Motor Vehicles Miscalculated Its Costs of Providing Information to Customers

Chapter Summary

In fiscal year 1989-90, the Department of Motor Vehicles (department) miscalculated its costs of providing registration and licensing information, thus establishing fees that are unreasonable and inequitable. Specifically, the department overstated its total costs for providing the information because the methodology it used to estimate database creation and maintenance costs had flaws. However, we could not determine the magnitude of the overstatement because the department did not retain the workload data directly associated with the database creation and maintenance activities.

The department also did not equitably allocate its costs to the products sold by the Office of Information Services (OIS), now known as the Information Services Branch. Therefore, when the department calculated the unit cost for each of its products, some unit costs were too high while others were too low. Further, errors in the data that the department compiled for fiscal year 1995-96 regarding registration and licensing information caused us to question the reliability of similar data that the department used to calculate its costs for fiscal year 1989-90. As a result of these errors and inequitable allocation, the department sometimes overstated the unit costs for providing registration and licensing information. The department bases its fees for information services products on the unit costs. Therefore, when the department calculates these costs incorrectly, some customers are required to pay fees that are higher than necessary while others may not be paying enough.

Finally, we estimated that the department has generated more than sufficient revenue from selling information to individuals and private entities; the revenue covers the department's cost of providing the information to these customers as well as to government entities, for whom the department cannot charge a fee for such data. Moreover, we estimated that during the past six fiscal years the department has made an average profit of \$16.5 million per year. Although we determined that total revenues exceeded total costs for the products sold by OIS, the department cannot assure that it establishes fair and adequate

prices for each of its products, identifies or manages product profitability, identifies products that are losing money, or develops plans to modify its products.

Background

The department maintains a database related to driver's licenses, as well as vehicle and vessel registration. The department's Information Services Branch formally known as OIS, is responsible for managing the delivery of this information to individuals as well as to private and government entities.

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The law requires the department to charge a fee sufficient to cover its costs of providing information.

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As mentioned in this report's introduction, the California Vehicle Code, Section 1811, authorizes the department to sell information from its database to individuals and private entities but requires the department to charge an amount sufficient to pay at least the entire actual costs of providing the information. In contrast, California Vehicle Code, Section 1812, prohibits the department from charging any county, city, state department, or the federal government for information obtained from its records.

Table 1 displays the department's fee schedule for registration and licensing information. The department generally charges fees based upon the method it uses to access or provide information regardless of whether the information relates to driver's licenses or to vessel and vehicle registration.


Table 1
The Department's Methods of Providing Information and Fees Charged

Method of Delivery	Fee (per record)
Magnetic Tape (Bulk)	\$.10
Magnetic Tape	2.00
On-Line Access by Customers	2.00
Key-Entry by the Department	5.00
Hard-Copy Records	20.00
Pull Notice Program	\$ 1.00

The department uses these six classifications to define certain products or methods of delivering registration and licensing information to customers. The department classifies as "tape bulk requests" the applications to obtain information from its database that do not refer to a specific vehicle identification



Private and government entities use the department's records for various purposes.



number, license plate number, or individual's name. For example, the department may provide a customer with the names and addresses of all owners of 1996 General Motors trucks registered in California so that the customer can notify the truck owners of a manufacturer's vehicle safety recall. In contrast, the department classifies as "magnetic tape requests" applications to obtain information from the database records that refer to a specific vehicle identification number, a license plate number, or individual's name.

In addition, the department allows certain private and government entities, such as law enforcement agencies, on-line access to its database. After receiving authorization from the department, these entities can use their own computer terminals to obtain information from the department's database. Similarly, staff in the department's field offices can access specific registration or driver's license information by key-entering a request directly into the database and can then provide to individuals a computer printout of their personal records.

The department also supplies "hard-copy" records to its customers. In these instances, the department generally provides a photocopy of information from specific registration and driver's license files.

Further, the California Vehicle Code, Section 1808.1(b) and (c), requires certain employers of drivers to participate in the department's pull notice program, which provides driver's license information. Generally, under the pull notice program, the department automatically notifies private entities employing professional drivers, such as bus companies, whenever a reportable action changes the record of any of the entities' drivers.

The Department Has Not Recently Updated Its Unit Costs To Provide Information

During fiscal year 1989-90, the department identified two major cost components and used a separate allocation process when it calculated the unit costs for providing information via the six different methods discussed earlier. As a result, the department revised the fees it charged for the information, and fees for certain types of information doubled and in one case almost tripled. For example, the fee the department charged customers for information obtained by the tape bulk method increased from 3.5 cents per record in fiscal year 1988-89 to 10 cents per record in fiscal year 1989-90. However, since 1989-90, the

—◆—
Costs have not been
reassessed nor fees
changed since fiscal year
1989-90.
—◆—

department has not reassessed its costs nor changed the fees that it charges those who request registration or driver's license information.

The two major components that the department calculated in fiscal year 1989-90 were the costs for the creation and maintenance of its database and costs for information services. The database creation and maintenance costs reflected expenses related to developing the records in the database and updating those records. The information services costs were those directly associated with OIS as well as a portion of the costs that other departmental units incurred while performing activities that contributed to products provided by OIS. For example, staff in the Outgoing Mail Unit processed and distributed all outgoing mail, including registration and licensing information that OIS sold. Therefore, the department allocated to OIS some of the costs associated with activities performed in the Outgoing Mail Unit.

The Department Used Flawed Methods To Determine the Costs for Its Database

In fiscal year 1989-90, the department made a serious error when it determined that the cost to create and maintain the database containing registration and licensing information was \$40.6 million. Rather than using just the actual expenditures for activities that specifically related to creating and maintaining the database, the department included in the calculation of database costs the majority of its fiscal year 1989-90 estimated expenditures from the governor's budget. Consequently, the department significantly overestimated its database costs.

To ascertain the magnitude of the department's overstatement of database costs, we requested workload data documentation from fiscal year 1989-90. However, because it calculated the costs seven years ago, the department did not retain this workload data that related to creating and maintaining the database.

In the absence of historical workload information we used fiscal year 1995-96 data to determine what we believe is a more accurate estimate of relevant database costs. In our calculations, we included only those expenditures that directly contributed to the creation and maintenance of the department's database. The department provided current workload data related to these activities, and it reports actual expenditures in its accounting system. Using this information and our modified methodology that we describe in Appendix B, we estimated that the database creation and maintenance costs

Using 1995-96 data, we estimated database costs of \$16.8 million compared to the \$69 million we calculated with the department's 1989-90 flawed method.

for the purposes of providing licensing and registration information for fiscal year 1995-96 were approximately \$16.8 million. In contrast, we arrived at a figure totaling approximately \$69 million for fiscal year 1995-96 when we applied the methods similar to those used by the department in fiscal year 1989-90. Therefore, we believe that the department used flawed methods when it arrived at \$40.6 million for database creation and maintenance costs in fiscal year 1989-90 and that the department significantly overstated its costs. The department's cost accounting manager agrees that the methodology we used appears to be a more sound approach to calculating database creation and maintenance costs.

The Department's Cost Model Does Not Properly Allocate Costs for Information Services

In addition to miscalculating the costs to create and maintain its database, the department improperly allocated to OIS some units' direct costs, which are staff hours and expenses related to a specific product line, section, or unit. During fiscal year 1995-96, the department understated direct costs to OIS by approximately \$1.5 million.

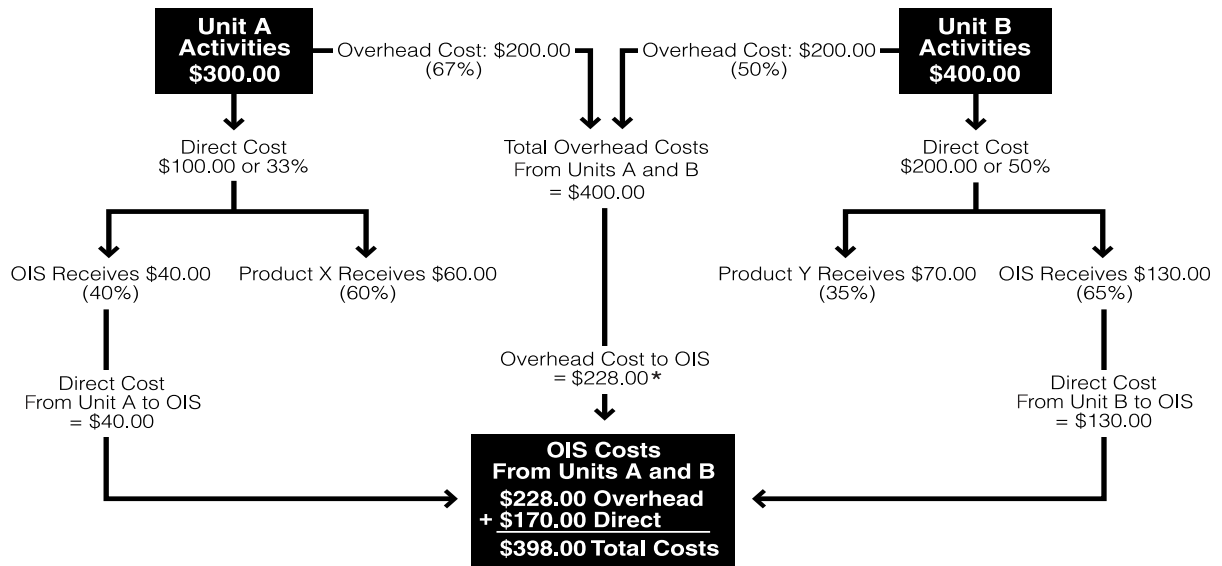
The department uses a cost model to determine the costs of other departmental divisions' or units' performing functions that assist the Information Services Branch, known as OIS before fiscal year 1996-97, and contribute to that branch's ability to sell registration and driver's license information. At the end of each fiscal year, the department's cost accounting unit uses this model to calculate the costs it should allocate to the various products that the department sells and, in some cases to departmental sections or units, such as the OIS, that also sell products.

The current process of identifying such costs begins with unit managers providing workload estimates to the cost accounting unit. Generally, managers use workload measures, such as volume statistics and time reports, to estimate their units' direct costs as well as the percentage of time staff in their respective units spent performing activities that do not directly benefit a product line, section, or unit (overhead). After determining the unit's overall percentage of direct costs, each unit manager then determines the percentage of these direct costs that should be allocated to the department's other units or products. For example, in Figure 1, Unit A allocates 67 percent of its costs to overhead and 33 percent to direct costs. Of the 33 percent in direct costs, approximately 40 percent is allocated to the branch we refer to as OIS. Likewise, Unit B allocates 50 percent of its

costs to overhead and the other 50 percent to direct costs. Of Unit B's direct costs, 65 percent goes to OIS.

Figure 1

**Example of Allocation of Costs to OIS
From Two Units Within the Department**



*** Overhead Cost Calculation**

Direct Costs Related to OIS: \$40.00 + \$130.00 = \$170.00
 Total Direct Cost: \$100.00 + \$200.00 = \$300.00


OIS Overhead Rate Calculation: $\$170.00 \text{ OIS} / \$300.00 = 57\%$
 Total Overhead Costs: \$400.00

Overhead Costs to OIS: $57\% \times \$400.00 = \228.00


Using the percentage estimates provided by the various managers and the expenditures recorded in the accounting records, the cost accounting unit generally determines the dollar amount of direct costs that the department should allocate to each of its products, sections, or units. Once it identifies these direct costs, the cost accounting unit then computes an overhead rate and uses it to distribute overhead costs to each of the department's products, sections, or units included in the cost model.

During fiscal year 1995-96, the department used its cost model to assign to OIS approximately \$22.1 million of its expenditures. To determine whether these costs were reasonable and equitable, we reviewed the activities and

expenditures of the 23 units that perform activities that directly contributed to OIS's function. Our review disclosed that the department understated the direct costs that it allocated to OIS.



Cost allocation errors resulted in a \$1.8 million understatement.



The most significant cost allocation errors occurred in the department's attempt to estimate the percentage of time that other units directly contributed to OIS products. Specifically, managers for 8 of the 23 units either did not provide sufficient documentation or did not use reliable methods to calculate the direct costs for their respective units. For example, the department may have understated by as much as \$2.7 million the amount of direct costs allocated to OIS from the Micrographics Unit. This miscalculation occurred because the department allocated only a small percentage of the Micrographic Unit's costs to OIS even though the activities performed by the unit primarily benefited OIS. In addition, the amount allocated to OIS for another unit's direct cost may have been overstated by approximately \$673,000 because it used outdated workload data. For the remaining 6 units, the unit managers either did not have sufficient documentation to support the cost estimates or did not use reasonable workload measures to determine the percentage of their costs to allocate to OIS. As a result of these shortcomings, the department understated the amount of direct costs allocated to OIS by approximately \$1.5 million. Further, a proportionate share of overhead costs totaling approximately \$300,000 related to the \$1.5 million in direct costs, thus increasing the total understated amount to \$1.8 million.

The Department Overstated the Total Costs for OIS To Provide Information

According to our estimates, despite its understating the fiscal year 1995-96 direct costs allocated to OIS, the department overstated by approximately \$22 million for the same year the total cost for providing registration and licensing information. Table 2 compares the total costs the department calculated for providing information to private and government agencies to the total costs we calculated for fiscal year 1995-96. Because the department has not updated since fiscal year 1989-90 its original calculation of \$40.6 million to create and maintain the database, we included this amount in the comparison of costs. As the table shows, the costs the department calculated for OIS to provide services to private and governmental entities are significantly higher than the costs we calculated. The primary reason for the discrepancy is that the department overstated the costs for its database, as we explained earlier in this chapter.

Table 2

***Estimated Costs for OIS To Provide Information
to Customers During Fiscal Year 1995-96
(Amounts in Millions)***

Description of Costs	Department Calculation	Auditor Calculation	Difference (Under)
Departmental Costs Allocated to OIS	\$22.1	\$23.9	\$(1.8)
Database Creation and Maintenance	40.6	16.8	23.8
Total Costs	\$62.7	\$40.7	\$22.0

***The Department Overstated
Unit Costs for Three OIS Products***

We were unable to evaluate the process the department used in fiscal year 1989-90 to allocate the information services costs to individual products sold by OIS because the cost accounting unit did not retain any documentation to support the methodology. However, we were able to analyze the department's method of allocating the database creation and maintenance costs and found that it had overstated unit costs for some products and understated others.


The department compiles data in its volume reports on the number of records sold, including those sold by the Information Services Branch, which is the former OIS. The department uses this information, commonly referred to as "volume data," for two purposes relative to OIS. First, it uses the volume data to determine what proportion of the database creation and maintenance costs should be allocated to the various products. The department then uses the data to calculate a unit or per record cost for each information services product.

Nevertheless, according to our review, the department's methods to calculate unit costs for the various information services products have two significant problems. First, the department allocated the costs to create and maintain the database to only three of the six products that should have received a proportionate share. Second, the volume data that the department used to calculate the cost per record is questionable. As a result, the cost per record for the various products sold by the Information Services Branch or OIS is not accurate.


The Department Used Questionable Volume Data To Allocate Database Costs

In fiscal year 1989-90, when it calculated the portion of its \$40.6 million database costs to allocate to OIS products, the department determined the number of records sold via each of its six delivery methods and the average amount of computer time required to process each request for information. The department then computed a weighted average for each product. Using these weighted averages, the department distributed the \$40.6 million to some of the products that OIS sold. For example, if OIS sold approximately 900,000 records using the on-line method of delivery and it took .158 seconds to process each of those records, then the weighted average for on-line products is 142,200. If the total weighted average volume for all the products the former OIS sells is 3.5 million records, then on-line products represent approximately 4 percent of the total; therefore, the department should allocate to the on-line method 4 percent or \$1.6 million, of the \$40.6 million in database creation and maintenance costs.

We could not verify the accuracy of the volume data that the department used to allocate the \$40.6 million database costs from its fiscal year 1989-90 calculation because the department did not retain all of its support for the volume data. However, we did review the same type of volume data compiled for fiscal year 1995-96 and found that the volume reports were not reliable; therefore, we question the reliability of the volume data that the department used in fiscal year 1989-90.




We found volume data to be unreliable because of significant discrepancies and calculation errors.




We found several discrepancies in the number of vehicle registration records that the department reportedly provided in fiscal year 1995-96. We saw in particular that the volume report contained calculation errors. For example, the department's original fiscal year 1995-96 volume report showed that the department used the tape bulk delivery method to sell approximately 4.8 million vehicle registration records to private entities. After we identified several mathematical errors in the report, the department corrected the errors and provided us with a revised report indicating that OIS had sold 10.8 million tape bulk records. However, we determined that the revised report was still inaccurate. Specifically, we determined that OIS had sold approximately 9.5 million records via the tape bulk method of delivery. The chief of the Information Services Branch, which is the former OIS, states that he is aware of some of the problems with reporting accurate volumes. However, he states that providing accurate, supportable volume amounts is "a work in process" and the department continues to work on improving the accuracy and reliability of the amounts reported.

Because the volume data the department compiled for fiscal year 1995-96 is inaccurate, we question the reliability of similar data the department used in fiscal year 1989-90 to determine the amount of database costs to allocate to OIS products. If the volume data that the department used in fiscal year 1989-90 were inaccurate, then the allocation of these costs to the various products could not be equitable. As a result, the unit costs the department calculated for each product sold by OIS may not have represented the actual costs OIS incurred to provide information to its customers.

The Department Did Not Fairly Distribute Database Costs to all OIS Products



The department should have allocated \$40.6 million to six rather than just three OIS products.



Besides using questionable volume data to determine how much of its database costs it should allocate to OIS products, the department did not include in the allocation process all of the products sold by OIS. In fiscal year 1989-90, the department allocated the \$40.6 million in database costs to just three of the six products sold by OIS, the department assigned costs to the two methods that use magnetic tape to access and deliver information from the database, and it also allocated expenses to the on-line method. By doing so, the department overstated the unit costs it calculated for these three products while it understated the unit costs for the pull notice, key-entry, and hard-copy products. Because the department bases customer fees on unit costs, customers requesting information via these three methods do not contribute equitably to the recovery of the department's costs to provide the information.


According to a May 1990 memo, because the law mandates that certain employers participate in the pull notice program, the department did not require customers that receive information via the pull notice method to share in the recovery of the database creation and maintenance costs. The memo further states that the department did not assign any of the database costs to the key-entry method because the department did not believe individuals requesting information from their own records should participate in the recovery of these costs. Likewise, the chief of the Information Services Branch, formerly the OIS, states that the department did not think it was reasonable for individuals that request information using the hard-copy method to share in the recovery of the database costs.

Even if the department did not believe that it should allocate a proportionate share of database costs to employers required to obtain information on its drivers or to customers requesting information from their own records, it was unreasonable to


allocate to the other OIS products the portion of the \$40.6 million that represents costs incurred to provide information via the pull notice, key-entry or hard-copy methods of delivery. Because the department included these costs when it determined the fees to charge customers that obtain information from the department's database using the tape bulk, magnetic tape, and on-line methods, the fees for these types of records were and continue to be higher than the department's actual costs of providing the information. In essence, these customers are subsidizing the department's costs of providing information to customers who obtain information from the pull notice, key-entry, and hard-copy methods of delivery.

The Department May Have Used Unreliable Volume Data To Calculate Unit Costs for OIS Products

After allocating in fiscal year 1989-90 the database and information services' costs to the various products sold by OIS, the department used the volume data to calculate a unit cost for each of the products. To determine the fees to charge for the products, the department divided the total costs to provide the information by the total number of records sold. For example, to determine the unit costs of providing information by tape bulk, the department divided the total costs of \$4,147,692 by the volume of records sold, 40,843,850, to arrive at a unit cost of 10 cents per record. After determining the unit cost for each OIS product, the department then used these unit costs to determine the fee it should charge customers for each product. However, because the department may have used unreliable volume data to calculate unit costs, it cannot assure that the fee the Information Services Branch, (the former OIS) currently charges for each of its products is reasonable or sufficient to cover the cost of providing that product.



Inaccurate volume data from 1989-90 affect current fees.



Paying Customers Subsidize the Department's Costs of Providing Information to Government Agencies

The California Vehicle Code, Section 1812, prohibits the department from charging any county, city, state department or federal government for copies of records or for information from departmental records. The department set its fees so that individuals and private entities required to pay for registration or driver's license information will cover the costs of providing information to all customers regardless of whether they pay for the information. Therefore, the department included in its unit

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Although it cannot charge government agencies, the department has chosen to have private customers cover these costs.

cost calculations all the costs it incurred in fiscal year 1989-90 to provide information to all of its customers but divided that amount by the number of records sold. For example, the total cost of providing information to customers who requested delivery of information by both magnetic tape and on-line methods was \$41,955,068. The department divided this amount by the number of records provided to paying customers, and it arrived at a unit cost of \$2 per record. However, if the department had included all the records provided by tape and on-line methods to all of its customers, the cost per record would be 50 cents. As a result, the unit costs that the department calculated for each information services product supplied to paying customers are higher than if the department had either included all the records provided during the fiscal year or limited the costs only to those incurred to provide records to paying customers.

The California Vehicle Code, Section 1811, requires the department to charge a fee sufficient to at least cover the cost of providing information to customers. This code does not specifically direct the department to require its paying customers to cover the cost of providing information to law enforcement and other government agencies. The Legislature should therefore consider whether it intends the department's paying customers to subsidize the costs of providing information to government agencies that do not purchase the information.

Regardless of whether it continues to have its paying customers subsidize the costs of providing information to government agencies, the department needs accurate cost and volume data to compute reliable unit costs. Because the department does not know its actual unit costs of providing information, it cannot determine whether it is complying with the law that requires it to charge a fee sufficient to cover at least the actual costs of providing information. Furthermore, it cannot assure that it has established fees that are fair, nor can it properly identify or manage product profitability.

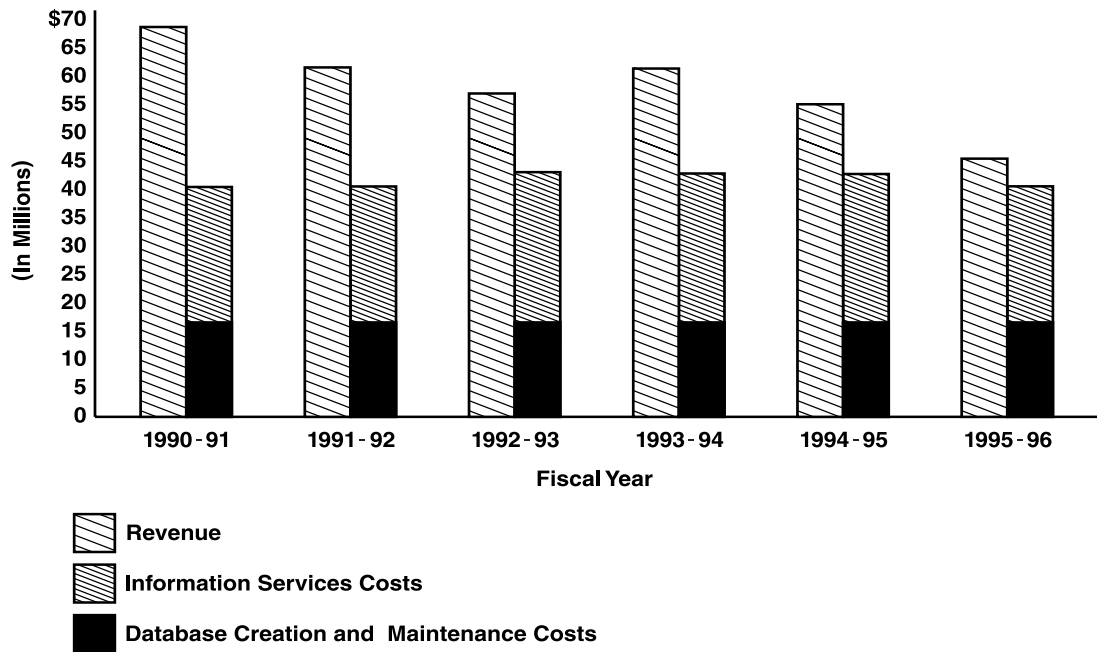
The Department Profits From the Sale of Registration and Licensing Information

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The department has generated \$16.5 million annually in excess of its costs.

Using our estimate of total costs we determined that during the last six fiscal years, the department generated an average profit of \$16.5 million per year for sales of registration and licensing information. To arrive at this figure, we compared the total revenue that the department generated from its sales of this information to our estimate of the related costs it incurred to provide the information. Each year the department identifies information services costs; however, it has not calculated

database creation and maintenance costs since fiscal year 1989-90. Because the department identifies only one of these two major cost components for providing registration and licensing information each fiscal year, we calculated database creation and maintenance costs of \$16.8 million for fiscal year 1995-96 and added that amount to the information services costs for each of the previous five fiscal years to arrive at an estimated total cost figure for each of the fiscal years. Although the actual database costs in the years before fiscal year 1995-96 may differ, we believe that adding this amount to the information services costs for each of the previous five fiscal years is a conservative approach to determining total costs for those other years. Using these estimates, we then compared total costs to the related revenue that the department generated each year.

Figure 2
Comparison of Total Costs to Related Revenue for Registration and Licensing Information



As Figure 2 above illustrates, the revenue the department generated from sales of registration and licensing information during the past six fiscal years is substantially higher than the costs incurred. Furthermore, we noted that, although 1995-96 sales of information to individuals and private entities represented less than one-third of the total volume of information that OIS provided, we estimate that the department

generated enough revenue from those sales to cover not only the respective costs of providing the information to individuals and private entities but also the cost of providing the same type information to government entities. We did note, however, that since fiscal year 1993-94, the department's revenues have declined and its profit margin has decreased. Although the law requires the department to charge fees that are sufficient to cover at least its entire actual costs for providing information from its records, the law does not impose limits on what those fees should be. Nonetheless, we believe that the department needs to establish fees based on actual costs and fix a reasonable profit margin.

Conclusion

In fiscal year 1989-90, the department miscalculated its total costs and its unit costs of providing registration and licensing information. These miscalculations occurred because the methodology that the department used to calculate database creation and maintenance costs had a serious flaw that resulted in a significant overestimate. In addition, the department distributed these database costs to only three of the six products that should have received a proportionate share of the costs. Furthermore, we question the reliability of the volume data the department used to identify the portion of database creation and maintenance costs it needed to distribute to various information services products and also to calculate the unit costs. Finally, the department has not reassessed or updated the unit costs that resulted from its 1989-90 calculations. As a result of these shortcomings, the department's unit costs of providing registration and licensing information are sometimes too high and do not represent the actual costs incurred. Because these unit costs remain the basis for the fees that the department charges, some customers are paying fees that are higher than necessary, while others may not be paying enough.

During our review, we also noted that the fees the department charges for registration and licensing information have generated revenues that exceed the related costs. In fact, using our total cost estimates we determined that during the last six fiscal years, the department has profited by an average of \$16.5 million per year. Furthermore, the department generated this revenue from sales to individuals and private entities even though these customers purchased less than one-third of the total volume of registration and licensing information that the department provided in fiscal year 1995-96. Because legislation prohibits the department from charging government

agencies for registration and licensing information, these paying customers are subsidizing the department's costs to supply such information to government agencies.

Recommendations

To establish reasonable and equitable fees for its registration and licensing information, the department should take the following steps:

- Update the unit cost calculations by using guidelines similar to those we describe in Appendix B.
- Compile reliable volume data to use in its unit cost calculations by implementing a system to track and report the number and type of records provided to individuals, private entities, and government agencies, and the method used to provide the records.
- Reassess and update its unit costs periodically to ensure that they represent the current activities and costs related to providing such information, and then modify its fee schedule accordingly.

In addition, the Legislature should consider whether it is reasonable and equitable for the public to continue subsidizing the department's costs of providing information to government agencies.

If the legislature determines that it is unreasonable or inequitable for the public to subsidize these costs, the department should modify its calculations of unit costs to include total records provided rather than total records sold.

After reassessing and updating its unit cost calculations, the department should establish fees sufficient to cover actual costs and provide for a reasonable profit margin.

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Chapter 2

In a Few Instances, the Department of Motor Vehicles Has Not Complied With the Law When Providing Registration and Licensing Information

Chapter Summary

The Department of Motor Vehicles (department) does not always comply with the law when it provides and charges for registration and licensing information. When it fails to comply with codes covering the generation and release of such information, the department jeopardizes individuals' privacy and overcharges some customers.

During fiscal year 1994-95, the Office of Information Services (OIS), now called the Information Services Branch, released confidential residence address information to a customer without first obtaining the required written assurance from the customer that use of the information would be restricted to statistical research or reporting and that the customer would not use the information to contact any person. The department thus exposed the subjects of this information to the risk of unwanted or unsolicited contact.


Further, contrary to the provisions of the law, some fees the department charges to provide information to certain customers are insufficient to cover the department's costs. The department must therefore subsidize these costs by charging other customers more than necessary or by using taxpayers' money.

The Department Inappropriately Released Confidential Information

In fiscal year 1994-95, the department did not comply with the law when it released confidential residence address information to a retail grocery store chain before the department had first acquired certain written assurances that the law requires. As a result, the department may have jeopardized the privacy of individuals who were the subjects of the information and exposed them to the risk of unwanted or unsolicited contact.

The California Vehicle Code, Section 1808.21(a), states that any residence address in any department record is confidential. However, the California Vehicle Code, Section 1808.23(c), allows the department to release confidential residence address information under certain circumstances. For example, the department can release the information if the request for the information specifies that no person will be contacted by mail or otherwise at the address included with the information released. This section of the California Vehicle Code further states that the department can release the information to a person who requests and uses the information as permitted by the California Civil Code, Section 1798.24. Specifically, the California Civil Code allows a state agency to disclose personal information to a person who provides the agency with advance adequate written assurance that the person will use the information solely for statistical research or reporting purposes; the state agency may disclose the information only if the data appear in a format that will not identify any individual.



In this case, the retail chain submitted to the department a list of 1,000 license plate numbers it had obtained from vehicles parked at two stores affiliated with other retail grocery store chains. In its request for information, the retail chain requested that the department provide addresses for each of the plate numbers in a format that would not associate the plate numbers with the addresses.


The department did not obtain required written assurances from a retail chain.

In response to the retail chain's request, the department supplied the retailer with a list containing confidential residence addresses and did not obtain the written assurances that the retail chain would not contact any individual and would restrict its use of the information to statistical research or reporting purposes. Even though the customer requested the department to provide the information in a format that would not associate the license plates with the addresses, we could not conclude that the department complied with either the California Vehicle Code or the California Civil Code because the department did not retain a copy of the information released. The department believes it fully complied with the law because it disclosed the confidential residence address information in a manner that did not identify specific individuals. However, when it releases such data to customers without obtaining the required written assurances, the department cannot ensure that the customer is aware of the restrictions the law imposes on the use of the confidential information.

Some Fees the Department Charges Are Not Sufficient To Cover Costs



The California Vehicle Code, Section 1811, requires the department to sell copies of its records at a charge sufficient to at least cover the entire actual cost of the copies sold. However, the department has not always complied with this requirement. For example, because the department's fee schedule does not contain a fee that applies to customers who request certain statistical information, OIS established a fee without ensuring that the fee fully recovers the department's costs of providing the information. In addition, the department's published fee for providing driver's license information for the pull notice program, which is the legally established method by which the department automatically notifies employers of professional drivers about changes in the drivers' records, does not cover the unit cost calculated by the department. Finally, the department charged a customer substantially less than its published fee for vessel registration information.


The department charged only \$70 for a statistical report costing \$1,000.


In addition to providing registration and licensing information to individuals and to private and government entities, the department also provides requested statistical information from its database. One request from fiscal year 1995-96 asked for a statistical report that identified the number of vehicles registered in each zip code area of California. Although data processing costs to compile the report totaled approximately \$1,000, OIS charged the customer just \$70, thus recovering only a fraction of the costs. The department's fee schedule does not list a fee for preparation of such statistical information, nor does it provide guidelines or procedures by which the department can calculate its costs and charge a fee sufficient to recover these costs. Because OIS could not provide us with the basis for the fee it charged, we determined that it set the fee without ensuring that it would recover all of its costs.

We also learned that, during fiscal year 1996-97, the department processed individually at least nine requests for the zip code report described above. Rather than processing one report for all nine requests, the department ran the computer program for each request; therefore, it incurred data processing charges totaling approximately \$9,000. Because the department only charges its customers \$70 for each report, it recovered just \$630, an amount representing 7 percent of the costs.

The department could provide the zip code report in a more cost-effective manner by running the computer program only once each year and supplying a photocopy of the report to customers requesting such information. This practice would eliminate the \$1,000 in data processing costs the department incurs each time it runs the computer program to fulfill a request for this statistical report. In addition, the department could calculate a reasonable fee that would cover its costs of providing the report by identifying all of its costs, including the one-time data processing charge, and by estimating the number of reports it expects to sell each year. This approach would minimize the costs to the department while allowing it to charge its customers a reasonable fee for the report. Although this method would not provide customers with the most current information, those customers who want current information could pay a fee sufficient to cover the \$1,000 data processing costs and any additional costs to the department.


For another information service provided, the department recovers only 77 percent of its costs.


Our review also disclosed that the department does not charge a fee sufficient to cover the costs it reportedly incurs when providing driver's license information using the pull notice method. In fiscal year 1989-90, the department estimated that its costs of providing driver's license information using this method was approximately \$1.30 for each record provided. Even though the California Vehicle Code requires the department to charge an amount sufficient to at least cover its costs to provide the information, the department did not modify the \$1 fee it charges for each record provided via the pull notice method. According to the chief of the Information Services Branch, because the law requiring employer participation had recently been enacted, and because the information furnished additional traffic safety benefits, the department decided to charge these employers a nominal fee of \$1 for each driver's license record provided. This decision to charge fees that are less than the costs incurred makes it necessary for the department to recover these costs from other customers or to use taxpayers' money.

Finally, we noted that in fiscal year 1994-95 OIS substantially undercharged a customer for approximately 38,000 vessel registration records that the department provided using the tape bulk method of delivery, which we describe in Chapter 1. When the department provides information to a private entity using this method, the California Code of Regulations, Section 350.44, requires it to charge the customer 10 cents for each record provided. However, instead of charging the customer \$3,800, OIS charged the customer only \$200 for the

information. When OIS charges less than the established fee for its products, it cannot be certain that it is recovering its costs to provide the products.

Conclusion

In a few instances, the department has not complied with the law when providing information to the public. Specifically, we noted an instance when OIS improperly released confidential residence address information without first obtaining the required written assurances. Also, we found that fees the department charges for certain products are insufficient to cover at least its actual costs of providing information as required by law. Further, the department's published fee for providing driver's license information for the pull notice program is not adequate to cover the cost the department reportedly incurs to provide such information. By not ensuring the full recovery of its costs to provide registration and licensing information, the department increases its need to charge some customers more than the actual costs for information they have requested or to use taxpayers' money to subsidize the deficit.

Recommendations

To ensure that it protects the confidential information in its records, the department should make certain that it complies with the law before releasing any information.

In addition, the department should develop and implement procedures to identify and recover all its costs of providing registration and licensing information and revise the applicable regulations to address the fee it should charge when providing statistical information.

Further, to minimize its costs and the fees it charges customers, the department should develop procedures that ensure it uses cost-effective methods when providing registration and licensing information.

Finally, the department should adhere to its fee schedule when charging customers for registration information.

We conducted this review under the authority vested in the state auditor by Section 8543 et seq. of the California Government Code and according to generally accepted governmental auditing standards. We limited our review to those areas specified in the audit scope of this report.

Respectfully submitted,

KURT R. SJOBERG
State Auditor

Date: July 2, 1997

Staff: Elaine M. Howle, CPA, Audit Principal
Debbie J. Meador, CPA
Ron Bawden, CPA
Brian Lewis, CPA
Sylvia See

July 2, 1997

96116

Sally Reed, Director
Department of Motor Vehicles
2415 First Avenue
Sacramento, California 95818

Subject: Additional Issues Related to the Department's Cost Model

Dear Ms. Reed:

As part of our audit report titled "Department of Motor Vehicles: Overstated Costs for Registration Information Have Resulted in Inequitable Charges to Customers," we reviewed the cost model that the Department of Motor Vehicles (department) uses to allocate costs to products, sections, and units, including the Office of Information Services (OIS), now referred to as the Information Services Branch. In addition to identifying the topics we discuss in our audit report, we found other issues that require your attention. Specifically, the department needs to reconsider the method by which it allocates expenditures from other divisions to its Investigation Units and the way it assigns to the department's revenue-generating products certain expenditures incurred by the Program and Policy Administration Division. This letter discusses these matters in detail.

In fiscal year 1995-96, the department included the Investigation Units as a product in its cost model so that the department could identify separately the costs of conducting investigations. Because the Investigation Units provide a regulatory service for driver's licenses, identification cards, vehicle and vessel registrations, and other departmental products, we do not believe that the department should treat the units as a product in the cost model. By including these units as a product in the model, the department inappropriately charged overhead costs from other divisions to the Investigation Units even though these other divisions do not contribute to investigative activities. As a result, the department is overstating the overhead costs assigned to the Investigation Units and understating costs it assigned to other products. If it plans to continue using its cost model to track the costs of conducting investigations, the department should modify its procedures to ensure that it allocates to the Investigation Units only those activities and related expenditures that directly or indirectly contribute to the Investigation Units' functions.

Sally Reed, Director
Department of Motor Vehicles
July 2, 1997
Page 2

Another issue that requires the department's attention is the way in which the department allocates its costs of performing investigations to the products that benefit from these investigations. Generally, the department's practice is to allocate expenditures incurred each fiscal year to its revenue-generating products or to sections, such as the Information Services Branch, that have such products. However, in fiscal year 1995-96, the department did not distribute to any of its revenue-generating products the costs allocated to the Investigation Units. According to the cost accounting manager, in the past the department allocated such costs to its revenue-generating products; however, this method resulted in unreasonably high costs for several products. We believe that the department should assign these costs to products that benefit from activities performed by the Investigation Units. However, before including the costs of conducting investigations in the computation of individual costs, the department must develop a reasonable, equitable method of assigning the investigative costs to the products.

Finally, we determined that in fiscal year 1995-96 the department allocated certain costs incurred by its Program and Policy Administration Division to all of the revenue-generating products, sections, and units in its cost model rather than to the specific group of products that benefit from the activities associated with the costs. As a result, the department is understating the costs of some products while overstating the costs of others. According to the cost accounting manager, the department does not currently have a direct allocation method by which it can allocate these costs to a specific group of products. However, to ensure that it distributes costs incurred by the Program and Policy Administration Division to those products that benefit from the activities performed by the division, the department needs to develop a reasonable, equitable method of allocating costs to the products.

Although the issues described above may not materially affect costs allocated to the Information Services Branch, the improper handling of these costs may have an impact on the actual costs computed for other products, sections, and units included in the cost model. Therefore, the department should modify its methodology with respect to how it allocates the costs for the Investigation Units and the Program and Policy Administration Division.

Please inform us by September 1, 1997, of the corrective action you have taken regarding these issues.

Sincerely,



KURT R. SJOBERG
State Auditor

Appendix B

Guidelines for Calculating Unit Costs That Represent Actual Costs at the Department of Motor Vehicles

Although several methods may exist for charging customers equitably and reasonably for the costs that the Department of Motor Vehicles (department) incurs when providing registration and licensing information, the following guidelines offer an alternative approach that we believe will result in unit costs that represent the department's actual costs. We developed this approach after evaluating the department's activities associated with providing registration and licensing information, its supporting cost data, and the methodologies the department used to calculate unit costs in fiscal year 1989-90. We did not calculate the unit costs for each information services product because we determined that the existing volume data are questionable and the department has not developed workload measures to assist with allocating information services costs to products sold by the Information Services Branch, formerly known as the Office of Information Services (OIS). Instead, we formulated methods that the department can use to recalculate its costs and then update its fee structure. We discussed our proposed guidelines with the department's cost accounting manager, and she stated that the guidelines and recommendations described here appear reasonable.

The Department Should Identify the Total Costs of Providing Information to Customers

Before it can compute unit costs, the department must identify its total costs related to providing registration and licensing information to all of its customers. In fiscal year 1989-90, when the department performed the unit cost calculation, it identified two major cost components that made up the total costs. The information services cost component represents direct, indirect (called "system generated direct" by the department), and overhead costs allocated to OIS through the application of the department's cost model each fiscal year. As noted in Chapter 1, for fiscal year 1995-96, the department underestimated this cost component by approximately

\$1.8 million because it used inaccurate or outdated workload measures in its calculation. We estimate that these information services costs should be approximately \$23.9 million instead of the \$22.1 million the department calculated.

The other cost component comprised expenses for database creation and maintenance. The department, which calculates information service costs each year, does not calculate these costs annually. In fact, the department has not calculated database costs since fiscal year 1989-90. Furthermore, when we reviewed the department's calculation of this component, we determined that the methods used to compute these costs had flaws and caused a significant overestimate of the amount. Therefore, we developed an alternative calculation method that we believe results in a fair, reasonable estimate of the department's fiscal year 1995-96 database costs.

Transaction Codes Could Help Calculate Database Costs

To calculate the database creation and maintenance costs, we identified for fiscal year 1995-96 the activities and related personal service expenditures associated with creating and updating records in the department's database. The department incurs personal services costs at its headquarters and district offices when it creates or updates a record. We were able to identify and measure personal services costs using the department's type transactions codes (TTCs), which identify such functions as creating or updating records in the database.

After identifying the applicable TTCs, we could compute a ratio of the amount of TTC activity associated with creating and updating the records in the database relative to total TTC activity. We applied this ratio to the related personal services expenditures to calculate the costs incurred whenever department staff created or updated records in the database. This calculation resulted in database creation and maintenance costs totaling approximately \$101.4 million for fiscal year 1995-96. However, all of the activities that generated these costs do not relate to providing registration and licensing information, so we developed a methodology to identify the proportion that did.

To determine the proportion of the \$101.4 million to charge customers that request registration and licensing information, we estimated the amount of time the database was accessed to provide this information. We then compared that amount to the total time the department spent accessing records during the fiscal year. For example, we estimated that the department

used approximately 82 million records in the database to fulfill requests for registration and licensing information, the total number of records accessed during the fiscal year was approximately 496 million. Therefore, the department could have allocated to OIS \$16.8 million, or 16.5 percent of the costs to create and maintain the database. Had the department used our methods and estimated \$16.8 million in the database creation and maintenance costs and then combined this amount with the \$23.9 million information services costs charged to OIS, the department could then have assigned these costs to each of its means of providing information, including tape, on-line, and key-entry. (We discuss these information delivery methods in Chapter 1 of this report.)

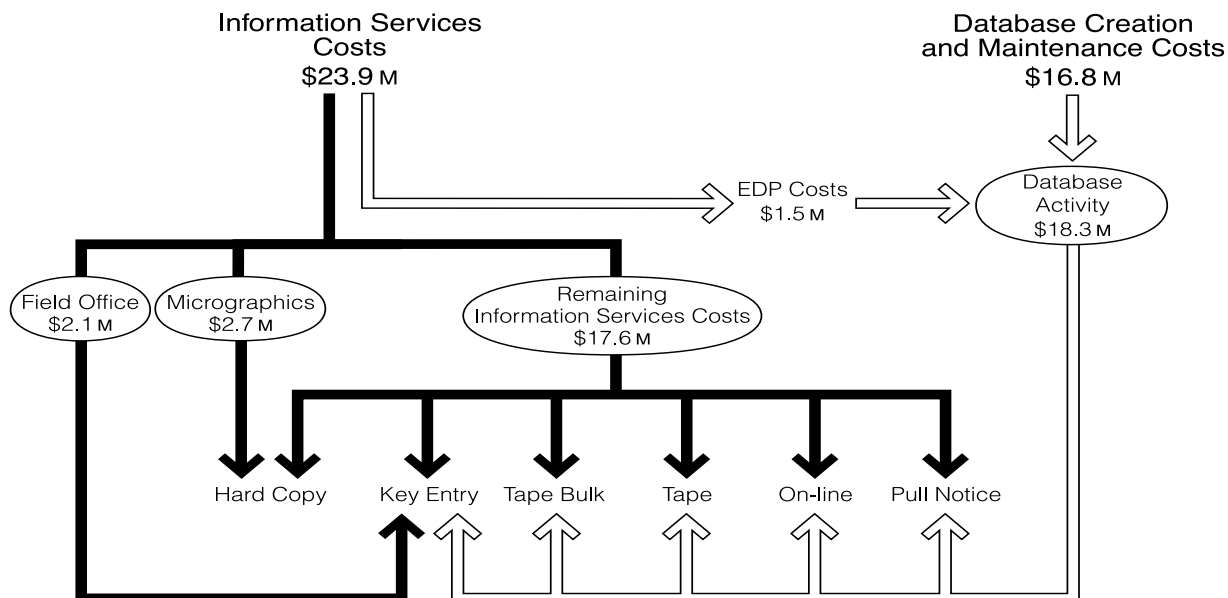
The Department Should Separate Total Costs Into Cost Pools

Once it identifies the total costs it incurred to provide registration and licensing information, the department should separate such costs into individual cost pools so that it can reasonably allocate the costs to the individual methods it uses to provide registration and licensing information. Figure 3 on page 32 shows four such cost pools that the department could use to separate costs. For example, the department could combine and classify as a database activity cost pool the electronic data processing (EDP) costs totaling approximately \$1.5 million that we calculated for OIS using the cost model plus the estimated database creation and maintenance costs of \$16.8 million.

The department should also identify a cost pool that consists of personal service and operating expense and equipment expenditures incurred by the Micrographics Unit on behalf of the Information Services Branch, formerly OIS, and its hard-copy method of providing information. We calculated expenditures totaling approximately \$2.7 million for the Micrographics Unit to microfilm vehicle and vessel registration records as well as driver's license records. The Micrographics Unit transfers the majority of its microfilm to the Information Services Branch so that customers can obtain information via the hard-copy method. Because the department indicated that all of these costs benefit only the hard-copy method of providing information, the department should assign the entire amount to this method.

Figure 3

Identification of Four Cost Pools and Allocation of These Costs to Methods of Information Delivery



See page 6 in Chapter 1 for descriptions of these six methods by which the department delivers registration and licensing information.

Similarly, the department can identify and measure the costs directly incurred for providing information using the key-entry method. The department incurred these costs in its field offices and charged them to OIS through the application of the department's cost model. Specifically, the department can determine the amount of computer activity associated with providing registration and licensing information by identifying the specific TTCs employees use for the key-entry method. As it did when it calculated the \$2.1 million for fiscal year 1995-96, the department can measure this activity and apply it to the related expenditures to calculate costs for the key-entry method.

The remaining cost pool could accumulate all the other costs charged to the Information Services Branch, formerly known as OIS, through application of the department's cost model. These costs would consist of personal service and operating expense and equipment expenditures incurred by the Information Services Branch as well as other areas within the department that support the delivery of registration and licensing

information. Although our approach shows a total of \$17.6 million in this cost pool, the department should review the activities that generated these costs to determine whether it can separate any of these costs and create additional cost pools.

The Department Needs To Allocate the Cost Pools to the Methods of Delivery

After accumulating costs into the various pools, the department should then allocate these costs to the individual methods that the Information Services Branch uses to provide registration and licensing information. We believe that this approach would allow the department to reasonably and equitably allocate the costs to the methods of delivery that benefit from the activities generating the costs. However, before assigning these costs, the department must have accurate volume data. In Chapter 1, we describe the problems we found with the number of records the department reportedly provided to customers during fiscal year 1995-96. The department must correct these problems before it distributes these costs to the information products.

The department can measure and allocate the \$18.3 million cost pool that contains the EDP and the database creation and maintenance costs to the various methods of delivery by using either the total number of records provided or those records sold during the fiscal year multiplied by the average computer time that each method requires to access a record. The department should use only the number of records sold if it determines that private entities will continue to subsidize its costs of providing information to government agencies. Otherwise, it should use in this calculation the total number of records sold and the number provided at no cost. The department can then compute volume weighted averages for each method by multiplying the average transaction time required for each method by the number of records. Using the weighted averages, the department can distribute the \$18.3 million cost pool to the various methods of delivery. For example, if the department provided 800 records using its key-entry method of delivery, and the average transaction time was .20 seconds to process each record, the weighted average volume for this method is 160. If the total weighted average volume for all methods is 10,600 records then the key-entry method represents approximately 1.5 percent of the total cost pool; therefore, the department should allocate to the key-entry method 1.5 percent of the \$18.3 million in database costs. This allocation strategy would allow the department to assign a proportion of the database activity costs pool to each method of delivery.

The remaining \$17.6 million in database costs includes personal services and operating expense and equipment expenditures that are direct, indirect, or overhead costs that the department charged to OIS using the cost model. Included in these costs are personal service expenditures incurred by OIS. Some of the activities performed by employees in the former OIS can be traced directly to a specific method or methods of providing information. In such instances, the department should identify and measure these direct costs by developing supportable workload measures that it can use to calculate the proportionate share of the direct costs to allocate to the applicable methods. The department also needs to develop supportable workload measures for any of its other areas whose activities directly benefit any of the various methods of delivery. Furthermore, after determining the amount of total direct costs, the department could allocate its remaining indirect and overhead costs to the various methods of delivery. Generally, the department could use the direct costs charged to the individual methods of delivery to calculate the proportionate share of indirect and overhead costs it will charge to the corresponding methods.

***The Department Must Use Accurate
Volume Data To Calculate Unit Costs***

Once the department has accumulated the estimated total costs for each method of delivering registration and licensing information, it can calculate a unit cost for each method. To calculate the unit costs for each method, the department should divide the total costs by the corresponding number of records provided during the fiscal year. However, to calculate unit costs that are equitable, the department must use accurate volume data.

In addition to ensuring that it uses accurate volume data, the department also needs to evaluate the reasonableness and fairness of its current methods for calculating unit costs; these methods result in individuals' and private entities' subsidizing the costs of providing information to government agencies. For the department to do so, the Legislature will first need to consider whether individuals and private entities should continue to subsidize the department's costs of providing information to government agencies. If the Legislature intends for this subsidizing to continue, the calculation of unit costs using only the number of records sold is reasonable and equitable. If, however, the Legislature does not intend to have

private entities pay for information requested by government agencies, then the unit cost calculations must include the number of records sold as well as the number provided to government agencies at no charge.

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BUSINESS, TRANSPORTATION AND HOUSING AGENCY

DEAN R. DUNPHY
Secretary

June 30, 1997

Kurt R. Sjoberg
State Auditor
Bureau of State Audits
660 "J" Street, Suite 300
Sacramento, CA 95814

Dear Mr. Sjoberg:

Thank you for the opportunity to comment on the Bureau of State Audits' (BSA) draft audit report entitled "Department of Motor Vehicles: Overstated Its Costs for Registration Information, Resulting in Inequitable Charges to Customers."

Before responding to the audit findings it is important to state that the Department of Motor Vehicles is one of the most effective and well managed departments in the State. They successfully license and register over 26 million motor vehicles, license 20 million motorists and collect approximately 5 billion dollars annually on behalf of state and local government. The department continues to be committed to provide better services to the motoring public.

Although the Business, Transportation and Housing Agency appreciates the efforts of BSA to improve the process by which the department provides requesters of information with driver license and vehicle registration information, I am concerned that the tone of the draft audit report is not consistent with the relative significance of the audit findings. I am also concerned that the auditors may not have fully considered all of the information provided to them during the course of the fieldwork. Of particular concern, is the fact that implementation of your recommendations could increase taxes and fees charged to the public and could result in increased profits for information vendors and insurance companies.

- ①*
- ②
- ③

*The California State Auditor's comments on this response start on page 43.

Mr. Sjoberg
June 30, 1997
Page 2

Attached please find responses to the recommendations of the draft audit report. Again, thank you for the opportunity to comment on audit findings of the BSA.

Sincerely,

A handwritten signature in black ink, reading "Dean R. Dunphy". The signature is written in a cursive style with a long, sweeping underline that extends to the left.

DEAN R. DUNPHY
Secretary

**DEPARTMENT OF MOTOR VEHICLES RESPONSE
TO DRAFT AUDIT REPORT**

CHAPTER 1

Recommendation 1

Update the unit cost calculations using guidelines similar to those we describe in Appendix B.

Response

Although we concur that the unit cost calculations for information provided to customers should be updated with complete data for the database creation and maintenance cost component, the guidelines recommended in Appendix B of the draft report are also missing critical elements needed to update the database. For example, the recommended methodology uses Type Transaction Codes (TTC) activity associated with creating and updating the records in the database relative to total TTC activity. However, this time measurement does not include other personnel time needed to complete customer transactions related to the TTC that created the database. Furthermore, the recommended methodology does not include other costs, such as those associated with salvage certificate processing, mandatory driver license actions, parking citation entries, lien sales, license eligibility work performed in the Consolidated Processing Area, and vehicle registration and driver license automation development work which ensures database accuracy and functionality.

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②

The department will perform a reevaluation of its costing methodology to ensure that it includes all relevant cost information. However, because the cost methodology recommended by the State Auditor does not include several cost elements and, therefore, might not generate revenues necessary to cover the costs of the information provided, its implementation could require charges to local government entities including law enforcement and increased costs in the form of taxes and fees for the general public.

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Recommendation 2

Compile reliable volume data to use in its unit cost calculations by implementing a system to track and report the number and type of records provided to private and government requesters and the method used to provide the records.

Response

We believe this recommendation was reached as a result of the auditors misunderstanding of the purpose for which summary data and trend analysis information is gathered and used by the department. Reliable volume data used for costing purposes is obtained by the department through more sophisticated tracking methods and verifications which were disclosed to the auditor during the course of the fieldwork.

⑥

Recommendation 3

Establish fees sufficient to cover actual costs and provide for a limited profit margin.

Response

Fees the department charges for information include a profit margin sufficient to comply with requirements under the law. Vehicle Code, Section 1811, is clear in its instruction that the department may sell information at a charge sufficient to pay at least the entire actual cost to the department of that information and that the charges are to be determined by the director. Furthermore, case law in 1984 (Shippen v DMV) has established that the department is permitted to charge more for information services products than their actual cost. However, Vehicle Code, Section 1812, prohibits the department from charging for the information given to local government entities such as law enforcement. Therefore, the law permits, and we believe public policy supports, charges in excess of cost in order to support these needs. The department is guided by the value of the information provided and the need to cover the cost of providing the information. Reducing the fees and therefore the profits currently charged could shift the costs from fee paying customers, such as insurance companies, to the general public through increased fees for driver licenses and vehicle registrations.

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Recommendation 4

Reassess and update its unit costs on a periodic basis to ensure that they represent the current activities and related costs of providing information, and the department should modify its fee schedule accordingly.

Response

As noted in the department’s response to the previous recommendation, the department believes that fees should be set to cover costs and avoid charges to law enforcement or increases in fees charged to the general public. However, the department will reassess and update its unit costs where appropriate and will continue to adhere to its fee schedule when charging customers for information.

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Recommendation 5

In addition, the Legislature should consider whether it is reasonable and equitable for the public to continue subsidizing the department’s costs of providing information to government agencies.

Response

As noted above, in Vehicle Code, Section 1812, the Legislature has directed the department to provide information to government agencies without charge. The cost of that service must be borne by someone. The department has determined that such service should be subsidized by for-profit requesters of information. Since information services revenue is currently deposited in the Motor Vehicle Account, any shortfall precipitated by reducing fees would necessarily be made up by vehicle owners and licensed drivers.

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Recommendation 6

If the Legislature determines that it is not reasonable or equitable for the public to subsidize these costs, the department should modify its calculations of unit costs to include total records provided rather than total records sold.

Response

The “public” referred to in the audit report consists of for-profit requesters of information not the general public consisting of holders of driver licenses and owners of motor vehicles. The department will respond to any legislative direction on this issue. However, the department would oppose measures to dramatically reduce costs for requesters of information at the expense of local government and the general public.

⑩

Chapter 2**Recommendation 1**

To ensure that it protects the confidential information in its records, the department should make certain that it complies with the law before releasing any information.

Response

The department acknowledges that in the case noted in the audit report, it did not retain sufficient documentation to show that the requirements of the law were met. The specific instance is one deficiency in the 50 to 70 requests for information studied by the auditors and is not representative of the department’s normal business practices. The department is committed to ensuring the privacy of all confidential information and endeavors to ensure public protection and compliance with law by a series of administrative, regulatory, technological, and contractual control measures. The department will review its controls and procedures for safeguarding information and, in the future, will ensure that information is released only when all requirements have been met.

⑪

Recommendation 2

The department should develop and implement procedures to identify and recover all its costs of providing registration and licensing information and revise the applicable regulations to address the fee it should charge when providing statistical information.

Response

The provision of statistical information is a minor part of the department’s business and is not specifically addressed in statute. The department currently has plans to modify the fees for providing statistical information; however, the modification plan does not take the form recommended by the auditors.

Recommendation 3

To minimize its costs and the fees it charges customers, the department should develop procedures that ensure it uses cost-effective methods when providing registration and licensing information.

Response

It is the department’s practice to provide the most current information available to its customers. Therefore, it is necessary to run programs for each customer so as to include all updated records. However, the department acknowledges that it could run the zip code report program once a year and provide that report to customers who specify that they are not in need of the most current information.

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Recommendation 4

The department should adhere to its fee schedule when charging customers for registration information.

Response

The department does adhere to its fee schedule for information for which specific fees have been established. For information not covered in either the fee schedule or statute, the department will review fees to ensure that they are appropriate.

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Comments

California State Auditor's Comments on the Response From the Business, Transportation and Housing Agency

To provide clarity and perspective, we are commenting on the Business, Transportation and Housing Agency's (agency) response to our audit report. The numbers correspond to the numbers we have placed in the response.

- ① We stand by the information in our report as presented. Facts provided by the Department of Motor Vehicles (department) fully support our report.
- ② During numerous discussions and meetings, department staff provided us with information and data that they believed encompassed all the costs related to creating and updating database records. We reviewed all of this data and consistently shared with the department our analyses and the methods we used to identify and measure the appropriate costs.

Following our exit conference, the department has searched for additional costs to reduce the \$23.8 million that we identified as overstated database costs. To reduce the database cost figure, the department identified \$2.9 million in personal service expenditures related to staff creating and maintaining records in the database that the department believes should be added to the \$16.8 million database costs we reported. If the department had provided this information during the audit, we would have reviewed these activities and costs to determine if they were reasonable, just as we did the other costs included in the database calculation. However, because of such short notice, we have not been able to assess the appropriateness of these costs. Nevertheless, including the newly identified costs would only serve to reduce the department's overstated database costs to \$20.9 million. Therefore, our conclusion that the department has significantly overstated its database costs would not change.

Other expenditures the department proposes to include in the calculation of database costs were for operating expenses and equipment. The department already distributes these expenditures among its products, including information services products, through the application of its cost model, which we

describe on page 9. If the department could develop a method to identify and measure the operating expenses and equipment expenditures that relate to creating and updating records in its database, it should reduce proportionately the expenditure amount already allocated to its other products.

At the exit conference, the department brought to our attention a category of costs related to employees performing activities that relate indirectly to database creation and maintenance, such as processing information before updating the database. We believe that these costs should remain allocated to the products that directly benefit from the activities performed by the staff.

- ③ The agency is incorrect. Implementing our recommendations would not increase taxes and fees to the public in order to increase profits for information vendors and insurance companies. Instead, implementation would result in the department's determining its actual costs to provide information so that it can establish fees that are reasonable and equitable.
- ④ Our methods of identifying and measuring costs would improve the department's cost allocation process by allowing it to distribute its costs to the products that benefit from the activities driving the costs. The department could then establish fees that are both reasonable and equitable. In fact, as we state on page 29, the cost accounting manager, who performed the costing calculations in fiscal year 1989-90 and was actively involved when we developed new methods, agreed that our proposed guidelines and recommendations to calculate unit costs for information services products appear reasonable.
- ⑤ Contrary to the agency's assertion, the use of our methodology will not result in charges to government entities such as law enforcement. Furthermore, if the Legislature decides that the department's paying customers should not subsidize law enforcement and government agencies, this decision would not result in these agencies being charged for information.
- ⑥ The agency is wrong. The volume data used by the department in fiscal year 1989-90 to calculate costs is the same type of data we reviewed for fiscal year 1995-96. Because the 1995-96 data is unreliable, we question the reliability of data used in 1989-90. As a result, the costs the department calculated for each product may not represent actual costs.

In addition, the department did not disclose any other tracking methods for compiling volume data.

- ⑦ Contrary to the agency's statement, a reduction in the information services revenue will not result in increased fees for driver's licenses and vehicle registration products. Even though our audit did not include a review of the department's driver's license and vehicle registration products, we determined that the law does not require the department to use revenue generated from information services products to subsidize the costs of its other programs nor its costs of providing information to government agencies.
- ⑧ Contrary to the agency's assertion, the department did not always adhere to its fee schedule.
- ⑨ The California Vehicle Code, Section 1811, does not direct the department to require customers purchasing information to cover the department's costs of providing information to government agencies.
- ⑩ Again, the agency is wrong in its response. The "public" to which our report refers includes the general public. As stated on page 15, the department set its fees so that individuals and private entities required to pay for registration or driver's license information will cover the department's costs of providing information to all of its customers, including government agencies.

Furthermore, the department has ignored the strict limitations the law imposes on the use of confidential information by private entities and has also overlooked the public benefits realized from the purchase of information by authorized private businesses. Specifically, the law does not permit private entities to use registration and licensing information for direct marketing or solicitation for the purchase of any consumer product or service. However, the law permits the department to release confidential information for specific purposes, such as assessing driver's risk or identifying vehicle owners. For example, businesses that employ professional drivers purchase information to evaluate the driving history of their employees. Additionally, vehicle manufacturers purchase information from the department's records to notify the public of safety recalls.

- ⑪ A lack of documentation is not the basis for our conclusion; rather, as we state on page 22 of the report, the department believed that it had fully complied with the law even though it did not obtain the required written assurances from the customer. In this instance, the department released 1,000 confidential addresses without ensuring that the recipient of the information was fully aware of the restrictions the law imposes on the use of such information. Furthermore, we

identified this instance of the department's failure to comply with the law while reviewing invoices to determine whether the department's charges for information products were consistent with its fee schedule.

- ⑫ If the department chooses to continue its practice of providing the most current information to its customers, it must charge a fee sufficient to cover all of its costs including the \$1,000 data processing costs.
- ⑬ The department did not adhere to its fee schedule published in the California Code of Regulations when it charged a customer \$200 instead of \$3,800 for vessel registration information. We cover this issue on page 24 of this report.

cc: Members of the Legislature
Office of the Lieutenant Governor
Attorney General
State Controller
Legislative Analyst
Assembly Office of Research
Senate Office of Research
Assembly Majority/Minority Consultants
Senate Majority/Minority Consultants
Capitol Press Corps