

# LEGISLATIVE AUDIT DIVISION

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## MEMORANDUM

**TO:** Legislative Audit Committee Members

**FROM:** John Harrington, Performance Auditor

**CC:** Tim Reardon, Director, Montana Department of Transportation  
Duane Williams, Administrator, Motor Carrier Services Division  
Larry Flynn, Administrator, Administration Division  
Dan Moore, Bureau Chief, Enforcement Bureau  
Vickie Murphy, Internal Audit Unit Manager  
Tracy Halubka, Program Manager, Fuel Tax Management and Analysis Section

**DATE:** December 2012

**RE:** Performance Audit Follow-Up (13SP-03): Controls Over Dyed Diesel Use in Montana (11P-01)

**ATTACHMENTS:** Original Performance Audit Summary

### Introduction

In September 2011, we presented our performance audit titled "Controls Over Dyed Diesel Use in Montana." The audit included six recommendations to the Montana Department of Transportation (department). In November 2012, we began gathering preliminary information from the department related to progress in implementing the recommendations. This memo summarizes the results of our follow-up work.

### **Overview**

This performance audit identified a number of areas in which the department could improve its processes for identifying and preventing the illegal use of dyed diesel fuel on Montana's public highways. Our follow-up work found the department has implemented all six recommendations made in the report. This memo outlines the steps the department has taken in response to each of the six recommendations.

### Background

Montana defines "special fuel" as any diesel fuel used in motor vehicles or equipment operating upon the public roads and highways of the state. Consumers in Montana can purchase two different types of diesel fuel, depending upon where the vehicle is operated. The cost of clear diesel fuel includes state and federal fuel tax of \$0.2440 and \$0.2775, respectively, for each gallon purchased. Any vehicles operating on public roads or working on public road construction projects (roads, bridges, etc.) must use clear diesel fuel.

The second type of diesel fuel is sold tax-free. Tax-free diesel fuel is intended to be used only for off-road purposes such as agricultural operations. It cannot be used in vehicles or equipment operating on

Montana's public roadways. Because certain diesel fuel is sold tax-free, there can be motivation for individuals to use it inappropriately. Untaxed diesel fuel is dyed red to provide a simple way to identify when it is being used. This is commonly referred to as dyed diesel.

Montana state law (Title 15, Section 70, Part 3) prohibits the use of dyed diesel fuel for purposes other than off-road use. These laws also require all contractors and subcontractors performing any work on public roads (construction, maintenance, etc.) to obtain a special fuel users (SU) permit. This permit requires SU permit holders to use clear diesel fuel at all times and prohibits them from storing or using dyed diesel. The department is responsible for enforcing statutes related to dyed diesel and for issuing SU permits to contractors and subcontractors. Our performance audit identified a number of ways in which the department could strengthen its processes for identifying vehicles and equipment operating on public roads illegally using dyed diesel fuel.

### **Follow-up Audit Findings**

The following sections summarize the department's progress toward implementation of the report recommendations.

#### **RECOMMENDATION #1**

**We recommend the Montana Department of Transportation expand contractor reviews to include subcontractors working on department road contracts to ensure they have the statutorily required special fuel users permit.**

#### **Implementation Status – Implemented**

The documentation compiled for each contractor now includes an indication of whether an applicant has an SU license, and also has a place to indicate whether an SU license is not necessary because all of the prospective contractor's vehicles use regular gasoline. This information is now documented in the department's construction file for each project.

#### **RECOMMENDATION #2**

**We recommend the Montana Department of Transportation provide training to local and federal government contracting personnel regarding special fuel users permit requirements.**

#### **Implementation Status – Implemented**

Department officials have visited every county in the state to distribute information about the SU permitting requirements and the need to use clear diesel fuel on public road projects. Much of the work was done in conjunction with the department's periodic International Fuel Tax Agreement training provided to local government staff. Documentation shows that the information was discussed at county offices, public works offices, federal offices, and the sites of various distributors. Officials said the program thoroughly covered the entire state in 2011, and training reminders were scaled back to include mostly the bigger cities in the state in 2012.

#### **RECOMMENDATION #3**

**We recommend the Montana Department of Transportation define its process and expectations for public road project inspections to help ensure contractors comply with state law related to dyed diesel use.**

#### **Implementation Status – Implemented**

The department documented visits to 24 public road projects and checks of 67 vehicles in fiscal year 2011, and 33 projects to check 92 vehicles in fiscal year 2012. The problems found did not involve the

use of dyed diesel in inappropriate situations, but rather that the definition of subcontractors was vague, and some vehicles on state highway projects did not have SU licenses. Most citations issued were to contractors who were burning clear (i.e. taxed) diesel but who did not have the required SU license, which they are supposed to have to work on a public road project. Department officials indicated there may be legislation in the 2013 Legislative Session to eliminate the SU permit and simplify the statutory language to require only that contractors and subcontractors working on public projects use clear (taxed) diesel exclusively.

#### **RECOMMENDATION #4**

**We recommend the department establish a risk based vehicle inspection program for its dyed diesel enforcement activities.**

#### **Implementation Status – Implemented**

Implementation of this recommendation involved different types of monitoring/checking for illegal use of untaxed fuel. In the first half of 2012 the department set up four check stations in four different areas of the state, targeting what the department believed were “high risk” opportunities for dyed diesel abuse – for example, in the Bakken oil region, and to coincide with livestock sale days in other parts of the state. These check stations were publicized ahead of time with press releases and public service announcements. A fifth diesel check station was conducted this fall in conjunction with a Department of Fish, Wildlife and Parks game check station. Implementation of this recommendation also involved enforcement officers staking out commercial dyed diesel pumps to watch for violators pumping the fuel illegally. These stake-outs have to date identified 19 vehicles illegally filling up. Beyond the people caught using dyed diesel, department officials believe the high profile of their enforcement efforts prevented other people from using the fuel.

#### **RECOMMENDATION #5**

**We recommend the Montana Department of Transportation design and implement a process to identify high risk areas related to dyed diesel that should be further examined by the Internal Audit Unit.**

#### **Implementation Status – Implemented**

The department’s Internal Audit Unit has now completed a risk assessment of potential audits related to the inappropriate use of dyed diesel. This includes identifying risks through fuel tax information and dyed diesel citations issued through department enforcement activities. The process for identifying high risk areas related to dyed diesel has been formalized and coordination is now occurring between the department’s tax process function, the SU permitting unit, and the Motor Carrier Services (MCS) Division.

#### **RECOMMENDATION #6**

**We recommend the Montana Department of Transportation strengthen dyed diesel enforcement by:**

- A. Using available information to prioritize enforcement activities.**
- B. Compiling data related to inspections for public road projects.**
- C. Tracking the disposition of dyed fuel tip line calls.**
- D. Sharing information related to the department’s appeals process.**

#### **Implementation Status – Implemented**

Parts A and B of this recommendation were addressed through check stations and fuel pump monitoring, which included a compilation of information related to these activities; and by inspecting public roads

projects and documenting the results. For Part C, the department provided documentation of 14 months' worth of calls to the dyed diesel enforcement hotline. These calls are now documented in a more thorough manner and all calls are referred to MCS patrol officers for follow-up in the area where a hotline call was received. The department also strengthened its appeal procedures for dyed diesel violations, which includes maintaining a status report of the appeals process so current information can be readily shared among department functions.

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