

# AUDITS GUIDANCE MANUAL



COMMONWEALTH OF KENTUCKY  
TRANSPORTATION CABINET

September 2007



Produced by Policy Support Branch  
Division of Personnel





**TRANSPORTATION CABINET**

Frankfort, Kentucky 40622  
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Deputy Secretary

**OFFICE OF THE SECRETARY  
OFFICIAL ORDER**

**104504**

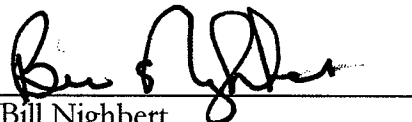
**SUBJECT:** *Audits Guidance Manual*

This manual has been prepared to provide information and guidance to personnel of the Kentucky Transportation Cabinet. Its purpose is to establish uniformity in the interpretation and administration of laws, regulations, policies, and procedures applicable to the operations and services of the Division of Audits, External Audit Branch, and Internal Audit Branch and their relationship with other units of the Cabinet.


The policies and procedures set forth herein are hereby approved and declared effective unless officially changed.


All previous instructions, written and oral, relative to or in conflict with this manual are hereby superseded.

Signed and approved this 8th day of November 2007.

  
\_\_\_\_\_  
Bill Nighbert  
Secretary

Approved as to Legal Form

  
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Office of Legal Services

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	<b>Chapter</b>  INTRODUCTION
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**PURPOSE** The *Audits Manual* is a guide for use in performing various types of audits for the Transportation Cabinet. The manual sets forth policies, procedures, standards, and instructions for planning and conducting all audits performed by Cabinet auditors.

**ORGANIZATION & NUMBERING**

**Chapters**—The subject matter in the manual is first divided into chapters. Each chapter is placed behind a blue tab with the chapter title and the chapter control number (100, 200, 300, etc.) printed on the tab. The chapter title also appears in the upper right-hand corner of the first page of a subject and in the upper left-hand corner of any subsequent page.

**Sections**—Some chapters are divided into sections. Each section title, instead of chapter title, appears in the upper right-hand corner of the first page of a subject and in the upper left-hand corner of any subsequent page.

**Subjects**—Chapters and sections are arranged by subjects.

**Subject Number**—Each subject is assigned a number, which appears in the upper right-hand corner of each page of the subject. For example, Chapter 200 includes subject 202, followed by subject 203, which is divided into section subjects 203-1 through 203-2.

**“AUD” Prefix**—Preceding each subject number, this prefix stands for the manual title *Audits*.

**Subject Title**—This title appears in the upper right-hand corner of the first page of a subject and in the upper left-hand corner of any subsequent page.

**Date**—The latest issuance date of a subject appears at the bottom of each page of the subject. This date agrees with the latest issuance date shown for the subject in the Table of Contents (**AUD-01**).

**Page Numbering**—Each subject has its own page numbering, which appears at the bottom of each page.

**TABLE OF  
CONTENTS**

The Table of Contents (**AUD-01**), placed behind a white tab, lists the titles of the manual's chapters and sections and their subjects, as well as other information, in numerical order. It includes the latest issuance dates of all the subjects. As the manual matures, these dates change.

**CROSS-REFERENCES  
IN MANUAL**


**Subject Numbers within Text**—A boldfaced subject number that appears within the text references the location of more information about the subject.

**QUESTIONS**

**Whom to Contact**—For copies of this manual, contact the [Policy Support Branch](#) within the Division of Personnel.

For information about the content of the manual, please contact the Chief Audit Executive, [Office of Budget and Fiscal Management](#).



	<b>Chapter</b> INTRODUCTION
	<b>Subject</b> Audit Structure & Services

**STRUCTURE**

The Cabinet has three audit groups:

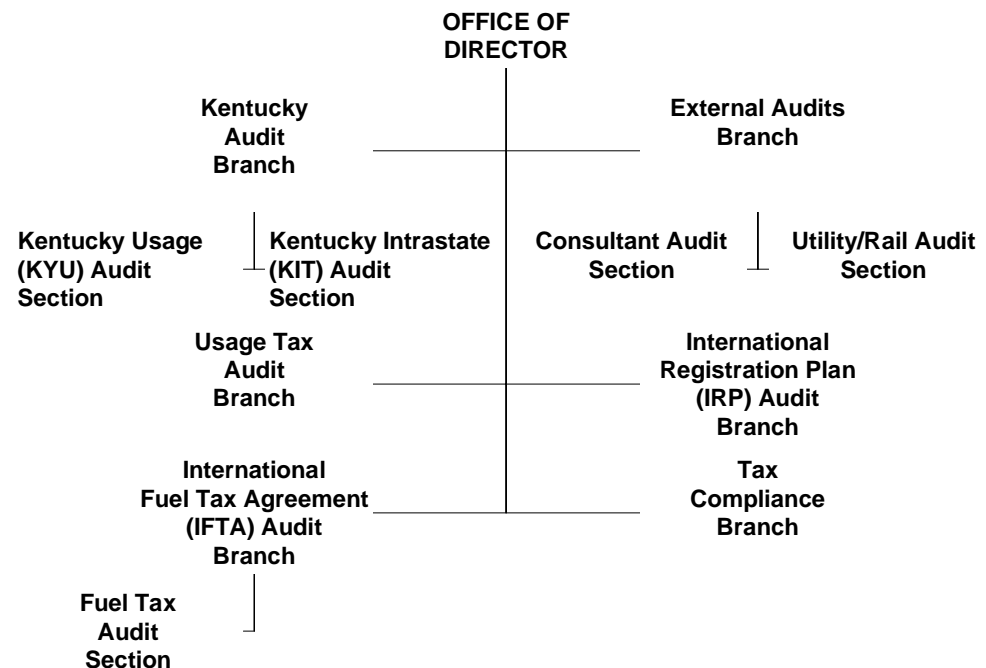
- Internal auditors
- External auditors
- Road fund auditors

Each audit group conducts certain types of audits, and this manual devotes a chapter to each audit type.

The Internal Audit Branch in the Office of the Executive Director of the Office of Budget and Fiscal Management performs all the Cabinet’s internal audits.

The Division of Audits performs all other audits for the Cabinet. The goal of the division is *“to protect Kentucky’s Road Fund revenue through education of, assistance to, and compliance by the users of the Kentucky highway system.”*

The division comprises six branches and five sections:




**SERVICES**

## The Division of Audits:

- Provides auditing functions to meet the various needs of Transportation Cabinet management
- Audits more than 900 permit holders that lease or rent automobiles to assure they comply with the state's U-Drive-It tax laws
- Conducts audits of more than 47,000 trucking companies traveling in Kentucky to ensure compliance with the state's weight-distance tax laws
- Performs fuel-tax audits in conformity with the International Fuel Tax Agreement (IFTA)
- Audits motor carriers with apportioned registration applications as required by the Motor Vehicle International Registration Plan (IRP)
- Performs intrastate fuel-tax audits on Kentucky-based carriers (KIT)
- Performs engineering and overhead engagements
- Audits engineering-design contracts
- Audits utility-relocation and railroad contracts



	<i>Chapter</i> INTRODUCTION
	<i>Subject</i> Authority & References

**STANDARDS**

Both the Internal Audit Branch and the External Audit Branch adhere to Generally Accepted Government Auditing Standards (GAGAS), often called the “Yellow Book”, issued by the Comptroller General of the United States.

Road fund auditors adhere to regulations as detailed in Chapters **AUD-400–700**.

**REFERENCE MATERIALS**

Auditors use a variety of resources for reference and guidance including:


- [American Institute of Certified Public Accountants](#)
- [Code of Federal Regulations](#)
- [Federal Acquisition Regulation](#)
- [Federal Highway Administration](#) program manuals
- [Government Accountability Office](#)
- Generally Accepted Accounting Principles
- Generally Accepted Auditing Standards
- Generally Accepted Government Auditing Standards
- [Governmental Accounting Standards Board](#)
- [Institute of Internal Auditors](#)
- [Kentucky Administrative Regulations](#)
- [Kentucky Revised Statutes](#)
- [Office of Management and Budget](#)
- Transportation Cabinet programmatic and administrative [policy manuals](#)

**ABBREVIATIONS &  
ACRONYMS**

Auditors use many different abbreviations and acronyms in their daily work. The following list represents those used in this manual, as well as in the engagements performed by the auditors:

- AICPA American Institute of Certified Public Accountants
- APA Auditor of Public Accounts
- BM Branch Manager
- CAE Chief Audit Executive
- CFR Code of Federal Regulations
- CPA Certified Public Accountant
- EAB External Audit Branch
- eMARS enhanced Management Administrative Reporting System
- FAC Finance and Administration Cabinet
- FAP Finance and Administration Policy
- FAR Federal Acquisition Regulation
- FHWA Federal Highway Administration
- GAAP Generally Accepted Accounting Principles
- GAAS Generally Accepted Auditing Standards
- GAGAS Generally Accepted Government Auditing Standards
- GAO Government Accountability Office
- GASB Governmental Accounting Standards Board
- IAB Internal Audit Branch
- IAC Internal Audit Committee
- IIA Institute of Internal Auditors
- IFTA International Fuel Tax Agreement
- IRP International Registration Plan
- KAR Kentucky Administrative Regulation
- KRS Kentucky Revised Statute
- KYTC Kentucky Transportation Cabinet
- OBFM Office of Budget and Fiscal Management
- OH Overhead
- OMB Office of Management and Budget
- SSAE Statements on Standards for Attestation Engagements
- SAS Statements on Auditing Standards
- WP Working papers



	<i>Chapter</i> INTRODUCTION
	<i>Subject</i> Auditor Conduct

### CONDUCT DURING AUDITS

Auditors of the Division of Audits and of the Internal Audit Branch are representatives of the Kentucky Transportation Cabinet and shall act in a professional manner that reflects positively upon the division, the branch, and the rest of the Cabinet. Auditors shall be courteous at all times when dealing with the public and with auditees.


When interacting with auditees, the audit staff shall:

- Behave courteously and professionally at all times
- Conduct themselves as independent and separate from the auditee
- Treat as confidential all information obtained from the auditee
- Avoid supplementing their income by preparing tax returns or similar items for auditees
- Refuse gifts of any kind from auditees
- Offer advice that will make procedures more efficient and economical
- Assist the auditee in improving the auditee's reporting methods
- Not allow the auditee to rely on the auditor for the performance of routine duties
- Make every effort to avoid antagonizing the auditee
- Make certain the auditee understands the reasons for the audit and for any adjustments determined during the audit
- Remain free from impairments that prevent exercise of good judgment
- Maintain independence from the entities being audited

### PROFESSIONAL CONFLICT

Auditors shall advise their supervisors of any audits scheduled in which a lack of independence may interfere with the performance of the audit. If for any reason an auditor feels that he or she cannot act independently with regard to a particular audit, the Audit Supervisor or Manager shall reassign that auditor.



	<b>Chapter</b>  INTRODUCTION
	<b>Subject</b>  Professional Certification

**PURPOSE** The Kentucky Transportation Cabinet (KYTC) supports the development of its business professional employees. KYTC values these employees and acknowledges the benefits associated with professional certifications for both employer and employees. Accountants and auditors who obtain professional certifications greatly benefit KYTC through improved professionalism, increased credibility, and an expanded knowledge base.

#### **CERTIFICATION**

**APPROVAL PROCESS** An employee desiring to obtain professional certification shall submit a written request to the Chief Audit Executive in the Office of Budget and Fiscal Management. The requested certification shall have a clear and direct relationship to the employee's current job duties and classification. The request shall contain:

- Description of the certification
- Cost of the review course
- Cost of examination fees
- Detailed description of subsequent benefits to KYTC

The Chief Audit Executive shall review the request and consider the employee's work performance, job-performance evaluations, and attendance. After reviewing these items, the Chief Audit Executive shall submit a recommendation to the Executive Director of the Office of Budget and Fiscal Management. The Chief Audit Executive shall notify the employee of submission as to the decision of the Executive Director.

Employees who are approved to seek certification and who desire to receive reimbursement for the review course and examination fees shall enter into a contract with KYTC that defines the duties and responsibilities of both parties (see [AUD-9001](#)).

#### **REVIEW COURSE POLICY**

KYTC shall reimburse any approved employee the cost of one (1) review course for the specified professional certification when taken as a KYTC employee. To request reimbursement, the employee shall complete and submit the TC 31-21 e-form, *eMARS Travel Reimbursement Request*, along with the certification approval, review course invoice, and proof of payment. The request for reimbursement must be approved by the Chief Audit Executive and processed in the same manner as all TC 31-21 requests.

**EXAMINATION  
POLICY**

KYTC shall reimburse employees for the cost of taking one (1) certification examination. If the employee does not pass the examination, he or she shall bear all expenses associated with retaking the examination.

To request reimbursement, the employee shall complete and submit the TC 31-21 e-form, *eMARS Travel Reimbursement Request*, along with a copy of the examination fee invoice and proof of payment. The request for reimbursement must be approved by the Chief Audit Executive and processed in the same manner as all TC 31-21 requests.

**LEAVE TIME**

KYTC shall allow any employee sitting for a certification examination to attend without using personal leave time for the number of days required to sit for the examination. However, KYTC shall grant leave with pay only once for the days required to sit for the examination. Should an employee need to repeat an examination, KYTC shall charge the associated time off against the employee's annual or compensatory leave balance.

**EXAMINATION &  
REVIEW COURSE  
TRAVEL EXPENSE**

KYTC shall not reimburse employees for travel expenses associated with review courses or examinations.

**PROBATIONARY  
EMPLOYEES**

Initial probationary employees are not eligible for reimbursement of fees associated with review courses or examinations. However, employees serving promotional probation are eligible.

**OBLIGATIONS OF  
EMPLOYEES**


Employees who receive professional certification reimbursement from KYTC are obligated to:

- Present to the Chief Audit Executive official evidence of certification for which KYTC granted reimbursement
- Maintain employment with KYTC for a minimum of 12 months after successful completion of the certification review course and examination
- Receive certification within 24 months of receiving reimbursement from the KYTC for costs associated with the certification review course and examination

**REIMBURSEMENT  
OBLIGATIONS**

Any employee not fulfilling the requirements of this policy shall be responsible for reimbursement of all certification-related expenses paid by KYTC. If KYTC does not receive reimbursement from the employee, KYTC has the right to offset and deduct the amount from the employee's paycheck.




	<i>Chapter</i> <p style="text-align: center;">INTRODUCTION</p>
	<i>Subject</i> <p style="text-align: center;">Employee Response to Auditor of Public Accounts</p>

**PROCEDURES  
FOR CABINET  
COMPLIANCE  
WITH KRS 43.080**

To ensure timely and accurate responses to requests by the Auditor of Public Accounts (APA), the Transportation Cabinet shall comply with [KRS 43.080](#), "Access to books and records—Power to obtain testimony" as follows:

1. Only office or department heads, or their designees, shall respond to requests from APA.
2. Cabinet respondents shall honor only hard-copy written requests (no e-mails) from APA, although they may honor requests by telephone if they require only brief factual responses.
3. APA shall submit one copy of a request to the Office of Budget and Fiscal Management (OBFM) and another to the Office of the Secretary.
4. OBFM shall date-stamp and log the request and ascertain that it is not a duplicate request.
5. OBFM shall forward the request to the appropriate office or department head for response.
6. OBFM shall track the status of the request to ensure timely response.
7. The department or office head shall submit response to OBFM.
8. OBFM shall review the response, making suggestions if appropriate.
9. OBFM shall forward the response to APA, and retain a copy on file.



	<b>Chapter</b>  INTERNAL AUDITS
	<b>Subject</b>  Introduction

**DEFINITION** The Institute of Internal Auditors defines *internal auditing* as “an independent, objective assurance and consulting activity designed to add value and improve an organization’s operations. It helps an organization accomplish its objectives by bringing a systematic, disciplined approach to evaluate and improve the effectiveness of risk management, control, and governance processes.”

**PURPOSE** The purpose of the Internal Audit Branch (IAB) is to ensure that the Transportation Cabinet’s internal control structure is properly designed and functioning efficiently and effectively.

The internal auditors must be free from impairments to independence, either actual or perceived. The IAB manager is responsible for assuring that auditors are impartial and not affected by personal or external impairments. To assure organizational independence, the IAB reports results of their engagements to the Secretary of the Cabinet and the Internal Audit Committee.

**RESPONSIBILITIES** The IAB conducts its engagements in accordance with generally accepted government auditing standards (GAGAS), also called the “Yellow Book”, issued by the Comptroller General of the United States. When necessary, internal auditors obtain additional guidance from standards issued by the American Institute of Certified Public Accountants (AICPA) and the Institute of Internal Auditors (IIA).

Internal auditors perform a variety of engagements, ranging from attestation engagements consisting of reviews, examinations, and agreed-upon procedures, to performance audits.

The IAB is responsible for:

- Determining that internal controls in place are adequate and functioning properly
- Determining compliance with laws, rules, regulations, policies, and procedures including state law as well as federal law
- Reporting to the Cabinet Secretary, the Internal Audit Committee (IAC), and management, noting any weaknesses or areas of improvement

**PROFESSIONAL  
CONDUCT**

The IAB shall conduct themselves in a professional manner at all times. IAB auditors shall:

- Be cognizant of professional relationships formed with other Cabinet Offices and Departments
- Treat Cabinet employees, as well as outside entities, with respect, courtesy, and dignity
- Become familiar with and abide by Cabinet personnel policies and procedures
- Not use confidential information obtained in their professional capacity for personal gain or in a manner that would be detrimental to the Cabinet or the public interest
- Adhere to applicable standards, laws, and regulations as prescribed by professional organizations, legislative bodies, or governmental agencies
- Identify and report on all significant deficiencies found in the course of their work
- Obtain sufficient evidential matter before expressing an opinion or conclusion
- Maintain credibility at all times
- Not give advice or information if not confident in its accuracy
- Present all recommendations to the IAB manager for review before submitting to the auditee
- Not remove work papers from the auditee site, only test original documents, and protect the documentation while in possession of it

**INTERNAL AUDIT  
COMMITTEE**

The Internal Audit Committee (IAC) consists of the following members:

- Secretary, ex officio
- Chief of Staff, Chair
- State Highway Engineer
- Executive Director, Office of Legal Services
- Executive Director, Office of Budget and Fiscal Management
- Chief Audit Executive (nonvoting)
- Internal Audit Branch Manager (nonvoting)
- Executive Director, Office of Inspector General (nonvoting)

**INTERNAL AUDIT  
COMMITTEE (CONT.)**

The duties of the IAC include:

- Directing and guiding Cabinet management on issues involving the Cabinet's internal control structure—including the internal audit function—and the Cabinet's use of independent external auditors
- Evaluating and making recommendations to the Secretary of Transportation regarding areas or programs to be audited
- At the direction of the Secretary, reviewing audit plans and reports issued by the Cabinet's Internal Audit Branch
- Reviewing and recommending actions to the Secretary on unresolved audit findings
- Meeting at the request of the Secretary or the Chief of Staff

The IAC meets quarterly. The IAB Manager discusses reports issued within the last quarter and highlights important findings. The Inspector General also attends and discusses reports his or her office has issued over the last quarter as well. The Internal Audit Committee then decides if further actions on the internal audit reports and inspector general reports are necessary.



	<b>Chapter</b>  INTERNAL AUDITS
	<b>Subject</b>  General Standards

## GENERAL STANDARDS

GAGAS prescribes general standards and provides guidance for performing financial audits, attestation engagements and performance audits. These ensure the credibility of auditors' results, which is essential to all audit organizations performing government engagements and audits. These standards consist of:

- Independence of the audit organization and its individual auditors
- Exercise of professional judgment in the performance of work and the preparation of related reports
- Competence of audit staff, including continuing professional education
- Existence of quality-control systems and external peer reviews

## INDEPENDENCE

According to GAGAS, the general standard related to independence is:

*In all matters relating to the audit work, the audit organization and the individual auditor, whether government or public, should be free in both fact and appearance from personal, external, and organizational impairments to independence.*

All internal auditors, including the branch manager, complete independence statements once a year and as needed throughout the year. The auditors scan these statements into the network drive and refer to them as a step in the audit program in each engagement conducted. These independence statements cover both personal and external impairments.

The IAB is free from organization impairments in that the IAB reports to the Internal Audit Committee, as well as to the Cabinet Secretary. The IAB is accountable to the:

- Internal Audit Committee
- Cabinet Secretary
- Chief Audit Executive

IAB auditors are free from political pressures and can conduct their audits/engagements objectively and report their findings, opinions, and conclusions objectively.

**PROFESSIONAL  
JUDGMENT**

The GAGAS general standard related to professional judgment states:

*Professional judgment should be used in planning and performing audits and attestation engagements and in reporting the results.*

All IAB auditors shall:

- Conduct themselves in a professional manner at all times
- Maintain the highest degree of integrity, objectivity, and independence in applying professional judgment to all aspects of their work
- Exercise professional skepticism, which involves a questioning mind and a critical assessment of evidence

Using professional judgment reasonably assures auditors that they will likely detect material misstatements or significant inaccuracies in data if they exist.

**COMPETENCE**

The GAGAS standard related to competence is:

*The staff assigned to perform the audit or attestation engagement should collectively possess adequate professional competence for the tasks required.*

All IAB auditors shall:

- Have a bachelor's degree that includes 20 semester hours or 30 quarter hours in accounting
- Possess a good working knowledge of GAGAS applicable to the type of engagement on which they are working, as well as a general knowledge of the Cabinet and subject under review
- Possess a good working knowledge of the AICPA general attestation standard related to criteria and of the AICPA attestation standards for field work and reporting, as well as of the related SSAEs, when performing attestation engagements
- Competently apply those standards and SSAEs to the engagement assigned
- Communicate clearly and effectively
- Comply with the continuing professional education (CPE) requirements set forth in GAGAS, which include completing in each two-year period the minimum of:

**COMPETENCE (CONT.)**

- ◆ 80 hours of CPE that directly enhances the auditors' professional proficiency to perform audits and attestation engagements
- ◆ 24 of the 80 hours in subjects directly related to government auditing, government environment, or specific environment in which they work (transportation-related)
- ◆ 20 hours of the 80 in any one year of the two-year period

An employee appointed by the IAB Manager maintains a CPE file for all auditors and monitors this file to ensure compliance.

The Cabinet provides IAB auditors various types of training, including on-the-job training, classroom training, self-study materials, and participation in professional organizations.

The Cabinet encourages participation in professional organizations and in most cases reimburses annual dues.

**QUALITY CONTROL  
& ASSURANCE**

The GAGAS general standard related to quality control and assurance states:


*Each audit organization performing audits and/or attestation engagements in accordance with GAGAS should have an appropriate internal quality-control system in place and should undergo an external peer review.*

Within the Office of Budget and Fiscal Management, the Deputy Executive Director serves as the Cabinet's Chief Audit Executive (CAE) and plays an active role in the day-to-day activities of the IAB.

Upon completion of an engagement, an audit supervisor, if applicable, reviews the working papers. The IAB Manager conducts a thorough review of the working papers, as well as the report. The CAE also performs a quality-control review of the report and, when necessary, the working papers as well.

The IAB participates in the [American Association of State Highway and Transportation Officials \(AASHTO\)](#) peer-review process, which is based on audit standards promulgated by the AICPA and GAGAS.



	<p><i>Section</i></p> <p>PERFORMANCE AUDITS</p>
	<p><i>Subject</i></p> <p>Fieldwork Standards</p>

**DEFINITION** The Internal Audit Branch (IAB) conducts performance audits to address specific objectives regarding economy, efficiency, and effectiveness of programs, functions, or other activities of the Transportation Cabinet. The IAB manager, in consultation with the Chief Audit Executive (CAE), determines the type of engagement to perform based on user needs, as well as standards.

**GAGAS FIELDWORK STANDARDS**

The fieldwork standards for performance audits relate to:

- Planning the audit
- Supervising staff
- Obtaining sufficient, competent, and relevant evidence
- Preparing audit documentation

The following pages describe these fieldwork standards.

**PLANNING AUDIT**

The IAB manager works with the auditors to define audit objectives, as well as the scope and methodology to achieve those objectives.

- **Documentation of Planning**—The auditors document their planning, which involves:
  - ◆ Considering the significance of various programs and needs of potential users of the report
  - ◆ Understanding the program to be audited
  - ◆ Understanding internal control as it relates to the objectives and scope of the audit
  - ◆ Developing procedures to detect significant noncompliance
  - ◆ Identifying criteria to evaluate audit issues
  - ◆ Considering results of prior audits and attestation engagements
  - ◆ Identifying sources of audit evidence
  - ◆ Considering whether the work of other auditors and experts may be useful

**PLANNING AUDIT  
(CONT.)**

- ◆ Providing appropriate and sufficient staff and other resources
- ◆ Communicating general information concerning the audit to management officials responsible for program being audited
- ◆ Preparing an audit program or altering existing audit program
- **Program Significance**—Auditors consider program significance and the purpose of the audit as they plan. Indicators of program significance include:
  - ◆ Visibility and sensitivity of the program under audit
  - ◆ Newness of the program or changes in its conditions
  - ◆ Role of the audit in providing information that can improve public accountability and decision making
  - ◆ Level and extent of review or other forms of independent oversight
- **Understanding of the Program**—Auditors obtain as much information about the program as possible, including:
  - ◆ Laws, regulations, and provisions of contracts or grant agreements
  - ◆ Purpose and goals of the program
  - ◆ Internal control
  - ◆ Efforts or amount of resources that are put into the program
  - ◆ Program operations
  - ◆ Outputs, such as the quantity of goods or services produced by the program
  - ◆ Outcomes, accomplishments, or results of the program
- **Internal Control**—The need for effective internal control is paramount. Some characteristics to consider are:
  - ◆ Effectiveness and efficiency of program operations (by examining policies and procedures that ensure the program meets its objectives)
  - ◆ Validity and reliability of data (by examining policies and procedures that ensure valid and reliable data are obtained, maintained, and fairly disclosed in reports)
  - ◆ Compliance with applicable laws and regulations and provisions of contracts or grant agreements (by examining policies and procedures that ensure compliance of program implementation)

**PLANNING AUDIT  
(CONT.)**

Auditors may make inquiries and observations, inspect documents and records, and review other auditors' reports.

- **Fraud, Abuse, and Noncompliance**—Auditors design the audit to provide reasonable assurance of detecting fraud, abuse, and noncompliance. The following conditions may indicate a heightened risk of fraud:
  - ◆ Management failing to enforce existing internal control or to provide adequate oversight
  - ◆ Inadequate separation of duties
  - ◆ Transactions out of the ordinary and not satisfactorily explained
  - ◆ Instances of employees' refusal to take vacations or accept promotions
  - ◆ Missing or altered documents or unexplained delays in providing information
  - ◆ False or misleading information
  - ◆ History of impropriety
- **Criteria**—These are the standards, measures, expectations, best practices, and benchmarks against which auditors compare or evaluate performance. Specific criteria include:
  - ◆ Purpose or goals prescribed by laws or regulations
  - ◆ Policies and procedures
  - ◆ Technically developed standards or norms
  - ◆ Expert opinions
  - ◆ Prior periods of performance
  - ◆ Performance of similar entities
  - ◆ Performance in private sector
  - ◆ Best practices of leading organizations
- **Communication with Management**—Auditors communicate information about the nature of the audit to all parties involved in the audit to help them understand the objectives, time frames, and any data needs. Auditors communicate in writing via an engagement letter and obtain signatures of all responsible parties. Auditors may accept e-mail correspondence as approval agreements from auditees.

**SUPERVISION**

Supervisors document reviews of audit work by initialing the working papers. The IAB manager performs a final review on all performance audits, including the working papers.

**EVIDENCE**

IAB auditors obtain sufficient, competent, and relevant evidence to provide a reasonable basis for their findings and conclusions. IAB auditors:

- Rely more heavily on evidence when internal controls are strong
- Obtain evidence through direct physical examination, observation, computation, and inspection
- Review original documents only at auditee's location, not elsewhere
- Interview key personnel
- Obtain at the end of the audit written representations concerning the competence and completeness of evidence obtained from auditee when deemed appropriate


**AUDIT****DOCUMENTATION**

IAB auditors prepare and maintain audit documentation that would enable an experienced auditor who has had no previous connection with the audit to ascertain from the audit documentation the evidence that supports the auditors' significant judgments and conclusions. Audit documentation supports findings, conclusions, and recommendations and therefore contains:

- Objectives, scope, and methodology of the audit, including sampling and other selection criteria used
- Auditors' determination that certain standards do not apply or that an applicable standard was not followed, the reasons thereof, and the known effect that not following the applicable standard had or could have had on the audit
- Work performed to support significant judgments and conclusions (descriptions of transactions and records examined)
- Evidence of supervisory review that supports findings and conclusions of audit report (**Note:** This review is before issuance of the audit report.)

IAB maintains hard-copy records of audits for three years after issuance of the final audit report and then transfers them to the Department for Libraries and Archives for storage. IAB maintains electronic records indefinitely.



	<p><i>Section</i></p> <p>PERFORMANCE AUDITS</p>
	<p><i>Subject</i></p> <p>Reporting Standards</p>

**GAGAS REPORTING STANDARDS**

The reporting standards for performance audits relate to the report:

- Form
- Contents
- Quality
- Issuance and Distribution

**REPORT FORM**

The IAB auditors prepare audit reports that communicate the results of each audit. The report shall be appropriate for its intended use, be issued in writing, and be addressed to the Cabinet Secretary.

The report shall:

- Detail clear results of the audit to management
- Make the results available for public inspection
- Facilitate follow-up to determine whether appropriate corrective actions have been taken

**REPORT CONTENTS**

To provide perspective and to explain any significant limitations, the IAB auditors include the following in the report:

- **Audit Objectives**—The IAB auditors shall clearly:
  - ◆ State specific, measurable, feasible objectives in a neutral manner that avoids assumptions
  - ◆ Explain why they undertook the assignment, what the report is to accomplish, and why the subject matter is important
- **Audit Scope**—The IAB auditors shall clearly:
  - ◆ Describe the amount of work they conducted to accomplish the audit’s objectives
  - ◆ Explain the relationship between what was sampled and what was audited, if sampling was involved
  - ◆ Describe the scope of work performed, any limitations, and any applicable standards they did not follow and the reasons for not following them

**REPORT CONTENTS  
(CONT.)**

- ◆ Identify locations and time frames of the audit
- ◆ Note the type of evidence obtained and any limitations encountered during the audit
- **Audit Methodology**—The IAB auditors shall clearly:
  - ◆ Explain how they accomplished the audit objectives, which includes referencing the evidence gathered and the analysis techniques used
  - ◆ Explain any significant assumptions they made when performing the audit
  - ◆ Describe the criteria used and the design of the sample if findings include exceptions found in testing and sampling
  - ◆ Explain why they chose the sample and whether the results can be projected to the population
- **Audit Results**—Results include findings, conclusions, and recommendations as applicable.
  - ◆ **Findings**—The IAB auditors shall report findings by providing sufficient, competent, and reliable evidence related to the audit objectives. The IAB auditors shall include background information to explain the significance of program and operations, as well as the auditee's responsibilities.

Elements of a finding often include criteria, condition, cause, effect, and recommendation. For performance audits, however, the elements needed for a finding depend on the audit objectives. Therefore, for performance audits, a finding is complete to the extent that it satisfies the audit objectives, and the report clearly relates those objectives to the elements of the finding.

As necessary, the IAB auditors shall develop the elements of criteria, condition, cause, and effect to assist management in understanding the need for taking corrective action.

- *Criteria* details what the required, expected, or desired state of the program or operation is. Common sources are laws, regulations, policies, procedures, Code of Federal Regulations, etc.

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**REPORT CONTENTS  
(CONT.)**

- *Condition* explains the situation the auditors found. The IAB auditors help management gain a better perspective by explaining the scope or extent of the condition.
- *Cause* provides factors responsible for the difference between the condition and the criteria. Sometimes the cause serves as a basis for the recommendation.
- *Effect* provides a clear, logical connection to establish the impact of the difference between what the auditors found and what should be. The effect is easier to understand when it is stated clearly, concisely, and, if possible, in quantifiable terms.

The IAB auditors shall also report significant deficiencies in internal control, all instances of fraud and illegal acts unless clearly inconsequential, significant violations of contracts or grant agreements, and significant abuse.

If the IAB auditors find deficiencies in internal control, they should report those deficiencies in a letter to management unless the deficiencies are clearly inconsequential on the basis of both qualitative and quantitative factors. The IAB auditors shall refer to the letter in the audit report and include evidence of all communications about internal-control deficiencies found during the audit.

If the IAB auditors conclude that fraud, illegal acts, significant violations of contracts or grant agreements, or significant abuse has occurred or is likely to occur, they shall include the relevant information in the audit report. See **Chapter 8.20–8.26 of the Yellow Book** for further information.

- ◆ **Conclusions**—The IAB auditors shall clearly state their conclusions on the basis of their findings. Conclusions are stronger when the evidence supporting the findings is persuasive and the logic used to form the conclusions is sound.
- ◆ **Recommendations**—When necessary, the IAB auditors shall recommend actions to correct problems identified during the audit and to improve programs and operations. Recommendations shall be practical, feasible, cost effective, and measurable. Recommendations shall follow findings and conclusions in the report, particularly when significant instances of possible fraud, illegal acts, or violations of contracts or grant agreements are noted or when abuse or deficiencies in internal control were found.

**REPORT CONTENTS  
(CONT.)**

- **Citations of Compliance with GAGAS**—The IAB auditors shall report that they conducted the performance audit in accordance with GAGAS, which includes all applicable standards that the auditors should have followed during the audit. If the auditors did not follow an applicable standard, they should qualify the GAGAS statement in the report. The auditors shall disclose in the **Scope** section of the report the applicable standard they did not follow, the reasons for not following it, and the effect of not following the standard had or could have had on the results of the audit.
- **Views of Responsible Management**—The IAB auditors shall:
  - ◆ Send all draft comments to management for response
  - ◆ Request that management responses be in writing and returned within one week-
  - ◆ State fairly and objectively their reasons for disagreeing with the auditee's comments or planned corrective actions if such disagreement occurs
  - ◆ Report management views concerning auditors' findings, conclusions, and recommendations, as well as planned corrective actions-
- **Omission of Privileged and Confidential Information**—If prohibited from reporting certain pertinent information, the IAB auditors shall state in their report the nature of the information omitted and the requirement that makes the omission necessary (for example, computer security).

**REPORT QUALITY**

The report shall be as timely, complete, accurate, objective, persuasive, clear, and concise as possible.

- **Timely**—The audit report shall provide relevant current information in time to respond to the legitimate needs of the auditee's management, legislative officials, and other users. With this goal in mind, auditors shall plan for the appropriate issuance date of the report as they conduct the audit.
- **Complete**—The audit report shall contain all evidence needed to satisfy the audit objectives and to promote an adequate and correct understanding of the matters reported.
- **Accurate**—The audit report shall contain only credible and reliable evidence. One inaccuracy in a report can lead to doubt on the reliability of the entire report and can distract attention from the substance of the report. The report shall include only the information, findings, and conclusions supported by sufficient, competent, and relevant evidence in the audit working papers. Auditors shall cross-reference all final reports to support the working papers.

**REPORT QUALITY  
(CONT.)**

- **Objective**—The audit report shall:
  - ◆ Be fair and balanced
  - ◆ Encourage management to act on the auditors' findings and recommendations
  - ◆ Recognize the positive aspects of the program reviewed if applicable to the audit objectives
- **Persuasive**—The audit results shall be responsive to the audit objectives, the findings shall be persuasive, and the conclusions and recommendations shall follow logically from the evidence presented.
- **Clear**—The audit report shall be easy to read and understand. The IAB auditors shall use straightforward, nontechnical language wherever possible. When using technical terms, abbreviations, and acronyms, auditors shall clearly define them. For lengthy reports, auditors shall consider using an Executive Summary that highlights the overall message.
- **Concise**—The audit report shall be no longer than necessary to convey and support the message.


**ISSUANCE &  
DISTRIBUTION  
OF AUDIT REPORT**

The IAB manager shall submit audit reports to:

- Appropriate management of the audited entities
- Appropriate management of the organizations requiring or arranging for the audits
- Cabinet Secretary
- Internal Audit Committee

The Cabinet CAE shall submit copies of the reports to the Federal Highway Administration (FHWA).



	<b>Section</b>  ATTESTATION ENGAGEMENTS FOR INTERNAL AUDITS
	<b>Subject</b>  Fieldwork Standards

**INTRODUCTION**

GAGAS incorporates the AICPA general standard on criteria, its fieldwork standards, and its reporting standards for attestation engagements, as well as the AICPA [Statements on Standards for Attestation Engagements \(SSAE\)](#) unless the Comptroller General of the United States excludes them by formal announcement.

For an attestation engagement, auditors issue an examination, review, or agreed-upon procedures report on a subject matter or an assertion about a subject matter that is the responsibility of another party.

- For an **examination**, auditors perform sufficient testing to express an opinion on whether the subject matter is based on or in conformity with the criteria in all material respects or whether the assertion is presented or fairly stated in all material respects based on the criteria.
- For a **review**, auditors perform sufficient testing to express a conclusion about whether any information came to the auditor's attention on the basis of the work performed that indicates the subject matter is not based on or in conformity with the criteria or that the assertion is not presented or fairly stated in all material respects based on the criteria.
- For an **agreed-upon procedures report**, auditors perform sufficient testing to issue a report of findings based on specific procedures performed on subject matter.

**AICPA GENERAL STANDARD**

The AICPA general standard related to criteria states:

*The practitioner/auditor shall perform an engagement only if he or she has reason to believe that the subject matter is capable of evaluation against criteria that are suitable and available to users.*

**AICPA FIELDWORK STANDARDS**

To provide a reasonable basis for the conclusion expressed in the report fieldwork standards require the work to be:

- Planned adequately
- Supervised properly
- Supported sufficiently by evidence

**AICPA FIELDWORK  
STANDARDS (CONT.)**

The IAB manager prepares and maintains an annual audit plan for attestation engagements and performance audits and submits the plan for approval to the Internal Audit Committee (IAC). The IAC may amend the plan as necessary. The IAB manager may submit any significant interim changes to the audit plan for approval.

The IAB manager assigns individual auditors to engagements contained in the annual audit plan and appoints a supervisor, if necessary, to oversee the engagements.

Planning includes but is not limited to:

- Establishing audit objectives
- Determining scope
- Contacting the Transportation Cabinet's Office of Inspector General (OIG) regarding any ongoing investigations
- Contacting the APA regarding any significant findings from its annual audit
- Reviewing prior engagements related to subject matter
- Obtaining the permanent file, if available
- Scheduling an entrance conference
- Preparing an engagement letter
- Preparing, obtaining, and editing the audit program

**ADDITIONAL GAGAS  
FIELDWORK  
STANDARDS**

For attestation engagements, GAGAS prescribes additional fieldwork standards that go beyond the requirements contained in the AICPA SSAEs. IAB auditors shall comply with these standards when citing GAGAS in their attestation engagement reports:

- **Auditor Communication**—Auditors shall communicate information regarding the nature, timing, and extent of planned testing and reporting on the subject matter or assertion about the subject matter to officials of the audited entity and to individuals contracting for or requesting the attestation engagement. Written communication is preferable, using an engagement letter to communicate the information.

**Note:** The IAB auditors shall prepare a written letter as part of each engagement performed. When necessary, the chair of the IAC shall sign this letter for IAB engagements.

- **Consideration of the Results of Previous Audits and Attestation Engagements**—The IAB auditors shall consider previous audits and engagements and follow up on significant findings and recommendations that directly relate to the subject matter or to the assertion about the subject matter.

**ADDITIONAL GAGAS  
FIELDWORK  
STANDARDS (CONT.)**

- **Internal Control**—When planning examination-level attestation engagements, the IAB auditors shall obtain a sufficient understanding of internal control that is material to the subject matter or assertion to plan the engagement and design procedures to achieve the objectives of the attestation engagement. This may relate to:
  - ◆ Effectiveness and efficiency of operations
  - ◆ Reliability of financial reporting
  - ◆ Compliance with applicable laws and regulations, provisions of contracts or grant agreements
  - ◆ Safeguarding of assets


The IAB auditors shall document their understanding of internal controls in a narrative for inclusion in the working papers. The IAB auditors shall consider performing an internal control questionnaire as well.

- **Detection of Fraud, Illegal Acts, Violations of Contracts or Grant Agreements, or Abuse**
  - ◆ For **examination** level—The IAB manager and auditors shall design the attestation engagement to provide reasonable assurance of detecting fraud, illegal acts, or violations of provisions of contracts or grant agreements that could have a material effect on the subject matter or assertion of the engagement and shall be alert to situations of transactions that may indicate abuse.
  - ◆ For **review or agreed-upon procedure** level—If indications of fraud, illegal acts, violations of provisions of contracts or grant agreements that could materially affect the subject matter or assertion exist, the IAB manager and auditors shall apply procedures specifically directed to ascertain whether violations have occurred. If indications of abuse that may significantly affect the results of the engagement exist, the IAB manager and auditors shall apply audit procedures specifically directed to determine whether abuse has occurred.
- **Development of Elements of Findings**—Elements needed for a finding depend entirely on the objectives of the attestation engagement. Therefore, a finding or set of findings is complete to the extent it satisfies the objectives of the attestation engagement. Upon identifying problems, the IAB auditors shall plan attest procedures to develop the elements of a finding to assist in developing the report.

**ADDITIONAL GAGAS  
FIELDWORK  
STANDARDS (CONT.)**

- **Attest Documentation**—Documentation of working papers related to planning, conducting, and reporting on the attestation engagement shall contain information sufficient to enable an experienced auditor who has had no previous connection with the attestation engagement to determine from the documentation the evidence that supports the auditors' significant judgments and conclusions. Documentation shall also contain support for findings, conclusions, and recommendations before the auditor issues the report. These working papers shall contain:
- ◆ Objectives, scope and methodology, including any sampling criteria
  - ◆ Auditor's determination of applicable standards, noting reasons for not following particular standards
  - ◆ Work performed to support significant judgments and conclusions
  - ◆ Auditor's consideration that the procedures performed achieve the objectives of the engagement when evidential matter obtained is highly dependent on computerized information systems and is material to the objectives of the engagement and that the auditors are not relying on the effectiveness of internal control over those systems that produced the information
  - ◆ Evidence of supervisory review
  - ◆ Legible 8½-inch by 11-inch sheets of paper with appropriate headers and footers
  - ◆ Purpose, source, and conclusion when necessary



	<b>Section</b>  ATTESTATION ENGAGEMENTS FOR INTERNAL AUDITS
	<b>Subject</b>  Reporting Standards

**AICPA  
REPORTING  
STANDARDS**

GAGAS incorporates the AICPA reporting standards for attestation engagements. In accordance with the four AICPA standards for all levels of reporting on attestation engagements, the report shall state:

- Subject matter or assertion being reported and the character of the engagement
- Auditor's conclusions about the subject matter or assertion in relation to the criteria used to evaluate the subject matter
- All the auditor's significant reservations about the engagement, the subject matter, and, if applicable, the assertion related thereto
- Use of the report is restricted to specified parties under certain circumstances

**ADDITIONAL GAGAS  
REPORTING  
STANDARDS**

GAGAS has additional standards for reporting on attestation engagements. The report shall:

- State compliance with GAGAS
- Contain any deficiencies in internal control, fraud, illegal acts, violations of contracts or grant agreements, and abuse, including all elements of a finding, such as criteria, condition, cause, and effect
- Include views of responsible officials if report discloses deficiencies in internal control, fraud, illegal acts, violations of contracts or grant agreements, or abuse are disclosed in the report
- State the nature of any information omitted and the requirement that makes the omission necessary if certain information is prohibited from general disclosure
- Be submitted in a timely manner to appropriate management of the audited entity and to appropriate management of the organizations requiring or arranging for the engagement

**ADDITIONAL GAGAS****REPORTING**


**STANDARDS (CONT.)** The IAB shall issue its final reports for attestation engagements to applicable management, with copies to the Internal Audit Committee as well as to FHWA.

The IAB manager shall review all reports and working papers before submitting the report to the Chief Audit Executive (CAE) for review. Upon CAE concurrence, the IAB manager shall send the draft report to the auditee for response, if findings are noted. The auditee shall have one week to respond to the draft report. The IAB shall include the auditee's response in the report and then submit to the appropriate persons, including the Office of Personnel Management if the report pertains to personnel-related matters.

**NOTE:** IAB auditors shall:

- Write all reports in the active voice and type them in 12 point CG Times
- Ascertain that the working papers support all the information in the report and that the report accurately cross-references the working papers



	<b>Chapter</b>  EXTERNAL AUDITS
	<b>Subject</b>  Introduction

**EXTERNAL AUDIT  
BRANCH**

The External Audit Branch (EAB) consists of the Consultant Audit Section and the Utility/Rail Audit Section and reports to the Director of the Division of Audits. The Chief Audit Executive oversees all audits the EAB performs.

**AUTHORITY**

The EAB conducts audits in accordance with:

- Generally accepted government auditing standards (GAGAS), also known as the Yellow Book
- [600 Kentucky Administrative Regulation \(KAR\) 3:030](#), *Relocation or reconstruction of utility and rail facilities; recordkeeping and audit requirements*
- [600 KAR 6:080](#) *Financial records and audits of firms*
- 23 CFR 112 Section 2c
- [Uniform Audit and Accounting Guide](#), prepared by the American Association of State Highway and Transportation Officials (AASHTO) Audit Subcommittee, which consists of chief auditors from state Departments of Transportation and Departments of Highways

**NOTE:** The purpose of the guide is to provide all interested parties a uniform reference about auditing consulting firms and developing overhead rates. The guide provides only assistance in determining allowance of costs and applicable Federal Acquisitions Regulations, not a standard, specification, or regulation.

- Consultation with the Southern Resource Center of the Federal Highway Administration (FHWA) and the American Council of Engineering Consultants (ACEC)

**CONSULTANT  
AUDIT SECTION**


The Consultant Audit Section provides the Division of Program Performance, which contracts with design consultants, audited overhead rates to use when contracting, as well as objective information and appraisals of the various consulting firms the Cabinet uses. Specifically, the Consultant Audit Section audits in accordance with the Federal Acquisition Regulations (FARs), the Kentucky Administrative Regulations (KARs), and applicable Transportation Cabinet policies. The Consultant Audit Section chiefly uses [FAR Part 48](#), Chapter 1, Title 31; and [600 KAR 6:080](#).

The Consultant Audit Section also performs *cost-plus and lump-sum* engagements. The section performs cost-plus engagements to determine the reimbursable cost of an engineering design contract.

**UTILITY / RAIL  
AUDIT SECTION**

The Utility/Rail Audit Section audits utility relocation and railroad maintenance contracts and billings. The section conducts utility and rail engagements to determine the reimbursable costs of a contract. Specifically, the Utility/Rail Audit Section audits in accordance with the Code of Federal Regulations (CFR, Part 23 [Section 645](#) (relating to utility companies), and Sections [140](#) and [646](#) (relating to railroads); and [600 KAR 3:030](#).



	<b>Chapter</b>  EXTERNAL AUDITS
	<b>Subject</b>  General Standards

## GENERAL STANDARDS

GAGAS prescribes general standards and provides guidance for performing financial audits, attestation engagements and performance audits. These ensure the credibility of auditors' results, which is essential to all audit organizations performing government engagements and audits. These standards consist of:

- Independence of the audit organization and its individual auditors
- Exercise of professional judgment in the performance of work and the preparation of related reports
- Competence of audit staff, including continuing professional education
- Existence of quality-control systems and external peer reviews

## INDEPENDENCE

According to GAGAS, the general standard related to independence is:

*In all matters relating to the audit work, the audit organization and the individual auditor, whether government or public, should be free in both fact and appearance from personal, external, and organizational impairments to independence.*

All external auditors, including the branch manager, complete independence statements once a year and as needed throughout the year. The auditors scan these statements into the network drive and refer to them as a step in the audit program in each engagement conducted. These independence statements cover both personal and external impairments.

The EAB is free from organization impairments in that it reports to the Utilities Branch of the Division of Right of Way and Utilities and to rail and utility companies. This freedom helps ensure that the audit results of the EAB are independent and free from both internal and external impairments.

The EAB auditors are free from political pressures and can conduct their audits/engagements objectively and report their findings, opinions, and conclusions objectively.

**PROFESSIONAL  
JUDGMENT**

The GAGAS general standard related to professional judgment states:

*Professional judgment should be used in planning and performing audits and attestation engagements and in reporting the results.*

All EAB auditors shall:

- Conduct themselves in a professional manner at all times
- Maintain the highest degree of integrity, objectivity, and independence in applying professional judgment to all aspects of their work
- Exercise professional skepticism, which involves a questioning mind and a critical assessment of evidence

Using professional judgment reasonably assures auditors that they will likely detect material misstatements or significant inaccuracies in data if they exist.

**COMPETENCE**

The GAGAS standard related to competence is:

*The staff assigned to perform the audit or attestation engagement should collectively possess adequate professional competence for the tasks required.*

All EAB auditors shall:

- Have a bachelor's degree that includes 20 semester hours or 30 quarter hours in accounting
- Possess a good working knowledge of GAGAS applicable to the type of engagement on which they are working, as well as a general knowledge of the Cabinet and subject under review
- Possess a good working knowledge of the AICPA general attestation standard related to criteria and of the AICPA attestation standards for field work and reporting, as well as of the related SSAEs, when performing attestation engagements
- Competently apply those standards and SSAEs to the engagement assigned
- Communicate clearly and effectively
- Comply with the continuing professional education (CPE) requirements set forth in GAGAS, which include completing in each two-year period the minimum of:

**COMPETENCE (CONT.)**

- ◆ 80 hours of CPE that directly enhances the auditors' professional proficiency to perform audits and attestation engagements
- ◆ 24 of the 80 hours in subjects directly related to government auditing, government environment, or specific environment in which they work (transportation-related)
- ◆ 20 hours of the 80 in any one year of the two-year period

An employee appointed by the EAB manager maintains a CPE file for all auditors and monitors this file to ensure compliance.

The Cabinet provides EAB auditors various types of training, including on-the-job training, classroom training, self-study materials, and participation in professional organizations.

The Cabinet encourages participation in professional organizations and in most cases reimburses annual dues.

**QUALITY CONTROL  
& ASSURANCE**


The GAGAS general standard related to quality control and assurance states:

*Each audit organization performing audits and/or attestation engagements in accordance with GAGAS should have an appropriate internal quality-control system in place and should undergo an external peer review.*

Upon completion of an engagement, another auditor with the experience and qualifications to perform reviews conducts the working-paper review and shares this review with the audit supervisor. The EAB Manager conducts a thorough review of the working papers, as well as the report. The CAE also performs a quality-control review of the report and, when necessary, the working papers as well.

The EAB participates in the American Association of State Highway and Transportation Officials (AASHTO) peer-review process, which is based on audit standards promulgated by the AICPA and GAGAS.



	<i>Chapter</i> EXTERNAL AUDITS
	<i>Subject</i> Consultant Engagements

**PURPOSE** The Transportation Cabinet hires consultants to perform a wide array of services. The Cabinet relies on the External Audit Branch (EAB), as well as outside CPA firms, to attest to these consultant overhead rates.

**TYPES OF  
CONSULTANT  
ENGAGEMENTS**

The Consultant Section of the External Audit Branch conducts six types of engagements:

- **Overhead**—performed to render an opinion on the consultant’s indirect cost for a specified period (usually a fiscal year)
- **Lump-sum**—a fixed price, including cost and operating margin agreed upon by the consultant and the Cabinet for a group of tasks without a breakdown of individual values (lot price); performed to determine the actual costs incurred under contracts and to show how the negotiated costs compare to the actual costs incurred under contracts
- **Cost-plus fixed fee**—a price based on actual allowable cost of the work plus any pre-established fixed amount for operating margin; performed to determine the actual costs incurred under contracts and to determine whether any amount is owed by or due to the Kentucky Transportation Cabinet under contracts
- **Pre-award**—performed to evaluate the reasonableness and accuracy of a cost proposal for a specific contract
- **Pay-rate**—performed to recommend pay rates for a specific period; performed only if the pay rates have not been verified for more than one year
- **Prequalification**—performed to verify the information submitted by consultants for prequalification to perform contract work for the Kentucky Transportation Cabinet (**NOTE:** The financial status of the company may be evaluated during this audit.)

Occasionally, the section conducts a “special” audit requested by management. Generally, however, the staff spends approximately 75 percent of its time on overhead engagements.

**OVERHEAD  
ENGAGEMENTS**

The main purpose of an overhead engagement is to determine the overhead ratio of a given consulting firm. The Division of Program Performance shall use this factor in negotiating a contract with the subject firm.

The consultant supervisor initiates the engagements, using the selection report issued by the Division of Program Performance.

Occasionally, the Division of Program Performance requests an overhead engagement. The division submits the request to the EAB, which records it in the directory of such engagements and then prepares an electronic engagement file, which includes the overhead packet submitted by the firm. Per [600 KAR 6:040, Section 3](#), each prequalified consulting firm shall submit an overhead packet within five months of the end of its fiscal year.

The supervisor then assigns the engagement. The assigned auditor performs a preliminary review to determine the best location and time for the engagement. Using the standard engagement program, the auditor then develops an engagement plan and sends the consultant an engagement letter requesting any missing documentation.

Upon completion of the engagement, the auditor prepares the draft engagement report and submits it to the supervisor for preliminary review, who then forwards the report to the branch manager for further scrutiny. The branch manager reviews and forwards the report to the chief audit executive (CAE) for approval. Upon notification from the CAE that the draft report is acceptable, the supervisor sends it to the consultant, with the proviso that the consultant has 15 days to submit in writing any objections to the results. The consultant auditor shall reconcile any review comments during the 15-day period.

If the consultant has not submitted a written objection by the end of the 15-day period or has agreed to the draft audit report, the Consultant Supervisor issues the official report, sending a copy to the consultant, along with a letter explaining the right to appeal.

The letter states that the consultant has 30 days to file an appeal to the External Audit Review Committee, if any, and that the appeal process shall be in accordance with [600 KAR 6:080](#). If the appeal results in any revisions to the report, the auditor shall evaluate whether the changes are reasonable and issue a revised report, appropriately labeled "Revision".

The External Audit Review Committee comprises the following:

- Executive Director, Office of Budget and Fiscal Management
- Executive Director, Office of Legal Services
- Deputy State Highway Engineer, Office of Project Development

The Chief Audit Executive attends the committee meetings as well.

**LUMP-SUM  
ENGAGEMENTS**

The purpose of a lump-sum engagement is to determine how the consultant performed in relation to the negotiated contract. The negotiator from the Division of Program Performance uses the results of a lump-sum engagement when negotiating future lump-sum contracts with the consultant.

Lump-sum engagements proceed basically the same as overhead engagements. However, there is no overhead packet to be included when the supervisor prepares the engagement file. As with overhead engagements, the auditor assigned performs a preliminary review to decide whether a site visit is necessary and then prepares the engagement plan, using the standard program.

Upon completion of the engagement, the auditor gives the work papers to the supervisor for review. Unless there are comments to reconcile, the supervisor returns the file to the auditor and then prepares and submits the report to the branch manager for review. After reviewing the file and reconciling any comments, the branch manager forwards the report to the CAE for review. Upon approving the file, the CAE returns the report to the supervisor, who sends it to the Division of Program Performance and to the consultant for response.

**COST-PLUS  
ENGAGEMENTS**

The Consultant Audit Section conducts cost-plus engagements after the completion of a project to verify the consultant has claimed only legitimate and appropriate costs. Once again, the auditor completes the preliminary review and decides after discussions with the supervisor or manager whether to expand the scope or not. Cost-plus engagements proceed basically the same as overhead and lump-sum engagements, with one addition: the supervisor also sends a copy of the report to the Division of Accounts.

**PREQUALIFICATION  
ENGAGEMENTS**

The Consultant Audit Section performs prequalification engagements at the request of the Division of Program Performance. When a consultant with no prior experience with the Cabinet desires to participate in potential design or other consulting work, part of the prequalification process is a "pre-audit".

The purpose of a prequalification engagement is to secure information regarding the financial and professional capabilities of a consultant desiring to enter into an agreement with the Cabinet. This information is highly confidential and remains secured in the files of the External Audit Branch. The report the auditor submits to the Division of Program Performance states in only general terms whether or not the prospective consultant could perform in accordance with Cabinet policies.

**PRE-AWARD  
ENGAGEMENTS**


At the request of the Division of Program Performance, the Consultant Audit Section conducts a pre-award engagement before the Cabinet signs a contract with a consultant. The purpose of the engagement is to determine whether the contract complies with all applicable federal and state statutes, regulations, and policies.

**PAY-RATE  
ENGAGEMENTS**

At the consultant's request, the Consultant Audit Section may perform a pay-rate engagement. The section, however, does not always grant the request. The section considers several factors to determine whether a pay-rate engagement is necessary:

- Time since last overhead engagement
- Significance of the difference in pay rates
- Other factors



	<p><i>Chapter</i></p> <p>EXTERNAL AUDITS</p>
	<p><i>Subject</i></p> <p>Utility &amp; Rail Engagements</p>

**PURPOSE**

The Transportation Cabinet is responsible for building and maintaining roads throughout the Commonwealth. The Cabinet has accommodated utility companies by permitting them to install their necessary lines (water, sewer, gas, electric, and telecommunications) along federal and state rights of way. As the Cabinet resurfaces or expands roads, it often needs to relocate utilities. The Cabinet and the Federal Highway Administration reimburse utility companies for the cost of these relocations.

The Utilities Branch of the Division of Right of Way and Utilities monitors the relocation process and provides guidance and support for the district utilities agents (DUAs) throughout the state by:

- Reviewing relocation plans, proposals, and agreements submitted by district personnel
- Establishing contracts
- Paying final bills
- Coordinating work with other Cabinet divisions and outside agencies

The Rails component of the Division of Right of Way and Utilities maintains an inventory of rail crossings of public roads throughout the state.

The Cabinet relies on the External Audit Branch (EAB) to attest to costs involved with the utility-relocation and rail-crossing expenditures.

**TYPES OF RELOCATION**

**CONTRACTS**

The Division of Right of Way and Utilities administers two types of relocation contracts: lump sum and keep cost.

In most cases, the Cabinet approves lump-sum contracts for only relocation projects of \$100,000 or less and for reasonable assurance that projects costs will not exceed the projected estimate. Lump-sum contracts have no records or billing requirements and can be paid either in one lump sum or as a percentage of completion.

Keep-cost contracts have no dollar restrictions and require itemized billings for reimbursement. The contract with the Cabinet requires the utility company to maintain records to support its billings. The company must submit a final and complete billing of the project before the Cabinet can close out the contract. Currently, the EAB audits only keep-cost contracts.

**ATTESTATION  
ENGAGEMENT**

When a relocation project is complete, the Cabinet requires the utility company to present one complete final billing of all project costs to the Utilities Branch manager. At the request of the Utilities Branch manager, the EAB performs attestation engagements on these final billings to:

- Verify costs billed
- Determine that costs were reimbursed under federal and state cost regulations
- Assess the utility company's compliance with the terms of the contract

The EAB performs an attestation engagement for all contracts over \$100,000 and as deemed necessary for those under \$100,000. Pursuant to [23 CFR 645.117 i \(3\)](#), "All utility cost records and accounts relating to the project are subject to audit by representatives of the State and Federal Government for a period of three (3) years from the date final payment has been received by the utility."

Upon deciding that an attestation engagement is necessary, the EAB manager assigns the engagement to a staff member to conduct a risk assessment to determine risk—high, moderate, or low—based on a formula developed by the EAB.

The EAB staff conducts varying levels of testing and reviewing to reach a conclusion. The staff then prepares any findings or questioned costs, submits the work papers for review, and finally clears any review comments.

The supervisor or reviewer of the Utility/Rail Audit Section of the EAB performs an in-depth review of the working papers and report. The EAB manager conducts a high-level review as well and sends the report to the Chief Audit Executive (CAE) for a final review.

The EAB submits utility reports to the manager of the Utilities Branch of the Division of Right of Way and Utilities or to the rail coordinator in the Division of Highway Design, depending on who requested the engagement. If federal funds are involved, the EAB sends a copy of the report to the manager of the Federal Billing Branch of the Division of Accounts. The CAE provides copies of all EAB reports to the Federal Highway Administration.

The EAB manager or supervisor sends the draft report to the utility company for response. Upon completion of the engagement, the EAB issues a final report to the Utilities Branch for final processing of the contract and provides a copy of the report to the Division of Accounts to close out the project or to take further action as required.

**UTILITY & RAIL  
APPEAL PROCESS**

[600 KAR 3:030 Section 5](#) states (in part) “. . . prior to the issuance of a final report, the . . . [EAB . . . shall present the preliminary findings and relevant work papers to the railroad or utility. A comment about or objection to the preliminary findings shall be submitted to the . . . [EAB] . . . in writing within fifteen (15) calendar days of the railroad's or utility's receipt of the preliminary findings. A comment or objection shall be taken into consideration by the . . . [EAB] . . . prior to finalizing the report. If a railroad or utility disagrees with the results of a final report . . . the railroad or utility may request a review by the External Audit Review Committee within thirty (30) calendar days of the date the final report is received by the utility or railroad. The request shall be in writing and clearly state the concern with the final report and the reason for the concern. If the concern and the reason are not clearly stated, the request for review shall not be accepted. “


The External Audit Review Committee shall consist of the following:

- Executive Director of the Office of Budget and Fiscal Management, Chairperson
- Deputy State Highway Engineer for Project Development
- Executive Director of the Office of Legal Services

A committee member may appoint a proxy to serve on this committee.

The External Audit Review Committee may request the utility, railroad, or auditor to answer questions. The request shall state whether a representative is to respond in person or in writing. If the railroad or utility is not satisfied with the decision of the Audit Review Committee, an appeal may be made to the Secretary of the Transportation Cabinet within 30 calendar days of receipt of the committee's decision. An administrative hearing for the appeal shall be held pursuant to the provisions of [KRS Chapter 13B](#).



	<b>Section</b>  ATTESTATION ENGAGEMENTS FOR EXTERNAL AUDITS
	<b>Subject</b>  Fieldwork Standards

## INTRODUCTION

GAGAS incorporates the AICPA general standard on criteria, its fieldwork standards, and its reporting standards for attestation engagements, as well as the AICPA Statements on Standards for Attestation Engagements (SSAE), unless the Comptroller General of the United States excludes them by formal announcement.

In an attestation engagement, auditors issue an examination, review, or agreed-upon procedures report on a subject matter or an assertion about a subject matter that is the responsibility of another party.

- In an **examination**, auditors perform sufficient testing to express an opinion on whether the subject matter is based on or in conformity with the criteria in all material respects or whether the assertion is presented (or fairly stated) in all material respects based on the criteria.
- In a **review**, auditors perform sufficient testing to express a conclusion about whether any information came to the auditor's attention on the basis of the work performed that indicates the subject matter is not based on or in conformity with the criteria or that the assertion is not presented or fairly stated in all material respects based on the criteria.
- Auditors conducting **agreed-upon procedures** perform sufficient testing to issue a report of findings based on specific procedures performed on subject matter.

## AICPA GENERAL STANDARD

The AICPA general standard related to criteria states:

*The practitioner/auditor shall perform an engagement only if he or she has reason to believe that the subject matter is capable of evaluation against criteria that are suitable and available to users.*

**AICPA  
FIELDWORK  
STANDARDS**

To provide a reasonable basis for the conclusion expressed in the report fieldwork standards require the work to be:

- Planned adequately
- Supervised properly
- Supported sufficiently by evidence

The EAB manager oversees the Utility and Rail Audit supervisor's and the Consultant Audit supervisor's annual audit plans.

Planning includes but is not limited to:

- Establishing audit objectives
- Determining scope
- Reviewing prior engagements related to subject matter
- Obtaining the permanent file, if available
- Scheduling an entrance conference when necessary
- Preparing an engagement letter
- Preparing, obtaining, and editing the audit program

**ADDITIONAL GAGAS  
FIELDWORK  
STANDARDS**

For attestation engagements, GAGAS prescribes additional fieldwork standards that go beyond the requirements in the AICPA SSAEs. The EAB auditors shall comply with these standards when citing GAGAS in their attestation engagement reports:

- **Auditor Communication**—The EAB auditors shall communicate information regarding the nature, timing, and extent of planned testing and reporting on the subject matter or assertion about the subject matter to officials of the audited entity and to individuals contracting for or requesting the attestation engagement. Written communication is preferable, using an engagement letter to communicate the information.

**Note:** The EAB auditors shall prepare a written engagement letter as part of each engagement performed.

- **Consideration of the Results of Previous Audits and Attestation Engagements**—The EAB auditors shall consider previous audits and engagements and follow up on significant findings and recommendations that directly relate to the subject matter or to the assertion about the subject matter.

**ADDITIONAL GAGAS  
FIELDWORK  
STANDARDS (CONT.)**

➤ **Internal Control**—When planning examination-level attestation engagements, the EAB auditors shall obtain a sufficient understanding of internal control that is material to the subject matter or assertion to plan the engagement and design procedures to achieve the objectives of the attestation engagement. This may relate to:

- ◆ Effectiveness and efficiency of operations
- ◆ Reliability of financial reporting
- ◆ Compliance with applicable laws and regulations, provisions of contracts or grant agreements
- ◆ Safeguarding of assets

The EAB auditors shall document their understanding of internal controls in a narrative for inclusion in the working papers and shall consider performing an internal control questionnaire as well.

➤ **Detection of Fraud, Illegal Acts, Violations of Contracts or Grant Agreements, or Abuse**


- ◆ For **examination** level—The EAB manager and auditors shall design the attestation engagement to provide reasonable assurance of detecting fraud, illegal acts, or violations of provisions of contracts or grant agreements that could have a material effect on the subject matter or assertion of the engagement and shall be alert to situations of transactions that may indicate abuse.
- ◆ For **review or agreed-upon procedure** level--If indications of fraud, illegal acts, violations of provisions of contracts or grant agreements that could materially affect the subject matter or assertion exist, the EAB manager and auditors shall apply procedures specifically directed to ascertain whether violations have occurred. If indications of abuse that may significantly affect the results of the engagement exist, the EAB manager and auditors shall apply audit procedures specifically directed to determine whether abuse has occurred.

➤ **Developing Elements of Findings**—Elements needed for a finding depend entirely on the objectives of the attestation engagement. Therefore, a finding or set of findings is complete to the extent it satisfies the objectives of the attestation engagement. Upon identifying problems, the EAB auditors shall plan attest procedures to develop the elements of a finding to assist in developing the report.

**ADDITIONAL GAGAS  
FIELDWORK  
STANDARDS (CONT.)**

- **Attest Documentation**—Documentation of working papers related to planning, conducting, and reporting on the attestation engagement shall contain information sufficient to enable an experienced auditor who has had no previous connection with the attestation engagement to determine from the documentation the evidence that supports the auditors' significant judgments and conclusions. Documentation shall also contain support for findings, conclusions, and recommendations before auditors issue their report. These working papers shall include:
- ◆ Objectives, scope and methodology, including any sampling criteria
  - ◆ Auditor's determination of applicable standards, noting reasons for not following particular standards
  - ◆ Work performed to support significant judgments and conclusions
  - ◆ Auditor's consideration that the procedures performed achieve the objectives of the engagement when evidential matter obtained is highly dependent on computerized information systems and is material to the objectives of the engagement and that the auditors are not relying on the effectiveness of internal control over those systems that produced the information
  - ◆ Evidence of supervisory review
  - ◆ Legible 8½-inch by 11-inch sheets of paper with appropriate headers and footers
  - ◆ Purpose, source, and conclusion when necessary



	<b>Section</b> ATTESTATION ENGAGEMENTS FOR EXTERNAL AUDITS
	<b>Subject</b> Reporting Standards

**AICPA  
REPORTING  
STANDARDS**

GAGAS incorporates the AICPA reporting standards for attestation engagements. In accordance with the four AICPA standards for all levels of reporting on attestation engagements, the report shall state:

- Subject matter or assertion being reported and the character of the engagement
- Auditor's conclusions about the subject matter or assertion in relation to the criteria used to evaluate the subject matter
- All the auditor's significant reservations about the engagement, the subject matter, and, if applicable, the assertion related thereto
- Use of the report is restricted to specified parties under certain circumstances

**ADDITIONAL GAGAS  
REPORTING  
STANDARDS**

GAGAS has additional standards for reporting on attestation engagements. The report shall:

- State compliance with GAGAS
- Contain any deficiencies in internal control, fraud, illegal acts, violations of contracts or grant agreements, and abuse, including all elements of a finding, such as criteria, condition, and cause and effect
- Include views of responsible officials if report discloses deficiencies in internal control, fraud, illegal acts, violations of contracts or grant agreements, or abuse are disclosed in the report
- State the nature of any information omitted and the requirement that makes the omission necessary if certain information is prohibited from general disclosure

**ADDITIONAL GAGAS  
REPORTING  
STANDARDS (CONT.)**

- Be submitted in a timely manner to appropriate management of the audited entity and to appropriate management of the organizations requiring or arranging for the engagement


The EAB shall issue its final reports to the companies audited, the FHWA, Federal Billing, and the Utilities manager of the Division of Right of Way and Utilities as appropriate.

The EAB manager shall review all reports and working papers before submitting the report to the CAE for review. Upon the CAE concurrence, the EAB manager shall send the draft report to the auditee for response, if findings are noted.

**NOTE:** EAB auditors shall:

- Write all reports in the active voice and type them in 12 point CG Times
- Ascertain that the working papers support all the information in the report and that the report accurately cross-references the working papers



	<p><i>Chapter</i></p> <p>INTERNATIONAL FUEL TAX AGREEMENT (IFTA) AUDITS</p>
	<p><i>Subject</i></p> <p>Background</p>

**PURPOSE** Kentucky adopted the [International Fuel Tax Agreement](#) (IFTA) July 1, 1996. IFTA is an agreement among states and Canadian provinces to simplify the reporting of fuel used by interstate and interjurisdictional motor carriers. This agreement enables participating jurisdictions to act cooperatively and provide mutual assistance in the administration and collection of motor-fuel-use taxes. By signing an IFTA license application or a renewal to operate under an IFTA license, a carrier agrees to abide by:

- Duties and obligations of licensees as set forth in the current agreement and as may be amended
- Laws and regulations of all jurisdictions in which it operates

By having an IFTA license, the motor carrier has one license, one set of decals, one quarterly fuel-tax report that reflects net tax or refund due, and one audit. These advantages lead to cost and time savings for the carrier.

**QUALIFICATIONS** To qualify under IFTA, a motor vehicle shall have:

- Interstate operations
- Two axles and gross vehicle weight or registered gross vehicle weight exceeding 26,000 pounds
- Three axles or more, regardless of weight

Each jurisdiction may have exemptions to the qualified units. For instance, recreational vehicles, farm-plated vehicles, buses, and government vehicles are exempt for Kentucky. The exemption section at [www.iftach.org](http://www.iftach.org) provides a listing of each jurisdiction's exemptions.

**PERMISSIONS** IFTA allows an interstate trucking company to obtain one fuel-tax license in its base jurisdiction instead of obtaining authority in all jurisdictions in which it operates. The trucking company pays taxes to each jurisdiction on the basis of the amount of fuel that the company consumes in each jurisdiction. The company may claim a refund on the IFTA quarterly tax report for any overpayment of tax in a reporting quarter. IFTA allows credit when the company purchases tax-paid fuel in that jurisdiction.

**PERMISSIONS  
(CONT.)**

IFTA allows the company to file one fuel-tax return for its base jurisdiction and to distribute and net the taxes among all other affected jurisdictions.


**Note:** A jurisdiction may allow a licensee to report intrastate-only motor vehicles on the IFTA return.

**AUDIT  
REQUIREMENTS**

The *International Fuel Tax Agreement Audit Manual* requires each base jurisdiction to audit at least an average of 3 percent of the number of the base jurisdiction's IFTA licensees. The jurisdiction meets the 3-percent requirement when it audits 3 percent of the jurisdiction's licensees during the IFTA Compliance Review four-year cycle.

The Division of Audits may select any Kentucky IFTA licensee for audit, but at least 15 percent shall be low-distance accounts, and at least 25 percent shall be high-distance accounts.



	<p><i>Chapter</i></p> <p>INTERNATIONAL FUEL TAX AGREEMENT (IFTA) AUDITS</p>
	<p><i>Subject</i></p> <p>Licensee Responsibility</p>

**RECORDS  
RETENTION**

IFTA requires that a licensee preserve all records pertaining to a quarterly tax return for four years from the tax return due date or filing date, whichever is later, plus any time included as a result of waivers or jeopardy assessments.

The licensee shall make the records available for audit upon request by any member jurisdiction. If the records requested for audit are located outside the base jurisdiction and if the base jurisdiction needs to send auditors to the location of the records, the licensee may be required to reimburse the base jurisdiction for reasonable per diem and travel expenses.

Failure to provide records for an audit extends the four-year record-retention requirement until the licensee provides the records. Moreover, failure to comply with the record-keeping requirements by not maintaining the records or by not making the records available for an audit may result in issuance of a jeopardy assessment and revocation of the IFTA license.

**ACCEPTABLE SOURCE  
DOCUMENTS**

IFTA requires the licensee to maintain detailed records relating to distance and motor-fuel usage in the conduct of business. The detailed distance records may be, at the option of the licensee, an electronic data-recording system.

Operational records shall include, but not be limited to:

- Taxable and nontaxable usage of fuel
- Distance traveled for taxable and nontaxable use
- Distance recaps for each vehicle for each jurisdiction in which the vehicle operated

At a minimum, the distance accounting system shall include distance data on each vehicle for each trip and shall provide a recapitulation of the data in monthly fleet summaries.

**ACCEPTABLE SOURCE****DOCUMENTS (CONT.)** Distance records shall include:

- Beginning and ending odometer readings
- Total mileage of each trip
- Beginning and ending date of each trip
- Trip origin and destination
- Route traveled on trip

All fuel records shall include:

- Date of each receipt of fuel
- Name and address of the person who purchased or received the fuel
- Number of gallons or liters purchased or received
- Type of fuel
- Identification of the vehicle or equipment into which the fuel was placed

Fuel records of retail purchases shall also include:

- Retailer's name and address
- Price per gallon or liter
- Total amount of sale


Fuel records of bulk purchases shall also include:

- Date of withdrawal and purchase
- Inventory records to substantiate payment of tax on all bulk purchases
- Copies of all delivery tickets or receipts
- Reconciliations of bulk-fuel inventory
- Documentation distinguishing fuel placed in qualified vehicles from other fuel uses

**OPERATIONAL  
ACCOUNTABILITY**

A licensee shall account for all operations of a qualified motor vehicle. *Total distance* means "all miles or kilometers traveled during the tax-reporting period by every qualified vehicle in a licensee's fleet, regardless of whether the miles or kilometers are taxable or nontaxable by a jurisdiction." Total mileage operated also includes all interstate movement—whether loaded, unloaded, deadhead, bobtail—or mileage generated while operating on a trip permit.



	<b>Chapter</b> INTERNATIONAL FUEL TAX AGREEMENT (IFTA) AUDITS
	<b>Subject</b> Audit Procedures

**GUIDANCE** The Division of Audits shall use the [International Fuel Tax Agreement \(IFTA\) Audit Manual](#) as guidance in conducting all IFTA audits.

**AUDIT NOTIFICATION** The Division of Audits shall notify the licensee in writing at least 30 days prior to conducting a routine audit. The notification shall advise the licensee of the approximate date of the audit and the time period the audit covers. Jurisdictions may contact one another before the audit to obtain pertinent information in accordance with each jurisdiction's disclosure policy.

For just cause, the Division of Audits shall have the right to waive notification requirements.

**OPENING  
CONFERENCE**

The auditor shall hold a documented opening conference with the licensee to outline:

- Licensee's operations
- Audit procedures
- Records to be examined
- Sample period
- Sampling procedures
- Other information relevant to the specific audit

The format of the conference is subject to the base jurisdiction's discretion.

**EVALUATION OF  
INTERNAL CONTROLS**

The auditor shall:

- Examine and evaluate the licensee's internal accounting control system
- Determine any changes in the licensee's accounting procedures or operations
- Identify the records the licensee keeps to support the tax return
- Document the licensee's system of internal controls and report any weaknesses to the licensee

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**SAMPLING** Unless a specific situation dictates, auditors shall conduct all audits on a sampling basis. The sample period shall be representative of the licensee's operation. Both the licensee and the auditor shall sign an agreement that the sampling methodology is appropriate. The auditor shall use the evaluation of internal controls to determine the size of the audit sample.

**CLOSING CONFERENCE** The auditor shall hold a documented closing conference with the licensee to outline preliminary findings, including:

- Penalty and interest
- Recommendations
- Rights of appeal
- Identification of whom the auditor shall address the audit report

The format of the conference is subject to the base jurisdiction's discretion. If the auditor and the licensee fail to hold or complete the closing conference, the auditor shall document the failure in the audit report.

**AUDIT REPORT** The auditor shall prepare a thorough report documenting the audit. The auditor shall submit the Licensee Audit Report to the licensee and the Interjurisdictional Audit Report to every jurisdiction the audit affects. Along with the Licensee Audit Report, the base jurisdiction shall provide the licensee with its customary notice of assessment, billing, or other notification that signifies the beginning of the licensee's appeal period.

**PAYMENT & APPEALS** In the absence of protest, the licensee shall make payment—including penalty and interest from the original due date—within 45 days from the date of the tax notice. The licensee may file a written protest, which shall include:

- Supporting statement and documents identifying the specific adjustments requested or the portions of the audit protested
- Reasons for the protest


The licensee shall file the protest with the Transportation Cabinet, Division of Audits, within 45 days from the date of the tax notice. Once the Cabinet issues a final ruling, the licensee may file a written protest with the Kentucky Board of Tax Appeals. If an IFTA member jurisdiction elects to exercise the right under Section 1360.100 of the IFTA [Articles of Agreement](#) to re-audit the taxpayer, the Cabinet shall consider this protest of the assessment by the taxpayer.

**AUTHORITY**

The following sources provide additional detailed information on IFTA and record-keeping requirements:

- *IFTA Articles of Agreement*
- *IFTA Procedures Manual*
- *IFTA Audit Manual*
- 601 KAR 1:201



	<p><i>Chapter</i></p> <p>INTERNATIONAL REGISTRATION PLAN (IRP) AUDITS</p>
	<p><i>Subject</i></p> <p>Overview</p>

**OVERVIEW**

Kentucky adopted the [International Registration Plan \(IRP\)](#) in 1973 for commercial motor vehicles engaged in interstate operations.


The plan authorizes the apportioned registration of vehicle fleets and their recognition as properly licensed vehicles by all member states. Under the plan the vehicle registration fee for each jurisdiction is determined by the percentage of miles traveled within a state relative to the total mileage.

A carrier's base state calculates fees due, collects fees, and distributes fees for all jurisdictions.

Under the IRP, the interstate operator is required to file an application with the state in which the operator is based. Any operator operating or intending to operate one or more than one apportionable vehicle into or through two or more of the member jurisdictions must be IRP registered or purchase trip permits for each jurisdiction.

[601 KAR 9:135](#)-Section 13 states “(1) In accordance with the provisions of the International Registration Plan, the Transportation Cabinet, Division of Audit Review [Audits] shall every five (5) years audit fifteen (15) percent of the apportioned registrants based in Kentucky. (2) An audit shall be performed in accordance with the “Uniform Operational Audit Procedure Guidelines”.”



	<p><i>Chapter</i></p> <p>INTERNATIONAL REGISTRATION PLAN (IRP) AUDITS</p>
	<p><i>Subject</i></p> <p>Contacting Registrant</p>

**PRE-AUDIT** The Division of Audits sends a letter notifying the registrant of an audit at least 30 days prior to the audit. The letter states the registration years, mileage periods, and records necessary for the audit. Enclosed with the letter is a pre-audit questionnaire for the registrant to complete and return.

**SCHEDULING** Scheduling an audit allows the auditor to:

- Follow up on the pre-audit letter
- Notify the registrant of the week or day of the audit
- Determine the location of the audit, the responsible party, and other pertinent information
- Discuss audit procedures including records to be examined and sample period


Pursuant to IRP Article XV, Section 1502, if the registrant does not have the necessary records, the auditor shall grant the registrant 30 days to produce the records.

**AUDIT LOCATIONS** Acceptable locations to conduct audits are:

- Registrant’s principal place of business
- Offices of persons holding or responsible for the records
- Offices of the base jurisdictions
- Other locations as agreed upon by the registrant and the base jurisdiction

According to [601 KAR 9:135](#) Section13 (5), “If it is determined that the registrant’s operational records are not located in Kentucky and it is necessary for the Transportation Cabinet’s auditors to travel to where the records are maintained, the registrant shall pay the Transportation Cabinet for the travel expenses incurred by its auditors in accordance with the per diem and travel rates established in [200 KAR 2:006](#).”



	<p><i>Chapter</i></p> <p>INTERNATIONAL REGISTRATION PLAN (IRP) AUDITS</p>
	<p><i>Subject</i></p> <p>Audit Procedure</p>

**GUIDANCE** The Division of Audits incorporates the *International Registration Plan Audit Procedures Manual* into this manual. Auditors shall follow the guidance of this manual when conducting IRP audits.


The manual states, “Under the provisions of Article XVI of the Plan, each base jurisdiction shall audit the apportioned registration applications and supporting documents of registrants displaying apportioned license plates as to the authenticity of distance figures derived from operational records and other registration information. Each base jurisdiction shall audit at least an average of 3 percent of the number of IRP fleets renewed that are required to be reported by the jurisdiction on the Annual Report of IRP Audit Activity for each year of the peer review period.”

**SAMPLING RECORDS** When auditing International Vehicle Distance Records (IVDRs), auditors shall ensure that they accurately record the information by sampling the source document and tracing to the recaps for selected vehicles and months. In the absence of IVDRs, drivers’ logs may serve as a substitute for the audit if they contain continuous point-to-point mileage and origin/destination.

**FULL AUDIT** If the sampling reveals major discrepancies, auditors shall conduct a more thorough audit or possibly a full audit for all vehicles for the 12-month audit period.

**INADEQUATE RECORDS** If the records are insufficient to perform an audit or they do not meet the standards, auditors shall allow the registrant 30 days to produce acceptable records. Upon failure to produce adequate records, auditors shall assess the registrant 100 percent of the registration fees of the base state. Previous payments made to other jurisdictions on the audit shall not reduce this assessment. The IRP does not grant refunds from other jurisdictions on the audit on 100 percent assessments or in the case of a registrant with inadequate records.



	<i>Chapter</i> INTERNATIONAL REGISTRATION PLAN (IRP) AUDITS
	<i>Subject</i> Audit Reporting


**AUDIT REPORT**

The auditor:

- Documents all pertinent information, including:
  - ◆ Name and address
  - ◆ Account and fleet number
  - ◆ Type of record audited
  - ◆ Original and audited miles
  - ◆ Changes in percentages and fees
  - ◆ Observations, findings, recommendations, and audit procedures
  - ◆ Date and signature of auditor
- Includes the documentation in the registrant's file
- Submits the report to the registrant's base state, which, in turn, distributes it to all affected jurisdictions
- Utilizes the report in the calculation of fees and for all billings and refunds

Fee changes are netted through all jurisdictions, with the registrant paying the net amount to the base state.



	<p><i>Chapter</i></p> <p>KYU/KIT AUDITS</p>
	<p><i>Subject</i></p> <p>Definition &amp; Purpose</p>

**DEFINITION**

[KRS 138.660](#) contains instruction regarding the Kentucky Weight Distance Tax (KYU). The statute states:

“(1) Every motor carrier, excluding charter bus operators registered pursuant to KRS Chapter 281, shall pay a tax at the rate levied in KRS 138.220 (1) and (2) on the amount of gasoline and special fuels used in operations on the public highways of this state. (2) In addition to the tax imposed in subsection (1) of this section, if the motor carrier is a heavy equipment motor carrier as defined in KRS 138.655, he shall pay a surtax at the rate of 2% of the average wholesale price as provided in subsection (1) of this section, on the amount of gasoline and at the rate of 4.7% on the amount of special fuels used in operations on public highways of this state. (3) Every motor carrier shall pay for every motor vehicle operated upon the public highways of this state with a combined licensed weight in excess of 59,999 pounds a weight distance tax computed at the rate of .0285 cents per mile. (4) Those taxes levied under this section shall be computed and paid as provided in KRS 138.685 and 138.690.”

According to [KRS 138.685](#), motor carriers must remit the weight distance tax to the Division of Motor Carriers quarterly.


The Kentucky intrastate tax (KIT) license is required for intrastate carriers whose vehicles have a gross registered weight exceeding 26,000 pounds or whose vehicles have three or more axles regardless of weight to report fuel use tax. This fuel tax is evaluated annually and is assessed based on the wholesale price. This is defined in KRS 138.660 Section 2 and reported quarterly to the Division of Motor Carriers.

Motor vehicle laws of 1986 (specifically, [KRS 138.655—138.7291 and 138.990, Sections 14 and 15](#)) govern the work the Division of Audits performs. These statutes establish a fee that all commercial operators of motor vehicles shall pay for use of the public highways.

**PURPOSE**

The purpose of an audit of a motor carrier is to determine the accuracy of the carrier’s reporting and to ensure that the taxes reported by the carrier are correct. Carriers are required by [KRS 138.680](#) to retain records relating to fuel purchases, fuel consumption, and miles operated on Kentucky highways for a five-year period. These records are subject to review by the Division of Audits.



	<p><i>Chapter</i></p> <p>KYU/KIT AUDITS</p>
	<p><i>Subject</i></p> <p>Audit Selection</p>

**ASSIGNMENT OF AUDITS**

Section supervisors are responsible for assigning audits. The Transportation Cabinet requires its auditors to conduct audits in all areas of the state and in other states as the workload dictates.


Upon receipt of an assignment the auditor shall determine the most efficient method to cover every audit within that location. The auditor shall make every effort to complete all audits when in a locality so that return trips are unnecessary. The auditor shall select the largest audit in the location first so that he or she may schedule smaller audits while auditing the larger account.

**ERRONEOUS CREDIT OR REFUND**

In the case of an erroneous credit or refund, it may be necessary to audit the five years prior to the tax return, scrutinize the last audit, or conduct an investigation to determine whether the credit or refund requested constitutes proper claims.

If the Cabinet erroneously credits or refunds gasoline or special fuels taxes, the Cabinet shall advise the licensee of the error. If the licensee fails to reimburse the Commonwealth within 15 days of receipt of the notice, the Cabinet may institute legal action in the Franklin County Circuit Court to recover from the licensee the amount of the erroneous credit or refund plus a penalty of 20 percent.




	<b>Chapter</b>  KYU/KIT AUDITS
	<b>Subject</b>  File Selection & Review

**PROCEDURE**

Upon selection of files for a geographic area from a listing or another source document, the auditor:

1. Writes on a 3-inch x 5-inch card:
  - Name of each carrier
  - KYU number of each carrier
  - Name of the auditor
  - Date
2. Presents the card to the file clerk in the Administrative Support Section of the Division of Motor Carriers to receive the appropriate tax files
3. Gives the tax files to his or her supervisor for final selection
4. Completes the *Document Charge Out* form for each file retained for audit
5. Returns the tax files not retained for audit, along with the *Document Charge Out* form, to the Administrative Support Section of the Division of Motor Carriers' Administrative Section
6. Sorts the files into most logistically convenient arrangement for fieldwork
7. Reviews the documents to become familiar with the files
8. Notes any discrepancies in reporting, omitted returns, etc.
9. Determines the general nature of the operations but does not establish definitive audit criteria until further investigation and discussion with carrier
10. Requests observation data and equipment listing at earliest opportunity and includes them in the audit folder
11. Accesses any previous audit of the carrier and reviews it for possible problems
12. Arranges all documents by date, with the most recent date on top
13. Staples the old material from prior audits into a packet and adds it to the audit folder
14. Loosely assembles the tax returns, printouts, and other documents applicable for the current audit period and adds them to the audit folder



	<i>Chapter</i> KYU/KIT AUDITS
	<i>Subject</i> Audit Methodology

**AUDIT PROGRAM**

The Division of Audits maintains audit programs designed to:

- Put forth the techniques and procedures required to accomplish audit objectives
- Serve as a guide to remind auditors of specific areas requiring testing or review
- Provide a permanent record for coverage of each audit

The Division of Audits has developed a highway-tax audit program for carriers. However, auditors shall consider any audit program as a flexible tool subject to revision. Each individual audit is unique; therefore, each audit program is unique, tailored to the individual audit.


The concept allows staff to perform audit procedures in a systematic logical manner based on evidence disclosed as work progresses.

**PURPOSE**

Specific purposes of any audit program include, but are not limited to:

- Documenting audit work performed
- Providing a systematic method of attaining objectives
- Reducing the amount of supervision required
- Confirming adequate audit coverage



	<p><i>Chapter</i></p> <p>KYU/KIT AUDITS</p>
	<p><i>Subject</i></p> <p>Carrier Contact</p>

**ENTRANCE LETTER**


The audit supervisor shall send each carrier to be audited an Entrance Letter at least two weeks prior to the audit. The letter shall inform the carrier of the:

- Dates the auditor will be in the area
- Period of time to be audited
- Documentation required for the audit

**CONTACT DOCUMENTATION**

The assigned auditor shall contact the carrier prior to the dates indicated in the Entrance Letter to schedule an appointment to conduct the audit. When the auditor encounters difficulty in setting an appointment or when the carrier fails to keep a scheduled appointment, the auditor shall maintain a record of all attempted contact (telephone calls, letters, e-mails, and other types of correspondence) to ensure sufficient documentation for a jeopardy assessment (if necessary).



	<b>Chapter</b> KYU/KIT AUDITS
	<b>Subject</b> Fieldwork

**ENTRANCE  
INTERVIEW**

Before arriving at the audit site, the auditor shall verify accounts for proper support and be prepared to adjust the program if the need arises.

Upon arriving at the audit site, the auditor shall:

- Discuss normal day-to-day procedures with the carrier, using industry verbiage
- Present the records that are available and necessary for the audit
- Inform the company about what the audit entails

The auditor shall then inquire about the following:

- Who is the company representative that will assist the auditor?
- Do you maintain recaps from your tax return? If not, how do you obtain the figures that go into the tax return?
- How do you accumulate and compile information? Do you use data processing? What controls or procedures do you use to ensure that you account for and process all source documents?
- Does your company trip-lease to other companies?
- Does your company have terminals in Kentucky? If so, which cities?
- In which states do you conduct most of your operations?
- Are there bulk purchases? Withdrawal records?
- How many taxable units does your company own? How many does your company lease?

Next, the auditor shall:

- Discuss procedures related to audit sampling
- Explain that he or she shall project to the entire audit period any errors discovered during the review of sample quarters to develop a questioned-cost amount
- Present the carrier the *Audit by Sampling Method* form for signature

**ENTRANCE****INTERVIEW (CONT.)**

The carrier may verbally agree to the quarter used for sampling purposes but may refuse to sign the form. If the carrier refuses to sign the form, the auditor shall:

1. Perform the audit as planned
2. Present the form to the carrier again at the exit interview
3. Make a notation on the form if the carrier still refuses to sign
4. Sign and date the form and give a copy to the carrier

The Division of Motor Carriers checks computations on the carrier's returns. If errors exist, the division shall show the corrected figures in red ink. The Division of Motor Carriers shall notify the carrier of the errors via a billing notice or correspondence.

The auditor shall review these items carefully. If the carrier has not paid the error amount, the auditor shall include the adjustments in the audit and cancel the error amount from the accounts receivable file.

**VERIFYING COMBINED****LICENSED WEIGHTS**

The definition of *combined licensed weight* is "the greater of: (a) the declared combined maximum gross weight of the vehicle and any towed unit for registration and (b) the highest actual combined gross weight of the vehicle and any towed unit when operated on the public highways of the Commonwealth during the current registration period per KRS 138.655(14)."

Sometimes, carriers misinterpret the meaning of combined licensed weight. Some carriers think that when they operate a vehicle with no load or with only a light load at times, they are to report taxes on the average only and not on the maximum. Carriers may attempt to evade weight-distance tax on this basis.

**WEIGH STATIONS**

Many weigh stations are open throughout the state. Key punch operators at each scales key in the KYU number of every vehicle that crosses the scales. Therefore, observation reports are in the computers as soon as the trucks pass the scales.

**VERIFYING MILEAGE**

Auditors may verify mileage by various methods:

- **Reporting by Odometer**—The auditor shall determine whether the odometer on a vehicle is registering correctly by checking the official Kentucky Map Mileage between points with the meter reading. If there appears to be a considerable difference, the auditor shall investigate further to determine the percentage-of-variance.

The auditor shall investigate:

- ◆ Whether the carrier has installed a new odometer
- ◆ When the fuel consumption appears irregular and no unusual operating conditions account for the variance

**VERIFYING MILEAGE  
(CONT.)**

- **Reporting by Trip Records**—Trip records maintained by carriers should adequately explain the highways used and the routes followed for all trips. The auditor shall always instruct carriers to indicate this data clearly in their records for an audit.

The auditor shall check route or trip mileage by a carrier for reporting, paying particular attention to the reporting of mileage for unusual routes. The auditor shall check the actual route using weight reports, fuel-purchase receipts, and similar data. For their own reasons, drivers sometimes use a route different from the one they report without the knowledge of the company. Carriers may make attempts at evasion by reporting the shortest route instead of the longer one used.

- **Continuity of Trips**—The auditor shall check the continuity of trips to determine whether carriers have properly reported trips. Carriers may overlook deadhead mileage between two terminal points or may report two trips originating from one terminal without a return trip to that terminal.
- **Off-Highway Mileage**—Off-highway miles are those miles operated on private property restricted to the public (for example, coal fields).

If the credit for off-highway miles is more than one percent of reported Kentucky miles, the taxpayer shall provide adequate documentation to support the claim. This support shall include but is not limited to the following:

- ◆ Odometer reading reports when entering and leaving the private property
- ◆ Periodical logs of trips entering and leaving the private property
- ◆ Verification of off-highway miles by any other governmental agency

The KYU/KIT Branch may accept other approaches if the taxpayer can adequately support them. However, the taxpayer shall not use any new method unless the branch has approved it.

**MISCELLANEOUS  
REPORTING**

If the fuel consumption of a vehicle varies considerably or shows a sudden change, the auditor shall make the final determination. Examining the fuel consumption may lead the auditor to errors in reporting as well as to any unreported mileage.

The auditor shall consider seasonal variations in a carrier's business. Normally, there are periods of heavy activity, which increase mileage accordingly. The auditor shall check for error of addition and other clerical errors in compiling trip data and transferring the data into the KYU return.

**MISCELLANEOUS  
REPORTING (CONT.)**

Carriers sometimes discontinue their KYU numbers, or the Cabinet cancels the numbers for cause, whereby there are quarters for which the carriers file no returns. The auditor shall never instruct carriers to file returns for these quarters but include the operations in the audit.

The major difficulty in this type of reporting is the failure of carriers to list complete mileage detail in reports. Most often, the data available on a listing is the vehicle number, the date of the trip, and the total mileage. The auditor is unable to check against file data without verification from the original document, which gives the routings and the beginning and ending trip points.

The auditor shall evaluate the methods of entering mileage, processing of that data, and its use in preparing reports. The actual computer processing is usually adequate. However, errors may result from a misunderstanding of the basic purpose of the processing.

Carriers usually code trips between fixed points with a route mileage. Processors may incorrectly apply or enter the codes or omit them entirely. Carriers identify vehicles by their company numbers, which may be incorrect in the system due to driver error, coding error, or incorrect entry.

In a large operation, an operating division furnishes the data to an accounting or tax division. The functions of these divisions and their goals are different, and often a breakdown in communication occurs between them. For example, one division may make changes in declared weights and assignments of vehicles without an adequate explanation to the other division. The auditor shall take care to check this possibility.

In all cases it is necessary that the auditor verifies basic reporting data, such as dispatch records, driver's logs, driver's time reports, or trip reports. The auditor shall ascertain that carriers process this data properly. The volume of data may be so great that a test check may be the only means possible to use. The auditor shall choose a test period that ensures that it properly represents the entire area of the audit.

**TEST CHECKS OF  
REPRESENTATIVE  
MONTHS**

In some instances, particularly where there are many vehicles and considerable mileage, a detailed audit of every vehicle and every month requires a great deal of time. Such an audit requires an extended stay in a carrier's office with consequent loss of time to the carrier as well as a mass of detailed schedule in the audit.

In such cases, the auditor may make a test check of representative months and determine a percent of error, which the auditor can apply against the periods not checked. The auditor shall ascertain that the type of error found runs generally throughout the entire period and is not unique to the test periods. The auditor shall make sure that the carrier thoroughly understands and agrees to this method and the chosen test periods.

**TEST CHECKS OF  
REPRESENTATIVE  
MONTHS (CONT.)**

When an initial test shows there is little probability of general error, the auditor may thoroughly check a single current quarter. If the auditor finds no system or policy error, he or she need not perform further detailed audit. Should the auditor find errors in the test quarter, it may be necessary to check additional quarters or all quarters in the audit period, depending on the circumstances.

After determining the percent error, the auditor shall apply it to the quarters. The auditor shall correct the total taxes paid by the other adjustments not included in the percentage before its application. Tax computation and duplication errors are examples that the auditor may need to include in the percent of error.

The auditor shall use similar ratios and comparisons whenever possible as indicators of possible error. For example, the auditor may check fuel to mileage reported, drivers' wages to taxes paid, or total expenses to taxes.

**AUDIT TESTS FOR  
KENTUCKY MILEAGE,  
FUEL PURCHASES, &  
MPG**

The auditor may perform the following tests to verify Kentucky mileage, fuel purchases, and miles per gallon:

**Kentucky Mileage**

- Prepare schedule of the trips, and compare reported miles to PC Miler for use.
- Cross-check the trip reports or driver's logs with the carrier's printout or recap to determine that the recap totals include all trips.
- Check records for "city miles" to determine whether the carrier included that mileage in the reported total mileage.
- Prepare a schedule of reported miles and corrected miles. Compute percent-of-error factor for the sample period.
- Apply the error factor for the sample to the entire period covered by the audit, and determine the total mileage the carrier should have reported.

**Fuel Purchases**

- Cross-check 100 percent of the fuel-purchase receipts against the reported Kentucky trips.
- Examine all bulk-purchase receipts and the corresponding withdrawal records for the use of bulk purchases.
- Prepare a schedule of miles reported and corrected miles. Compute a percent of error factor for the sample period. Apply the error factor for the sample quarter(s) to the entire period covered by the audit and determine the total miles the carrier should have reported. This test should determine the correct fuel purchases for the audit period.

**AUDIT TESTS FOR  
KENTUCKY MILEAGE,  
FUEL PURCHASES, &  
MPG (CONT.)**

**MPG (miles per gallon)**

- Calculate MPG by dividing total miles by total fuel purchases. Compare the reported MPG with the amount determined using the corrected mileage and fuel consumption from the audit work.

**AUTHORIZED  
DEDUCTIONS ON  
HIGHWAY QUARTERLY  
TAX RETURNS**

Every licensed motor carrier may deduct on the quarterly tax return the amount of tax paid on fuel at the time of purchase, provided the carrier made the purchase in Kentucky and paid the Kentucky motor fuel tax. The carrier is to obtain a valid receipt as evidence of purchase from the person making the sale or delivery.

A valid purchase receipt shall be an original prepared by a station or vendor located in Kentucky. The receipt shall have an imprinted Kentucky address. Other station locations outside Kentucky are invalid.

The purchase receipt shall include:

- Name and station location of the vendor
- Date of the purchase
- Number of gallons
- Type of fuel purchased
- Company unit number of vehicle or registration number of units
- Licensee's name

Bulk or storage purchasers of fuel shall maintain a withdrawal or disbursement record when using such fuel in taxable highway or road units. Purchasers shall keep this record on all units fueling from this tank, showing the gallons withdrawn and the date of withdrawal. Pursuant to [KRS 138.220](#) and [234.320](#), bulk or storage purchasers shall pay the tax at the time of the purchases. If a motor carrier uses tax-free bulk storage to fuel taxable units (highway units), tax shall be levied on total fuel purchased for bulk storage.

Any use of fuel from a tax-free storage tank without adequate records to prove nonhighway use shall be taxable. The Revenue Cabinet shall issue approved location of tax-free storage before the carrier may purchase tax-free fuel.

Credit for fuel purchases other than for taxable units shall not be allowed.

In instances where trip-leased units purchase fuel, the lessee is responsible for the Kentucky highway tax; all receipts shall show the name of the lessee. Receipts with a name other than the person or company responsible for the fuel tax shall be invalid.

The carrier shall retain all receipts for five years, subject to examination by representatives of the Transportation Cabinet or the Revenue Cabinet.

**FINALIZING  
AUDIT**

The auditor shall complete the audit by following these steps:

- Prepare an assessment schedule to document the final audit results and the total amount of the assessment or refund.
- Calculate the amounts of any additional taxes due and the penalties and interest payable by the carrier.
- Conduct an exit interview with the carrier representatives to explain the reason for potential adjustments and advise the carrier that the audit results will be released after the audit manager has reviewed them.
- Send the carrier a copy of the summary of assessment schedule (if applicable) and the related audit documentation upon completion of all reviews.



	<p><i>Chapter</i></p> <p>KYU/KIT AUDITS</p>
	<p><i>Subject</i></p> <p>Penalty</p>

**TYPES OF PENALTY**

The Cabinet shall apply an audit penalty to each quarter’s assessment at the rate of 20 percent of the additional taxes resulting from the audit as follows:

- For each quarter that reflects a tax due, penalty shall apply.
- For each quarter that uses a credit against the tax due with a net result of a smaller tax due, penalty shall apply on the net tax due.


For each quarter that reflects no tax due or shows a credit, no penalty shall apply.

**REDUCTION OF PENALTY**

Penalty reduction may be considered after receiving written reasons from the carrier. The Cabinet may reduce the penalty if the discrepancy does not merit a 20-percent penalty. The Cabinet may modify the penalty to 5 percent of the tax due or to 1 percent of the tax due if this is the licensee’s first violation.

Disputed audits that involve legal staff shall carry forward the 20-percent penalty. -



	<p><i>Chapter</i></p> <p>KYU/KIT AUDITS</p>
	<p><i>Subject</i></p> <p>Computation of Interest</p>

**AUTHORITY** Per [KRS 131.183](#), “All taxes payable to the Commonwealth not paid at the time prescribed by statute shall accrue interest at the tax interest rate. The tax interest rate for tax liabilities that are assessed on or after July 1, 1982, shall be sixteen percent (16%). This tax interest rate shall apply until July 1, 1983, when the tax interest rate shall be adjusted as provided in this section. The commissioner of revenue shall adjust the tax interest rate not later than November 15 of any year, beginning in 1982, if the adjusted prime rate charged by banks during October of that year, rounded to the nearest full percent, is at least one (1) percentage point more or less than the tax interest rate which is then in effect. The tax interest rate shall be equal to the adjusted prime rate charged by banks rounded to the nearest full percent, and shall become effective on January 1 of the immediately succeeding year.”

**COMPUTATION DATE** The date of the computation of interest shall be the due date of the return. Thus, the interest charges shall begin with May, August, November, or February, depending on the quarter audited. The interest charges shall continue to and include the month auditors make the assessment.


**INTEREST RATE** Auditors shall compute interest on the amount of tax determined from the audit, using the interest rate applicable for the tax period assessed, not the interest rate applicable at the time of the assessment

**COMPUTATION DETAILS** Auditors shall not compute interest for any period less than a month. For that reason, interest to the first day of the month shall be the same as the interest to the last day. For clarity, auditors shall show the exact date on the audit report. If the audit closing date is near the end of the month and billing does not occur until the succeeding month, auditors shall compute interest for that month. The Division of Audits shall update the interest from that point forward.

Auditors shall show on the working papers the detailed computation of interest, including the rate and amount for each quarter. The total interest shall appear only on the audit recap.

Interest charges cannot be reduced due to statutory requirements.



	<i>Chapter</i> KYU/KIT AUDITS
	<i>Subject</i> Audit Working Papers

**PURPOSE** Working papers are the link between the fieldwork and the audit report. They contain the evidence to support the findings, judgments, and conclusions in the report. The auditor shall ensure the safe custody and retention of working papers for the time sufficient to meet legal and administrative requirements.

**ASSEMBLY OF DATA** Upon completion of the audit, the auditor shall assemble all schedules, working papers, and other supporting data and attach them to the index sheet so that the audit is a complete and an understandable file in itself without reference to another file. The auditor shall avoid using tax returns filed by the carrier as working papers, thereby leaving the tax return paperwork as close to its original condition as possible when filed.

The minimum schedule requirement for all audits in which an adjustment occurs is an audit report and an adjustment schedule. These two documents, together with the audit review notes, represent the entire audit. However, in the majority of cases there are a number of supporting schedules. The auditor shall cross-reference the schedules to the appropriate working papers.

The auditor shall properly index and number all working papers and supporting schedules and shall file them together in the following order:

1. Index
2. Audit Recap
3. Audit Report Narrative
4. Audit Program
5. Summary of Assessment Schedule
6. Mileage Working Papers
7. Fuel-Purchases Working Papers

**COMPLETENESS & ACCURACY** Working papers shall be complete and accurate to provide proper support for findings, judgments, and conclusions and to enable demonstration of the nature and scope of examination work.

**CLARITY &  
UNDERSTANDING**

Working papers shall be understandable, without detailed supplementary oral explanations. They should be complete yet concise. Anyone using them should be able to determine readily their purpose, , nature, scope of work done, and the preparer's conclusions. Conciseness is important; however, the auditor shall not sacrifice clarity and completeness to save time or paper.


**LEGIBILITY &  
NEATNESS**

Working papers shall be legible and neat. Otherwise, the auditor may waste time in reviewing them and in preparing reports. Moreover, inadequate working papers may lose their worth as evidence. The auditor shall avoid crowding and writing between lines by anticipating space needs and arranging the working papers before writing.

**RELEVANCE**

The auditor shall restrict information in working papers to matters that are materially important and relevant to the objectives of the assignment. There are no substitutes for a working understanding of the audit objectives, the reasons for performing a specific task, and its relationship to the objectives. This understanding comes from well-planned and well-organized work programs and effective instructions by supervisors. The practice of having all working papers contain clear statements of purpose, source and conclusion is very helpful in ensuring that information accumulated is relevant to audit objectives and reporting.



	<i>Chapter</i> KYU/KIT AUDITS
	<i>Subject</i> Audit Report

#### PREPARATION OF AUDIT

The auditor shall:

- Prepare audit reports that are concise and cover all details
- Explain all reasons for all adjustments
- Include information about the operations and details that will make the next audit easier for the auditor
- Refrain from making comments that a carrier could construe as personal criticism

When writing comments the auditor shall consider the following information:

- What is the type of carrier and commodity?
- With whom were records checked?
- Is the ownership unchanged?
- Is the file presently active? If not, will the carrier reinstate any pertinent information?

#### COMPLETION OF AUDIT

Upon completion of the audit, the auditor shall:

- Review the audit file to determine the file is in order and properly indexed
- Cross-reference the net account to the audit recap, narrative audit report, audit working papers, and summary of taxes due if there is an assessment or refund
- Include an audit recap with a brief and clear explanation of the reasons for an assessment or refund
- Submit the file for review to the audit supervisor

The supervisor shall give the file to the branch's audit reviewer, who shall:

- Perform an in-depth examination of the auditor's working papers
- Complete an audit comment sheet outlining the reviewer's concerns, should there be a problem with the audit
- Return the file to the supervisor who shall examine the reviewer's comments

**COMPLETION OF  
AUDIT (CONT.)**

The supervisor shall determine additional action the auditor needs to take. After making corrections, the auditor shall return the file to the reviewer for examination.

The reviewer shall process the corrected audit file (as well as those files that required no corrections) and then submit the files to the audit manager for final review.


Upon completion of final review, the audit manager submits the audit working papers to the division's administrative assistant for filing and, if appropriate, for preparation of a tax-assessment letter to the taxpayer.

**TAX-ASSESSMENT  
LETTER**

The tax-assessment letter informs the taxpayer of the following:

- Period of time the audit covered
- Gross amount of tax due, including penalty and interest
- Reasons for the assessment
- Explanation that the Division of Motor Carriers shall send a detailed billing (taxpayer has 30 days from the date of the division's tax-due statement to protest the assessment)
- Procedure for filing a protest of the assessment



	<i>Chapter</i> KYU/KIT AUDITS
	<i>Subject</i> Testifying at Hearings

**PURPOSE OF  
HEARINGS**

The purpose of a hearing is to present all sides to an impartial person. This person shall judge the matter by considering the testimonies of all parties and base his or her opinion on the data presented.


When a company protests an audit and is subject to a hearing at the request of a carrier, the auditor may have to testify before a court or as an expert witness.

**AUDITOR CONDUCT  
AT HEARINGS**

At hearings, auditors shall:

- Conduct themselves in a calm, professional manner at all times
- Be alert and attentive to all questions
- Take time to consider the intent of each question before responding
- Refrain from interrupting questions; instead, listen to entire questions before responding
- Demonstrate by their actions that they realize the importance of their answers
- Testify truthfully on the basis of their knowledge of the situation
- Avoid responding to questions of which they have no knowledge; instead, simply state that they have no knowledge related to the situation
- Avoid injecting their opinions or judgments into responses unless specifically asked
- Speak slowly, clearly, distinctly, and confidently
- Maintain eye contact with the questioner



	<p><i>Chapter</i></p> <p>KYU/KIT AUDITS</p>
	<p><i>Subject</i></p> <p>Auditing Coal Haulers</p>

**STATISTICS**

Coal haulers use approximately 3,740 miles of state-maintained highways to transport coal. Kentucky registered more than 2,667 coal trucks during 2006, and the sale of extended-weight coal decals generated \$833,294.

Kentucky has approximately 97 coal rail-loading facilities. Statewide, 45 coal river terminals are located on the Ohio River, and its tributaries serve Kentucky coal shippers (34 within Kentucky). The coal river terminals are located as follows:

- 14 in eastern Kentucky
- 6 in central Kentucky
- 25 in western Kentucky

**FLOW OF COAL**

To audit the mileage for coal haulers, the auditor needs to be able to track the physical routes taken by the haulers. The points of origin include:

- Underground mines
- Strip mines
- Prep plants\*

\* A coal prep plant is a facility that washes coal of soil and rock, preparing it for transport to market.

The points of destination include:

- Tipples\*\*
- Prep plants
- River terminals
- Power plants

\*\* Originally the place where the mine cars were tipped and emptied of their coal, and still used in that same sense, although now more generally applied to the surface structures of a mine, including the preparation plant and loading tracks

Route 23—the “KY Coal Highway”—links eastern Kentucky coal mines to the river terminals located on Route 23 near Catlettsburg and the AEP power plant located on Route 23 near Louisa.

**HOW COAL  
COMPANIES  
OPERATE**

Large companies may have company-owned trucks and ship all of the coal themselves.

Large companies may also own a separate trucking company and utilize contractors. In this case, the trucking company handles most shipments from their prep plant directly to the river terminal or power plant and lets the contractors do intraproperty hauls between mines and their prep plants located on their property. After making several intraproperty hauls, the contractor is then given a long distance haul to the river terminals or the power plant (AEP). In doing this, the coal company minimizes its off-road miles, resulting in less maintenance, fewer repairs, and a higher miles per gallon (MPG) for company-owned trucks.

Coal companies may award one or several contracts to large carriers that use their own equipment or contract out a portion of the work. Coal companies may also award contracts to many carriers to reduce their exposure if a carrier were to go out of business.

Some coal companies sell fuel directly to their carriers, using bulk tanks located on coal company property. This practice is becoming less prevalent due to high recordkeeping cost burdens on the coal companies.

Some coal companies allow the owner of a major contract to keep bulk storage tanks on mine property.

**THE PAPER TRAIL**

Coal trucks are weighed before and after loading at the mine or prep plant, generating the weigh ticket. The truck is then weighed full and empty at the river terminal or tipple, establishing the basis for generating the settlement sheet.

The coal company or the major contract holder of each contract hauler generates the settlement sheet showing:

- Date of each haul
- Unit number
- Gross and net tons
- Rate per ton
- Total amount paid for the load (net tons × rate per ton)
- All loads totaled and reflecting the amount paid to the carrier

The settlement sheet may also show:

- Hours × rate/hour for yard work

**Note:** Yard work is hauling material from one area of a mine to another and is paid by the hour vs. rate per ton since the amount of material hauled is never weighed.

**THE PAPER TRAIL  
(CONT.)**

- Fuel purchased from the coal company

**Note:** This practice has been decreasing since the costs of recordkeeping outweigh any benefits to be derived by the coal company.

Settlement sheets are usually prepared on the 16<sup>th</sup> and last day of the month. The total of all settlement sheets at year end should equal gross revenue on Schedule C of the federal and state income tax returns. This is one way of ascertaining that the coal hauler has accounted for all trips.

The settlement sheet provides the basis for reporting income at year end and is also the documentation they will use to determine the pay of their drivers or any contractors they may have working for them. Drivers and contractors typically receive 20 to 25 percent of what their truck makes, so these documents are needed to determine their pay.

**AUDITING TOTAL  
MILES**

Unless the coal hauler is a large carrier or utilizes a tax-reporting service, the hauler may likely not have mileage records. Instead, the coal hauler will multiply gallons of fuel by an estimated MPG to arrive at total miles.

The auditor should follow these guidelines when determining mileage for coal haulers' vehicles:

- Use extended-weight decals in conjunction with KIT or IFTA decals to determine the number of taxable units and then confirm through AVIS. Extended-weight decals are purchased by the taxpayer, are VIN-number-specific, and allow the taxpayer to haul up to 120,000 pounds GVW (gross vehicular weight) on approved roads. These decals cost approximately \$350 each for a 120,000-pound decal and are the best tool for determining how many vehicles a coal hauler is running. Extended-weight decals are for coal hauling only; they cannot be used by rock and gravel haulers.
- Obtain current odometer readings on all vehicles, even if the taxpayer says they are broken. Use AVIS to determine the odometer reading at the time the truck was originally registered and subtract that from the current odometer reading to determine the total audited miles driven by the taxpayer.

**Note:** In general, since most mines are not located in the middle of towns, using PC Miler to determine Total Audited Miles is usually very inaccurate and a waste of time.

- If, after calculating mileage per truck per quarter, the mileage appears low, visually inspect the odometers in one of two ways:
  - ◆ Make arrangements to inspect the truck along the route from the mine to the tippie or river terminal.
  - ◆ Take odometer readings after trucks return to the garage at night.

**AUDITING TOTAL  
MILES (CONT.)**

- If the original odometer readings on AVIS are not valid (for example, an obviously fictitious reading of 50,000, 100,000, etc.) use settlement sheets to determine total miles by extending all the on-road and off-road miles per trip by the number of trips shown on the settlement sheets. However, if the revenue per the settlement sheets do not correspond with the income tax return (Schedule C), the auditor will be unable to determine whether he or she has all of the settlement sheets or the identities of all coal companies for which the taxpayer hauled.

If the taxpayer says he or she has no settlement sheets, then proceed with one of the following:

- ◆ Ask the taxpayer to obtain the settlement sheets from the coal company.
- ◆ Ask the taxpayer to sign a release that allows you to obtain the records directly from the coal company.

**Note:** The coal company retains these records in a database for IRS purposes.

- When auditing miles, ask the taxpayer what routes he or she specifically travels. Do not look at a map and assume that it is the shortest route from the mine to the tipple or river terminal. Because coal trucks are prohibited from using (or unable to navigate) certain roads or bridges, actual miles can be substantially greater than what appears on a map.

**PREP  
PLANTS**

The auditor can locate prep plants by using the East or West Kentucky Preparation Plants and Rail Loading Facilities listings (see **REFERENCES** at the end of this section). These lists include all prep plants and rail terminals, as well as the nearest towns and intersections and are very useful sources of information for performing the audit.

**RIVER  
TERMINALS**

The auditor can locate river terminals by using the East or West Kentucky Coal River Terminals (see **REFERENCES** at the end of this section). These lists detail the terminals, mile posts, and other information, including other names by which a terminal is known. These can be very helpful if difficulties arise when trying to locate one of the terminals.

**OFF-ROAD  
MILES**

Kentucky and Ohio off-road miles are **nontaxable**. West Virginia, Tennessee, Illinois, and Virginia off-road miles are **taxable**.

**OFF-ROAD  
MILES (CONT.)**

If a road is dirt or gravel, it is not necessarily off-road. Off-road is a road that is not a “public highway” as defined in [KRS 138.655\(3\)](#):

*“Public highway” means every way or place generally open to the use of the public as a matter of right for the purpose of vehicular travel notwithstanding that it may be temporarily closed or travel thereon restricted for the purpose of construction, maintenance, repair or reconstruction; also including all city streets, alleys and any way or place on which a toll is charged for using such way or place.*

For questions concerning a road’s status as a public highway or “off-road,” the auditor shall refer to his or her audit manager.

**AUDITING  
OFF-ROAD MILES**

Off-road miles as a percent of total miles can vary from 0 percent to 100 percent. **In general, the Cabinet does not allow credit for off-road miles unless the taxpayer can furnish documentation. The Cabinet does not accept a blanket X percent of total miles as being off-road.** The taxpayer can document the percentage using trip sheets to document the off-road miles or using settlement sheets to extend the number of trips per origin (destination) by the off-road miles pertaining to that origin (destination).

When auditing coal haulers, complete the *Coal Haulers Off-Road Miles* form to document the operations of the taxpayer. Information from this form is useful in completing the “Taxpayer’s Operations” section of the audit report. This form is available on the N drive at:

[N:\AUDITS\RoadFundAudits\KIT-KYU\Coal Haulers Off-Road Miles Form](#)

Auditors can determine off-road miles for mine locations by:

- **Calling the coal company**—This is the most reliable and expedient method. When contacting the coal company, the auditor should ask for the engineering department, since it generates the mine maps and can specify the off-road miles from the beginning of the coal mine property to the point where the coal is picked up. If the department gives a range, the auditor shall use the high end of the range. For example, if the department gives the range of 3—4 miles, the auditor should use 4 miles. The auditor should ensure the miles given are defined as “one way” or “round trip” and shall make the proper documentation in his or her work papers. If the audit is protested and goes to court or to the Board of Tax Appeals, this source gives the Cabinet the most defensible source of data.
- **Reference other audits**—The auditor may use these if documentation of off-road miles exists and the information is not significantly out of date.
- **Use of a mine map**—This method is not recommended, since it is too time consuming. The auditor would first need to know the mine permit numbers and then go to the [UK Mine Map Center](#) (appointment needed).

**AUDITING OFF-ROAD  
MILES (CONT.)**

- **Driving on the mine property with the taxpayer**—This method is not recommended, since the auditor may not be certain where the taxpayer is actually driving.

**AUDITING FUEL**

The auditor audits fuel for coal haulers the same as auditing any other road carrier. Fuel is purchased in bulk and or at the pump. If the coal hauler purchases fuel from the coal company, there may not be an actual receipt, but the transaction will appear on the settlement sheet.

Fuel receipts noted as “dyed low-sulfur diesel” are for fuel designated for use in equipment in underground applications with very low sulfur emissions and are not to be included in fuel credit calculations. If the taxpayer also purchases off-road fuel, the auditor should document these purchases in his or her worksheets.

**MPG**

If the coal haulers do not maintain mileage records, the auditor may need to determine the total audited miles by multiplying total audited gallons by an estimated MPG.

The Cabinet has a documented range of actual MPG on an Excel spreadsheet that auditors may use for calculating miles in these situations.


**REFERENCES**

The following resources may assist in the audits of coal haulers:

- The Kentucky Department for Energy Development and Independence website ([www.energy.ky.gov](http://www.energy.ky.gov)), which has the following files:
  - ◆ West KY Coal River Terminals
  - ◆ East KY Coal River Terminals
  - ◆ West KY Preparation Plants & Rail Loading Facilities
  - ◆ East KY Preparation Plants & Rail Loading Facilities
- Extended Weight Decals, located on the N Drive at:
  - N:\Audits\RoadFundAudits\Coal Permits
- KIT or IFTA Decals, located on KYIMS
- Map of KY Coal Mines, located in the Office of Audits
- The Kentucky Office of Mine Safety & Licensing website ([www.omsf.ky.gov](http://www.omsf.ky.gov))

**Note:** To access coal companies’ general information, first click on “Technical Information Library,” and then select the appropriate “Coal Mines Licensed in (year).”



	<i>Chapter</i> U-DRIVE-IT AUDITS
	<i>Subject</i> Authority

**KRS 138.463**

Pursuant to [KRS 138.463](#), Collection of U-Drive-It Tax:

“(1) A holder of a permit as required under [KRS 281.615](#) to operate as a U Drive-It as defined in [KRS 281.014](#) may pay the usage tax as provided in [KRS138.460](#) or, subject to the provisions of this section, may pay a usage tax of six percent (6%) levied upon the amount of the gross rental or lease charges paid by a customer or lessee renting or leasing a motor vehicle from such holder of the permit.

“(2) The provisions of [KRS 138.462](#) and this section shall apply to all rental and leasehold contracts entered into after March 9, 1990.

“(3) A holder of the permit shall pay the usage tax as provided in [KRS 138.460](#) unless he shows to the satisfaction of the Cabinet that he is regularly engaged in the renting or leasing of motor vehicles to retail customers as a part of the an established business. The issuance of a U-Drive-It permit under the provisions of [KRS Chapter 281](#) shall create a rebuttable presumption that the holder of a permit is regularly engaged in renting or leasing. Persons first engaging in the renting or leasing of motor vehicles to retail customers shall, in addition to obtaining a permit required under [KRS 281.615](#), demonstrate to the satisfaction of the Cabinet that they are prepared to qualify under the standards set forth in this subsection.

“(4) In the event the holder of such permit qualifies under subsection (3) of this section and elects to pay the usage tax by the alternate method as provided in subsection (1) of this section, or is required by subsection (8) of this section to pay by the alternate method, he shall pay the seat tax imposed by [KRS 186.281\(3\)](#) and in addition shall pay the monthly tax authorized by subsection (1) of this section.

“(5) The tax authorized by subsection (1) of this section shall be the direct obligation of the holder of the permit but it may be charged to and collected from the customer in addition to the rental or lease charges. The tax due shall be remitted to the cabinet.

**KRS 138.463  
(CONT.)**

“(6) A. As soon as practicable after each return is received, the cabinet shall examine and audit it. If the amount of tax computed by the cabinet is greater than the amount returned by the taxpayer, the excess shall be assessed by the cabinet within four (4) years from the date the return was filed, except as provided in paragraph (c) of this subsection, and except that in the case of a failure to file a return or of a fraudulent return the excess may be assessed at any time. A notice of such assessment shall be mailed to the taxpayer. The time herein provided may be extended by agreement between the taxpayer and the cabinet.

“(6) B. For the purpose of paragraphs (a) and (c) of this subsection, a return filed before the last day prescribed by law for the filing thereof shall be considered as filed on such last day.


“(6) C. Notwithstanding the four (4) year time limitation of paragraph (a) of this subsection, in the case of a return where the tax computed by the cabinet is greater by twenty-five percent (25%) or more than the amount returned by the taxpayer, the excess shall be assessed by the cabinet within six (6) years from the date the return was filed.

“(7) Failure of the holder of the permit to remit the taxes applicable to the rental charges as provided herein shall be sufficient cause for the Department of Vehicle Regulation to void the permit issued to such holder and the usage tax on each of the motor vehicles which had been registered by the holder under the permit shall be due and payable on the retail price of each such motor vehicle when it was first purchased by the holder.

“(8) Notwithstanding the provisions of KRS 138.460 and subsection (1) of this section, a holder of a permit operating a fleet of rental passenger cars which has been registered pursuant to an allocation formula approved by the cabinet shall pay the tax by the method provided in this section. The provisions of this section shall apply to all vehicles rented by the holder in this state.

“(9) The usage tax reported and paid on every rental or lease of a vehicle registered pursuant to this section shall be based on the fair market rental or lease value of the vehicle. Fair market rental or lease value shall be based on standards established by administrative regulation promulgated by the cabinet. The cabinet may remove a vehicle from the U-Drive-It program without a hearing if it is determined by the cabinet that no taxes have been remitted on that vehicle during the registration period. However, the tax reported and paid to the Transportation Cabinet shall not be less than the amount due based on the actual terms of a rental or lease agreement. The burden of proving that the consideration charged by the holder satisfies this subsection is on the holder.”



	<p><i>Chapter</i></p> <p>U-DRIVE-IT AUDITS</p>
	<p><i>Subject</i></p> <p>General Policies</p>

**OVERVIEW**

[KRS 138.463](#) was amended so that the U-Drive-It Section of the Division of Motor Carriers now assesses taxes based upon the fair market rates established by the Transportation Cabinet for all lease and rental agreements. These new assessments are in lieu of the assessments based upon [KRS 138.460](#). The audit of the permit holder shall determine the actual use of each vehicle entered into the U-Drive-It System.

**POLICIES FOR RENTAL VEHICLES**

**Permit Holders with Adequate Records**—Upon determination that a permit holder rented or loaned a rental unit at less than arms-length rates (legal term used in the statute) to a customer, the U-Drive-It Section shall assess receipts for the rental agreement on the basis of the actual use of the vehicle and the average daily rental rate determined by the audit.

If the U-Drive-It Section cannot determine the actual use of the vehicle from the rental agreement, the section shall assess receipts on the basis of the average rental agreement amount determined by the audit.

The section shall assess missing rental agreements on the basis of the average rental agreement amount. If the manufacturer pays the permit holder for the use of the vehicle when the permit holder provides warranty service, the section may consider the reimbursement received by the permit holder fair market for the use of the vehicle. Similarly, the section may consider payments by an insurance company as reimbursement for the use of a vehicle fair market for the use of a vehicle.

**Permit Holders without Adequate Records**—If the permit holder uses the vehicles as loaners or the U-Drive-It Section cannot determine the actual use, the section shall assess receipts on the basis of the average daily rental rates determined by a survey of five national rental car agencies. The section shall assess the average daily rental rates for each day that the vehicle is on the permit holder's U-Drive-It permit.

If the section cannot determine that the permit holder has rented or loaned a vehicle on a monthly basis at less than arms-length rates, the section shall assess receipts on the basis of the average monthly rental rates determined by the survey of five national rental car agencies.

The section shall perform annual surveys of daily and monthly rental rates in June of each year.

**POLICIES FOR  
RENTAL VEHICLES  
(CONT.)**

A survey conducted by the Division of Audits shows the NADA classification for all vehicles and the average daily and monthly rental rates as determined by the annual survey for use in computing the receipts for fair market assessments.

**POLICY FOR  
LEASED VEHICLES**

If the permit holder leases or loans a vehicle at less than arms-length rates, the U-Drive-It Section shall assess receipts on the basis of the average lease payment amount for each \$1,000 of the manufacturer's suggested retail price (MSRP). The section conducts a survey of 250 leased vehicles to obtain the MSRP and lease payment due. For the survey the section:

1. Adds the MSRPs for all the vehicles and divides the total price by the total number of vehicles to determine the average MSRP
2. Adds the monthly lease payments and divides the total payment by the total number of vehicles to determine the average lease payment
3. Divides the average lease payment by the average MSRP to determine the fair market lease payment for each dollar of MSRP
4. Multiplies the fair market lease payment for each dollar of MSRP by 1,000 to determine the fair market lease payment for each \$1,000 of MSRP

The section shall conduct the survey annually to reflect changes in interest rates and other factors that could affect the monthly payment due.


The survey shows the average monthly lease payment per \$1,000 of MSRP as determined by the survey for use in computing the receipts for fair market assessments.

To test the reasonableness of the residual values used in the calculations of the lease payment due, the section uses the projected residual values published in the *Black Book Official Finance/Lease Guide*, which the National Auto Research Division of Hearst Media Corporation publishes monthly.

**CREDIT**

The section shall give credit for any taxes paid on the monthly tax returns.



	<p><i>Chapter</i></p> <p>U-DRIVE-IT AUDITS</p>
	<p><i>Subject</i></p> <p>Sampling Schedules</p>

**PERCENTAGE-OF-ERROR DETERMINATION**

As used in auditing, a percentage-of-error determination is a device used to decrease the amount of work and time necessary to complete audits of large detailed accounts. This method is basically an agreement with a carrier that any error found in a check of a portion of an audit period shall apply equally to the months not checked. It is accurate only when errors are consistent throughout the audit period and when a sufficient base period is checked to ascertain the amount of error.

A 10-percent error in understanding miles means that for every 100 miles traveled, the carrier reports 110 miles. If a check of representative trips throughout the audit period shows this consistent understatement, carriers can save much time by increasing all mileage 10 percent without a complete check of each trip. Carriers can express the amount of error in this manner for miles or dollars, depending on the circumstances. Auditors shall ascertain that carriers understand the method.

Auditors shall prepare a schedule illustrating clearly how to determine and apply the percentage. Auditors shall not use less than one quarter in a year for a detailed check. Large carriers may select one test quarter per year or one quarter for the entire audit period. Carriers are to select test quarters to cover both slack and peak periods of an operation with seasonal fluctuation. It is advisable to slide the quarters year to year, that is, to use different quarters in different years.

Auditors shall exclude unusual variances from the computation—for example, a misplaced decimal, an incorrect rate, or exceptionally large mileage errors—unless these variances occur throughout the entire period of the audit. The normal percentage shall express normal continuing errors only. When excluding unusual items, auditors shall add or subtract from reported taxes to obtain corrected taxes. Auditors shall then apply the percent of variance to the corrected taxes to obtain the additional taxes due. Auditors shall then separately adjust these excluded items, add them to each quarter's percentage adjustment, and clearly show the adjustment in their schedules.

Auditors shall apply the percentage of variance to each quarter's taxes and compute the interest for each month. It is preferable to show the actual adjustment for these months when auditing the entire return.



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**PROFESSIONAL CERTIFICATION AGREEMENT**

This agreement is made this \_\_\_\_\_ day of \_\_\_\_\_, 20 \_\_\_\_\_,  
between the Kentucky Transportation Cabinet (First Party), and  
\_\_\_\_\_, an employee of the Kentucky Transportation  
Cabinet (Second Party), regarding the professional certification of \_\_\_\_\_.

1. Second Party agrees to complete the Review Course entitled  
\_\_\_\_\_ (Course),  
sponsored by \_\_\_\_\_, to begin on  
\_\_\_\_\_ and to be completed on \_\_\_\_\_.
2. First Party agrees to pay the actual costs of tuition, books, and  
supplies incurred by Second Party to complete this Course, limited to one review  
course per professional certification.
3. Second Party agrees to pay for all other expenses incurred in  
completing the Course, including but not limited to expenses of travel, lodging,  
and meals.
4. First Party agrees to pay the actual costs of the Certification  
Examination (Examination) incurred by Second Party once. If Second Party  
does not pass the Examination, Second Party is responsible for all costs incurred  
in retaking the Examination.
5. First Party agrees to grant Second Party leave with pay only for those  
days required to sit for the Examination one time. If Second Party requests leave  
time to retake the Examination, First Party shall charge the time off against  
Second Party's annual or compensatory leave balance.

6. Second Party agrees that First Party, in its sole discretion, may recover from Second Party all sums expended by First Party for the Course and Examination by withholding from the salary of the Second Party amounts equal to the sums expended, if any one of the following three events occur:

(a) Second Party's employment with First Party is voluntarily or involuntarily terminated within twelve (12) months of the date the Course and Examination are completed; or

(b) Second Party receives payments for the Course from a third party source; or

(c) Second Party fails to pass the Examination within twenty-four (24) months of First Party's reimbursing costs associated with certification.

7. Second Party authorizes First Party to contact and obtain information from the Course's sponsor related to Second Party's class attendance and homework completion records, as well as the Examination's sponsor related to the Examination scores.

The parties have signed this Agreement on the date set forth above.

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First Party  
Kentucky Transportation Cabinet

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Second Party  
Kentucky Transportation Cabinet Employee