



AUDITOR GENERAL

DAVID W. MARTIN, CPA



DEPARTMENT OF BUSINESS AND PROFESSIONAL REGULATION

CIGARETTE TAX STAMPS

Operational Audit

SUMMARY

This operational audit, for the period March 2005 through July 2007, focused on the sale and safeguarding of cigarette tax stamps (tax stamps) by the Department of Business and Professional Regulation (Department), Division of Alcoholic Beverages and Tobacco (Division). Our audit disclosed the following:

Finding No. 1: The Division did not adequately monitor its contractor's manufacture, storage, and destruction of tax stamps.

Finding No. 2: Controls over the Division's district office tax stamp inventory vaults could be improved.

Finding No. 3: District offices did not always perform required observations of the physical inventory counts of stamping agents.

Finding No. 4: Subsidiary records maintained to account for credit sales to stamping agents were not always complete.

Finding No. 5: Tax refunds, credits, and stamp destruction were not always appropriately documented.

Finding No. 6: Subsidiary records relating to tax refunds paid to stamping agents were not routinely reconciled to general ledger accounting records.

BACKGROUND

Section 210.02, Florida Statutes, imposes an excise or privilege tax on the sale, receipt, purchase, possession, consumption, handling, distribution, and use of cigarettes in the State of Florida (State). The Bureau of Auditing (Bureau) within the Division is responsible for collecting cigarette excise taxes through the sale of cigarette tax stamps to licensed cigarette stamping agents. The district offices are responsible for selling tax stamps and performing tax and compliance audits. The Department reported approximately \$420 million in tax stamp revenue for the 2006-07 fiscal year. Revenues are allocated to the General Fund (66.9 percent), the Public Medical Assistance Trust Fund for the payment of indigent health care (29.3 percent), the Revenue Sharing Trust Fund for Counties (2.9 percent); and the Alcoholic Beverage and Tobacco Trust Fund (.9 percent).

FINDINGS AND RECOMMENDATIONS

Finding No. 1: Monitoring of Stamp Contractor

On June 15, 2005, the Department entered into a five-year contract with Meyercord Revenue, Inc., (Meyercord) to manufacture tax stamps. Tax stamps are purchased from Meyercord by the case

with each case typically containing 25 tax stamp rolls. Each tax stamp roll contains 30,000 stamps with a tax value of approximately \$10,000, and each roll is assigned a unique sequential roll number that is shown on each of the stamps contained in the roll.

Meyercord manufactures tax stamps using a unique safety-tinted mill-controlled paper. The contract requires Meyercord to provide the Bureau with a periodic accounting, with signed affidavit, of the paper used in the production of tax stamps, including spoilage and destruction amounts. Such information, in conjunction with other monitoring procedures, such as the Department periodically conducting site visits to Meyercord, help ensure that the State's tax stamps are properly produced, accounted for, and safeguarded.

Our audit included a review of applicable contract provisions, Bureau practices, and procedures related to the production of State cigarette tax stamps. Our audit disclosed:

- The current contract with Meyercord includes a provision for the Department to inspect the plant and all records and books of accounting pertaining to its tax stamps. However, as of July 2007, no site visits had been made.
- To provide off-site verification of Meyercord's accountability for Florida cigarette tax stamps, the Department should periodically reconcile production data certified by Meyercord to the stamps received by the Department. To prepare such reconciliations, the Department must obtain information concerning the total amount of paper used to produce Florida's stamps, the roll numbers shipped to the Department, the roll numbers of misprinted stamps destroyed by Meyercord, and the amount of paper

that may have been spoiled during the production process.

Meyercord submitted to the Bureau certified listings of rolls shipped (by roll number), which also included the rolls (by roll number) "not in circulation" and set aside for future destruction. Meyercord also submitted signed affidavits of tax stamps destroyed. However, Meyercord's affidavit, contrary to contractual requirements, did not report the amount of paper used in production. The affidavit also did not include the roll numbers destroyed, which would be needed for meaningful analyses and reconciliations.

Recommendation: We recommend that the Department monitor Meyercord's tax stamp production process. Monitoring procedures should include:

- Periodic site visits by Department personnel to Meyercord, and
- Performance of periodic reconciliations of production data and related analyses and investigations of significant variances.

Finding No. 2: Controls Over Inventories

Our audit included a review of controls over the vaults used to secure tax stamp inventories. In performing this review, we found that the Department did not have written policies and procedures to address:

- The limiting of vault access to only appropriately authorized staff members,
- A prohibition against the sharing of access security codes among staff members,
- The removal of terminated staff members' access codes from the vault's physical security system, and
- The use and periodic review of the vault's access log.

The adoption and communication of written procedures, coupled with Division management's monitoring of procedural compliance, would significantly enhance tax stamp inventory security. Our observation of vault security actually in place at the Tallahassee, Tampa, and Jacksonville district offices disclosed that each of these district offices was equipped with a security system that was capable of electronically logging the times and the names of individuals accessing the vault. However, the Tallahassee District Office did not obtain or review its security logs and the Tampa and Jacksonville district offices were not fully utilizing their security systems.

Absent appropriate vault controls, the Department may lack the ability to fix responsibility for losses should they occur.

Recommendation: We recommend that the Department implement policies and procedures to enhance vault security at its district offices.

Finding No. 3: Observation of Stamping Agent Physical Inventories

Division procedures require stamping agents to conduct two physical inventory audits per year, with at least one of the inventories to be observed by a district office field auditor. Physical inventory observations, along with the performance of other audit procedures by the district office field auditor, help provide assurance that all cigarettes sold by stamping agents are stamped and, thus, applicable taxes have been paid. Our audit included a review of Division records relating to the stamping agent physical inventories observed by Tallahassee, Tampa, and Jacksonville district office field auditors.

Our audit disclosed that none of the out-of-State stamping agents regulated by the Tallahassee and Jacksonville district offices had, in recent years, been subjected to Division inventory observation procedures. The most recent inventory observation had been performed in 2001. In response to our inquiry, Division personnel stated that budget constraints have not allowed out-of-State travel by its auditors.

Recommendation: We recommend the Division perform inventory observations as required by Division procedures.

Finding No. 4: Cigarette Tax Stamps Credit Sales

The Bureau manually records each credit sale to a respective stamping agent's monthly accounts receivable ledger card (subsidiary record). Our tests of 50 credit sales and related payments totaling approximately \$10 million from the Tallahassee, Tampa, and Jacksonville district offices disclosed that nine payment amounts totaling \$1.4 million in settlement of nine credit sales of the Jacksonville District Office were not posted to the applicable subsidiary records. We also noted that an overpayment by a stamping agent had been caused by a failure of the Jacksonville District Office to carry forward in a subsidiary record a credit memo from the previous month. Incomplete or inaccurate subsidiary records decrease the assurance that the proper amounts are timely collected from the stamping agents.

Recommendation: We recommend the Bureau take steps to ensure all transactions are accurately recorded in stamping agent subsidiary records.

Finding No. 5: Credit or Refund of Cigarette Tax Stamps

Our audit included tests of tax stamp credits and refunds. The Request for Credit or Refund of Cigarette Indicia Form (Credit/Refund Form) was used by the Division to process credit or refund requests for tax stamps destroyed or returned to the manufacturer. Our tests disclosed:

- Division procedures required that a Credit/Refund Form involving a destruction of tax stamps must include a reason for the destruction. Reasons for the return of tax stamps for destruction included: 1) The stamps were damaged and thus unusable; 2) The stamping machine erroneously placed tax stamps on a carton flap instead of the individual cigarette packages; or 3) The cigarette packages with tax stamps affixed were deemed to be unsalable. We found that for 10 of the 32 tested refunds or credits (approximately 31 percent), the Credit/Refund Form did not include a complete description of the reason for the transaction. For example, we could not determine whether the destroyed tax stamps were affixed to cigarette packs or were still in a roll or partial roll.
- The destruction of returned stamps was evidenced only by the signature of a Division employee. The destruction of the stamps should be witnessed, and both the witness and the employee who destroyed the stamps should sign the Credit/Refund Form or other affidavit to attest to the destruction of the stamps.

Absent complete descriptions of the reasons for the credit/refund transaction and a witness to the destruction, the Department may be unable, at a level of assurance commensurate with the risk of loss, to document the basis for credit and

refund transactions and demonstrate proper accountability for returned stamps.

Recommendation: We recommend that adequate descriptions of destroyed stamps be recorded and that destruction of stamps be witnessed and documented with an appropriately worded, signed affidavit.

Finding No. 6: Refund Requests

Each cigarette tax stamp refund request is to be input into an Access database refund log, which automatically assigns a control number each time a new refund record is created. Approved refunds are then paid and recorded in the Florida Accounting Information Resource (FLAIR), the State's accounting system.

According to FLAIR records, the amounts refunded during the audit period totaled approximately \$345,000. Effective controls, including reconciliations between the refund log and FLAIR, provide assurance that should an error occur, it will be timely detected. However, the Division did not reconcile its refund log to corresponding payment amounts shown in FLAIR. A reconciliation between the refund log and FLAIR would have increased the likelihood of the following errors being detected.

- A total of 16 control numbers were missing from the database refund log. The Department was unable to explain the reason for the missing record numbers.
- A duplicate tax stamp refund in the amount of \$434.46 was paid to a vendor. The refund request was originally paid on February 28, 2006, and again (improperly) on July 2, 2006.
- Two tax stamp refunds were paid from the wrong fund.

Recommendation: We recommend that the Division account for all refund log control

numbers and periodically reconcile the refund log to corresponding payment amounts recorded in FLAIR.

OBJECTIVES, SCOPE, AND METHODOLOGY

This operational audit focused on the procedures and practices of the Division of Alcoholic Beverages and Tobacco, related to the sale and safeguarding of the State's cigarette tax stamps.

Our objectives were:

- To evaluate the effectiveness of established internal controls in achieving management's control objectives in the categories of compliance with controlling laws, administrative rules, and other guidelines; the economic, efficient, and effective operation of State government; the validity and reliability of records and reports; and the safeguarding of assets.
- To evaluate management's performance in achieving compliance with controlling laws, administrative rules, and other guidelines; the economic, efficient, and effective operation of State government; the validity and reliability of records and reports; and the safeguarding of assets.

Our audit included examinations of various records and transactions (as well as events and conditions) occurring during the period March 2005 through July 2007. This operational audit was made in accordance with applicable Generally Accepted Government Auditing Standards. In conducting our audit we:

- Interviewed selected Department and Division personnel.
- Obtained an understanding of internal controls and observed, documented, and tested key processes and procedures related to cigarette tax stamps.
- Examined various controls and documents for maintaining cigarette tax

stamp inventories at three of the Division's district offices (Tallahassee, Tampa, and Jacksonville).

- Examined various controls and documents for the purchase and sale of cigarette tax stamp rolls at the Tallahassee, Tampa, and Jacksonville district offices (30 cigarette tax stamp rolls from a population of 32,618 cigarette tax stamp rolls purchased from March 1, 2005, through February 28, 2007).
- Examined 32 requests for credit or refund of cigarette tax stamp from a population of 118 credit and refund transactions.
- Reviewed the five-year contract between the Department and Meyercord Revenue, Inc., the manufacturer of State of Florida cigarette tax stamps.
- Performed various other auditing procedures, including analytical procedures, as necessary to accomplish the objectives of the audit.

AUTHORITY

Pursuant to the provisions of Section 11.45, Florida Statutes, I have directed that this report be prepared to present the results of our operational audit.



David W. Martin, CPA
Auditor General

MANAGEMENT RESPONSE

In a letter dated May 13, 2008, the Interim Secretary provided responses to our findings. The letter is included in its entirety at the end of this report as Appendix A.

This audit was conducted by Yueh-Lin DeGrove, CPA, and supervised by Frank Belt, CPA. Please address inquiries regarding this report to Kathryn Walker, CPA, Audit Manager, by e-mail (kathrynwalker@aud.state.fl.us) or by telephone (850-487-9085).

This report and other audit reports prepared by the Auditor General can be obtained on our Web site (<http://www.myflorida.com/audgen>); by telephone (850-487-9024); or by mail (G74 Claude Pepper Building, 111 West Madison Street, Tallahassee, Florida 32399-1450).

**APPENDIX A
MANAGEMENT RESPONSE**



**DEPARTMENT OF BUSINESS & PROFESSIONAL REGULATION
OFFICE OF INSPECTOR GENERAL**

CHARLIE CRIST
GOVERNOR

CHUCK DRAGO
INTERIM SECRETARY



May 13, 2008

David W. Martin, CPA
Auditor General
State of Florida
G74 Claude Pepper Building
111 West Madison Street
Tallahassee, FL 32399-1450

Dear Mr. Martin:

In accordance with Section 11.45(4)(d), Florida Statutes, enclosed is our response to the Auditor General's April 14, 2008 preliminary and tentative audit findings and recommendations based on an Operational Audit of the Department of Business and Professional Regulation, Division of Alcoholic Beverages and Tobacco, Cigarette Tax Stamps.

We appreciate the time and energy put forth by your staff, and your efforts to improve the operations of state government.

If you have any questions, please let me know.

Sincerely,

A handwritten signature in black ink, appearing to read "Chuck Drago".

Chuck Drago
Interim Secretary

CD/rf

Enclosure

cc: Ron Russo, Acting Deputy Secretary of Professional Regulation
Ron Ferguson, Acting Inspector General
Cynthia Hill, Director, Division of Alcoholic Beverages and Tobacco

APPENDIX A
MANAGEMENT RESPONSE (CONTINUED)

Department of Business and Professional Regulation
Division of Alcoholic Beverages and Tobacco
Response to Findings and Recommendations
Auditor General Report
Cigarette Tax Stamps

Finding No. 1:

The Division did not adequately monitor its contractor's manufacture, storage, and destruction of tax stamps.

Recommendation:

We recommend that the Department monitor Meyercord's tax stamp production process. Monitoring procedures should include:

- Periodic site visits by Department personnel to Meyercord, and
- Performance of periodic reconciliations of production data and related analyses and investigations of significant variances.

Agency Response:

We agree with this finding.

The Bureau of Auditing has not made a site visit to the Meyercord stamp manufacturing plant, and has not reconciled their production records with stamp receipts. Our procedures are being revised to include the audit and analysis necessary to reconcile production data certified by Meyercord to the stamps received by the department. These procedures should be completed and the reconciliation practices in place by June 30, 2008. A site visit is planned for this fiscal year, and costs for such visits will be included in future budget allotments.

Finding No. 2:

Controls over the Division's district office tax stamp inventory vaults could be improved.

Recommendation:

We recommend that the Department implement policies and procedures to enhance vault security at its district offices.

Agency Response:

We agree with this finding.

All of our district offices do not currently have the capabilities of accessing a vault access log, and those that do have the capabilities have not utilized the logs to monitor access to the stamp vaults. The Bureau of Auditing is working with the three different alarm companies for the various district stamp vaults to obtain the vault access logs. The cost of upgrading the security services to include the access logs is being determined, and the capability for monitoring the access is being implemented. Written policies and procedures are being revised to include the proper issuance, use, and maintenance of vault security codes and the review of vault access logs. Field office inspections are being revised to include inspections and reviews of the cigarette vault access procedures

APPENDIX A
MANAGEMENT RESPONSE (CONTINUED)

Department of Business and Professional Regulation
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to ensure that vault security is enhanced in each district office. The revised procedures and the office inspections will be fully implemented by June 30, 2008.

Finding 3:

District offices did not always perform required observations of the physical inventory counts of stamping agents.

Recommendation:

We recommend the Division perform inventory observations as required by Division procedures.

Agency Response:

We agree with this finding.

Instate cigarette wholesalers are audited on a semi-annual basis, with a physical inventory taken at each warehouse. Unlike Florida based distributors, cigarette stamping agents located outside of Florida do not normally carry a stamped inventory of cigarettes for Florida. The cigarettes are stamped as needed for sales into Florida. With this lack of stamped inventory, and ever present budget constraints, the Bureau of Auditing has placed a lower priority on performing physical inventory observations at the out of state locations. However, the Bureau is now scheduling field visits to several of these locations within the fourth quarter of this fiscal year, and will schedule periodic visits in the future. During these audits, procedures for stamping Florida taxed cigarettes will be observed, and a review of their records will be conducted to assure that all cigarettes sold in Florida are being taxed and that the appropriate taxes are being submitted to the division. As these audits are performed, a determination will be made as to the frequency of future audits necessary to assure compliance by out of state wholesalers with Florida tax laws.

Finding 4:

Subsidiary records maintained to account for credit sales to stamping agents were not always complete.

Recommendation:

We recommend the Bureau take steps to ensure all transactions are accurately recorded in stamping agent subsidiary records.

Agency Response:

We agree with this finding.

Our cigarette stamp accounting system is a manual system of logging in cigarette stamp sales and then posting the sales to individual account ledger cards. The Division does not have a computerized system that will record, track, and account for our cigarette stamp

APPENDIX A
MANAGEMENT RESPONSE (CONTINUED)

Department of Business and Professional Regulation
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inventories or sales. While training a new employee to sell cigarette stamps, some postings to the applicable ledger cards were overlooked by our Jacksonville office. The postings have now been recorded and the resulting miss-payment corrected. Internal procedures will be reviewed to assure that steps are taken to prevent any future errors. In addition, during the processing of monthly reports and payments, the ledger cards will be verified to the reports, and unrecorded sales should be revealed. During an audit, the payments will be verified in the FLAIR system, again reconciling payments to amounts due. Field office inspections are being revised to include inspections and reviews of the cigarette sales recording procedures, which will ensure that all transactions are accurately recorded in the stamping agent subsidiary records. The new office inspection procedures will be fully implemented by June 30, 2008.

Finding 5:

Tax refunds, credits, and stamp destruction were not always appropriately documented.

Recommendation:

We recommend that adequate descriptions of destroyed stamps be recorded and that destruction of stamps be witnessed and documented with an appropriately worded, signed affidavit.

Agency Response:

We agree with this finding.

The credit/refund form used by the Division to process credit or refund requests for cigarette tax stamps destroyed or returned to the manufacturer can be confusing. The form has signature spaces for both the licensee and the division representatives, which are used to support either the licensee's claim for returned product, or the licensee and Division's affirmation of the stamps destroyed. However, without specific wording, it can be confusing as to what is being confirmed. We have revised the form to include specific spaces for the different scenarios, including a descriptive area for any destruction, and a signature area that will give the licensee and the division representative's attestation to their particular areas. Our procedures are being revised to include the approval of the district supervisor for the destruction of stamps, and should be implemented by June 30, 2008. The form has been placed on our Internet site, and the auditors and supervisors will be instructed in the use of the new form in our May supervisors and auditors meetings.

Finding 6:

Subsidiary records relating to tax refunds paid to stamping agents were not routinely reconciled to general ledger accounting records.

**APPENDIX A
MANAGEMENT RESPONSE (CONTINUED)**

**Department of Business and Professional Regulation
Division of Alcoholic Beverages and Tobacco
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Recommendation:

We recommend that the Division account for all refund log control numbers and periodically reconcile the refund log to corresponding payment amounts recorded in FLAIR.

Agency Response:

We agree with this finding.

Our refund log was created about ten years ago by a casual user of Microsoft Access, to assist in our refund process. It does not have all the controls in place that a professionally developed application should have, including the proper treatment of records that are not valid. Until the database can be revised, our staff members have been instructed to maintain a documented accounting of all refund log control numbers. On April 17th, the Bureau of Auditing was provided access to an area of FLAIR that will allow us to verify that all refunds issued are subsequently paid by the Treasurer's Office. Written procedures will be developed encompassing all aspects of the refund process, including the requirements for the new form and monthly reconciliation of refund applications to refund payments. The estimated completion date for implementation of the written procedures is June 30, 2008.

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