

DEPARTMENT OF REVENUE

**CURRENT AUDIT FINDINGS AND RECOMMENDATIONS**

Financial Statement Audit Findings:

**Finding No. 2014-005:**

Internal controls were not adequate to 1) ensure that information being accepted from the banks is sufficient to verify the amount remitted is accurate, and 2) ensure bank taxes were accurately recorded and distributed on the State's accounting system and reported properly in the State's financial statements. This is the third consecutive audit to contain a similar finding.

*Type of Finding:* Significant Deficiency

Analysis:

During fiscal year 2014, the Department of Revenue (DOR) did not have adequate policies and procedures in place over the collection and recording of Bank Taxes. The lack of formal policies and procedures reduced the effectiveness of the controls that ensure that Bank Taxes were accurately recorded and reported. We noted the following errors:

- The periods in which the state tax returns were recorded were not consistent:
  - Five returns were delinquent and did not appear so on the DOR's system, one return erroneously appeared delinquent and was not and one bank taxpayer had more than one return marked with the same period.
- We found multiple variances on State return calculations and some returns were missing information. Four of the variances required follow-up; however, there was no formal policy on how or when follow-up procedures are performed.
- We noted errors that were made when recording payments in the taxpayers' individual ledgers:
  - One taxpayer was consolidated during the year, however; the payments were not properly moved to the correct bank ledger.
  - Three payments of \$400,000, \$300,000 and \$20,000 were posted to the wrong period on the individual taxpayer ledgers. This information was then utilized for reporting purposes, causing inaccuracies in the amount reported on the State's financial statements.

RECOMMENDATION:

1. We recommend that controls be implemented to ensure that bank taxes are accurately recorded and distributed on the State's accounting system.

Auditee's Corrective Action Plan:

During fiscal year 2014, the Department converted administration of the bank franchise tax from an Access database to the department's Cedar tax system. During the conversion, we identified inconsistencies with return periods and whether returns were indicated as delinquent, particularly for taxpayers whose tax year does not correspond with the calendar year. These inconsistencies were corrected at that time so no ongoing corrective action is necessary.

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The conversion to Cedar now allows for electronic filing and payment of the bank franchise tax. Utilizing electronic filing and payment of bank franchise tax also eliminates return calculation errors and immediately identifies returns which have been filed without attaching the federal income tax return. Returns filed via paper are encoded into the Cedar tax system which immediately identifies calculation discrepancies between the taxpayer and the Department. Statements of Account (i.e. Billing Notices) are sent monthly to taxpayers who have balances due or delinquent returns and quarterly to taxpayers who have credit balances.

The Bank Franchise Tax Specialist, also hired during fiscal year 2014, follows up with any taxpayer who has failed to include the requisite information with their return. The Bank Franchise Tax Specialist is developing a procedures manual to document a formal policy on how and when follow up is performed for specific situations.

The Department agrees there were estimated quarterly payments identified as an incorrect tax year on a taxpayer's ledger. Utilizing electronic payments will reduce the occurrence of this by requiring the taxpayer to identify the tax period but it may be difficult to develop absolute internal controls to completely eliminate this issue without repealing the requirement for taxpayers to make quarterly estimated payments.

**Finding No. 2014-006:**

Internal controls were not adequate to 1) ensure proper distribution of cigarette excise tax to tribal entities and 2) ensure proper reporting of the State's liability. This is the second consecutive audit to contain a similar finding.

*Type of Finding:* Significant Deficiency

**Analysis:**

As authorized by SDCL 10-50, the State imposes a tax on cigarettes held for sale. The Department of Revenue (DOR) is required to revert back the tax collected on the tribal reservations according to separate collection agreements with each individual tribe. To verify the number of cigarettes sold on each reservation, the DOR requires cigarette distributors to report the number of cigarettes sold on the reservation and submit the information to the DOR by the 10<sup>th</sup> of each month. The Department does not track which distributors are required to file this report or if the reports are filed as required. This resulted in incorrect distribution of cigarette taxes to tribal entities and inaccurate reporting of the State's liabilities in the amount of \$11,239.37.

**RECOMMENDATION:**

2. We recommend that controls be implemented to ensure cigarette distribution reports are submitted timely to the DOR and also reviewed to ensure that reversions to tribal reservations are accurate.

**Auditee's Corrective Action Plan:**

The DOR requested the inclusion of their response to the prior year audit finding no. 2013-003 which states:

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“The Department of Revenue concurs with the audit findings and has implemented additional procedures to strengthen internal controls.

To ensure that cigarette distribution reports indicating sales on any of the eight Indian country areas are submitted on a timely basis, the Department is establishing the following procedures:

1. Include a notice of the requirement to report any cigarette sales, by Indian country area, on any of the eight Indian country areas in the annual license renewal for tobacco distributors and wholesalers. This notice will also include the requirement to report cigarette sales by the 10<sup>th</sup> of the month following the sales.
2. Continue to utilize the spreadsheet developed to track the licensees who are reporting this tax. The Department will notify any licensee who has not submitted reports by the 10<sup>th</sup> of each month, and document the contact in the Department’s tax system.
3. The Department will explore statutory changes to require tobacco wholesalers and distributors to file reports timely subject to monetary penalties and/or licensure action.

Educating the taxpayers on the requirement to report this information and to report on a timely basis will ensure the Department properly reports the State’s liability.”

The Department will also redesign the tobacco distributor/wholesaler application in an effort to better identify the licensees who are selling cigarettes on tribal reservations. Additionally, the Department will initiate tracking and documentation of all contact with licensees who have not submitted the required reports by the 10<sup>th</sup> of each month. The documentation will be updated to track all changes.

**Finding No. 2014-007:**

Internal controls over the physical inventory of cigarette stamps are not adequate.

*Type of Finding:* Significant Deficiency

Analysis:

There is a lack of oversight in the processing of cigarette tax stamps with one employee being responsible for receiving customer orders and payments, filling the orders, updating the perpetual inventory sheet, and being responsible for inventory that has been lost or damaged.

Procedures for conducting periodic inventories of cigarette tax stamps are not being conducted adequately. Physical inventories were not conducted at regularly scheduled times or at the intervals documented by the DOR, resulting in an increased risk of physical inventory errors going undetected.

**RECOMMENDATIONS:**

3. We recommend that additional oversight controls be implemented to ensure lost or returned inventory is adequately documented and duties in the processing of this inventory be segregated.
4. We recommend that procedures be developed for conducting regularly scheduled physical inventory counts of cigarette tax stamps.

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Auditee's Corrective Action Plan:

To the extent possible, the Department is segregating duties related to cigarette stamps. See our internal control document for cigarette excise tax. While it is extremely rare for cigarette stamps to be lost during shipping, a written internal control policy will be prepared and implemented to address the necessary processes in the event the situation occurs in the future.

The Department will change the frequency of the physical inventory counts of cigarette stamps from a quarterly basis to a monthly basis, and will perform this routinely on the last business day of each month. The inventory counts are being recorded in an excel spreadsheet which is utilized to track and document the process. Additionally, the policy is being updated to ensure the physical inventory will be conducted by two employees of the Department of Revenue.