

Audit Report

**Comptroller of the Treasury
Field Enforcement Division**

July 2008



OFFICE OF LEGISLATIVE AUDITS
DEPARTMENT OF LEGISLATIVE SERVICES
MARYLAND GENERAL ASSEMBLY

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Karl S. Aro
Executive Director

DEPARTMENT OF LEGISLATIVE SERVICES
OFFICE OF LEGISLATIVE AUDITS
MARYLAND GENERAL ASSEMBLY

Bruce A. Myers, CPA
Legislative Auditor

July 2, 2008

Senator Verna L. Jones, Co-Chair, Joint Audit Committee
Delegate Steven J. DeBoy, Sr., Co-Chair, Joint Audit Committee
Members of Joint Audit Committee
Annapolis, Maryland

Ladies and Gentlemen:

We have audited the following divisions of the Comptroller of the Treasury for the periods noted:

Field Enforcement Division (FED) – July 1, 2007 to December 31, 2007
Regulatory and Enforcement Division (RED) – July 1, 2005 to June 30, 2007
Motor Fuel Tax Division (MFTD) – December 8, 2003 to September 30, 2005

Certain organizational changes that occurred within the Office of the Comptroller are explained on pages 3 and 4 of this audit report.

Our audit disclosed that FED did not perform physical inventories of confiscated property as required, record applicable transactions in the detail inventory records in a timely manner, and establish adequate internal controls over cash received from the sale of confiscated goods.

Respectfully submitted,

Bruce A. Myers, CPA
Legislative Auditor

Background Information

Organizational Changes and Agencies' Responsibilities

Effective October 1, 2005, certain duties and responsibilities within the Comptroller of the Treasury were reorganized. Specifically, the Motor Fuel Tax Division was merged into the Regulatory and Enforcement Division (RED).

RED was responsible for the administration of the laws and regulations governing 1) State motor fuel and motor carrier taxes, and 2) the manufacture, storage, transportation, sale, and distribution of alcoholic beverages and tobacco. RED was also responsible for the enforcement of trade practice regulations and revenue laws related to alcoholic beverages, tobacco, motor fuel, and sales and use taxes. Furthermore, RED was responsible for collecting excise taxes on alcoholic beverages and tobacco, reviewing motor carrier tax returns and refund requests, and performing certain licensing functions.

Subsequently, the Comptroller of the Treasury reorganized RED into two separate divisions effective July 1, 2007. Specifically, certain responsibilities were transferred from RED to create the Motor-fuel, Alcohol and Tobacco Tax Division (MATT), and the name of RED was changed to the Field Enforcement Division (FED) for the remaining responsibilities. These organizational changes are illustrated in the diagram on page 4 of this report.

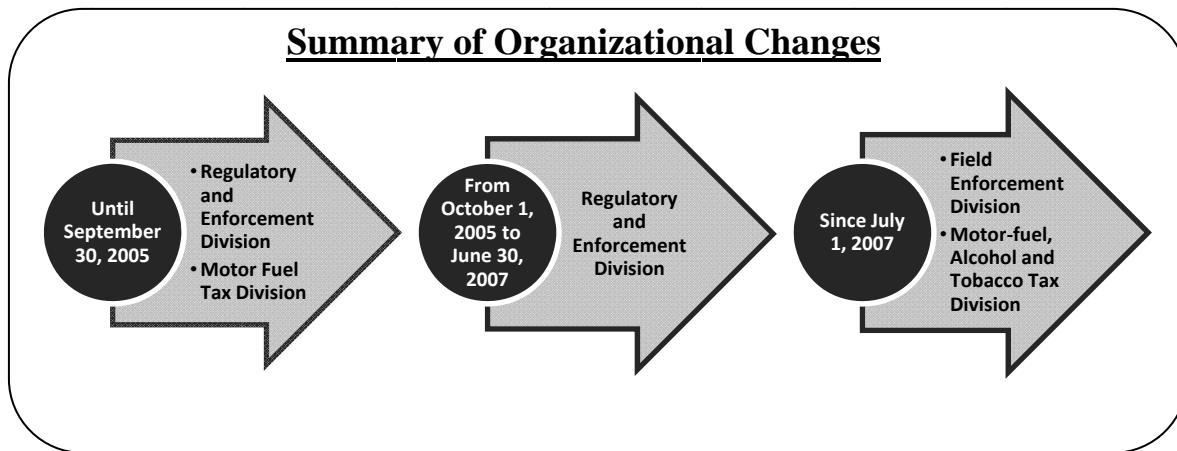
FED is responsible for the enforcement of trade practice regulations and revenue laws related to alcoholic beverages, tobacco, motor fuel, and sales and use taxes. Additionally, FED is responsible for the issuance of certain business licenses and testing motor fuel quality.

MATT administers laws and regulations pertaining to the manufacture, storage, transportation, sale, and distribution of alcoholic beverages, tobacco, and motor fuel, and collects the related excise taxes. MATT's primary responsibilities consist of reviewing alcohol, tobacco and motor carrier tax returns and refund requests, and performing certain licensing functions. Certain responsibilities of MATT have been delegated to other units within the Comptroller of the Treasury. For example, processing and distributing of alcohol and tobacco tax receipts and motor fuel tax receipts are the responsibility of the Revenue Administration Division.

According to the records of the Comptroller of the Treasury, revenues applicable to alcohol and tobacco taxes totaled approximately \$308 million during fiscal year 2007. Those same records showed that net revenues applicable to motor fuel and

motor carrier taxes and related fees totaled approximately \$755.7 million during fiscal year 2007. In accordance with State law, after deducting \$7.8 million for administrative costs, the remaining \$747.9 million were distributed to the Transportation Trust Fund (\$731.3 million), other special programs (\$3.4 million) and the General Fund (\$13.2 million).

The scope of this audit includes the activities of FED and the related former divisions for the periods outlined in the cover letter of this report. We will separately audit and report on the activities of MATT.



Status of Findings From Preceding Audit Reports

We reviewed the status of the two findings included in our preceding audit report of the former Regulatory and Enforcement Division, dated November 1, 2005. We determined that this Division satisfactorily addressed these two findings. We also reviewed the status of the six findings included in our preceding audit report of the former Motor Fuel Tax Division, dated June 1, 2004. We determined that these six findings were satisfactorily addressed.

Findings and Recommendations

Confiscated Property

Finding 1

The Field Enforcement Division (FED) did not perform physical inventories of confiscated property and update the related inventory records as required. In addition, controls over cash received from sales of confiscated property were inadequate.

Analysis

Physical inventories of confiscated property were not performed as required and the related inventory records were not updated timely. In addition, controls over cash received from sales of confiscated property were inadequate. Specifically, we noted the following conditions:

- As of January 2008, FED had not conducted a physical inventory of confiscated property since May 2005. FED's *Procedures Manual* requires that a physical inventory of all confiscated property be completed every six months. In addition, FED had not updated the detail inventory records to reflect sales and destructions of confiscated items since January 2007. For example, during the period from January 2007 to January 2008, FED completed three bulk sales of confiscated items (such as 100,000 packs of cigarettes) totaling approximately \$185,000. In addition, the aforementioned inventory records had not been updated to reflect 16,700 packs of cigarettes, approximately 2,800 containers of alcohol and 27,000 tins of chewing tobacco that had been sold, returned or destroyed prior to January 2007.
- Cash receipts from sales of confiscated property (including motor vehicles) were received by employees responsible for completing such sales. Although such checks were to be forwarded to the Accounting Department for deposit, the Department may not readily identify any checks that were not received since it was not provided documentation alerting it to pending sales of confiscated property. As a result, the related cash receipts could potentially be misappropriated without detection. As previously noted, during the period from January 2007 to January 2008, FED collected approximately \$185,000 from sales of confiscated property.

According to its records, during fiscal year 2007, FED confiscated approximately 50,000 packs of cigarettes and 6,600 containers of alcohol (beer, wine and distilled spirits) valued at approximately \$207,000 and \$175,000, respectively.

Recommendation 1

We recommend that FED maintain the inventory records of confiscated property on a current basis and conduct physical inventories of confiscated property every six months as required. We also recommend that FED require that individuals and entities that purchase confiscated property remit related payments directly to the Accounting Department. We advised FED on accomplishing the necessary separation of duties using existing personnel.

Audit Scope, Objectives, and Methodology

We have audited the following divisions of the Comptroller of the Treasury for the periods noted:

Field Enforcement Division (FED) – July 1, 2007 to December 31, 2007

Regulatory and Enforcement Division (RED) – July 1, 2005 to June 30, 2007

Motor Fuel Tax Division (MFTD) – December 8, 2003 to September 30, 2005

The audit was conducted in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

As prescribed by the State Government Article, Section 2-1221 of the Annotated Code of Maryland, the objectives of this audit were to examine the divisions' financial transactions, records and internal control, and to evaluate compliance with applicable State laws, rules, and regulations. We also determined the status of the eight findings included in our preceding audit reports on the former Regulatory and Enforcement Division (two findings) and the former Motor Fuel Tax Division (six findings).

In planning and conducting our audit, we focused on the major financial-related areas of operations based on assessments of materiality and risk. Our audit procedures included inquiries of appropriate personnel, inspections of documents and records, and observations of the divisions' operations. We also tested transactions and performed other auditing procedures that we considered necessary to achieve our objectives. Data provided in this report for background or informational purposes were deemed reasonable, but were not independently verified.

Our audit did not include a review of certain support services provided to the divisions by the Comptroller of the Treasury – Office of the Comptroller. These support services (such as processing of invoices, maintenance of accounting records, and related fiscal functions) are included in the scope of our audits of the Office of the Comptroller. Our audit also did not include certain support services provided to the divisions by the Comptroller of the Treasury – Information Technology Division related to the procurement and monitoring of information technology equipment and services. These support services are included in the scope of our audits of the Information Technology Division.

Our audit scope was limited with respect to certain of MFTD's cash transactions because the Office of the State Treasurer was unable to reconcile the State's main bank accounts during a portion of the audit period. Due to this condition, we were unable to determine, with reasonable assurance, that all MFTD cash transactions prior to July 1, 2005 were accounted for and properly recorded on the related State accounting records as well as the banks' records.

The divisions' management is responsible for establishing and maintaining effective internal control. Internal control is a process designed to provide reasonable assurance that objectives pertaining to the reliability of financial records, effectiveness and efficiency of operations including safeguarding of assets, and compliance with applicable laws, rules, and regulations are achieved.

Because of inherent limitations in internal control, errors or fraud may nevertheless occur and not be detected. Also, projections of any evaluation of internal control to future periods are subject to the risk that conditions may change or compliance with policies and procedures may deteriorate.

Our reports are designed to assist the Maryland General Assembly in exercising its legislative oversight function and to provide constructive recommendations for improving State operations. As a result, our reports generally do not address activities we reviewed that are functioning properly.

This report includes a finding related to a condition that we consider to be a significant deficiency in the design or operation of internal control that could adversely affect FED's ability to maintain reliable financial records, operate effectively and efficiently, and/or comply with applicable laws, rules, and regulations. Our audit did not disclose any significant instances of noncompliance with applicable laws, rules or regulations. Other less significant findings were communicated to the divisions that did not warrant inclusion in this report.

The Office of the Comptroller's response, on behalf of FED, to our findings and recommendations is included as an appendix to this report. As prescribed in the State Government Article, Section 2-1224 of the Annotated Code of Maryland, we will advise the Office regarding the results of our review of its response.

APPENDIX



Peter Franchot
Comptroller

Linda L. Tanton
Deputy Comptroller

June 30, 2008

Mr. Bruce A. Myers, CPA
Legislative Auditor
Department of legislative Services
Office of Legislative Audits
301 West Preston Street, Room 1202
Baltimore, MD 21201

Dear Mr. Myers:

We are in receipt of your report on the recent audit of the Comptroller's Field Enforcement Division (FED) and the Motor-fuel, Alcohol & Tobacco Tax Regulatory Division (MATT) for the period ending December 31, 2007. The Comptroller appreciates your objective appraisal of our operations and your recommendations for continuous improvement, and commends your auditors for their professionalism and thorough review.

In response to your auditors' recommendation, FED implemented a revised and comprehensive inventory control procedure that requires, *inter alia*, annual physical inventories of 100% of confiscated property, which has already begun. In addition, the procedure requires perpetual inventory adjustments to reflect all acquisitions and dispositions of confiscated property. Also in response to the recommendation, FED has revised their procedures to require that checks received pursuant to sales of confiscated property be remitted directly to the Accounting Department and have developed additional procedures to segregate cash-handling duties, all as discussed with your auditors. We have assigned responsible FED personnel to monitor compliance with the procedures.

We trust you will agree that the reported actions indicate satisfactory implementation of the audit recommendation. Please direct any questions to Rhea R. Reed, Director of Internal Audit. You may contact her by telephone at (410) 260-6252, or by email at rreed@comp.state.md.us.

Yours truly,

A handwritten signature in black ink, appearing to read "Linda E. Tanton".

Linda E. Tanton
Deputy Comptroller

A handwritten signature in black ink, appearing to read "J. A. Kelly".

Jeffrey A. Kelly
Director, Field Enforcement Division

cc: Peter Franchot, Comptroller

AUDIT TEAM

Peter J. Klemans, CPA
Audit Manager

W. Thomas Sides
Senior Auditor

Adam M. Auerback
Staff Auditor