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STATE OF NEW YORK
OFFICE OF THE STATE COMPTROLLER

November 23, 2004

Mr. Andrew S. Eristoff
Commissioner
Department of Taxation and Finance
State Office Campus - Building #9
Albany, NY 12227

Re: Report 2004-F-33

Dear Mr. Eristoff:

Pursuant to the State Comptroller's authority as set forth in Article V, Section 1 of the State Constitution; and Article II, Section 8 of the State Finance Law, we have followed up on the actions taken by officials of the Department of Taxation and Finance (Department) to implement the recommendations contained in our audit report, *Selected Controls over Cigarette Licensing and Excise Taxes* (Report 2002-S-58).

Background, Scope and Objectives

The New York State Tax Law (Law) authorizes the Commissioner of the New York State Department of Taxation and Finance (Department) to levy and collect a cigarette excise tax (excise tax) on all cigarettes for use and/or sale in New York State (State). The Department collects this tax through the sale of tax stamps (to be affixed to each pack of cigarettes) to its licensed cigarette-stamping agents. Agents subsequently sell the cigarettes, with the appropriate tax stamp (State-only or joint State/New York City) to licensed cigarette wholesalers, who then sell them to retailers for sale to the general public. Tax stamps are manufactured under contract by Meyercord, Inc., located in Illinois. Excise tax revenue from the sale of tax stamps to licensed agents is collected, accounted for and distributed to the State and New York City by Fleet Bank (Fleet) under contract with the State. For the fiscal year ended March 31, 2004, excise tax revenue and licensing fees exceeded \$1 billion.

Our initial audit report, which was issued on October 21, 2003, examined controls over the Department's cigarette licensing and excise tax revenue. Our report found that the Department should take some additional steps to strengthen its controls over cigarette licensing and excise tax revenues. Our audit identified a need to improve procedures to detect unregistered retailers, a need to follow up on overdue excise taxes and a need to better control the cigarette tax stamp process. The objective of our follow-up, which was conducted in accordance with Generally Accepted Government Auditing Standards, was to assess the extent of implementation as of October 29, 2004 of the eight recommendations included in our initial report.

Summary Conclusions and Status of Audit Recommendations

We found that Department officials have made significant progress in correcting the problems we identified. Our review identified that all eight prior recommendations have been implemented.

Follow-up Observations

Recommendation 1

Expedite the development of the website for wholesalers to use to confirm that retailers possess a valid C of R.

Status - Implemented

Agency Action - The Department recently made operational a website that wholesalers can use to confirm that retailers possess a valid Certificate of Registration (C of R). This web site shows the status of each retailer and each wholesaler as active, inactive or suspended.

Recommendation 2

Develop written procedures which require TSRD to provide both Enforcement and licensed wholesalers with information identifying retailers who have not renewed their cigarette registration.

Status - Implemented

Agency Action - The Department established procedures to notify the Office of Tax Enforcement (OTE) of retailers who did not renew their C of R. This procedure will document the process of identifying a retailer that did not renew their registration. Those identified will be sent a “failure to file” letter reminding them of their obligation to renew their registration. If the Department does not receive a response to this letter, the information will be referred to OTE for appropriate action.

Recommendation 3

Continue to follow up on and investigate the exceptions disclosed during our visits to selected retailers and as appropriate impose penalties on those retailers in violation of the Law.

Status - Implemented

Agency Action - OTE has completed their investigation of exceptions and the Transaction & Transfer Tax Bureau (TTTB) has imposed appropriate penalties.

Recommendation 4

Follow up with agents, wholesalers and retailers who failed to file or filed a zero-dollar return but had inventory on hand as of the Department's physical inventory counts.

Status - Implemented

Agency Action - The Department has followed up and investigated those retailers and wholesalers who had failed to file or filed a zero-dollar return but had inventory counts. All discrepancies were initially addressed by September 2003; all unresolved cases were billed in February 2004.

Recommendation 5

Investigate all large discrepancies between the Department's calculated potential liability and the actual amount of remittance.

Status - Implemented

Agency Action - The Department has followed up and investigated all large discrepancies between the Department's calculated potential floor tax liability and the actual amount of remittance. This was completed in June 2003.

Recommendation 6

Develop and provide formal written procedures to the Midwestern Regional Office (MRO) auditors for monitoring the stamp production and shipment process. Conduct periodic visits to Meyercord to determine whether MRO auditors are complying with procedures.

Status - Implemented

Agency Action - In July 2003, the Department updated its written procedures related to the destruction of stamps and have identified contract language that provides specific guidance on responsibilities for production, distribution and storage. Further, the supervisor of MRO operations in Chicago now makes periodic site visits to Meyercord to determine whether MRO auditors are complying with procedures.

Recommendation 7

Work with Fleet officials to develop formal written procedures for managing the tax stamp inventory at Fleet's six emergency sites. Conduct periodic site visits to determine whether the stamp inventory is accounted for and properly managed in accordance with procedures.

Status - Implemented

Agency Action - The Department has revised their emergency site procedures. In addition, the Department has developed procedures for performing reviews at the emergency cigarette tax stamp sites and officials provided us with the results of their 2004 review of these emergency sites. Officials have scheduled additional visits for November 2004.

Recommendation 8

Require Fleet to maintain records that accurately show the name of the stamp custodian at each emergency site.

Status - Implemented

Agency Action - Officials provided us with the names of the custodians of the cigarette tax stamps at the six emergency sites. They had received this information from Fleet Bank in August 2004.

Major contributors to this report were Brian Mason, Arthur F. Smith and David Pleeter.

We thank the management and staff of the Department for the courtesies and cooperation extended to our auditors during this process.

Very truly yours,

Steven E. Sossei
Audit Director

cc: Robert Barnes, Division of the Budget
Andrew Maguire, Department of Taxation and Finance