



John Keel, CPA
State Auditor

A Follow-up Audit Report on The Alcoholic Beverage Commission's Excise Tax Collection Process

June 29, 2012

Members of the Legislative Audit Committee:

The Alcoholic Beverage Commission (Commission) fully implemented 8 (53 percent) of 15 recommendations that auditors selected for follow-up from *An Audit Report on the Alcoholic Beverage Commission's Excise Tax Collection Process* (State Auditor's Office Report No. 10-010, October 2009). Specifically, of the 15 recommendations selected for follow-up audit work:

- The Commission fully implemented 4 of the 8 recommendations related to its excise tax collection processes.
- The Commission fully implemented 4 of the 7 recommendations related to its information resources.

While the Commission has made progress in implementing the prior audit recommendations, it should continue its efforts to improve processes related to its excise tax reports, training, and information resources. Specifically:

- The Commission did not appropriately review excise tax reports submitted by wholesalers and distributors. The Commission's supervisory reviews were not in compliance with its *Excise Tax Report Procedures Manual*. In addition, the Commission did not retain supporting invoices for excise tax reports until a supervisor could perform a review.
- The Commission did not develop policies and procedures to document the amount and type of required and recommended training for regional field auditors. In addition, the Commission did not appropriately maintain supporting documentation necessary to validate the training that regional auditors attend or complete.

During review of the implementation status of prior audit recommendations, auditors determined that the Commission's excise tax audit data in its Agency Reporting and Tracking System (ARTS) was incomplete and unreliable. Specifically, data was missing from the audit date field, and the system lacked status updates on audits that had been started but not completed.

Auditors communicated other, less significant issues related to excise tax audits and training documentation to the Commission's management separately in writing.

Background Information

In October 2009, the State Auditor's Office issued *An Audit Report on the Alcoholic Beverage Commission's Excise Tax Collection Process* (State Auditor's Office Report No. 10-010). Auditors selected all 15 recommendations in that report for follow-up based on Commission management's original responses to the recommendations, the Commission's subsequent self-reported recommendation implementation status and implementation dates, and the level of risk.

Implementation Status Definitions

Fully Implemented - Successful development and use of a process, system, or policy to implement a prior recommendation.

Substantially Implemented - Successful development but inconsistent use of a process, system, or policy to implement a prior recommendation.

Incomplete/Ongoing - Ongoing development of a process, system, or policy to address a prior recommendation.

Not Implemented - Lack of a formal process, system, or policy to address a prior recommendation.

SAO Report No. 12-040

Table 1 provides additional details on the Commission’s implementation of prior State Auditor’s Office recommendations.

Table 1

Status of Implementation of Prior Audit Recommendations				
No.	Recommendation	Implementation Status as Reported by the Commission	Implementation Status as Determined by Auditors	Auditor Comments
Recommendations Regarding the Commission’s Excise Tax Processes				
1	The Commission should rotate assignments for Tax Division employees who conduct the initial reviews of excise tax reports.	Fully Implemented	Incomplete/Ongoing	The Commission asserted that it rotated assignments for Tax Division employees who conduct the initial reviews of excise tax reports; however, the Commission did not continue to rotate assignments.
2	The Commission should ensure that supervisory reviews are conducted and documented for a sample of excise tax reports that includes reports with and without identified errors.	Fully Implemented	Incomplete/Ongoing	The Commission’s supervisory reviews were not consistent and in compliance with its current <i>Excise Tax Report Procedures Manual</i> . Specifically, the Commission destroyed the supporting invoices for the excise tax reports without errors before a supervisor could perform a review.
3	The Commission should ensure that it retains supporting documentation for all excise tax reports for an appropriate length of time determined by Commission management to verify the accuracy and completeness of tax payments due to the State.	Fully Implemented	Incomplete/Ongoing	The Commission did not retain supporting documentation for all excise tax reports for an appropriate length of time to allow the supervisory reviewer to verify the accuracy and completeness of tax payments due to the State.
4	The Commission should ensure that regional field auditors complete audit documentation in accordance with the Commission’s <i>Excise Tax Manual</i> .	Fully Implemented	Fully Implemented	The Commission’s regional field auditors completed audit documentation in accordance with the Commission’s <i>Field Operator’s Audit Manual</i> .
5	The Commission should develop and implement standard procedures for its regional offices to use when selecting distributors and wholesalers for excise tax audits. The Commission should consider including procedures for a risk-based approach to planning audits.	Fully Implemented	Fully Implemented	The Commission developed and implemented standard procedures for a risk-based approach when selecting distributors and wholesalers for excise tax audits.
6	The Commission should ensure that it conducts Ports of Entry Bridge Excise Tax audits in a timely manner.	Fully Implemented	Fully Implemented	The Commission conducted Ports of Entry Bridge Excise Tax audits in a timely manner.
7	The Commission should develop and implement approved, written policies and procedures for its regional offices to use when conducting Ports of Entry Bridge Excise Tax audits. These policies should include guidance on the selection and approval of bridges to audit.	Fully Implemented	Fully Implemented	The Commission developed and implemented approved, written policies and procedures for Ports of Entry Bridge Excise Tax audits. According to the documented policies and procedures, the Ports of Entry division director, regional manager, and quality control shall develop an audit schedule during each fiscal year to help ensure that the Commission audits each ports of entry district.

Status of Implementation of Prior Audit Recommendations				
No.	Recommendation	Implementation Status as Reported by the Commission	Implementation Status as Determined by Auditors	Auditor Comments
8	<p>The Commission should ensure that it develops and implements written policies and procedures for:</p> <ul style="list-style-type: none"> ▪ The amount and type of required and recommended training for regional field auditors. ▪ Compiling and retaining supporting documentation necessary to validate the training that regional auditors attend or complete. 	Fully Implemented	Incomplete/Ongoing	<p>The Commission did not develop policies and procedures for regional field auditor training. The Commission did not have sufficient documentation necessary to verify whether auditors attended and completed the required/recommended training courses required by the in-house training curriculum.</p>
Recommendations Regarding the Commission's Information Technology				
9	The Commission should review each employee's access to Agency Reporting and Tracking System (ARTS) to ensure that access is appropriately limited to only the level necessary for the employee's job duties.	Incomplete/Ongoing	Incomplete/Ongoing	As of April 2012, the Commission was planning additions to ARTS, including limiting employee access as a part of the Case Management-At Risk database project. The target implementation date is September 2012.
10	The Commission should implement edit checks within the ARTS that capture not only who makes changes but also what change was made and which record was affected.	Incomplete/Ongoing	Incomplete/Ongoing	The Commission plans to add edit checks to ARTS as a part of the Case Management-At Risk database project. The target implementation date is September 2012.
11	The Commission should implement a process that requires Commission management to periodically review the change tracking log and approve changes made to ARTS.	Incomplete/Ongoing	Incomplete/Ongoing	The Commission plans to add change tracking in ARTS as a part of the Case Management-At Risk database project. The target implementation date is September 2012.
12	The Commission should design and implement access controls within the LicenseEase system that limit employees' access to the level that is appropriate for each employee's job needs.	Fully Implemented	Fully Implemented	The Commission periodically reviewed access to Versa Regulation, which replaced the LicenseEase system.
13	The Commission should determine whether unlimited access is required for any one user of the LicenseEase system and make adjustments to reflect this determination.	Fully Implemented	Fully Implemented	The Commission limited database administrator access to Versa Regulation, which replaced the LicenseEase system, to information resources division staff.
14	The Commission should ensure that it complies with the State's information security standards as defined in Title 1, Texas Administrative Code, Chapter 202.	Substantially Implemented	Fully Implemented	The Commission made appropriate changes to its information technology controls to improve its compliance with the State's information security standards.

Status of Implementation of Prior Audit Recommendations				
No.	Recommendation	Implementation Status as Reported by the Commission	Implementation Status as Determined by Auditors	Auditor Comments
15	The Commission should ensure that it complies with the State's information security standards as defined in Title 1, Texas Administrative Code, Chapter 202, by defining an owner for the LicenseEase system and requiring the owner to periodically review and adjust access as appropriate.	Fully Implemented	Fully Implemented	The Commission designated its Licensing Division as the owner of data in Versa Regulation, which replaced the LicenseEase system. The Commission also periodically reviewed access to Versa Regulation.

Recommendations

The Commission should:

- Rotate assignments for Tax Division employees who conduct the initial reviews of excise tax reports.
- Ensure that supervisory reviews are conducted and documented for a sample of excise tax reports that includes reports with and without identified errors.
- Ensure that it retains supporting documentation for all excise tax reports for a length of time determined by Commission management that is sufficient to verify the accuracy and completeness of tax payments due to the State.
- Ensure that it develops and implements written policies and procedures for:
 - ◆ The amount and type of required and recommended training for regional field auditors.
 - ◆ Compiling and retaining supporting documentation necessary to validate the training that regional auditors attend or complete.
- Review each employee's access to ARTS to ensure that access is appropriately limited to only the level necessary for the employee's job duties.
- Implement edit checks within ARTS that capture not only who makes changes but also what change was made and which record was affected.
- Implement a process that requires Commission management to periodically review the change tracking log and approve changes made to ARTS.

In addition, the Commission should develop a process for periodically reviewing ARTS data to identify tax data that is incomplete or inaccurate and records that should be updated.

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The Commission agreed with the above recommendations, and its management's responses are in the attachment to this letter.

Sincerely,

John Keel, CPA
State Auditor

Attachment

cc: Members of the Alcoholic Beverage Commission
Mr. Jose Cuevas, Jr., Presiding Officer
Ms. Melinda Fredricks
Dr. Steven Weinberg
Ms. Sherry Cook, Interim Administrator



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Attachment

Section 1

Objectives, Scope, and Methodology

Objectives

The objectives of this audit were to:

- Determine the implementation status of prior State Auditor's Office recommendations.
- Make selected site visits to verify the implementation status that agencies report.

Scope

The scope of this audit included reviewing the implementation status of the prior audit recommendations in *An Audit Report on the Alcoholic Beverage Commission's Excise Tax Collection Process* (State Auditor's Office Report No. 10-010, October 2009). The scope covered the Alcoholic Beverage Commission's (Commission) actions between October 2009 and June 2012.

Methodology

The audit methodology included identifying and collecting information on the implementation of the prior audit recommendations. To determine the implementation status of the recommendations, auditors conducted interviews, reviewed the Commission's policies and procedures, and performed selected tests and procedures.

Auditors also assessed the reliability of the Commission's data associated with excise tax audits and regional field auditor training and determined that the excise tax audit data in the Commission's Agency Reporting and Tracking System (ARTS) was not sufficiently reliable for purposes of this audit. As a result, auditors used hard-copy excise tax audit files to verify excise tax audit information.

Information collected and reviewed included the following:

- *An Audit Report on the Alcoholic Beverage Commission's Excise Tax Collection Process* (State Auditor's Office Report No. 10-010, October 2009).
- The Commission's policies and procedures for excise tax report invoices, document retention, ports of entry excise tax audits, and information technology password settings.

- The Commission's *Field Operations Audit Manual*.
- The Commission's in-house training curriculum.
- The Commission's new field operations auditor training documentation.
- The Commission's excise tax manager review spreadsheet.
- The Commission's *Excise Tax Report Procedures Manual*.
- The Commission's excise tax reports and audit documents.
- The Commission's risk-base criteria and logic that it used in excise tax audit selection.
- The Commission's ports of entry audits list from fiscal years 2010 and 2011.
- The Commission's planning documents for its Case Management-At Risk database project.
- The Commission's documentation related to access rights.

Procedures and tests conducted included the following:

- Reviewed excise tax manager spreadsheets and excise tax reports to determine whether adequate supervisory reviews were performed.
- Reviewed the Commission's *Excise Tax Report Procedures Manual* to determine whether it included a requirement to retain supporting documentation for all excise tax reports for an appropriate length of time.
- Reviewed completed excise tax audits to verify the Commission's selection process for wholesalers and distributors and to determine whether the audits were completed in compliance with the Commission's *Field Operations Audit Manual* and Texas Alcoholic Beverage Code, Section 206.08.
- Reviewed the Commission's *Field Operations Audit Manual* to determine whether it included policies and standardized procedures for conducting excise tax audits and required a risk-based approach for excise tax audit selection.
- Reviewed the Commission's new field operations auditor training documentation to determine whether it complied with the Commission's in-house training curriculum.

- Reviewed the Commission's risk-based criteria and logic document that ARTS used to assign risk factors to wholesalers and distributors, which the Commission used for excise tax audit selection.
- Reviewed the Commission's ports of entry bridge audit policies and procedures to determine whether they had been approved and implemented and included guidance on the selection and approval of bridges to be audited.
- Reviewed the completed ports of entry bridge audits to ensure they have been audited timely in accordance with the ports of entry bridge audit policies and procedures.
- Reviewed planning documentation for the Case Management-At Risk database project to determine whether access can be appropriately limited, audit trails will capture changes made to the system, and procedures for audit trails review are included.
- Reviewed the Commission's information technology access report to determine whether the Commission periodically reviewed employee access levels and whether those access levels were appropriately assigned.
- Reviewed the Commission's password policies and procedures to determine whether they complied with the Texas Administrative Code, and reviewed Versa Regulation password settings to determine whether they complied with the Commission's password policies and procedures.

Criteria used included the following:

- Title 1, Texas Administrative Code, Sections 202.21 and 202.25.
- Texas Alcoholic Beverage Code, Section 206.08.
- *Carrying Out a State Regulatory Program: A NSAA Best Practices Document*, National State Auditors Association.
- The Commission's *Excise Tax Report Procedures Manual*.
- The Commission's risk-based criteria and logic documentation the Commission used for excise tax audit selection.
- The Commission's *Field Operations Audit Manual*.
- The Commission's in-house training curriculum.
- The Commission's ports of entry bridge audit policies and procedures.

Project Information

Audit fieldwork was conducted from April 2012 through June 2012. We conducted this performance audit 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.

The following members of the State Auditor's staff performed the audit:

- Thomas Andrew Mahoney, CGAP (Project Manager)
- Namita Pai, CPA (Assistant Project Manager)
- Ishani Baxi, CIDA
- Jacqueline Gomez
- J. Scott Killingsworth, CIA, CGAP, CGFM (Quality Control Reviewer)
- Ralph McClendon, CISSP, CCP, CISA (Audit Manager)

Management's Responses

1. ***The Commission should rotate assignments for Tax Division employees who conduct the initial reviews of excise tax reports.***

COMMENTS: *The Commission asserted that it rotated assignments for Tax Division employees who conduct the initial reviews of excise tax reports; however, the Commission did not continue to rotate assignments.*

RESPONSE: *The Agency agrees with the SAO audit findings and recommendation. When the aforementioned audit was conducted in Fiscal Year 2010, the Excise Tax Section consisted of 4 FTE's. As with the majority of state agencies, we were mandated to reduce staff and one of those reductions occurred in the Excise Tax Section. During Fiscal Year 2010, Excise Tax Section personnel reviewed 46,000 tax and non-tax reports. During Fiscal Year 2012, we estimate the Section will review an estimated 54,000 reports. Due to the reduction in staff, the agency felt that rotating assignments would not be an effective nor efficient use of staff personnel. Although each person specializes in the type of tax collected and tax corresponding report, all excise tax personnel are cross trained to assist others as needed. All reports checked by Excise Tax Section personnel go through an additional review when an excise tax audit is conducted by field auditors.*

The excise tax review is a very extensive manual process. Several requests have been made in past legislative sessions to fund an automated system for filing excise tax reports and taxes. Twice this request was approved and funded, however, due to mandatory budget reductions those funds were later returned. Additionally, the Excise Tax Section has been through two legislatively mandated Sunset Reviews and three internal audits. The most recent internal audit was conducted in 2009. Key findings in all of those audits determined (with no significant recommendations) the Excise Tax Section has effective procedures, in place, for processing and correcting the excise tax reports.

2. ***The Commission should ensure that supervisory reviews are conducted and documented for a sample of excise tax reports that includes reports with and without identified errors.***

COMMENTS: *The Commission's supervisory reviews were not consistent and in compliance with its current Excise Tax Report Procedures Manual. Specifically, the Commission destroyed the supporting invoices for the excise tax reports without errors before a supervisor could perform a review.*

RESPONSE: *The Agency agrees with the SAO audit findings and recommendation. The reviews (with and without errors) were fully*

implemented and consistent with the original response and updated manual following the initial audit. During the follow-up audit, it was determined the supervisory review needed to be conducted during the reporting periods prior to discarding the supporting invoices without errors (see #3). The Excise Tax Report Procedures Manual has been updated to reflect this revised procedure.

- 3. The Commission should ensure that it retains supporting documentation for all excise tax reports for an appropriate length of time determined by Commission management to verify the accuracy and completeness of tax payments to the State.**

COMMENTS: The Commission did not retain supporting documentation for all excise tax reports for an appropriate length of time to allow the supervisory review to verify the accuracy and completeness of tax payments due to the State.

RESPONSE: The Agency agrees with the SAO audit findings and recommendation. The recommendation was fully implemented immediately following the initial audit. Section personnel were instructed to maintain all supporting documentation for three reporting periods.

The manual has been updated and current procedures require that all supporting documentation be maintained for two reporting periods following the initial review (See #2).

- 4. The Commission should ensure that regional field auditors complete audit documentation in accordance with the Commission's Excise Tax Manual.**

COMMENTS: The Commission's regional field auditors completed audit documentation in accordance with the Commission's Field Operator's Audit Manual.

RESPONSE: The Agency agrees with the SAO audit findings and recommendation.

- 5. The Commission should develop and implement standard procedures for its regional offices to use when selecting distributors and wholesalers for excise tax audits. The Commission should consider including procedures for a risk-based approach to planning audits.**

COMMENTS: The Commission developed and implemented standard procedures for a risk-based approach when selecting distributors and wholesalers for excise tax audits.

RESPONSE: The Agency agrees with the SAO audit findings and recommendation.

6. The Commission should ensure that it conducts Ports of Entry Bridge Excise Tax audits in a timely manner.

COMMENTS: The Commission conducted Ports of Entry Bridge Excise Tax audits in a timely manner.

RESPONSE: The Agency agrees with the SAO audit findings and recommendation.

7. The Commission should develop and implement approved, written policies and procedures for its regional offices to use when conducting Ports of Entry Bridge Excise Tax audits. These policies should include guidance on the selection and approval of bridges to audit.

COMMENTS: The Commission developed and implemented approved, written policies and procedures for Ports of Entry Bridge Excise Tax audits. According to the documented policies and procedures, the Ports of Entry division director, regional manager, and quality control shall develop an audit schedule during each fiscal year to help ensure that it audits each Ports of Entry district.

RESPONSE: The Agency agrees with the SAO audit findings and recommendation.

8. The Commission should ensure that it develops and implements written policies and procedures for:

- a. The amount and type of required and recommended training for regional field auditors.**
- b. Compiling and retaining supporting documentation necessary to validate the training that regional auditors attend or complete.**

COMMENT: The Commission has not developed policy and procedures for regional field auditor training.

RESPONSE: The Agency agrees with the SAO comment. While the Agency has developed/implemented procedures for regional field auditor training of new and tenured Auditing staff, it has not documented this process into a written policy/procedure. The Agency will amend its Compliance Procedure Manual to reflect required training.

COMMENT: The Commission did not have sufficient documentation needed to verify whether the auditors attended and completed the required/recommended training courses required by the in-house training curriculum.

RESPONSE: The Agency agrees with the SAO comment. The Agency has implemented documentation standards used by the Texas Commission on Law Enforcement Officer Standards & Education (TCLEOSE) for all employees training courses.

- 9. The Commission should review each employee's access to ARTS to ensure that access is appropriately limited to only the level necessary for the employee's job duties.**

COMMENT: As of April 2012, the Commission was planning additions to its Agency Reporting and Tracking System (ARTS), including limiting employee access as a part of the Case Management-At Risk database project. The target implementation date is September 2012.

RESPONSE: The Agency has agreed with this recommendation since the original audit date of October 2009, and was prepared to implement the recommendation in FY10 before project funding was cut as part of a 5% budget reduction as a result of the last legislative session. Recently, the Agency secured grant funding for a Case Management-At Risk project which includes ARTS modifications. With this funding, the Agency will be making the appropriate changes to limit ARTS access for employees to only the level necessary for the employee's job duties. The Agency will also implement a process to ensure that management periodically reviews employee access to the appropriate system functions in ARTS.

- 10. The Commission should implement edit checks within the Audit Reporting and Tracking System (ARTS) that capture not only who makes changes but also what change was made and which record was affected.**

COMMENT: The Commission plans to add edit checks to ARTS as a part of the Case Management-At Risk database project. The target implementation date is September 2012.

RESPONSE: The Agency has agreed with this recommendation since the original audit date of October 2009, and was prepared to implement the recommendation in FY10 before project funding was cut as part of a 5% budget reduction as a result of the last legislative session. Recently, the Agency secured grant funding for a Case Management-At Risk project which includes ARTS modifications. With this funding, the Agency will be making the appropriate changes to implement edit checks within ARTS in order to track changes by staff person and changes to key data elements.

11. The Commission should implement a process that requires Commission management to periodically review the change tracking log and approve changes made to ARTS.

COMMENT: The Commission plans to add change tracking in ARTS as a part of the Case Management-At Risk database project. The target implementation date is September 2012.

RESPONSE: The Agency has agreed with this recommendation since the original audit date of October 2009, and was prepared to implement the recommendation in FY10 before project funding was cut as part of a 5% budget reduction as a result of the last legislative session. Recently, the Agency secured grant funding for a Case Management-At Risk project which includes ARTS modifications. With this funding, the Agency will be implementing workflow functionality within ARTS so changes result in action with appropriate notification to the supervisor. The Agency can track workflow history to track specific modifications to each record.

12. The Commission should design and implement access controls within the LicenseEase system that limit employees' access to the level that is appropriate for each employee's job needs.

COMMENT: The Commission periodically reviewed access to Versa Regulation, which replaced the LicenseEase system.

RESPONSE: The Agency agrees with the SAO audit findings and recommendation.

13. The Commission should determine whether unlimited access is required for any one user of the LicenseEase System and make adjustments to reflect this determination.

COMMENT: The Commission limited database administrator access to Versa Regulation, which replaced the LicenseEase system, to information resources division staff.

RESPONSE: The Agency agrees with the SAO audit findings and recommendation.

14. The Commission should ensure that it complies with the State's information security standards as defined in Title 1, Texas Administrative Code, Chapter 202.

COMMENT: The Commission made appropriate changes to its information technology controls to improve its compliance with the State's information security standards.

RESPONSE: The Agency agrees with the SAO audit findings and recommendation.

15. The Commission should ensure that it complies with the State's information security standards as defined in Title 1, Texas Administrative Code, Chapter 202, by defining an owner for the LicenseEase system and requiring the owner to periodically review and adjust access as appropriate.

COMMENT: The Commission designated its Licensing Division as the owner of data in Versa Regulation, which replaced the LicenseEase system. The Commission also periodically reviewed access to Versa Regulation.

RESPONSE: The Agency agrees with the SAO audit findings and recommendation.