

# STATE OF NEVADA

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## Performance Audit

Department of Taxation  
Marijuana Regulation and Enforcement

2019



Legislative Auditor  
Carson City, Nevada

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# Audit Highlights



Highlights of performance audit report on the Department of Taxation issued on March 14, 2019.

Legislative Auditor report # LA20-05.

## Background

The Department of Taxation (Department) administers, collects, and distributes a majority of the State's taxes. The Department collects about \$6 billion annually from 17 different taxes. In November of 2016, voters approved the Regulation and Taxation of Marijuana Act which legalized the sale of recreational marijuana in Nevada. The Department is responsible for administering the Act.

The Department oversees and enforces marijuana statutes and regulations; issuance, renewal, suspension, and revocation of licenses; and collection of taxes, fees, and penalties.

A tax of 15% is assessed on the first wholesale transfer of marijuana. In addition, a 10% tax is assessed on recreational marijuana sales at the time of purchase. In fiscal year 2018, about \$70 million was collected from these excise taxes. The tax revenues cover the cost of the program, fund schools, and supplement the Rainy Day Fund. In addition to the taxes above, sales tax is collected at the appropriate county rate for all retail marijuana sales.

## Purpose of Audit

The audit included a review of certain marijuana regulatory and cash collection activities for fiscal year 2018. The purpose of our audit was to determine if regulatory activities related to monitoring marijuana inventory and taxes were adequate, including controls over cash collections.

We encountered certain limitations in obtaining licensee inventory and other records.

Documentation could have provided insight regarding system and tax return accuracy.

## Audit Recommendations

This audit report contains 13 recommendations to improve the regulation of marijuana. These recommendations will help ensure the Department effectively monitors marijuana tax revenues and inventory.

The Department of Taxation accepted the 13 recommendations.

## Recommendation Status

The Department of Taxation's 60-day plan for corrective action is due on June 7, 2019. In addition, the six-month report on the status of audit recommendations is due on December 7, 2019.

# Marijuana Regulation and Enforcement

## Department of Taxation

### Summary

The Department needs to improve its regulation and oversight of the marijuana industry. For instance, the Marijuana Enforcement Tracking Reporting and Compliance (METRC) information system was not accurate or complete. This system is central to the Department's regulation of the industry and maintaining an accord with federal authorities because it is the primary way marijuana cultivation, production, and sales are tracked to prevent diversion and inappropriate activity. Because data in the system is not accurate and complete, it cannot be utilized to verify marijuana tax returns, which did not always appear to be correct. Inaccurate and incomplete data occurred partly because effective monitoring and oversight of the system has not been performed by the Department and guidance has not been provided to licensees. Additionally, the Department has not identified how METRC can be efficiently used, nor has it implemented procedures to identify inappropriate licensee activity. Finally, enhancements to the cash collection process are necessary due to the increase in marijuana taxes.

Marijuana regulation and enforcement is a new and emerging function for the Department. Therefore, an efficient and effective regulatory program is necessary to ensure licensees comply with laws and regulations and the industry withstands federal scrutiny. Because METRC is not used to its capabilities, efficiency is lost and it is difficult for the Department to determine the resources needed to effectively regulate the program.

### Key Findings

The Department does not reconcile METRC data to licensee inventory records or tax returns to ensure data in the system is accurate or complete. We compared the tax returns of 10 cultivators and 5 dispensaries to METRC data for the 6-month period spanning January to June 2018, and found the following:

- For wholesale marijuana tax returns filed by cultivators, METRC data did not agree about 70% of the time.
- For retail marijuana tax returns filed by dispensaries, METRC data did not reasonably compare about 57% of the time.
- For sales tax returns filed by dispensaries, METRC data did not reasonably compare about 60% of the time.

Variances reflecting lower inventory sales and transfers in METRC indicate licensees are not recording all appropriate transactions in METRC. Conversely, sales and transfer totals in METRC exceeding that reported on tax returns suggests tax collections may be improper or inadequate. (page 7)

Current procedures performed by the Department do not involve reviewing the accuracy of waste data entered in METRC. As a result, 9 of 10 cultivators tested did not enter data, or entered meaningless information into the system that was not identified and corrected by the Department. Monitoring waste data is important for preventing marijuana products from being diverted outside the regulated system. (page 9)

Products designated for medical cardholders due to the tetrahydrocannabinol (THC) content exceeding statutory limits were sold to recreational consumers. Specifically, we found 262 of 610 (42.9%) single units of medical products tested were sold inappropriately. The Department did not identify or follow-up with licensees regarding inappropriate sales because THC content is not consistently reported in METRC and the Department is not monitoring for these types of activities. (page 10)

Procedures have not been developed to ensure medical marijuana products are accounted for under the proper license in METRC. The Department indicated high potency products should only be associated with a medical license. However, we found dual-licensed facilities are not always associating products or consumer sales to the correct license. As a result, inappropriate sales cannot be easily identified. (page 12)

The Department is not effectively using METRC to monitor production waste amounts. Our analysis of nine cultivators revealed significant fluctuations in the percentage of product recorded as waste during the harvest process. The average waste percentage calculated for individual cultivators varied from a low of 7.9% to a high of 54.3%. (page 13)

METRC's system notifications, which could assist the Department by flagging irregular transactions, have not been activated. METRC allows regulatory agencies to setup custom notifications based on a variety of parameters. When notifications are not active, errors and adjustments made by the licensees are not automatically brought to the attention of the Department. (page 14)

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This report contains the findings, conclusions, and recommendations from our performance audit of the Department of Taxation, Marijuana Regulation and Enforcement. This audit was conducted pursuant to the ongoing program of the Legislative Auditor as authorized by the Legislative Commission. The purpose of legislative audits is to improve state government by providing the Legislature, state officials, and Nevada citizens with independent and reliable information about the operations of state agencies, programs, activities, and functions.

This report includes 13 recommendations to improve the regulation of marijuana. We are available to discuss these recommendations or any other items in the report with any legislative committees, individual legislators, or other state officials.

Respectfully submitted,

  
Rocky Cooper, CPA  
Legislative Auditor

March 4, 2019  
Carson City, Nevada

# Marijuana Regulation and Enforcement

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# Introduction

## Background

The Department of Taxation (Department) administers, collects, and distributes a majority of the State's taxes. The mission of the Department is to provide fair, efficient, effective administration of tax programs for the State of Nevada in accordance with applicable statutes, regulations, and policies; serve the taxpayers, state and local government entities, and enable and recognize Department employees.

The Nevada Tax Commission exercises general supervision and control over Department activities. The Tax Commission adjudicates contested cases, adopts regulations, and ensures the fair and equitable treatment of taxpayers. The Director administers the daily activities of the Department and serves as the secretary to the Tax Commission and the State Board of Equalization.

The Department collects nearly \$6 billion annually in state and local government revenue from 17 different taxes. Distributions of tax collections are made to various state and local government agencies.

Department headquarters are located in Carson City with satellite operations in Henderson, Las Vegas, and Reno. The Department has six major sections: Administrative Services, Compliance, Executive, Information Technology, Local Government Services, and Marijuana Enforcement. The Department operates with 382 full-time equivalent personnel of which 44 are assigned to marijuana enforcement. Operations are funded mainly by a General Fund appropriation and marijuana excise taxes.

### **Marijuana Enforcement**

Nevada voters approved Question 2, the Regulation and Taxation of Marijuana Act on November 8, 2016, which allowed for the sale and use of marijuana by persons 21 years of age or older and required the industry be regulated similar to other legal businesses. The Department is responsible for administering the requirements of the Regulation and Taxation of Marijuana Act including:

- Adoption of regulations.
- Issuance, renewal, suspension and revocation of licenses to marijuana retailers, cultivators, product manufacturing facilities, testing facilities, and distributors.
- Determining qualifications for licensure, security, packaging, labeling, and testing of marijuana.
- Oversight and enforcement of marijuana businesses and licensees including: record keeping, signage, marketing, display, advertising, and other requirements.
- Collection of taxes, fees, and penalties.

The Department licenses cultivators, dispensaries, labs, production facilities, and distributors for medical and recreational activities. Most licensees operate as dual-licensed facilities for both medical and recreational products. Exhibit 1 shows the number of licensees by type as of November 2018.

### **Active Marijuana Licenses November 2018**

### **Exhibit 1**

<b>License Type</b>	<b>Recreational</b>	<b>Medical</b>	<b>Dual-License</b>	<b>Totals</b>
Cultivation	1	16	126	143
Production	2	12	86	100
Retail/Dispensary	2	1	60	63
Laboratory	0	1	10	11
Distribution	35	0	0	35
<b>Totals</b>	<b>40</b>	<b>30</b>	<b>282</b>	<b>352</b>

Source: Department of Taxation, Marijuana Enforcement.

Marijuana is taxed at the point of cultivation and retail sale. A 15% excise tax is paid on the fair market value of various plant products sold or transferred by licensed cultivators. A 10% excise tax is paid on recreational consumer, nonmedical cardholder sales by retailers. The revenue from these taxes covers the cost of regulating the industry, benefits Nevada schools, and supplements the Rainy Day Fund. Finally, sales tax is collected, based on the appropriate county rate, for all retail sales. During fiscal year 2018, the Department collected nearly \$70 million in excise taxes.

Federal law prohibits the sale and use of marijuana. Federal authorities traditionally relied on states and local law enforcement agencies to address marijuana activity through enforcement of narcotics laws. To address the enactment of state laws that authorize marijuana production, distribution, and possession, the federal government issued guidance indicating an expectation that states implement strong and effective regulatory and enforcement systems that address public safety, public health, and other law enforcement interests. This includes implementing effective measures to prevent diversion of marijuana outside of the regulated system and to other states.

## **Scope and Objective**

The scope of our audit included a review of certain marijuana regulatory activities and cash collections during fiscal year 2018. Our audit objective was to:

- Determine if regulatory activities related to monitoring marijuana inventory and taxes were adequate, including controls over cash collections.

This audit is part of the ongoing program of the Legislative Auditor as authorized by the Legislative Commission, and was made pursuant to the provisions of NRS 218G.010 to 218G.350. The Legislative Auditor conducts audits as part of the Legislature's oversight responsibility for public programs. The purpose of legislative audits is to improve state government by providing the Legislature, state officials, and Nevada citizens with independent and reliable information about the operations of state agencies, programs, activities, and functions.

### **Limitations – Access to Certain Records Denied**

We conducted our audit in accordance with government auditing standards. Standards require we report constraints imposed on the audit approach and limitations on access to information. During the audit, the Department denied our request to access certain records and documentation of marijuana licensees.

We requested assistance from the Department to access licensee inventory and other records to determine whether the seed to sale system known as Marijuana Enforcement Tracking Reporting and Compliance (METRC) matched licensee inventory records or marijuana tax returns. While this documentation was not available at the Department, statute provides authority for the Department to obtain marijuana inventory records and other documentation as part of the regulatory and tax verification processes. Access to this documentation could have provided additional clarity and insight regarding the accuracy of the METRC system and related tax returns.

Furthermore, this documentation would have allowed us to conclude whether system data or tax return information was the more accurate representation of monthly marijuana cultivation and



sales activity for the month and licensee tested. In spite of this limitation, we believe our conclusions, and the estimate of tax deficiency, to be reasonable based on the evidence collected. We acknowledge certain exceptions and amounts may have been different had we been able to access these records.

We informed the Department of our desire to obtain inventory and other records to substantiate system data and tax return information in June and requested specific documentation by licensee in July 2018. Although the Department initially agreed to provide the requested information, it later denied our request to obtain documentation. The Department's letters regarding our requests can be found in Appendix A on pages 19 and 20.

## Certain Regulatory Activities Need Improvement

The Department needs to improve its regulation and oversight of the marijuana industry. For instance, the Marijuana Enforcement Tracking Reporting and Compliance (METRC) information system was not accurate or complete. This system is central to the Department's regulation of the industry and maintaining an accord with federal authorities because it is the primary way marijuana cultivation, production, and sales are tracked to prevent diversion and inappropriate activity. Because data in the system is not accurate and complete, it cannot be utilized to verify marijuana tax returns, which did not always appear to be correct. Inaccurate and incomplete data occurred partly because effective monitoring and oversight of the system has not been performed by the Department and sufficient guidance has not been provided to licensees. Additionally, the Department has not identified how METRC can be efficiently used, nor has it implemented procedures to identify inappropriate licensee activity. Finally, enhancements to the cash collection process are necessary due to the increase in marijuana taxes.

Marijuana regulation and enforcement is a new and emerging function for the Department. Therefore, an efficient and effective regulatory program is necessary to ensure licensees comply with laws and regulations and the industry withstands federal scrutiny. Because METRC is not used to its capabilities, efficiency is lost and it is difficult for the Department to determine the resources necessary to effectively regulate the program.

### **Marijuana Inventory System (METRC) Not Accurate**

Licensees are not properly recording all marijuana cultivation, inventory, sales, and waste activity into the METRC system. For example, data in the METRC system did not compare to totals reported on marijuana tax returns for 86 of 120 (72%) returns tested with certain variances suggesting a potential unpaid tax

liability of over \$500,000 for the 6-month period tested. In addition, for 246 of 1,085 (22.7%) harvests, licensees failed to enter sufficient data regarding waste and package weights. Insufficient and inaccurate data prevents the Department from effectively regulating the industry, verifying the accuracy of tax collections, protecting consumers, and preventing diversion of marijuana to the black market.

State regulations require licensees to establish, maintain, and reconcile an inventory system, which tracks the flow of materials through the process and connects to the system selected by the Department. According to the Department, licensees must update METRC records daily and reconcile to physical records quarterly. METRC is considered by the Department to be the system of record for marijuana products and is used to track and regulate all inventory in Nevada. The system was launched near the end of calendar year 2017, replacing a previous system that did not adequately support the regulatory needs of the Department.

#### **Variations Exist Between METRC and Tax Returns**

The Department does not reconcile METRC data to licensee inventory records or tax returns to ensure data in the system is accurate or complete. We compared the tax returns of 10 cultivators and 5 dispensaries to METRC data for the 6-month period spanning January to June 2018 and found the following:

- For wholesale marijuana tax returns filed by cultivators, METRC data did not agree about 70% of the time.
- For retail marijuana tax returns filed by dispensaries, METRC data did not reasonably compare about 57% of the time.
- For sales tax returns filed by dispensaries, METRC data did not reasonably compare about 60% of the time.

Variations reflecting lower inventory sales and transfers in METRC indicate licensees are not recording all appropriate transactions in METRC. Conversely, sales and transfer totals in METRC exceeding that reported on tax returns suggests tax collections

may be improper or inadequate. Examples of variances are shown in Appendix B on pages 21 to 23 and illustrate some types of the inconsistencies found.

For those tax return variances that indicated underreporting of sales and transfers, we calculated the potential tax liability to provide perspective on the significance of the issue. For the tax returns in our sample, these variances suggest a potential unpaid tax liability of over \$500,000 for the 6-month period tested. As indicated on page 4, the Department denied our request to access certain licensee records. Because of this limitation, the potential tax liability is based on records maintained by the Department and amounts were not corroborated by reviewing licensee inventory, sales, and transfer records.

Tax returns are based on marijuana product sales transactions, which should be logged in METRC according to the Department. The system, designed to record and track marijuana from the earliest stages of cultivation, through production, and consumer sale, captures appropriate data to compare against totals reported on tax returns. Yet, the Department did not utilize this information after launching the METRC system to identify inconsistencies and pursue compliance.

To determine why totals on tax returns did not agree to transactions recorded in METRC, we requested additional documentation be obtained from licensees. Our request was denied by the Department since the records were not readily available in Department files. Although the Department has the authority to obtain requested records, state law does not require the Department to obtain and provide these records. See Appendix A on pages 19 and 20 for the Department's responses to our request for records.

### **Required Reports Should Be Obtained**

Reports required by statute are not currently obtained from the marijuana industry. NRS 372A.285 requires marijuana licensees submit monthly sales, purchase, production, and price information by marijuana product to the Department at least quarterly.

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Information in the reports could have been used to validate data in METRC, calculate fair market values, and corroborate tax returns. Additionally, reports may be beneficial in focusing regulatory activities by identifying inconsistent information to select licensees for further investigation or audit.

### **Waste and Package Weight Data Not Always Entered in METRC**

Current procedures performed by the Department do not involve reviewing the accuracy of waste data entered in METRC. As a result, 9 of 10 cultivators tested did not enter data, or entered meaningless information into the system that was not identified and corrected by the Department. Monitoring waste data is important for preventing marijuana products from being diverted outside the regulated system.

Cultivators are required to enter waste data in METRC throughout the marijuana production cycle, including when plants are harvested and trimmed into useable product. We reviewed all 1,085 harvests produced by 10 cultivators over the 6-month period January to June 2018, and found the following:

- Waste weights were not entered for 169 (15.6%) harvests. Waste is a natural byproduct of the manufacturing process and would be expected unless the plants were sold as wet whole plants, an infrequent transaction.
- Unreasonable waste weights were entered for 61 (5.6%) harvests. Because other data is calculated automatically based on waste weights, corresponding amounts were inaccurate or incomplete.
- Final product package weights were not entered for 16 (1.5%) harvests. Package weights show useable product that should be tracked until sold to the consumer.

Waste and package data is an essential component of monitoring for product diversion during the cultivation production process since consumable product can be categorized as waste for any given harvest and diverted outside the regulated system. As

## **METRC Not Effectively Used for Regulatory Activities**

such, the Department needs to ensure data is complete and accurate, and routinely analyzed to properly regulate the industry.

METRC is not being used effectively to regulate the industry. For example, the Department is not monitoring marijuana sales to ensure high potency (medical<sup>1</sup>) products are sold appropriately. Additionally, METRC is not being used to track medical inventory and ensure products are associated with the correct license. Finally, the system should be used to monitor production waste and provide notifications to assist with identifying irregular transactions.

### **High Potency Products Sold to Recreational Consumers**

Products designated for medical cardholders due to the tetrahydrocannabinol (THC) content exceeding statutory limits were sold to recreational consumers. Specifically, we found 262 of 610 (42.9%) single units of medical products tested were sold inappropriately. The Department did not identify or follow up with licensees regarding inappropriate sales because THC content is not consistently reported in METRC and the Department is not monitoring for these types of activities using METRC data.

NRS 453D.310(2) details single package THC limits on recreational product sales. Generally, recreational product sales cannot exceed the following:

- Capsules cannot contain more than 100 milligrams of THC per capsule or more than 800 milligrams per package.
- Tinctures cannot contain more than 800 milligrams of THC per package.
- Edibles cannot contain more than 100 milligrams of THC per package.
- Topicals cannot contain a concentration of more than 6% THC or 800 milligrams per package.

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<sup>1</sup> Medical products are defined by potency limits established in NRS 453D.310(2). Most potency limits refer to tetrahydrocannabinol (THC) the main psychoactive compound in marijuana. Per the Department, products exceeding established limits must be tagged as medical inventory products, sold under a medical license, and to medical cardholders.

- Suppositories or transdermal patches cannot contain more than 800 milligrams of THC per package.
- All other products must not exceed 800 milligrams of THC per package.

The majority of marijuana sales are made to recreational consumers whose product purchases and possession amounts are limited in statute. Since medical products can contain higher potencies than those allowed for recreational users, statutes require the supervision of a healthcare provider to consume medical marijuana products. According to the Department, products exceeding recreational THC limits should be tagged as medical inventory, associated with a medical license, and sold only to consumers with a validated medical need. Exhibit 2 shows five highly potent medical products tested and related sales to recreational consumers.

### Medical Products Sold to Recreational Consumers Five Highly Potent Medical Products Tested

### Exhibit 2

Product Description in METRC	Product THC Content	Recreational THC Content Maximum <sup>(1)</sup>	Produced Units for Inventory Tag	Units Sold to Recreational Consumers
Incredible Orange Bar	550 mg	100mg	15	15
Dark Chocolate Xtra Strength	528 mg	100mg	67	59
Incredible Affogato	506 mg	100mg	9	9
Dark Chocolate Bar	491 mg	100mg	25	8
Milk Chocolate Bar	237 mg	100mg	59	52

Source: Auditor analysis of METRC sales data and lab reports.

<sup>(1)</sup> The "Recreational THC Content Maximum" is the regulated maximum amount of THC content that can be sold to recreational consumers for the specific product type.

As discussed later in this report, medical products were not always associated with a medical license, which complicates tracking and monitoring of sales to the appropriate consumer. We reviewed sales associated with 10 dual-licensed facilities and found the following sales of medical products to recreational consumers:

- Sales From Medical License – 198 of 269 (73.6%) units of medical products from 12 different inventory packages

were sold to recreational consumers. These sales were made by four licensees tested.

- Sales From Recreational License – 64 of 341 (18.7%) units of medical products from 12 different inventory packages were sold to recreational consumers. These sales were made by four licensees tested.

The Department currently only reviews a small sample of units during the annual inspection process to confirm sales are made to the appropriate consumer. Review and monitoring of METRC sales data and product information would be more efficient, effective, and provide for broader identification of inappropriate activity. Medical marijuana products contain high THC levels and are intended to be used for the exclusive benefit of a person to mitigate the symptoms or effects of a debilitating medical condition. Allowing recreational users to consume medical products threatens the health and safety of the consumer, the general public, and the integrity of the industry.

### **High Potency Inventory Not Effectively Tracked in METRC**

Procedures have not been developed to ensure medical marijuana products are accounted for under the proper license in METRC. The Department indicated high potency products should only be associated with a medical license. However, we found dual-licensed facilities are not always associating products or consumer sales to the correct license. As a result, inappropriate sales cannot be easily identified.

State regulations allow dual-licensed facilities to operate as a combined marijuana establishment provided its' inventory is securely segregated. Regulations also require operations to be segregated for each facility type, medical or recreational, including financial records. In addition, employees must hold agent cards for both medical and recreational facilities if service is to be provided seamlessly across the combined establishment.

Some licensees we reviewed accepted and accounted for medical inventory under a recreational license. The Department indicated products with a medical inventory tag should not be associated



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with a recreational license. However, transfers were made from the medical license of a production facility to the recreational license for three of the five dual-licensed retailers tested. We also reviewed sales activity from 17 dual-licensed dispensaries and found:

- For one dispensary, all sales were recorded under the medical license even though 81% of the sales recorded were to recreational consumers.
- For eight dispensaries, all sales were recorded under the recreational license even though 18% of the sales were to medical patients. Medical cardholders can purchase recreational marijuana products. However, it is unlikely these eight dual-licensed facilities are not stocking high potency products that should be accounted for and sold under a medical license.
- The remaining eight retailers examined had sales attributed to both licenses, as would be expected from a dual-licensed facility.

Ineffective tracking of medical inventory in METRC makes it difficult to identify inappropriate sales to consumers. As previously noted, our audit found many sales of high potency products to recreational consumers.

#### **METRC Not Used Effectively to Monitor Production Waste**

The Department is not effectively using METRC to monitor production waste amounts. Our analysis of nine cultivators revealed fluctuations in the percentage of product recorded as waste during the harvest process. The average waste percentage calculated for individual cultivators varied from a low of 7.9% to a high of 54.3%.

Production waste and moisture loss depend on many factors including methods used, temperature and humidity, location, and product strain. Even though we noted variations between the high and low percentages, the majority of waste data reviewed was relatively consistent. As such, the Department should be able to

isolate and review transactions that appear unreasonable without significant resources.

METRC was designed to be an information reservoir for marijuana activity for states to utilize in regulating the industry. Marijuana products are susceptible to loss and theft and misappropriations can be covered up through the waste process. Because of this, other states have programs to analyze and identify unreasonable activity that complement and support more traditional investigation activities.

The Department has not developed a process to isolate unreasonable activity and pursue further scrutiny or compliance. Analyzing waste data and identifying trends in the industry can help focus Department investigation and regulatory efforts on licensees needing additional oversight.

#### **METRC Notifications Could Assist the Department**

METRC system notifications, which could assist the Department by flagging irregular transactions, have not been activated. METRC allows regulatory agencies to setup custom notifications based on a variety of parameters. When notifications are not active, errors and adjustments made by the licensees are not automatically brought to the attention of the Department.

The Department indicated it is in the process of identifying and establishing certain system notifications. Some of these notifications are derived from other states or are standard notifications developed by system personnel. These notifications, while beneficial, may not always address the Department's most pressing regulatory needs. Because of this, the Department should continually evaluate METRC capabilities and identify how best to efficiently utilize the system in its regulatory efforts.

### **Additional Guidance for Licensees Necessary for Consistency**

The Department needs to determine and provide appropriate instructions to licensees regarding how THC should be reported in METRC. Accurate and consistent reporting of THC is necessary for the Department to adequately monitor medical products and related sales. Furthermore, additional guidance is needed over

revenue reporting on wholesale tax returns so month-end sales are reported in the same manner.

### **Important Regulatory Data Not Easily Found in METRC**

Lab results and related THC potency data cannot be easily found in the METRC system. Review of system information and lab results reflect no consistent or efficient method for identifying a product's THC content. Additionally, lab results do not always calculate the total THC for packaged products that may contain multiple servings. As a result of these issues, we could not determine THC content for 3 of 12 products tested and could not find THC data in METRC for 6.

Department personnel indicated THC information may be located in the METRC system in three unique areas: the product title or description, lab results screen, or the item detail screen. Our review of 12 products found THC information was sporadically available in these three locations for the products tested. This occurs because the Department has not determined the most effective way to report THC content or provided licensees with guidance on how this information should be reported. Exhibit 3 shows the 12 products tested and if potency information was determinable from METRC information or lab results.

**THC Potency Found in METRC or Lab Reports**

**Exhibit 3**

<b>Product Description</b>	<b>METRC – Lab Screen</b>	<b>METRC – Product Description</b>	<b>METRC – Product Detail Screen</b>	<b>Lab Reports</b>
Cookie Square Snickerdoodle				
Strainz Tincture				X
Orange Bar		X		X
Dark Chocolate Bar		X		X
Relief Lotion	X			X
Gummy Cherry				
Tropical Twist Gummies		X		
Dark Chocolate Sea Salt Bar		X	X	
Edible				
Cherry Gummies				X
Grape Gummies				X
Dried Pineapple		X	X	
<b>Totals</b>	<b>1</b>	<b>5</b>	<b>2</b>	<b>6</b>

Source: Auditor analysis of METRC information and lab reports.

State regulations establish the maximum THC content for recreational marijuana products. However, the unit of measure input for THC content in METRC is different than the unit of measure established to regulate most marijuana products. This, combined with inconsistent METRC and lab reporting, unnecessarily complicates efforts to monitor and track medical products and sales.

It is critical for the successful regulation of marijuana products that the Department be able to monitor and identify high potency products efficiently. Current Department processes only review a few high potency transactions during an inspection, which is required annually. The infrequency in the inspection process and the limited number of transactions or products evaluated necessitates the use of METRC in ensuring THC content is appropriately regulated.

**Reporting of Month-End Sales Transactions Should Be Clarified**

The Department has not provided sufficient guidance to licensed cultivators on how to report month-end transactions for tax purposes. As a result, cultivators are not accounting for transactions correctly. Specifically, some cultivators report transactions based on the date the product was shipped while

## **Increased Cash Intake Requires Additional Security Enhancements**

others report transactions based on the date the product was received. The Department indicated wholesale transactions should be recorded based on the date the product is received; but the Department did not include this expectation in the instructions for the wholesale marijuana tax return.

Security enhancements are needed at Department offices that collect taxes and fees. The legalization of recreational marijuana increased cash collections; but, facilities were not properly equipped prior to July 2017 to efficiently handle this increase. The Department was awarded about \$340,000 for security enhancements during the 2017 Legislative Session. As of the end of fiscal year 2018, the Department had only spent approximately \$23,000 of the funding provided. The Department indicated that turnover of key personnel and higher than expected quotes delayed certain enhancements.

The Department consulted with the Department of Public Safety and the Public Works Division to identify and implement necessary security enhancements. It also received funding for armed security at the June 2018 Interim Finance Committee meeting.

### **Recommendations**

1. Develop additional policies and procedures to verify the ongoing accuracy and completeness of METRC data. Procedures should address all significant data elements.
2. Utilize METRC to identify licensees at risk for potential tax deficiencies and incorporate the use of METRC data into the audit selection process.
3. Obtain reports required by NRS 372A.285. Compare the reports to METRC and utilize information to regulate the industry.
4. Develop procedures to monitor data in METRC regarding harvest weights, waste, package weights, and moisture loss. Follow up on incomplete, erroneous, or irregular entries.
5. Establish additional procedures to regulate and identify inappropriate sales of high potency (medical) products.

6. Establish procedures to ensure marijuana products are accounted for and sold under the proper license.
7. Develop statistics and benchmarks from METRC data regarding regulatory activities.
8. Establish a program to monitor METRC data and identify and investigate irregular activity.
9. Identify and establish system notifications using METRC data. Review and follow up on notifications.
10. Revise how THC is reported in METRC and on lab reports. Ensure total product THC is identifiable and congruent with state law.
11. Provide licensees guidance regarding data input requirements for THC information and lab results. Monitor licensee compliance with data input.
12. Revise tax return instructions to provide appropriate guidance to licensees regarding how month-end wholesale transactions should be recorded on tax returns.
13. Evaluate and install additional security measures.

# Appendix A

## Department's Letters Regarding Records Request



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WILLIAM D. ANDERSON  
Executive Director

STATE OF NEVADA  
DEPARTMENT OF TAXATION

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June 11, 2018

Rocky Cooper, CPA, Legislative Auditor  
Legislative Counsel Bureau  
401 S. Carson Street  
Carson City, NV 89701-4747

*Via Email: [rocky.cooper@lcb.state.nv.us](mailto:rocky.cooper@lcb.state.nv.us)  
and inter-office mail*

Re: Marijuana Inventory – Response to LCB Letter Dated June 4, 2018

Dear Mr. Cooper,

The Department understands that the Legislative Auditor would like records from some marijuana licensees concerning inventory and sales documentation needed to verify reporting to the Department. Specifically, the Department understands that the Legislative Auditor would like to compare the books and records of the marijuana licensee with tax returns that the licensees file with the Department, and to the information reported in Metric (the Department's "seed to sale tracking" system implemented pursuant to R092-17AP, Sec. 109).

Marijuana cultivation facilities and retail marijuana stores are required to maintain the records necessary to determine the amount of the liability of the taxpayer pursuant to NRS 372A.200 to 372A.380, inclusive. NRS 372A.270(1)(a). The Department may demand to make inspection of those records at reasonable times during regular business hours. NRS 372A.270(1)(c), R092-17AP, Sec. 86(6)(c) and (d). The Department also may request documentation generated by the marijuana establishment when it monitors its inventory pursuant to R092-17AP, Sec. 108(5) through (7). R092-17AP, Sec. 108(8)(b). Further, the Department has the authority to examine the books, papers, and records of any taxpayer to verify the accuracy of any return filed by a taxpayer. NRS 372A.280(1).

Subject to this authority, the Department will request that an agreed-upon sample of marijuana licensees provide their books, papers, and records to the Department for verification with those taxpayers' returns and information reported to Metric starting with the most recent data available.

The Department reserves its right to object to any further request of the Legislative Auditor as beyond the scope of the audit or as unduly burdensome.

Sincerely,

William D. Anderson  
Executive Director  
Nevada Department of Taxation

# Appendix A

## Department's Letters Regarding Records Request (continued)



BRIAN SANDOVAL  
Governor  
JAMES DEVOLLD  
Chair, Nevada Tax Commission  
WILLIAM D. ANDERSON  
Executive Director

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August 3, 2018

Rocky Cooper  
Legislative Counsel Bureau  
Legislative Building  
401 S. Carson Street  
Carson City, Nevada 89701

Re: LCB letter of July 24, 2018

Dear Mr. Cooper:

The Department of Taxation (the "Department") has received your request to provide detailed inventory reports and sales, or other supporting documents, for the months of April and May 2018 for a sample of 50 licensed marijuana establishments. You state in your request that the Department has the authority to obtain this information, but that the Department does not have this information available in its records. Therefore, you have requested that the Department obtain the information from licensees for your use in "reviewing data contained in METRC, the Department's seed to sale inventory system, and to confirm the accuracy of licensee tax remittances."

The Department understands that this audit is being conducted pursuant to the authority given in NRS Chapter 218G which is intended to be a post audit of all accounts, funds and other records of a State agency in its possession. The Department is not aware of any authority for the Legislative Auditor to audit the accuracy of the returns filed with the Department. Nor is the Department aware of any authority for the Legislative Auditor to request that the audited agency obtain information solely for purposes of the audit.

Because the Department is not aware of any authority supporting this request, the Department respectfully declines to provide the additional information sought. The Department will continue to provide full access to the records and information in its possession, consistent with its duties under NRS Chapter 218G.

Sincerely,

A handwritten signature in black ink that reads "William D. Anderson".  
William D. Anderson  
Executive Director  
Nevada Department of Taxation

cc: Melissa Flatley, Deputy Attorney General



# Appendix B

## Illustrative Examples of System Errors

### Example 1: Retailer/Dispensary – METRC Sales Less Than Reported on Retail Marijuana and Sales and Use Tax Returns

Company A	Retail Marijuana Tax <sup>1</sup>	Sales and Use Tax <sup>2</sup>
May 2018 Sales Recorded in METRC	\$469,001.72	\$525,278.78
Sales Reported on May 2018 Return	633,972.00	716,710.00
<b>Difference – METRC Sales Under Licensee Reported</b>	<b>(\$164,970.28)</b>	<b>(\$191,431.22)</b>

Company A	Retail Marijuana Tax <sup>1</sup>	Sales and Use Tax <sup>2</sup>
June 2018 Sales Recorded in METRC	\$ 2,976.73	\$ 3,124.26
Sales Reported on June 2018 Return	619,052.00	746,400.00
<b>Difference – METRC Sales Under Licensee Reported</b>	<b>(\$616,075.27)</b>	<b>(\$743,275.74)</b>

### Example 2: Retailer/Dispensary – METRC Sales More Than Reported on Retail Marijuana and Sales and Use Tax Returns

Company B	Retail Marijuana Tax <sup>1</sup>	Sales and Use Tax <sup>2</sup>
April 2018 Sales Recorded in METRC	\$2,127,290.52	\$2,878,792.36
Sales Reported on April 2018 Return	1,463,042.88	2,052,829.04
<b>Difference – METRC Sales Over Licensee Reported</b>	<b>\$ 664,247.64</b>	<b>\$ 825,963.32</b>

Company B	Retail Marijuana Tax <sup>1</sup>	Sales and Use Tax <sup>2</sup>
May 2018 Sales Recorded in METRC	\$1,921,870.62	\$2,566,077.17
Sales Reported on May 2018 Return	1,446,853.57	2,002,488.03
<b>Difference – METRC Sales Over Licensee Reported</b>	<b>\$ 475,017.05</b>	<b>\$ 563,589.14</b>

Source: Auditor analysis of tax returns and METRC data.

<sup>1</sup> The Retail Marijuana Tax is calculated based on recreational marijuana sales only.

<sup>2</sup> The Sales and Use Tax is calculated based on recreational marijuana sales, medical marijuana sales, and the sales of marijuana paraphernalia. We used a reasonable variance to account for paraphernalia sales when estimating the difference between marijuana sales on the Sales and Use Tax Return and METRC sales data.

# Appendix B

## Illustrative Examples of System Errors (continued)

### Example 3: Wholesale Cultivator – METRC Inventory Less Than Reported on Tax Return:

<b>Company C</b>		<b>Wholesale Marijuana Tax Return – Inventory Classifications</b>					
	<b>Popcorn<sup>3</sup></b>	<b>Flowers/ Buds<sup>3</sup></b>	<b>Shake/ Trim<sup>3</sup></b>	<b>Immature Plants<sup>4</sup></b>	<b>Wet Whole Plant<sup>3</sup></b>	<b>Seeds<sup>4</sup></b>	<b>Pre- Rolls<sup>4</sup></b>
January 2018 METRC Inventory Transfers	4.4390	75.9213	144.0670	–	–	–	3,401
January 2018 Return	4.4400	85.7300	146.3400	–	–	–	3,401
<b>Difference – Under</b>	<b>(0.0010)</b>	<b>(9.8087)</b>	<b>(2.2730)</b>	–	–	–	–

<b>Company D</b>		<b>Wholesale Marijuana Tax Return – Inventory Classifications</b>					
	<b>Popcorn<sup>3</sup></b>	<b>Flowers/ Buds<sup>3</sup></b>	<b>Shake/ Trim<sup>3</sup></b>	<b>Immature Plants<sup>4</sup></b>	<b>Wet Whole Plant<sup>3</sup></b>	<b>Seeds<sup>4</sup></b>	<b>Pre- Rolls<sup>4</sup></b>
February 2018 METRC Inventory Transfers	–	92.7552	27.1618	–	–	–	15,708
February 2018 Return	–	111.1200	43.9200	–	–	–	27,451
<b>Difference – Under</b>	–	<b>(18.3648)</b>	<b>(16.7582)</b>	–	–	–	<b>(11,743)</b>

<b>Company E</b>		<b>Wholesale Marijuana Tax Return – Inventory Classifications</b>					
	<b>Popcorn<sup>3</sup></b>	<b>Flowers/ Buds<sup>3</sup></b>	<b>Shake/ Trim<sup>3</sup></b>	<b>Immature Plants<sup>4</sup></b>	<b>Wet Whole Plant<sup>3</sup></b>	<b>Seeds<sup>4</sup></b>	<b>Pre- Rolls<sup>4</sup></b>
June 2018 METRC Inventory Transfers	–	99.4483	–	–	–	–	20,110
June 2018 Return	–	165.0000	–	–	–	–	108,655
<b>Difference – Under</b>	–	<b>(65.5517)</b>	–	–	–	–	<b>(88,545)</b>

<sup>3</sup> Amounts are reported on the tax return based on the number of pounds sold.

<sup>4</sup> Amounts are reported on the tax return based on the number of units sold.

# Appendix B

## Illustrative Examples of System Errors (continued)

### Example 4: Wholesale Cultivator – METRC Inventory More Than Reported on Tax Return:

<b>Company E</b>		<b>Wholesale Marijuana Tax Return – Inventory Classifications</b>					
	<b>Popcorn<sup>3</sup></b>	<b>Flowers/ Buds<sup>3</sup></b>	<b>Shake/ Trim<sup>3</sup></b>	<b>Immature Plants<sup>4</sup></b>	<b>Wet Whole Plant<sup>3</sup></b>	<b>Seeds<sup>4</sup></b>	<b>Pre- Rolls<sup>4</sup></b>
March 2018 METRC Inventory Transfers	–	56.6309	–	–	–	–	26,314
March 2018 Return	–	56.0000	–	–	–	–	22,646
<b>Difference – Over</b>	<b>–</b>	<b>0.6309</b>	<b>–</b>	<b>–</b>	<b>–</b>	<b>–</b>	<b>3,668</b>

<b>Company D</b>		<b>Wholesale Marijuana Tax Return – Inventory Classifications</b>					
	<b>Popcorn<sup>3</sup></b>	<b>Flowers/ Buds<sup>3</sup></b>	<b>Shake/ Trim<sup>3</sup></b>	<b>Immature Plants<sup>4</sup></b>	<b>Wet Whole Plant<sup>3</sup></b>	<b>Seeds<sup>4</sup></b>	<b>Pre- Rolls<sup>4</sup></b>
May 2018 METRC Inventory Transfers	–	58.8276	23.1793	516	–	–	8,754
May 2018 Return	–	52.1300	24.4000	–	–	–	8,541
<b>Difference – Over/(Under)</b>	<b>–</b>	<b>6.6976</b>	<b>(1.2207)</b>	<b>516</b>	<b>–</b>	<b>–</b>	<b>213</b>

<b>Company F</b>		<b>Wholesale Marijuana Tax Return – Inventory Classifications</b>					
	<b>Popcorn<sup>3</sup></b>	<b>Flowers/ Buds<sup>3</sup></b>	<b>Shake/ Trim<sup>3</sup></b>	<b>Immature Plants<sup>4</sup></b>	<b>Wet Whole Plant<sup>3</sup></b>	<b>Seeds<sup>4</sup></b>	<b>Pre- Rolls<sup>4</sup></b>
June 2018 METRC Inventory Transfers	8.0612	95.8590	74.6560	–	–	–	1,106
June 2018 Return	8.9000	55.1000	–	–	–	–	–
<b>Difference – Over/(Under)</b>	<b>(0.8388)</b>	<b>40.7590</b>	<b>74.6560</b>	<b>–</b>	<b>–</b>	<b>–</b>	<b>1,106</b>

<sup>3</sup> Amounts are reported on the tax return based on the number of pounds sold.

<sup>4</sup> Amounts are reported on the tax return based on the number of units sold.

# Appendix C

## Audit Methodology

To gain an understanding of the Department of Taxation (Department), we interviewed staff and reviewed statutes, regulations, and policies and procedures significant to its operations. We also reviewed financial information, prior audit reports, budgets, legislative committee minutes, and other information describing the activities of the Department. Furthermore, we documented and assessed the Department's controls related to regulating marijuana and collecting cash.

To determine if data in the METRC system was accurate, we randomly selected 10 cultivation and 5 dispensary licenses. At the time of our selection, there were 241 active cultivation and 128 active dispensary licenses. For cultivators, we downloaded marijuana sales and transfers from METRC, adjusted for secondary transfers, and compared totals to amounts reported on wholesale tax returns for the months January to June 2018. For dispensaries, we downloaded sales transactions from METRC, adjusted for medical sales, and compared totals to the amounts reported on retail tax returns for the same time period. METRC sales data was also compared to amounts reported on sales and use tax returns filed. We discussed with the Department the implementation of METRC, procedures for monitoring and verifying data, and variances found.

To evaluate data regarding production waste, we downloaded and analyzed METRC waste data for the 10 cultivators selected previously. We reviewed data for missing, incomplete, or illogical entries and analyzed remaining data for trends and consistency. Additionally, we discussed the production waste process with other states who oversee legal marijuana programs and who also use METRC. We inquired with management whether waste data was monitored or if parameters had been developed for

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determining the reasonableness of production waste reported by the licensees.

To determine if medical marijuana products were sold to recreational consumers, we randomly selected 17 dispensaries. We obtained sales data for all 17 dispensaries for January to June 2018. Next, we judgmentally selected 24 marijuana packages based on the likelihood the selected products were medical products. We requested lab reports for packages selected and received 12 of 24 reports. We compared lab reports to METRC information and determined if packages were medical products. Furthermore, we reviewed information in METRC and determined if data regarding THC content was consistently reported. Finally, we reviewed sales data and determined if medical products were sold to recreational consumers.

To evaluate whether marijuana inventory was properly tagged and tracked as medical or recreational product, we discussed METRC product tags and license parameters with Department and METRC personnel. For medical product tracking we also reviewed transfer reports for five dispensaries and identified those from medically licensed cultivators and producers. We determined if medical products were associated with or sold under a recreational license.

To evaluate the security and collection of cash, we observed and documented the physical controls at each office. We also discussed current and planned physical controls with staff and management of the Department. To determine if cash received was deposited, we reconciled cash register receipt tapes to armored car service logs for each office. We also reviewed the time cash was stored by randomly selecting 3 months for each office and comparing the date the cash was received to the date it was picked up by the armored car service.

For our testing involving samples, we used nonstatistical audit sampling, which was the most appropriate and cost-effective method for concluding on our audit objective. Based on our professional judgment, review of authoritative sampling guidance, and careful consideration of the underlying statistical concepts, we

believe that nonstatistical sampling provided sufficient appropriate evidence to support our conclusions in the report. We have identified whether our samples were selected randomly or judgmentally and the related populations where appropriate and determinable. If population information is not identified it is because it was not efficient to determine the entire population. We did not project the results of our testing to populations because METRC data was not complete, populations were not known, or errors were not projectable.

Our audit work was conducted from January to November 2018. 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.

In accordance with NRS 218G.230, we furnished a copy of our preliminary report to the Director of the Department of Taxation. On February 19, 2019, we met with agency officials to discuss the results of the audit and requested a written response to the preliminary report. That response is contained in Appendix D, which begins on page 27.

Contributors to this report included:

Eugene Allara, CPA  
Deputy Legislative Auditor

Shannon Ryan, CPA  
Audit Supervisor

Yuriy Ikovlev, MBA  
Deputy Legislative Auditor

Daniel L. Crossman, CPA  
Chief Deputy Legislative Auditor

# Appendix D

## Response From the Department of Taxation



STEVE SISOLAK  
Governor  
JAMES DEVOLLD  
Chair, Nevada Tax Commission  
MELANIE YOUNG  
Executive Director

### STATE OF NEVADA DEPARTMENT OF TAXATION

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Rocky Cooper, Legislative Auditor  
Legislative Council Bureau  
Legislative Building  
401 S. Carson Street  
Carson City, NV 89701-4747

March 1, 2019

Dear Mr. Cooper,

Thank you for the information provided in your preliminary audit report dated February 21, 2019. The Department generally agrees with all recommendations, and looks forward to improving the activities of the Department's Marijuana Regulation and Enforcement Division.

Our program was successfully launched in less than eight months, significantly faster than any other state which has legalized cannabis to date. The rapid implementation of the Metrc marijuana system has been especially challenging as we have had to continually adapt programming to regulatory changes. The Department was aware of a number of issues identified in the audit, and has been endeavoring to remediate them as resources allow.

Nevertheless, the Metrc system has enabled the Department to identify numerous discrepancies resulting in investigations and administrative charges. Licensees are on notice that failure to accurately record data may result in sanctions, up to and including loss of licensure. As additional training is provided to both licensees and staff, data quality and overall compliance will continue to improve. This is further supported through inspections, audits and investigations.

While inventory tracking is an invaluable component of the Department's regulatory framework, it is only one of several tools used for triggering enforcement actions. The deficiencies identified in the Metrc system and its monitoring do not impair the Department's overall ability to provide for public safety oversight of the marijuana industry.

**Recommendation 1: Develop additional policies and procedures to verify the ongoing accuracy and completeness of METRC data. Procedures should address all significant data elements.**

Response: Recommendation accepted.

The Department has developed procedures to monitor data and identify and investigate irregular activity through a Metrc notifications system, canned reports, SQL queries, monthly reports and audits.

**Recommendation 2: Utilize METRC to identify licensees at risk for potential tax deficiencies and incorporate the use of METRC data into the audit selection process.**

Response: Recommendation accepted.

On February 5, 2019, Metrc provided background SQL query templates to the Department. These templates provide tools to customize data pulls from Metrc and allow the Department to

better identify deficiencies. In accordance with NRS 372A.285, listserv emails were distributed to licensees with a directive that effective January 1, 2019, all cultivation facilities, production facilities and dispensaries are required to submit monthly reports to the Department. The monthly reports include data for harvests, production and sales. NAC 453D.426 requires all facilities to conduct a quarterly physical inventory. On February 28, 2019, a listserv was distributed requiring all licensees to provide their quarterly inventory documents to the Department. The monthly reports and the quarterly inventory documents will be utilized in conjunction with Metrc queries/reports during the audit process.

The Department has implemented an audit program to audit 15% wholesale marijuana tax and compare Metrc with the filed tax return. Auditor training was completed on February 20, 2019. Audits started February 28, 2019.

**Recommendation 3: Obtain reports required by NRS 372A.285. Compare the reports to METRC and utilize information to regulate the industry.**

Response: Recommendation accepted.

In accordance with NRS 372A.285, listserv emails were distributed to licensees with a directive that effective January 1, 2019, all cultivation facilities, production facilities and dispensaries are required to submit monthly reports to the Department that include data for harvests, production and sales. The monthly reports will be utilized in conjunction with Metrc queries/reports to regulate the marijuana industry.

**Recommendation 4: Develop procedures to monitor data in METRC regarding harvest weights, waste, package weights, and moisture loss. Follow up on incomplete, erroneous, or irregular entries.**

Response: Recommendation accepted.

On Tuesday, February 19, 2019, the notifications feature became active in Metrc and included notifications for plants destroyed, package weights, and package adjustments on packages that have been submitted to testing. As it becomes aware, the Department follows up on incomplete, erroneous, and irregular activities.

The following notification categories are pending implementation in Metrc: harvest weights and package adjustments on packages that have not been submitted for testing. Metrc is designing a tool that will give the Department the flexibility of creating custom notifications, which will result in faster implementation of notifications.

**Recommendation 5: Establish additional procedures to regulate and identify inappropriate sales of high potency (medical) products.**

Response: Recommendation accepted.

The following notification category is pending implementation in Metrc: sales of products with THC baseline of 100mg. Metrc is designing a tool that will give the Department the flexibility of creating custom notifications, which will result in faster implementation of notifications. As it becomes aware, the Department follows up on incomplete, erroneous, and irregular activities.



**Recommendation 6: Establish procedures to ensure marijuana products are accounted for and sold under the proper license.**

Response: Recommendation accepted.

The Department has submitted a system design change request to Metrc to immediately prevent packages that exceed the recreational THC limits from being sold under a recreational license and require the sale to occur under the medical license.

Currently the Metrc system allows the Department to query each transaction to determine if it was sold to a patient or a customer.

**Recommendation 7: Develop statistics and benchmarks from METRC data regarding regulatory activities.**

Response: Recommendation accepted.

The Department currently utilizes dashboard statistics, canned reports and SQL queries. The Department has requested Metrc to provide canned reports or SQL code for the following additional areas: destructions, adjustments, waste, clones to plants, external transfers and transfers not accepted.

**Recommendation 8: Establish a program to monitor METRC data and identify and investigate irregular activity.**

Response: Recommendation accepted.

The Department has established a program to monitor data and identify and investigate irregular activity through a Metrc notifications system, canned reports, SQL queries, monthly reports and audits.

**Recommendation 9: Identify and establish system notifications using METRC data. Review and follow up on notifications.**

Response: Recommendation accepted.

On Tuesday, February 19, 2019, the notifications feature became active in Metrc and included notifications for limited/no activity, test results, package limits, product waste/destruction, transfers and sales not reported. The implementations of several other notifications are currently pending with Metrc. As it becomes aware, the Department follows up on incomplete, erroneous, and irregular activities.

**Recommendation 10: Revise how THC is reported in METRC and on lab reports. Ensure total product THC is identifiable and congruent with state law.**

Response: Recommendation accepted.

The Department submitted a request with Metrc to add a "Total mg THC per Unit" count as a lab result. Once the new category is implemented in Metrc, a requirement notification will go out to the labs.

**Recommendation 11: Provide licensees guidance regarding data input requirements for THC information and lab results. Monitor licensee compliance with data input.**

Response: Recommendation accepted.

Licensees do not have access to upload THC or lab results. They must provide the lab results to Metrc and the Department for upload into the system. Metrc and licensed labs are the only individuals with access to input THC or lab results. Licensees are required to put the THC amount in the item description.

When Metrc was first implemented at the end of 2017, beginning inventory did not require lab test results to be loaded into Metrc. Industry Metrc Bulletin #006, outlined that effective April 18, 2018, the State and Metrc would be removing the functionality to create a package without a source. This change required licensees to contact Metrc and the Department to upload lab test results prior to being able to transfer product.

On February 28, 2019, a listserv was distributed to licensees requiring all lab results for beginning inventory to be uploaded into Metrc prior to April 1, 2019. Any beginning inventory that does not have lab results in Metrc by April 1, 2019 will have to be destroyed.

**Recommendation 12: Revise tax return instructions to provide appropriate guidance to licenses regarding how month-end wholesale transactions should be recorded on tax returns.**

Response: Recommendation accepted.

The Wholesale Marijuana Tax Return form has been updated with a clarifying statement s of "All sales must be reported in the month that the sale occurred." The Retail Marijuana Tax Return form is pending an update with the Department and should be updated by April 1, 2019. A listserv email was distributed on February 28, 2019, clarifying that the tax return must include all sales in a calendar month, regardless if it has been delivered.

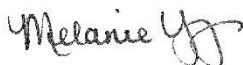
**Recommendation 13: Evaluate and install additional security measures.**

Response: Recommendation accepted.

The department has evaluated and implemented additional security measures including armed security guards at each office location. Due to the sensitive nature of our security measures, additional details are confidential but the department is willing to share these details with appropriate staff upon request.

Thank you once again for your recommendations to improve the activities of the Department's Marijuana Regulation and Enforcement Division.

Sincerely,



Melanie Young, Executive Director  
Nevada Department of Taxation

Department of Taxation

## Department of Taxation's Response to Audit Recommendations

<u>Recommendations</u>	<u>Accepted</u>	<u>Rejected</u>
1. Develop additional policies and procedures to verify the ongoing accuracy and completeness of METRC data. Procedures should address all significant data elements.....	<u>    X    </u>	<u>        </u>
2. Utilize METRC to identify licensees at risk for potential tax deficiencies and incorporate the use of METRC data into the audit selection process.....	<u>    X    </u>	<u>        </u>
3. Obtain reports required by NRS 372A.285. Compare the reports to METRC and utilize information to regulate the industry .....	<u>    X    </u>	<u>        </u>
4. Develop procedures to monitor data in METRC regarding harvest weights, waste, package weights, and moisture loss. Follow up on incomplete, erroneous, or irregular entries .....	<u>    X    </u>	<u>        </u>
5. Establish additional procedures to regulate and identify inappropriate sales of high potency (medical) products .....	<u>    X    </u>	<u>        </u>
6. Establish procedures to ensure marijuana products are accounted for and sold under the proper license .....	<u>    X    </u>	<u>        </u>
7. Develop statistics and benchmarks from METRC data regarding regulatory activities.....	<u>    X    </u>	<u>        </u>
8. Establish a program to monitor METRC data and identify and investigate irregular activity .....	<u>    X    </u>	<u>        </u>
9. Identify and establish system notifications using METRC data. Review and follow up on notifications .....	<u>    X    </u>	<u>        </u>
10. Revise how THC is reported in METRC and on lab reports. Ensure total product THC is identifiable and congruent with state law.....	<u>    X    </u>	<u>        </u>
11. Provide licensees guidance regarding data input requirements for THC information and lab results. Monitor licensee compliance with data input .....	<u>    X    </u>	<u>        </u>
12. Revise tax return instructions to provide appropriate guidance to licensees regarding how month-end wholesale transactions should be recorded on tax returns .....	<u>    X    </u>	<u>        </u>
13. Evaluate and install additional security measures.....	<u>    X    </u>	<u>        </u>
TOTALS	<u>    13    </u>	<u>        </u>