

# 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)