

FOLLOW-UP REPORT

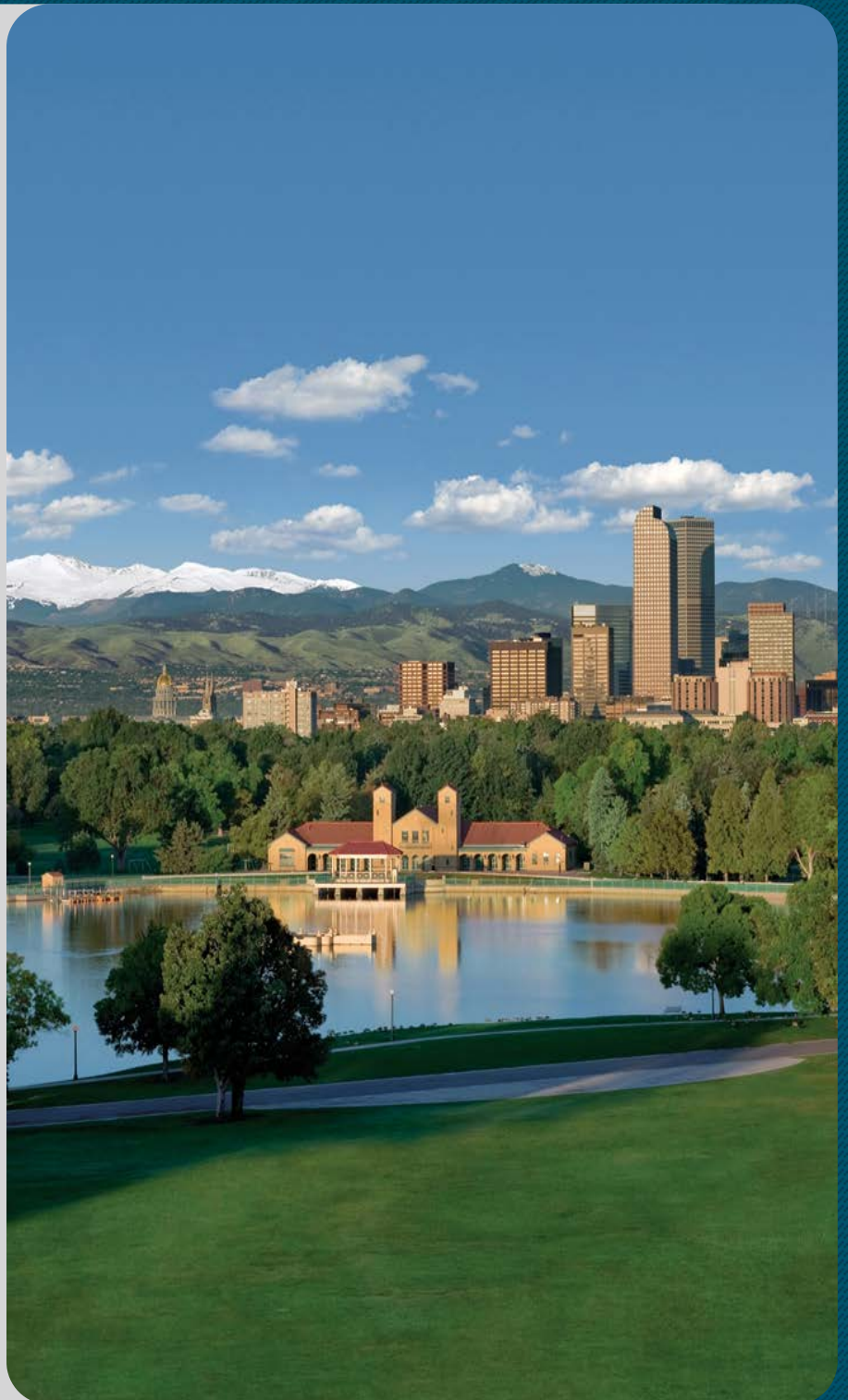
Medical Marijuana Taxation

June 2016

**Office of the Auditor
Audit Services Division
City and County of Denver**



**Timothy M. O'Brien, CPA
Denver Auditor**



The Auditor of the City and County of Denver is independently elected by the citizens of Denver. He is responsible for examining and evaluating the operations of City agencies for the purpose of ensuring the proper and efficient use of City resources and providing other audit services and information to City Council, the Mayor and the public to improve all aspects of Denver's government. He also chairs the City's Audit Committee.

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June 2, 2016

Steve Ellington, Financial Executive
Department of Revenue, Treasury Division
City and County of Denver

Re: Audit Follow-Up Report

Dear Mr. Ellington:

In keeping with generally accepted government auditing standards and the Audit Services Division's policy, as authorized by D.R.M.C. § 20-276, our Division has a responsibility to monitor and follow-up on audit recommendations to ensure audit findings are being addressed through appropriate corrective action and to aid us in planning future audits.

This report is to inform you that we have completed our follow-up effort for the Medical Marijuana Taxation audit issued September 18, 2014. Our review determined that the Treasury Division has adequately implemented all of the recommendations made in the audit report.

For your reference, this report includes a Highlights page that provides background and summary information on the original audit and the completed follow-up effort. Following the Highlights page is a detailed implementation status update for each recommendation.

This concludes audit follow-up work related to this audit. I would like to express our sincere appreciation to you and to Treasury Division personnel who assisted us throughout the audit and follow-up process. If you have any questions, please feel free to contact me at 720-913-5000 or Katja Freeman, Internal Audit Supervisor, at 720-913-5158.

Denver Auditor's Office

A handwritten signature in black ink, appearing to read "Timothy M. O'Brien".

Timothy M. O'Brien, CPA
Auditor



Medical Marijuana Taxation June 2016

Status

The Treasury Division has adequately implemented all recommendations made in the September 2014 audit report.

Background

The Treasury Division within the City's Department of Finance collects, records, and deposits all City and County of Denver taxes and other revenues. It is made up of two sections: Tax Compliance and Motor Vehicle. The Tax Compliance Section is responsible for billing, collecting, and payment processing, recording, and reconciling all collected taxes. Medical marijuana is subject to 7.62 percent Colorado combined sales tax.

Purpose

The audit evaluated the adequacy of Treasury's processes and controls pertaining to the administration, enforcement, and collection of taxes due from medical marijuana businesses operating within the City and County of Denver. Although the audit focuses on medical marijuana, our audit work showed that existing tax compliance risks and controls related to medical marijuana are very similar to those related to recreational (retail) marijuana. Therefore, in the discussions related to the tax compliance risks and controls throughout this audit report, we may make references to both medical and retail marijuana.

REPORT HIGHLIGHTS

Highlights from Original Audit

The audit found that the Treasury Division (Treasury) has supplemented its standard tax compliance activities with additional efforts intended to mitigate some of the potential risks associated with taxing medical marijuana (MMJ) businesses. However, Treasury has not sufficiently addressed the unique challenges associated with tax collection from the MMJ industry, which was apparent in two areas. First, we found that the Citywide marijuana policy does not address tax collection and the importance of compliance enforcement. Second, Treasury has not gathered sufficient data to ensure that its current MMJ industry tax compliance program is adequately mitigating the unique tax risks of the MMJ industry. Specifically, Treasury has not:

- Gathered sufficient data through completion of its current audits of MMJ business to ensure that its current tax compliance program is working effectively to ensure tax compliance by the MMJ industry.
- Enhanced its taxpayer education efforts to ensure that MMJ businesses have the information they need to comply with tax regulations
- Engaged in collaborative efforts with other jurisdictions as a means of assessing its performance in the area of MMJ tax collection and enforcement

Although the percentage of tax dollars from MMJ is small compared to the sum total of all the City's tax revenue streams, the percentage will only grow as the retail marijuana industry becomes more established.

Further, there is a significant public relations risk exposure to the City related to MMJ operations owing to the nascent and controversial nature of marijuana sales. Treasury should use its experience with the MMJ industry to proactively ensure that it is prepared to carry out its responsibilities for ensuring tax compliance by the retail marijuana industry.

Findings at Follow-up

The City has implemented all four audit recommendations. Specifically, we found that Treasury had completed twenty-eight MMJ tax Audits as of April 15, 2015, with another thirty-eight MMJ tax audits assigned to audit staff in 2015, to be completed as resources allow. Additionally, Treasury published an MMJ tax guide, which is available on Treasury's website and was provided to MMJ businesses in October 2014. Finally, Treasury continues to work in coordination with the Office of Marijuana Policy, the State Department of Revenue, and other jurisdictions.

For a complete copy of this report, visit www.denvergov.org/auditor
Audit Contact Person: Katja Freeman | 720.913.5158 | Katja.Freeman@denvergov.org

Recommendations: Status of Implementation

Recommendation	Auditee Action	Status
Finding: The Treasury Division Has Not Sufficiently Addressed the Unique Challenges of Tax Collection from the Medical Marijuana Industry		
<p>1.1 Strategic Planning – Treasury should take on a more active role in the City’s strategic planning for marijuana policy. Specifically, Treasury should, in collaboration with the Office of the Chief Financial Officer, ensure that the review of City tax compliance is one of the steps toward achieving the strategic goal of efficient and effective enforcement of MMJ regulation.</p>	<p>We verified that Treasury has increased its attendance at scheduled Marijuana Team meetings held by the City’s Office of Marijuana Policy since the audit was published in September 2014. A review of the agendas for these meetings revealed that Treasury did not bring forward any specific initiatives to add efficient and effective tax enforcement compliance as part of a Citywide marijuana policy. However, we found that since the audit, Treasury has made improvements in reducing tax compliance risk by increasing the number of marijuana business audits. In addition, Treasury has been using reports from the state-mandated Marijuana Enforcement Tracking Reporting Compliance (METRC) System, a seed-to-sale inventory system, to independently check inventories against the taxpayers’ accounting systems when conducting these audits, which allows Treasury to verify that marijuana business owners report all sales.</p>	<p>Implemented</p>

Recommendations: Status of Implementation

	Recommendation	Auditee Action	Status
1.2	<p>Compliance Audits – Treasury should expedite the completion of its ongoing MMJ industry audits and determine whether additional action regarding Treasury’s tax compliance efforts is warranted, such as expanding the number of MMJ audits conducted.</p>	<p>As of April 2015, Treasury had completed twenty-nine audits of both medical and recreational marijuana businesses. These audits allowed Treasury to collect an additional \$1.1 million in taxes. One audit was completed in 2011, seven in 2014, and twenty-one in 2015. According to Treasury, another thirty-nine marijuana business audits are currently assigned and are still in progress. These audits are selected in accordance with sampling methods and risk factors identified by the Audit Unit management and Audit staff members.</p>	<p>Implemented</p>
1.3	<p>Educational Outreach – Treasury should develop taxpayer information and educational material specific to the MMJ industry and disperse it as needed.</p>	<p>Treasury produced a tax guide for the marijuana industry, both medical and recreational, which was issued in October 2014 and is available on Treasury’s website. Additionally, Treasury reported that they mailed a copy of the guide to all marijuana businesses in October 2014. Treasury stated that Taxpayer Service personnel also routinely use the guide in interactions with marijuana businesses for educational purposes.</p>	<p>Implemented</p>

Recommendations: Status of Implementation

	Recommendation	Auditee Action	Status
1.4	<p>Inter-Agency Coordination – Treasury should initiate outreach to the State of Colorado and other tax jurisdictions to share information and ideas about the risks and trends associated with the MMJ industry. As part of this outreach, Treasury should explore the possibility of using the state-mandated marijuana inventory tracking system or other system for sales tax audit purposes.</p>	<p>Treasury met with the Colorado Department of Revenue on January 12, 2015, to learn about the usage of specific reports from the state-mandated Marijuana Enforcement Tracking Reporting Compliance (METRC) System that would be useful to Treasury’s Tax Compliance Audit Unit when conducting marijuana business audits. All marijuana businesses in the State of Colorado are required to use the METRC System. The Colorado Department of Revenue directed Treasury’s tax auditors to request that marijuana businesses run these reports for each of Treasury’s audits. Treasury’s tax auditors have been using this methodology for all audits since the meeting in 2015. Additionally, Treasury reports that they confer with other jurisdictions regarding best practices in the marijuana industry. Treasury stated that most often these meetings are informal and advisory in nature with jurisdictions that have fewer and less experience with marijuana businesses than the City and County of Denver.</p>	Implemented

Conclusion

We found that the Treasury Department has fully implemented all recommendations and adequately mitigated the risk identified during the original audit. As a result, we conclude our follow-up effort related to the Medical Marijuana Taxation Audit.

On behalf of the citizens of the City and County of Denver, we thank staff and leadership from the Treasury for their cooperation during our follow-up effort and their dedicated public service.