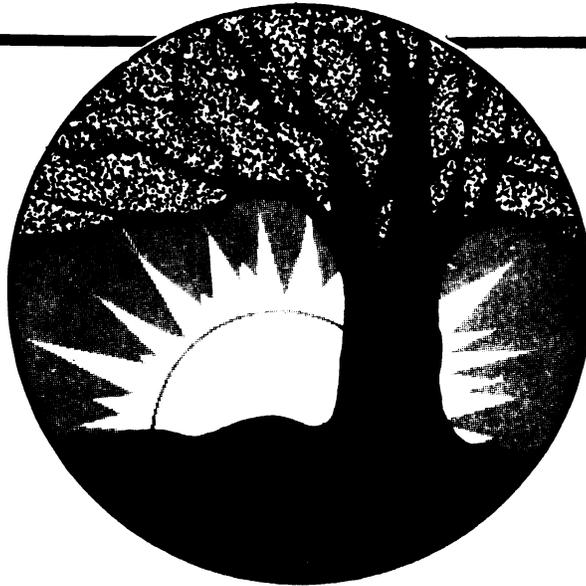


# PERFORMANCE AUDIT

Tennessee Alcoholic Beverage Commission

October 2009



Justin P. Wilson  
Comptroller of the Treasury



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Comptroller of the Treasury  
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October 13, 2009

The Honorable Ron Ramsey  
Speaker of the Senate  
The Honorable Kent Williams  
Speaker of the House of Representatives  
The Honorable Bo Watson, Chair  
Senate Committee on Government Operations  
The Honorable Susan M. Lynn, Chair  
House Committee on Government Operations  
and  
Members of the General Assembly  
State Capitol  
Nashville, Tennessee 37243

Ladies and Gentlemen:

Transmitted herewith is the performance audit of the Tennessee Alcoholic Beverage Commission. This audit was conducted pursuant to the requirements of Section 4-29-111, *Tennessee Code Annotated*, the Tennessee Governmental Entity Review Law.

This report is intended to aid the Joint Government Operations Committee in its review to determine whether the commission should be continued, restructured, or terminated.

Sincerely,

Arthur A. Hayes, Jr., CPA  
Director

AAH/js  
09-009

State of Tennessee

# Audit Highlights

Comptroller of the Treasury

Division of State Audit

Performance Audit  
**Tennessee Alcoholic Beverage Commission**  
October 2009

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## AUDIT OBJECTIVES

The objectives of the audit were to determine whether the Tennessee Alcoholic Beverage Commission (TABC) has resolved the lack of internal controls over cash receipting noted in two previous financial and compliance audits; to determine whether the commission's policies and procedures have been reviewed and revised as necessary to reflect changes in technology, industry, consumer practices, and state and federal laws; to determine whether the commission adequately and consistently enforces inspections, fines, and revocations; to determine whether the commission resolved accuracy and access issues noted in the most recent financial and compliance audit; to determine whether the commission can and should obtain criminal background checks for licensees; to determine whether the commission has allowed the account balance to exceed the authorized maximum of \$1,500; and to determine whether the commission has an audit committee as required by statute.

## FINDINGS

**In Spite of Three Cases of Employee Theft of Cash, Management of the Tennessee Alcoholic Beverage Commission Still Has Not Established Adequate Segregation of Duties in the Receipting, Depositing, and Reconciling of Cash at the Nashville Office to Effectively Safeguard Against Additional Fraud in the Future**

Although there have been improvements in the Nashville office, currently one individual collects cash and checks, prepares the deposit, maintains a deposit log, and enters the deposit data into the state accounting system (page 7).

**Management of the TABC Has Failed to Adequately Document Its Review of the Policy and Procedures Manual and Update Those Policies and Procedures in a Timely Manner**

Although changes in technology and personnel have altered the procedures followed by TABC, these revised procedures are not included in the policies and procedures manual. We found that 104 of the 145 policies (72%) in the manual have not been documented as reviewed since May 5, 1993 (page 9).

**Management of the TABC Has Failed to Effectively or Efficiently Pursue Unpaid Fines From Citations**

Although TABC sends a notice to the violator at the time of license renewal indicating any fines owed, the violator is not required to pay outstanding fines before being allowed to renew a license (page 10).

**The TABC Has Operated the Server Permit Program at a Deficit for Two Years Without Assessing Fees Sufficient to Cover Costs of Operating the Program**

In the most recent two of the four years reviewed, the program's expenses exceeded the revenue collected. Despite knowing that revenue does not cover expenses of the program, the commission has not yet met the statutory requirement to assess server permit fees to cover the deficiency (page 12).

**The TABC Does Not Perform Background Checks to Ensure Those With Criminal Backgrounds Do Not Obtain Liquor Licenses**

Statutes prohibit persons who have violated certain criminal codes from obtaining licenses or permits, and allow the TABC to conduct a criminal record review of applicants. However, TABC does not perform any

criminal background checks but relies on applicants to self-report (page 15).

**The Confidential Informant Fund (Petty Cash) Was Allowed to Exceed the \$1,500 Maximum on Multiple Occasions**

We reviewed the confidential funds account for the period from January to November 2008 and found the balance in the account exceeded \$1,500 for 10 of 11 months reviewed. It appears that neither the TABC nor the Department of Finance and Administration have adequate control of this account and the replenishment process (page 17).

**The TABC Has Not Established an Audit Committee, nor Has the Commission Requested an Exception as Required by State Law Since 2005**

The "State of Tennessee Audit Committee Act of 2005" requires state entities to establish audit committees and allows the Comptroller of the Treasury to set guidelines and approve exceptions. In November 2005, the Comptroller sent a reminder to entities subject to the act to either establish an audit committee or seek an exception. The TABC has not taken either action (page 19).

**OBSERVATIONS AND COMMENTS**

The audit also discusses the following issues: improvement in confiscated inventory procedures, improvement in issues related to property and equipment, confusion in submission of financial integrity and risk assessment letters, low participation in the responsible beer vendor certificate program, enacting a liquor-by-wire program in Tennessee, consideration of alcoholic beverage sales in grocery stores, and inspection of liquor-by-the-drink establishments (page 20).

## **ISSUES FOR LEGISLATIVE CONSIDERATION**

The General Assembly may wish to consider the following: allowing penalties for unpaid fines and withholding licensing and renewal until all debts to the state are paid; increasing fees in or appropriations to the server permit program, or terminating the program; revising statutes to meet the federal government's criteria to allow national criminal history background checks on applicants; and either terminating the Responsible Vendor Certificate Program or making participation mandatory, based on analysis by the Tennessee Alcoholic Beverage Commission (page 25).

# Performance Audit Tennessee Alcoholic Beverage Commission

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# **Performance Audit Tennessee Alcoholic Beverage Commission**

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## **INTRODUCTION**

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### **PURPOSE AND AUTHORITY FOR THE AUDIT**

This performance audit of the Tennessee Alcoholic Beverage Commission was conducted pursuant to the Tennessee Governmental Entity Review Law, *Tennessee Code Annotated*, Title 4, Chapter 29. Under Section 4-29-230, the Tennessee Alcoholic Beverage Commission was scheduled to terminate June 30, 2009, and is currently in wind-down, pending legislative action. The Comptroller of the Treasury is authorized under Section 4-29-111 to conduct a limited program review audit of the agency and to report to the Joint Government Operations Committee of the General Assembly. The audit is intended to aid the committee in determining whether the Tennessee Alcoholic Beverage Commission should be continued, restructured, or terminated.

### **OBJECTIVES OF THE AUDIT**

The overall objectives of this audit were to review the commission's legislative mandate and the extent to which the commission has carried out that mandate efficiently and effectively, and to make recommendations that might result in more efficient and effective operation of the commission. To that end, we focused our efforts on the following:

1. Cash Receipting/Deposits – Determine whether the Tennessee Alcoholic Beverage Commission (the commission) has resolved the lack of internal controls over cash receipting noted in two previous financial and compliance audits.
2. Policies and Procedures – Determine whether the commission's policies and procedures have been reviewed and revised as necessary to reflect changes in technology, industry, consumer practices, and state and federal laws.
3. Licensing – Determine whether the commission adequately and consistently enforces inspections, fines, and revocations.
4. Alcohol Server Training Program – Determine whether the commission corrected inadequate controls over the Server Training Program noted in the prior financial and compliance audit.
5. Background Checks – Determine whether the commission can and should obtain criminal background checks for licensees.

6. Confidential Informant Fund (Petty Cash) – Determine whether the commission has allowed the account balance to exceed the authorized maximum of \$1,500.
7. Audit Committee – Determine whether the commission has an audit committee as required by statute.
8. Property and Equipment – Determine whether the commission resolved accuracy and access issues noted in the most recent financial and compliance audit.
9. Confiscated Inventory – Determine method used by the commission for confiscated inventory.
10. Required Documents – Determine whether the commission has prepared documents and submitted them timely to other state agencies as required.
11. Responsible Beer Vendor Certificate Program – Determine whether the commission has assessed factors such as lack of industry support that affect the viability of this program.
12. Title VI Implementation Plan – Determine whether the commission has submitted the required Title VI Implementation Plan timely.

## **SCOPE AND METHODOLOGY OF THE AUDIT**

We reviewed the activities of the Tennessee Alcoholic Beverage Commission for the period from October 1998 through March 2009, but concentrated on fiscal years 2006-2008. We conducted this performance audit in accordance with generally accepted government auditing standards. These 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. Our methodology included

1. review of applicable legislation and policies and procedures;
2. interviews with commission members, management, and staff, as well as representatives of various alcoholic beverage manufacturers and purveyors and related industries;
3. examination of the entity's records, files, reports, and information summaries;

4. observing procedures for receiving cash, making deposits, maintaining confiscated inventory; and
5. verifying confiscated and sensitive equipment items to the commission records.

## **HISTORY AND STATUTORY RESPONSIBILITIES**

The Tennessee Alcoholic Beverage Commission was established by Chapter 257 of the Public Acts of 1963, codified as Section 57-1-101 et seq., *Tennessee Code Annotated*. The commission is responsible for regulating the alcoholic beverage industry, excluding beer (regulated by district beer boards). The commission issues the following:

- Annual licenses
  - Manufacturer, distiller, or rectifier
  - Liquor wholesaler
  - Liquor retailer
  - Winery
- Three-year employee permits for selling alcoholic beverages at liquor stores
- Five-year server permit cards for serving alcohol at liquor-by-the-drink facilities
- Certification of the providers and instructors of the Server Training Program.

Fees collected for licenses and permits go directly into the state's general fund. The commission conducts inspections, issues citations, and assesses civil penalties for violations of applicable state law. The commission also provides agents on a temporary assignment basis for the Governor's Task Force for the Eradication of Marijuana.

According to Section 57-1-102, *Tennessee Code Annotated*, the commission has three members appointed by the Governor. The Governor appoints one member from each of the state's grand divisions and, according to statute, should strive to ensure that at least one person is at least 60 years of age and that one person is of a racial minority. The commission at the time of audit work had at least one member at least 60 years of age and at least one person of a racial minority. As required by Section 57-1-104, the commission meets monthly.

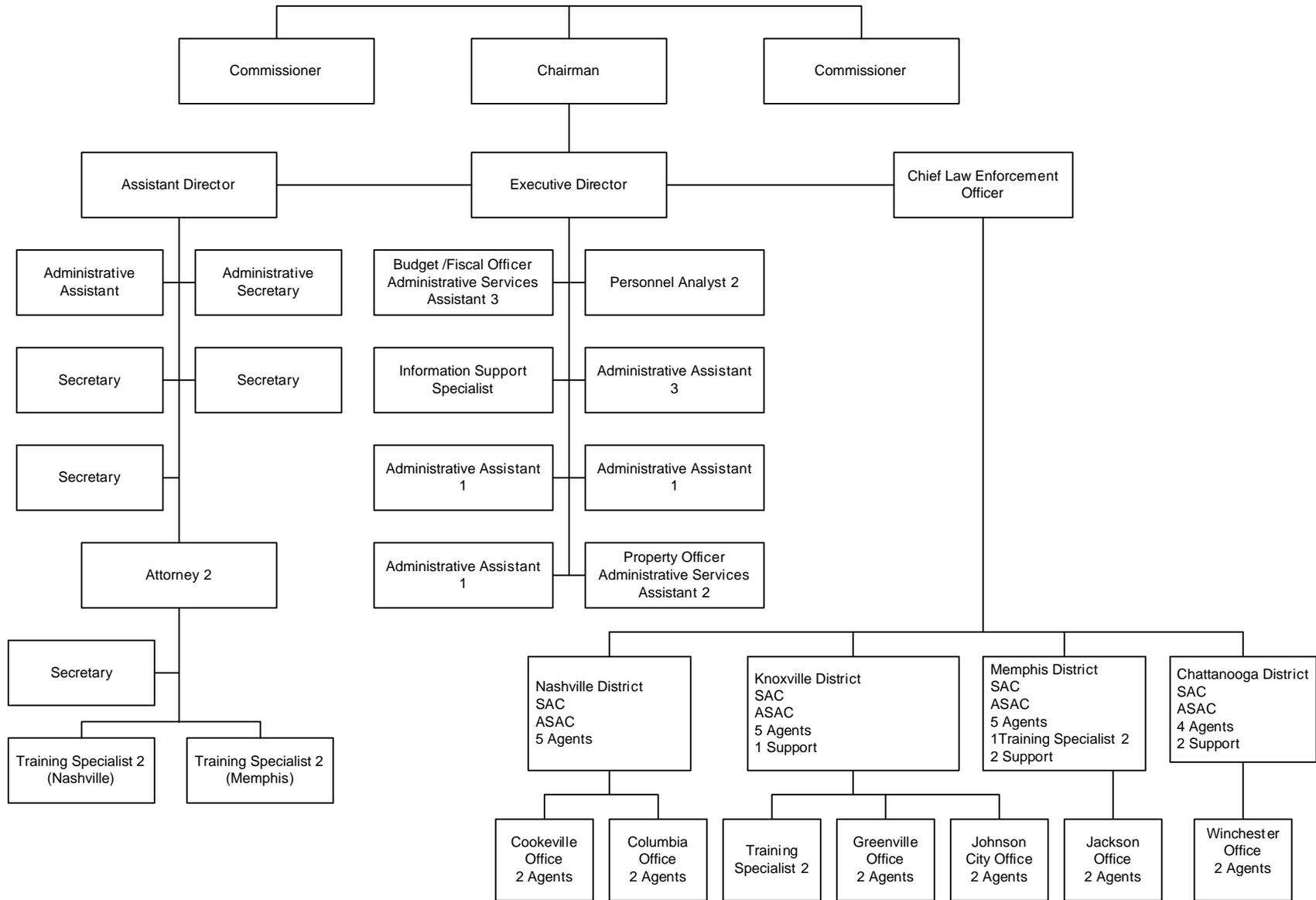
As of November 2008, the commission has 53 employees, including the executive director, the assistant director, the chief law enforcement officer, two training specialists, 30 agents, and 18 support staff. In addition to the central office in Nashville, the commission operates district offices in Chattanooga, Knoxville, and Memphis, and six subsidiary posts of duty (Columbia, Cookeville, Greeneville, Jackson, Johnson City, and Winchester).

The executive director, aided by the assistant director and the chief law enforcement officer, oversees the following major program areas:

- regulating the alcoholic beverage industry;
- licensing wholesalers, wineries, retailers, and liquor-by-the-drink establishments;
- operating the Alcoholic Beverage Server Training Program to certify training programs and issue server permits;
- operating the Responsible Beer Vendor Program; and
- participating in the Governor's Marijuana Eradication Task Force.

Distribution of responsibility over program areas is illustrated in the organization chart on the following page. (SAC = Special Agent In-charge, ASAC = Assistant Special Agent In-charge)

# Tennessee Alcoholic Beverage Commission Organization Chart



## REVENUES AND EXPENDITURES

### Revenues by Source For Three Quarters of the 2009 Fiscal Year (July 2008-March 2009)

<i>Source</i>	<i>Amount</i>	<i>Percent of Total</i>
Current Services	\$3,618,951	84.1%
Fines	536,981	12.5%
Interdepartmental Transfers (federal grant funds)	141,491	3.3%
FICA Savings	2,193	0.1%
<b>Total Revenue</b>	<b><u>\$4,299,616</u></b>	<b><u>100.0%</u></b>

### Expenses by Object For Three Quarters of the 2009 Fiscal Year (July 2008-March 2009)

<i>Account</i>	<i>Amount</i>	<i>Percent of Total</i>
Personal Services	\$1,728,077	53.2%
Employee Benefits	736,137	22.7%
Rentals and Insurance	352,847	10.9%
Travel	212,706	6.5%
Professional Services From Other State Agencies	80,671	2.5%
Supplies	59,656	1.8%
Communications and Shipping	29,075	0.9%
Printing, Duplicating, Film Processing	22,910	0.7%
Professional & Administrative Services	17,519	0.5%
Unclassified Expenses	2,748	0.1%
Grants & Subsidies	2,600	0.1%
Motor Vehicle Operation	1,451	0.0%
Maintenance, Repairs, and Services	976	0.1%
Awards & Indemnities	260	0.0%
<b>Total Expenses</b>	<b><u>\$3,247,633</u></b>	<b><u>100.0%</u></b>

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## FINDINGS AND RECOMMENDATIONS

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1. **In spite of three past cases of employee theft of cash, management of the Tennessee Alcoholic Beverage Commission still has not established adequate segregation of duties in the receipting, depositing, and reconciling of cash at the Nashville office to effectively safeguard against additional fraud in the future**

### Finding

As part of our work on this audit, we followed up on findings related to improper handling of cash. These findings are in prior audit reports issued by the Division of State Audit.

The July 2007 Financial and Compliance audit report of the Tennessee Alcoholic Beverage Commission reported three cases of employee theft of cash from the commission. The report also contains a finding that the TABC has “inadequate controls over cash receipting and the theft of funds, and the commission cannot ensure that all funds have been collected and properly deposited.” The July 2002 Financial and Compliance audit report also contained a finding that “controls over cash receipts need improvement.” Deficiencies noted in the two reports include deposits made one to three days late, assets not safeguarded, and a lack of segregation of duties. In addition, auditors noted there “are no independent reconciliations of cash receipts.”

During this current audit, we observed cash receipting and depositing at the central office in Nashville and at the other three posts of duty that collect and deposit cash payments. We conclude that the commission has resolved inadequate controls over cash and improved segregation of duties at the field offices. Although there have been improvements in the Nashville office, changes have not eliminated one deficiency in the adequate segregation of duties. Currently, one individual collects cash and checks from several persons who initially receive them. That same person prepares the deposit slip, maintains a daily deposit log, and enters the deposit data for all posts of duty into the state accounting system.

This employee has a backup person, but the position has been vacant for six months, so there is currently no one who directly oversees the work performed. The employee has access to cash and checks and almost total responsibility for deposits. The opportunities for manipulation of funds or theft that could go undetected illustrate insufficient internal controls. Such a breakdown of controls contributes to a situation in which future acts of fraud are more likely to occur. Since the time of field work, the executive director began checking the deposits and the Chief Law Enforcement Officer takes the deposits to the bank each day. According to the executive director, as of October 15, 2009, the TABC will no longer accept cash as payment for licenses or citations.

## **Recommendation**

We recommend the executive director continue steps to improve internal controls to reduce opportunities for individuals to commit fraud. TABC management should segregate the duties of the Budget/Fiscal Director regarding cash receipting and deposits. Examples include assigning another employee as a backup, someone independent of the cash receipting and depositing function to enter the daily deposit data, and giving another person responsibility to deposit funds into the bank. The executive director should take other steps to demonstrate and communicate to all staff that internal controls should be implemented and not overridden and circumvented. All staff should be reminded regularly of their responsibility to be alert to any indications of fraud, waste, and abuse and should report any indications directly to their supervisor.

## **Management's Comment**

We concur. The TABC concurs with the audit report finding that one employee—the fiscal officer—receives the cash from the employees receipting the money in the Nashville office, prepares the deposit slip, deposits the money in the bank, and enters the deposit data for all posts into the state accounting system.

To rectify this situation, once the currently vacant Human Resources position is filled, this employee will act as the backup for the fiscal officer. The TABC's Chief Law Enforcement Officer, Assistant Director, or Executive Director now make the daily deposits—thus, segregating the duty of receiving deposits from actually depositing the monies.<sup>1</sup> Deposit reconciliations are independently documented by the Executive Director as recommended by the 2007 financial audit.

As of September 28, 2009, the TABC has received permission to fill one support position. This employee will be stationed in an office with a window that has a small opening and a door capable of being locked. All receipting for the Nashville office will be done by this employee and all monies will be secured at all times behind locked doors. Only management and the employee will have access to the office.

In an additional effort to reduce the opportunity for fraud, as of October 15, 2009, the TABC will no longer accept cash as payment for licenses or citations.

Further, the TABC now utilizes the INOVAH system through Edison as required by the Department of Finance and Administration—such was not in effect at the time of the audit. Segregation of licensing, collecting, receipting, and depositing of monies will continue as was implemented in 2004.

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<sup>1</sup> No other employee is currently available to do so on a regular basis who does not otherwise have responsibility related to the issuance of licenses/permits/citations; the receipt of monies submitted; or to reconciling monies collected to the receipts written.

It should be noted that since the 2004 employee theft<sup>2</sup> that has been referenced in both the 2007 audit and this performance audit, no further instance of theft or fraud has occurred. This should be attributed to the efforts that have been implemented by the TABC on its own accord since 2004, as well as those implementing those recommendations suggested by the 2007 fiscal audit.

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**2. Management of the Tennessee Alcoholic Beverage Commission has failed to adequately document its review of the commission's written policies and procedures manual and update those policies and procedures with needed changes in a timely manner**

**Finding**

The 2007 financial and compliance audit noted that the written policy over cash receipting was created in 1993. Although changes in technology and personnel have altered the procedures followed by TABC, these revised procedures are not written and are not included in the policies and procedures manual. According to the date and authorizing director's signature appearing on the written policy, the current cash receipting policy in the manual was last reviewed on May 5, 1993. Current management stated that several of the policies have been reviewed over the past 15 years, but we found during our examination of TABC's policies and procedures manual that the reviews have not been documented with the review date(s) and the director's signature. We found that 104 of the 145 policies (72%) in the policies and procedures manual have not been documented as reviewed since May 5, 1993. Without proper written policies and procedures, it is difficult to ensure consistent actions among current staff and smooth transition during turnover.

**Recommendation**

With changes in society, laws, and technology, it is necessary for TABC to review its Policies and Procedures Manual regularly and make any necessary changes. Management's review and authorization of the Policies and Procedures Manual should be documented even if significant changes are not made to the policies and procedures.

**Management's Comment**

We concur. The TABC has not documented its changes to the policies and procedures manual. That is not to say that changes have not occurred and been communicated to TABC staff through staff meetings, instructions, and memorandums. For example, the audit indicates that the current cash receipting policy was last reviewed in May, 1993. However, as set forth above, the cash receipting policy has been modified and its steps communicated to the staff through staff meetings and instructions. Additionally, the policy and procedures manual was

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<sup>2</sup> The employee was fired and criminally prosecuted for felony theft: jail time and restitution was ordered.

reviewed in approximately 2004 as indicated on an agenda for a staff meeting. Further, in August and September, 2009, the entire policy and procedures manual was reviewed and modified by the Assistant Director, Chief Law Enforcement Officer, and the Executive Director: additional changes and updates have been made and are in the process of being typed and printed. Documentation of this has been made, and future changes to the manual will also be documented.

**3. Management of the Tennessee Alcoholic Beverage Commission has failed to effectively or efficiently pursue unpaid fines from citations in a timely manner**

**Finding**

The Tennessee Alcoholic Beverage Commission (TABC) has the statutory authority to investigate violations of the state’s regulations for the manufacture and sale of alcoholic beverages and to issue citations for violations of those regulations. After issuing a citation, the TABC conducts a hearing and issues a consent order pursuant to the settlement reached at the hearing. Depending on the violation, the TABC may revoke a license or assess a fine and penalty. Fines collected by TABC are deposited into the state’s general fund. Fines and citations are necessary for effective enforcement of the law and are used by TABC for more efficient and effective operations.

Currently, the management at the TABC does not actively attempt to collect unpaid fines. Although TABC sends a notice to the violator at the time of license renewal indicating any fines owed, the violator is not required to pay outstanding fines before being allowed to renew a license. A licensee must pay any taxes owed before they can renew, but statutes do not require licensees to pay unpaid fines prior to renewal. TABC management provided citation disposition information for 1,667 of the 1,760 citations issued in calendar year 2007 and 1,864 of the 1,960 citations issued in calendar year 2008. These are described in the table below:

**Disposition of Citations Issued for Calendar Years 2007 and 2008**

<i>Citation Disposition</i>	Number		Dollar Amount	
	<u>2007</u>	<u>2008</u>	<u>2007</u>	<u>2008</u>
Paid in full	1,183	959	\$760,100	\$534,725
Paid in Excess over Current Year	8	17	-\$9,900	-\$27,900
Unpaid, business closed	191	164	\$1,382,575	\$281,150
Dismissed or Voided	53	83	\$16,400	\$24,650
Reduced amount	96	66	\$261,745	\$146,700
Reduced to warning	24	28	\$26,150	\$9,150
Unpaid, license revoked	1	0	\$2,250	0
Balance uncollected	<u>111</u>	<u>547</u>	<u>\$345,105</u>	<u>\$741,150</u>
Total Issued	1,667	1,864	\$2,784,425	\$1,709,625

*Source: Tennessee Alcoholic Beverage Commission.*

State statutes require TABC to defer an application to renew a license until the Department of Revenue confirms that the applicant has paid all taxes due to the state, but TABC cannot deny a renewal for failure to pay fines from TABC citations. Section 57-3-408, *Tennessee Code Annotated*, requires TABC to report unpaid fines and fees to the Office of the Attorney General for collection.

For calendar year 2008, the TABC investigators issued 1,960 citations and collected \$534,725 in fines. A balance of \$741,150 remained uncollected at March 31, 2009. The commission has not turned these or any other unpaid accounts over to the Office of the Attorney General for collection, as directed by statute. We also noted that the spreadsheet provided to us by TABC was missing information for 96 out of 1,960 (4.9%) citations for 2008 and 69 out of 1,736 (4%) citations for 2007. The TABC has been neither efficient nor effective using the current procedure for collecting fines from citations.

### **Recommendation**

TABC should consider more actively pursuing unpaid fines and citations to include more current and complete recordkeeping of amounts due the state for penalties and fines. The General Assembly may wish to consider amending Section 57-3-408, *Tennessee Code Annotated*, to allow TABC to assess penalties for unpaid fines. The General Assembly may also wish to consider amending the license renewal statute to allow TABC to withhold licenses and renewals of licenses until all debts due to the state, whether taxes, fees, fines, or penalties, are paid. In accordance with Section 57-3-408, *Tennessee Code Annotated*, the TABC should make use of collection assistance provided by the Office of the Attorney General.

### **Management's Comment**

We concur. The TABC does not have adequate personnel to set hearings and to pursue unpaid citations in an effective manner. The TABC has two attorneys on staff: the Assistant Director and the Executive Director. The everyday duties of these two employees include, but are not limited to, conducting the day-to-day operations of the TABC; management of the agency's personnel; the review of all new license applications;<sup>3</sup> legislative analysis and liaisons; overseeing agency programs—including server training, direct shipment, and responsible vendor; as well as the issuance and settlement of citations and consent orders (which have also greatly increased in numbers with the increased number of licensees and permittees). The agency has a vacant attorney position available—this position has been vacant for several years and discussions have occurred regarding the possibility of filling it. However, during the same number of years, the agency has (as have all departments) been subject to reversions of its

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<sup>3</sup> Since 1995, the number of jurisdictions that have passed liquor-by-the-drink has increased 71%, while the number of jurisdictions that have passed retail sales has increased 66%—thus, a total increase of 69%. With the advent of new jurisdictions come new applications/licensees for an increase of 38% during the same time period. This does not include the vast increased numbers in special occasion licenses, non-resident seller permits, and winery and wholesale licenses that are issued each year.

budget, plans for possible reductions in force, and hiring freezes. In an effort to comply with the Department of Finance and Administration's policies as previously stated, the TABC has neither filled nor requested to fill the attorney position (as well as other vacant positions) for the past several years. This vacant position has contributed to the agency's inefficient manner of pursuing unpaid fines. As a result, this service on behalf of the TABC has suffered. Such reductions in service have been anticipated: in an interview on December 13, 2008, for the *Chattanooga Times Free Press*, Finance and Administration Commissioner Dave Goetz is quoted as stating that "At that number [\$1 billion dollars in cuts], it's hard to avoid losses of services and impacting employees in some fashion. We will do our best to continue delivering services to the best of our ability." The TABC has attempted to the best of its ability with limited resources to collect unpaid citations.

Also impacting the ability to set hearings and collect outstanding citations are the costs associated with such hearings. It should be noted that the initial cost to merely schedule a hearing is \$200. In the past, when successful at a hearing, the TABC has attempted to have the costs of a hearing passed to the respondent—the motion has been denied on every occasion. In fact, the TABC spent \$4,600 on six hearings conducted by an administrative law judge in a seven-month period.

Currently, efforts are made when renewing licenses to collect outstanding citations. Further, new licenses will not be issued to an applicant if outstanding citations exist at other locations. Notwithstanding the admission that improvements must be made to collect the outstanding citations, it should be noted that in 2007, 93% of the citations issued by the agency were settled in some manner. Although the percentage of citations settled in 2008 is lower (71%), the full renewal cycle has not occurred for that year: it is anticipated that the percentage of settled citations will increase by year's end.

To improve the collection of outstanding citations, the TABC will do the following: (1) Seek an exception to the hiring freeze and fill the vacant attorney position; (2) Amend the language of the citation by setting a 30-day limit for response before a default judgment is entered; (3) Set more hearings before the Commission; (4) Seek legislative assistance for a statutory change to withhold licenses and renewals of licenses until all debts due to the state (taxes, fees, fines or penalties) are paid; (5) Seek collection assistance provided by the Office of the Attorney General.

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**4. The Tennessee Alcoholic Beverage Commission has operated the server permit program at a deficit for two years without assessing fees sufficient to cover costs of operating the program**

**Finding**

The primary legislative intent of Title 57, Chapter 3, Part 7, known as the "Alcohol Server Responsibility and Training Act of 1995," is to prevent intoxication-related deaths,

injuries, and other damages by requiring that servers of alcoholic beverages are trained in responsible alcohol serving practices and awareness. Servers must have a valid permit to work in a liquor-by-the-drink establishment or that establishment will be in violation of statute and the employer will be subject to disciplinary action. After completing an alcohol awareness class, servers are eligible to obtain a server permit. Permits cost \$5.00 and are valid for five years. Individuals and companies outside the TABC provide the training classes, for a fee, but the TABC certifies and licenses those trainers.

At the creation of the program in 1997, the federal government provided \$200,000 in grant funds each year for three years. By the end of the three-year grant period, the commission should have been able to accurately project the revenue and expenses of the program. Using this projection, the commission should have adjusted permit fees to match the projected expenses. Section 57-3-709, *Tennessee Code Annotated*, states, “The commission shall assess an application and renewal fee for the permits issued under this part in an amount sufficient to fund any cost to the state which results from loss of federal funds to implement and administer this program.” However, the commission has not increased permit fees to cover the revenue shortfall. According to management, an increase in fees is part of management’s update of the commission’s rules. The updated rules are waiting approval by the Attorney General’s office.

In the most recent two of the four years reviewed, the program’s expenses exceeded the revenue collected. Further, the program would have operated at a deficit in 2006 without the sales of temporary permits, but temporary permits have since been discontinued. Despite knowing that revenue does not cover expenses of the program, the commission has not yet met the statutory requirement to assess server permit fees to cover the deficiency.

**Alcoholic Beverage Server Permit Program  
Revenues and Expenses for Fiscal Years 2006-2009**

<i>Fiscal Year</i>	<u>2006</u>	<u>2007</u>	<u>2008</u>	<u>2009</u>
<i>Revenues</i>				
Server training	\$243,015	\$248,966	\$252,185	\$242,540
Permits	235,015	278,741	175,936	168,540
Carry Forward*	<u>32,417</u>	<u>64,185</u>	<u>N/A</u>	<u>N/A</u>
Total revenue	\$510,447	\$591,922	\$428,121	\$411,080
<i>Expenses</i>				
Server training	\$288,877	\$221,525	\$288,628	\$262,624
Permits	<u>221,570</u>	<u>184,010</u>	<u>187,800</u>	<u>194,552</u>
Total expenses	\$510,447	\$405,535	\$476,428	\$457,176
<i>Revenue minus expenses</i>	\$0	\$186,387	(\$48,307)	(\$46,096)

\*Prior year rollover of excess funds collected for temporary permits of \$96,602. These funds were exhausted in fiscal year 2007.

**Number of Server Permits Issued and Active  
Fiscal Years 2004-2008**

	<u>2004</u>	<u>2005</u>	<u>2006</u>	<u>2007</u>	<u>2008</u>
Issued	23,620	22,715	19,306	21,187	22,032
Total active	69,632	83,977	103,050	110,923	110,031
Annual Change in Total Active		14,345	19,073	7,873	-892

Source: Tennessee Alcoholic Beverage Commission.

As noted in the July 2007, financial and compliance audit, the computer system that TABC uses to issue server permits, "Tennessee Anytime," has several shortcomings that impede the efficient and effective administration of this program. Some problems have been corrected, but others remain, such as cumbersome search and navigation features, inability to track changes in server information, and incomplete permit documentation.

The vendor of the Tennessee Anytime system, installed in 2001, informed TABC that it cannot fix the current problems, and recommends TABC purchase a new system from them costing approximately \$400,000. TABC has not taken the necessary steps to increase permit fees sufficiently "to implement and administer this program" as it exists, or to prepare the computer system for future needs, including an estimated \$20,000 to upgrade the existing system to a photo permit card system.

**Recommendation**

- Management of TABC should take steps as they stated they would in response to the 2007 financial and compliance audit to address the problems with the server permit database, such as cumbersome search and navigation features, inability to track changes in server information, and incomplete permit documentation.
- The TABC should determine whether the Alcoholic Beverage Server Permit program should continue despite expenses exceeding revenue. If the decision is made to continue the server permit program, TABC should procure a more efficient and effective computer system.
- TABC should increase the fee charged for a server permit card to cover expenses, including the cost of a new computer system and/or photo permit card system.
- If the permit fees cannot be increased, the General Assembly may wish to consider whether the program is beneficial enough to warrant other state appropriations, or whether the program should be terminated.

## Management's Comment

We concur. The audit report indicates that the server training program operated at a deficit in fiscal years 2008 and 2009 (\$48,307 and \$46,096, respectively). In FY 2007, the last of the carry forward money was utilized for program expenses. The deficit beginning in FY 2008 corresponds to the lack of “carry forward” money within the program. Beginning in approximately 2007, the TABC began an extensive review and rewrite of the entire set of rules and regulations associated with the sale and distribution of alcohol in the State of Tennessee—including the server training program. A rulemaking hearing was conducted on April 1, 2009, and the proposed changes were approved by the Commission. These rules are currently at the Office of the Attorney General awaiting approval. Among the rules amended are rules increasing the fees<sup>4</sup> for server permits, employee permits, wholesaler employee permits, and server training.

In addition to the need for the increased fees to cover the costs of the server training program as is statutorily required, the computer system used to issue server permits has “several shortcomings that impede the efficient and effective administration of this program.” This was noted in the 2007 fiscal audit and in this performance audit. To upgrade this computer system and correct known problems will cost the agency at least \$400,000. Due to the economic downturn and requests from the Department of Finance and Administration not to request budget improvements, the TABC has not requested an improvement to pay for a new computer system. Without legislative approval of the rules adopted by the Commission—including the increased fees for server and employee permits—the program costs will not be covered by revenues generated and the computer system cannot be replaced or upgraded.

In conclusion, the TABC has increased the fees of permits that would cover all costs associated with the server training program. The fee increase will take effect upon approval by the Attorney General's Office and 90 days after filing with the Secretary of State's Office.

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### **5. The Tennessee Alcoholic Beverage Commission does not perform background checks to ensure those with criminal backgrounds do not obtain liquor licenses**

#### **Finding**

Title 57, Chapter 3, *Tennessee Code Annotated*, contains the qualifications for individuals applying for licensure as wholesalers, employees of retailers, servers in liquor-by-the-drink establishments, and winery operators. Among the qualifications, the statutes prohibit persons who have violated criminal codes (with certain exceptions) from obtaining licenses or permits. Depending upon the severity of the offense and when it occurred in relation to the application date, the board might still issue a license. The executive director or the assistant director reviews

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<sup>4</sup> Fees associated with these permits have not been increased since the early 1980s, when a server permit was \$5.00 for a three-year permit, and \$2.00 for a one-year employee permit.

incoming applications prior to submitting them to the commission for approval. An application rejected by the executive director or assistant director does not go before the board.

Section 57-3-706, *Tennessee Code Annotated*, allows the commission to conduct a criminal record review of applicants for employee or server permits to ensure compliance. However, TABC does not perform any criminal background checks on applicants but relies on applicants to self-report criminal code violations. Self-reporting is not reliable. To encourage compliance and to deter fraudulent license applications, TABC should perform background checks on applicants for which criminal backgrounds are a bar to obtaining a license or permit. If doing background checks on each applicant is cost prohibitive, TABC should at least perform random background checks.

Current Tennessee statutes do not meet the FBI's criteria to be able to perform background checks for criminal history in other states. According to a representative from the Tennessee Bureau of Investigation, an addition to the statute needs to say, "*Criminal background checks should include fingerprint checks against state and federal criminal records maintained by the Tennessee Bureau of Investigation and the Federal Bureau of Investigations.*" This addition would allow TABC to obtain nationwide criminal history background checks on licensure applicants.

### **Recommendation**

TABC should confer with legal and law enforcement experts such as the state's Attorney General and Tennessee Bureau of Investigation to determine what steps the commission can take under the current law to provide some assurance beyond self-reporting. The TABC should work with the General Assembly to revise state laws to contain wording that meets the federal government's criteria to allow national criminal history background checks. Following that change, TABC should perform criminal background checks on applicants rather than rely solely on self-reporting by those applicants. Criminal history checks might be performed on a random basis as a cost-saving measure, but full coverage would be more effective. Because additional violations of the law can occur at any time, we also recommend that TABC add requirements that licensees immediately notify TABC of any subsequent convictions and that TABC perform random follow-up checks during license renewals.

### **Management's Comment**

We concur. Applicants for retail stores and retail licensees are required to submit a certificate of compliance with their application, and every two years after licensure. This certificate of compliance is issued by the municipality in which the retail store is located, and by issuing the certificate of compliance, such municipality is certifying that the applicant or licensee does not have a disqualifying criminal conviction.

On the other hand, certificates of compliance are not required for liquor-by-the-drink licensees or for server/employee permits. The TABC does not perform criminal background checks on these entities. Although the TABC may conduct criminal background checks in conjunction with a criminal investigation (NCIC), the agency is prohibited by statute from using these checks for licensing purposes. The Tennessee Bureau of Investigation confirms that the TABC is limited to obtaining background checks through the Tennessee Online Records Information System at \$29/check. This check is limited to only Tennessee convictions, and relies on information submitted by the applicant in regard to name, birth date, social security number, or other identifying items. Thus, if an applicant gave a wrong birth date or misspelled name, no information would be returned indicating a conviction.

The TABC issues approximately 28,000 server permits and liquor-by-the-drink licenses annually. At \$29/check, the cost to the TABC would be \$812,000, and that check would only result in a review of any convictions in the State of Tennessee—not nationwide. This amount cannot be absorbed by the agency, and would not be covered by the proposed increased server or employee permit fees.

It should be noted that the TABC did conduct random background checks on servers in the late 1990's. Every 200th applicant for a server permit was requested to come to TABC offices to be fingerprinted, and the fingerprints were submitted for a background check. However, due to the man hours associated with scheduling a time for the applicant to be fingerprinted, the uncertainty associated with whether the applicant would actually show up to be fingerprinted, and the number of returns of the fingerprint cards as being unreadable (not to mention the inconvenience for an applicant who may have to travel over an hour to be fingerprinted at a TABC office), TABC management discontinued the practice.

The TABC will communicate with the General Assembly to review state laws that would allow national criminal history background checks. If the General Assembly passes such legislation, the TABC will establish a policy and procedure to conduct random background checks, and will conduct such pursuant to that policy.

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**6. The Confidential Informant Fund (Petty Cash) was allowed to exceed the \$1,500 maximum on multiple occasions**

**Finding**

In 1963, TABC was authorized by the Department of Finance and Administration to open a non-interest-bearing bank account to have money available to pay an informant, pay cover charges to investigate an establishment, or use for some other investigative need. While there is one account, the cash of that account is allocated among the posts of duty to allow field agents more timely access during an investigation. When an amount of money is needed, the special agent in-charge at one of the four major posts of duty (Knoxville, Chattanooga, Memphis, or Nashville) requests funds in writing. The special agent in-charge submits the request to the chief

law enforcement officer, who approves or denies the request. If approved, the chief law enforcement officer submits the request to the fiscal officer. If the fiscal officer approves the request, he or she then issues a check. Most expenses are relatively small dollar amounts, such as a cover charge, purchase of drinks or alcohol, or other investigation-related items.

Following the expenditure, the field agent sends a copy of the receipt and a report of how the funds were used to the fiscal officer, who requests the Department of Finance and Administration to replenish the bank account. A representative of each post of duty submits a monthly report of confidential fund activity to the chief law enforcement officer, who reviews these reports and keeps them on file.

We reviewed the confidential funds account for the period January to November 2008 and found the balance in the bank account added to the receipts and cash on hand at all posts of duty exceeded \$1,500 for 10 of 11 months reviewed. The amounts by which the monthly balances exceeded the maximum ranged from \$60 to more than \$1,000. Neither TABC's staff, nor the contact person at the Department of Finance and Administration could explain how the account exceeds the maximum amount of \$1,500. It appears that neither the TABC nor the Department of Finance and Administration have adequate control of this account and the replenishment process.

In the course of our review, a secondary and possibly contributing issue came to our attention. The original authorized balance of the confidential funds account was \$1,500 and has not been increased since 1963. In March 2008, the executive director of the commission, in accordance with Finance and Administration Policy 07, requested that the Department of Finance and Administration authorize an increase in the maximum amount of the confidential fund account from \$1,500 to \$10,000 citing increased volume of illegal activity and the rising cost of illegal drugs and alcohol. After more than a year, the TABC's request is still pending at the Department of Finance and Administration, so the account remains at the same level it has been for 45 years. The chief law enforcement officer believes that additional funds would help fund more investigations and, while he does not have evidence to prove it, believes it is possible that agents now must forgo an investigation while waiting for funds to be available. He agrees that it would not be efficient or effective to have any of the 38 agents idle while waiting for their share of \$1,500. However, he added that the agents have other responsibilities besides investigations, like inspections. Because the fund was established in 1963, it seems reasonable that the costs of investigating illegal activity, including paying confidential informants, have gone up and that some increase ought to be made after 45 years.

### **Recommendation**

The total amount of cash and receipts in this account should not exceed the maximum amount authorized. This is an internal control issue for both TABC and the Department of Finance and Administration. TABC should coordinate with the Department of Finance and Administration to maintain the account balance at or below the maximum, and the Department of

Finance and Administration should make a decision on the TABC's request to increase the maximum amount of the confidential funds account.

### **Management's Comment**

We concur. As noted in the audit, this fund is used not only for paying confidential informants, but also for criminal and regulatory investigations. The \$1,500 maximum was established in 1963. As costs of illegal controlled substances and illegal alcohol that are subject to investigations conducted by the TABC increase, this limit has been substantially insufficient. In fact, on numerous occasions, investigations initiated by the TABC have been transferred to other state and federal agencies because the TABC could not afford to conduct a proper investigation. Thus, for over a year, the TABC has requested that the \$1,500 limit be increased, but a decision has yet to be made by the appropriate authorities.

It should be noted that the audit does not indicate that any fraud or misuse of these funds exists—only that the \$1,500 limit had been exceeded on several occasions. To correct the problem of the confidential funds exceeding the limit, the TABC will cease all expenditures associated with this fund for at least a two-month period. This will enable the TABC to determine exactly how much money in the account exceeds \$1,500. Once that determination is made, the TABC will request from the Department of Finance and Administration how to dispose of the overage and will act accordingly. Subsequent to this, each district (Nashville, Memphis, Knoxville, and Chattanooga) will be limited to \$350 at any given time to conduct its criminal and regulatory investigations. No replenishment of the confidential funding will occur until proof is submitted of the expenditure and only in the amount of such expenditure. The TABC will continue to request a decision on the increase limit.

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**7. The Tennessee Alcoholic Beverage Commission has not established an audit committee, nor has the commission requested an exception as required by state law since 2005**

### **Finding**

The "State of Tennessee Audit Committee Act of 2005," Section 4-35-101 et seq., *Tennessee Code Annotated*, requires state entities to establish audit committees and develop an audit committee charter. The act allows the Comptroller of the Treasury to set guidelines and approve exceptions and require the creation or review by the audit committee of a code of conduct and conflict-of-interest policy for the entity. By his letter dated November 23, 2005, the Comptroller of the Treasury sent a reminder to the entities subject to the audit committee act to either establish an audit committee or seek an exception to the law. The commission members of the Alcoholic Beverage Commission have not taken either action.

Many of the findings in this audit report and other audit reports of the TABC involve issues that should be addressed by an audit committee, such as thefts of commission funds and

failures to take appropriate proactive measures to correct lingering internal control weaknesses. These problems reflect a need for focus on the accountability and transparency that an audit committee can provide. The continued failure of the TABC to establish an audit committee since 2005 contributes to other problems of internal control, efficiency, and effectiveness.

### **Recommendation**

The agency should make the establishment of an audit committee a priority for the commission.

### **Management's Comment**

We concur. The TABC will either establish an audit committee or request an exception by October 31, 2009.

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## **OBSERVATIONS AND COMMENTS**

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The topics discussed below did not warrant a finding but are included in this report because of their effect on the operations of the Tennessee Alcoholic Beverage Commission and on the citizens of Tennessee.

### **CONFISCATED INVENTORY**

The Division of State Audit's most recent financial and compliance audit, released July 2007, noted that TABC did not have a comprehensive or consistent method of recording confiscated inventory statewide. We found that TABC has resolved most of the inventory issues. We visited four posts of duty and examined the method of recording and maintaining the confiscated inventory, observed cash collections, and matched the inventory list to the inventory on site. TABC now maintains the inventory in an electronic format and uses consistent descriptions and abbreviations across regions. However, there is no glossary of explanations of what each abbreviation means. We also found one item that had not been converted to the new system. TABC staff corrected that discrepancy. We additionally found that TABC does not always have at least two persons present when logging confiscated inventory in and out of storage. The special agents assigned to maintaining the inventory intend to correct this oversight.

Although the current inventory system does not assign dollar values to confiscated inventory items, the security of the inventory is important to retain evidence for use at trials and to prevent seized illegal products from returning to the public, where they could be used or sold. Even an item that must be destroyed (such as moonshine) has a street value that could be

significant. Other confiscated items may include illegal drugs, vehicles, cigarettes, or cash. We determined through observation and testwork that the confiscated inventory appears securely labeled, logged, and stored.

## **PROPERTY AND EQUIPMENT**

Work performed during the July 2007 financial and compliance audit found that the property and equipment inventory contained some inaccuracies in descriptions and locations. These inaccuracies were discussed with management, but no finding was taken. During this current audit we found that issues related to property and equipment inventory have improved, but have not been entirely resolved. We selected a sample of sensitive equipment items, including firearms, laptop computers, digital cameras, and surveillance equipment. We located and verified by state tag/and or serial number 189 out of 191 items of sensitive equipment. We determined that the location of 2 of the 191 items selected (1%) could not be verified. One of these items was in the process of being surplus, but the other could not be located even though it has been on the inventory list for at least ten years. Three other items were described inaccurately or incompletely in the property database of the State of Tennessee. One was listed as a stun gun but is actually a Glock pistol. One is listed as "Monitor/Other peripheral," but is actually a radio mounted in a vehicle. The third item is a projector with the incorrect manufacturer listed. We recommend that management include accurate descriptions of equipment items and their locations in its inventory list so that the equipment can be readily located and identified.

## **REQUIRED DOCUMENTS**

According to Section 9-18-104(a), *Tennessee Code Annotated*, the head of each executive state agency shall annually submit a letter to the commissioner of the Department of Finance and Administration and to the Comptroller of the Treasury acknowledging management's responsibility for maintaining the internal control system of the agency. This letter is called the "Financial Integrity Act" (FIA) letter and had been due by June 30 of each year. Statute changed the due date to December 31 in 2008, but inadvertently left the June 30 date until it was deleted in 2009. The TABC is required to submit this letter.

According to Section 9-18-104(b), *Tennessee Code Annotated*, the head of each state agency shall transmit to the commissioner of the Department of Finance and Administration and the Comptroller of the Treasury a report of management's assessment of risk performed by the agency. This report is called the "Risk Assessment Report" and is due by December 31 of 2003, 2007, and every year thereafter. The TABC is required to submit this report.

There seems to be confusion at TABC on the due dates for these letters. We found that the FIA letters due June 30, 2006, and June 30, 2008, were not submitted timely. In addition, the TABC has been submitting the Risk Assessment Reports in combination with its FIA letters instead of two separate and distinct documents. The letters submitted as the FIA/Risk

Assessments on December 15, 2008, and December 20, 2007, were timely for risk assessments (due December 31) but late for the 2008 FIA letter (due June 30). Section 9-18-104(b)(2), *Tennessee Code Annotated*, states that if significant deficiencies or material weaknesses are found, the Risk Assessment Report should include a corrective action plan with a schedule for making the corrections. While not identified as corrective action plans, the reports submitted by the TABC include statements about changes they made to correct the problems found.

For the four-year period between 2005 and 2008, two risk assessment reports were submitted timely (December 2007 and 2008), one was submitted early (June 2007), and one report (June 2005) was submitted as part of the FIA letter but was not required for that year. Because the FIA letter and the Risk Assessment Report had different due dates in past years, they should have been submitted separately, but timely.

These problems reinforce the need to have an independent audit committee focused on these important matters, comprised of individuals who can become knowledgeable of the relevant requirements.

## **RESPONSIBLE BEER VENDOR CERTIFICATE PROGRAM**

The Responsible Vendor Act of 2006 (Section 57-5-601 et seq., *Tennessee Code Annotated*) provides for a voluntary program administered by the TABC intended to discourage beer sales to underage persons, reduce accidents and deaths related to intoxication, encourage vendors to be prudent in their selling practices of beer, and reduce sanctions imposed by local beer boards on participating vendors. The program began July 1, 2007, and is promoted by the commission via local regulatory agencies and industry groups such as grocers' associations.

Vendors who apply for the responsible vendor program pay an annual nonrefundable \$35 fee plus an additional fee based on the number of certified clerks at the time of application, as shown in the table below. The money is to be used only for activities of the program.

<u>Number of Certified Clerks</u>	<u>Annual Fee</u>
0-15	\$25
16-49	\$75
50-100	\$150
Over 100	\$250

Clerks employed by a responsible vendor must complete a TABC-approved server training course within 61 days of employment. Certified clerks must attend at least one annual meeting where the responsible vendor disseminates information prescribed by the commission. While TABC has authority over the training requirements, local beer boards retain authority over all aspects of the beer permit process. Statute requires a beer board to consider a retailer's status as a responsible vendor when assessing fines or initiating suspensions. A certified clerk who makes a sale to a minor loses certification for one year from the date of the beer board's

determination. A vendor who has two violations within 12 months will have certification status revoked for three years.

In its two years of operation, the TABC has not yet evaluated the effectiveness of the responsible beer vendor program, but there is minimal participation by vendors. There is no state database of beer vendors available to TABC because beer vendors are licensed and regulated by local beer boards. However, the TABC executive director estimates there are about 12,000 beer vendors in Tennessee. Of those, only 263 beer vendors joined the responsible vendor program as of February 2007, with another 26 applications pending, for a total of 289 (2.4%). Vendor participation has not met expectations expressed by TABC management and has increased minimally over time. The program collected \$9,600 in fiscal year 2008 and \$9,200 in fiscal year 2009. Revenue is deposited into a special fund and can only be used for responsible vendor program activities, but the program is not required to be, nor is it, self-sufficient. Expenditures for the program include \$165,000 for the computer application to maintain the database of responsible vendors and \$9,500 for supplies. No salaries are allocated to the program, but the executive director estimates it requires about five hours per week of administrative time.

The TABC should determine a reasonable estimate of the total cost of continuing this program, should evaluate the effectiveness of the program, and should conclude how the program might be improved. Based on the analysis performed by the TABC, the General Assembly may wish to consider terminating the responsible vendor program, or may wish to increase participation by making the program mandatory.

## **LIQUOR-BY-WIRE**

The sales and shipment of alcoholic beverages directly to consumers through the Internet or mail order sales is known as liquor-by-wire. The potential need for changes in state law was mentioned in the 1998 performance audit of TABC and remained a legislative and public issue of interest for the next 11 years. Although limitations on “liquor-by-wire” sales vary from state to state, some version of direct-to-consumer sales of wines is allowed by approximately 60% of U.S. states.

On May 21, 2009, the General Assembly passed SB 166 (2009 Public Chapter 348) to amend Title 57, Chapter 3, *Tennessee Code Annotated*. This bill allows direct sale and shipment of wine, by common carrier, to citizens of Tennessee. The law went into effect July 1, 2009. A wine manufacturing, rectifying, or bottling company desiring to sell directly to Tennessee citizens must pay to the TABC a one-time application fee of \$300 for a direct shipper’s license, then pay the annual license fee of \$150. If approved, a licensee may ship up to nine liters of wine per month and up to 27 liters of wine per year to an individual. Receiving addresses must be located in a jurisdiction that has authorized the sale of alcoholic beverages by local option referendum. Each package of wine delivered must be signed for by an individual at least 21 years of age. The direct shipper is responsible for remitting all sales taxes and any gallonage tax due from the sales. Public Act 348 refers to a 2003 Federal Trade Commission report that interstate direct shipping caused few problems with tax collection or shipping to minors while

boosting consumer access to “thousands of labels from small wineries.” TABC is projected in the Fiscal Note to the bill to add one additional administrative employee, but is expected to increase revenue to the state’s General Fund by \$4.6 million in the first year and \$9.5 million annually in subsequent years. Review of the operation of this program is left to future audits.

## **ALCOHOLIC BEVERAGE SALES IN GROCERY STORES**

The sale of wine and/or alcoholic beverages in grocery stores, allowed in many states, is an issue that continues to receive attention from the General Assembly, the commission, and the public. Bills to allow the sale of wine in retail food stores were introduced during the General Assembly’s 2009 regular session, but the bills stalled at the committee level. Because the General Assembly is giving consideration to allowing these sales, there may be a future impact on the activities of the Tennessee Alcoholic Beverage Commission. If retail food stores in Tennessee are allowed to sell wine or liquor, the TABC would probably need to increase the number of regulative and administrative staff to handle the additional licensees.

## **RESTAURANT INSPECTIONS**

According to Section 57-4-102, *Tennessee Code Annotated*, a restaurant licensed to serve liquor by the drink must have a seating capacity of at least 75 people, employ sufficient staff to prepare, cook, and serve food, serve at least one meal per day five days a week, and serving meals should be the principal business conducted. A licensed “gourmet restaurant” must seat at least 40 people, must obtain at least two-thirds of annual gross sales from food, and must obtain at least two-thirds of its annual alcoholic beverage sales from sale of wine. For food audits, the revenue from food sales may be less than 50% as long as the sale of food is the main purpose of the business. Revenue may also come from cover charges and advertising, as well as liquor sales. During inspections, agents determine that restaurants have kitchen equipment sufficient to prepare and serve meals.

We found that between 1980 and 2008, the combined number of liquor-by-the-drink establishments (LBDs) and liquor retailers in the state increased from 650 to 3,388. During that same time, the number of agents employed by the TABC decreased from 34 to 31. Thus, the ratio of LBDs and retailers to agents increased from 19:1 to 108:1. During the 2008 elections, the number of cities allowing LBD by referenda increased by 14 (74 to 88), and the number allowing retail liquor stores increased by 10 (84 to 94). Additionally, according to TABC staff, there were significant increases in the number of special occasion events and educational events conducted, both regularly inspected by TABC agents.

According to TABC management, as of September 2009 the approximate number of restaurants in Tennessee licensed to serve liquor by the drink is 2,254. Agents focus on new applicants and renewals, establishments that appear more like a club, or those with a history of violations. In 2006, TABC agents inspected 92 restaurants and issued 92 citations for a violation of section 57-4-102(27), *Tennessee Code Annotated*. In 2007, agents inspected 128 restaurants

and issued 128 citations. In 2008, 104 inspections resulted in 102 citations and two audits where no citation was issued because the restaurant was in compliance. For the first eight months of 2009, a total of 47 citations have been issued.

According to TABC management, after a violation is issued the agent will usually revisit after a few months. To find unlicensed or improperly licensed establishments, agents utilize their knowledge of the geographical area, communicate with local law enforcement, pay attention to radio and TV advertising, listen to word of mouth, and tap into confidential informants. Wholesalers are required to check for valid licensing before making a sale, and TABC provides lists to wholesalers of all licensees, and updates that list when there is a suspension or revocation.

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## RECOMMENDATIONS

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### LEGISLATIVE

This performance audit identified areas in which the General Assembly may wish to consider statutory changes to improve the efficiency and effectiveness of the commission's operations.

1. The General Assembly may wish to consider amending Section 57-3-408, *Tennessee Code Annotated*, to allow TABC to assess penalties for unpaid fines. The General Assembly may also wish to consider amending the license renewal statute to allow TABC to withhold licenses and renewals of licenses until all debts due to the state, whether taxes, fees, fines, or penalties, are paid.
2. If the permit fees of the Alcoholic Beverage Server Program cannot be increased, the General Assembly may wish to consider whether the program is beneficial enough to warrant other state appropriations, or whether the program should be terminated.
3. Working with the TABC, the General Assembly may wish to revise state laws to contain wording that meets the federal government's criteria to allow national criminal history background checks.
4. Based on the analysis performed by TABC, the General Assembly may wish to consider terminating the Responsible Beer Vendor Certificate Program or may wish to increase participation by making the program mandatory.

### ADMINISTRATIVE

The Tennessee Alcoholic Beverage Commission should address the following areas to improve the efficiency and effectiveness of its operations.

1. The executive director should immediately design and implement effective internal controls to reduce opportunities for individuals to commit fraud. TABC management should segregate the duties of the Budget/Fiscal Director's regarding cash receipting and deposits.
2. TABC should review its Policies and Procedures Manual regularly and make any necessary changes. Management's review and authorization of the Policies and Procedures Manual should be documented even if significant changes are not made to the policies and procedures.
3. TABC should consider more actively pursuing unpaid fines and citations to include more current and complete recordkeeping of amounts due the state for penalties and fines. In accordance with Section 57-3-408, *Tennessee Code Annotated*, the TABC should make use of collection assistance provided by the Office of the Attorney General.
4. Management of TABC should take steps as they stated they would in response to the 2007 financial and compliance audit to address the problems with the server permit database, such as cumbersome search and navigation features, inability to track changes in server information, and incomplete permit documentation.
5. The TABC should determine whether the Alcoholic Beverage Server Permit program should continue despite expenses exceeding revenue. If the decision is made to continue the server permit program, TABC should procure a more efficient and effective computer system.
6. TABC should increase the fee charged for a server permit card to cover expenses, including the cost of a new computer system and/or photo permit card system.
7. TABC should confer with legal and law enforcement experts such as the state's Attorney General and Tennessee Bureau of Investigation to determine what steps the commission can take under the current law to provide some assurance beyond self-reporting.
8. Following revision of state laws, TABC should perform criminal background checks on applicants, at least randomly, rather than rely solely on self-reporting by those applicants. TABC should also add requirements that licensees immediately notify TABC of any subsequent convictions and that TABC perform random follow-up checks during license renewals.
9. TABC management should coordinate with the Department of Finance and Administration to maintain the account balance in the confidential informant account at or below the maximum, and the Department of Finance and Administration should

make a decision on the TABC's request to increase the maximum amount of the account.

10. TABC should make the establishment of an audit committee a priority.
11. TABC should include accurate descriptions of equipment items and their locations in its inventory list so that the equipment can be readily located and identified.
12. TABC management should prepare the annual Financial Integrity Act letters and risk assessment reports separately and on time.
13. TABC management should determine a reasonable estimate of the total cost of continuing the responsible beer vendor program, should evaluate the effectiveness of the program, and should conclude how the program might be improved.

## Appendix Title VI Information

All programs or activities receiving federal financial assistance are prohibited by Title VI of the Civil Rights Act of 1964 from discriminating against participants or clients on the basis of race, color, or national origin. In response to a request from members of the Governmental Operations Committee, the audit team compiled information concerning efforts of the TABC to comply with Title VI requirements. The results of the information gathered are summarized below. The TABC has not had any discrimination complaints in at least the past two years and has a designated Title VI Coordinator. The coordinator has adequately prepared and properly submitted TABC's Title VI Implementation Plans for 2008 and 2007 to the Division of State Audit.

### Ethnicity and Gender of Tennessee Alcoholic Beverage Commission Members December 2008

<u>Gender</u>		<u>Ethnicity</u>	
<i>Male</i>	<i>Female</i>	<i>White</i>	<i>Black</i>
2	1	2	1

*Source: TABC staff.*

### Ethnicity and Gender of Tennessee Alcoholic Beverage Commission Staff December 2008

<i>Title</i>	<u>Gender</u>		<u>Ethnicity</u>	
	<i>Male</i>	<i>Female</i>	<i>White</i>	<i>Black</i>
Administrative Assistant	0	6	4	2
Administrative Secretary	0	6	5	1
Administrative Services Assistant	0	4	3	1
Assistant Special Agent In Charge	4	0	3	1
Associate Executive Director	0	1	1	0
Chief Law Enforcement Officer	1	0	1	0
Executive Director	0	1	1	0
Human Resources Analyst	0	1	1	0
Information Resources Specialist	1	0	1	0
Special Agent In Charge	3	1	4	0
Special Agent 1	1	3	2	2
Special Agent 2	11	3	14	0
Special Agent 3	4	0	4	0
Training Specialist	1	1	1	1
<b>Total</b>	<b>26</b>	<b>27</b>	<b>45</b>	<b>8</b>

*Source: TABC staff.*