



**STATE OF TENNESSEE  
COMPTROLLER OF THE TREASURY**

**TENNESSEE ALCOHOLIC BEVERAGE  
COMMISSION**

**Performance Audit Report**

November 2016

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**Justin P. Wilson, Comptroller**



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November 15, 2016

The Honorable Ron Ramsey  
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The Honorable Beth Harwell  
Speaker of the House of Representatives  
The Honorable Mike Bell, Chair  
Senate Committee on Government Operations  
The Honorable Jeremy Faison, Chair  
House Committee on Government Operations  
and  
Members of the General Assembly  
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Nashville, Tennessee 37243

The Honorable Mary McDaniel, Chairman  
Tennessee Alcoholic Beverage Commission  
3436 Wynmont Grove Cove  
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and  
Mr. Clayton Byrd, Executive Director  
Tennessee Alcoholic Beverage Commission  
Davy Crockett Tower  
500 James Robertson Parkway, 3<sup>rd</sup> Floor  
Nashville, Tennessee 37220

Ladies and Gentlemen:

We have conducted a performance audit of selected programs and activities of the Tennessee Alcoholic Beverage Commission for the period July 1, 2011, through March 31, 2016. This audit was conducted pursuant to the requirements of the Tennessee Governmental Entity Review Law, Section 4-29-111, *Tennessee Code Annotated*.

Our audit disclosed certain findings that are detailed in the Objectives, Methodologies, and Conclusions section of this report. Management of the commission has responded to the audit findings; we have included the responses following each finding. We will follow up the audit to examine the application of the procedures instituted because of the audit findings.

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,

Deborah V. Loveless, CPA  
Director

DVL/dbc  
16/206

State of Tennessee

# Audit Highlights

Comptroller of the Treasury

Division of State Audit

Performance Audit

**Tennessee Alcoholic Beverage Commission**

November 2016

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## AUDIT SCOPE

We have audited the Tennessee Alcoholic Beverage Commission for the period July 1, 2011, through March 31, 2016. Our audit scope included a review of internal control and compliance with laws and regulations in the areas of confiscated evidence, background checks on permit applicants, licensing, conflicts of interest, confidential funds, information systems, and cash receipts. Management of the Tennessee Alcoholic Beverage Commission is responsible for establishing and maintaining effective internal control and for complying with applicable laws, regulations, and provisions of contracts and grant agreements.

For our sample design, we used nonstatistical audit sampling, which was the most appropriate and cost-effective method for concluding on our audit objectives. Based on our professional judgment, review of authoritative sampling guidance, and careful consideration of underlying statistical concepts, we believe that nonstatistical sampling provides sufficient appropriate audit evidence to support the conclusions in our report. We present more detailed information about our methodologies in the individual report sections.

We conducted our audit in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

## CONCLUSIONS

### AUDIT FINDINGS

**As noted in the 2007 financial and compliance audit, the Tennessee Alcoholic Beverage Commission did not maintain proper internal controls over confiscated evidence, increasing the risk that evidence misappropriation or misuse will not be prevented, detected, or corrected\***

Management did not fully utilize evidence management software to maintain control over confiscated evidence. In addition, management did not ensure commission staff performed independent inventories, maintained complete evidence listings, maintained case files and ensured descriptions of evidence agreed with case files, maintained a log of persons accessing evidence, disposed of evidence timely, and transferred evidence to the commission's central office (page 11).

**Management of the Tennessee Alcoholic Beverage Commission did not maintain proper controls over issuing permits to and performing background checks on individuals manufacturing, distributing, selling, or serving alcoholic beverages, increasing the risk that ineligible applicants will be issued permits**

Management did not establish adequate reconciliation, identification, and documentation controls relative to permit issuance. In addition, management did not ensure that logs of and invoices for background checks were reconciled properly, that adequate supporting documentation for background checks was maintained, and that background checks were performed for all permit types (page 21).

**Management of the Tennessee Alcoholic Beverage Commission did not establish adequate licensing policies, document the approval of license applications, or close expired licenses timely, increasing the risk that licensees will distribute alcoholic beverages in Tennessee without regulation**

Policies related to non-resident seller's licenses were inadequate. In addition, direct shipper license applications were not always approved properly, and employees did not always close expired direct shipper licenses and non-resident seller's licenses timely once the licenses expired (page 29).

**As noted in the 2007 audit, the Tennessee Alcoholic Beverage Commission did not develop adequate conflict-of-interest policies and forms or enforce its existing policy, increasing the risk that conflicts of interest will not be prevented, detected, or addressed timely\***

Management did not always ensure that employees and commission members properly completed conflict-of-interest forms or that the forms were adequately maintained (page 35).

\* This finding is repeated from the 2007 audit.

# 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, Title 4, Chapter 29, *Tennessee Code Annotated*. Under Section 4-29-238, the Tennessee Alcoholic Beverage Commission is scheduled to terminate June 30, 2017. 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. This audit is intended to aid the committee in determining whether the commission should be continued, restructured, or terminated.

### **ORGANIZATION AND STATUTORY RESPONSIBILITIES**

The Tennessee Alcoholic Beverage Commission was established by Public 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 low-gravity beer/malt beverages, which are regulated by county and municipal beer boards.

As of October 2016, the commission has 88 positions, including the Executive Director, the Assistant Director, the Chief Law Enforcement Officer, 2 attorneys, 1 Training Specialist, 10 Regulatory Officers, 40 agents, and 32 support staff. In addition to the central office in Nashville, the commission operates district offices in Chattanooga, Knoxville, and Memphis, and five subsidiary posts of duty in Tennessee (Columbia, Cookeville, Jackson, Johnson City, and Winchester). During our audit fieldwork, the commission operated an additional post in Talbott, Tennessee; however, the commission closed this post in March 2015.

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. At the time of audit work, the commission had at least one member at least 60 years of age, at least one person of a racial minority, and at least one member from each of the state's grand divisions. As required by Section 57-1-104, the commission meets monthly.

The commission issues the following licenses and permits:

- annual licenses (Section 57-3-201, *Tennessee Code Annotated*), including



- manufacturer, distiller, rectifier, and high gravity brewer;
- liquor wholesaler;
- liquor retailer;
- liquor-by-the-drink (LBD) restaurant, catering, special occasion, private club, premier type tourist resort, commercial airline, passenger train, paddlewheel steamboat, and Tennessee River resort;
- non-manufacturing non-resident liquor seller;
- non-resident seller;
- winery;
- wine collector;
- winery self-distribution;
- Armed Forces import;
- direct shipper;
- alcoholic beverage collector;
- winemaking on premises;
- farm wine; and
- retail food store (beginning July 1, 2016);
- five-year retailers employee permits (Sections 57-3-204[c] and 57-3-702);
- five-year distillers employee (non-resident) permits (Section 57-3-202);
- five-year wholesalers employee permits (Sections 57-3-203[e] and 57-3-702);
- five-year wholesalers representative permits (Sections 57-3-203[d] and 57-3-702);
- five-year LBD restaurant server permits (Sections 57-3-702 and 57-3-704);
- responsible vendor (low gravity beer/malt beverages) (Section 57-5-601 et seq.);
- responsible vendor (retail food store/wine) (Section 57-3-818);
- retail manager (retailer and retail food store) (Section 57-3-816);
- wine satellite facilities (Section 57-3-207); and
- certification of the providers and instructors of the Alcoholic Beverage Server Training Program (Section 57-3-705).

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 (including all licensing and permitting noted above);
- licensing wholesalers, wineries, retailers, and LBD establishments;

- operating the Alcoholic Beverage Server Training Program to certify training programs and issue server permits;
- operating the Responsible Vendor Program; and
- participating in the Governor’s Task Force on Marijuana Eradication.

The commission’s duties include issuing licenses and permits to qualified applicants. The commission’s jurisdiction covers alcoholic beverages with over 5% alcohol content by weight, but the commission does not issue beer permits. The commission also provides agents for the Governor’s Task Force on Marijuana Eradication on a temporary assignment basis.

The commission’s staff conduct inspections, issue citations, and assess civil penalties for violations of applicable state law. These citations and penalties are directly deposited into the state’s general fund. The commission’s operations are primarily funded from application, permitting, and licensing fees collected during the course of the fiscal year. The commission also was appropriated state funding for fiscal years 2012, 2013, and 2014; however, the commission did not expend any of these appropriations, according to the “State of Tennessee Budget.” After fiscal year 2014, the commission did not receive state appropriations. See Table 1 below.

**Table 1**  
**Tennessee Alcoholic Beverage Commission**  
**Expenditures by Funding Source**

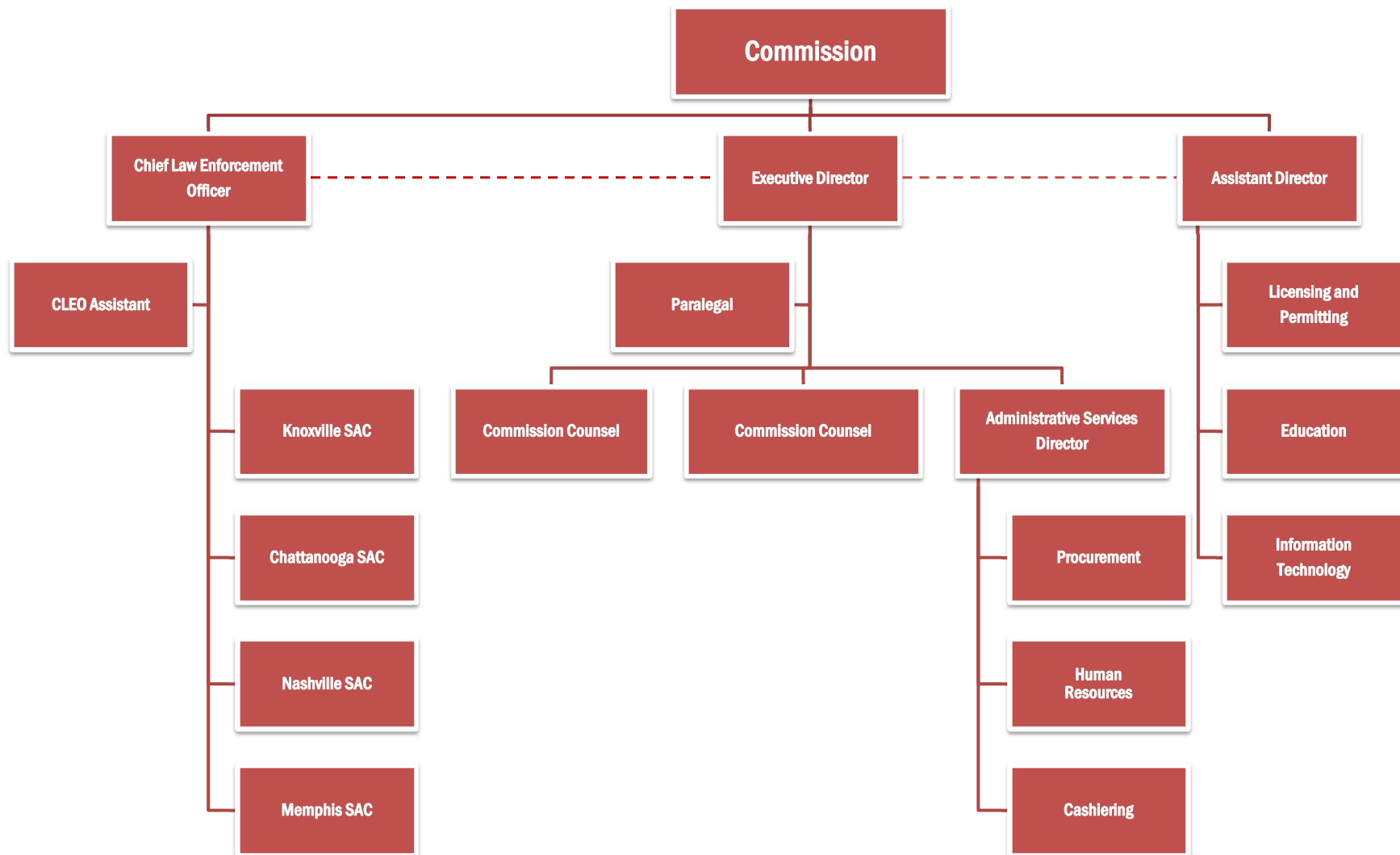
	Actual FY 2011-2012	Actual FY 2012-2013	Actual FY 2013-2014	Actual FY 2014-2015	Actual FY 2015-2016
<b>Expenditures</b>					
Payroll	\$2,999,200	\$3,207,000	\$3,982,600	\$4,557,100	\$ 5,624,200
Operational	1,408,400	2,038,500	1,458,500	1,617,700	\$4,705,600
<b>Total</b>					
<b>Expenditures:</b>	<b>\$4,407,600</b>	<b>\$5,245,500</b>	<b>\$5,441,100</b>	<b>\$6,174,800</b>	<b>\$10,329,800</b>
<b>Funding Sources</b>					
State	\$0	\$0	\$0	\$0	\$0
Federal	0	0	39,500	20,600	27,000
Other	\$4,407,600	\$5,245,500	\$5,401,600	\$6,154,200	\$10,302,800

Source: State of Tennessee Budget for fiscal years 2013–2014, 2014–2015, 2015–2016, 2016–2017, and the commission.

The commission’s business unit code is 316.03. An organization chart of the commission is on the following page.



## Tennessee Alcoholic Beverage Commission Organizational Chart



The Executive Director of the commission resigned during our audit fieldwork on March 24, 2016. Throughout the report, he is referred to as the former Executive Director. On May 26, 2016, the commission appointed the current Executive Director, who officially started on June 8, 2016.

## **WINE IN GROCERY STORES**

Management of the Tennessee Alcoholic Beverage Commission provided the following information regarding its implementation of wine in grocery stores in accordance with Section 57-3-8, *Tennessee Code Annotated*:

The roll out of “wine in grocery stores,” also called WIGS, would not have been possible without our dedicated employees and cooperation from the alcoholic beverage industry of Tennessee. By July 1, 2016, the TABC successfully oversaw, administered, and implemented WIGS, the largest change in the state’s alcoholic beverage law since prohibition, and the commission accomplished these tasks utilizing existing staff and resources.

For months, the staff diligently reviewed every single pending application before the commission, often multiple times by request of changing leadership.

By the roll out, the commission had issued WIGS licenses to every single applicant eligible to receive a license on the July 1 effective date of the WIGS legislation. If an applicant did not hold a license on July 1, it was either due to the store’s ineligibility for a license or its failure to provide the commission with documentation, even after multiple requests from the staff.

To illustrate the scope and depth of the application process, below please find a summary of the review. Retail food store applications must contain the following documents as part of the review process:

- Corporate papers;
- Financial documentation - tax return for 2015;
- Certificate of compliance;
- Certificate of existence;
- List of officers;
- Declaration of citizenship for all appropriate individuals;
- Deed and/or lease;
- Certificate of occupancy;
- Tennessee sales tax;
- City and county business licenses;

- Landlord affidavit;
- Affidavit on taxable sales;
- Affidavit on retail floor space;
- Designated manager permit application/documents;
- Responsible vendor application;
- Certified clerk's lists; and
- Site plan.

Once all documents are received, the file then goes for final legal review with the Executive Director or Staff Attorney. Next, an inspection is completed by field agents. Once this process is completed, a license payment is made by the applicant and processed by staff. Finally, a retail food store license is printed and issued to the applicant.

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## AUDIT SCOPE

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We have audited the Tennessee Alcoholic Beverage Commission for the period July 1, 2011, through March 31, 2016. Our audit scope included a review of internal control and compliance with laws and regulations in the areas of confiscated evidence, background checks on permit applicants, licensing, conflicts of interest, confidential funds, information systems, and cash receipts. Management of the commission is responsible for establishing and maintaining effective internal control and for complying with applicable laws, regulations, and provisions of contracts and grant agreements.

For our sample design, we used nonstatistical audit sampling, which was the most appropriate and cost-effective method for concluding on our audit objectives. Based on our professional judgment, review of authoritative sampling guidance, and careful consideration of underlying statistical concepts, we believe that nonstatistical sampling provides sufficient appropriate audit evidence to support the conclusions in our report. We present more detailed information about our methodologies in the individual report sections.

We conducted our audit in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

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## **PRIOR AUDIT FINDINGS**

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Section 8-4-109, *Tennessee Code Annotated*, requires that each state department, agency, or institution report to the Comptroller of the Treasury the action taken to implement the recommendations in the prior audit report. The Tennessee Alcoholic Beverage Commission filed its report with the Department of Audit on December 21, 2007. The prior financial and compliance audit report was dated July 2007 and contained seven findings. We conducted a follow-up of one of the seven prior audit findings, concerning the Alcoholic Beverage Server Training Program, in the October 2009 performance audit report and in the follow-up review dated August 17, 2012, and determined that management had corrected the finding. We conducted a follow-up of the six remaining prior audit findings as part of the current audit.

All the findings in the October 2009 performance audit report were resolved in the follow-up review dated August 17, 2012.

### **RESOLVED AUDIT FINDINGS**

The current audit disclosed that the Tennessee Alcoholic Beverage Commission has corrected four of the six remaining prior audit findings from the July 2007 report. The resolved findings were related to cash receipts, Title VI compliance reporting, and noncompliance with the Financial Integrity Act and the Audit Committee Act.

### **REPEATED AUDIT FINDINGS**

The July 2007 prior audit report also contained findings concerning confiscated evidence and conflicts of interest. These findings have not been resolved and are repeated in the applicable sections of this report.

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## **OBJECTIVES, METHODOLOGIES, AND CONCLUSIONS**

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### **CONFISCATED EVIDENCE**

The Tennessee Alcoholic Beverage Commission employs agents to enforce all laws, rules, regulations, policies, and procedures under its authority regarding the sale and consumption of alcoholic beverages and drugs. In addition to regulatory cases, agents conduct criminal investigations of suspected violations of federal and state laws. Many of these regulatory and criminal cases require agents to confiscate evidence such as liquor, liquor paraphernalia, drugs, drug paraphernalia, gambling paraphernalia, weapons, and cash.

The commission's policies and procedures state that the Special Agent-In-Charge of each district office works under the general supervision of the commission's Chief Law Enforcement Officer. In April 2014, the commission maintained confiscated evidence in evidence storage rooms in nine locations: Nashville, Memphis, Knoxville, Chattanooga, Johnson City, Columbia, Cookeville, Winchester, and Talbott.<sup>1</sup> The Nashville location is responsible for securing cash evidence. The evidence custodian at each location is responsible for maintaining a complete listing of confiscated evidence, maintaining a log of all persons accessing the evidence room and the purpose of entry, and destroying or disposing of evidence once properly authorized. Once the court or other competent authority issues a destruction or disposal order, the evidence custodian is required to dispose of the evidence in accordance with the terms of the disposal order. For example, the terms of a disposal order could require commission staff to deposit confiscated cash into the state treasury, return confiscated property to its original owner, destroy the evidence, or dispose of the evidence in some other manner.

When agents confiscate evidence, they transfer it to the evidence custodian at one of the evidence storage rooms located across the state. In 2012, the commission purchased electronic software, Evidence Management System (EMS), to help commission staff manage confiscated evidence. In addition, the evidence custodians maintain handwritten logs or electronic spreadsheets to record confiscated evidence.

## **Objectives**

The objectives of our review of the confiscated evidence process were to follow up on the prior audit finding and to determine whether management

- updated policies and procedures for confiscated evidence to reflect current operations;
- fully utilized EMS to maintain oversight and control over the commission's confiscated evidence;
- ensured that an employee without custodial or recordkeeping responsibility reconciled evidence listings to the confiscated evidence at each location;
- ensured that staff in each location maintained a log of everyone who accessed the confiscated evidence room;
- ensured that confiscated cash evidence was transferred to the central office, as required by commission policy;
- ensured that confiscated evidence agreed to evidence listings and case files; and
- ensured that confiscated evidence was available for inspection, disposed of timely, or properly deposited in the state treasury.

## **Methodologies**

We obtained and reviewed the policies and procedures to determine whether management updated them to reflect current operations. We interviewed key personnel and performed

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<sup>1</sup> The Talbott location closed in March 2015.

walkthroughs of the procedures at all nine evidence rooms to gain an understanding of controls over confiscated evidence.

After we obtained listings of confiscated evidence items from EMS, handwritten logs, and/or electronic spreadsheets available for each location, we reviewed the listings to determine if commission management fully utilized EMS to maintain oversight and control over the commission's confiscated evidence.

We obtained and reviewed reconciliations of confiscated evidence for each location to determine if an independent employee (that is, an employee without custodial or recordkeeping responsibility) performed the reconciliation of the evidence listings to the confiscated evidence. In addition, we requested evidence room access logs to determine if staff at each location maintained a log of everyone who accessed the location's evidence storage room.

To determine whether management ensured (a) evidence custodians transferred confiscated cash evidence to the central office, (b) confiscated evidence stored at each location matched the location's evidence listings and case files, and (c) confiscated evidence was available for inspection or disposed of timely,<sup>2</sup> we

- obtained the confiscated evidence listings at each of the nine locations,<sup>3</sup> which included items currently held and items disposed of during the period tested;
- selected and tested a nonstatistical, random sample of confiscated evidence from the listings at each location; and
- selected and tested a nonstatistical, haphazard sample of confiscated evidence observed at each location.

The following table includes the locations tested, date of confiscated evidence listings, total number of confiscated evidence items on the listings, sampling methods, and sample sizes.

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<sup>2</sup> After discussion with commission management, it was determined that confiscated non-cash evidence would be considered disposed of timely if commission staff disposed of the evidence within one year of the date of the disposal order.



**Table 2**  
**Listing of Confiscated Evidence Items**

<b>Location</b>	<b>Date of Confiscated Evidence Listings</b>	<b>Total Number of Confiscated Evidence Items on Listings</b>	<b>Nonstatistical, Random Sample Size</b>	<b>Nonstatistical, Haphazard Sample Size</b>	<b>Total Sample Size</b>
Nashville	April 10, 2014	656	20	10	30
Memphis	April 3, 2014	550	15	10	25
Knoxville	April 4, 2014	271	15	10	25
Chattanooga	April 4, 2014	180	20	10	30
Johnson City	April 4, 2014	361	15	10	25
Columbia	May 7, 2014 <sup>3</sup>	19 <sup>3</sup>	Not applicable <sup>4</sup>	Not Applicable <sup>4</sup>	19 <sup>4</sup>
Cookeville	April 3, 2014	114	15	10	25
Winchester	April 8, 2014	259	15	10	25
Talbott <sup>5</sup>	April 4, 2014	287	15	10	25
<b>Totals</b>		<b>2,697</b>	-	-	<b>229</b>

Source: Created by auditors using information obtained from the commission.

Because evidence custodians maintained their own evidence listings (which provides an opportunity to conceal the misappropriation of assets), we were unable to perform procedures to determine whether our population of evidence items was complete. Therefore, we were unable to project our audit results to all evidence items.

We also obtained a listing of all 21 confiscated cash evidence items held in the central office as of March 28, 2014, totaling \$14,889; a listing of all 17 confiscated cash evidence items held in the central office as of February 9, 2015, totaling \$20,773; and respective confiscated evidence case files. We reviewed the cash evidence to determine whether the evidence was available for inspection, agreed to the evidence listing and case file, and/or was properly deposited in the state treasury as ordered by the court or proper authority. In evaluating whether commission staff deposited the cash evidence properly in the state treasury, we considered such factors as the timeliness of the deposit once the disposal order was issued,<sup>6</sup> whether the cash was deposited into the proper bank account, and whether the amount deposited agreed with supporting documentation.

<sup>3</sup> The Chief Law Enforcement Officer failed to ensure that commission staff maintained an evidence listing for the Columbia location. As a result, we prepared an evidence listing based on observation of all evidence items in the location's vault on May 7, 2014.

<sup>4</sup> For Columbia, we tested the entire population; therefore, a sampling method was not applicable.

<sup>5</sup> The Talbott office closed in March 2015; however, we included the Talbott office because it was in operation during our audit period and was thus relevant to our audit objectives.

<sup>6</sup> After discussion with commission management, it was determined that confiscated cash evidence would be considered disposed of timely if commission staff deposited the cash in the state treasury within 30 days after the date of the disposal order.

## Conclusions

Based on the procedures performed, we determined that management

- updated policy and procedures for confiscated evidence to reflect current operations;
- did not fully utilize EMS to maintain oversight and control over the commission's confiscated evidence (see finding 1);
- did not ensure an independent employee reconciled evidence listings to the confiscated evidence at each location (see finding 1);
- did not ensure that staff in each location maintained a log of everyone who accessed the evidence room (see finding 1);
- did not ensure that confiscated cash evidence was transferred to the central office, as required by commission policy (see finding 1);
- did not ensure confiscated evidence agreed to the evidence listings and case files (see finding 1); and
- ensured confiscated evidence was available for inspection; however, management did not always ensure confiscated evidence was disposed of timely and cash evidence was properly deposited in the state treasury (see finding 1).

### **Finding 1. As noted in the 2007 financial and compliance audit, the Tennessee Alcoholic Beverage Commission did not maintain proper internal controls over confiscated evidence, increasing the risk that evidence misappropriation or misuse will not be prevented, detected, or corrected**

Management has not strengthened the controls over confiscated evidence. In the prior audit, we noted that Tennessee Alcoholic Beverage Commission management and staff did not

- maintain a master listing of all confiscated evidence (current and disposed of); and
- ensure someone other than the evidence custodians performed an inventory of confiscated evidence.

Management concurred with the prior finding and stated that they would create, maintain, and reconcile a master listing and find someone independent of law enforcement to perform an inventory. Management purchased software, the Evidence Management System (EMS), to help commission staff manage confiscated evidence; however, management did not fully utilize EMS to maintain oversight and control over the commission's confiscated evidence. As a result, management still did not maintain an independent, master listing of all confiscated evidence (see Condition A). In addition, management still did not ensure someone other than the evidence custodians performed an inventory of confiscated evidence (see Condition B).

We also found that evidence custodians and the Chief Law Enforcement Officer did not always

- ensure that all evidence was documented on the evidence listings (see Condition C);
- maintain case files and ensure descriptions of evidence agreed with case files (see Condition D);
- maintain a log of everyone who entered evidence storage rooms, as required by commission policy (see Condition E);
- dispose of confiscated evidence timely once a disposal order had been issued (see Condition F); and
- transfer cash evidence to the commission's central office (see Condition G).

**Condition and Cause A. – Failure to Fully Utilize EMS**

Based on our review, the Chief Law Enforcement Officer did not fully utilize EMS to maintain oversight and control over the commission's confiscated evidence. EMS, which the commission purchased in 2012, can be used to maintain a master listing of confiscated evidence. However, we noted that not all evidence custodians used EMS to keep record of the confiscated evidence, and not all confiscated evidence was entered into the system. Specifically, the evidence custodians at three of the nine locations (Nashville, Chattanooga, and Winchester) did not enter all evidence into the system and maintained separate listings outside EMS. Because custodians maintained their own records and no master listing existed, the commission had no independent record of what confiscated inventory should be on hand.

Based on discussion with the Chief Law Enforcement Officer and evidence custodians, staff were trained on EMS, and the Chief Law Enforcement Officer assumed evidence custodians would use it; however, the use of EMS was not mandatory.

**Condition and Cause B. – An Independent Inventory Was Not Performed at All Locations**

Based on testwork performed, for four of nine locations, the Chief Law Enforcement Officer did not ensure that a staff member independent of the custodial function for evidence conducted an inventory of confiscated evidence. Instead, the evidence custodians of the Nashville, Memphis, Knoxville, and Winchester locations performed inventories of their own confiscated evidence.

When we asked the Chief Law Enforcement Officer why this problem occurred, he stated that he was not aware that, in response to a 2007 prior audit finding, management had agreed that inventories should be conducted by someone independent of the custody or recording of evidence.

**Condition and Cause C. – Evidence Listings Were Incomplete**

Based on testwork performed on confiscated evidence, we noted that for 3 of 177 items tested (2%), the commission's evidence custodians did not ensure that all evidence was documented on the evidence listings. Specifically, we noted that one sampled item in each of the

Nashville, Memphis, and Winchester locations was found in the location's evidence room but was excluded from the location's evidence listings.

According to the evidence custodians of the Nashville and Memphis locations, they did not include all evidence on evidence listings because the items were transferred from other locations and the evidence custodians did not update the evidence listings to account for the items transferred. At the Winchester location, the evidence custodian explained that the evidence was stored in the evidence storage room before he was assigned to work at the Winchester location.

**Condition and Cause D. – Case Files Were Not Maintained and Evidence Descriptions Did Not Always Match Case Files**

Based on our testwork of confiscated evidence, we found that for 6 of 176 items tested (3%), the evidence custodians could not locate the case files or did not ensure the description of the confiscated evidence on the evidence listings matched the case files. Specifically, we noted the following:

- **Nashville** - The evidence custodian could not locate the case files for 2 of 30 confiscated evidence items tested (7%) and did not ensure the description of the evidence on the evidence listing matched the case file for 2 of 28 items tested (7%).
- **Cookeville** - The evidence custodian could not locate the case files for 2 of 12 confiscated evidence items tested (17%).

Based on discussion with the Chief Law Enforcement Officer and the former Administrative Services Assistant 2, the case files that were missing were destroyed. According to the Chief Law Enforcement Officer, the description of the evidence did not match one case file due to human clerical error, and he was not sure why the description of the evidence did not match the other case file.

**Condition and Cause E. – A Log of all Persons Accessing an Evidence Room Was Not Maintained**

During our review of confiscated evidence, we noted that the evidence custodian at the Winchester location did not maintain a log of everyone who accessed the evidence room and their purpose of entry. Based on discussion with commission staff, subsequent to our fieldwork, staff initiated the use of an evidence room entry log at the Winchester location. We will verify the action taken subsequent to our fieldwork during the next audit.

According to the Chief Law Enforcement Officer, this problem occurred because the evidence custodian at the Winchester location was not aware of the proper procedures necessary to maintain a log of everyone who accessed the evidence room.

## **Criteria for Conditions A Through E**

The U.S. Government Accountability Office's *Standards for Internal Control in the Federal Government* (Green Book), Section OV2.24, states, "Management designs an internal control system to provide reasonable assurance regarding prevention or prompt detection and correction of unauthorized acquisition, use, or disposition of an entity's assets." Commission management cannot meet this objective unless management

- fully utilizes available resources to maintain an independent master listing of all confiscated evidence,
- ensures that inventories are performed by staff other than the evidence custodian responsible for maintaining the inventory, and
- ensures that evidence custodians maintain case files and confirm that descriptions of evidence agree with case files.

Commission Policy and Procedures 3-3-10, "Handling and Collecting Evidence," Section IX, C.4 and C.5, states,

The primary evidence custodian will be responsible for . . . [m]aintain[ing] a log of all persons accessing evidence room and the purpose of entry . . . [and] [m]aintaining a complete inventory of items in evidence room.

## **Condition F. – Evidence Not Disposed of Timely**

Based on testwork performed on confiscated evidence, we noted that the commission's evidence custodians did not always dispose of evidence timely once a disposal order was issued.

### **Confiscated Cash Evidence**

We considered confiscated cash evidence to have been disposed of timely if the Chief Law Enforcement Officer ensured commission staff deposited the cash in the state treasury within 30 days after the date of the disposal order. Based on testwork performed on confiscated cash evidence, for 7 of 10 confiscated cash evidence items tested (70%), totaling \$7,906, from the listing dated March 24 2014, the Chief Law Enforcement Officer did not ensure commission staff deposited the cash in the state treasury timely once a disposal order was issued. Commission staff deposited the cash between 147 to 599 days after the disposal orders were issued. We also noted that, for two of eight confiscated cash evidence items tested (25%), totaling \$192, from the listing dated February 9, 2015, the Chief Law Enforcement Officer did not ensure commission staff deposited the cash in the state treasury timely once a disposal order was issued. Commission staff deposited the two items between 77 and 84 days after the disposal orders were issued.

### **Confiscated Evidence Other Than Cash**

For non-cash confiscated evidence, we considered the confiscated evidence to have been disposed of timely if commission staff disposed of the evidence within one year of the date of the

disposal order. For 27 of 68 items tested (40%), we noted that the confiscated items were either disposed of or remained in the evidence room between 402 and 5,725 days after the disposal order was issued. See the table below.

**Table 3**  
**Non-Cash Confiscated Items Not Disposed of Timely**

Location	Number of Items Not Disposed of Timely	Number of Items Tested	Percentage	Number of Days That Items Were Maintained in Inventory After a Disposal Order Was Issued <sup>7</sup>	
				Minimum	Maximum
Nashville	6	8	75%	671	5,725
Memphis	2	5	40%	402	2,521
Knoxville	0	5	0%	0	0
Columbia	0 <sup>8</sup>	0 <sup>8</sup>	0% <sup>8</sup>	0 <sup>8</sup>	0 <sup>8</sup>
Chattanooga	5	12	42%	1,065	2,201
Johnson City	2	8	25%	795	795
Cookeville	1	13	8%	496	496
Winchester	10	10	100%	950	2,080
Talbott <sup>9</sup>	1	7	14%	674	674
<b>Totals</b>	<b>27</b>	<b>68</b>			

Source: Created by auditors using information obtained from the commission.

### **Criteria for Condition F**

Commission Policy and Procedures 3-3-10.7, “Uniform Destruction of Physical Evidence,” Section II, states,

It is the policy of the Alcoholic Beverage Commission to routinely and in a timely fashion destroy or dispose of contraband evidence which has been stored as evidence for criminal prosecution.

In addition, Policy and Procedures 3-3-10.1, “Confiscated Property,” Section V, states,

Property/evidence will be disposed of in accordance with existing laws or as directed by the court or other competent authority.

Section 53-11-204, *Tennessee Code Annotated*, states,

<sup>7</sup> These date ranges were calculated as the difference between the date of the disposal order and the earlier of the disposal date (if the commission had disposed of the item) or the dates of our testwork (for items commission staff had not disposed of at the time of our testwork).

<sup>8</sup> None of the evidence items observed at the Columbia location were tested for timely disposal because disposal orders had not been issued for any of the items we observed.

<sup>9</sup> The Talbott office closed in March 2015; however, we included the Talbott office because it was in operation during our audit period and was thus relevant to our audit objectives.

The proceeds of all seizures, confiscations and sales made by a state agency pursuant to this chapter shall be transmitted to the state treasurer and deposited in the state treasury.

### **Cause for Condition F**

Based on discussion with the Chief Law Enforcement Officer, he did not ensure commission staff deposited confiscated cash evidence timely because the agents did not monitor the status of their cases timely; therefore, the agents did not provide the disposal orders to him timely. Based on discussions with the Chief Law Enforcement Officer, Special Agents In-Charge, and the former Executive Director, for confiscated evidence other than cash, commission staff failed to dispose of the evidence timely primarily due to understaffing and evidence custodians waiting to collect a sufficient amount of evidence so that evidence could be disposed of all at once.

### **Condition G. – Not All Cash Evidence Was Transferred to the Commission’s Central Office**

Based on testwork performed on confiscated cash evidence, we noted that the evidence custodian for the Winchester location did not transfer all cash evidence to the central office within 24 hours after confiscation. We noted that \$1,200 in cash evidence was held in the Winchester evidence room without prior authorization from the Chief Law Enforcement Officer or the former Executive Director. The confiscated cash remained in the Winchester evidence room as of April 8, 2014 – 109 days after it was checked into the room.

### **Criteria for Condition G**

The commission’s Policy and Procedures 3-3-10.1, “Confiscated Property,” Section IV, C.2, states,

Seized moneys will be transported as soon as practical to Headquarters and receipted out to the CLEO [Chief Law Enforcement Officer], Budget Officer, or Director. Until this transfer is completed the money will be unquestionably secure. In no case will the money be kept longer than twenty-four (24) hours, without transfer to Headquarters, unless prior approval has been given by the Director or CLEO.

### **Cause for Condition G**

Based on discussion with the evidence custodian, the confiscated cash evidence was held at the Winchester location as part of a joint investigation with the Tennessee Bureau of Investigation (TBI). The custodian was not aware that cash held for TBI should be transferred to the Nashville location within 24 hours of receipt. Based on discussion with the Chief Law Enforcement Officer and the former Executive Director, they were not aware that the Winchester location had funds that were not transferred to the central office.

## **Condition and Criteria H. – Failure to Adequately Identify and Assess Risks Related to Confiscated Evidence**

Given the pervasiveness of problems identified during our fieldwork related to confiscated evidence, we also reviewed the commission’s Financial Integrity Act Risk Assessment. We found that management did not identify any risks or mitigating controls related to confiscated evidence in its annual risk assessment.

According to Sections 7.02 and 7.05 of the Green Book, “Management identifies risks throughout the entity to provide a basis for analyzing risks. . . . Management analyzes the identified risks to estimate their significance, which provides a basis for responding to the risks.”

### **Effect for All Conditions**

Failure to maintain adequate controls over confiscated evidence increases the risk that commission staff will misappropriate or misuse confiscated evidence and that the commission’s law enforcement efforts will be undermined due to the failure to maintain a proper chain of custody for evidence.

### **Recommendation**

The Executive Director and the Chief Law Enforcement Officer should ensure that

- management fully utilizes EMS to maintain oversight and control over the commission’s confiscated evidence and that the evidence custodian at each location uses EMS to document all evidence held in inventory and all disposed-of evidence;
- commission employees independent of the custody and recording of evidence perform periodic inventories of evidence;
- the evidence custodian at each location maintains a complete log of everyone who accesses the evidence room and their purpose for entry;
- commission staff adequately document and describe all confiscated evidence in the case files;
- commission staff maintain all case files until evidence is properly disposed of;
- evidence custodians dispose of confiscated evidence timely in accordance with the applicable disposal order; and
- commission staff transfer all confiscated cash evidence to the central location within the required timeframe.

The Executive Director and the Chief Law Enforcement Officer should also ensure that risks related to confiscated evidence are adequately identified and assessed in management’s documented risk assessment activities. The Chief Law Enforcement Officer should implement effective controls to mitigate the risks identified through the risk assessment process.



## **Management's Comment**

We concur. Under the leadership of a new Executive Director, the TABC has implemented revised policies regarding the collection, handling, storage, and disposal of evidence or other property. These revised policies function as proper internal controls and will decrease the risk of evidence misappropriation and misuse.

Specifically, we have revised the following policies:

- Handling and Collecting Evidence, Policy 3-3-10;
- Disposal of Evidence, Policy 3-3-10.1;
- Vehicle Seizures, Policy 3-3-10.3;
- Firearm Seizures, Policy 3-3-10.4;
- Alcoholic Beverage Seizures, Policy 3-3-10.5;
- Seized Property Disposition Negotiation, Policy 3-3-10.6;
- Evidence Management System, Policy 3-3-10.7; and
- Safeguarding Property, Policy 3-3-11.

Generally, the revised policies above require evidence custodians to use TABC's Evidence Management System (EMS) to log all evidence, to ensure the log coincides with the evidence present in the storage room, and to log the disposal of all evidence. They require all confiscated cash to be submitted to the evidence storage room immediately and then delivered to the Nashville headquarters office within five days. The policies also require agents to review their cases at least once per year to determine whether seized items may be disposed of. Money will be disposed of within 30 days of a disposal order, and all other items will be disposed of within one year.

Furthermore, the revised policies impose three levels of internal inventory to ensure that all evidence is handled uniformly and securely:

- I. In the first level, the Executive Director will designate someone independent of TABC law enforcement to conduct a complete inventory of each evidence storage room once per calendar year. The person will confirm that the EMS evidence log matches the evidence on hand and the description in the case file. Additionally, the person will confirm that the operation of the evidence storage room complies with all TABC policies, including policies governing the timely disposal of evidence and the maintenance of an access log. Any time the person designated as the evidence custodian changes, a complete inventory will be conducted of the evidence storage room.
- II. In the second level, the evidence custodian will conduct a spot check inventory, consisting of at least 20% of the evidence in the EMS log, twice per calendar year.

- III. In the third level, the Chief Law Enforcement Officer will conduct an unannounced, abbreviated inventory of each evidence storage room at least once per calendar year.

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## **BACKGROUND CHECKS ON PERMIT APPLICANTS**

The Tennessee Alcoholic Beverage Commission is authorized by statute to issue licenses and permits related to the distribution of alcohol by manufacturers/distillers, wholesalers, retailers, and liquor-by-the-drink establishments. Sections 57-3-202, 57-3-203, and 57-3-204, *Tennessee Code Annotated*, require representatives of distilleries and wholesalers, employees of retail stores and wholesalers, and servers to obtain permits before taking orders, soliciting orders, or dispensing alcoholic beverages. Sections 57-3-703 and 57-3-704, *Tennessee Code Annotated*, establish requirements for individuals applying for employee and server permits, including demonstrating that the applicant has not been convicted of any felony within the previous four years or of any crime involving the sale or distribution of alcohol within the previous eight years.

Although state law does not require the commission to perform background checks on permit applicants, the commission has developed a written policy for conducting background checks on a sample basis to determine whether applicants for employee or server permits are eligible. The commission's Policy and Procedures 1-3-26, "Background Checks for Permits," prescribes processes related to requesting, receiving, and evaluating Tennessee Bureau of Investigation (TBI) background checks on distiller's representative, wholesale salesperson, wholesale employee, retail employee, and server permit applicants.

According to the background check policy, the Executive Director shall annually determine the procedure for selecting permit applicants for a random TBI criminal background check. Once a permit applicant has been selected for a background check, the staff member processing the application forwards the applicant's personal information to the Chief Law Enforcement Officer or his designee, who then forwards the applicant's information to TBI. The results of the background checks are provided to the Chief Law Enforcement Officer or his designee, who then approves or denies the application based on the results. According to the policy, the Executive Director or his designee may also review the results and determine whether an application should be approved or denied.

TBI invoices the commission monthly and charges \$29 for each background check performed. The Chief Law Enforcement Officer maintains a log of the background checks requested and compares the names on the monthly TBI invoices to the names in the request log. Once the Chief Law Enforcement Officer has verified that an individual on the request log has been included in the monthly TBI invoice, the Chief Law Enforcement Officer documents the associated invoice number in the log to indicate that TBI has invoiced the commission for the background check.

### **Objectives**

The original objectives of our review were to obtain, verify, and compare the number of background checks performed during our audit period and the number of permits issued during

our audit period. After obtaining this information, we planned to determine the percentage of applicants denied based on the results of the background checks and to conclude whether the commission's sampling procedures effectively prevented ineligible applicants from receiving permits. Therefore, we initially requested listings of all documented distiller's representative, retail employee, server, wholesale employee, and wholesale representative permits issued from July 1, 2011, to February 28, 2014, and reviewed selected permit applicant files that were available.

We were unable to meet our objectives because the total population of permits issued during the audit period could not be verified because the Assistant Director, Administrative Services Director, and former Executive Director did not maintain adequate controls over the issuance of permits. Specifically, we noted that management did not establish adequate procedures to ensure that staff

- reconciled the permit numbers distributed to commission employees to the permit numbers commission employees issued to the public,
- assigned each permit number to only one permit applicant,
- assigned each permit applicant only one permit number, and
- recorded permit numbers accurately in permit logs.

The internal control deficiencies we identified while attempting to obtain and verify the population of permits issued during our audit period are detailed in finding 2.

Although we could not verify the number of permits issued, we were able to revise our objectives and make limited determinations regarding management's controls over background checks. Specifically, our revised objectives were to determine whether

- the Chief Law Enforcement Officer maintained an accurate log of background checks requested;
- the Chief Law Enforcement Officer properly reconciled the log of background checks requested to the monthly TBI invoices;
- the appropriate officials performed approvals and denials of applications;
- commission staff requested background checks for permits when required; and
- commission staff attached background check results to the applicable permit application and maintained the results in the respective applicant's file.

## **Methodologies**

To gain an understanding of controls over background checks, we obtained and reviewed policies and procedures and interviewed key personnel. To determine whether the Chief Law Enforcement Officer maintained an accurate log of background checks requested (request log) and properly reconciled the request log to the monthly TBI invoices, we obtained the request logs for the periods July 1, 2011, through February 28, 2014, totaling 1,100 background checks,

and May 1, 2014, through December 31, 2014, totaling 232 background checks, and reconciled them to all TBI monthly invoices paid by the commission for the respective periods. In order to determine whether background check results were attached to the applicable permit application and maintained in the respective applicant's file, we reviewed permit applicant files during our reconciliation procedures.

We interviewed key personnel and reviewed permit logs to determine whether commission staff requested background checks for permits when required and whether the appropriate officials performed approvals and denials of applications.

## **Conclusions**

Based on the procedures performed, we determined that

- the Chief Law Enforcement Officer did not maintain an accurate log of background checks requested (see finding 2);
- the Chief Law Enforcement Officer did not properly reconcile the log of background checks requested to the monthly TBI invoices (see finding 2);
- the appropriate officials performed approvals and denials of applications;
- commission staff did not always request background checks for permits when required (see finding 2); and
- commission staff did not always attach background check results to the applicable permit application and maintain the results in the respective applicant's file (see finding 2).

## **Finding 2. Management of the Tennessee Alcoholic Beverage Commission did not maintain proper controls over issuing permits to and performing background checks on individuals manufacturing, distributing, selling, or serving alcoholic beverages, increasing the risk that ineligible applicants will be issued permits**

### **Condition A. – Inadequate Controls Over the Issuance of Permits**

The Assistant Director, Administrative Services Director, and former Executive Director (management) did not maintain adequate controls over the issuance of permits. Specifically, we noted the following control deficiencies:

- Management did not establish procedures for reconciling the permit numbers distributed to commission employees to the permit numbers commission employees issued to the public. As a result, we identified 11,200 permit numbers that could not be accounted for due to gaps in the sequences of permit numbers issued to the public, and we identified 260 distiller's representative permits issued to the public that were not included in the log of permit cards distributed to commission employees.

- Management did not establish adequate procedures to ensure that staff assigned each permit number to only one permit applicant. As a result, we identified 15 permit numbers that staff assigned to multiple permit applicants. We confirmed that 10 permit numbers were issued to more than one applicant; however, we could not determine whether the remaining 5 were issued to more than one applicant because commission staff were unable to provide supporting documentation for the permits.
- Management did not establish adequate procedures to ensure that staff assigned each permit applicant only one permit number. Specifically, for 138 permit holders, commission staff assigned each of the permit holders multiple permit numbers in the commission’s server permit software. We could not determine whether commission staff actually issued the permit holders more than one permit because staff could not provide supporting documentation for the permit holders.
- Management did not establish adequate procedures to ensure that commission staff recorded permit numbers accurately in permit logs. As a result, we noted that administrative staff incorrectly recorded 22 permit numbers in the logs of issued permits.

Given the problems identified during our fieldwork, we also reviewed the commission’s Financial Integrity Act Risk Assessment. We determined that management did not include any risks or mitigating controls associated with permit issuances in management’s annual risk assessment.

### **Criteria**

The U.S. Government Accountability Office’s *Standards for Internal Control in the Federal Government* (Green Book), Section OV2.24, states, “Management designs an internal control system to provide reasonable assurance regarding prevention or prompt detection and correction of unauthorized acquisition, use, or disposition of an entity’s assets.” The commission cannot meet this objective unless staff

- assign one unique permit number to each permit holder;
- maintain a complete, accurate log of all permits issued to the public; and
- reconcile permits distributed to various offices to permits issued to the public.

### **Cause**

The former Executive Director stated that he did not know the items above were problems. We noted in our review of the log of permit cards distributed to commission employees that management did not issue distiller’s representative permit cards in sequential order, making it difficult for management to track permits through the entire distribution process.

### **Effect**

Failure to establish adequate reconciliation procedures for permits and to ensure that each permit holder is issued a unique permit number increases the risk that management will fail to

detect the misappropriation of cash generated from the sale of permits. Failure to prevent or detect instances in which a single server permit holder is issued multiple permits increases the risk that ineligible individuals will obtain permits through improper means.

### **Condition B. – Inadequate Controls Over Background Checks**

Based on our reconciliation of the log of background checks requested to Tennessee Bureau of Investigation (TBI) invoices during our audit work, we determined that the Chief Law Enforcement Officer did not

- ensure that random background checks were requested and performed on any of the 1,210 distiller’s representative permits issued between January 1, 2012, and February 28, 2014;
- ensure that TBI was paid for 27 background checks performed, totaling \$783;
- identify nine background checks that were each billed and paid for twice, resulting in a total overpayment of \$261;
- ensure that commission staff documented three background checks that were requested and performed in the background check request log;
- detect that one background check was not performed on the correct individual;
- properly document that TBI had invoiced the commission for background checks performed for five permit applicants; and
- document the TBI invoice number in the background check request log for three permit applicants.

We also noted that the Assistant Director and the Administrative Services Director did not ensure that staff maintained complete files for seven applicants and did not ensure that administrative staff maintained adequate supporting documentation to verify whether a background check was performed on the correct individual for two additional permit applicants.

Given the problems identified during our fieldwork, we also reviewed the commission’s Financial Integrity Act Risk Assessment. We determined that management did not include any risks or mitigating controls associated with background checks in management’s annual risk assessment.

### **Criteria**

The commission’s Policy and Procedures 1-3-26, “Background Checks for Permits,” stated that staff will “maintain a file and list of the background checks” and “attach the results of the background check to the applicable permit application.” In addition, the policy stated, “[i]t is the policy of the Alcoholic Beverage Commission to conduct random state-wide background checks on applicants for distiller’s representative permits.”

The Chief Law Enforcement Officer provided us with a revised copy of Policy and Procedures 1-3-26, “Background Checks for Permits,” effective February 13, 2015, that did not require random background checks to be performed for distiller’s representative permits; however, we still included this problem in the finding because the background checks for distiller’s representative permits were required during our audit period.

Section 10.03 of the Green Book states, in part, “Management clearly documents internal control and all transactions and other significant events in a manner that allows the documentation to be readily available for examination . . . Documentation and records are properly managed and maintained.”

Based on review of Department of Finance and Administration Policy 4, “Recognition of Revenues and Expenditures Definition and Guidance,” paragraph 12, state agencies are required to recognize all expenditures in their accounting records. Because the expenditures for background checks were incurred upon the receipt of the background checks from TBI, the commission’s expenditure records should have included all background checks TBI provided to the commission, regardless of whether TBI had billed for them.

### **Cause**

Based on discussions with the Chief Law Enforcement Officer and Administrative Assistants, a variety of factors caused or contributed to the issues we noted, including the following:

- According to the Chief Law Enforcement Officer, he does not ensure that all background check requests recorded in the log are included in TBI’s invoices.
- Per discussion with the Chief Law Enforcement Officer, there is no process in place to verify whether staff properly document when TBI has invoiced the commission for an applicant’s background check.
- Administrative Assistants were not aware that the background check policy required random background checks for distiller’s representative permits.
- According to an Administrative Assistant, when the commission moved to its current location, the commission lost denied server permit files.

### **Effect**

Unless commission staff prepare and maintain documentation that demonstrates that background check request logs are complete and accurate, background checks are performed on the proper individuals for all permit types, and background check reconciliations are performed properly, management cannot ensure that controls over background checks effectively reduce the risk of issuing permits to ineligible individuals. Furthermore, unless reconciliation procedures for invoices are designed and operating effectively so that duplicate billings and under-billings are detected and resolved, management cannot ensure that the commission’s resources are used efficiently and that its accounting records are correct.

## **Recommendation**

Management should include the risks noted in this finding in management's documented risk assessment. The Executive Director should ensure staff adequately document the risk assessment and the mitigating controls.

### **Recommendation for Condition A. – Inadequate Controls Over the Issuance of Permits**

In order to establish adequate controls over the issuance of permits, the Executive Director should revise the commission's policies to require information regarding permits distributed to commission offices and permits issued to the public to be recorded in an electronic format, such as a central database. The Executive Director, with assistance from information technology staff, should ensure that the information system includes edit checks to prevent or detect inaccurate permit number entries and to help ensure that each permit holder is issued one unique permit number.

The Executive Director should develop policies and procedures that require staff to periodically reconcile logs of permits distributed to commission offices and permits issued by staff to the public. These reconciliations should be documented and performed by an individual otherwise independent of duties related to permit issuance. The Assistant Director should promulgate specific, written guidance so that commission staff apply the guidance consistently.

### **Recommendation for Condition B. – Inadequate Controls Over Background Checks**

In order to strengthen controls over background checks, the Executive Director should revise the background check policy to require staff who receive background checks from TBI and staff who reconcile TBI invoices to background check requests to record information in the request log to facilitate an automated reconciliation process. This information should include names, dates of birth, and other identifying information included in background checks from TBI and in TBI invoices; the number of background checks performed per the TBI invoices; and the dates on which the background checks were performed.

The Executive Director should then assign information technology staff to redesign the spreadsheet currently used as the background check log so that staff can use the spreadsheet to automatically reconcile information from the background check request log, the background check received from TBI, and the monthly TBI invoice. Once the reconciliation is complete, staff should be notified if information entered from the background check log or the monthly TBI invoice indicates that the background check was performed on the incorrect individual, that a duplicate charge was included in the invoice, that the invoice is incomplete, or that the log is incomplete. Staff should be required to follow up on and document the resolution of any discrepancies, and management should secure the spreadsheet to prevent accidental modification.

## **Management's Comment**

We concur. The TABC is in the process of implementing an online Regulatory Licensing and Permitting System (RLPS). RLPS will contain proper controls and will eliminate the



concerns of the finding as it will only allow a permit to be issued after a permit application is fully vetted and approved by staff. RLPS issues a unique record for all applications and associated permits, which will prevent duplicate permit numbers and the need to manually reconcile permit logs.

Additionally, the agency will regularly request a random sample of background checks for wholesale and server permits, as authorized by statute, and reconcile all TBI invoices to a newly designed background check request log. In addition to ensuring the Chief Law Enforcement Officer performs an accurate reconciliation of the background check request log and TBI invoices, management has assigned staff, outside of the supervision of the Chief Law Enforcement Officer, to perform a regular, additional reconciliation of the background check request log and TBI invoices. The background check results will be maintained in the applicant's file or electronically uploaded to the applicant's file in the RLPS system once it is deployed.

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## LICENSING

### **General Background and Statute**

The Tennessee Alcoholic Beverage Commission is responsible for managing and enforcing regulations regarding the alcohol industry in Tennessee. State statutes on the distribution of alcoholic beverages require manufacturers, distilleries, wineries, importers, brokers, wholesalers, and retailers to obtain various licenses issued through the commission, including annual licenses for liquor retailers, liquor wholesalers, wineries, liquor-by-the-drink establishments, direct shippers, and non-resident sellers. As part of the audit of the commission, we selected two separate licensing processes for review: direct shipper licenses and non-resident seller's licenses. We selected these two licenses because our initial interview procedures indicated that there was a higher risk that the commission was not meeting its objectives related to these two licenses due to staff turnover and an apparent lack of detailed policies and procedures.

According to Tennessee law, manufacturers and importers are generally only permitted to distribute alcoholic beverages to wholesalers licensed in Tennessee; however, state law also permits manufacturers and importers to ship wine directly to Tennessee residents over the age of 21 (direct shipping). Specifically, Section 57-3-217, *Tennessee Code Annotated*, authorizes direct shipping of wine by common carrier and requires a manufacturer or importer to obtain a direct shipper license from the commission.

According to Section 57-3-602(a), *Tennessee Code Annotated*, any manufacturer, distillery, winery, importer, broker, or person selling or distributing alcoholic beverages to any wholesaler or manufacturer is required to have a non-resident seller's license unless the seller or distributor is already licensed in Tennessee as a manufacturer, wholesaler, or winery.

### **Direct Shipper Licensure Process**

The formal process for direct shipper licensing is detailed in the commission's Policy and Procedures 1-4-24, "Winery Direct Shipper License Examiner," and the licensing process is currently assigned to an Administrative Assistant. After a manufacturer or importer applies for the license and pays a licensing fee, the direct shipper license is valid for one year from the date of issue. The commission's policy also requires that the commission send renewal notices to direct shipper license holders to inform them that they should begin the process of applying for a new direct shipper license and what steps they must take to complete the process. Furthermore, the policy requires the commission to maintain a database to track the direct shipper program.

### **Non-Resident Seller's Licensure Process**

The commission's formal process for the non-resident seller's licenses (also referred to as permits) is governed by the commission's Policy and Procedures 1-4-26, "Retail License Examiner." The policy requires the license examiner to receive and process new and renewal non-resident seller's licenses, maintain a mailing list of non-resident sellers, and send renewal notices to non-resident seller's license holders. After an entity applies for the license and pays the licensing fee, the non-resident seller's license is valid until the end of the calendar year and expires on December 31, regardless of when it was issued during the year.

### **Closure of Both Types of Licenses Upon Expiration**

For both direct shipper and non-resident seller's licenses, the commission has established a closing process for expired licenses that involves commission staff noting in the database that the license has been closed before removing the expired license from the active license database.

### **Objectives**

The objectives of our review were to determine whether

- the Assistant Director ensured that the responsibilities for managing the non-resident seller's licenses were adequate;
- the Executive Director documented the approval of direct shipper licensees' applications prior to the issuance of licenses, as required by commission policy;
- the Administrative Assistant complied with policies to distribute renewal notices to direct shipper licensees;
- the Administrative Assistant closed expired direct shipper and non-resident seller's licenses timely; and
- the Assistant Director, Staff Attorney, or Executive Director approved non-resident seller's applications prior to the issuance of the licenses.

## **Methodologies**

To gain an understanding of controls over direct shipper and non-resident seller's licenses, we obtained and reviewed policies and procedures, interviewed key personnel, and performed walk-throughs of the procedures.

In order to test whether commission management complied with their policies for approvals of direct shipper licenses and closed expired direct shipper licenses timely, we requested the complete listing of direct shipper licenses issued between July 1, 2011, and April 23, 2014. Commission staff provided us a listing of all active direct shipper licenses maintained in the commission's license database as of April 23, 2014. However, based on discussion with commission staff, the commission only had a log of direct shipper licenses issued since July 2013, the month commission staff started tracking license issuances using an electronic database. According to management, the previously issued licenses were tracked manually on paper logs that could not be located. Using the listing from the database, we selected a nonstatistical, random sample of 60 licenses from the 126 included in the direct shipper license database. We reviewed the respective 60 applicant files for documentation of the Executive Director's approval (signature) before the license was issued. Additionally, we compared the dates of issuance and expiration of the licenses from the file to the listing of active licenses from the database. Because we were unable to obtain a complete population, none of the direct shipper license sample results can be projected to all licenses issued during the period.

We interviewed key personnel to determine whether the Administrative Assistant complied with policies to distribute renewal notices to direct shipper licensees. We obtained a listing of all direct shipper licenses that expired between January 1, 2014, and April 15, 2014, to determine the number of renewal notices staff were required to distribute during that time period. We also obtained a listing of all 71 direct shipper licensees whose licenses were scheduled to expire in January and February 2015 and who were contacted by commission staff. We selected a nonstatistical, random sample of 5 licensees from each month (for a total of 10 licensees) and reviewed available renewal notices to verify that commission staff submitted renewal notices to the selected direct shipper licensees.

In order to test whether the Administrative Assistant closed expired non-resident seller's licenses timely, we requested and received a listing of non-resident seller's licenses included in the commission's active license database as of March 20, 2014. We performed an analysis to determine whether any of the 1,628 licenses included in the active database were expired, based on license issuance dates.

We discussed the licensing process for non-resident seller's licenses with key personnel and analyzed the listing of non-resident seller's licenses referenced above for issuances since December 2013 to determine whether the Assistant Director, Staff Attorney, or Executive Director approved non-resident seller's applications prior to the issuance of the licenses.

## **Conclusions**

Based on procedures performed, we determined that

- the Assistant Director did not ensure that the responsibilities for managing the non-resident seller's licenses were adequate (see finding 3);
- the Executive Director did not always document the approval of direct shipper licensees' applications prior to the issuance of the licenses (see finding 3);
- the Administrative Assistant complied with policies to distribute renewal notices to direct shipper licensees;
- the Administrative Assistant did not close expired direct shipper and non-resident seller's licenses timely (see finding 3); and
- the Assistant Director, Staff Attorney, or Executive Director approved non-resident seller's applications prior to the issuance of the licenses.

### **Finding 3. Management of the Tennessee Alcoholic Beverage Commission did not establish adequate licensing policies, document the approval of license applications, or close expired licenses timely, increasing the risk that licensees will distribute alcoholic beverages in Tennessee without regulation**

#### **Condition – Inadequate Policies for Non-Resident Seller's Licenses**

The Assistant Director did not ensure that the responsibilities for managing the non-resident seller's licenses were adequate. Based on a review of the commission's policies during fieldwork, the responsibilities for managing the non-resident seller's licenses were mentioned briefly in Policy and Procedures 1-4-26, "Retail License Examiner," because the retail license examiner was previously responsible for managing the non-resident seller's licenses program. The policy was not updated to reflect the separation of non-resident seller's license management responsibilities from the retail license examiner, and the policy did not adequately detail the administrative duties associated with the program.

Given the problems identified during our fieldwork, we also reviewed the commission's Financial Integrity Act Risk Assessment. We determined that management did not document the risks or mitigating controls associated with adequately documenting and periodically updating policies and procedures.

#### **Criteria**

The U.S. Government Accountability Office's *Standards for Internal Control in the Federal Government* (Green Book), Section 12.03, states,

Management documents in policies for each unit its responsibility for an operational process's objectives and related risks, and control activity design,

implementation, and operating effectiveness. . . . Each unit also documents policies in the appropriate level of detail to allow management to effectively monitor the control activity.

### **Cause**

The Assistant Director stated that the commission's policies and procedures have not been updated for some time and there were no plans to draft a new policy until the computerized licensing and permitting system is implemented.

### **Condition and Cause – Lack of Documentation of Direct Shipper Application Approvals**

The two former Executive Directors did not comply with the commission's policy by reviewing all direct shipper applications and documenting their approval for the issuance of licenses. We determined that 53 of 60 new and renewal direct shipper license applications (88%) did not have the former Executive Directors' approval documented in the licensees' files.

The Assistant Director stated that management expanded the approval process to allow the Assistant Director or Staff Attorney to approve direct shipper licenses in lieu of the two former Executive Directors, but management failed to update the written policy to reflect this change. In addition, based on discussion with commission staff, the Assistant Director, Staff Attorney, or former Executive Directors only reviewed and approved new applications rather than all applications, including renewals, as required.

We also found that there was no formal process for the Assistant Director, Staff Attorney, or two former Executive Directors to document their approvals. Specifically, in prior years, management documented their approvals of direct shipper licenses on a transmittal sheet; however, management discontinued this practice.

Given the problems identified during our fieldwork, we also reviewed the commission's Financial Integrity Act Risk Assessment. We determined that management did not document the risks or mitigating controls associated with ensuring that the Executive Director approves direct shipper licenses before staff issue the licenses.

### **Criteria**

According to the commission's Policy and Procedures 1-4-24, "Winery Direct Shipper License Examiner," the Administrative Assistant responsible for the direct shipper program is required to complete the following steps: "[r]eceive, review [the] Direct Shipper applications; forward to [the Executive] Director for review and signature; [and] process license."

### **Condition – Expired Direct Shipper and Non-Resident Seller's Licenses Were Not Closed Timely**

The Assistant Director did not ensure that commission staff closed expired direct shipper and non-resident licenses timely.

Direct shipper licenses expire at various times throughout the year; therefore, the timing of the closing process is less predictable. As a result, we considered a direct shipper license to have been closed timely if the license was closed within six months after the license’s expiration date. We also did not take issue with licenses expired less than six months as of April 23, 2014 (the date of the listing of active direct shipper licenses). However, we considered licenses that had been expired six months or longer as of April 23, 2016, and had not been closed an error. Upon analysis of 60 licenses from the listing of active direct shipper licenses provided, we determined that 12 of 60 licenses tested (20%) were not closed timely. The expired licenses were still included in the database between 18 and 285 days beyond the six-month cutoff.

For non-resident seller’s licenses, all of the licenses expire on December 31 of each year; therefore, the timing of the closing process is more predictable. As a result, we considered a non-resident seller’s license to have been closed timely if the license was closed within 60 days after the license’s expiration date. Upon analysis of a listing of 1,628 active non-resident seller’s licenses, we determined that 582 of 1,628 licenses (36%) were not closed timely. The expired licenses were still included in the database between 19 and 1,480 days beyond the 60-day cutoff (see Table 4 below).

**Table 4**  
**Expired Non-Resident Licenses Included in Database**

<b>Expiration Date</b>	<b>Number of Expired Licenses</b>
12/31/2009	2
12/31/2010	74
12/31/2011	68
12/31/2012	131
12/31/2013	307
<b>Total</b>	<b>582</b>

Source: Created by auditors using information obtained from the commission.

Given the problems identified during our fieldwork, we also reviewed the commission’s Financial Integrity Act Risk Assessment. We determined that management did not document the risks or mitigating controls associated with closing licenses timely.

**Criteria**

Section 13.04 of the Green Book states, “Management obtains relevant data from reliable internal and external sources in a timely manner based on the identified information requirements.” In order for management to make appropriate decisions based on reliable licensee data, commission staff must close licenses timely, which includes removing expired licenses from the database of active licenses.

**Cause**

Based on discussion with the Assistant Director, commission staff failed to close direct shipper and non-resident seller’s licenses timely because turnover within the licensing program was high and the database used to document closures of direct shipper and non-resident seller’s

licenses was antiquated and did not readily provide the information staff needed to address these problems.

### **Effect**

Unless licenses are properly approved prior to issuance and closed timely upon expiration, the Executive Director cannot ensure that licensees are eligible and maintain valid licenses, which hinders the commission's regulatory mission. Failure to develop and maintain detailed policies and procedures increases the risk that commission staff will fail to meet management's expectations related to proper issuance and closure of licenses.

### **Recommendation**

The Executive Director should develop and promulgate policies and procedures for ensuring that expired licenses are closed timely, including timely removal of licenses from the active license databases. In addition, the Executive Director should develop and implement separate policies and procedures for the non-resident seller's program and ensure that all staff responsible for the licensing programs understand and comply with the commission's updated policies and procedures.

The Executive Director should assess all significant risks, including the risks noted in this finding, in management's documented risk assessment. The Executive Director should ensure staff adequately document the risk assessment and the corresponding mitigating controls. The Executive Director should implement effective controls to ensure compliance with applicable requirements, assign employees to be responsible for ongoing monitoring of the risks and any mitigating controls, and take action if deficiencies occur.

### **Management's Comment**

We concur. The TABC has updated its policies regarding non-resident seller licenses to minimize the risk of distributing alcoholic beverages without regulation, to be consistent with current practice, and to add specificity. Additionally, the TABC further updated policies to provide greater detail regarding the issuance and renewal of licenses. Specifically, the TABC has taken the following corrective actions:

- updated relevant policies regarding direct shipper licenses to specify that a designee of the Executive Director may approve all new licenses prior to issuance, instead of requiring approval of the Executive Director;
- created detailed policies and procedures regarding the renewal of direct shipper licenses and non-resident seller permits and the timely closure of such licenses and permits that have not been renewed. The policies include the following requirements:
  - Direct shipper licenses not renewed must be closed within one month of the license expiration date. Management may only extend the deadline in writing, for good cause, up to two months.

- If a direct shipper does not submit the required renewal documents by the expiration date, the TABC will send a second notice informing the direct shipper of the untimely renewal and a date certain to submit the required documents. If such deadline is not met, then the notice will provide that the license will be closed as expired.
- Non-resident seller licenses, because the renewal date for all non-resident seller licenses is December 31 of each year, must be closed out by March 15. Management may extend the deadline in writing and for good cause to no later than April 15.
- If a non-resident seller does not submit the required renewal documents by the expiration date, the TABC will send a second notice informing them of this and a date certain to submit the required documents or the license will be closed as expired.
- updated renewal notices to be consistent with policy;
- trained relevant staff regarding the policy for implementation; and
- closed and will continue to close all licensees who have not submitted the required documents and fees or are otherwise not eligible for renewal within the time restrictions specified in the new policy.

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## CONFLICTS OF INTEREST

According to Sections 57-1-108, and 57-3-105, *Tennessee Code Annotated* (conflict-of-interest statutes), individuals with certain statutorily defined conflicts of interest are ineligible to be a member of the Tennessee Alcoholic Beverage Commission or to be employed in any capacity with the commission. Specifically, the statutes' requirements prohibit having any of the following interests:

- any interest in or on any premises where alcoholic beverages are sold;
- any interest in any business wholly or partially devoted to the sale, transportation, or storage of alcoholic beverages;
- direct or indirect financial or other interests in any distillery, wholesale dealer, or retail detailer licensed as such in Tennessee;
- family members who are employed by any distillery, wholesale dealer, or retail dealer;
- family members who hold any alcoholic beverage license in Tennessee;
- interest of any kind in any building, fixtures, or premises occupied by any person, firm, or corporation licensed under Title 57, Chapter 1, *Tennessee Code Annotated*; and



- any stock or interest of any kind, by a loan, mortgage, gift, seeking a loan, or guaranteeing the payment of any loan, in any distillery, wholesale dealer, or retail dealer licensed under Title 57, Chapter 1, *Tennessee Code Annotated*.

To promote compliance with the statute, management developed Policy and Procedures 1-1-10, “Interest Precluding Employment by the Commission,” which required employees to document conflicts of interest annually in a form, “Statement of Interests of All Employees and Appointments of the Tennessee Alcoholic Beverage Commission” (disclosure statement), and to have the disclosure statement notarized. In addition to commission employees, commission members also complete the disclosure statement.

### **Objectives**

The objectives of our review were to follow up on the prior audit finding and determine whether management ensured that

- the commission’s conflict-of-interest policy and disclosure statement addressed all requirements of the conflict-of-interest statutes;
- staff maintained disclosure statements; and
- each employee and commission member signed and dated disclosure statements and the statements were notarized.

### **Methodologies**

In order to gain an understanding of controls over conflicts of interest, we obtained and reviewed the policy and procedures related to conflicts of interest and interviewed key personnel.

In order to determine whether the commission’s conflict-of-interest policy and disclosure statement addressed all requirements of the conflict-of-interest statutes, we reviewed the policy and disclosure statement and compared them to the statutes.

We obtained a list of all active commission members and employees as of March 6, 2014, and requested all annual conflict-of-interest disclosure statements for calendar years 2011 through 2014, but management was unable to provide disclosure statements for 2011 and 2013. To determine whether a 2014 disclosure statement was on file and properly signed, dated, and notarized, we performed testwork on all 72 commission employees and commission members on the March 6, 2014, listing. We also performed similar testwork on the 2012 disclosure statements for the 49 commission employees and commission members on the March 6, 2014, listing who were hired or appointed on or before December 31, 2012.

### **Conclusions**

Based on procedures performed, we determined that management

- did not ensure that the commission’s conflict-of-interest policy and disclosure statement addressed all requirements of the conflict-of-interest statutes (see finding 4);
- did not ensure that staff maintained disclosure statements (see finding 4); and
- ensured that each employee and commission member signed the available disclosure statements; however, the disclosure statements were not always properly dated and notarized (see finding 4).

**Finding 4. As noted in the 2007 audit, the Tennessee Alcoholic Beverage Commission did not develop adequate conflict-of-interest policies and forms or enforce its existing policy, increasing the risk that conflicts of interest will not be prevented, detected, or addressed timely**

In a prior audit finding in the 2007 financial and compliance audit of the commission, we noted that the commission’s conflict-of-interest policy and disclosure forms were not adequate because

- the policy and the disclosure statement only quoted part (a) of Section 57-1-108, *Tennessee Code Annotated*, and excluded parts (b) and (c); and
- the policy only required employees to complete the disclosure statement once every four years.

In the 2007 audit, we also found that employees did not always complete disclosure statements every four years, and employees and commission members did not always date the statements and have the statements notarized. Management concurred with the prior audit finding and stated,

Although all employees have signed conflict-of-interest disclosure statements and they are on file, such statements had not been updated on an annual basis. Disclosure statements will be modified and strengthened and will be given to each employee—including commission members—to be signed on an annual basis. Staff will be assigned to monitor and insure compliance with all requirements and take prompt action should exceptions occur.

Management revised its Policy and Procedures 1-1-10, “Interest Precluding Employment by the Commission,” on September 9, 2009, to require notarized conflict-of-interest disclosure statements to be submitted annually rather than every four years; however, the current audit disclosed that management still did not develop adequate conflict-of-interest policies and disclosure statements, and employees still did not ensure disclosure statements were notarized. In addition, we found that commission staff improperly notarized disclosure statements and did not maintain disclosure statements.

## **Condition – Inadequate Policy and Conflict-of-Interest Disclosure Statements**

We noted during our fieldwork that the former Executive Director did not ensure all parts of the requirements listed in the revised policy and disclosure statement mirrored the requirements outlined in Sections 57-1-108 and 57-3-105, *Tennessee Code Annotated*. Specifically, the policy and disclosure statement only quoted part (a) of Section 57-1-108, *Tennessee Code Annotated*, and excluded parts (b) and (c). In addition, the policy and disclosure statement excluded the requirements in Section 57-3-105, *Tennessee Code Annotated*.

Given the problems identified during our fieldwork, we also reviewed the commission's Financial Integrity Act Risk Assessment. We determined that management did not document the risks or mitigating controls associated with ensuring that management develops policies and procedures that are consistent with the state statutes that management designed the policies to address.

### **Criteria**

Section 57-1-108, *Tennessee Code Annotated*, states,

(a) No person shall be eligible to be appointed as a member of the commission, and no person shall be employed in any capacity by the commission, if such person shall have any interest, financial or otherwise, either direct or indirect, in any distillery, wholesale dealer or retail dealer licensed as such in the state of Tennessee. No family member, including spouse, child or children, father or mother, niece or nephew by blood or marriage, son-in-law or daughter-in-law, shall be employed by any distillery, wholesale dealer or retail dealer, nor shall any family member hold or have issued to them any alcoholic beverage license in the state of Tennessee.

(b) No such person shall have interest of any kind in any building, fixtures, or in the premises occupied by any person, firm or corporation licensed under this chapter.

(c) No such person shall own any stock, nor shall have any interest of any kind, direct or indirect, pecuniary or otherwise, by a loan, mortgage, gift, seeking a loan, or guaranteeing the payment of any loan, in any distillery, wholesale dealer or retail dealer licensed under this chapter.

Section 57-3-105, *Tennessee Code Annotated*, states,

No member of the commission and no person employed by the commission shall have any interest, direct or indirect, either proprietary or by means of any loan, mortgage or lien, or in any other manner, in or on any premises where alcoholic beverages are sold; nor shall they or any of them have any interest, direct or indirect, in any business wholly or partially devoted to the sale, transportation or storage of alcoholic beverages.

## **Cause**

Regarding the omission of parts (b) and (c) of Section 57-1-108, *Tennessee Code Annotated*, from the conflict-of-interest policy and disclosure statement, the Administrative Services Director stated that the statute is cited in the disclosure statement and policy, so quoting all parts in the disclosure statement is not necessary.

## **Condition – Conflict-of-Interest Disclosure Statements Were Not Maintained**

The former Human Resources Analyst (Analyst) did not maintain the 2011 and 2013 disclosure statements for any employee or commission member. We also determined that the Analyst did not maintain the 2012 disclosure statements for 11 of 49 employees and commission members (22%).

Given the problems identified during our fieldwork, we also reviewed the commission's Financial Integrity Act Risk Assessment. We determined that management did not document the risks or mitigating controls associated with ensuring that staff maintain sufficient documentation to demonstrate compliance with the commission's policies.

## **Criteria**

The U.S. Government Accountability Office's *Standards for Internal Control in the Federal Government* (Green Book), Section OV4.08, states, "Documentation is a necessary part of an effective internal control system. . . . Management develops and maintains documentation of its internal control system." Unless staff maintain conflict-of-interest disclosure statements, commission management cannot evaluate compliance with Policy and Procedures 1-1-10, "Interest Precluding Employment by the Commission," which states that disclosure statements "shall be required for re-submittal yearly and by all new employees."

## **Cause**

According to the Analyst, the missing statements for calendar years 2011, 2013, and portions of 2012 were accidentally disposed of when the commission moved its offices in May 2013.

## **Condition – Improperly Notarized Conflict-of-Interest Disclosure Statements**

We determined that the Analyst did not ensure that 9 of 38 disclosure statements tested (24%) for 2012 were properly notarized. Specifically, we found that the Analyst did not

- include her signature with her notary on two statements,
- affix her notary seal to one statement, and
- ensure six statements were notarized.

We also determined that the Analyst did not ensure that 3 of 72 disclosure statements tested (4%) for 2014 were properly notarized. Specifically, the Analyst did not include her signature with her notary for two statements, and she notarized one statement with an expired commission.

Regarding the expired commission, we asked the Analyst and the Information Resource Support Specialist (Specialist) about the signatures and dates on the Specialist's conflict-of-interest disclosure statement. We discovered that although the disclosure statement contained the signature and the Analyst's notary, dated January 16, 2014, the Specialist stated that he actually signed the disclosure statement and the Analyst acted as a notary witness on March 31, 2014. The Analyst confirmed that she witnessed the Specialist's signature, notarized the disclosure statement, and both the Analyst and Specialist backdated their signatures on March 31, 2014. The Analyst's notary commission expired on March 3, 2014, and she did not renew her notary by March 31, 2014.

### **Criteria**

During our audit work, the commission's Policy and Procedures 1-1-10 required that disclosure statements be notarized. Section 8-16-112, *Tennessee Code Annotated*, states that in order for notaries to acknowledge signatures, "the notary public's seal shall be affixed and the notary public shall sign such documents in ink by the notary's own hand unless otherwise provided by law."

Management revised the conflict-of-interest policy, Policy and Procedures 1-1-10, effective February 26, 2015, by removing the requirement to notarize disclosure statements. We still included this problem in the finding because the revised policy was applicable to conflict-of-interest disclosure statements prepared for 2015 and forward, not the disclosure statements that we tested.

According to Section 8-16-120, *Tennessee Code Annotated*,

It is unlawful for any person who has been commissioned as a notary public, either as a result of election or upon direct appointment by the governor, to take acknowledgments or otherwise act in an official capacity after the expiration of such notary's commission. A violation of this section is a Class C misdemeanor.

### **Cause**

Based on discussion with the Analyst, the Analyst did not ensure the disclosures statements were properly notarized in her rush to complete her collection of the annual disclosure statements.

### **Effect**

Conflict-of-interest disclosure statements are designed to ensure that the public's interest is protected and that employees who make key decisions about investigations and business

operations are independent from other involved parties. Annual written disclosures help ensure that commission members and employees are acting on the state's behalf. By failing to develop and enforce such a critical part of effective internal controls, the Executive Director is not maintaining the proper control environment and is not ensuring compliance with state law.

### **Recommendation**

The Executive Director should ensure that specific conflict-of-interest policies are developed that address all parts of the related statutes. The Executive Director and the Administrative Services Director should ensure that all employees and commission members submit complete conflict-of-interest disclosure statements annually. The Administrative Services Director should also ensure compliance with the established conflict-of-interest policy.

The Executive Director and the Administrative Services Director should assess all significant risks, including the risks noted in this finding, in the commission's documented risk assessment. The risk assessment and the mitigating controls should be adequately documented and approved by the Executive Director. The Executive Director should implement effective controls to ensure compliance with applicable requirements, assign employees to be responsible for ongoing monitoring of the risks and any mitigating controls, and take action if deficiencies occur.

### **Management's Comment**

We concur. TABC has revised Policy 1-1-10 to include all provisions of Section 57-1-108, *Tennessee Code Annotated*, including Subsection (b) and (c), and Section 57-3-105. Additionally, the affidavit included in the policy has been revised to include the provisions of both relevant statutes.

In September 2016, new management of the TABC distributed the updated policy and affidavit to all employees and commission members to be signed and notarized. A copy of each employee's and commission member's signed and notarized affidavit is kept electronically on the agency's shared electronic network drive, and a hard copy is maintained with the agency's Human Resources division. All new employees and new commissioners are required to complete the affidavit when beginning employment with the TABC. All employees and commissioners, per the revised policy, will be required to submit a signed, notarized copy of the affidavit annually.

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### **CONFIDENTIAL FUNDS**

The Tennessee Alcoholic Beverage Commission uses an authorized account to provide confidential funds to its special agents for the purchases of goods, services, contraband, or information that cannot be obtained through standard purchasing procedures. The account was initially set at \$1,500, and in September 2013, the Department of Finance and Administration approved and increased the confidential funds available to \$10,000.

Authorized staff in the commission's district offices use the confidential funds much like a petty cash fund so that the money is accessible to special agents while in the field. In order to replenish the district offices' confidential funds, Special Agents in-Charge (SACs) at the district offices send requests to the Chief Law Enforcement Officer at headquarters in Nashville. The commission's Policy and Procedures 3-2-10, "Use of Confidential Funds," requires the SACs to provide the funds to special agents as necessary. The policy also requires special agents to submit a completed, dated, and signed Statement of Confidential Funds Disbursements (disbursement form) and document payments to informants on Property Receipt/Release Forms. When disbursing confidential funds, special agents are required to obtain receipts unless doing so would jeopardize an investigation. If special agents obtain receipts, special agents must submit the original receipt along with the disbursement forms. The SACs at the district offices are required by policy to submit, at a minimum, monthly Confidential Funds Reports of all funds disbursed to headquarters, with the disbursement forms and supporting documentation attached.

### **Objectives**

The objectives of our review were to determine whether commission management ensured that

- commission staff disbursed confidential funds for allowable purchases and supported disbursements of confidential funds with proper documentation, including signatures of special agents, dates, and calculations;
- commission staff properly completed Property Receipt/Release Forms when payments were made to informants;
- special agents submitted receipts supporting disbursements of confidential funds (when obtaining a receipt would not jeopardize the investigation);
- commission staff reimbursed district offices with the correct amount of confidential funds; and
- SACs submitted monthly Confidential Funds Reports.

### **Methodologies**

We interviewed key personnel at the Nashville office and reviewed the commission's policies and procedures manual, disbursement forms, and monthly Confidential Funds Reports to gain an understanding of the confidential funds reimbursement process. We obtained the population of 39 confidential funds transactions that occurred from July 1, 2011, to November 30, 2013, totaling \$10,699, and selected a nonstatistical, random sample of 25 confidential funds transactions, totaling \$6,603. We also obtained the population of 28 confidential funds transactions that occurred from July 1, 2014, to January 31, 2015, totaling \$7,823, and selected a nonstatistical, random sample of 6 confidential funds transactions, totaling \$3,053. For both samples, we reviewed the corresponding disbursement forms from the individual special agents and corresponding monthly fund reports from SACs to determine whether the commission complied with its policies and procedures.

## **Conclusions**

Based on procedures performed, we determined that management ensured

- commission staff disbursed confidential funds for allowable purchases and supported disbursements of confidential funds with proper documentation, including signatures of special agents, dates, and calculations;
- commission staff properly completed Property Receipt/Release Forms when payments were made to informants;
- special agents submitted receipts supporting disbursements of confidential funds (when obtaining a receipt would not jeopardize the investigation);
- commission staff reimbursed district offices with the correct amount of confidential funds; and
- SACs submitted monthly Confidential Funds Reports.

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## **INFORMATION SYSTEMS**

The Tennessee Alcoholic Beverage Commission relies on various information systems, databases, and applications to capture and maintain information regarding its activities. These systems include

- the Evidence Management System, which is used for tracking confiscated evidence;
- Microsoft Access, the database used for maintaining a listing of licenses and permits;
- iNovah, the application used for processing cash receipts;
- Responsible Vendor, the application that documents participants in the Responsible Vendor Program; and
- Tennessee Anytime, the application that processes server permit cards and maintains a listing of issued server permits.

The objective of our review of the commission's information systems was to determine whether management followed best practices for the information systems industry in one specific area.

To determine whether management followed industry best practices in one area, we compared management's internal control activities to industry best practices.

Based on the procedures performed, we determined that management did follow best practices for the information systems industry in the one area we reviewed.



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## CASH RECEIPTS

The Tennessee Alcoholic Beverage Commission uses Edison, the state's accounting system, and iNovah, a revenue management system, to account for payments from customers for licenses, permits, training, and citations. To obtain a license or permit, customers submit an application with the applicable fees, as well as any required training fees. Cash receipts also include collections of imposed fines from citations issued in cases where licensees violated state law. The commission uses iNovah to process checks and money orders (the commission does not accept cash). The commission receives payments in person or via postal mail at the commission's central fiscal office in Nashville, as well as at offices in Memphis, Knoxville, and Chattanooga.

Commission employees review the applications and citations to ensure the amounts paid are the applicable amounts due. In addition, the employees record the fees and fines in iNovah, issue iNovah cash receipts to the customers, prepare mail logs, deposit the fees and fines collected, and reconcile the iNovah cash receipts to the mail logs and bank receipts.

The objectives of our review of cash receipts were to

- follow up on the prior audit finding to determine whether management developed and implemented adequate controls over cash receipts and whether commission staff deposited fees and fines timely; and
- determine if management ensured that fees and fines were adequately supported and that the correct amount was charged and recorded.

We interviewed key personnel and reviewed supporting documentation to gain an understanding of the commission's controls and procedures over cash receipts.

We obtained all 103,514 cash receipt transactions in Edison between July 1, 2011, and November 30, 2013, totaling \$18,036,032, and selected a nonstatistical, random sample of 110 cash receipt transactions, totaling \$14,926. For the transactions tested, we reviewed the deposit slips, bank receipts, mail logs, iNovah cash receipts, and the information in Edison to determine if the transactions were adequately supported and if the correct amount was recorded correctly in Edison. We reviewed the iNovah cash receipts and the commission's fee and fine amounts to determine if the correct amounts of fees and fines were charged and collected. We also reviewed the date on the iNovah cash receipts and the date on the bank receipts to determine if the transactions were deposited timely.

Based on the procedures performed, we determined that

- management developed and implemented adequate controls over cash receipts, and commission staff deposited fees and fines timely; and
- management ensured that fees and fines were adequately supported and that the correct amounts were charged and recorded.

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**APPENDIX**

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**TITLE VI AND OTHER INFORMATION**

The Tennessee Human Rights Commission (THRC) issues a report, *Tennessee Title VI Compliance Program* (available on its website), that details agencies' federal dollars received, Title VI and other human rights related complaints received, whether the agency Title VI implementation plans were filed timely, and whether THRC findings were taken on agencies. Below are staff and Tennessee Alcoholic Beverage Commission member demographics, as well as a summary of the information in the latest THRC report for the Tennessee Alcoholic Beverage Commission.

The Tennessee Alcoholic Beverage Commission received \$1,638,100 in federal funds during fiscal year 2015. The Alcoholic Beverage Commission submitted its Title VI Implementation Plan to THRC by the October 1, 2014, deadline, and THRC found that the fiscal year 2015 plan was compliant. The Alcoholic Beverage Commission received two Title VI complaints for fiscal year 2015; however, Title VI investigations did not result in reporting a finding of noncompliance to THRC related to these complaints. THRC conducted a compliance review on the Alcoholic Beverage Commission and identified findings in the following program areas: Limited English Proficiency, Complaint Procedures, Title VI Training, and Data Collection in the fiscal year 2015 *Tennessee Title VI Compliance Program* report.

**Tennessee Alcoholic Beverage Commission  
Commission Members' Ethnicity and Gender  
March 2016**

	Gender			Ethnicity						
	Male	Female	Total	American Indian	Asian	Black	Hispanic	White	Other	Total
Commission Members	2	1	3	0	0	1	0	2	0	3

Source: Created by auditors using information obtained from the commission.

**Tennessee Alcoholic Beverage Commission  
Staff Ethnicity and Gender  
By Job Position  
March 2016**

Title	Gender			Ethnicity						
	Male	Female	Total	American Indian	Asian	Black	Hispanic	White	Other	Total
Assistant Director	0	1	1	0	0	0	0	1	0	1
Assistant Special Agent-In-Charge	2	2	4	0	0	1	1	2	0	4
Chief Law Enforcement Officer	1	0	1	0	0	0	0	1	0	1
Executive Director	1	0	1	1	0	0	0	0	0	1
Program Supervisor	0	1	1	0	0	0	0	1	0	1
Regulatory Officer	0	1	1	0	0	0	0	1	0	1
Special Agent 1	4	1	5	0	0	1	1	3	0	5
Special Agent 2	15	5	20	0	0	2	0	18	0	20
Special Agent 3	3	1	4	0	0	0	0	4	0	4
Special Agent-In-Charge	4	0	4	0	0	0	0	4	0	4
Account Clerk	0	5	5	0	0	0	2	2	1	5
Administrative Assistant 1	0	5	5	0	0	0	0	5	0	5
Administrative Assistant 2	0	1	1	0	0	1	0	0	0	1
Administrative Secretary	0	4	4	0	0	2	0	2	0	4
Administrative Services Assistant 2	0	3	3	0	0	1	0	2	0	3
Administrative Services Director 2	1	0	1	0	0	0	0	1	0	1
Attorney 2	1	0	1	0	0	0	0	1	0	1
Auditor 3	0	1	1	0	0	1	0	0	0	1
Executive Administrative Assistant 1	0	1	1	0	0	0	0	1	0	1
Human Resources Analyst 2	0	1	1	0	0	1	0	0	0	1
Human Resources Manager 1	0	1	1	0	0	0	0	1	0	1
Information Resource Support Specialist 2	1	0	1	0	0	0	0	1	0	1
Information Systems Consult	1	0	1	0	0	0	0	1	0	1
Procurement Officer 2	0	1	1	0	0	0	0	1	0	1
Programmer/Analyst 2	1	0	1	0	1	0	0	0	0	1
Secretary	0	2	2	0	0	0	0	2	0	2
Training Specialist 2	1	0	1	0	0	1	0	0	0	1
<b>Totals</b>	<b>36</b>	<b>37</b>	<b>73</b>	<b>1</b>	<b>1</b>	<b>11</b>	<b>4</b>	<b>55</b>	<b>1</b>	<b>73</b>

Source: Created by auditors using information obtained from the commission.