

DEPARTMENT OF ALCOHOLIC BEVERAGE CONTROL

Special Financial and Limited Performance Audit
For Procedures Performed During Fiscal Year 2016

Report No. 16-02



OFFICE OF THE STATE AUDITOR

AUDIT LEADERSHIP:

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OFFICE OF THE
UTAH STATE AUDITOR

September 27, 2016

Members of the Utah Alcoholic Beverage Control Commission
and

Mr. Salvador D. Petilos, Executive Director
Department of Alcoholic Beverage Control

Dear Commissioners and Mr. Petilos:

We performed various procedures on certain aspects of the Department of Alcoholic Beverage Control's (DABC's) internal control reviewed during fiscal year 2016. These procedures were performed in accordance with *Utah Code*, Section 32B-2-302, were agreed to by DABC management, and were approved by the DABC Commission. This report covers the procedures outlined in the "Executive Summary."

These procedures do not constitute an audit conducted in accordance with generally accepted auditing standards, the objectives of which would be the expression of an opinion on DABC's internal control. Accordingly, we do not express such an opinion. Had we performed additional procedures, other matters might have come to our attention that would have been reported to you. Our recommendations resulting from the procedures are found within this report.

By its nature, this report focuses on exceptions, weaknesses, and problems. This focus should not be understood to mean there are not also various strengths and accomplishments. We appreciate the courtesy and assistance extended to us by DABC's personnel during the course of the engagement, and we look forward to a continuing professional relationship. If you have any questions, please contact me.

Sincerely,

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Executive Summary

The Department of Alcoholic Beverage Control (DABC) is statutorily required to be audited every year. This report provides recommendations in five financial and performance areas to strengthen DABC's operations, internal controls, accounting practices, and compliance with law. Each area is outlined below.

CONTROL STATE BEST PRACTICES

We surveyed and compared operational practices between Utah and other alcohol control jurisdictions to determine business best practices and found:

- DABC has inadequate tracking and evaluating of store level costs
- Key metrics used by other jurisdictions could benefit DABC
- Enhanced store performance evaluations could benefit DABC
- DABC's warehousing square footage is better utilized than at most other jurisdictions

STAFFING ANALYSES

We analyzed DABC's available data to determine the effectiveness and efficiency of its use in labor allocation decisions for DABC's retail stores and found that DABC's staffing of stores is not adjusted relative to sales trends.

We also reviewed the employee performance evaluation process as well as staff promotion and raise processes and found feedback to employees can be strengthened. The following issues were noted:

- One salary increase we reviewed was neither documented nor approved
- Employee performance evaluations were not in accordance with policies
- Quarterly evaluations at stores are not occurring

We analyzed the composition of employee compensation relative to industry norms and found hourly wages trend lower than control states but are comparable to the convenience store industry.

We reviewed industry practices regarding at-will and career service positions and found variances from the market in these employee-type classifications.

We reviewed DABC training practices and found that DABC should continue to develop and expand its product knowledge trainings to strengthen store employees' expertise.

PRODUCT ORDERING SYSTEM

We reviewed the use and effectiveness of the product ordering system, particularly in regards to the ordering of limited products and found the following:

- Ordering and stocking of product could be improved by use of forecasting tools to replace uninformative out-of-stock reports
- More frequent monitoring of limited product levels could improve product selection
- Product Special Request System appears to be operating effectively

FOLLOW-UP OF PRIOR YEAR FINDINGS

We performed procedures to follow up on issues identified in prior year audit reports and found:

- Certain accounting controls are still not in place
- Reconciliations still are not occurring as required
- Brewery, distillery, and winery reports are still not verified
- Security guard contracts have been updated to follow IRS guidelines

FINANCIAL REPORTS

We performed procedures to verify the accuracy of the information presented in financial reports prepared for the Commission and found that overall they are accurate but could be modified to provide the Commission with key performance metrics.

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Staffing Of Stores Could Be More Responsive To Sales

EXISTING SALES DATA NOT EFFECTIVELY UTILIZED TO MAKE STAFFING DECISIONS

We analyzed the Department of Alcoholic Beverage Control's (DABC's) available data to determine the effectiveness and efficiency of its use in labor allocation decisions for DABC's retail stores. DABC staff provided the Office of the State Auditor with access to sales, shipment, and employee records. The sales and shipment data contained millions of records placing the time, location, quantity, and price of transactions from all retail locations from January through July 2015. Digitized employee data was less detailed, showing the number of hours DABC employees work on particular days over the corresponding time period; however, the records do not show where, when, or in what activities employees were engaged during these days. This lack of detailed employee information made analyzing the effectiveness of labor allocation nearly impossible. Digitizing detailed labor data by store time and task would allow DABC to effectively measure the efficiency of its labor allocation strategies and help align DABC with modern retail operations.

DABC does not use any staffing software to perform similar analysis. Currently, DABC authorizes a set number of labor hours to be allocated to each store. Store managers assign these allocated hours to necessary tasks throughout the year. At the end of each year, DABC compares the actual payroll to hours allocated to ensure the number of man-hours has not exceeded those which were authorized.

LABOR ALLOCATION PRACTICES COULD BE IMPROVED THROUGH MORE DETAILED DATA ANALYSIS

To augment the available labor data noted above, we digitized the paper time card records for five DABC retail stores for the same time frame as the sales and shipment data. Using this data, we performed several analyses to evaluate current labor allocation practices, such as sales per associate hour (SPAH) and sales quantity (not dollars) per associate hour (QPAH) efficiency measures. Appendix One of this report provides brief descriptions of these analyses with a sample of relevant charts and graphs. These analyses provide management with useful tools to consider implementing to strengthen DABC's labor allocation practices. Some of the key takeaways from these analyses revealed the following:

- The number of available registers can impact efficiencies; however, most stores appear to have enough registers to adjust to peak demand.
- A more precise measure of store load and peak sales demand relative to store capacity (a common measure in private retail operations) would require additional systems to be put in place to record in-store customer counts relative to the SPAH at high volume periods.
- Relative weaknesses and strengths exist within and among the various stores in their ability to adapt to changing patterns of demand. Using the SPAH analytical approach would allow managers to compare their experience with particular patterns in the data to make optimal labor allocation decisions in the face of imperfect but somewhat predictable patterns of customer behavior.
- Most stores allocate too much labor on Monday through Thursday and too little labor on Friday and Saturday.
- Each store allocates a wide variety of labor to inventory management, which suggests that DABC should reevaluate labor use in its various activities to optimize the effective allocation of labor in and among stores.

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- Nearly every store shows much higher efficiency on Fridays and Saturdays than exhibited during the week.
- DABC administration could allocate additional budgeted full-time employees to the areas of most impact using the QPAH analysis as well as to target staffing levels at all stores and to help redirect staff to stores with high workloads from stores with less severe demands.

DABC COULD APPLY BEST PRACTICE ANALYSES OF OTHER ALCOHOL CONTROL JURISDICTIONS

We surveyed various alcohol control jurisdictions across the United States to identify operational best practices (see more detailed information regarding these surveys in Appendix Two). These surveys showed that most jurisdictions use a variety of reports to analyze staffing in their stores during slow times compared to peak times. Some valuable analyses being performed by other jurisdictions are noted below. DABC could use these analyses to better staff its retail stores, which could help reduce labor costs, increase profits, and improve customer satisfaction.

- Montgomery County, Maryland uses the Microsoft Retail Management System (RMS) to help managers plan ahead and prepare for peak sales times.
- Virginia calculates a monthly allocation based on sales history which is used by store management to properly allocate staff.
- Pennsylvania typically determines its store staffing based on unit volume (bottles) per store, which is reviewed annually and periodically. Additionally, Pennsylvania's register system tracks sales per hour, and during particularly peak sales times like New Year's Eve, sales-per-hour information may be used in addition to unit volume analysis to staff stores accordingly.
- Alabama store directors monitor sales and yearly trends to staff stores accordingly during peak seasons and times of the year.

Recommendations

To strengthen DABC's labor allocation practices, we recommend DABC:

- Digitize employee data collection to allow DABC management to monitor and address differences in labor variability between stores.
- Optimize labor allocation strategies to increase service levels or profits from the sale of liquor.
- Consider shifting labor allocations from weekdays to Fridays and Saturdays and to higher volume sales times to match peak demands.
- Look at shifting some employee tasks (e.g. shelving, cleaning, etc.) from higher volume weekend days to slower weekdays.
- Consider performing analyses similar to those of other alcohol control jurisdictions to aid in better matching staff allocations to peak sale times within retail stores.
- Consider adding additional systems that would record in-store customer counts relative to the SPAH at high volume periods.

Additional Performance Metrics Could Improve Decision Making And Operational Practices

TRACKING STORE LEVEL COSTS RELATIVE TO REVENUE WOULD HIGHLIGHT RETAIL INEFFICIENCIES

Most alcohol control jurisdictions forecast and track their revenue and expenses for retail stores. Historically, DABC has only forecasted sales and revenue for its stores, but has not tracked or forecasted expenses at the store level. Tracking store level expenses, in addition to store revenues, will help management determine net profit addition by store, which may aid in the efficient operation of each store.

KEY METRICS USED BY OTHER CONTROL JURISDICTIONS COULD BENEFIT DABC

Key metrics used by DABC include high-level, post hoc, bottles per man hour, inventory turnover, and receivables turnover. Each alcohol control jurisdiction uses distinctive key metrics to evaluate its financial performance. Some metrics used by other jurisdictions that may be beneficial for DABC to use include the following:

- Revenue per bottle, revenue per order
- Order accuracy
- Fleet costs per order
- Warehouse costs per order
- Acceptable in-stock/out-of-stock levels for all general list products
- Acceptable levels of warehouse breakage/shrinkage on a yearly basis
- Freight costs per zone
- Entire warehouse inventory turnover per year
- Target number of warehouse turns
- Growth of dollar sales
- Target profit sent to general fund
- Targets for Cost of Goods Sold and Gross Profit as Percentages of Sales

ENHANCED STORE PERFORMANCE EVALUATIONS COULD BENEFIT DABC

Each alcohol control jurisdiction has its own evaluation process regarding store performance. DABC currently uses “by bottles sold per man hour” and “sales per square foot” for this evaluation. In addition to the evaluation tools DABC is currently using, the following evaluation processes used by other control jurisdictions could be beneficial:

- Inventory valuation – by store, by all stores, and by category within a store
- Inventory turnover – by store, by all stores, and by category within a store
- Net Profit by store
- Percentage of expenses to sales
- Inventory losses to sales
- Labor usage and employee utilization

- Store conditions
- Product stock levels

Recommendations

To strengthen DABC operational practices, we recommend DABC:

- Begin tracking expenses at the store level, in addition to analyzing sales and revenues, to better understand each store's overall performance.
- Incorporate the key performance metrics discussed above in the evaluation of operations at both the department level and the individual store level.

Ordering And Stocking Of Product Could Be Improved

EXISTING OUT-OF-STOCK INFORMATION COULD BE BETTER UTILIZED AND STRENGTHENED

DABC tracks the number of days a limited product is out of stock, but does not currently track why a product is out of stock, nor does it exclude products that are limited by outside parties (due to seasonality, limited supply, etc.). An out-of-stock analysis for limited products is only performed on a monthly basis. The report used for this analysis is grouped by product and then by store and shows current inventory levels, total sales, and the amounts currently available in the warehouse. Additional analysis is not done to determine how often a particular limited product is out of stock. Such information is key in making effective purchasing decisions.

Purchasing decisions for limited products are currently based on the prior month's sales, employee expertise, and vendor recommendations. If DABC utilized additional out-of-stock information to identify items that are consistently out of stock, both in stores and in aggregate, it could make more accurate purchasing decisions and improve the allocation of limited product to each store.

FORECASTING TOOLS CAN ENHANCE OUT-OF-STOCK REPORTS

In order to analyze the effectiveness of ordering and replenishing products, many alcohol control jurisdictions review sales in combination with using target inventory levels that are either state or vendor managed. Virginia and Wyoming use forecasting tools that look at prior sales history and current sales to help predict future sales and stock inventory adequately. DABC and a few other jurisdictions currently use out-of-stock reports to determine the effectiveness of ordering and replenishing products.

MORE FREQUENT MONITORING OF LIMITED PRODUCT LEVELS COULD IMPROVE PRODUCT SELECTION

Currently, DABC analyzes out-of-stock limited products monthly. A more frequent analysis is not done due to limitations of staffing—only one employee works with multiple distributors to make these purchasing decisions. Our survey of alcohol control jurisdictions showed that most jurisdictions are using daily, weekly, or monthly reports at the warehouse/store levels to monitor out-of-stock products. DABC could benefit from some of the analyses performed by other jurisdictions such as:

- Weekly analysis reviewing “zero-inventory” items and “low-weeks-of-supply” items.
- Daily review of backorder reports with a comparison of stock levels to sales.
- Setting target out-of-stock levels for the warehouse and each individual store for limited listing products, where possible.

Recommendations

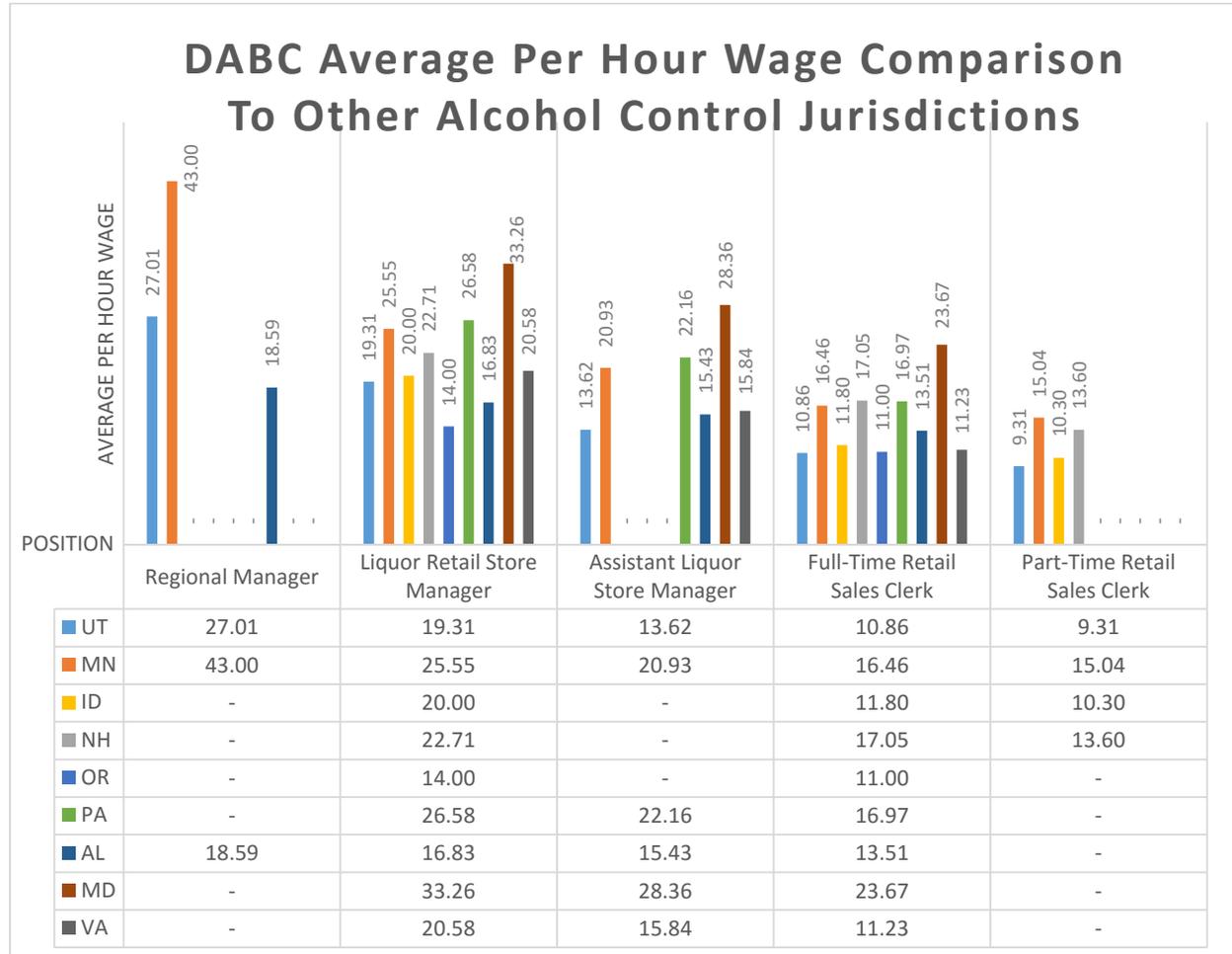
We recommend DABC:

- Create another level of information to assist in purchasing and product allocation decisions by developing and utilizing better out-of-stock reports.
- Use a forecasting type analysis to better manage replenishment of product.
- Monitor limited and general products more frequently using the reports discussed above.

DABC Hourly Wages Trend Lower Than Other Control Jurisdictions But Are Comparable To Retail Industry

DABC HOURLY WAGES LOWER THAN OTHER ALCOHOL CONTROL JURISDICTIONS

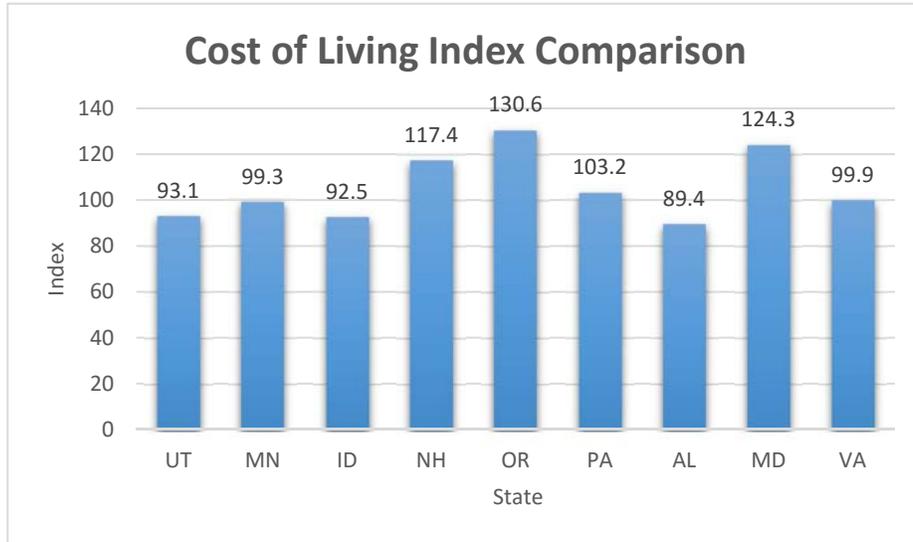
Using the pay period ended January 29, 2016, we calculated the average wage for each store position level at DABC and compared those with other alcohol control jurisdictions, as gathered in our surveys (see more detailed information regarding these surveys in Appendix Two).



As shown above, DABC pays liquor retail store managers more than Oregon and Alabama. Regional managers are also paid more in Utah than Alabama. However, for all other positions DABC's hourly wages are lower than all other jurisdictions shown above.

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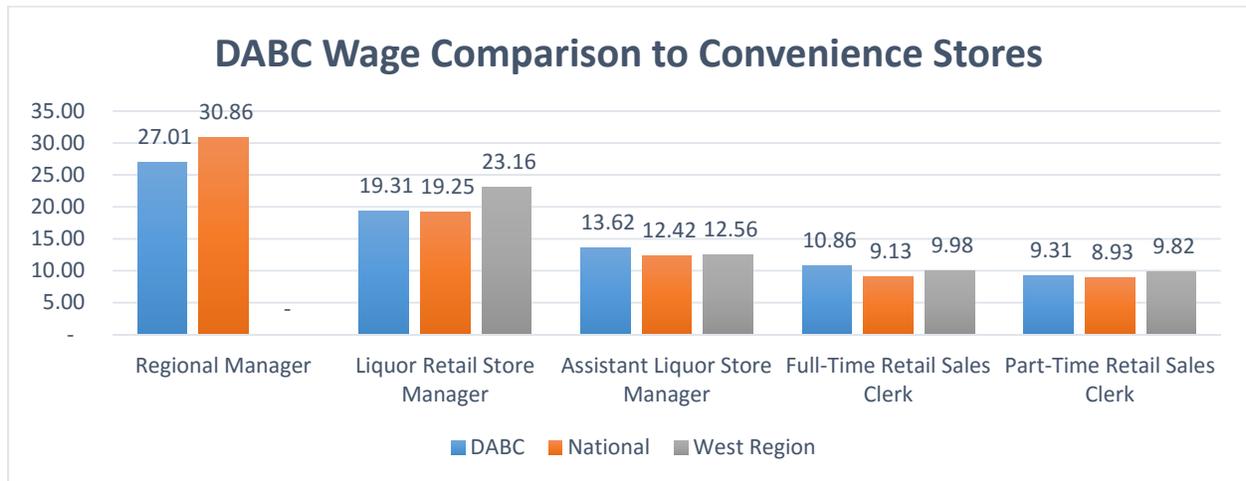
Based on the responses to our survey questions, the alcohol control jurisdictions appear to offer comparable employee benefits. We obtained a cost of living index comparison from the Missouri Economic Research and Information Center Composite Cost of Living (Scaled) for First Quarter 2016 for comparability purposes.



After applying the indices presented in the graph above to the hourly wages, we found that the wages for DABC still trend lower than other alcohol control jurisdictions.

DABC HOURLY WAGES COMPARABLE TO CONVENIENCE STORES

DABC retail stores operate in a somewhat comparable labor market to the convenience store industry. Using the same DABC wage information above, we compared DABC’s store employee wages to the wages of the convenience store industry using the *2014 National Association of Convenience Stores Compensation Report*. We did not factor in cost of living, unemployment rates, benefit packages, or other factors that can affect comparability and differences.



When compared to western region averages for convenience stores, DABC pays store employees more, except for liquor retail store managers. When compared to the national averages for convenience stores, DABC pays store employees more, except for regional managers.

BENEFITS COMPRISE A SIGNIFICANT PORTION OF TOTAL COMPENSATION

Using the 2014 National Association of Convenient Stores Compensation Report, we also compared key employee benefits provided by DABC to those provided by the convenience store industry. The benefits we reviewed were (1) health care benefits, (2) retirement benefits, and (3) paid time off / leave benefits. Appendix Three provides the details of the data used. For simplicity, we highlight two sample cases—a retail sales clerk and a store manager. In both cases, the employees are full-time, fully benefitted employees. The first item to note is that the cost of employment benefits constitutes a significant portion of total employee compensation. Second, DABC offers a significantly richer benefit package relative to the average cost of those offered by the convenience store industry in the western region.

In our first example, we considered an employee with one year of tenure who has selected a single plan for medical insurance and who qualifies for the State’s Tier II retirement plan.

	Convenience Store Industry	DABC
Annual Wage	\$20,592.00	\$20,976.80
Employer-Paid Medical Premium - Single	\$3,386.70	\$4,888.26
Employer-Paid Retirement Contribution	\$1,688.54	\$2,768.16
Paid Time Off (Annual & Sick Leave)	8	26

In our second example, we selected an employee with five years of tenure who works in store management, has chosen a family plan for medical insurance, and qualifies for the State’s robust (Tier I) retirement package at DABC.

	Convenience Store Industry	DABC
Annual Wage	\$37,148.80	\$34,247.20
Employer-Paid Medical Premium - Family	\$6,547.52	\$13,455.78
Employer-Paid Retirement Contribution	\$2,340.37	\$8,783.78
Paid Time Off (Annual & Sick Leave)	11	29.25

Compensating employees too little can result in difficulty attracting and retaining employees, whereas paying employees too much can create unnecessary additional costs.

Recommendation

We recommend DABC perform further analysis into the wage differences between DABC, other alcohol control jurisdictions, and the convenience store industry.

Ratio Of DABC “Protected” Employees Comparable To Other Alcohol Control Jurisdictions But Not To Retail Industry

DABC CAREER SERVICE EMPLOYEE-TYPE CLASSIFICATIONS ARE SIMILAR TO OTHER ALCOHOL CONTROL JURISDICTIONS

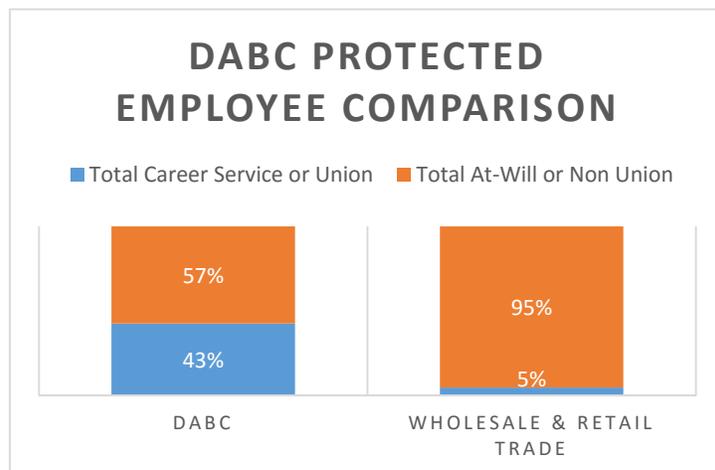
A career service (protected) employee is one who “has successfully completed a probationary period of service in a position covered by the career service.” Career service (aka Merit) systems were designed to protect public employees from unfair personnel practices occurring with political changes. Typically, employers may have more difficulty in dismissing poor-performing career service employees. Conversely, the employment relationship for “at-will” or “non-union” employees may be terminated for any or no reason. We reviewed the classification of employees at DABC to determine the ratio of career service employees to at-will employees.

In our survey of alcohol control jurisdictions, we found DABC career service (CS) and at-will (AW) classifications by position are consistent with how other jurisdictions classify their store employees, as summarized below:

	<u>AL</u>	<u>ID</u>	<u>MD</u>	<u>NH</u>	<u>OR</u>	<u>PA</u>	<u>UT</u>	<u>VA</u>
Retail Store Managers	CS	CS	CS	CS	AW	CS	CS	CS
Retail Clerks	CS	CS	CS	CS	AW	CS	CS	CS
PT/Temp Clerk or Other		AW		AW			AW	AW

DABC CAREER SERVICE EMPLOYEE-TYPE CLASSIFICATIONS TREND HIGHER THAN UNIONS

Publicly-available, industry-specific information regarding career service employment classifications is limited; however, Union employees possess some of the same protections as those considered career service employees. Therefore, we obtained a copy of the Bureau of Labor Statistics’ News Release on Union Members for 2015 and compared the breakout of Union and non-union employees to DABC’s breakout of career service and at-will positions as shown below:



DABC has a significantly higher ratio of employees with career service protections—43 percent compared to 5 percent for the retail industry. Because of the difficulties often associated with dismissing poor-performing career service employees, having too many career service employees may unnecessarily increase labor costs and decrease customer satisfaction.

Recommendation

We recommend DABC evaluate its operation relative to the retail and wholesale trade industry in regards to employee classification.

Employee Expertise Can Be Strengthened

NEW-HIRE TRAINING SHOULD BE MORE RELEVANT AND TIMELY

When new employees are hired at a DABC retail store, they are required to attend an orientation at DABC headquarters. During the orientation, new employees are taken through a series of trainings: human resources policies and procedures, DABC policies, customer service training, workplace safety, credit card security training, and alcohol control and safety. Employees are then given a very detailed, 94-page, product knowledge manual before they begin employment. Our review of this manual showed that while most the information is informative and useful for DABC employees to learn, the most valuable information to a newly-hired employee is found in one section at the end titled “Customer Assistance.”

In addition to the department-wide training discussed above, employees are given training on how their store operates, conducting lawful sales, and the location of items in the store. This in-store training should happen within the first few days of employment; however, the training does not always occur within this time frame. Delaying in-store training could lead to poor customer service given by new employees, as employees may not yet have basic knowledge as to location of items in the store or basic store operations.

DABC SHOULD CONTINUE TO DEVELOP MORE ROBUST TRAINING AND OFFER TRAINING TO MORE EMPLOYEES

DABC also offers a more extensive product knowledge course for employees upon recommendation from store managers. The course is 4 weeks long, held one night per week for 3 to 4 hours. It is only offered a few times per year. Different product representatives teach the course introducing different product categories to the employees. Along with tasting and gaining an understanding of the different products, employees tour the warehouse, breweries, and/or distilleries. This course was discontinued during the recession and reinstated in June 2014. DABC is in the process of organizing an advanced product knowledge course which is more in-depth to enhance knowledge regarding wines. This course will be mainly for employees at the wine stores and stores that sell many of the limited listing wines.

Alcohol control jurisdictions operating their own retail stores appear to have various courses, similar to DABC, which they offer to their employees. Some of these courses are offered to all levels of employees, while others are offered to specific management levels; thus, allowing flexibility in the education provided to employees.

Recommendations

We recommend DABC:

- Direct new employees to focus their initial reading of the product knowledge manual on the “Customer Assistance” section.
- Require the in-store new-hire training to be completed within the first week of employment.
- Continue to develop and expand its training to more store employees and at more advanced levels.

Feedback To Employees Can Be Strengthened

A SMALL PORTION OF EMPLOYEE INCREASES REVIEWED WERE NEITHER DOCUMENTED NOR APPROVED

We reviewed a sample of incentive awards (84), service awards (5), promotions (5), salary increases (14), and other increases (3) given to employees to ensure they were properly supported and in compliance with both DABC and state policies and procedures. We found the following:

- DABC did not document the reason for one salary increase reviewed. It also did not document approval of the increase.
- DABC did not properly document the percent increase, salary range, or budget sufficiency areas on the form for 13 salary increases, as required by policy.
- The justifications appeared reasonable for all other increases and incentive awards reviewed, the forms were properly approved, and DABC was in compliance with policy.

DABC should follow department and state policies and ensure that all employee awards and increases are properly documented and approved.

EMPLOYEE PERFORMANCE EVALUATIONS ARE NOT IN ACCORDANCE WITH POLICIES

We reviewed a sample of 50 employee performance evaluations to determine if the evaluations had been given annually and in accordance with applicable policies and procedures. We found the following:

- Six employees did not receive an annual evaluation. Five of these employees worked in the administrative office.
- One evaluation lacked the required performance standards and expectations because it was not given on the standard evaluation form.
- Twelve evaluation forms were not signed by the employees. As a result, we could not determine if the evaluations were actually given to the employees and if they were given the opportunity to comment.

QUARTERLY EVALUATIONS FOR STORE EMPLOYEES ARE NOT OCCURRING

In 2015, in order to improve communication among store managers and their employees, DABC instructed store management to begin giving quarterly evaluations (status updates) to all store employees. These status updates are not documented in written policies or procedures and are less formal than the required annual evaluation. We selected a sample of store employees to determine if these status updates were completed by their store's management team. For the 49 employees reviewed, only the following quarterly evaluations were given:

- 16 evaluations in Q1 of 2015
- 15 evaluations in Q2 of 2015
- 2 evaluations in Q3 of 2015
- 12 evaluations in Q4 of 2015
- 25 evaluations in Q1 of 2016

DABC management implemented this level of feedback to improve the communication between store management and their employees; however, by not consistently giving this feedback to store employees, DABC's concerns regarding communication are likely to still exist. It appears store managers are not held accountable for performing quarterly evaluations. Timely and sufficient feedback is necessary for employee retention and ensuring customer service satisfaction.

Recommendations

We recommend DABC:

- Ensure all awards and salary increases are appropriately documented and approved.
- Ensure employee evaluations are properly filled out and each employee is receiving their evaluations annually.
- Create written policies and procedures for the quarterly evaluation process.
- Better train store managers on the objectives of the quarterly evaluation process and ensure these evaluations are given consistently.

Follow Up Of Prior Year Findings

Since 2013, DABC has been statutorily required to be audited every year by the Office of the State Auditor. We prioritized the findings issued in the past three audit reports and followed up on the most critical findings. DABC had improvements in two areas:

- DABC has updated its process for reviewing and writing off accounts receivable such that any inappropriate write-offs would be detected.
- DABC revised the contracts for security guards to meet IRS criteria for classification as independent contractors.

Corrective actions for other areas were either not implemented or not fully implemented, as noted below.

ACCOUNTING CONTROLS STILL NOT IN PLACE

In our report dated May 26, 2015, we issued a finding related to a lack of separation of duties. We determined that a financial analyst had access to cash on a back-up basis and also prepared the daily deposit. While this employee is no longer allowed to open the mail, her other duties remain the same. As long as this employee has access to cash, even in a back-up situation, there is still an inadequate separation of duties that can allow errors and fraud to occur without detection.

In our report dated May 26, 2015, we issued a finding in regards to a lack of receipt records being reconciled to the validated deposit tickets or bank statements to ensure that all receipts have been deposited into the bank. Through inquiries, we determined that no procedures have changed and these reconciliations are still not occurring.

CARILLON RECONCILIATIONS STILL NOT OCCURRING AS REQUIRED

In our report dated May 26, 2015, we recommended DABC reconcile its subsidiary general ledger, Carillon, to the State's general ledger, FINET, at least quarterly. We found that the financial analyst performs the reconciliation quarterly for each month in the quarter. While the reconciliation is performed quarterly, DABC's updated policy requires it to be performed monthly. We also noted that while the reconciliations are performed and detect differences, no necessary adjustments had been made at the time of our audit. Per DABC Policy 01-01, the reconciliation should be done to ensure that receipts in Carillon agree with revenues in FINET. Therefore, if Carillon and FINET do not agree, adjustments should be made when the reconciliation is performed. If differences are not corrected, they can cause the monthly financial reports presented to the Board to be misstated. For the reconciliations we reviewed, the amounts appear insignificant.

BREWERY, DISTILLERY, AND WINERY REPORTS STILL NOT VERIFIED

In our report dated May 26, 2015, we identified an issue where DABC was not verifying the accuracy of sales reports prepared by the Brewery, Distillery, and Winery Package Agencies. These reports are used for calculation of the alcohol tax; therefore, inaccuracies may result in lost revenue to the State. Through inquiry with DABC financial staff, we found that no policies or procedures have been implemented, and therefore, there is still no verification of these sales reports.

In our report dated May 26, 2015, we reported that DABC did not monitor monthly sales reports submitted by Brewery, Distillery, and Winery Package Agencies to ensure the reports were timely, reasonable, and complete. As of October 2015, DABC now requires the majority of these package agencies to pay via ACH, which has improved timing of payments. Based on our sample selection, DABC appears to be receiving funds monthly as required but is still not verifying that reports are reasonable and complete.

Recommendations

We recommend DABC:

- Train accounting personnel on the importance of internal controls;
- Review conflicting duties and separate them as appropriate or implement compensating controls as needed;
- Reconcile receipt records to validated deposits to ensure that all receipts have been deposited into the bank;
- Perform the reconciliations between Carillon and FINET in compliance with policy and make the necessary adjustments noted in the reconciliation to agree Carillon to FINET; and
- Verify the accuracy of sales reports prepared by Brewery, Distillery, and Winery package agencies.

Product Special Request System Appears To Operate Effectively

In March of 2015, DABC implemented its online ordering for special requests (products not typically carried in its retail stores). DABC, along with many other alcohol control jurisdictions, require customers to purchase an entire case for special order products, since this is the minimum quantity vendors require for purchase.

Orders submitted to the website have a quoted minimum of an eight-week wait time but can take longer since the item requested may not be immediately available, may be of a very limited nature, or DABC does not have an established relationship with the vendor. The system tracks orders by status so DABC can evaluate each order's progress at any given time.

We selected a sample of prior product requests from general consumers and traced them through the special order process. Overall DABC typically completes orders within the eight weeks or notifies the customer of any exceptions. However, the database only keeps the most recent status update; therefore, it was difficult to determine how frequently DABC updated the customer during the ordering process.

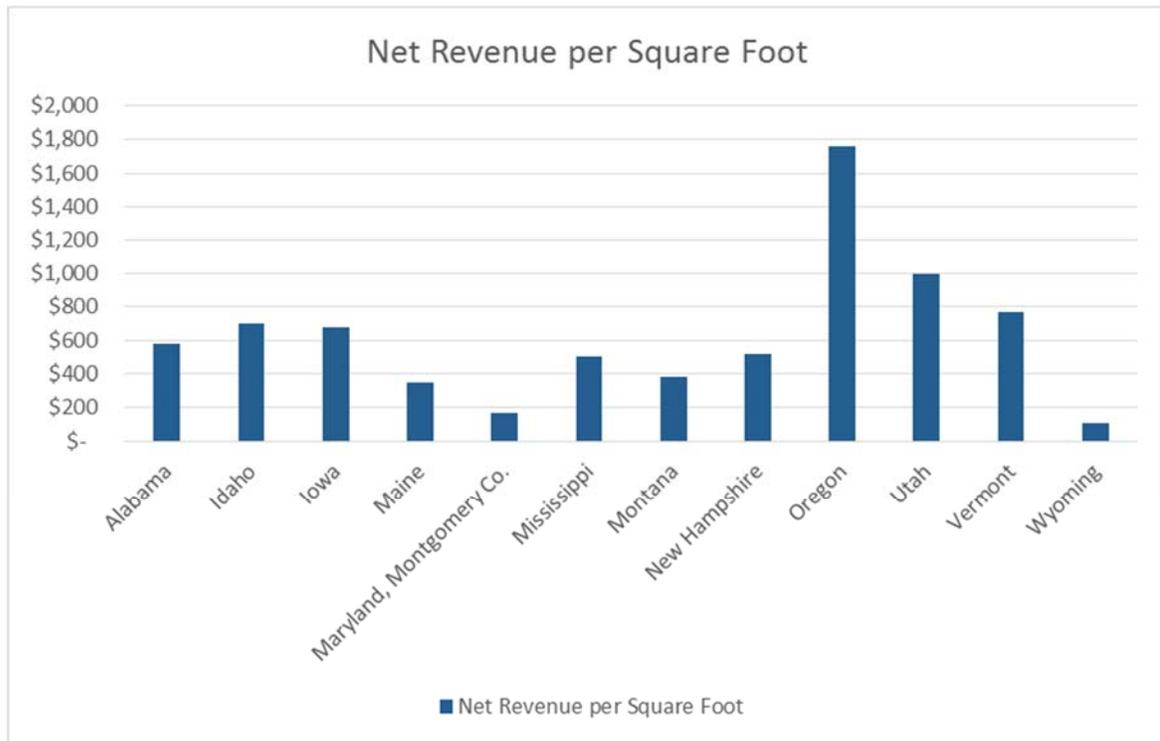
Recommendation

We recommend DABC consider using a log to document all interactions with customers and contacting them more frequently when orders take longer than the standard eight weeks.

Warehousing Square Footage Better Utilized At DABC Than At Most Other Jurisdictions

Based on our survey of the alcohol control jurisdictions, 14 out of 15 respondents have a central warehouse, similar to DABC. Pennsylvania was the only respondent that does not have a central warehouse; however, it does have three regional warehouses throughout the state. The graph below compares the total warehousing square footage for each jurisdiction’s warehouse(s). Also, for a size comparison, it presents the net revenues for each jurisdiction. In the chart below, net revenue exceeding square footage indicates an effectively managed warehouse.

Overall, it appears that Utah generally utilizes its warehousing square footage better than most other jurisdictions with comparative sizes. Oregon and Utah appear to utilize their warehousing square footage most effectively, as shown below.



The above net revenue data was obtained using the NABCA’s *Beverage Alcohol Control Agency Info Sheets*.

Recommendation

While DABC appears to be doing a fairly good job of utilizing its warehousing square footage to sales, we recommend DABC determine if there are any best practices used by Oregon that can help strengthen its warehouse square footage utilization.

Financial Report Presentation Can Be Enhanced

FINANCIAL STAFF SHOULD WORK WITH COMMISSIONERS TO INCREASE USEFULNESS OF REPORTS

DABC's accounting department provides the Commission with monthly reports, snapshots of each month's operations, as well as a year-end financial report covering the entire fiscal year. These reports have been presented in the same format for many years. The year-end report is presented to the Commission in the October commission meeting. At previous presentations, the commissioners have requested additional information from management that has not yet been provided, e.g. sales per employee and sales per square footage. Commissioners have also mentioned their inability to understand the Balance Sheet as it is presented because it is formatted in a unique manner.

FINANCIAL REPORTS HAD SOME VARIANCES FROM THE ACCOUNTING LEDGER

DABC prepared its financial reports using a reporting system called DragNet, which uses financial data imported from the State's accounting system, FINET. Currently, DABC does not have any written policies or procedures related to the preparation of these financial reports. We reviewed the account codes and determined that the accounts are reasonably classified in the financial statement line items with some exceptions relating to the implementation of new pension accounting standards. We performed high-level analytics and ratio analysis and noted nothing unusual or inappropriate in comparison to prior year balances. We scanned the detail listings of the Accounts Receivable and Accounts Payable balances and reviewed higher dollar transactions. We inquired of accounting staff and reviewed the supporting transactions as necessary and noted nothing that appeared to be unusual or inappropriate.

We re-ran the FINET queries used to create the financial statements for the 2015 Annual Report and the January 2016 monthly report and noted only a few exceptions between FINET and the amounts presented, including the following:

- On the 2015 Annual Report: DABC periodically transfers the cash balance into the TAX Markup Holding Fund, as required per statute, and then annually transfers the funds from there to the General Fund (usually each September). Since this cash is still accessible to DABC at June 30th, it should be included in the financial statement presentation, but DABC is not currently including it due to limitations of DragNet. Also, footnote D in the annual report, titled "Cash," does not clearly describe the above process.
- On the January 2016 monthly Balance Sheet: The taxes payable amount was \$2 million more than the amount recorded in FINET, and the current profit amount was \$2 million less than the amount recorded in FINET.

FINANCIAL REPORTS HAD SOME VARIANCES FROM THE STATE OF UTAH COMPREHENSIVE ANNUAL FINANCIAL REPORT

We compared the DABC 2015 Annual Report to the State of Utah's 2015 Comprehensive Annual Financial Report (CAFR) and found that, overall, the classification and amounts presented were comparable. However, we did note the following differences:

- Pension related amounts were misclassified in DABC's 2015 Annual Report.

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- Various nonoperating revenues and expenses were combined and classified with operating revenues and expenses in the DABC 2015 Annual Report.
- The “Other Assets” section in the DABC 2015 Annual Report includes some assets that should be considered current.

Recommendations

In order to enhance the usefulness of the DABC financial reports, we recommend DABC:

- Work with the Commission to design reports that are more beneficial to their review and decision-making processes.
- Properly classify the pension amounts within the DABC Annual Report.
- Report the cash that is available for use by DABC at June 30 within the DABC Annual Report and update its cash footnote to describe the cash transfers appropriately.
- Correct the Parents Empowered entry using double entry accounting to accurately report current profit and operating expenses.
- Properly separate operating and nonoperating revenues/expenses, as appropriate.
- Properly separate current and non-current assets, as appropriate.

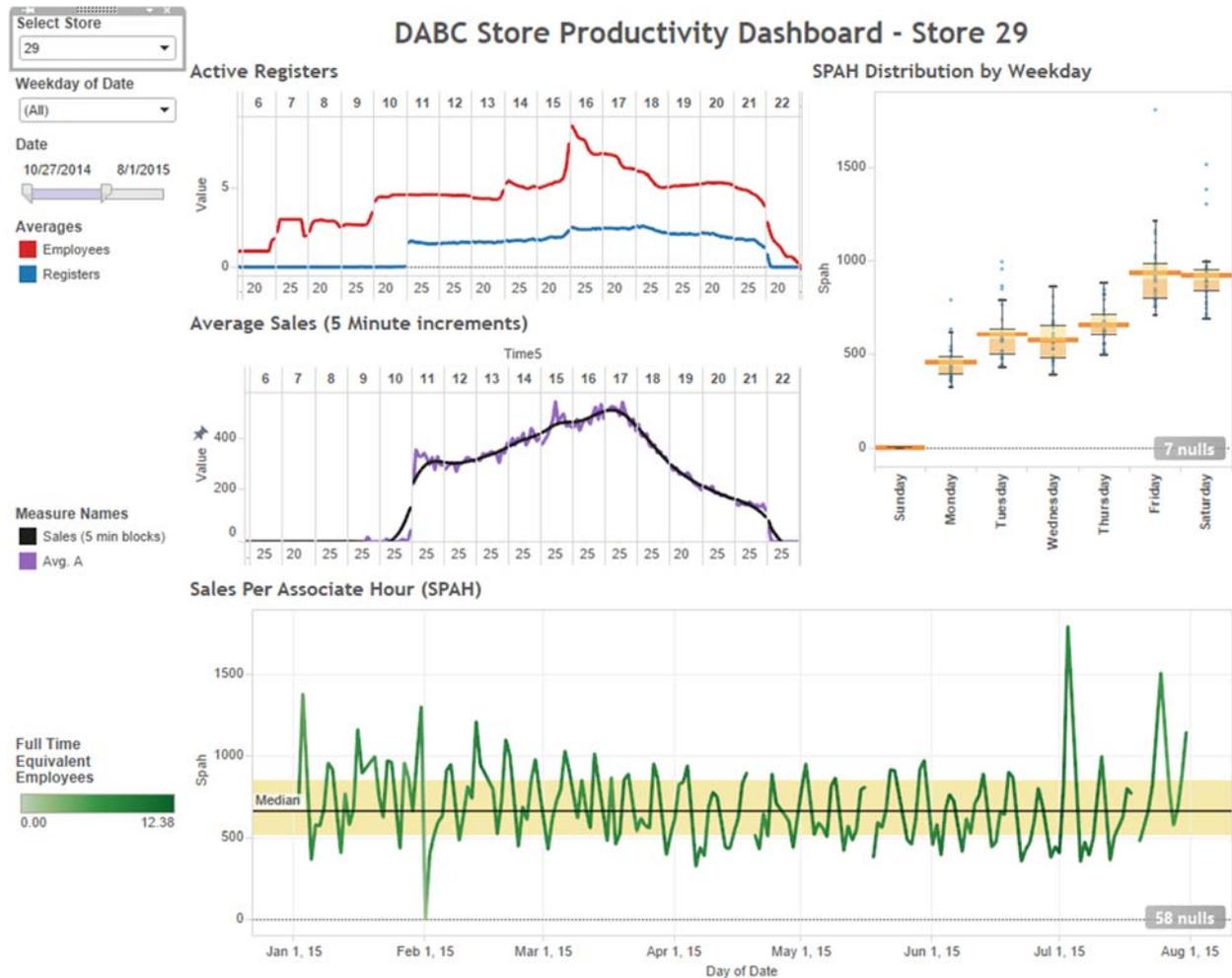
Appendix One

We collected information from DABC’s information systems to ascertain the effectiveness and efficiency of its labor allocation decisions. Several types of analyses were used to evaluate current labor allocation practices. Below are brief descriptions of the types of analyses performed with a few sample cases or summaries of wider analysis. Additional charts and tables were provided to DABC administrators and business analysts over the relevant time period, but are not presented here in full due to space constraints.

SALES PER ASSOCIATE HOUR IS BENEFICIAL IN ANALYZING EFFICIENCIES

Analyzing a large volume of information regarding the interaction of employees, sales, and shipments requires a useful framework at many levels of decision making. We produced an interactive productivity dashboard to illustrate these concepts (see Figure A below). We linked the sales and employee data to introduce an efficiency measure called Sales per Associate Hour (SPAH).

Figure A.



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An interactive dashboard, similar to the one shown above, could help DABC administrators or store managers view how they are allocating the demand for labor in a particular store on specific dates, days of the week, or times of unusual demand. As an investigational tool, these charts show the strengths, weaknesses, local facts, and uniqueness surrounding the operation of each particular store.

For example, the above charts show that at Store 29 (Holladay) average sales rise gradually in the afternoon and peak around 5:00 PM then fall sharply, so by 7:00 PM less than half of the peak volume is being sold. However, the average employee count spikes at 4:00 PM, falls during the peak, and remains elevated at 5 employees even while sales decreased by a third. We expect SPAH to fluctuate throughout the day, but DABC could improve efficiency by targeting the time of shift changes, stocking, deliveries, or other predictable factors to minimize the strain during peak times. As shown in the *SPAH Distribution by Weekday* graph above, the distribution of SPAH is approximately 50-100% higher on Friday and Saturday compared with other days of the week. Assuming that consistent and even customer service is an important DABC goal, the chart indicates too much labor is allocated Monday through Thursday and too little is allocated Fridays and Saturdays for Store 29 (Holladay). Analysis at other stores revealed similar deficiency in labor allocation for most stores.

NUMBER OF AVAILABLE REGISTERS CAN IMPACT EFFICIENCY

There are some physical constraints that can impact labor allocation strategies. The availability of additional registers to process transactions can impact efficiency measures by creating a cap on the speed of sales. There are also limits to the physical size of buildings, stock rooms, and floor space that could impact how a store plans labor allocation. Properly integrating these factors with efficiency measures presented is essential.

To determine if some stores had excess pressure on their existing registers, we compared the amount and variance of time between transactions at stores with multiple registers. We discovered that most stores have enough registers to adjust to peak demand, but some stores could benefit from additional registers at particular times. The graphs below show the two main outcomes of the analysis.

Figure B.

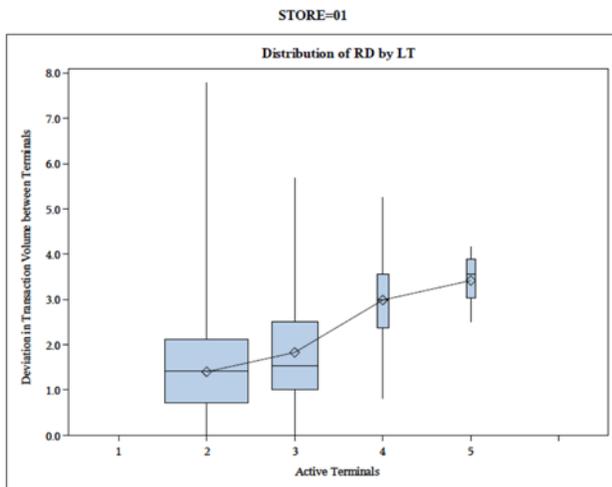


Figure C.

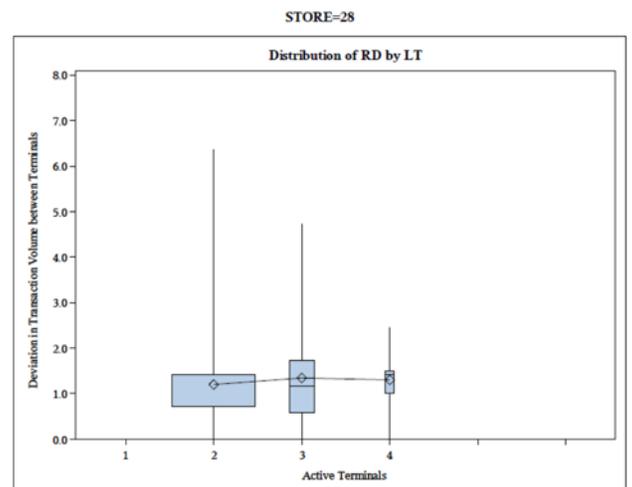


Figure B shows that Store 1 (Salt Lake – Downtown) has high variability in sales demand and can open up to 5 registers to process sales. This happens infrequently (the width of the boxplot shows the relative volume of transactions processed through a given number of simultaneously active registers). This trend occurred in 40 of the 44 stores.

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Figure C for Store 28 (Vernal) shows a flattening of the deviation in transaction volumes when multiple registers are open. This pattern points to a relatively high load of sales volume on the last register during the busiest times of service. We noted in these cases that the volume of sales occurring with all registers active is small relative to the total. Store 27 (Moab), Store 28 (Vernal), Store 42 (Hurricane) and Store 43 (Heber) all experienced this pattern.

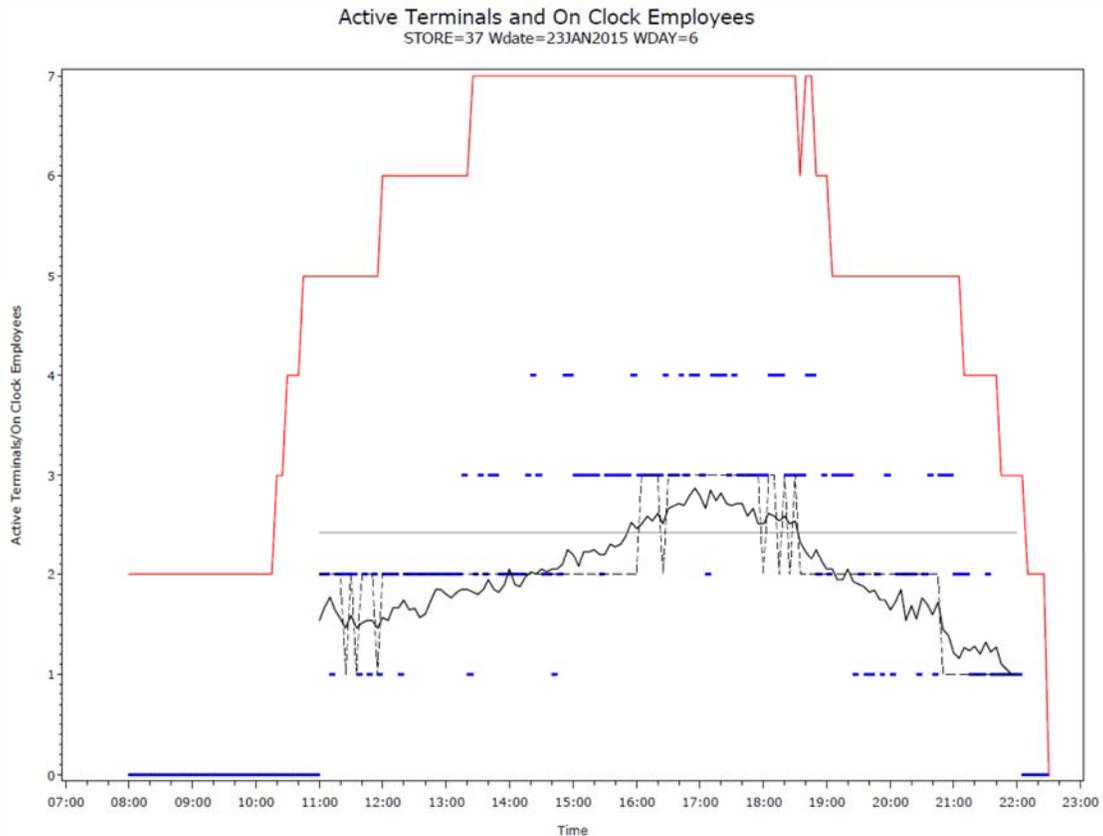
A more precise measure of store load and peak sales demand relative to store capacity, which is common in private retail operations, would require additional systems to be put in place to record customer counts in store relative to the SPAH at high volume periods.

ANALYZE SALES AND REGISTER USE TO IMPROVE LABOR ALLOCATION

We also analyzed sales volume per employee for sample stores (and active registers for all stores) for every day between October 2014 and July 2015 to allow comparison and visualization of smoothing techniques. The graph below illustrates the employment and sales patterns for Store 37 (Park City – Kimball Junction) on Friday, January 23, 2015.

This analysis can highlight the relative weakness and strength each store has in adapting to changing patterns of demand within and among the various stores. Using this type of analytical approach would allow managers to compare their experience with particular patterns in the data to make optimal labor allocation decisions in the face of imperfect but somewhat predictable patterns of customer behavior.

Figure D.



The red line represents the number of employees working at a given time. The peak number of employees working is from 1:30 PM to 7:00 PM when there are 7 employees working. The broken blue horizontal lines represent how many registers are actively making sales during five-minute windows of this day. This illustrates that fewer registers were in use between 11:00 AM and 1:00 PM and again from

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7:30 PM until close, suggesting the store was not very busy at those times. The solid black line represents the average number of registers open at a particular moment on an average Friday for this store. On average, there are more than two registers open on Fridays from 4:00 PM until 6:30 PM. The dashed black line represents the median number of registers open at a particular moment; it is different from the average in that it is more representative of the typical day transition of demand, evident by the jump in the dashed line from 1 to 2 active registers around 2:00 PM and the step down in the same line a little after 7:00 PM. Adapting to these trends can help optimally plan store shifts.

Figure E.

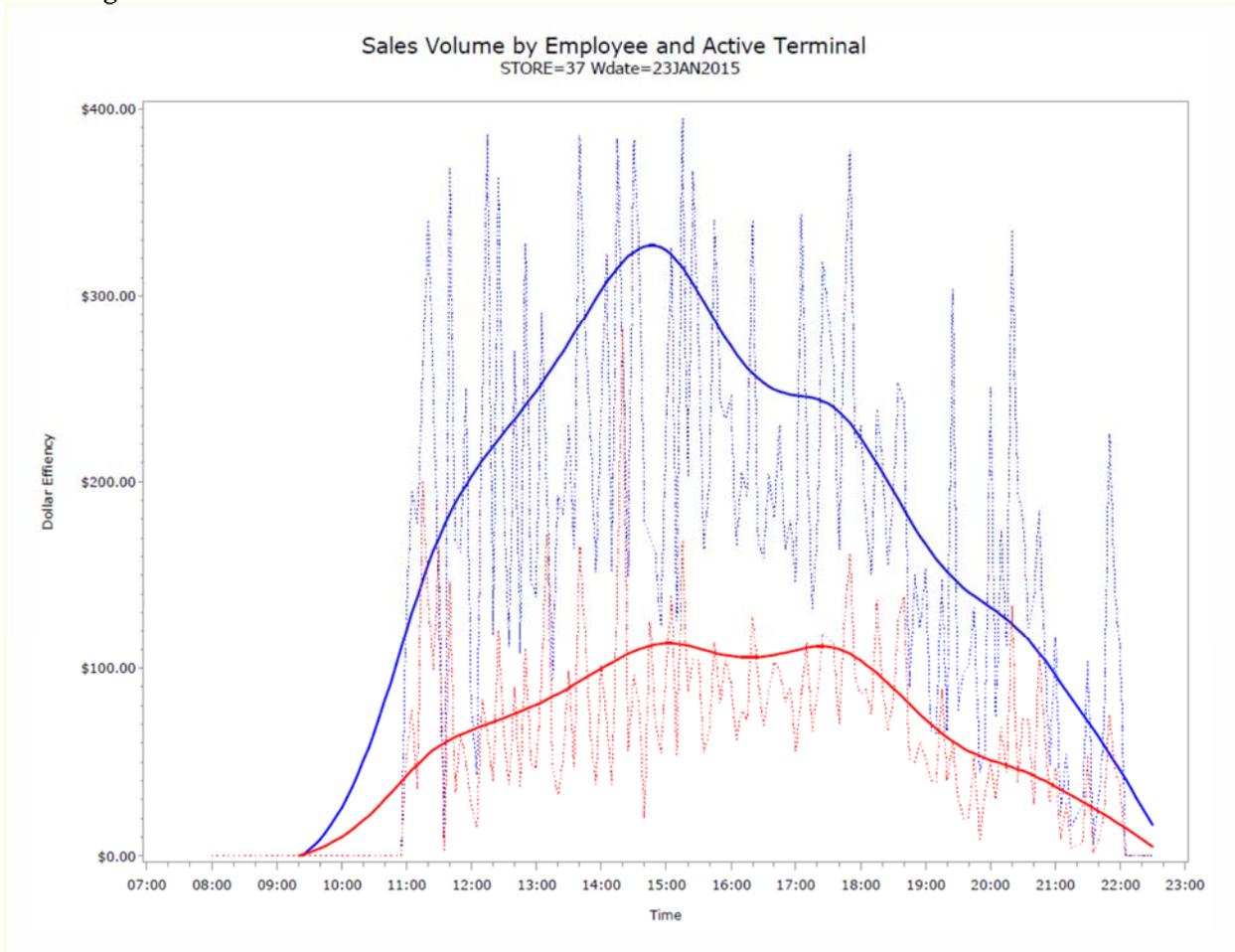


Figure E above is a more straightforward representation. For the same day and store analyzed above—Store 37 (Park City – Kimball Junction) on Friday, January 23, 2015—the dark blue line represents the smoothed sales volume per active register for every 5 minutes per active register. On this day, sales volume peaks around 3:00 PM at around \$300 when only 2 registers were active. The timing of working employees at peak times (Figure D red line) corresponds with a flattening of the red line above which represents the SPAH (sales per associate hour). The store appears to do a fairly good job of smoothing sales volume between the busiest sales time period of 2:00 PM and 6:00 PM.

We also generated a labor optimization model based upon sales quantity (rather than product value). The Quantity per Associate Hour (QPAH) patterns were similar to the SPAH, as shown above. DABC management indicated that movement of product is the basis of many of their performance metrics.

DETAILED STORE EMPLOYEE TASK DATA UNAVAILABLE

While available time card data showed when employees were working, it did not necessarily show what activities they were performing. Using existing shipping data, we constructed a model to separate the approximate amount of labor dedicated to receiving and stocking versus other retail activities. This was accomplished by comparing the predicted amount of labor hours used in handling the sales transactions for non-shipment days to those days that did receive shipments.

Figure F.

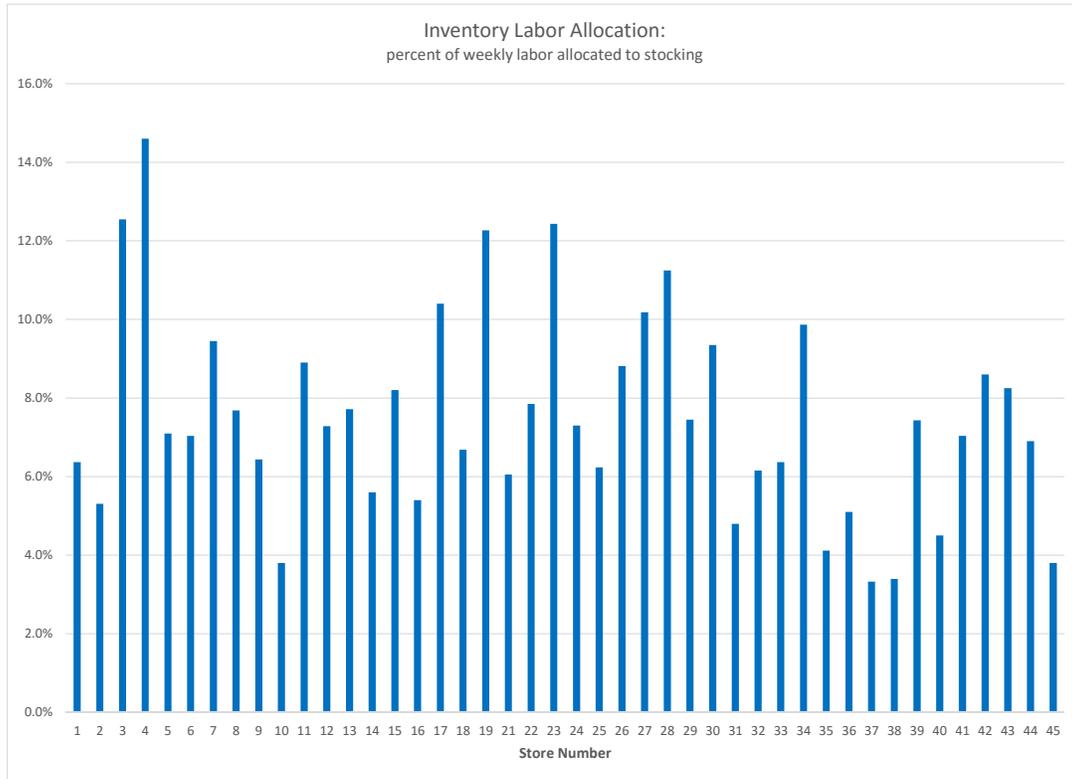


Figure F above illustrates the wide variety of approximate labor allocated to inventory management for each store. A handful of stores use less than 5% of available labor to process shipments. There were four stores—Store 3 (West Valley), Store 4 (Salt Lake – Foothill), Store 19 (Ogden) and Store 23 (Roy)—that used more than double the amount of labor to manage inventory relative to the best performers. The wide variances in labor allocation shown above suggests that DABC should reevaluate labor use in its various activities to optimize the effective allocation of labor in and among stores. DABC might consider tracking labor activities with greater detail to improve insight into the costs of various activities, particularly processing incoming in-store product shipments. Labor saved from potential inventory management changes could be allocated to other purposes such as improving customer service or decreasing labor costs overall.

STORES SHOULD SHIFT LABOR HOURS TO FRIDAY AND SATURDAY

Based on current procedures, DABC could not produce an accurate sum of the total hours employees worked on a given day in a particular store. As a proxy for this information, we used payroll assignments from the SAP system to sum all reported employee work hours for a particular store. There was evidence on paper time cards that some employees worked at multiple stores; as a result the following tables and graphs are less precise than desired.

Figure G.

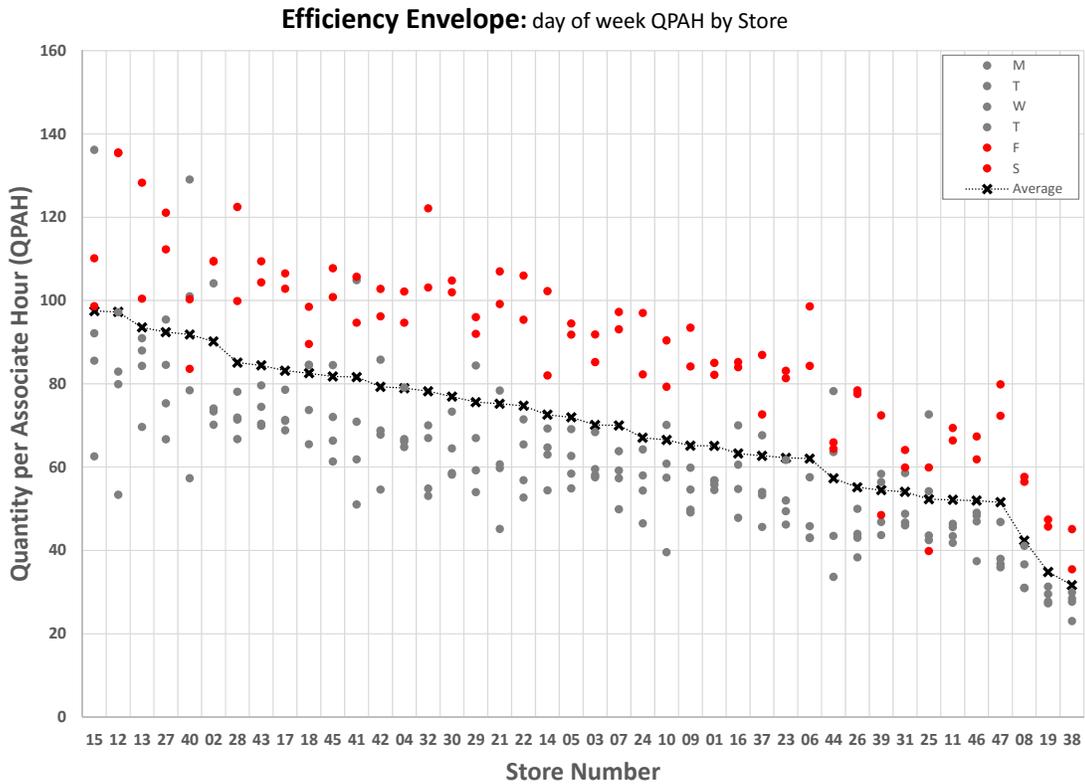


Figure G above shows the day of the week Quantity per Associate Hour (QPAH) relative efficiency frontier at which stores are currently operating after adjusting for labor involved in the unloading of shipments. Nearly every store shows much higher efficiency on Fridays and Saturdays (red dots) than exhibited during the week (gray dots). The consistency of the gap between these days of the week shows that targeting efficiency measures could help DABC administration monitor, shift, and optimize resources among stores, including potentially shifting labor hours from weekday (Monday through Thursday) to the weekend (Friday and Saturday) to improve customer service metrics on the weekend.

A two or three employee minimum rule will cause some stores to be, at times, relatively inefficient using the QPAH efficiency measure. While elimination of a full-time employee (FTE) could cause a large increase in the QPAH, it could also result in unacceptable declines in customer service. This type of analysis could guide management in determining where to best locate an additional unit of labor.

QPAH CAN HELP DABC ALLOCATE EMPLOYEES TO AREAS OF MOST IMPACT

Analyzing sales and employee data using the QPAH efficiency measure allows for objective evaluation of both excellent and deficient performance as it relates to retail store operations. Using the limited QPAH information, we sought to determine where additional full-time or part-time labor would have the most effect. We ran a simulation in which we modeled assigning another employee to work during the operating hours of each store. We then compared how much each store’s efficiency measure (QPAH) would change across various levels of staffing.

Figure H shows one potential optimization algorithm that could rank the expected improvements in store operations from marginal additions of labor. This could allow DABC administration to allocate additional budgeted FTEs to the areas of most impact. The robust design of such a tool could be extended to target staffing levels at all stores and help redirect staff from stores with less severe demands to stores with high workloads. If an additional unit of labor was available, this method would recommend hiring another employee at store 40 because it is ranked number 1.

In proceeding with such optimization, accurate data and the incorporation of important qualitative information (e.g., labor rules) is essential to build into the modeling framework. Ideally, these algorithms would be tuned for sensitivity to factors like employee retention, customer service level, and a host of complicated factors that influence retail operations.

Figure H.

QPAH Changes - Add Half Employee

STORE	prior	new	change	pred	resid	from		RANK
						mean	score	
1	79	71	-8	60	-12	9	-21	13
2	90	81	-9	67	-13	20	-34	5
3	77	66	-11	56	-10	7	-17	16
4	82	60	-21	51	-9	12	-21	12
5	52	47	-5	41	-7	-18	11	36
6	76	65	-11	55	-10	6	-16	17
7	55	40	-15	35	-5	-15	10	34
8	65	57	-9	48	-9	-5	-4	27
9	70	62	-8	52	-10	0	-10	22
10	52	44	-8	38	-6	-18	12	39
11	62	51	-11	43	-7	-8	1	30
12	52	45	-7	39	-6	-18	12	38
13	92	71	-20	60	-12	22	-33	6
14	54	45	-9	39	-6	-15	9	33
15	63	57	-7	48	-8	-7	-2	28
16	65	60	-5	51	-9	-5	-4	26
17	97	66	-31	56	-10	28	-38	2
18	75	61	-14	51	-9	5	-15	19
19	62	53	-9	45	-8	-8	0	29
21	67	60	-7	51	-9	-3	-6	24
22	35	28	-7	25	-3	-35	32	41
23	92	73	-20	61	-12	22	-34	4
24	94	77	-17	64	-13	24	-36	3
25	83	72	-11	61	-12	13	-25	9
26	79	69	-10	58	-11	9	-20	14
27	83	68	-15	57	-11	13	-23	10
28	54	43	-11	38	-6	-16	10	35
29	82	71	-11	60	-11	12	-23	11
30	84	73	-11	61	-12	14	-26	8
31	42	39	-4	34	-5	-28	23	40
32	32	28	-4	25	-3	-38	36	42
35	52	47	-6	40	-6	-18	11	37
36	57	40	-18	35	-5	-13	8	32
37	72	65	-7	55	-10	2	-12	21
38	73	66	-6	56	-10	3	-13	20
39	85	72	-13	60	-12	15	-27	7
40	97	83	-14	69	-14	27	-41	1
41	67	57	-10	48	-9	-3	-5	25
42	63	47	-16	40	-7	-7	1	31
43	70	57	-13	48	-8	0	-9	23
44	75	63	-11	53	-10	5	-15	18
45	78	68	-11	57	-11	8	-19	15

Appendix Two

In the United States, 17 states and a few jurisdictions within other states control the sale of distilled spirits and, in some cases, wine through government agencies at the wholesale level. Thirteen of those jurisdictions also exercise control over retail sales for off-premises consumption, either through government-operated package stores or designated agents. We surveyed all alcohol control jurisdictions to assist us in a comparison of operational best practices. We received responses from Alabama, Idaho, Iowa, Maine, Montgomery County in Maryland, Minnesota (wage information only), Mississippi, Montana, New Hampshire, North Carolina, Oregon, Pennsylvania, Utah, Vermont, Virginia, and Wyoming. We compared the responses between Utah and other alcohol control jurisdictions and included the key takeaways throughout the body of the report. The full survey responses were also given to DABC management.

Appendix Three

This appendix provides information regarding employment benefits for DABC employees and for employees within the convenience store industry.

DABC EMPLOYEE BENEFITS

PEHP ANNUAL MEDICAL RATES 2014-2015

	Employer	Employee	Employer Contribution Rate
Star Plan (Summit or Advantage)			
Single	\$4,888.26	\$ -	100.0%
Family	\$13,455.78	\$ -	100.0%
Traditional Plan (Summit or Advantage)			
Single	\$4,888.26	\$543.14	90.0%
Family	\$13,455.78	\$1,495.00	90.0%

STATE EMPLOYEE RETIREMENT BENEFITS (Utah Retirement Systems)

Tier I Pension Plan	22.19% of salary
Tier I 401(k) Plan	1.5% of salary
Tier II 401(k)/Hybrid Plan	10.00%* of salary
401(k) Matching Plan	\$26 per pay period

* Note: A Tier II employee receives a 10% retirement benefit although the contribution rate is 20.02% of salary. The difference is used to “prop up” the Tier I system to address its underfunded status. As such, we don’t consider the 10.02% difference as a “benefit” to the Tier II employees.

DEPARTMENT OF ALCOHOLIC BEVERAGE CONTROL

STATE EMPLOYEE LEAVE BENEFITS

Total Hours Paid in Pay Period	Annual Leave Accrual (Hours)				Sick Leave Accrual (Hours)
	Less than 5 years	At least 5 and less than 10 years	At least 10 and less than 20 years	20 years or more	
	4 Hours	5 Hours	6 Hours	7 Hours	
4	0	0	0	0	0
8	0	1	1	1	0
12	1	1	1	1	1
16	1	1	1	1	1
20	1	1	2	2	1
24	1	2	2	2	1
28	1	2	2	2	1
32	2	2	2	3	2
36	2	2	3	3	2
40	2	3	3	4	2
44	2	3	3	4	2
48	2	3	4	4	2
52	3	3	4	5	3
56	3	4	4	5	3
60	3	4	5	5	3
64	3	4	5	6	3
68	3	4	5	6	3
72	4	5	5	6	4
76	4	5	6	7	4
80	4	5	6	7	4

2014 NACS State of the Industry Compensation Report

Average Annual Premium Contribution for Single Coverage

Firm Size B, Store Managerial, Non-exempt: \$3,852
Firm Size B, Store Managerial, Exempt: \$4,842
Firm Size B, Store Hourly: \$4,770

Average Annual Premium Contribution for Family Coverage

Firm Size B, Store Managerial, Non-exempt: \$8,848
Firm Size B, Store Managerial, Exempt: \$11,878
Firm Size B, Store Hourly: \$12,940

Average Contribution to Medical Coverage

Firm Size B, Store Managerial, Non-exempt: 74%
Firm Size B, Store Managerial, Exempt: 70%
Firm Size B, Store Hourly: 71%

401(K) Plan Details

Average matching, Store Managerial, Non-exempt: 6.3%
Average matching, Store Managerial, Exempt: 7.7%
Average matching, Store Hourly: 8.2%

Average Time Off in Days

Firm Size B, Store Managerial, Non-exempt: 0-13 (7 days after 1 year, 11 days after 5 years)
Firm Size B, Store Managerial, Exempt: 2-18 (8 days after 1 year, 14 days after 5 years)
Firm Size B, Store Hourly: 0-17 (8 days after 1 year, 14 days after 5 years)

**Department Of Alcoholic Beverage Control's
Response To Findings And Recommendations**



GARY R. HERBERT
Governor

SPENCER J. COX
Lieutenant Governor

State of Utah

DEPARTMENT OF ALCOHOLIC BEVERAGE CONTROL

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September 21, 2016

Mr. John Dougall, State Auditor
Office of the State Auditor
315 House Building State Capitol Complex
Salt Lake City, UT 84115

State Auditor Dougall,

Thank you for the opportunity to respond to your audit, "Special Financial and Limited Performance Audit for Procedures Performed During Fiscal Year 2016." While the DABC realizes that there is room for improvement, we also appreciate that the audit highlights the need for additional resources if improvements are to be made.

The DABC, in principle, agrees with the audit recommendations. In fact, the department has employed, in certain areas, measures contained in the audit recommendations. For example, the department used "bottles sold per associate hour," the equivalent of the State Auditor recommended QPAH (Quantity per associate hour) metric, as the basis for allocating amongst stores, the retail sales clerk FTEs funded by the Legislature during the 2016 General Session. Likewise, DABC Division of Finance has, over the last year, developed store-based financial statements with sufficient granularity to provide a better understanding of store performance.

The DABC continues to focus on efforts to use data to inform decisions. The department agrees with the State Auditor that digitizing employee work data will assist in improving analyses of labor allocations which, in turn, could affect efficiency and customer satisfaction. The DABC will confer with DHRM with regard to the feasibility of changes that would allow greater granularity to the current time reporting system. The department welcomes the State Auditor's recognition that digitization requires investment in additional systems.

The DABC will continue its efforts at improving process efficiencies and full adoption of "best practices" as determined by the DABC Workgroup which is composed of administrative and store staff. Management will confer with the Workgroup in efforts to address the State Auditor's concerns regarding demand-based staffing.

Still, incremental efficiencies achieved via process changes can be overwhelmed by actual demand, and the department is concerned about the feasibility of modifications in staffing deployment recommended by the State Auditor, *all things being equal*. DABC stores have seen

their workload – using the bottles sold per associate hour measure - increase approximately 22% in the period between Fiscal Year 2012 – Fiscal Year 2016, while its FTE count remained virtually unchanged during the same period.

The DABC staffs stores based on sales volume. The ability to seamlessly match staffing with demand while remaining within budget is complicated by factors such as: minimum staffing requirements required by internal controls, training, licensee order fulfillment, load days and high turnover rates. Absent additional resources, demand-based staffing as envisioned by the State Auditor may be problematic.

We also agree with the State Auditor that “additional performance metrics could improve decision making and operational practices.” While the DABC sees value in metrics, we also realize that having too many metrics can be detrimental to optimal performance and the department must be careful to insure that metrics adopted and monitored speak to critical DABC strategic and operational initiatives.

The DABC welcome’s the State Auditor’s survey of comparative wage data and classification information from regulated states and the private sector. The information will help to inform discussions by stakeholders on broader policy concerns such as: time v. performance based compensation; feasibility of adopting employment trends in the broader economy and the retail sector in particular; changes in compensation structures of state employees; adequate compensation for state employees in light of local economic conditions; and the statutory changes required to implement changes to be adopted.

The DABC strongly believes that training is necessary for a business that not only provides quality services, but is also capable of facing changes in the environment and demand for services. We agree with the State Auditor that it is incumbent upon the department to provide a robust training program. As noted in the report, this belief has led the DABC to either create or participate in formal training programs to: a) make new employees aware of policies and resulting expectations; b) improve leadership and management skills; c) provide basic and advanced product knowledge. It is the department’s expectation that as the product knowledge programs mature, additional cohorts will be able to partake of the training provided.

Ensuring that employees have the necessary knowledge and skill to succeed also requires, feedback on performance. As noted in the report, DABC implemented the policy requiring quarterly reviews to provide more timely feedback regarding job performance because exit surveys indicated that the scarcity of feedback as to performance when the department only required an annual review, contributed to turnover. The department concurs with the State Auditor’s conclusion that “by not consistently giving feedback to store employees ... concerns regarding communication are likely to still exist.”

This is an area where the creation of the DABC Workgroup promoted a better understanding of the reasons for creating the policy and the impact the policy had on store operations. The Workgroup has been critical in developing a performance evaluation form that balances the need for feedback and efficiency. Management will work in partnership with the Workgroup to communicate the need for accuracy and compliance with requirements in the

incentive award process. It is the department's belief that the Workgroup's effort, will improve compliance with the policy in the future.

The DABC values the State Auditor's recognition that staffing limitations is a barrier to more effective analyses of the replenishment of limited products. We agree that easier access to data on limited products can improve purchasing decisions. Currently, data regarding a limited product's out of stock history is difficult to access with analyses requiring manual reviews of purchase orders. Manual reviews are labor intensive and time consuming. Consequently, deep dives into the frequency and reason for a limited product being out of stock is conducted on an as needed basis.

The DABC believes in a culture of continuous improvement and agree that improving service levels can be achieved via improvements in ordering and replenishing products. We anticipate that purchasing suggestions involving limited products will be conducted more frequently in the near future. The new system that is currently being deployed will allow easy access to a wide array of data and provide forecasting tools that we believe will greatly improve the speed and accuracy of the purchasing process thus addressing out of stocks, product rotation, and statewide distribution. Still, forecasting tools do not address the core issue that limited products are not always available.

The DABC agrees with the State Auditor's findings in the section titled "Follow Up of Prior Year Findings." The department inadvertently undercut a separation of duties requirement, did not perform reconciliations as frequently as required by policy, and did not implement a verification process for brewery, distillery and winery reports. We will use the recommendations as starting points for improving controls and processes further.

The department is well aware of the importance of internal controls. Accounting staff, indeed all administrative staff, received internal control training from the State Division of Finance. Additionally, the DABC submits required Internal Control Questionnaires to State Division of Finance for review and comment as part of our continuing efforts to minimize exposure to fraud.

That a financial analyst responsible for preparing deposits had access to cash on a back-up basis was the unintended consequence of the reduction in force implemented as a result of budget cuts DABC experienced in Fiscal Year 2016. The loss of an Office Tech II required members of both Divisions of Finance and Licensing and Compliance to assist in covering the front desk and switchboard. The inadequate separation of duty identified by the State Auditor was resolved when Compliance and Licensing received funding for an Office Specialist in the 2016 General Session, and hired for the position in July 2016.

The Licensing and Compliance Division conducted 34 compliance audits of manufacturing licensees from June 1, 2015 to May 31, 2016. While records were reviewed during the compliance audit related to tracking product, the verification process had not yet been finalized and therefore not completely implemented. The department's review of statute raised several concerns beyond merely verifying monthly sales reports. We found a complicated issue area which, we believe requires input from stakeholders and deliberate action to adequately resolve. We continue to engage with stakeholders and to use the process outlined in statute to arrive at resolution.

The DABC concurs that financial reports can be enhanced to foster transparency and bolster understanding of its financial position. DABC Finance will confer with DABC Commissioners to better respond to their concerns, and will continue with its efforts to improve financial and annual reports.

Sincerely,

A handwritten signature in blue ink, appearing to read "Salvador D. Petilos". The signature is written in a cursive style with a large initial "S".

SALVADOR D. PETILOS
DEPT. OF ALCOHOLIC BEVERAGE CONTROL