



PERFORMANCE AUDIT REPORT

Tennessee Alcoholic Beverage Commission

September 2020

Justin P. Wilson
Comptroller of the Treasury



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September 3, 2020

The Honorable Randy McNally
Speaker of the Senate
The Honorable Cameron Sexton
Speaker of the House of Representatives
The Honorable Kerry Roberts, Chair
Senate Committee on Government Operations
The Honorable Martin Daniel, Chair
House Committee on Government Operations
and
Members of the General Assembly
State Capitol
Nashville, TN 37243
and
The Honorable Russell Thomas, Executive Director
Tennessee Alcoholic Beverage Commission
500 James Robertson Parkway
Nashville, TN 37219

Ladies and Gentlemen:

We have conducted a performance audit of selected programs and activities of the Tennessee Alcoholic Beverage Commission for the period April 1, 2016, through April 30, 2020. 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, which are detailed in the Audit 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,

A handwritten signature in black ink that reads "Deborah V. Loveless".

Deborah V. Loveless, CPA, Director
Division of State Audit

DVL/mc
20/065



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AUDIT HIGHLIGHTS

Tennessee Alcoholic Beverage Commission's Mission Statement
To protect the public through regulation, education, and enforcement of
Tennessee's alcoholic beverage laws.

We have audited the Tennessee Alcoholic Beverage Commission for the period April 1, 2016, through April 30, 2020. Our audit scope included a review of internal controls and compliance with laws, regulations, policies, and procedures in the following areas:

Scheduled Termination Date:

June 30, 2021

- wine in grocery stores;
- background checks for permit applicants;
- direct shipper and non-resident seller licenses;
- confiscated evidence;
- conflicts of interest;
- commission structure and responsibilities;
- information systems; and
- staff turnover.

KEY CONCLUSIONS

FINDINGS

- The commission's management did not establish written policies and procedures governing the Wine in Grocery Stores program and did not establish effective controls over the program's licensing process (page 5).

- Commission management did not ensure that system program changes worked as intended and did not update the background check policy to reflect current practice (page 15).
- As noted in the prior audit, commission management did not establish adequate licensing policies over direct shipper and non-resident seller licenses, did not ensure licensees were notified of expiring licenses, and did not ensure that licenses were closed upon expiration as required in statute (page 21).
- Commission management did not provide adequate internal controls in three specific areas (page 37).

OBSERVATIONS

The following topics are included in this report because of their effect on the commission and the citizens of Tennessee: although commission management improved their internal controls over disposed evidence, management did not perform adequate supervisory review of case files and did not maintain evidence disposition reports as required (page 32), and the commission experienced high employee turnover during the last four years (page 39).

TABLE OF CONTENTS

	<u>Page</u>
INTRODUCTION	1
Audit Authority	1
Background	1
AUDIT SCOPE	1
PRIOR AUDIT FINDINGS	2
Report of Actions Taken on Prior Audit Findings	2
Resolved Audit Findings	3
Partially Resolved Audit Findings	3
AUDIT CONCLUSIONS	3
Wine in Grocery Stores	3
Finding 1 – The commission’s management did not establish written policies and procedures governing the Wine in Grocery Stores program and did not establish effective controls over the program’s licensing process	5
Background Checks for Permit Applicants	11
Finding 2 – Commission management did not ensure that system program changes worked as intended and did not update the background check policy to reflect current practice	15
Direct Shipper and Non-resident Seller Licenses	19
Finding 3 – As noted in the prior audit, commission management did not establish adequate licensing policies over direct shipper and non-resident seller licenses, did not ensure licensees were notified of expiring licenses, and did not ensure that licenses were closed upon expiration as required in statute	21
Confiscated Evidence	27
Observation 1 – Although commission management improved their internal controls over disposed evidence, management did not perform adequate supervisory review of case files and did not maintain evidence disposition reports as required	32
Conflicts of Interest	33
Commission Structure and Responsibilities	34
Information Systems	36

TABLE OF CONTENTS (continued)

	<u>Page</u>
Finding 4 – Commission management did not provide adequate internal controls in three specific areas	37
Staff Turnover	38
Observation 2 – The commission experienced high employee turnover during the last four years	39
APPENDICES	41
Appendix 1 – Internal Control Significant to the Audit Objectives	41
Appendix 2 – Commission’s Organizational Structure	45
Appendix 3 – Wine in Grocery Stores Application Documentation Requirements	48
Appendix 4 – Expenditures and Revenues for Fiscal Years 2018 to 2019	49
Appendix 5 – <i>Tennessee Code Annotated</i> and <i>Rules of the Tennessee Alcoholic Beverage Commission</i> on the Wine in Grocery Stores Program	51
Appendix 6 – Wine in Grocery Stores On-site Inspection Checklist	53
Appendix 7 – <i>Tennessee Code Annotated</i> for the Tennessee Alcoholic Beverage Commission’s Direct Shipper’s License	54
Appendix 8 – Management’s Comment to Observation 1	57

INTRODUCTION

AUDIT AUTHORITY

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 4-29-242, the commission is scheduled to terminate June 30, 2021. 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.

BACKGROUND

Organization and Statutory Responsibilities

The Tennessee Alcoholic Beverage Commission is responsible for regulating Tennessee's alcoholic beverage industry, excluding low-gravity beer/malt beverages, which are regulated by county and municipal beer boards (Section 57-1-101 et seq., *Tennessee Code Annotated*). State statutes require manufacturers, distilleries, wineries, importers, brokers, wholesalers, and retailers to obtain commission-issued licenses, including annual licenses for liquor retailers, liquor wholesalers, wineries, liquor-by-the-drink establishments, direct shippers, and non-resident sellers. (For further information, see **Appendix 2** for the commission's structure and organizational chart.)

The Tennessee Alcoholic Beverage Commission's mission is to protect the public through regulation, education, and enforcement of Tennessee's alcoholic beverage laws.

AUDIT SCOPE

We have audited the Tennessee Alcoholic Beverage Commission for the period April 1, 2016, through April 30, 2020. Our audit scope included a review of internal controls and compliance with laws, regulations, policies, and procedures in the following areas:

- wine in grocery stores;
- background checks for permit applicants;
- direct shipper and non-resident seller licenses;
- confiscated evidence;
- conflicts of interest;

- commission structure and responsibilities;
- information systems; and
- staff turnover.

Commission management is responsible for establishing and maintaining effective internal control and for complying with applicable laws, regulations, policies, and procedures.

We provide further information on the scope of our assessment of internal control significant to our audit objectives in **Appendix 1**. In compliance with generally accepted government auditing standards, when internal control is significant within the context of our audit objectives, we include in the audit report (1) the scope of our work on internal control and (2) any deficiencies in internal control that are significant within the context of our audit objectives and based upon the audit work we performed. We provide the scope of our work on internal control in the detailed methodology of each audit section and in **Appendix 1**, and we identify in our audit conclusions, findings, and observations any internal control deficiencies significant to our audit objectives.

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. Although our sample results provide reasonable bases for drawing conclusions, the errors identified in these samples cannot be used to make statistically valid projections to the original populations. We present more detailed information about our methodologies in the individual sections of this report.

We conducted our audit in accordance with generally accepted government auditing standards, which 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.

PRIOR AUDIT FINDINGS

REPORT OF ACTIONS TAKEN ON PRIOR AUDIT FINDINGS

Section 8-4-109(c), *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 prior audit report was dated November 2016 and contained four findings. The Tennessee Alcoholic Beverage Commission filed its report with the Comptroller of the Treasury on May 31, 2017. We conducted a follow-up of the prior audit findings as part of the current audit.

RESOLVED AUDIT FINDINGS

The current audit disclosed that the commission resolved the previous audit findings concerning

- adequate conflict-of-interest policies and forms; and
- maintaining proper controls over issuing permits and reconciling background checks requested and paid.

PARTIALLY RESOLVED AUDIT FINDINGS

The current audit disclosed that the commission partially resolved two previous audit findings:

- *The commission's overall lack of internal controls over confiscated evidence*
The commission still needs to address internal controls for evidence disposition reports as required by policy (see **Observation 1**).
- *The commission's lack of a documented approval for direct shipper license applications*
We found that management still did not maintain adequate policies of the licensing process for direct shipper and non-resident licenses, nor did management ensure that expired licenses were closed upon expiration (see **Finding 3**).

TENNESSEE ALCOHOLIC BEVERAGE COMMISSION AUDIT FINDINGS

November 2016 Performance Audit

4 findings

September 2020 Performance Audit

Resolved 3 of 4 prior audit findings in full or in part, with one condition dropped to an observation

Repeated 1 prior audit finding

Reported 3 new findings

AUDIT CONCLUSIONS

WINE IN GROCERY STORES

In 2014, the General Assembly enacted the Sale of Wine in Retail Food Stores Act, commonly known as the “wine in grocery stores” law, codified in Section 57-3-803 et seq., *Tennessee Code Annotated*. Section 57-3-803(a) required the Tennessee Alcoholic Beverage Commission to implement the Wine in Grocery Stores (WIGS) program on July 1, 2016. While statute allowed the commission to accept applications from retail food stores and to begin processing applications before July 1, 2016, retail food stores were not permitted to begin wine sales before that date. As of February 12, 2020, the commission has issued 794 WIGS licenses.

Regulatory Licensing and Permitting System

Since the prior audit, the commission has replaced its paper-based licensing and permitting process by contracting with a vendor¹ to purchase and implement an electronic system. The commission's new Regulatory Licensing and Permitting System (RLPS) phased in traditional applications, licenses, and permits in January 2018, and WIGS came online in March 2018.

Licensing Process

Original and Renewals

Applicants seeking either licenses or permits submit their application in RLPS and upload any required documentation. After the commission receives an application for licensure, along with the \$400 application fee, commission staff perform a preliminary review to ensure that the application contains all required documentation. (For a complete list of documentation requirements in Section 57-3-8, *Tennessee Code Annotated*, and Chapter 0100-11 of the *Rules of the Tennessee Alcoholic Beverage Commission*, see **Appendix 3** of this report.)

When staff find missing information during the application review, they contact the applicant to communicate what documentation is needed and note the nature of the missing documentation in a comment section in RLPS. In addition, during the preliminary application review process, a special agent performs an on-site inspection of the retail food store. (See **Appendix 6** of this report for the inspection checklist.) After both parts of the review process are complete, the commission's legal staff perform the final review and approve² or deny the application in RLPS. For approved applications, RLPS generates an email to the approved applicant with instructions for paying the \$1,250 annual license fee. Once the commission staff confirm the applicant has remitted the license fee, staff approve the applicant's license and RLPS automatically generates the license or permit. The applicant can then print the license or permit from RLPS.

Licensee Fees for Clerk Training

Approximately a month before the establishment's license expires, RLPS generates an email to the licensee requesting a certified clerks report, which lists each certified clerk employed by the establishment. Upon receiving the certified report, the commission staff determine the appropriate fees owed by the establishment and bill the licensee through RLPS. The required fees cover the Responsible Vendor Training Program³ for the licensee's certified clerks.

¹ The commission contracted with Accela, Inc. to purchase and implement the licensing system.

² Commission members delegated approval authority to legal staff on June 28, 2016, for a limited period and extended the delegation until August 29, 2017, when they permanently delegated approval to legal staff.

³ Section 57-3-818(b), *Tennessee Code Annotated*, requires that each retail food wine licensee and retailer participate in the Responsible Vendor Training Program.

Audit Results

1. Audit Objective: Did commission management have sufficient written policies and standard operating procedures for the Wine in Grocery Stores (WIGS) program?

Conclusion: Based on our review, management did not establish written policies and procedures for the WIGS program. See **Finding 1**.

2. Audit Objective: Did commission management ensure that staff appropriately issued licenses to sell wine in grocery stores by obtaining all necessary documentation, as described by statute and commission rules?

Conclusion: Based on our testwork, management did not ensure that staff issued licenses in compliance with statute and commission rules. Specifically, staff did not ensure the licensees were located within a municipality with a full-time police or sheriff's department; acknowledged applicable rules and regulations; had submitted the corporate charter/articles of organization; or had updated their citizenship declarations. See **Finding 1**.

Methodology to Achieve Objectives

To assess management's design, implementation, and operating effectiveness of internal controls as they relate to the WIGS program, we met with the commission legal counsel to gain an understanding of WIGS controls. We reviewed Title 57, Chapter 3, of *Tennessee Code Annotated*, and Chapter 0100-11 of the *Rules of the Tennessee Alcoholic Beverage Commission*.

To determine whether management ensured that staff appropriately obtained all required licensure documentation, verified requirements, and documented their approval before issuing licenses, we obtained a population of 782 WIGS licenses that were issued through RLPS from March 9, 2018, through February 12, 2020. We selected and tested a nonstatistical, random sample of 25 WIGS licenses issued to review all license-related documentation. Because the sample represented licenses that started as paper applications that were then completed through RLPS, we selected 1 additional license haphazardly so we could review a license that fully originated in and was completed in RLPS. We performed internet searches to determine if each county or municipality had a full-time police or sheriff's department and reviewed the commission's *Tennessee Referendum Guide* to determine if the referendum had passed.

Finding 1 –The commission's management did not establish written policies and procedures governing the Wine in Grocery Stores program and did not establish effective controls over the program's licensing process

Overall Condition, Criteria, and Effect

Management of the Tennessee Alcoholic Beverage Commission is responsible for establishing internal controls over all the commission's programs; however, we found that

management has not yet developed written policies and procedures governing the program processes or implemented the necessary controls to ensure compliance with the Wine in Grocery Stores (WIGS) state statute and program rules, resulting in noncompliance with both.

The U.S. Government Accountability Office's *Standards for Internal Control in the Federal Government* (Green Book) sets internal control standards and is considered best practice for nonfederal entities. Green Book Principle 10.02, "Response to Objectives and Risks," states,

Management designs control activities in response to the entity's objectives and risks to achieve an effective internal control system. Control activities are the policies, procedures, techniques, and mechanisms that enforce management's directives to achieve the entity's objectives and address related risks.

Green Book Principle 10.03, "Design of Appropriate Types of Control Activities," states that management should divide key duties among different people to reduce the risk of error, misuse, or fraud. Principle 12.02, "Documentation of Responsibilities Through Policies," states, "Management documents in policies the internal control responsibilities of the organization." Furthermore, Principle 12.03 explains that management should document their responsibility for the objectives and related risks of operational processes, and that each unit should document its policies to allow management to effectively monitor the control activity.

Condition, Criteria, Cause, and Effect

Lack of Program Policies, Procedures, and Documentation

Lack of Documentation for Establishment Locations

Management could not provide evidence or documentation to support that they complied with statute to ensure that they issued licenses only to establishments located within a county or municipality that

- had a full-time police or sheriff's department as required by Section 57-3-803(a), *Tennessee Code Annotated*, and
- had passed the necessary referendum authorizing the sale of wine at retail food stores by local option election, pursuant to Section 57-3-801, *Tennessee Code Annotated*.

Section 57-3-803(a), *Tennessee Code Annotated*, states,

Notwithstanding any other law to the contrary, an additional class of licenses allowing the sale of wine at retail food stores is created. These licenses shall be known as "retail food store wine licenses" and shall be issued by the alcoholic beverage commission; provided, that licenses shall only be issued to a retail food store located in a county or municipality that has authorized the sale of wine at retail food stores by local option election pursuant to 57-3-801 and has full-time law enforcement through a police or sheriff's department.

We tested a sample of 26 issued licenses for the WIGS program, and based on our discussion with the commission’s legal counsel, he did not know how staff verified whether a county or municipality had a full-time police or sheriff’s department. He also contacted the commission’s former Executive Director to ask him; however, the former Executive Director could not recall how this licensing requirement was met. For each license in our sample of 26 issued licenses, we performed additional procedures to ensure that the establishment’s county or municipality had met the referendum requirement and had a full-time police or sheriff’s department. Specifically, we performed internet searches to determine if each county or municipality had a full-time police or sheriff’s department and reviewed the commission’s *Tennessee Referendum Guide* to determine the referendum had passed.

Lack of Documentation and Procedures for Signed Acknowledgements

Chapter 0100-11.01(1)(a) of the *Tennessee Alcoholic Beverage Commission’s Rules for Sales of Wine at Retail Food Stores* states,

Applications shall be submitted to the [Tennessee Alcoholic Beverage Commission] Headquarters offices in Nashville, Tennessee or on-line at the [Tennessee Alcoholic Beverage Commission] website. In addition to the application and other forms provided by the Commission, the following data, written statements, affidavits, evidence or other documents must be submitted in support of an application for a retail food store license: . . .

11. Acknowledgement of the rules and regulations.

For 17 of the 26 licensees we tested (65%), commission management did not ensure that staff obtained an acknowledgement of the applicable rules and regulations signed by the licensee. Additionally, management has not developed written instructions for staff to follow to ensure licensees submit all required documentation. According to the commission’s legal counsel, the special agent who inspects the retail store obtains the signed acknowledgement of the rules and regulations during the inspection. At the end of the inspection, the special agent provides the licensee an inspection report, which includes information on the WIGS program’s rules and regulations, and the licensee provides the special agent with an electronic signature. However, the special agents did not upload copies of the inspection report in RLPS; therefore, we could not determine if the special agents made the licensees aware of the rules and regulations.

Without comprehensive policies and procedures and effective mitigating controls over the WIGS program, the commission risks not complying with statute and rules and has issued licenses without evidence that the licensees acknowledged program rules and regulations.

Noncompliance With Rules

From our review of the *Rules of the Tennessee Alcoholic Beverage Commission*, Chapter 0100, and specifically Rule 0100-11-.01, “Rules for Sales of Wine At

“[T]he commission . . . has issued licenses without evidence that the licensees acknowledged [WIGS] program rules and regulations.”

Retail Food Stores – Licenses and Permits,” effective November 2017, we found that management has not updated the rule to incorporate the commission’s system changes as a result of the implementation of RLPS. In addition, although the current rule requires the commission to obtain specific documentation from the applicant, we found that the commission has not established written policies and procedures to ensure management and staff complied with these rules. Specifically, based on our review, we determined that commission staff were not obtaining the required documentation, as outlined in **Table 1**.

Table 1
Comparison of the Commission’s Rules to Current Practice for
the Wine in Grocery Stores Program

Rules Requirement	Current Practice
Applicants must submit a corporate charter or articles of organization.	Management stopped requiring applicants to submit the corporate charter or articles of organization and allowed for alternate documentation that did not conform to the rules.
Applicants must submit completed declarations of citizenship.	Management did not require staff to obtain updated citizenship declarations for license renewals because management believe applicants were only required to provide the declarations for new applications, not for renewals.

Source: Rules documentation required obtained from the *Rules of the Tennessee Alcoholic Beverage Commission*, Chapter 0100-11-.01-(1)(a). Current practice obtained from walkthrough with commission staff.

Written rules do not serve their intended purpose when they are outdated, incomplete, and/or unused. By not having updated rules that reflect current practice, commission management risks that staff will not obtain all required documentation, which may result in issuing licenses to ineligible applicants.

Commission’s Risk Assessment

Given the problems identified during our fieldwork, we reviewed the commission’s December 2019 Financial Integrity Act Risk Assessment and determined that management did not properly assess the WIGS program for any potential risks of errors, fraud, waste, abuse, fiscal and operational risks, and noncompliance with state law or other regulatory requirements.

“[M]anagement did not properly assess the WIGS program for any potential risks of errors, fraud, waste, abuse, fiscal and operational risks, and noncompliance with state law or other regulatory requirements.”

Commission management is responsible for identifying, analyzing, and responding to risks over the WIGS program. The U.S. Government Accountability Office’s *Standards for Internal Control in the Federal Government* (Green Book) sets internal control standards and is considered best practice for nonfederal entities. Green Book Principle 7.01, “Identify, Analyze, and Respond to Risks,” states,

Management should identify, analyze, and respond to risks related to achieving the defined objectives.

Attributes

The following attributes contribute to the design, implementation, and operating effectiveness of this principle:

- Identification of Risks
- Analysis of Risks
- Response to Risks

Recommendation

The Executive Director should ensure that management formalize written policies and procedures for the Wine in Grocery Stores program. In addition, the Executive Director should ensure management and staff follow statutes and rules. Commission members and the Executive Director should review statute and the *Rules of the Tennessee Alcoholic Beverage Commission* for program relevance and applicability and should seek changes when necessary.

Management should perform the risk assessment to identify risks associated with operations, fiscal management, fraud, waste, abuse, and errors.

Management should implement effective controls to address the risks noted in this finding. Based on their own risk assessment, management should assign staff to be responsible for ongoing monitoring of the risks and mitigating controls, and take action if deficiencies occur.

Management's Comment

We concur in part.

Lack of Documentation for Establishment Locations

We concur. TABC has allocated resources for the last three years to research and update the list of counties and municipalities that have passed a referendum authorizing the sale of wine at retail stores. TABC legal counsel verifies the existence of these referendums for each wine in grocery store (WIGS) application. TABC legal counsel refers and checks this list so frequently that it has not been necessary to check it each time a new application is submitted. The Commission is not aware of ever approving a license in a jurisdiction that has not passed the appropriate referendum. TABC recognizes that this staff confirmation of the referendum is not a verifiable control that can be tested by auditors, but that fact does not mean that (1) the TABC did not have an adequate process for confirming the referendum, (2) the staff confirmation was not performed, or (3) any licenses were issued incorrectly. The TABC will be adding an acknowledgment question to the application process so that documentation of the existence of the referendum will be an application control question for the applicant. The applicant will answer the question in the application process. Adding this step will provide a documented control of the customer

acknowledging that the referendum is in place and the TABC will compare the referendum to the list maintained by legal staff as before. We expect this to be implemented by the end of the second quarter of this fiscal year.

The audit noted the TABC did not establish control procedures to document that the licensees are located in areas that have either a full-time sheriff or police department. T.C.A. 57-8-303 requires that a retail food store licensee must be located in areas that have “full-time law enforcement through a police **or** sheriff’s department.” The Tennessee Constitution requires every county to elect a Sheriff. Article VII Tennessee Constitution. The Tennessee Attorney General has opined that “[t]he sheriff has the same duty to patrol and enforce the laws inside an incorporated area of a county without a city police force that he or she has with respect to unincorporated areas of the county.” Opinion No. 08-134. It is a legal impossibility for a licensee to be located in an area within the state that does not meet the requirements of T.C.A. 57-8-303. To respect the statutory requirement the TABC will be adding an acknowledgment question to the application process. This question will provide documentation from the applicant of the presence of a sheriff or local police department. This addition to the application process will satisfy the controls needed to verify the existence of a law enforcement presence. We expect this to be implemented by the end of the second quarter of this fiscal year.

Lack of Documentation and Procedures for Signed Acknowledgements

We concur. At the time of the audit, a TABC Special Agent was requiring the licensee to acknowledge the Rules and Regulations by providing an electronic signature on the Agent’s laptop at in-person inspections. The control issue was that in some cases this signature was captured, but the text of the rules acknowledgment was not attached with the signature. While the rules acknowledgment is standard language that did not vary among applications, the TABC acknowledges this concern and has already implemented an acknowledgment of rules and regulations across all license and permit types into the online application process which will provide documented proof of these controls that were lacking in the past. This was implemented before the end of the Sunset Audit.

Noncompliance with Rules

We concur in part. We concur that the TABC Policy Manual needs to be updated to include updated policies regarding retail food store licensure. The TABC has a Regulatory Licensing & Permitting System (RLPS) Operational Guide that all staff receive training on that illustrates step by step guides on how to perform the tasks required to review WIGS license and renewal applications. The TABC recognizes that this is not a substitution for a policy. The TABC Assistant Director and Legal Counsel were already in the process of writing a policy for WIGS before the audit ended. We expect this to be implemented by the end of the second quarter of this fiscal year.

We do not concur with the determination that the commission staff was not obtaining the required documentation as outlined in Rule 0100-11-.01. Rule 0100-11-.01 only applies to new applications for a retail food store and not to renewal applications. While we typically asked applicants to submit everything required of a new application when they first submitted a renewal application in the RLPS system, so that as much of this documentation would be in the RLPS

system as possible, the resubmission of this information was not required by this rule, and this request of the applicant was only made as a matter of convenience to have as much documentation as readily accessible as possible. Similarly, some documents like the corporate charter and operating agreement for large chains like Kroger were typically provided in what was internally called master company records, and not necessarily in each separate application, as this document would apply to all applications made by such large chains. The TABC agrees however that this rule could be clarified to make more clear that this only applies to new applications and that certain documents like the corporate charter/operating agreement need to be provided for each licensee, but not necessarily with each application. The TABC will be submitting updates to the Rules and Regulations to make these clarifications. These submissions are in the process with intentions to begin this process in the second quarter of this fiscal year.

Commission's Risk Assessment

We concur. TABC leadership submits the Financial Integrity Act Risk Assessment annually each December with input from senior leadership. The 2019 Risk Assessment did address concerns regarding fraud, waste, and abuse concerning the work performed by staff inputting data into the system and unauthorized changes made to the systems. These two areas of risk refer to TABC monitoring of staff RLPS usage and being accountable for the work. TABC acknowledges that further explanation of controls is needed to cover the risks associated with RLPS and WIGS not provides adequate mitigating controls for the WIGS program. However, the TABC Internal Audit's Risk Assessment addressed these issues before the audit. The risks should have been more specific in terms of RLPS and the controls in place and the 2020 Financial Integrity Act Risk Assessment will reflect the controls in place at TABC in a more detailed and specific manner which we expect to complete in the second quarter of this fiscal year.

BACKGROUND CHECKS FOR PERMIT APPLICANTS

The Tennessee Alcoholic Beverage Commission is authorized to issue distiller's representative permits, wholesaler employee permits, and server permits⁴ in accordance with the requirements in Section 57-3-702, *Tennessee Code Annotated*. Sections 57-3-703 and 57-3-704 establish requirements for individuals applying for wholesale employee and server permits, including demonstrating that the applicant has not been convicted of certain felonies or of any crime involving the sale or distribution of alcohol within the previous eight years. Pursuant to Section 57-3-706, the commission may conduct a criminal record review of any applicant for an employee or server permit to ensure the applicant's compliance with statutory requirements; to do so, the commission should use "the best available means to conduct this investigation." The commission's permit application process through the Regulatory Licensing and Permitting System (RLPS) requires applicants to state whether they have been convicted of any crimes—both alcohol related and others—and to list any such crimes before submitting their application. Applicants who are approved for permits receive a unique permit number generated and recorded by RLPS.

⁴ A distiller representative is an employee of a distillery that produces and supplies alcoholic beverages for commercial purposes. A wholesale employee is a representative or salesperson of a wholesale licensee with a permit for wholesale alcohol sales. A server is authorized to serve beer, wine, or other alcoholic beverages in a licensed establishment.

The Fresh Start Act (2018 Public Chapter No. 793) altered both the substance and procedure of the commission’s review of initial applications and renewal applications for the licenses and permits that the commission regulates. Under Section 62-76-104(b)(1), *Tennessee Code Annotated*, a licensing authority such as the commission

shall not deny an application for a license, certificate, or registration, or refuse to renew a license, certificate, or registration due to a prior criminal conviction that does not directly relate to the applicable occupation, profession, business, or trade.

Commission Policy 1-3-26, “Background Checks for Permits,” requires random, statewide background checks on applicants for wholesale salesperson’s permits, wholesale employee permits, and server permits; and requires the commission

“Commission Policy . . . requires random, statewide background checks on applicants for wholesale salesperson’s permits, wholesale employee permits, and server permits.”

“to provide a clear, orderly, and random method in order to check the criminal background of permit applicants to ensure the applicable requirements for the permits are properly met.” The policy describes the procedures commission staff must complete to request, receive, and evaluate the Tennessee Bureau of Investigation’s (TBI) background check on the permit applicant.

To accomplish the selection process, management has designed the RLPS program code to select certain applications based on a predetermined number of each permit type, which flags the selection for a background check. Every 100th server permit ending in the number 89 is flagged and cannot be approved until the staff have requested a background check from TBI and evaluated the results. Staff perform a search of applications flagged for a background check to initiate the process with TBI. For wholesale salespersons and wholesale employees, the system was set to flag every permit number ending in 37 and 89.

Background Check Fee Process

Once a permit applicant is selected for a background check, commission staff forward the applicant’s personal information to the commission’s Chief Law Enforcement Officer or his designee, who forwards the applicant’s information to TBI. TBI provides the results to the Chief Law Enforcement Officer or his designee, who approves or denies the application in RLPS. When the results include potentially disqualifying information, the Executive Director or his designee may also review the results to determine whether an application is approved or denied.

TBI charges the commission \$29 for each background check performed, and TBI invoices the commission monthly. The Director of Administrative Services receives TBI’s invoice, which includes the Tennessee Open Records Information System⁵ (TORIS) transaction number, the permit applicant’s name, and the date of the corresponding background check. The Law Enforcement Administrative Assistant reviews the invoice and verifies that TBI’s monthly invoice includes the applicant on the request log and that the TORIS transaction number matches the

⁵ The Tennessee Open Records Information System is TBI’s central repository, providing public access to criminal history information based only on those records resulting from an arrest that occurred in the State of Tennessee.

applicant's name. Once the Law Enforcement Administrative Assistant reviews the invoice, she initials and dates it and returns it to the Director of Administrative Services with the approval to pay TBI.

Results of Prior Audit

In the commission's November 2016 performance audit report, we identified inadequate controls over issuing permits and performing background checks. We found that management did not establish adequate procedures to reconcile permit numbers; did not ensure that staff assigned each permit number to only one permit applicant and that each permit applicant only had one permit number; and did not ensure that staff recorded permit numbers accurately in the logs. We also noted multiple problems relating to background checks.

Management concurred with the finding and stated they were in the process of implementing a new information system, RLPS, which would contain the proper controls to correct the finding. A permit would only be issued through RLPS after an applicant had been fully vetted and approved by staff, and RLPS would also prevent the issuance of duplicate permit numbers. Management also stated that they would regularly request a random sample of background checks for wholesale and server permits, and that they would reconcile all TBI invoices to a newly designed background check request log. Background check results would be maintained in the applicant's file or electronically uploaded to the applicant's file in RLPS once the system was deployed.

Audit Results

1. Audit Objective: In response to the prior audit finding, did management ensure compliance with the commission's background check policy for distiller permits?

Conclusion: Based on our testwork of background checks for distiller permits, management ensured compliance with the commission's policy.

2. Audit Objective: In response to the prior audit finding, did commission management ensure that staff maintained a record of background checks requested, reconciled the background check results to the requests, and paid for the background checks performed?

Conclusion: Based on our review, management maintained a record of requested background checks, reconciled the background check results to the requests, and paid for background checks.

3. Audit Objective: In response to the prior audit finding, did commission management have a process to issue unique permit numbers, to record the permits, and to reconcile permit numbers issued to the permit numbers commission employees issued to the public to ensure that each new alcohol permit holder received a unique permit number?

Conclusion: Based on our analysis and testwork of issued permit numbers, the permit issuance function is now automated and centralized through RLPS. Management ensured RLPS issued unique permit numbers and accurately recorded them. Therefore, there was no need for manual reconciliation.

4. Audit Objective: Did commission management and staff maintain up-to-date background check policies and procedures and ensure background checks were performed for alcohol server permits, wholesaler representatives, and wholesaler employees?

Conclusion: Based on our review, we found that management did not maintain up-to-date policies and procedures for the commission's background check policy. Additionally, we learned that management's selection process for background checks excluded wholesaler permits due to a programming error in RLPS that went undetected until we notified management during the audit. See **Finding 2**.

Methodology to Achieve Objectives

To assess management's design, implementation, and operating effectiveness of internal controls as they relate to background checks for permit approvals/denials, we interviewed the Assistant Director, the Law Enforcement Administrative Assistant, and the Director of Administrative Services. We performed walkthroughs of the procedures to gain an understanding of internal controls for background checks, background check invoice reconciliations to background check results received from TBI, and the issuance of permit numbers. We obtained and reviewed state statute, the commission's policy and procedures, and the Fresh Start Act of 2018 to gain an understanding of the commission's background check requirements.

We obtained a population of 58,639 server permits; 1,399 wholesale permits; and 1,328 supplier permits issued from February 1, 2018, through February 19, 2020. We then analyzed the populations to determine if staff issued each permit holder a unique permit number. This analysis was performed by a State Audit information systems auditor using Audit Command Language software, by indexing and then summarizing the population of permit numbers. The results were then filtered to count any numbers greater than one to determine if any permit numbers were duplicated.

We obtained a population of 661 background checks that the commission requested for server permit applications from January 1, 2018, through February 12, 2020. We filtered the population to include only those background checks performed after February 1, 2018, the date of the implementation of RLPS, for a population of 647 background checks. We selected a nonstatistical, random sample of 60 background checks to determine if the commission followed policy; accurately documented the results in the applicant's record; approved or denied the appropriate individual based on the results of the background check; recorded the correct invoice number on the log and paid the invoice only once; reconciled the invoice submitted to the

background check requested by documenting a review and approval on the invoice; and issued each applicant a unique permit number.

Finding 2 – Commission management did not ensure that system program changes worked as intended and did not update the background check policy to reflect current practice

The Tennessee Alcoholic Beverage Commission did not establish internal controls to ensure that system program changes worked as intended for selecting license applicants for background checks and did not update its written policies and procedures for background checks after implementing its new licensing and permit system. As a result, we found that background checks on wholesale permit applicants were not performed in accordance with the commission’s policy. With the implementation of the Regulatory Licensing and Permitting System (RLPS) in January 2018, the commission’s Information Technology staff were responsible for developing a program code in RLPS to select certain applications of each permit type and flag them for background checks.

“[B]ackground checks on wholesale permit applicants were not performed in accordance with the commission’s policy.”

Condition and Cause

Inadequate Review of System Program Changes

According to the commission’s Executive Director, the commission’s Internal Auditor and General Counsel discovered in 2019 that commission staff failed to ensure that wholesale permit applicants were included in the commission’s selection process for background checks. According to the commission’s Information Technology Manager, the program change was made to include wholesale permits in June 2019, almost a year and a half after management implemented the new system. The commission’s management were unaware that the program code fix attempted in June 2019 did not work as intended until we brought it to their attention in February 2020.

According to the Information Technology Manager, the program change was not tested to ensure it worked because applications for those permits are random and infrequent. Additionally, staff did not expect that an application ending in the applicable numbers would be flagged for selection for some time, so the Information Systems staff relied on system users to monitor the system’s success. However, staff assigned to process the background checks did not realize the system was not flagging each type of applicant as intended.

Management’s Actions After We Identified the Problem

When we notified management in February 2020, management requested the background checks on the seven wholesale salesperson and employee permit applicants who should have been flagged after the IT management attempted to correct the program code selection process in June 2019. The results of the background checks showed that the applicants had no prohibitive criminal history. Although management did not find that they had issued improper permits, we

believe management should continue to ensure the system is flagging applicants as required by policy.

Based on additional follow-up with commission management, they stated that the staff have now created, tested, and implemented on March 4, 2020, a corrective action for the system to select the correct applicant types. We will audit the latest corrective action during our next audit of the commission.

Outdated Background Check Policy and Procedures

From our review of the commission’s policy and procedures for “Background Checks for Permits,” which was last updated in February 2015, we found that management had not incorporated changes as a result of the implementation of RLPS. See **Table 2**.

Table 2
Comparison of Policy to Current Practice for the
Commission’s Background Checks for Permits

Policy States	Current Practice
“On an annual basis, the Executive Director shall determine the procedure for choosing a random number of applicants on whom background checks will be performed.”	RLPS automatically chooses the applicants for a background check based on a systematic ⁶ sampling method. Although the policy calls for randomly selected background checks, the process used is actually a systematic method of selection since a pre-determined number is chosen.
“If an applicant is selected for the random background check, he or she will be notified of his or her selection. A written notice will be handed to applicants who applied in-person and the written notice will be mailed to the applicants who applied by mail or whose application was delivered by an Agency certified trainer.”	Staff no longer notify the permit applicant if staff selected the applicant for a background check.
“The original application and the permit fee will be processed by the Agency, pending the results of the background check. The application, receipt and permit card will be kept together pending the results of the background check.”	The information is now maintained electronically in RLPS. Staff do not issue the permit card until they approve the applicant’s permit.
“Upon receipt of the background check results from the TBI, the Agency employee will attach the results of the background check to the applicable permit application.”	Staff maintain background check results on a shared computer drive and maintain the permit application in RLPS.
“If the applicant is eligible for the permit for which he or she applied, an Agency employee will mail the permit to the address listed on the application.”	The permit is no longer mailed to the applicant. Once approved for a permit, the applicant must go online in RLPS and print the permit.

Source: Procedure steps obtained from commission Policy 1-3-26, “Background Checks for Permits.” Current practice obtained from walkthroughs with commission staff.

⁶ Systematic sampling involves selecting items from an ordered population using a sampling interval, which means that every “nth” data sample is chosen in a large data set.

Management did not provide a reason as to why they did not update the policies and procedures; however, management stated that they would review and revise policies to reflect the commission's current procedures.

Commission's Risk Assessment

Given the problems we identified during our fieldwork, we reviewed the commission's December 2019 Financial Integrity Act Risk Assessment and determined that management did not properly assess potential risks within the background check process. Management's risk assessment should consider all potential risks associated with fiscal and operational risks, including the risk of errors, fraud, waste, abuse, and noncompliance with state law or other regulatory requirements. As identified in our audit work, we found risks within system controls and compliance with policy requirements. Without assessing all potential risks, management cannot be assured that an internal control is in place that will prevent the commission from not achieving its mission and objectives.

“[M]anagement did not properly assess potential risks within the background check process.”

Criteria and Effect

Best practices in the National Institute of Standards and Technology's Special Publication 800-53 (Rev. 4), *Security and Privacy Controls for Federal Information Systems and Organizations*, Section CM-3(2), “Configuration Change Control | Test/Validate/Document Changes,” state that the organization should test, validate, and document changes to the information system before implementing the changes on the operational system.

The U.S. Government Accountability Office's *Standards for Internal Control in the Federal Government* provides guidance to management for the periodic review of control activities. According to Principle 12, “Implement Control Activities,”

12.05 Management periodically reviews policies, procedures, and related control activities for continued relevance and effectiveness in achieving the entity's objectives or addressing related risks. If there is a significant change in an entity's process, management reviews this process in a timely manner after the change to determine that the control activities are designed and implemented appropriately.

The commission's control environment is weakened when system program changes are not tested first to ensure those changes will work in the operation environment.

Written policies and procedures do not serve their intended purpose when they are outdated, incomplete, and unused. When management does not regularly reevaluate and update written policies, these documents do not reflect the changes in personnel, processes, systems, or regulations. Furthermore, when management does not provide for and set expectations for staff to follow policies and procedures, they cannot ensure that staff are performing their work as intended and that the commission's mission and organizational objectives are met.

By not having a policy that reflects current practice, commission management risks that staff will not perform the background checks as prescribed by policy, which could result in an ineligible applicant receiving a permit.

Recommendation

The Executive Director should ensure that management immediately implement and document appropriate information system controls for program changes. Commission management should also update their policy to reflect current practices for background checks. Management should perform an adequate risk assessment to identify risks associated with fraud, waste, abuse, noncompliance, error of the commission's operations, and mission. Management should then implement effective controls to address the risks noted in this finding and based on an adequate risk assessment. As necessary, management should assign staff to be responsible for ongoing monitoring of the risks and mitigating controls, and take action if deficiencies occur.

Management's Comment

We concur.

Inadequate Review of System Program Changes

Before the start of this audit, the Commission identified this problem and began implementing a solution which was put into effect before the completion of this audit. TABC was not pulling wholesale permit applicants for background checks. TABC noticed this error in June 2019, and Information Technology (IT) staff implemented a program update to correct the exclusion. Server permit applications outnumber wholesale employee permits significantly, and with there being fewer wholesale employee permits a year, TABC staff did not notice that the program change malfunctioned. Upon notification from the Comptroller's staff that there were no wholesale employee background checks in the sample, TABC's Information Technology Manager reviewed the program update and resolved the issue. The program update was corrected before the ending of the audit, and the wholesale employee permits are now subject to the same background checks as server permits. The TABC Information Technology Manager and Internal Auditor have instructed staff to notify both parties as the system selects wholesale employee permit applications for background checks to ensure that this update was successful as the system tests the controls in place. This has been resolved.

Outdated Background Check Policy and Procedures

The Background Checks for Permits policy was last updated in 2015 before RLPS and technology updates increased the efficiency and productivity of TABC staff. Before RLPS the process for pulling applications for background checks took ninety (90) days from application selection to completion of the background checks; with RLPS and other technology now used by the TABC, the process for a background check takes significantly less time, typically less than twenty-four (24) hours. As a result of these changes the Background Check Policy is outdated and no longer reflects practical necessities. The TABC affirms that there was no adverse impact on the applicant or citizen by the lack of a policy update. TABC recognizes a need for a new Background Check policy which will update the selection process in place, remove unneeded notification

procedures, and establish the newest procedures for background checks. The changes made to the policy have greatly decreased the time and labor involved in completing the background check and improved the process for the applicants involved. We expect this to be implemented by the end of the second quarter of this fiscal year.

Commission's Risk Assessment

We concur. TABC leadership submits the Financial Integrity Act Risk Assessment annually each December with input from senior leadership. The 2019 Risk Assessment did not specify all of the potential risks and mitigating controls that were in place. TABC will correct this error with the 2020 Financial Integrity Act Risk Assessment by listing the risks involved in the background check process and the mitigating controls that TABC has implemented. We expect this to be implemented by the end of the second quarter of this fiscal year.

DIRECT SHIPPER AND NON-RESIDENT SELLER LICENSES

State statute generally requires alcohol-related businesses to be located within the state borders in order to conduct business in Tennessee; two exceptions include licensed direct shippers and non-resident sellers.

Direct Shipper and Non-Resident Seller Defined

Manufacturers and importers are generally only permitted to distribute alcoholic beverages to wholesalers licensed in Tennessee; however, statute 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* (see **Appendix 7**), authorizes direct shipping of wine by common carrier and requires a manufacturer or importer to obtain a direct shipper license from the Tennessee Alcoholic Beverage Commission.

According to Section 57-3-602(a), *Tennessee Code Annotated* (see **Appendix 7**), 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.

Current License Process for Direct Shippers and Non-Resident Sellers

Direct shipper licenses expire 12 months from the date the license is issued. All non-resident seller licenses expire annually on December 31, no matter the date of issuance. According to the commission's Training Specialist and Commission Counsel, the Regulatory Licensing and Permitting System (RLPS) automatically classifies licenses as "about to expire" 45 days prior to their expiration. Licenses that are not renewed after the expiration date continue to be classified as "about to expire" in RLPS. Although at that point licensees are not legally allowed to conduct business within the state, the commission has permitted an undefined grace period for expired licenses by allowing the licensee to continue business while in the "about to expire" status. This allows the licensee more time to renew before the commission officially closes the license. After

this undefined grace period elapses and the licensee has failed to renew, the commission will manually change the status of the license to closed in RLPS. Once a license is closed, the shipper/seller must apply for a new license.

Results of Prior Audit

In the commission's November 2016 performance audit report, we found that commission management did not ensure that the policies for managing the non-resident seller's licenses were adequate; commission management did not always follow policy or document the approval of direct shipper licensee applications and renewals prior to issuing the licenses; and commission management did not ensure staff closed expired direct shipper and non-resident seller's licenses timely.

Management concurred with the finding and stated that they implemented new policies related to direct shipper and non-resident seller licenses, and they included specific timeframes for the closure of both types of licenses.

Audit Results

1. Audit Objective: In response to the prior audit finding, did commission management establish comprehensive written policies and procedures for direct shipper and non-resident seller licenses and ensure that direct shipper and non-resident seller expired licenses were closed upon expiration?

Conclusion: Based on our review, we determined that management did not update written policies and procedures for direct shipper and non-resident seller licenses to include critical process controls. Based on our testwork and review, we found that management did not update the existing policy to address license closures. We also found that management and staff did not ensure that staff closed expired direct shipper and non-resident licenses. See **Finding 3**.

2. Audit Objective: In response to the prior audit finding, did commission management ensure that a licensing and permitting specialist and the commission's legal counsel documented their review prior to issuing new licenses and renewing licenses?

Conclusion: Based on our review, we determined that management ensured that the appropriate staff member documented their review prior to issuing and renewing licenses.

3. Audit Objective: Did commission management ensure that notices were sent to licensees whose license was about to expire in accordance with the commission's policy?

Conclusion: We found that the commission's licensing system did not always send renewal notices to licensees in accordance with the commission's policy. See **Finding 3**.

Methodology to Achieve Objectives

To assess management's design, implementation, and operating effectiveness of internal controls as they relate to direct shipper and non-resident seller licenses, we obtained and reviewed the commission's policies and procedures. We also discussed these policies and procedures with management and staff. We conducted walkthroughs of the license application and renewal process.

To determine if management ensured the licensing and permitting specialist and commission's legal counsel documented their approval of applications for direct shipper and non-resident seller licenses prior to issuing a license, we conducted interviews and reviewed examples of submitted applications. From a population of 251 direct shipper and 384 non-resident seller licenses issued from January 22, 2018, to February 13, 2020, we selected a nonstatistical, random sample of 60 licenses of each type. We then reviewed documentation to determine whether staff followed the commission's processes by documenting their approval of applications for direct shipper and non-resident seller licenses prior to issuing the license.

To determine if management ensured that the appropriate staff member documented his or her review prior to renewing direct shipper and non-resident seller licenses and that any required notices were sent to licensees whose license was about to expire, we conducted interviews and reviewed examples. From a population of 940 direct shipper and 1,512 non-resident seller licenses up for renewal from January 22, 2018, through February 13, 2020, we selected a nonstatistical, random sample of 60 licenses of each type. We then reviewed documentation to determine whether staff sent renewal notices to licensees whose license were about to expire, and whether staff followed the commission's processes by documenting their approval prior to renewing licenses.

To determine if management ensured that expired direct shipper and non-resident licenses were closed upon expiration, we inquired with management and staff. We tested the entire population of 13 direct shipper and 49 non-resident seller licenses that the commission closed from January 22, 2018, to February 13, 2020, and compared the closure date to the expiration date to determine the difference.

Finding 3 – As noted in the prior audit, commission management did not establish adequate licensing policies over direct shipper and non-resident seller licenses, did not ensure licensees were notified of expiring licenses, and did not ensure that licenses were closed upon expiration as required in statute

Condition and Cause

Condition A: *Written policies and procedures for direct shipper and non-resident seller licenses were inadequate.*

As noted in the prior audit, the Tennessee Alcoholic Beverage Commission did not maintain up-to-date policies for direct shipper and non-resident seller licenses. Specifically, the commission management still did not update written policies and procedures for direct shipper and non-resident seller licenses to include

- designating management or staff positions with authority to approve or deny license applications and renewals;
- defining the timeframe for sending renewal notifications to licensees before a license is set to expire; and
- defining an appropriate timeframe for changing expired licenses to a closed status.

Currently the commission’s policy for direct shipper licenses states that the Executive Director is responsible for reviewing and approving all licenses. According to management’s interpretation of this policy, the Executive Director has the authority to designate staff to perform these functions. When we asked current management about former management’s response to the prior finding related to updated policies, current management stated they could not find these updated policies.

Condition B: *Expired direct shipper and non-resident licenses were not closed as specified in statute.*

As noted in the prior audit, commission management did not timely close licenses that had expired. Based on our analysis of licenses closed by the commission, we found that management and staff closed 26 of 62 direct shipper and non-resident seller licenses (42%) between 2 to 410 days after the license expiration date. Based on our discussion, commission management has chosen to manually close expired licenses instead of automating the closure process through RLPS. See **Table 3**.

Table 3
Number of Days and Licenses Closed After Expiration

1–60 Days Late	61–180 Days Late	Over 181 Days Late
19	5	2

According to commission management, they wanted to provide licensees a renewal grace period after their license expiration date because once the commission official closes a license, the licensee is required to restart the license application process to obtain a new license. Additionally, management stated that because licensees encountered issues when they tried to renew their license during the transition from the previous paper licensing process to RLPS, they allowed the grace period to extend beyond the actual license expiration date.

“[M]anagement stated that because licensees encountered issues when they tried to renew their license during the transition . . . to RLPS, they allowed the grace period to extend beyond the actual license expiration date.”

To provide further context for their decision, management explained that there was a statutory moratorium in Section 57-3-204, *Tennessee Code Annotated*,⁷ which was passed in 2018 and lasts through

⁷ This statute covers retailer’s licenses, fees, permits for employees, and permit renewal and is effective until July 1, 2021. This statute specifically does not allow for new licenses to be issued during this time period.

2021, requiring that no new package store licenses be issued. The commission's counsel stated that he understood the purpose of this moratorium was to support existing liquor stores as they adjusted to the Wine in Grocery Stores statute because liquor stores were now dealing with new competition from grocery stores. Due to the moratorium on new licenses, if an existing license expired, and the commission closed that expired license, the business could not obtain a new license during the moratorium and would be forced to close. The commission did not want to close a license before the store had every chance to renew; as a result, the commission did not implement policies on closing any licenses after expiration.

Management also noted that 57-3-213, *Tennessee Code Annotated*, states the license shall expire "unless the licensee has filed a renewal application and paid the annual license fee or privilege tax required by this title." Based on discussion management acknowledged that some of the 26 licenses should have closed.

Management also noted that they had implemented a process in January 2020 to close any expired licenses 45 days after expiration. Our scope population consisted of closed licenses through February 2020, thus we could not test management's newly implemented 45-day process for closing licenses.

We believe, however, that no provision in statute grants or defines this authority to allow licensees to continue business after the direct shipper/non-resident license has expired, unless the licensee has submitted the renewal application and paid the required fee.

Condition C: *Commission management and staff did not ensure RLPS automatically generated renewal notices for non-resident seller licenses.*

According to the training specialist, the commission notifies all licensees 45 days before their license expires, and RLPS generates a notice to the licensee 45 days before the license's expiration date. RLPS automatically sends the renewal notice to the business's email account. However, based on our testwork, we found that RLPS did not send renewal notices to 7 of 60 non-resident seller licensees (12%) within 45 days of the license expiration. The renewal notices were sent between 62 and 108 days late, and we could not determine if the commission sent a notice for 1 licensee. Specifically,

- for 5 of 7 licensees, the renewal notice was sent late for 2018;
- for 1 of 7 licensees the renewal notice was sent late for 2018 and 2019; and
- for 1 of 7 licensees, the renewal notice was sent late for 2019.

According to the commission's Business Analyst and Information Systems Manager, RLPS did not set some licenses to "about to expire" status in 2018 due to an issue with RLPS's programming script. Management did not know why the programming script failed. Staff had to manually change the status to "about to expire" and send the renewal notice themselves when the system did not automatically generate the renewal notice.

Commission’s Risk Assessment

Given the problems identified during our fieldwork, we reviewed the commission’s December 2019 Financial Integrity Act Risk Assessment and determined that management did not

“[M]anagement did not properly assess potential risks within the licensing application and renewal process.”

properly assess potential risks within the licensing application and renewal process. Management’s risk assessment should consider all potential risks associated with fiscal and operational risks, including the risk of errors, fraud, waste, abuse, and noncompliance with state law or other regulatory requirements. As identified in our audit work, we found risks within system controls and compliance with policy requirements. Without assessing all potential risks, management cannot be assured that

an internal control is in place that will prevent the commission from not achieving its mission and objectives.

Criteria and Effect

According to Section 57-3-213(a), *Tennessee Code Annotated*, “Each license shall expire twelve (12) months following the date of its issuance. The commission is authorized to issue renewal licenses for all qualified persons.” According to Section 17 of commission Policy 1-4-26, “Retail License Examiner,” the commission is required to “Send out renewal notices for non-resident seller permit holders.”

Commission management is responsible for establishing internal controls over the direct shipper and non-resident seller licenses. The U.S. Government Accountability Office’s *Standards for Internal Control in the Federal Government* (Green Book) sets internal control standards and is considered best practice for nonfederal entities. Green Book Principle 10.02, “Response to Objectives and Risks,” states,

Management designs control activities in response to the entity’s objectives and risks to achieve an effective internal control system. Control activities are the policies, procedures, techniques, and mechanisms that enforce management’s directives to achieve the entity’s objectives and address related risks.

Written policies and procedures do not serve their intended purpose when they are outdated, incomplete, and unused, and the commission and management cannot meet their mission to regulate the licenses they issue. Also, without adequate processes to send renewal notices and to close expired licenses, management increases the risk that licensees will continue business operations without an active license.

Recommendation

The commission should ensure management and staff follow statute governing direct-shipper and non-resident seller licenses or seek amendments to the law if needed. The commission should ensure that the Executive Director and the management team update the commission’s comprehensive written policies and procedures that address direct shipper and non-resident seller licenses. The Executive Director should also ensure that commission management and staff

consistently follow these written policies and procedures. Management should perform an adequate risk assessment to identify all risks associated with the license process for direct shippers and non-resident sellers. Management should implement effective controls to address the risks noted in this finding and in management's adequate risk assessment as necessary; assign staff to be responsible for ongoing monitoring of the risks and mitigating controls; and take action if deficiencies occur.

Management's Comment

We concur in part.

Written Policies and Procedures for direct shipper and non-resident seller licenses were inadequate.

We concur in part. The TABC implemented sweeping changes to its licensing process largely in part to address these prior findings. The TABC developed and implemented a digital-based system with features that ensured adequate policies were in place to notify licensees of expiring licenses and ensure that staff adequately monitored license closures and renewals in a way that met statutory obligations while avoiding unnecessary disruption to businesses. TABC has established licensing policies related to direct shippers and non-resident sellers. Application submissions are through the Regulatory Licensing and Permitting System (RLPS). Licensing staff review submitted applications using the steps provided in the Licensing Processing Guide. The guide provides an updated list of documents needed to determine eligibility and instructions on how to include those documents in RLPS. Final approval of the applications is completed by a member of the legal staff.

This is sufficient to comply with the applicable standards. The U.S. Government Accountability Office's *Standards for Internal Control in the Federal Government* (Green Book) sets internal control standards and is considered best practice for nonfederal entities. Green Book Principle 10.02, "Response to Objectives and Risks," amongst the control activities are procedures, techniques, and mechanisms in addition to policies. RLPS by definition and setup is a control mechanism purchased to maintain controls. Applicants are required to answer a series of questions and provide specific documentation to complete the application. This documentation is checked by TABC staff as a control factor to ensure that the proper documentation has been provided. The RLPS Operational Guide is a procedure manual guiding staff through the operation of RLPS and how to complete tasks concerning the submission of applications. The Green Book Principle 10.03 "Design of Appropriate Types of Control Activities" provides appropriate control activities that include segregation of duties, review of actual performance, and management of human capital all of which are done by TABC. The TABC's RLPS Operational Guide is sufficient to comply with the Green Book Standards.

Nevertheless, the TABC is in the process of clarifying policies regarding the direct shipper and non-resident seller licenses. This is expected to be completed by the end of the second quarter of this fiscal year.

Expired direct shipper and non-resident licenses were not closed as specified in statute.

We concur in part.

The TABC's review of the 26 licenses noted in the audit finds that 20 of the 26 had either (1) had a duplicate license for the same establishment that was properly and timely renewed and therefore the noted expired license was void and of no effect or (2) ceased operations in the state to where licensure was no longer required but had failed to notify the TABC upon such closure as required by TABC rule 0100-03-.09 (5). There were only 6 out of the 62 sample size (9.6%) that were closed after the license's expiration date for a reason other than as described above, but the TABC does not agree with the conclusion that the TABC was required to immediately close such six licenses after their expiration date and is respectful of the practical and legal consequences of taking an approach where we always immediately close such a license out.

TABC Rule 0100-06-.08(2) states that a failure of a non-resident seller permittee to timely and properly renew their non-resident seller permit "shall be deemed a violation of the rule, and may result in the prohibition of the importation and/or distribution of each brand of alcohol registered by the non-resident seller permittee." This rule codifies the TABC's interpretation that the closure of an expired license is not automatic or required under T.C.A. 57-3-213. The TABC considers the term "expired" to be distinctly different from the term "closed" or requiring the immediate closure of a business. Thus, while T.C.A. 57-3-213 requires that the license expires on its expiration date, the statute does not require the closure of the license on such date and a license continues to be operable until such closure occurs.

A reading of T.C.A. 57-3-213 to require the immediate closure of all licenses that have not submitted a renewal by their expiration date regardless of the circumstances could result in grossly unfair outcomes, the loss of revenue for the licensee, possible closure of small businesses, and the creation of legal issues for the state and TABC, such as issues related to notice and due process. The TABC is required to give notice before closing a license, and requiring immediate closure would be unduly burdensome for both TABC staff and customers, as well as would fail to provide appropriate due process to licensees. The immediate closure of expire licenses would also have significant practical effects. For example, if a package store was a day late in submitting their renewal, then under this interpretation, the TABC would be required to close the license of said package store, but due to the moratorium on new package stores that is in effect until July 1, 2021, then the package store would not be able to just reapply for the license or sell their store as a package store, and the result would be the ending of a package store business until at least July 1, 2021. Some other instances that the TABC has had in which we feel the immediate closure of the license would have been grossly unfair were instances where the licensee has a death in the family or the owner around the time of the renewal which understandably caused them to be a little late in submitting the renewal and instances surrounding the initial implementation of the online RLPS application system in 2018 in which there was a significant learning curve for our licensees in learning and using the system which caused some delays in the submittal of their renewal application. It is the opinion of the TABC that T.C.A. 57-3-213 should be read in light of these legal and practical considerations along with the fact that the T.C.A. 57-3-213 does not specifically require immediate closure of the license to conclude that immediate closure of an expired license is not required. As stated above, this was codified by a rule concerning non-resident seller permits in TABC Rule 0100-06-.08(2).

The TABC implemented a process, in January 2020, to ensure these licenses are closed within forty-five (45) days. TABC is creating a set of policies regarding license closures for all

types of licenses that clarify that there can be a window during which the applicant can get the license renewed without license closures occurring. This is expected to be implemented by the end of the second quarter of this fiscal year.

Commission management and staff did not ensure RLPS automatically generated renewal notices for non-resident seller licenses.

We concur in part. TABC acknowledges that there were some late renewal notices in the first year utilizing RLPS which TABC was working to correct before the audit, but the TABC does not agree with the characterization of this matter as a current finding as the issue was resolved long before the end of the audit and while providing such notices is best practice to help our customers timely renew their licenses, such notifications are not required as their license specifying the expiration date is the notice of the date in which the license expires. At the time of the late notices, TABC staff investigated the error and could not locate an exact root cause within the system. Upon review, it was noticed that staff had manually changed some license statuses to “about to expire” to initiate renewal processes and the timing of this manual intervention contributed to a few abnormal notifications. TABC recognizes that human intervention contributed to this issue because of the confusion of using the new system during its first year of service. Given the significant amount of change the RLPS brought to the license processing, the first year of RLPS use was complicated for users, and there was a significant learning curve to overcome. In the operating period since these abnormal notifications, an additional cycle of Direct Shipper and Non-Resident Seller renewals has been completed without the issue occurring. TABC will re-enforce the prevention of similar issues from occurring with additional staff training before the end of the second quarter.

Commission’s Risk Assessment

We concur. ABC leadership submits the Financial Integrity Act Risk Assessment annually each December with input from senior leadership. The 2019 Risk Assessment did not address the areas of risk regarding the license application and renewal process. The areas of the assessment that are relevant concerns staff errors concerning the work performed by staff implementing data in RLPS and unauthorized changes made to the systems. TABC acknowledges that the risks should have been more specific regarding licensing and renewal processes in terms of RLPS and elaborating on the risks and mitigating controls in place. The 2020 Financial Integrity Act Risk Assessment will reflect risks and mitigating controls in place at TABC which will be complete in the second quarter of the fiscal year.

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 Chief Law Enforcement Officer (CLEO) oversees the storage and disposal of confiscated evidence, as well as the supervision of agents and regulatory officers. Confiscated evidence can include items such as weapons, illegally distilled liquor, and cash. The commission was part of the Governor’s Task Force for Marijuana Eradication; however, pursuant to Section 57-1-208, *Tennessee Code Annotated*, as of January 1, 2018, the commission is no longer part of the task force. With this statute change, the commission confiscated significantly less drugs, drug paraphernalia, weapons, and cash during our audit period.

“Confiscated evidence can include items such as weapons, illegally distilled liquor, and cash.”

Storage of Confiscated Evidence

During our last performance audit and for most of the current audit period, the commission maintained confiscated evidence in storage rooms at nine locations across the state: Nashville, Memphis, Knoxville, Chattanooga, Johnson City, Columbia, Cookeville, Winchester, and Talbott. The commission closed five of those locations: Johnson City in February 2018; Columbia, Cookeville, and Winchester in August 2017; and Talbott in March 2015. The commission continues to store confiscated evidence in Memphis, Nashville, Chattanooga, and Knoxville.

In accordance with commission Policy 3-3-10, “Handling and Collecting Evidence,” commission agents who confiscate evidence must transfer it to the custodian at one of the four evidence storage rooms within 72 hours and record evidence items into the commission’s Evidence Management System.⁸ The evidence custodian is responsible for maintaining the evidence inventory, including destroying or disposing⁹ of evidence after authorization. The policy requires all cash evidence collected to be hand delivered to the CLEO, Budget Officer, or Director within 5 working days, and the money must be deposited in accordance with commission Policy 3-3-10.1, “Disposal of Evidence.” Additionally, the evidence custodian maintains a logbook of anyone accessing the evidence room and the purpose of entry.

Disposal of Confiscated Evidence

In accordance with commission Policy 3-3-10.1, “Disposal of Evidence,” once the court or other competent authority¹⁰ issues a disposal order, the evidence custodian is required to dispose of the evidence in accordance with the terms of the order. For example, the order could require commission staff to deposit confiscated cash into the state’s treasury, return confiscated property to its original owner, destroy the evidence, or dispose of the evidence in some other manner. When an item is ordered to be destroyed, commission policy requires the evidence custodian, an agent, and one other person to witness the complete destruction of the evidence. Next, the evidence custodian completes the evidence disposition report, which includes the signatures and dates of

⁸ The Evidence Management System is an inventory system for managing evidence items.

⁹ Disposal of inventory could include destroying evidence, returning property to the owner, or disposing of the evidence in some other manner depending on the authorization of the disposal order resulting from either criminal prosecution or other administrative action.

¹⁰ The commission’s Executive Director can write a disposal order in instances when the district attorney or judge will not write a disposal order.

the witnesses, and then places the report in the case file. The report is the commission's only documentation of destroying the evidence. According to the CLEO, the agent-in-charge reviews case files for completeness.

Results of Prior Audit

In the commission's November 2016 performance audit report, we found that commission management did not maintain proper internal controls over confiscated evidence, increasing the risk that evidence misappropriation or misuse will not be prevented, detected, or corrected. Specifically, we found that management

- failed to fully utilize the commission's Evidence Management System;
- did not ensure that an independent employee reconciled inventory lists at all locations, that evidence lists were complete, that case files were maintained, and that evidence descriptions always matched case files;
- did not ensure that commission staff maintained logs of all persons accessing the evidence room;
- did not ensure that evidence was disposed of timely and that all cash evidence was transferred to the commission's central office and deposited; and
- did not adequately identify and assess risks related to confiscated evidence.

Management concurred with the prior audit finding and stated that, under the leadership of a new Executive Director, the commission had implemented revised policies regarding the collection, handling, storage, and disposal of evidence or other property.

Our focus was to follow up on management's corrective action to address the conditions reported in our prior audit finding.

Audit Results

1. Audit Objective: Did commission management ensure that all staff were using the Evidence Management System (EMS) to maintain a proper inventory of confiscated evidence? Did commission management ensure that the staff who reconciled evidence lists to the evidence at each location, and to the case files, were independent of custodial or recordkeeping responsibility for confiscated evidence?

Conclusion: Based on our review, commission staff were using EMS to manage confiscated evidence inventory. We also found that the appropriate commission staff were performing the evidence reconciliations.

2. Audit Objective: Did commission staff at each location maintain a log of persons who accessed the confiscated evidence room to ensure confiscated evidence was always controlled and protected from misappropriation and misuse? Did

commission management ensure that confiscated evidence agreed to case files and EMS?

Conclusion: Commission staff at each location maintained a log of persons who accessed the confiscated evidence room. Based on our testwork, commission management ensured that confiscated evidence agreed to the case files and EMS, with minor deficiencies.

3. Audit Objective: Did commission management ensure that confiscated evidence was available for inspection and disposed of timely as documented on the evidence disposition reports, as required by commission policy? Was cash evidence properly transferred and deposited in the state treasury, as required by the commission's policy? Did management identify and assess risks associated with confiscated evidence?

Conclusion: Based on our testwork, commission management ensured that confiscated evidence was available for inspection and disposed of timely; however, commission management did not maintain evidence disposition reports as required by policy. See **Observation 1**. We found that cash evidence was properly transferred and deposited timely in the state treasury, with minor deficiencies. We found that management did include risks associated with confiscated evidence in their risk assessment.

Methodology to Achieve Objectives

To assess management's design, implementation, and operating effectiveness of internal controls as they relate to confiscated evidence items, we met with the commission's CLEO. We reviewed the commission's policies and procedures on confiscated evidence and performed a walkthrough of how staff enter confiscated evidence items into EMS. We obtained lists of confiscated evidence items from EMS and reviewed the list to determine if commission management fully utilized EMS to maintain oversight and control over the confiscated evidence.

We obtained and reviewed the annual reconciliations of confiscated evidence for each location to determine if an independent employee (an employee without custodial or recordkeeping responsibility) performed the reconciliation of the evidence lists to the confiscated evidence. Commission staff walked us through the independent employee evidence reconciliations. Additionally, we performed walkthroughs of the four evidence storage rooms and viewed evidence room access logs to determine if staff at each location maintained a log of individuals who accessed the location's evidence storage room.

To determine whether management ensured (a) that evidence custodians transferred confiscated cash evidence to the central office; (b) that confiscated evidence stored at each location matched the location's evidence lists and case files; and (c) that confiscated evidence was available for inspection and disposed of timely,¹¹ we

¹¹ Commission policy requires staff to dispose of cash evidence within 30 days of the disposal order; policy requires staff to dispose of all evidence other than cash within 1 year of the disposal order.

- obtained a list of all confiscated items from EMS for each of the four locations, which included items currently held and items disposed of during our audit period;
- selected and tested a nonstatistical, random sample of confiscated evidence from each location’s evidence list; and
- selected and tested a haphazard sample of confiscated evidence observed at each location.

Table 4 includes the locations tested, total number of confiscated evidence items on the lists, sampling methods, and items tested.

Table 4
List of Confiscated Evidence Items

Location	Total Number of Confiscated Items in EMS	Items Selected From EMS List	Items Selected On-Site	# of Items Tested
Memphis	17	17*	17*	17
Nashville	274	20	15	35
Chattanooga	30	30*	30*	30
Knoxville	138	15	15	30
Total	459	-	-	112

Source: Commission population of all confiscated evidence items in EMS as of February 7, 2020.

* For Memphis and Chattanooga, we tested the entire population.

We also obtained a list of all 32 deposited cash items, totaling \$35,313, and 2,953 non-cash evidence items disposed during the period April 1, 2016, through February 10, 2020. We reviewed all 32 cash items to determine whether the evidence agreed to the evidence list and case file, and/or whether commission management properly deposited the items in the state treasury as ordered by the court or proper authority, as required by commission Policy 3-3-10.1, “Disposal of Evidence.” For the confiscated cash items that we found were deposited, we considered such factors as the timeliness of the deposit once the disposal order was issued, whether it was deposited into the proper bank account, and whether the amount deposited agreed with supporting documentation.

From the population of 2,953 non-cash evidence items, we selected a random sample of 51 non-cash items disposed and 9¹² other non-cash items that were disposed after we requested the disposal list, for a sample of 60 items. During testwork, we selected an additional 8 items to ensure accuracy of items in the report, for a total of 68 non-cash items. We tested these items to determine whether the evidence agreed to the evidence list and case file, and/or was properly ordered for disposal by the court or proper authority. In evaluating whether commission staff disposed the item properly, we considered such factors as the timeliness of the disposal once the disposal order was issued and the signatures and dates of the evidence disposal report, as required by commission policy.

¹² Commission staff disposed nine items after our request for a list of disposed items. The auditor was concerned that there might be something odd about these items and decided to test all nine items to make sure there was nothing different about these particular disposed items. Based on our testwork and further research, we found that it is common for the commission to batch items together and dispose of them at one time.

Observation 1 – Although commission management improved their internal controls over disposed evidence, management did not perform adequate supervisory review of case files and did not maintain evidence disposition reports as required

Management of the Tennessee Alcoholic Beverage Commission did not ensure supervisors performed their supervisory review of case files to ensure that case files were complete. Based on our discussion with the Chief Law Enforcement Officer, he stated that the agent in-charge should be reviewing the case files. Based on our review of case files, however, the agents-in-charges were not documenting their review.

We also reviewed evidence disposition reports based on the requirements of commission Policy 3-3-10, “Handling and Collecting Evidence.” Commission management established the policy as a control to mitigate risks associated with evidence disposal. The policy requires staff to use an evidence disposition report to document the proper disposal of evidence items. We found that for 15 of 68 non-cash evidence disposals (22%), commission management did not maintain or complete the reports as required. Specifically,

- 3 reports were missing from case files, and commission staff could not locate them during our audit fieldwork; and
- 12 reports did not include all required signatures, were missing dates, or had different signatory dates of agents and witnesses.

Commission Policy 3.3-10.1(IV)(d) states,

If the evidence is to be destroyed, it shall occur as follows:

1. The evidence custodian, an agent, and one other person should witness the complete destruction of the evidence.
2. The evidence custodian should complete Part II of the Evidence Disposition Report, including the date and method of destruction and the signatures of the witnesses of the destruction.

The commission cannot be assured that case files contain all required reports and that these reports were completed properly without an adequate supervisory review. The Chief Law Enforcement Officer (CLEO) stated that he became the Interim Chief Law Enforcement Officer in November 2016 and assumed the position permanently in February 2017. He stated that he has made confiscated evidence management a top priority since taking the position, and he started by reducing the number of inventory storage rooms; properly labeling and organizing evidence items and storage rooms; and entering each evidence item into the Evidence Management System. The CLEO cited human error as the reason staff did not properly sign and date the reports and place them in the case file. We agree that improvement has been made and that management seems committed to continued improvement.

Overall Effect and Management's Responsibility for Internal Control

Adequate controls over confiscated evidence decrease the risk of noncompliance, fraud, waste, and abuse. Management should continue working toward improving internal controls over the disposal of confiscated evidence by ensuring staff know and follow commission policy.

Management's Comment

See **Appendix 8** for management's comment to this observation.

CONFLICTS OF INTEREST

The Tennessee Alcoholic Beverage Commission is required to mitigate the risk of conflicts of interest for its commission members and employees. According to Section 57-1-108, *Tennessee Code Annotated*, neither the commission members and employees nor their family members may

- a. hold alcoholic beverage licenses or interests in Tennessee distilleries, wholesale dealers, or retail dealers in Tennessee;
- b. own interest of any kind in any property occupied by commission licensees; or
- c. own stock or direct or indirect interest of any kind by loan, mortgage, or gift, or guarantee the payment of any loan in any commission-licensed distillery, wholesale dealer, or retail dealer.

To promote compliance with the statute, management developed Policy 1-1-10, "Interest Precluding Employment by the Commission," which states that employees are required to complete annually the "Statement of Interests of All Employees and Appointments of the Tennessee Alcoholic Beverage Commission" (disclosure statement) and have the disclosure statement notarized.

Results of Prior Audit

In the commission's November 2016 performance audit report, we found that the 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. Specifically, we noted that

- commission management did not ensure that the commission's conflict-of-interest policy and disclosure statement addressed conflicts relating to ownership interest of any kind in any property owned by a licensee and stock and other investment interest of any licensed distillery, wholesale dealer, or retail dealer;
- management did not ensure that staff maintained disclosure statements and that each employee and commission member signed the available disclosure statements; and
- disclosure statements were not always properly dated and notarized.

Management concurred with the prior audit finding and stated that the commission revised Policy 1-1-10 to include all provisions of Section 57-1-108. Furthermore, the commission stated that new management distributed the policy and affidavit to all employees and commission members to be signed and notarized.

Audit Results

1. Audit Objective: In response to the prior audit, did commission management ensure that the commission’s conflict-of-interest policy and disclosure statements address all requirements of the conflict-of-interest statutes?

Conclusion: Management revised the commission’s conflict-of-interest policy and disclosure statements to address all requirements of the statutes.

2. Audit Objective: In response to the prior audit, did commission management ensure that each employee and commission member signed and dated disclosure statements annually and that the statements were notarized?

Conclusion: Based on our testwork, commission management ensured that each employee and commission member signed, dated, and notarized disclosure statements annually, with minor exceptions.

Methodology to Achieve Objectives

To assess management’s design and implementation of internal controls as they relate to conflicts of interest, we met with the Human Resources Manager to obtain an understanding of relevant controls for conflicts of interest at the commission and to discuss the corrective action taken to address the prior audit finding. We reviewed the commission’s conflict-of-interest policy and disclosure statements.

To test our objectives, we obtained a list of all commission members and employees from January 1, 2019, through December 31, 2019. We reviewed all 2019 conflict-of-interest disclosures for 100 employees and the 3 commission members to determine if management ensured that each employee signed and dated a conflict-of-interest disclosure and that the disclosure was notarized.

COMMISSION STRUCTURE AND RESPONSIBILITIES

Commission Members

Section 57-1-102(a), *Tennessee Code Annotated*, requires the Governor of the State of Tennessee to appoint a commission for the Tennessee Alcoholic Beverage Commission:

There is hereby created and established the alcoholic beverage commission, which shall consist of three (3) members, to be appointed by the governor. One (1)

member of the commission shall be appointed and reside in each grand division of the state. The members comprising the commission shall not be less than thirty (30) years of age and shall have been residents and citizens of this state for at least five (5) years preceding their appointment. In making appointments to the commission, the governor shall strive to ensure that at least one (1) person serving on the commission is sixty (60) years of age or older and that at least one (1) person serving on the commission is a member of a racial minority.

The appointment of the commission is concurrent with the term of the Governor. See **Table 5** for commission members during the period of April 1, 2016, through April 30, 2020. Commission members appoint the Executive Director, Assistant Director, and the Chief Law Enforcement Officer and meet monthly to vote on key decisions such as the approval of new licensees.

**Table 5
Commission Members**

Board Member	Term Date	Region
Mary McDaniel	2/28/2011 to 3/23/2017	West Tennessee
John Jones	1/15/2011 to 6/1/2019	East Tennessee
Bryan Kaegi	2/28/2011 to 12/31/2017	Middle Tennessee
Richard Skiles	3/22/2017 to 1/21/2023	West Tennessee
Ashleigh Roberts	3/14/2018 to 1/21/2023	Middle Tennessee
David Tomita	5/27/2019 to 1/21/2023	East Tennessee

Source: Information obtained from the commission’s Internal Audit Director.

Commission Meetings

The commission meets monthly in Nashville, Tennessee, at the commission’s office. The commission’s paralegal and the Assistant Director are responsible for preparing and posting public notices on the commission’s website prior to commission meetings. Legal staff within the commission prepare meeting agendas. The Commission Counsel reviews the matters to go before the commission and then presents them to the Executive Director before the meeting. Section 57-1-104(b), *Tennessee Code Annotated*, states, “Two (2) members of the commission shall constitute a quorum for the transaction of any business, or in the performance of any duty, power or function of the commission.” The paralegal or the Assistant Director posts the meeting minutes on the commission’s website after the commission approves them at the subsequent commission meeting.

Audit Results

1. Audit Objective: Did the commission members meet the statutory qualifications?

Conclusion: Based on our testwork, the commission met the statutory qualifications.

2. Audit Objective: Did the commission meet and achieve the quorum standards in statute or bylaws?

Conclusion: Based on our testwork, the commission members met and achieved the quorum standards in accordance with statute.

3. Audit Objective: Did the commission members consistently attend meetings?

Conclusion: Based on our testwork, the commission members consistently attended meetings.

Methodology to Achieve Objectives

To meet our objectives, we obtained and reviewed state statute. We met with the commission's paralegal and reviewed the commission's website to gain an understanding of internal controls over the commission meetings. We obtained a list of all commission members that served and obtained the commission meeting minutes for the period April 1, 2016, through February 19, 2020. We performed testwork to determine if members' appointments met the statutory requirement, if members achieved the quorum standards for the meetings, and if members attended meetings consistently.

INFORMATION SYSTEMS

To help achieve its mission, the Tennessee Alcoholic Beverage Commission uses two information systems: the Regulatory Licensing and Permitting System (RLPS) and the Evidence Management System (EMS). RLPS provides online applications for alcoholic beverage licensing and a record depository of the licenses; commission management contracted with Accela to implement RLPS in January 2018. The commission uses EMS to manage confiscated evidence items that agents obtain while enforcing laws and regulations regarding the sale and consumption of alcoholic beverages.

The commission merged its information technology (IT) personnel with Strategic Technology Solutions in February 2020 to help stabilize IT personnel turnover and provide greater coordination for the commission.

Audit Results

Audit Objective: Did management follow state information systems security policies and industry best practices regarding information systems controls?

Conclusion: We determined that management did not provide adequate internal controls in three specific areas. See **Finding 4**.

Methodology to Achieve Objective

To achieve our objectives, we compared management's internal control activities to state information systems security policies and industry best practices.

Finding 4 – Commission management did not provide adequate internal controls in three specific areas

The Tennessee Alcoholic Beverage Commission and the Department of Finance and Administration’s Strategic Technology Solutions (STS) did not effectively design and monitor internal controls in three areas. For these areas, we found internal control deficiencies where both the commission and STS did not adhere to state policies and best practices.

Ineffective implementation and operation of internal controls increase the likelihood of errors, data loss, and unauthorized access to department information. Pursuant to Standard 9.61 of the U.S. Government Accountability Office’s *Government Auditing Standards*, we omitted details from this finding because they are confidential under the provisions of Section 10-7-504(i), *Tennessee Code Annotated*. We provided the commission and STS management with detailed information regarding the specific conditions we identified, as well as the related criteria, causes, and our specific recommendations for improvement.

Recommendation

Management should remedy these conditions by promptly developing and consistently implementing internal controls in these areas. Management should implement effective controls to ensure compliance with applicable requirements; assign staff to be responsible for ongoing monitoring of the risks and mitigating controls; and take action if deficiencies occur.

Management’s Comment: Tennessee Alcoholic Beverage Commission

We Concur. TABC acknowledges that TABC and STS did not effectively design and monitor controls in three areas. TABC is working with STS to correct the issue. TABC is designing and implementing controls in the three areas to ensure that state policies and best practices are in place. We expect these changes to be implemented by the end of the second quarter of the fiscal year.

Management’s Comment: Department of Finance and Administration’s Division of Strategic Technology Solutions

We partially concur. Documentation requested by State Audit during the audit could not be located by the Commission’s IT staff, which are managed by STS through centralized IT. After receiving the finding, and upon further examination of the individual exceptions by the STS Endpoint Management group, we were able to locate the requested records. At that point, however, fieldwork had already concluded and there was no time for additional consideration.

STS has taken many steps to improve the processes surrounding this particular finding over the past two to three years and continues to evaluate and improve them as opportunities arise.

STAFF TURNOVER

According to the U.S. Bureau of Labor Statistics, employees have separated from noneducation jobs within state and local government at a rate of approximately 20% for the past four calendar years of available data.

From January 1, 2016, through December 31, 2019, the commission had an average of 18 separations per year and an average turnover rate of 24%.

Commission Separation Statistics

Separations from the Tennessee Alcoholic Beverage Commission include employees who died, retired, voluntarily resigned, or whose appointment expired. Total separations for years 2016, 2017, 2018, and 2019 included 71 employees. Special Agents 2 were the highest number of employee separations, with 12 employee separations (17% of all separations). Resignations were the reason for 44% of all separations. Employee separations were highest in employees with 0 to 5 service years, accounting for 54% of all separations. In 2019, we identified 2 high turnover positions—Programmer/Analyst 4 and Special Agent 2—each with 3 separations. See **Table 6** for the last 4 years of turnover rates at the commission. As of January 2020, the commission had 75 employees.

Table 6
Staff Turnover Rates
For Calendar Years 2016, 2017, 2018, and 2019

Calendar Year	Separations	Average Employees Per Year	Turnover Rate
2016	15	75	20%
2017	13	78	17%
2018	21	75	28%
2019	22	74	30%

Source: Edison, the state's enterprise resource planning system.

Audit Results

Audit Objective: Did the commission experience turnover that affected the ability to meet its mission, and how has management handled staff turnover?

Conclusion: Based on our analysis of the commission's average turnover rates for calendar years 2016 through 2019, the commission experienced high employee turnover and has taken steps to address. See **Observation 2**.

Methodology to Achieve Objective

To achieve our objective, we met with the Executive Director, the Human Resources Manager, and the Chief Law Enforcement Officer to assess management's design and implementation of internal controls as they relate to employee turnover. We also performed a walkthrough of the methods the commission uses to track employee turnover and the steps the

commission has taken to address it. Additionally, we used Edison, the state’s enterprise resource planning system, to obtain a list of all employees on staff from January 1, 2016, through December 31, 2019. Using computer assisted auditing techniques, we isolated the number of staff employed during this period by calendar year, and then we identified the staff with employment end dates, calculating an annual average turnover rate. We analyzed turnover rates by job titles to find any outliers.

Observation 2 – The commission experienced high employee turnover during the last four years

Management of the Tennessee Alcoholic Beverage Commission has implemented changes in their response to employee turnover in order to improve the commission’s ability to meet its mission. These changes include merging information technology personnel with Strategic Technology Solutions (STS) and raising special agents’ pay.

Since 2016, the commission has experienced high turnover in the positions of Programmer/Analyst 4 and Special Agent 2. Additionally, the commission has experienced turnover in the key positions¹³ of Executive Director and Assistant Directors and in the law enforcement area, including the Chief Law Enforcement Officer, Special Agent-In-Charge, Assistant Special Agent-In-Charge, and Special Agents. See **Table 7** for details of key employee turnover.

**Table 7
Employee Turnover for Key Positions**

Key Position	Number of Separations for Calendar Years 2016–2019
Executive Director	1
Assistant Director	2
TABC Chief Law Enforcement Officer	1
Deputy Chief Law Enforcement Officer	1
TABC Special Agent-In-Charge	3
TABC Assistant Special Agent-In-Charge	4
TABC Special Agent 3	2
TABC Special Agent 2	12
TABC Special Agent 1	5
Programmer/Analyst 4*	4

*These positions were merged with Strategic Technology Solutions in February 2020.

According to commission management, high turnover rates in IT contributed to delayed planned upgrades to the new licensing system. Over the last two years, the commission transitioned from a paper-based licensing system to a computer-based licensing system. Furthermore, we noted that the commission had a turnover of 3 Programmer/Analyst 4 employees in 2019 and 1 Programmer/Analyst 4 employee in 2018. As a result of these

¹³ The current Executive Director, Assistant Director, and Chief Law Enforcement Officer have been in their positions for approximately 1 year, 11 months, and 3 years, respectively.

challenges, commission management recognized the need to merge its IT personnel with STS in February 2020. Commission management feels STS will be able to quickly replace employees and provide the commission with the necessary IT assistance to address the commission's needs.

Law enforcement agents, or regulatory officers, currently make up 60% of the active employees at the commission. The commission employs agents to enforce all laws, rules, regulations, policies, and procedures under its authority regarding the sale and consumption of alcoholic beverages; therefore, these employees are key to the commission's mission. Commission management requested and received a pay increase for agents, effective July 1, 2018, and commission management stated that they believe the pay increase helped with the employee turnover in this area. Some agent turnover is inevitable, commission management explained, because some agents transfer to other law enforcement areas, such as the Tennessee Bureau of Investigation, as they continue to advance in their careers. Commission management has focused on hiring and promoting to leadership positions those agents who want to stay with the commission long-term, and management feels the pay increase and experienced leadership in supervisory positions will help mitigate the high agent turnover.

Management's Comment

We concur.

APPENDICES

APPENDIX 1 Internal Control Significant to the Audit Objectives

The U.S. Government Accountability Office’s *Standards for Internal Control in the Federal Government* (Green Book) sets internal control standards for federal entities and serves as best practice for non-federal government entities, including state and local government agencies. As stated in the Green Book overview,¹⁴

Internal control is a process used by management to help an entity achieve its objectives . . . Internal control helps an entity run its operations effectively and efficiently; report reliable information about its operations; and comply with applicable laws and regulations.

The Green Book’s standards are organized into five components of internal control: control environment, risk assessment, control activities, information and communication, and monitoring. In an effective system of internal control, these five components work together to help an entity achieve its objectives. Each of the five components of internal control contains principles, which are the requirements an entity should follow to establish an effective system of internal control. We illustrate the five components and their underlying principles below:

Control Environment		Control Activities	
Principle 1	Demonstrate Commitment to Integrity and Ethical Values	Principle 10	Design Control Activities
Principle 2	Exercise Oversight Responsibility	Principle 11	Design Activities for the Information System
Principle 3	Establish Structure, Responsibility, and Authority	Principle 12	Implement Control Activities
Information and Communication			
Principle 4	Demonstrate Commitment to Competence	Principle 13	Use Quality Information
Principle 5	Enforce Accountability	Principle 14	Communicate Internally
Risk Assessment		Principle 15	Communicate Externally
Principle 6	Define Objectives and Risk Tolerances	Monitoring	
Principle 7	Identify, Analyze, and Respond to Risks	Principle 16	Perform Monitoring Activities
Principle 8	Assess Fraud Risk	Principle 17	Evaluate Issues and Remediate Deficiencies
Principle 9	Identify, Analyze, and Respond to Change		

In compliance with generally accepted government auditing standards, we must determine whether internal control is significant to our audit objectives. We base our determination of significance on whether an entity’s internal control impacts our audit conclusion. If some, but not all, internal control components are significant to the audit objectives, we must identify those internal control components and underlying principles that are significant to the audit objectives. In the following matrix, we list our audit objectives, indicate whether internal control was significant to our audit objectives, and identify which internal control components and underlying principles were significant to those objectives.

¹⁴ For further information on the Green Book, please refer to <https://www.gao.gov/greenbook/overview>.

**Internal Control Components and Underlying Principles
Significant to the Audit Objectives**

Audit Objectives	Significance	Control Environment					Risk Assessment				Control Activities			Information & Communication			Monitoring		
		1	2	3	4	5	6	7	8	9	10	11	12	13	14	15	16	17	
Wine in Grocery Stores																			
1	Did commission management have sufficient written policies and standard operating procedures for the Wine in Grocery Stores (WIGS) program?	Yes	No	No	No	No	No	Yes	No	No	No	No	No	Yes	No	No	No	No	No
2	Did commission management ensure that staff appropriately issued licenses to sell wine in grocery stores by obtaining all necessary documentation, as described by statute and commission rules?	Yes	No	No	No	No	No	No	No	No	No	Yes	No	No	No	No	No	No	No
Background Checks for Permit Applicants																			
1	In response to the prior audit finding, did management ensure compliance with the commission's background check policy for distiller permits?	Yes	No	No	No	No	No	Yes	No	No	No	No	No	Yes	No	No	No	No	No
2	In response to the prior audit finding, did commission management ensure that staff maintained a record of background checks requested, reconciled the background check results to the request, and paid for the background checks performed?	Yes	No	No	No	No	No	No	No	No	No	Yes	No	No	No	No	No	No	No
3	In response to the prior audit finding, did commission management have a process to issue unique permit numbers; to record the permits; and to reconcile permit numbers issued to the permit numbers commission employees issued to the public to ensure that each new alcohol permit holder received a unique permit number?	Yes	No	No	No	No	No	No	No	No	No	Yes	No	No	No	No	No	No	No
4	Did commission management and staff maintain up-to-date background check policies and procedures and ensure background checks were performed for alcohol server permits, wholesaler representatives, and wholesale employees?	Yes	No	No	No	No	No	No	No	No	No	Yes	No	No	No	No	No	No	No
Direct Shipper and Non-resident Seller Licenses																			
1	In response to the prior audit finding, did commission management establish comprehensive written policies and procedures for direct shipper and non-resident seller licenses and ensure that direct shipper and non-resident seller expired licenses were closed upon expiration?	Yes	No	No	No	No	No	Yes	No	No	No	No	No	Yes	No	No	No	No	No

**Internal Control Components and Underlying Principles
Significant to the Audit Objectives**

Audit Objectives		Significance	Control Environment					Risk Assessment				Control Activities			Information & Communication			Monitoring	
			1	2	3	4	5	6	7	8	9	10	11	12	13	14	15	16	17
2	In response to the prior audit finding, did commission management ensure that a licensing and permitting specialist and the commission's legal counsel documented their review prior to issuing a new license and renewing a license?	Yes	No	No	No	No	No	No	No	No	No	Yes	No	No	No	No	No	No	No
3	Did commission management ensure that notices were sent to licensees whose license was about to expire in accordance with the commission's policy?	Yes	No	No	No	No	No	Yes	No	No	No	Yes	No	No	No	No	No	No	No
Confiscated Evidence																			
1	Did commission management ensure that all staff were using the Evidence Management System to maintain a proper inventory of confiscated evidence? Did commission management ensure staff independent of custodial or recordkeeping responsibility for confiscated evidence, reconciled evidence listings to the evidence at each location and to the case files?	Yes	No	No	No	No	No	Yes	No	No	No	Yes	No	Yes	No	No	No	No	No
2	Did commission staff at each location maintain a log of persons who accessed the confiscated evidence room to ensure confiscated evidence was always controlled and protected from misappropriation and misuse? Did commission management ensure that confiscated evidence agreed to case files and the Evidence Management System?	Yes	No	No	No	No	No	No	No	No	No	Yes	No	Yes	No	No	No	No	No
3	Did commission management ensure that confiscated evidence was available for inspection and disposed of timely as documented on the evidence disposition reports as required by commission policy? Was cash evidence properly transferred and deposited in the state treasury as required by commission policy? Did management identify and assess risks associated with confiscated evidence?	Yes	No	No	No	No	No	Yes	No	No	No	Yes	No	Yes	No	No	No	No	No

**Internal Control Components and Underlying Principles
Significant to the Audit Objectives**

Audit Objectives		Significance	Control Environment					Risk Assessment				Control Activities			Information & Communication			Monitoring	
			1	2	3	4	5	6	7	8	9	10	11	12	13	14	15	16	17
Conflicts of Interest																			
1	In response to the prior audit finding, did commission management ensure that the commission's conflict-of-interest policy and disclosure statements address all requirements of the conflict-of-interest statutes?	Yes	No	No	No	No	No	Yes	No	No	No	Yes	No	Yes	No	No	No	No	No
2	In response to the prior audit finding, did commission management ensure that each employee and commission member signed and dated disclosure statements annually and the statements were notified?	Yes	No	No	No	No	No	No	No	No	No	Yes	No	Yes	No	No	No	No	No
Commission Structure and Responsibilities																			
1	Did commission members meet the statutory qualifications?	Yes	No	No	No	No	No	No	No	No	No	No	No	No	No	No	No	No	No
2	Did the commission members meet and achieve the quorum standards in statute or bylaws?	Yes	No	No	No	No	No	No	No	No	No	Yes	No	No	No	No	No	No	No
3	Did the commission members consistently attend meetings?	Yes	No	No	No	No	No	Yes	No	No	No	Yes	No	No	No	No	No	No	No
Information Systems																			
1	Did management follow state information systems security policies and industry best practices regarding information systems controls?	Yes	No	No	No	No	No	No	No	No	No	Yes	Yes	No	No	No	No	No	No
Staff Turnover																			
1	Did the commission experience turnover that affected the ability to meet its mission and how has management handled staff turnover?	Yes	No	No	No	No	No	Yes	No	No	No	Yes	No	Yes	No	No	No	No	No

APPENDIX 2

Commission's Organizational Structure

Commissioner and Staff Authority

According to Section 57-1-102, *Tennessee Code Annotated*, the Governor appoints three members to serve as commissioners. 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. As required by Section 57-1-104, the Tennessee Alcoholic Beverage Commission meets monthly.

As of February 2020, the commission has 88 positions, including the Executive Director, the Assistant Director, the Chief Law Enforcement Officer, 2 attorneys, one 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.

The Executive Director is the commission's chief administrative officer and is responsible for performing all duties and functions delegated by the commission. He also serves as the commission's secretary and keeps the commission's meeting minutes. The Assistant Director is responsible for performing such duties and functions assigned by the Executive Director and commissioners.

The commission also has the statutory authority to appoint a Chief Law Enforcement Officer. A Special Agent-In-Charge oversees each district office and reports to the Chief Law Enforcement Officer. Agents and regulatory officers are charged with enforcing all laws, rules, regulations, policies, and procedures under the commission's authority regarding the sale and consumption of alcoholic beverages. In addition to regulatory cases, agents conduct criminal investigations of suspected violations of federal and state criminal alcohol-related 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, with liquor being the primary focus.

The commission also employs an Internal Auditor; a Legislation, Policy, and Communications Director; a Human Resources Director; and an Administrative Services Director, who oversees the commission's fiscal activities, including accounting and procurement. The commission also employs legal counsel and licensing and permitting staff. These employees report to either the Assistant Director or Executive Director.

Commission's Programs

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 previously described);
- licensing wholesalers, wineries, retailers, and liquor-by-the-drink establishments;

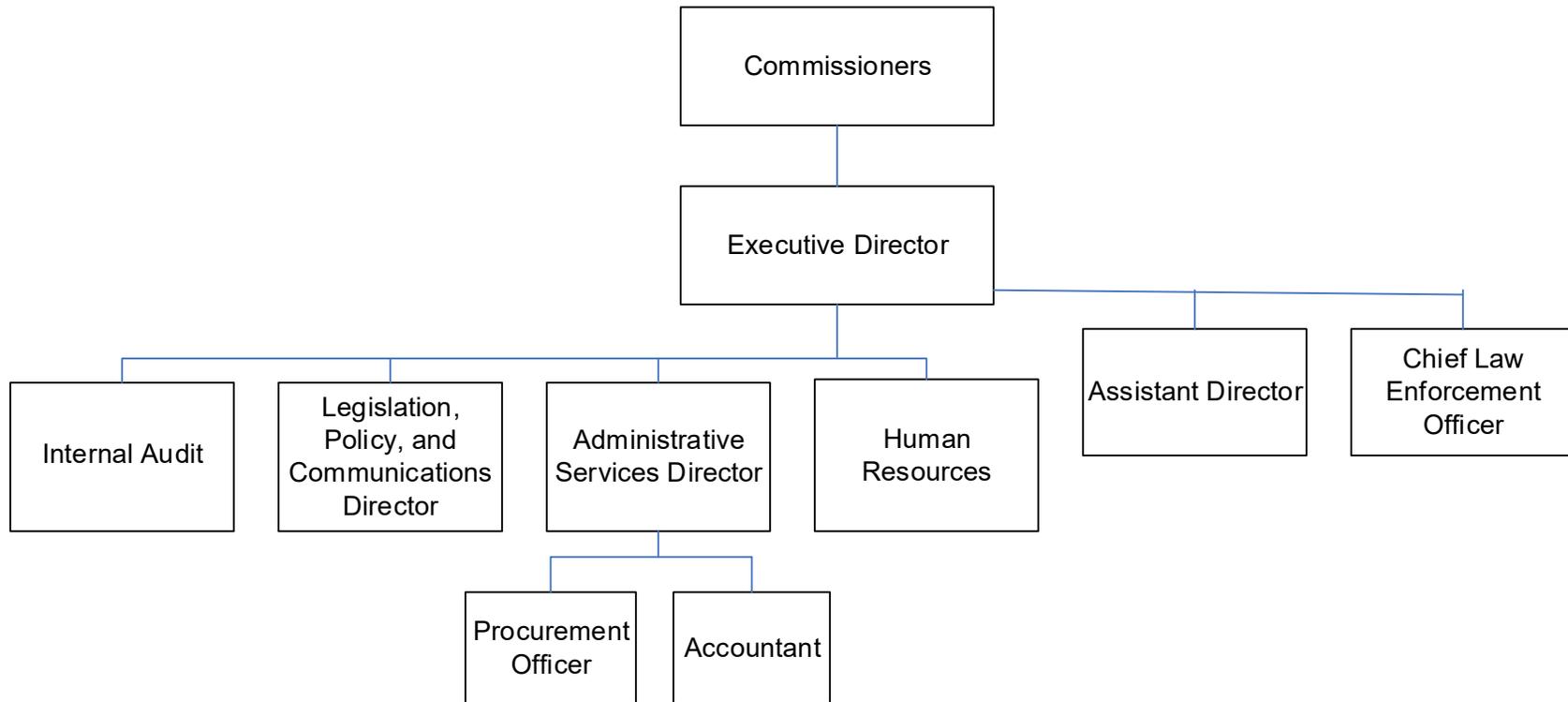
- operating the Alcoholic Beverage Server Training Program to certify training programs and issue server permits;
- operating the Responsible Vendor Training Program; and
- participating in the Governor’s Task Force on Marijuana Eradication (ended January 1, 2018).

The commission certifies several different alcohol awareness training programs; employees who work in the alcohol field are required to take a course and receive a certification in order to distribute alcoholic beverages to the public. For the two programs, the Alcoholic Beverage Server Training Program and the Responsible Vendor Training Program, the commission certifies third-party vendors to provide the training. The Assistant Director oversees the alcohol awareness training certification programs.

Commission-Issued Licenses and Permits

According to Section 57-3, *Tennessee Code Annotated*, the commission issues 15 annual licenses to manufacturers, wholesalers, retailers, distributors, collectors, and vendors. The commission also issues 5-year employee permits to individuals who work for retailers, distillers, and wholesalers. Other permits and certifications are for responsible beer/malt beverage vendors, retail managers, wine satellite facilities, and providers and instructors of the Alcoholic Beverage Service Training Program.

Tennessee Alcoholic Beverage Commission
Organizational Chart
January 2020



Source: Internal Audit Director.

APPENDIX 3
Wine in Grocery Stores
Application Documentation Requirements

The following items must be submitted with Wine in Grocery Stores applications:

- questionnaires from all individuals with 10% or more ownership interest in the business or from all executive officers of a corporate applicant;
- proof of possession of the licensed premises (lease agreements, assignments, subleases, and/or deed to the property);
- if the retail food store is in a shopping center or other development, documentation that the sale of alcohol by others has not been prohibited or restricted;
- for renewal licenses, documentation that the licensee maintained a minimum of 20% of the licensee's sales taxable sales from the retail sale of food and food ingredients;
- an affidavit regarding the amount of retail floor space;
- a site-plan designating the premises and parking areas;
- a Certificate of Compliance completed by the county or municipality stating that the applicant has not been convicted of a felony and that the location complies with all zoning laws of the local jurisdiction;
- a local and national criminal history record obtained from a third party;
- the applicant's acknowledgement of the rules and regulations;
- proof that the entity is registered with the Tennessee Secretary of State's Office;
- a Certificate of Existence/Good Standing issued by the Tennessee Secretary of State's Office;
- a copy of the corporate charter or articles of organization;
- a copy of their Sales and Use Tax Certificate of Registration;
- declarations of citizenship;¹⁵
- designation of who will be in actual control of the retail wine sale operations;
- identification of all retail liquor stores located within 500 feet;
- the name and address of the owner for premises owned by a person, partnership, limited liability company or corporation, if it is not the applicant; and
- a list of the certified clerks employed by the applicant.

¹⁵ Section 4-58-103(1), *Tennessee Code Annotated*, requires that each applicant for a state benefit be a citizen of the United States or lawfully present in the United States.

APPENDIX 4
Expenditures and Revenues for Fiscal Years 2018 to 2019

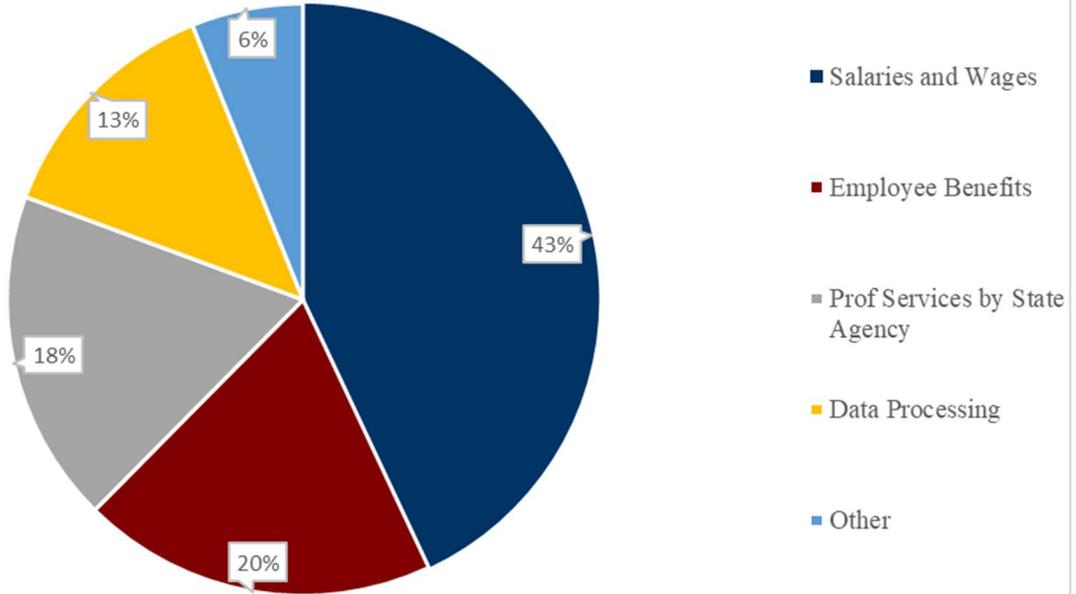
UNAUDITED INFORMATION

Description	Fiscal Year	
	2018	2019
Expenditures		
Training	\$ 38,692	\$ 55,750
Salaries and Wages	3,947,319	3,854,738
Supplies and Materials	105,257	126,085
Employee Benefits	1,780,279	1,560,752
Travel	128,239	160,611
Rentals and Insurance	11,294	22,123
Professional Services by State Agency	1,673,015	1,564,672
Motor Vehicle Operation	16,416	9,031
Printing and Duplicating	55	109
Maintenance & Repairs	3,530	3,265
Professional Services Third Party	225,247	236,705
Data Processing ¹⁶	1,215,853	312,587
Awards and Indemnities	317	633
Communications	16,926	6,973
Unclassified ¹⁷	13,786	21,804
Total Expenditures	\$ 9,176,225	\$ 7,935,836
Revenues		
Fines	923,244	900,387
Refund of Prior Year Expenditures	88	-
Federal Revenue	213,089	20,015
Current Services	9,300,998	10,364,975
Interdepartmental	94,500	129,826
Appropriations		
Carryforward Unencumbered Balance	3,757,624	3,519,382
Revenue Expansion (Fed, Other)	94,500	97,800
Total Revenues	\$ 14,500,718	\$ 15,032,385

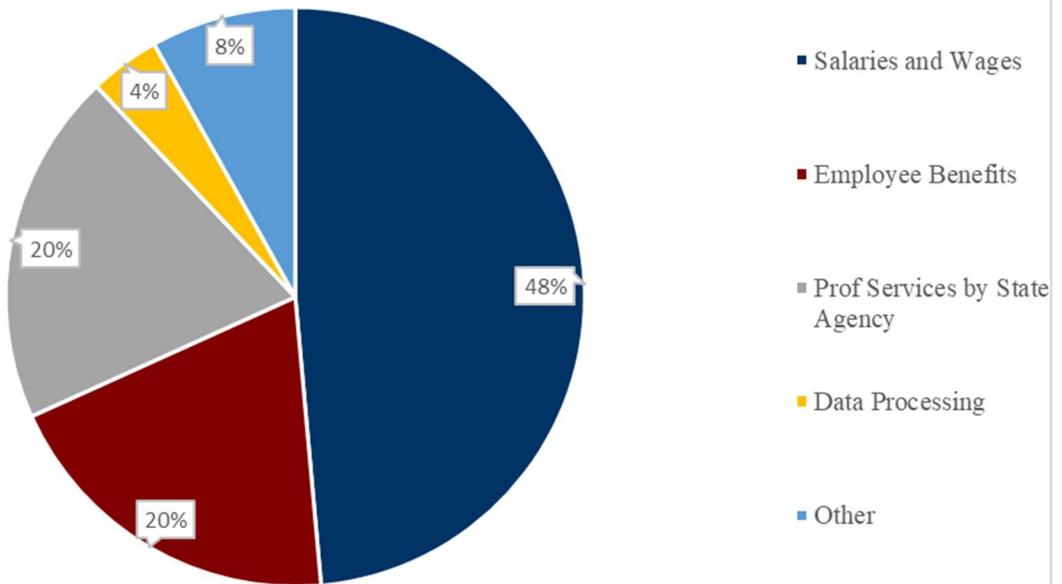
¹⁶ Data processing expenditures in fiscal year 2018 were the result of the implementation of RLPS which included Accela annual maintenance, license, and development fees.

¹⁷ Unclassified expenditures are expenses by agents to conduct compliance checks for licenses and permits.

2018 Chart of Expenditures



2019 Chart of Expenditures



APPENDIX 5

Tennessee Code Annotated and Rules of the Tennessee Alcoholic Beverage Commission on the Wine in Grocery Stores Program

Section 57-3-803(a), *Tennessee Code Annotated*, states,

Notwithstanding any other law to the contrary, an additional class of licenses allowing the sale of wine at retail food stores is created. These licenses shall be known as “retail food store wine licenses” and shall be issued by the alcoholic beverage commission; provided, that licenses shall only be issued to a retail food store located in a county or municipality that has authorized the sale of wine at retail food stores by local option election pursuant to 57-3-801 and has full-time law enforcement through a police or sheriff’s department.

Section 57-3-818(c), *Tennessee Code Annotated*, states,

Each retail food store and retailer shall be required to annually file a report stating the number of certified clerks employed by the licensee in the twelve (12) months preceding the date of the report. The list shall include the first and last name of each clerk. The licensee shall maintain records for each clerk sufficient to verify that annual training has been completed. Training shall be a minimum of one (1) hour annually. Each retail food store and retailer shall pay a fee as follows:

- 1) 0-15 certified clerks - \$150;
- 2) 16-30 certified clerks - \$200;
- 3) 31-45 certified clerks - \$250;
- 4) 46-60 certified clerks - \$300;
- 5) 61-100 certified clerks - \$350;
- 6) 101-150 certified clerks - \$400;
- 7) 151-200 certified clerks - \$450; and
- 8) \$50.00 for each additional 50 certified clerks over 200.

Chapter 0100-11.01(1)(a), “Rules for Sales of Wine at Retail Food Stores” of the *Rules of the Tennessee Alcoholic Beverage Commission* states,

Applications shall be submitted to the [Tennessee Alcoholic Beverage Commission] Headquarters offices in Nashville, Tennessee or on-line at the [commission] website. In addition to the application and other forms provided by the Commission, the following data, written statements, affidavits, evidence or other documents must be submitted in support of an application for a retail food store license: . . .

11. Acknowledgement of the rules and regulations; . . .

13. Corporate charter/Articles of Organization; . . .
17. Completed declarations of citizenship to be submitted by owner(s), member(s), executive officer(s), and/or principal(s) of the applicant and others as required by P.C. 1061 (2012).

APPENDIX 6
Wine in Grocery Stores
On-site Inspection Checklist

The special agent checks for the following items while conducting on-site inspections for the Wine in Grocery Stores program:

- verifies that the retail food store derives at least 20% of its sales taxable sales from the retail sale of food and food ingredients for human consumption, not including prepared food;
- verifies that the records are current and maintained to demonstrate that 20% of food and food ingredient sales are being met;
- verifies that the retail food store's floor space consists of at least 1,200 square feet;
- looks for any indications of sales to minors, visibly intoxicated persons, or any person without first checking identification;
- verifies that the retail food store is not selling wines with an alcohol content greater than 18% by volume;
- verifies that there is no indication of the sale or offering of liquor, spirits, or high gravity beer;
- looks for any indications that two or more items, one of which is wine, are being sold or advertised at a combined price;
- looks for any indication that tastings are being conducted in the retail food store;
- verifies that the food retailer does not hold a license to sell alcoholic beverages for consumption on the premises (if the food retailer does hold such a license, the special agent is to ensure the location is separate and distinct from the retail food store);
- verifies that the license is prominently displayed;
- verifies that the pregnancy sign is prominently displayed; and
- verifies that purchases are made exclusively by designated managers.

APPENDIX 7
Tennessee Code Annotated for the Tennessee Alcoholic Beverage Commission's Direct Shipper's License

Section 57-3-217, *Tennessee Code Annotated*, states,

- (a) Any person, firm or corporation that holds a federal basic permit pursuant to the Federal Alcohol Administration Act (27 U.S.C. § 201 et seq.), and is in the business of manufacturing, bottling or rectifying wine may apply to the commission for a winery direct shipper's license under this section. Applicants for a winery direct shipper's license shall submit to the commission a copy of the federal basic permit and a permit for the manufacturing, bottling, or rectification of wine from the state where such wine is produced.
- (b) A winery direct shipper, meeting the requirements of this section, shall be authorized to make sales and delivery of wine, as defined in § 57-3-101, by common carrier to the citizens of this state over the age of twenty-one (21) who have purchased the wine directly from the winery direct shipper, subject to the limitations and requirements imposed by this section.
- (c) As a condition to the issuance of a winery direct shipper's license as authorized in this section, an applicant for the license must satisfy the following conditions:
 - (1) Pay to the commission a one-time nonrefundable fee in the amount of three hundred dollars (\$300) when the application is submitted for review. A winery direct shipper's license under this section shall not be issued until the applicant has paid to the commission the annual license fee of one hundred fifty dollars (\$150);
 - (2) Execute a consent to jurisdiction and venue of all actions brought before the commission, any state agency or the courts of this state, such that any and all hearings, appeals and other matters relating to the license of the winery direct shipper shall be held in this state;
 - (3) Acknowledge, in writing, that it will contract only with common carriers that agree that any delivery of wine made in this state shall be by face-to-face delivery and that deliveries will only be made to individuals who demonstrate that the individuals are over twenty-one (21) years of age and the individuals sign upon receipt of the wine.
- (d)
 - (1) No winery direct shipper may ship more than a total of nine (9) liters of wine to any individual during any calendar month nor shall the shipper ship more than twenty-seven (27) liters of wine to any individual in any calendar year.
 - (2) Any shipment of wine pursuant to this section shall be made only in containers that clearly indicate on the exterior of the container, visible to a person at least three feet (3') away, that the container "CONTAINS ALCOHOL: SIGNATURE OF PERSON AGE 21 OR OLDER REQUIRED FOR DELIVERY".

- (e) (1) A winery direct shipper shall be responsible for remitting all sales taxes due resulting from any sale made under this section. In addition to all sales taxes imposed upon such sale, a winery direct shipper shall remit the gallonage tax as imposed by § 57-3-302.
- (2) The taxes levied on sales made by a winery direct shipper as authorized by this section shall become due and payable on the first day of each month following the month during which the sales occur, and shall become delinquent if not paid on or before the twentieth day of each such following month. For the purpose of ascertaining the amount of tax due, it is the duty of any winery direct shipper licensed pursuant to this section to transmit to the commissioner of revenue appropriate returns on forms prescribed by the commissioner.
- (3) Upon request of the commission or its designated agent, any winery direct shipper licensed pursuant to this section shall provide to the commission, under penalty of perjury, a list of any wine shipped to an address within this state, including the addressee.
- (4) The commission may enforce the requirements of this section by administrative action, may suspend or revoke a winery direct shipper's license and may accept an offer in compromise in lieu of suspension.
- (5) A winery direct shipper that is found to have violated this title, in addition to any fine imposed by the commission, shall reimburse the commission for all costs incurred in connection with the investigation and administrative action, including the out-of-pocket costs and reasonable personnel costs.
- (6) No winery direct shipper may avoid liability under this section by subcontracting with a third party to perform its obligations required pursuant to this section.
- (f) The commission and the department of revenue are authorized to promulgate rules and regulations that may be necessary to implement this section, in accordance with the Uniform Administrative Procedures Act, compiled in title 4, chapter 5.
- (g) (1) It is an offense for a person who does not possess a winery direct shipper's license to ship wine to residents of this state.
- (2) A violation of subdivision (g)(1) is a Class E felony, punishable by a fine only.
- (h) (1) Each common carrier that contracts with a winery direct shipper under this section for delivery of wine, beer, or other alcoholic beverages into this state shall prepare and file monthly with the department of revenue a report of known wine, beer, or other alcoholic beverage shipments containing the name of the common carrier making the report, the period of time covered by the report, the name and business address of the consignor, the name and address of each consignee, the weight of the package delivered to each consignee, a unique tracking number, and the

date of delivery. Reports received by the department of revenue must be made available to the public pursuant to the open records law, compiled in title 10, chapter 7.

- (2) Upon the request of the commissioner of revenue, any records supporting the report must be made available to the department of revenue within a reasonable time after the commissioner makes a written request for such records. Any records containing information relating to such reports must be retained and preserved for a period of two (2) years, unless destruction of the records prior to the end of such retention period is authorized in writing by the department of revenue. Such records must be open and available for inspection by the department of revenue upon written request. Reports must also be made available to any law enforcement agency or regulatory body of any local government in this state in which the common carrier making the report resides or does business.
- (3) Any common carrier that willfully fails to make reports in accordance with this section or that violates any rules of the department of revenue for the administration and enforcement of this section is subject to a notification of violation. If a common carrier continually fails to make reports, the common carrier may be fined in an amount not to exceed five hundred dollars (\$500) for each delivery not reported to the department of revenue. Unpaid fines assessed under this subdivision (h)(3) must be collected in accordance with title 67, chapter 1.
- (4) This subsection (h) does not apply to common carriers regulated under 49 U.S.C. §§ 10101 et seq., or to rail trailer-on-flatcar/container-on-flatcar (TOFC/COFC) service, as defined in 49 CFR § 1090.1, or highway TOFC/COFC service provided by a rail carrier, either itself or jointly with a motor carrier, as part of continuous intermodal freight transportation, including, without limitation, any other TOFC/COFC transportation as defined under federal law.

Section 57-3-602(a), *Tennessee Code Annotated*, states,

- (a) A nonresident seller's permit is required of any manufacturer, distillery, winery, importer, broker, or person which sells or distributes alcoholic beverages to any wholesaler licensed under § 57-3-203 or any manufacturer licensed under § 57-3-202, regardless of whether the sale is consummated inside or outside Tennessee. No such permit is required if such manufacturer, distillery or winery is operating pursuant to § 57-2-104, § 57-3-202, § 57-3-203 or § 57-3-207.

APPENDIX 8

Management's Comment to Observation 1

We concur.

Since 2016 the Chief Law Enforcement Officer (CLEO) has mandated Evidence Management System (EMS) usage across the state for all TABC agents and field offices to correct the previous audit findings. EMS allows for easier inspection of completeness of the paperwork and allows for the Special Agents in Charge (SAC) and Assistant Special Agents in Charge (ASAC) to review each case file submitted by the special agent to ensure that paperwork is complete and signed.

Agents have “read-only” rights in the criminal case file database and only SACs and ASACs can save case files and documents in the database. When a case file is ready for closure, the agent will submit a case closure request to the SAC and ASAC along with any other required documents for case closure, such as Evidence Disposition Report and judgment. The SAC and ASAC will review the case file and all documents to ensure completeness before submitting the case closure request to the CLEO or his designee. The CLEO or his designee will review all documents in the case file for completeness and upload a Case Closure Notice signed by the CLEO. This control activity has greatly decreased missing forms and missed signatures.

TABC will also be conducting additional training before the end of the calendar year to ensure that all agents are familiar with the procedures on completing case files and ensuring signature completion.

TABC is also taking the necessary tasks to ensure proper procedures are in place regarding evidence destruction. At each destruction the primary evidence custodian, a witness that is not part of the TABC Law Enforcement Division, and another agent provide signatures and complete the paperwork on-site, each ensuring controls are in place.

TABC will also be purchasing new software which will have increased serviceability and added functions. Once the software is in place law enforcement personnel will undergo additional training on software usage and the need for accurate and complete paperwork.