

LEGISLATIVE AUDIT DIVISION

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MEMORANDUM

TO: Legislative Audit Committee Members

FROM: John Harrington, Senior Performance Auditor

CC: Department of Revenue:
Gene Walborn, Director
Becky Schlauch, Administrator, Alcoholic Beverage Control Division
Department of Justice:
Tim Fox, Attorney General
Angela Nunn, Administrator, Gambling Control Division

DATE: October 2019

RE: Performance Audit Follow-Up 19SP-04: *Coordination of Liquor Licensing Compliance Programs* (orig. 16P-02)

ATTACHMENTS: Original Performance Audit Summary

Introduction

The *Coordination of Liquor Licensing Compliance Programs* (16P-02) report was issued to the Legislative Audit Committee in June 2017. The audit included four recommendations, three to the Department of Revenue and one to both the Department of Revenue (DOR) and the Department of Justice (DOJ). We conducted follow-up work with both agencies to assess implementation of the report recommendations. This memorandum summarizes the results of our follow-up work.

Overview

After a brief trial, the Department of Revenue Alcohol Beverage Control Division is no longer conducting follow-up compliance work for certain requirements of certain alcohol licenses as recommended in the audit. By broadening the scope of its on-site inspections to include premises licensed only for retail alcohol sales in addition to gambling licensees, the Department of Justice has increased compliance with state laws and rules among non-gaming alcohol licensees. Improved administrative rules have removed some ambiguity regarding walls and signage at certain categories of licensed establishments.

Background

Our original performance audit found opportunities for increased compliance work by the Gambling Control Division (GCD) of the DOJ in the inspection of premises licensed only for alcohol sales in addition to those licensed for both gambling and alcohol. At the DOR, the audit found opportunities to improve compliance efforts of the Alcoholic Beverage Control Division (ABCD) when various types of alcohol licenses are up for annual renewal. Audit work also found ambiguity in administrative rules related to walls and signage at certain licensed establishments, and we recommended these rules be clarified.

Audit Follow-Up Results

The following sections summarize the progress toward implementation of the report recommendations. In conducting follow-up work, we interviewed administrators of both the GCD and the ABCD along with selected staff members. We reviewed new forms used for various licensee inspections and reviewed statistics reflecting the GCD's initial efforts at conducting site visits at establishments licensed for alcohol sales but not for gaming. We reviewed letters sent by the ABCD to local law enforcement agencies and to restaurant-beer-wine licensees across the state. We also reviewed new administrative rules and observed their implementation at a licensed business in Helena.

RECOMMENDATION #1

We recommend the Department of Revenue and Department of Justice work together to add observable alcohol compliance items to the Gambling Control Division's on-premises inspection checklist, and conduct inspections at licensed businesses that are not also licensed for gaming.

Implementation Status – Implemented

This recommendation was based on audit work showing that locations licensed for alcohol sales but not for gaming were not subject to site visits by any state oversight agency. Because the GCD was already conducting site visits at businesses licensed for gaming, it was appropriate for the division to expand its on-site inspections to include businesses licensed for alcohol sales but not gaming.

Investigators from the GCD began making site inspections at businesses licensed for alcohol but not gaming at the start of fiscal year 2018. The division developed several checklists for use at various types of licensed premises, including restaurant-beer-wine, manufacturers, etc. The division also moved all its compliance reporting to an electronic format, so investigators now complete and submit forms on laptops rather than on paper copies.

The addition of non-gaming alcohol licensees to the pool of potential site visits had the effect of nearly doubling the number of licensees the GCD could visit, which led to an increase in the time between visits to a given establishment. Whereas all gaming licensees were visited within about 18 months previously, many businesses will now go longer between site inspections. The increased workload is countered somewhat by efficiencies gained through electronic reporting.

Our follow-up work found a higher number of violations reported after the initial round of compliance visits to non-gaming alcohol licensed businesses, in part because those premises had never been inspected once they were open (unlike gambling licensees, who were paid subsequent inspection visits). Convenience stores, for example, were never previously visited by GCD. Initial licensees must file a floor plan, and for these new alcohol licensee visits, the original floor plan (on file at DOR, which may be several years old) may not match the current layout, resulting in a violation. Statistics provided by GCD show that the inspections being expanded to include liquor-only licensees led to significantly more violations being discovered. In fiscal year 2017, when all inspections were done at premises licensed for both gaming and alcohol, the division reported 73 violations in non-alcohol-related categories (floor plan alterations, names of location managers, etc.). In fiscal year 2018, the number of violations in these categories was 204, at locations that were licensed for alcohol only.

RECOMMENDATION #2

We recommend the Department of Revenue implement of process to determine if licensees renewing liquor licenses have been cited by local law enforcement agencies during the most recent licensing period when conducting the annual license renewal process.

Implementation Status – *Not Implemented.*

Audit work found that ABCD staff performed little to no compliance work on annual license renewals. The audit found that when alcohol licensees submit their annual renewal forms, they affirm that there had been no alcohol-related citations associated with the license in the previous 12 months, but ABCD staff was not researching these claims to determine whether licensees were being honest on their renewal forms. Beyond taking the word of licensees and encouraging local law enforcement agencies to fill out and submit a notice of violations, ABCD was not doing any additional compliance work to verify claims of no violations.

The renewal date for alcohol licenses is July 1. When we began our follow-up work, ABCD officials indicated the division was preparing to send letters to local law enforcement agencies to determine if licensees who had most recently renewed their licenses had been cited for any alcohol-related violations in the previous license period. We were told there was a lag of several months between the license renewal date and the mailing of the letters because staff needed time to ensure the rest of the renewal application was complete and accurate.

We provided the division additional time to send letters to law enforcement agencies and obtain responses from them as part of the license renewal process. According to division officials, 384 letters were sent to local law enforcement agencies for 2018 license renewals. This represented 15 percent of the state's 2,543 on-premise licensees. The division received 183 responses and no reports of any additional violations.

Based on the lack of additional citations and what it called a "large increase in workload on our limited resources," the division discontinued this compliance work after one year's worth of renewals. It did not do any follow-up work with local law enforcement agencies for 2019 license renewals and told us it has no plans to do any more in future license renewals. Thus, given the division has no plans to continue this step in future license renewal years, this recommendation is not implemented. By deciding to no longer perform any additional compliance checks with local law enforcement agencies across the state, we do not believe ABCD is fulfilling its role as the oversight and compliance entity for alcohol licenses in Montana.

RECOMMENDATION #3

We recommend the Department of Revenue:

- A. Require additional information from restaurant-beer-wine licensees to confirm 65 percent of gross revenue comes from sale of food, or**
- B. Seek legislation to change Montana Code related to business food sales criteria for restaurant-beer-wine licensees.**

Implementation Status – *Not Implemented.*

As with the previous recommendation, initial audit work found ABCD was not conducting any follow-up work with licensees renewing their restaurant-beer-wine licensees. Owners of these licenses are required to gain 65 percent or more of their gross revenue from the sale of food. But other than asking on the renewal form whether the 65 percent threshold was met, the division was not requiring any proof or additional documentation from restaurant-beer-wine licensees.

DOR did not seek legislation in the 2019 Legislative Session to change Montana Code related to business food sales criteria for restaurant-beer-wine licensees (part B of the recommendation). Through our follow-up work we learned that DOR elected to implement Part A of this either/or recommendation.

The renewal date for alcohol licenses is July 1. As with the preceding recommendation, at the outset of follow-up work we learned letters were still being prepared to send to a sample of restaurant-beer-wine licensees to collect additional information related to the percentage of the businesses' sales attributable to food.

Because letters to restaurant-beer-wine licensees had not been sent at the time initial follow-up audit work was done, we provided the division additional time to send letters and compile the results. According to division officials, 65 letters were sent to restaurant-beer-wine licensees for 2018 license renewals. This represented 25 percent of the state's 260 restaurant-beer-wine licensees. The letters requested an income statement from the most recent 12 months, with food and alcohol sales broken out to indicate that the 65 percent requirement for food sales was being met. The division indicated that among those licensees who received the request for additional documentation, the information provided by the licensees indicated they were meeting the statutory requirement for food sales to represent 65 percent of total sales.

According to division officials, the affirmative responses to the letters sent indicated there were no compliance issues with restaurant-beer-wine licensees. They also indicated this process created a large increase in workload on their limited resources. The division decided to discontinue this compliance work and did not conduct follow-up with restaurant-beer-wine licensees for 2019 license renewals. Consequently, the recommendation is not implemented since the division has no plans to continue requesting restaurant-beer-wine licensees to provide documentation their businesses are selling the required percentage of food.

RECOMMENDATION #4

We recommend the Department of Revenue implement recently adopted Administrative Rules regarding:

- A. Physical separation requirements between alcohol manufacturing operations and other attached businesses.**
- B. Exterior signage requirements on beer manufacturing businesses, taprooms, and other types of co-located alcohol licensed businesses.**

Implementation Status – *Implemented.*

The Department of Revenue addressed this recommendation through the adoption of administrative rules in April 2017. The rules brought additional clarity to the physical separation requirements between alcohol beverage licensees and attached businesses. This clarification included exterior signage requirements on beer manufacturing businesses, taprooms, and other co-located businesses with alcohol licenses. The new rules also better addressed definitions of walls and the types of separation required between licensed manufacturing businesses and other entities co-located in the same building.

At one licensed business in Helena at which the application of the old signage rules was in dispute, we observed a new sign that more clearly indicates which portion of the facility is for manufacturing and which is a licensed business open for public sales of alcohol. This is an indication the new rules have increased clarity and are being followed.