INTERNAL AUDIT OF THE ENFORCEMENT ADMINISTRATION AS OF JANUARY 14, 2014

AT THE

TEXAS ALCOHOLIC BEVERAGE COMMISSION

Approved by the Commission

on March 25, 2014

MONDAY N. RUFUS, P.C.
Certified Public Accountants and Consultants

MONDAY N. RUFUS, P.C.

Certified Public Accountants & Consultants

Member: American Institute of Certified Public Accountants

Commission Members
Texas Alcoholic Beverage Commission
Austin, Texas

We have evaluated the controls implemented by the Texas Alcoholic Beverage Commission (Commission) regarding the Enforcement Administration as of January 14, 2014. The results of our evaluation disclosed that the Commission has procedures and controls in place related to the Enforcement administration. We noted some opportunities for enhancing the controls in place. The report that accompanies this letter summarizes our comments and recommendations.

We have already discussed this report with various Commission personnel, and we will be pleased to discuss it in further detail at your convenience.

Monday N. Rufus, P.C.

January 14, 2014
Austin, Texas

TABLE OF CONTENTS

Executive Summary……4

Internal Audit Results…….6

Objectives, Observations, Recommendations……7

Appendices

1. Enforcement Action Plan Fiscal Year 2013…….11
2. Definitions…….....……12
3. Objective and Scope..……..13
4. Background …….....15
5. Report Distribution ……..17

Executive Summary

Background Information

In 1935, the Legislature created the Texas Alcoholic Beverage Commission (formerly the Texas Liquor Control Board).

The Texas Alcoholic Beverage Commission (Commission) is the state agency that regulates all phases of the alcoholic beverage industry in Texas. The duties of the Commission include regulating sales, taxation, importation, manufacturing, transporting, and advertising of alcoholic beverages.

The Commission collects in excess of $200 million annually in taxes and fees from alcoholic beverage license and permit fees, alcohol beverages taxes, cigarette taxes, airline beverage tax, and revenue collected on audits. This revenue aids in the financing of the state's public schools, local governments, research, human services, and other areas in which state government provides services to all Texans and is deposited into the General Revenue Fund.

The Texas Alcoholic Beverage Commission regulates the alcoholic beverage industry in Texas in part by conducting inspections of licensed retail locations. The Commission strives to inspect all licensed premises at least once a year. As of August 31, 2013, there were 52,959 licensed locations subject to inspection in Texas. In order for the agency to try to accomplish this task each year, Enforcement agents and Audit & Investigations auditors join efforts to inspect licensed premises. In Fiscal Year 2013, 45,589 of the licensed 52,959 locations were inspected by Enforcement and the Audit & Investigations divisions. Enforcement agents conducted 27,267 of the 45,589 unique inspections in Fiscal Year 2013.

> ***Unique Inspection***
>
> Unique inspections are conducted to evaluate a location that has not yet been inspected during the current fiscal year.

The Enforcement administration is within the Field Operations Division which is the TABC's largest division. Inspections, audits, investigations, and other activities conducted by the Commission in monitoring licensed premises for compliance with the Texas Alcoholic Beverage Code is a joint effort by the Enforcement, Audit & Investigations, and other agency divisions. The goal of Enforcement is to protect the peace and safety of the public by encouraging voluntary compliance with the Texas Alcoholic Beverage Code and other state laws and by undertaking enforcement and regulatory actions that are both fair and effective.

For Fiscal Year 2013, the Commission's legislative appropriated budget for Enforcement was $22,326,448; a 52.48% of the Agency's budget.

At the time of the internal audit engagement the Enforcement Administration section has 238 Full-Time-Equivalent (FTEs) employees statewide consisting of:

1 Chief of Field Operations
1 Assistant Chief of Enforcement

13	Lieutenants
2	Majors
3	Captains
25	Sergeants
138	Agents
38	Agent Trainees
14	Administrative Assistants
2	Management Analysts
1	Inspector
238	Total

On April 23, 2013 Field Operations changed the Compliance Division into the Audit & Investigations division. Enforcement division personnel interact with the Audit & Investigations division which is comprised of field auditors and two new investigations units: Special Investigations Unit (SIU) and a Financial Crimes Unit (FCU).

Investigations of at-risk locations, financial criminal activities, and inspections with public safety violations are handled by enforcement commissioned agents. The commissioned agent will take the lead in the case and the auditor assists the agent on the case until it is closed.

A location that is cited for a public safety violation is included on the agency's Priority List. Initiatives which are considered to constitute a *public safety violation* during an inspection are:

- Sale/Service/Delivery of Alcohol to Minors
- Sale/Service/Delivery of Alcohol to Intoxicated Individuals
- Narcotics
- Breaches of the Peace
- Sale and Consumption of Alcohol During Prohibited Hours
- Human Trafficking

Risked-Based focus inspections are conducted on TABC licensed locations that have a recent violation history. These locations are known as "priority locations" and are put on a Priority List, with risked-based inspections conducted to ensure that they comply with the law. The frequency of inspections is based on whether a location is a Priority 1, Priority 2, or Priority 3.

Priority 1: Inspected at least every 14 days.
Will become Priority 2 after three clean inspections.
Priority 2: Inspected at least once a month.
Will become Priority 3 after six clean inspections.
Priority 3: Inspected at least every 3 months.
Will be dropped off the Priority List after 12 months.

Risk-Based Inspections are conducted at locations on which one or more public safety administrative or criminal violations have occurred within the previous 12 months.

TABC is required to maintain current and accurate records for Enforcement certified peace officer training as required by the Texas Commission on Law Enforcement (TCOLE).

During Fiscal Year 2013 the licensed locations inspected by Enforcement

Division agents combined with the inspections conducted by the Audit & Investigation Division contributed to inspecting 45,589 of 52,959 (86.08%) of the licensed establishments.

The Fiscal Year 2013 legislative Output measure required for Enforcement Agents in the five (5) statewide districts to conduct a total of 103,954 inspections. The total number of inspections conducted by Enforcement agents in fiscal year 2013 were 74,305 (**Appendix 1**).

Enforcement agents use the Agency Reporting and Tracking System (ARTS) to report their inspections and investigations and other daily activities being conducted statewide in enforcing and promoting the Texas Alcoholic Beverage Code. Enforcement agents also use the software called NetRMS:CrisNet (CrisNet) for inputting administrative and criminal violations cases which also allows agents to access the database of written cases and provide instant access to reports state-wide. The agents also input their daily inspection times and activities into the Daily Activity Report (DAR) database system which is linked to ARTS.

Summary of Internal Audit Results

Procedures and controls are in place to ensure that inspections and investigations conducted by the Enforcement administration of licensed and unlicensed premises are complying with the Texas Alcoholic Beverage Code, TABC Administrative rules, and other legislative requirements. Enforcement personnel in the five districts input inspections and investigations information and scan documents into ARTS, DARS, and CrisNet systems for case management and accessibility by TABC headquarters and district enforcement personnel. While the Enforcement administration operations continue to become more electronic and paperless, documents which may support or assist an active or on-going case or investigation will be maintained at the local districts for immediate accessibility until cases are closed.

Summary of Management's Response

Management agrees with the audit findings and recommendations.

When a complaint against a retailer is unfounded and no administrative case was filed, but more investigation is required, a second complaint should be opened against the person or persons being investigated. It is now standard operating procedure for the agency to open a second complaint should the original be unfounded and further investigation against other individuals is necessary.

A copy of each letter that is sent to licensees/permittees that refused to sell alcohol to a minor during a minor sting operation conducted on their premise is now being kept at each of the District Offices.

Objectives, Observations, Recommendations, and Management's Response

The primary objectives of the internal audit were:

1. Reliability and Integrity of Information

2. Compliance with Policies, Procedures, Laws, and Regulations

3. Efficiency and Effectiveness of Operating Procedures

4. Safeguarding of Assets

RESULTS AND RECOMMENDATIONS

Internal Audit Objective 1: Reliability and Integrity of Information

Personnel involved in the administration and operations of Enforcement appear to be very knowledgeable regarding daily operations of statewide inspections and investigations activities.

There is on-going communication among Enforcement district personnel, Headquarters management, and other Commission divisions involved in the inspections, investigations, licensing, and other activities regarding licensed and unlicensed premises statewide.

Internal and External complaints from the public against Enforcement and other Commission personnel are being timely investigated, documented, and addressed by the Commission's executive management in order to maintain the integrity of the Commission in serving the public.

During fiscal years 2012 and 2013, there were 26 internal and external complaints filed with the Commission.

	Complaints (a)			(b)	Enforcement
	Total	Internal	External	Allegations	Individuals
FY 2012	14	14	0	30	11
FY 2013	12	10	2	18	13
	26	24	2	48	24

A sample of the external complaints from fiscal year 2013 and three (3) internal complaints from fiscal year 2012 were reviewed by the internal auditors with the following results:

- All internal and external complaints received and listed for fiscal years 2012 and 2013 were investigated by the Office of Professional Responsibility (OPR).
- On each chase investigated, OPR investigators met with both the Complainants and Respondents during the investigation.
- The Commission's executive management approved the final decisions made regarding each complaint case investigated.

The Enforcement agents in the five (5) TABC districts use the Commission's Agency Reporting and Tracking System (ARTS) for reporting their daily inspections and investigations activities and a Daily Activity Report (DAR) to report the time used on each inspection or investigation. The DAR and the ARTS systems are also linked to each other and associate each enforcement agent's name with each inspection and investigation conducted. Inspection and investigation cases which result in an administrative or criminal violations are also entered by enforcement agents into the Commission's CrisNet database system which provides instant access to reports state-wide.

During our testing of Enforcement inspection and investigation case files, the auditors noticed that two of the Other Criminal Activity (OCA) -Trafficking Investigation Complaint files from District 4 (Austin) which had been selected for testing had been transferred to the Audit & Investigations- Special Investigations Unit (SIU). The two investigation files were transferred to SIU due to the nature of the criminal violations involved, time-intensive focus on the cases, and coordination with other law enforcement agencies involved in the investigations. The two complaint investigation files were reviewed at the SIU by the auditor for proper recording in the ARTS and CrisNet systems, and for supporting documentation on their current status.

Finding 1: Miscoding of Investigation Case in CrisNet Database System.

During testing of enforcement agent investigation files by the internal auditors at District 4, we found that an Open Compliance check conducted (ARTS case #1318270) which had resulted in no violations had been miscoded and entered by the enforcement agent into the CrisNet database system as a Source investigation with administrative and criminal violations. Management has recoded the case file to properly reflect the nature of the investigation.

Recommendation

The status of inspections and complaints cases should be more closely monitored by Enforcement management to ensure proper and accurate reporting of enforcement cases.

Management's Response:
Management agrees with the findings and recommendation. When a complaint against a retailer is unfounded and no administrative case was filed, but more investigation is required, a second complaint should be opened against the person or persons being investigated. It is now standard operating procedure for the agency to open a second complaint should the original be unfounded and further investigation against other individuals is necessary.

Internal Audit Objective 2: Compliance with Policies, Procedures, Laws, and Regulations

TABC is required to maintain accurate and current records for Enforcement certified peace officer training as required by the TCOLE who is legislatively authorized to certify peace officers. Enforcement officers training is on a 4-year cycle of 2-year units with 40 hours of training required by each 2-year unit. Training is also conducted based on the requirements of mandates depending on the officer's classification. For the 2-year unit from 9/1/2011-8/31/2013 there were 309 enforcement officers trained.

We selected a sample of these training records to determine compliance with training requirements and record keeping. No exceptions were noted. TCOLE also has oversight of the training courses taken by TABC commissioned enforcement personnel to ensure they meet minimum requirements for certification and to determine that enforcement training records are properly kept.

Enforcement Administration has an *Enforcement Manual* which applies to all personnel acting in an enforcement capacity. There is a process in place for updating the manual's policies and procedures by executive management. The Enforcement Manual is included in the TABC intranet and accessible to enforcement and agency personnel.

The Commission's executive management is in the process of approving written policies and guidelines to be included in the Fields Operations Manual. These policies and guidelines will outline the functions of the Special Investigations Unit and the Financial Crimes Unit within the Fields Operations division. These written policies and guidelines will also outline the roles and responsibilities of personnel within Enforcement and the Audit & Investigations divisions of Field Operations.

Finding 2: Supporting Documentation Lacking for Required Minor Sting Operations Letters Sent To Representatives of Locations Not Selling Alcohol to Minors.

Section 3.6 (m) of the Enforcement manual policies and procedures requires supervisors at the Enforcement districts to write and send letters to representatives of locations where sting operations were conducted but no alcohol was sold to the minor, acknowledging the location for complying with the law. During our testing of minor sting operations case files entered into the ARTS system we noticed that 3 of 5 minor sting operations case files reviewed in District 4, and 7 of 8 minor sting operations case files reviewed in District 5 where no alcohol was served to the minor, did not have copies of the letters or evidence that the letters were sent.

Enforcement administration management recently developed a Minor Sting operations electronic complimentary letter to be sent to licensees/permittees who refused to sell alcohol to a minor during a minor sting operation conducted on their premise.

Recommendation

Management should include in the policies and procedures instructions on how a copy of the letter or a checklist should be saved (electronically or in paper form) after it is sent as evidence of complying with the written policies and procedures.

Management's Response:

Management agrees with the finding. A copy of each letter that is sent to licensees/permittees that refused to sell alcohol to a minor during a minor sting operation conducted on their premise is now being kept at each of the District Offices.

Internal Audit Objective 3: Efficiency and Effectiveness of Operating Procedures

The Enforcement agents work jointly with Audit & Investigations inspectors and auditors in conducting inspections and investigations to ensure compliance by licensed retail locations with the Texas Alcoholic Beverage Code. It is crucial that Enforcement commissioned agents and auditors work together during inspections if a public safety violation is discovered or suspected.

While conducting enforcement inspections of licensed and unlicensed premises, the Agents and other auditors also use it as a means to open communications with the licensees/permittees to answer questions regarding compliance with the Texas Alcoholic Beverage Code and to provide training to their employees.

At the time of the internal audit, the Commission was in the process of developing policy and guidelines for the Special Investigations Unit (SIU) and Financial Crimes Unit (FCU). Management has indicated that once the policies and guidelines are implemented , it will be able to plan, coordinate, and allocate Enforcement Administration and Audit & Investigations personnel and resources in long-term investigations and other inspections/investigations with time mandated goals.

Internal Audit Objective 4: Safeguarding of Assets

Personnel involved in the administration and Enforcement administration operations appear to be very knowledgeable regarding daily operations of statewide inspections of licensed premises.

Enforcement Administration management has developed a Minor Sting operations electronic standard complimentary letter to send to licensees/permittees who refused to sell alcohol to a minor during a minor sting operation conducted on their premise. Management believes this electronic letter will save the Commission some personnel time, paper supplies, ink, and postage which was used with the previous paper letters, and ultimately ensure efficiency of operating procedures.

Appendix 1

Enforcement Action Plan Results
FY 2013

Inspections of Licensed & Unlicensed Locations:

Inspection Type	Statewide
Inspections of Licensed Premises:	
Cops in Shop (LP)	31
Exterior Surveillance	6244
License Status Check	107
Minor Sting (LP)	6948
Open Compliance Check	50413
Operation Fake Out (LP)	25
Other Undercover	1262
Prohibited Hours – Open	5709
Prohibited Hours – UC	211
Other	156
Total – Inspections of Licensed Premises	71,106
Inspections of Unlicensed Premises:	
Exterior Surveillance	453
License Status Check	135
New Location Check	251
Open Compliance Check	2078
Other Undercover	92
Prohibited Hours –Open	85
Prohibited Hours – UC	3
Other	102
Total – Inspections of Unlicensed Premises	3,199
Total – All Inspections	74,305

Annual Inspection Annual Goal	103,954
Percentage of Annual Goal Obtained	71.48%

Appendix 2

DEFINITIONS:

Licensed Premises
The grounds and all buildings, vehicles, and appurtenances pertaining to the grounds of a location for which an alcoholic beverage permit/license has been issued.

Complaint Investigation
General term used for an investigation conducted by the TABC since the agency conducts all investigations in response to complaints.

Public Safety Violations
Any violation that presents a risk to the public safety of the people of Texas.

Risk-Based Enforcement
The risk-based enforcement program involves increased inspection frequency for retailers with past histories of public safety violations, prioritizing complaints from these establishments, and emphasis on "after hours" establishments.

Risk-Based Inspections
Inspections conducted at locations on which one or more public safety administrative or criminal violations have occurred within the previous 12 months.

Priority Inspections
A priority level is assigned to retailers and determine the frequency of inspections. The highest priority level is reserved for retailers whose owner or employees have recently committed a public safety offense.

Unique Inspection
An inspection completed at a licensed location that has not yet been inspected during the current fiscal year.

Prioritized Complaint Investigations
Priority investigations are immediately assigned if they involve an alleged public safety offense.

Minor Stings
Young under aged people, who are under the close supervision of TABC enforcement agents go into licensed establishments and attempt to buy alcoholic beverages.

Source Investigation

An investigation conducted for the purpose of identifying the source of alcoholic beverages consumed by an individual(s), involved in an incident that results in serious bodily injury, death, or a felonious assault; and determining whether the source of the alcohol violated the Alcoholic Beverage Code.

Appendix 3

Objective and Scope

Objective

The audit objectives are to determine the following:

- Reliability and Integrity of Information
- Compliance with policies, procedures, laws and regulations
- Efficiency and Effectiveness of Operating Procedures
- Safeguarding of assets

Scope

The audit scope of the internal audit work included reviewing the effectiveness of the Commission's Enforcement Administration processes in the reporting of inspections and investigations for licensed and unlicensed premises for compliance with the Texas Alcoholic Beverage Code, Tax Administrative Rules, and Enforcement Manual.

Methodology

Our procedures included collecting information and documentation; performing selected tests and other procedures; analyzing and evaluating the results of the tests; reviewing operating policies and procedures, laws, and regulations, conducting interviews with the appropriate staff of the Commission, testing for compliance with policies, procedures and laws, and review of other pertinent reports and documentation.

Information collected and reviewed included the following:

- The Commission's *Enforcement Manual*
- Texas Alcoholic Beverage Code (2013)
- TABC Administrative Rules – Chapter 35. Enforcement (January 2013)
- Texas Peace Officer's Guide (September 2013)
- General Appropriation Act (2012-2013)
- Commission Appropriated Budget (FY 2012-2013)
- Summary of Enforcement Action Plan Results (FY 2013)
- State Auditor's Office Audit Reports for Commission
- TABC Agency Website (www.tabc.state.tx.us)

Procedures and tests conducted included the following:

- Interviewed Enforcement Administration Headquarters Commission management and staff to obtain an understanding of the Enforcement Administration's inspections and investigations of licensed and unlicensed premises.
- Gaining an understanding of the Commission's control structure related to the Enforcement Administration's inspection and investigations activities, recording and reporting processes.

- Testing internal controls over inspection and complaint processes, management reviews, and information reporting.

- Testing for supporting documentation at selected statewide district offices.

- Tracing Enforcement agents inspections and investigations activities and daily times information.

- Tested for compliance with the *Enforcement Manual* used by Enforcement personnel.

- Tested for compliance with Legislative requirements, Texas Alcoholic Beverage Code, TABC Administrative Rules, and Texas Peace Officer's Guide.

- Other pertinent reports and documents

Other Information

Our internal audit was conducted in accordance with *generally accepted government auditing standards*. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our internal audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our internal audit objectives. Our internal audit also conforms with the Institute of Internal Auditor's (IIA) *International Standards for the Professional Practice of Internal Auditing.*

Appendix 4

Background Information

In 1935, the Legislature created the Texas Alcoholic Beverage Commission (formerly the Texas Liquor Control Board).

The Texas Alcoholic Beverage Commission (TABC) is the state agency that regulates all phases of the alcoholic beverage industry in Texas. The duties of the Commission include regulating sales, taxation, importation, manufacturing, transporting, and advertising of alcoholic beverages.

The TABC collects in excess of $200 million annually in taxes and fees, which aids in the financing of the state's public schools, local governments, research, human services, and other areas in which state government provides services to all Texans.

The Alcoholic Beverage Code, which was enacted to protect against involvement of the criminal element in alcoholic beverage trafficking authorizes the Texas Alcoholic Beverage Commission to:

- Grant, refuse, suspend, or cancel permits and licenses in all phases of the alcoholic beverage industry;
- Supervise, inspect, and regulate the manufacturing, importation, exportation, transportation, sale, storage, distribution, and possession of alcoholic beverages;
- Assess and collect fees and taxes;
- Investigate for violations of the Alcoholic Beverage Code and assist in the prosecution of violators;
- Seize illicit beverages;
- Adopt standards of quality and approve labels and size of containers for all alcoholic beverages sold in Texas;
- Pass rules to assist the agency in all of the above.

The Governor, with the advice and consent of the Senate, appoints three public members of the Commission for staggered six-year terms.

The Commissioners appoint an Administrator who supervises the Commission's activities. The Commission's operating budget is prepared and approved by the Commission on an annual basis, whereas the State legislative appropriation request is determined every two years. Both the budget and appropriations are reviewed and approved by the State Legislature.

The Commission is divided into thirteen divisions: Executive; Field Operations – Enforcement, Audit & Investigations, Ports of Entry; Business Services; Education and Prevention; Human Resources; Information Resources; Legal Services/General Counsel; Licensing; Office of Professional Responsibility; Tax and Marketing; and Training. The Executive Division, which is headed by the Administrator, provides oversight of the Assistant Administrator, Director of the Office of Professional Responsibility, and the Director of Communications and Government Relations. The other divisions report directly to the Assistant Administrator while General Counsel reports directly to the Commissioners.

The Commission generates revenue from alcoholic beverage license and permit fees, alcohol beverages taxes, cigarette taxes, airline beverage tax, and revenue collected on audits. This revenue is deposited into the General Revenue Fund.

Appendix 5

Report Distribution

As required by Gov't Code 2102.0091, copies of these reports should be filed with the following:

Governor's Office of Budget and Planning

Attn: Kate McGrath
P.O. Box 12428
Austin, Texas 78711
Phone: (512) 463-1778

Legislative Budget Board

Attn: Ed Osner
P.O. Box 12666
Austin, Texas 78711
Phone: (512) 463-1200

State Auditor's Office

Attn: Internal Audit Coordinator
P.O. Box 12067
Austin, Texas 78711
Phone: (512) 936-9500

Sunset Advisory Commission

Attn: Ken Levine
P.O. Box 13066
Austin, Texas 78711
Phone: (512) 463-1300

Texas Alcoholic Beverage Commission

Jose Cuevas, Jr., Presiding Officer
Steven M. Weinberg, MD, JD
Melinda S. Fredricks

Texas Alcoholic Beverage Commission Management

Sherry Cook, Administrator