

Department of Alcoholic Beverage Control

2015 SLAA REPORT

December 29, 2015

Alexis Podesta, Acting Secretary
California Business, Consumer Services and Housing Agency
915 Capitol Mall, Suite 350-A
Sacramento, CA 95814

Dear Ms. Podesta,

In accordance with the State Leadership Accountability Act (SLAA), the Department of Alcoholic Beverage Control submits this report on the review of our systems of internal control and monitoring processes for the biennial period ended December 31, 2015.

Should you have any questions please contact Randy Deems, Division Chief, Headquarters, at (916) 419-2511, randall.deems@abc.ca.gov.

BACKGROUND

Upon the repeal of Prohibition in 1933 and the return of the legal sale of alcoholic beverages to California, taxation and regulation of the manufacture, distribution, and sale of alcoholic beverages were given to the State Board of Equalization. In 1955, an amendment to the State Constitution became effective removing the authority from the State Board of Equalization and placing it with the Department of Alcoholic Beverage Control (ABC). California Constitution, Article XX, Section 22, vests ABC with the exclusive right and power to license and regulate the manufacture, importation, and sale of alcoholic beverages within the State.

ABC's mission is to administer the provisions of the Alcoholic Beverage Control Act in a manner that fosters and protects the health, safety, welfare, and economic well being of the people of the State. The ABC Director is responsible for carrying out the organization's mission and goals with an emphasis on public safety, and efficient licensing and alcohol enforcement. The Director is appointed by the Governor and oversees three major divisions and 24 district offices to meet its constitutional mandate to regulate 88,490 ABC licensed businesses.

Our core values guide the actions of our 436 employees. In cooperation with local communities, we conduct our licensing, enforcement and regulatory mandates with honesty, impartiality, and the highest degree of concern for the people of the State. The Department's workload is divided into three elements: administration, licensing, and compliance. Roles and responsibility are clearly defined through our policies, training and communication with our employees throughout our Department.

RISK ASSESSMENT PROCESS

ABC's Director, Chief Deputy Director and Division Chiefs meet regularly to identify and discuss significant department-wide risks. ABC started the risk assessment process by identifying issues and trends that could impact ABC's ability to carry out our mission. Our management team prioritized each risk based on factors such as impact on our mission and likelihood of occurrence and identified the controls in place to evaluate their effectiveness on mitigating the risks.

A series of meetings comprised of all Executive Staff members as well as other supervisory and managerial personnel from different programs within the Department conducted a Strategic, Weaknesses, Opportunities, and Threats (SWOT) analysis that formed the basis of identifying key goals and objectives. This effort included meeting with our external stakeholders to assess their needs and expectations of ABC.

The Department is in the process of updating our strategic plan beginning January 2016 to further

identify risks and to ensure the continued relevance of our licensing and compliance operations as it relates to our performance goals and objectives.

EVALUATION OF RISKS AND CONTROLS

Operations- Internal- Technology—Data Security

ABC's mission requires it to obtain certain personal information from its employees and licensees. Therefore, there is always a risk that this information can be intentionally or unintentionally made available to persons that are not authorized to have it. This risk has significant financial and reputational consequences. The State has developed a set of policies and standards that represent the State's requirements for departments in terms of IT and data security. ABC was recently found to be out of compliance with some of these policies and must evaluate and address identified risks.

Increase IT Staffing - ABC currently has just 12 staff supporting nearly 450 employees and 25 different offices across the State as well as developing and maintaining a highly customized enterprise business application (ABIS). Currently, all IT security work is redirected from staff that have other primary responsibilities, resulting in low level of resource for these activities and a lack of separation of duties between those who manage the IT resources and a security oversight function. Further, given the demands of day to day operations and enhancement of the ABIS system, more proactive activities often take lower priority to work that is necessary to keep systems going and users productive in the short-term. Increasing staffing to create capacity to go beyond reactive priorities and creating some amount of truly independent IT/Data security oversight would mitigate this risk.

Address any IT Security Compliance Issues - In an effort to obtain a comprehensive view of ABC's IT Security function and building upon previous audits, perform a detailed assessment of ABC's compliance with State policies and standards for IT/data security and risk management and address any deficiencies identified. This will be initially achieved through the utilization of outside resources (consultants or retired annuitants) and institutionalized as part of the project. This approach addresses the largest hurdle for improving ABC's IT security processes, the upfront work of assessment, development, and implementation.

Operations- External- FI\$Cal Conversion

ABC is a Wave 1 Department for FI\$Cal conversion. This conversion has been challenging for our Accounting operations due to resources spent training and mastering a new system. In addition, unanticipated conditions due to the design of the new system has created inefficiencies, duplication of work and failure to achieve desired outcomes. Specifically, FI\$Cal presents the following risks:

- Increased level of control in budget process (moving from appropriation level to line item) has significantly increased workload in budget and accounting for the development and administration of the ABC budget. Risk of inaccuracy and staff burnout has increased significantly.
- FI\$Cal driven changes to the procurement and revolving fund processes have significantly increased the workload involved in performing these tasks.

ABC meets regularly with FI\$Cal staff to communicate technical issues and deficient processes. This control can lead to improved understanding of the system and any tools or mitigations that have already been developed that could assist. Further, this feedback loop enables the FI\$Cal team to understand the issues being created and could lead to adjustments that can improve the situation in the future.

ABC staff continues to attend FI\$Cal trainings to further develop their knowledge and familiarity

with the system. Training will continue to be critical to mitigating the risks presented by the implementation of Fi\$Cal. Staff must be fully aware of all features and capabilities of the system to prevent unnecessary frustrations and work arounds.

Operations- Internal- Technology—Inadequate Support, Tools, Design, or Maintenance

ABC's day to day functions rely on our internal system known as ABIS. Since implementation, the system design and our resources to maintain the system had caused functionality issues. These issues include disruption of department-wide operations due to system failures, design flaws in work processes and lack of expertise in IT personnel to maintain and improve the system. Our IT staff is constantly in the mode of trying to fix functionality issues and find "work arounds" for poorly designed processes. This restricts our ability to devote resources to high priority projects such as on-line renewal payments of ABC licenses and on-line licensing applications.

Increase staff capacity to support the ABIS system - ABC's small IT staff is responsible for the maintenance and enhancement of ABIS. This development team currently has some gaps that need to be addressed in order to have well-rounded, fully functioning application development capacity. Specifically, ABC does not have business analysts to assist with the identification, communication, and documentation of business requirements, database administrators to manage and optimize the performance of the database, nor an experienced project manager to coordinate the development team, system users, and the executive team toward the goal of a high-performing ABIS. Establishing positions and/or filling current vacancies will mitigate the risk that the system does not meet ABC's business needs.

Create a Project/System Governance process - Establish a formal steering committee and core business team to facilitate strategic decision making, open communication, focused priorities, and increase the overall efficiency of the resources available to advance the development of ABIS.

Operations- External- Staff—Recruitment, Retention, Staffing Levels

The Department continues to face retention challenges in our Agent classifications. Data collection at time of separation reflects most Agents transfer to other state agencies that utilize the Investigator classification, providing better working conditions and the same salary as ABC Agents. The dramatic difference in working conditions, personal risk and pay similarities between the ABC Agent classification and all other Investigator classifications has substantially contributed to the Department's inability to retain sworn staff. Also, to a lesser extent, ABC loses Agents to the California Department of Justice, Special Agent classification, who make 19% more than ABC Agents.

This chronic and significant vacancy problem creates workload issues for our management staff due to backlog of enforcement cases, shifting priorities and constant training of new Agents which diminishes our ability to provide essential public safety services at licensed premises and other venues where alcoholic beverages are sold and consumed. Further, the issue of high turnover results in 1) less experienced sworn workforce, often working in a plain clothed or undercover capacity in dangerous situations, which can result in a higher risk of error and 2) a decrease in return on the considerable investment of dollars and staff time that ABC puts in to the recruitment, hiring, and training of staff.

In addition, the Department faces similar recruitment challenges as other law enforcement agencies in California, each competing for prospective new hires from a limited candidate pool of the population with the education, integrity and character required for this profession. Even with these challenges, the Department has been relatively successful recruiting sizable pools of interested candidates who meet the criteria for participation in the selection process to become an ABC Agent. ABC's selection process then identifies those candidates who are best qualified and have the aptitude to perform the duties required of the position. This process, although recently modified, continues to enable a number of candidates to be selected for hire that later separate from the Department due to poor job compatibility reasons.

There are factors that inherently make retention of sworn staff difficult at ABC - most notably the necessity to work nights, weekends and holidays with considerable frequency. To increase retention, ABC will pursue options to compensate sworn staff for the arduous work schedule inherent to ABC's mission. If sworn staff are given increased incentive to stay, the reduced turnover would increase the overall experience and knowledge of the workforce and significantly reduce the number of sworn resources that are currently dedicated to recruiting, hiring, and training new staff. These are resources that can be directed to providing more advanced training for Agents and/or increase ABC's enforcement presence in the field.

There are two interrelated objectives of this control: 1) reduce the time it takes to get new sworn staff hired and 2) improve the ability to hire candidates that have the desire and aptitude to perform the duties of an ABC Agent.

ABC will implement a targeted recruiting process, provide exams more frequently and at points in time when groups of potential candidates become eligible, and work to decrease the gaps between the many steps involved in the hiring process for sworn staff. By decreasing the time between when a candidate becomes eligible and when they enter the ABC hiring process and by increasing the pace at which candidates move through the process, ABC intends to be able to be more selective and pursue candidates with a stronger fit with the department.

Operations- Internal- Staff—Key Person Dependence, Succession Planning

In many ABC units and district offices there is a staff member who is relied upon almost exclusively for their knowledge and skill set in a specific area. If one of these staff members were to leave the Department, it would create a deficiency in meeting our administrative, licensing and enforcement functions. The Department does not have a formal plan to ensure these key staff members are continually cross-training and sharing their institutional knowledge.

Evaluate and make mitigation plans for high risk areas of "hero" dependency - There are several areas in which this problem is particularly acute and can be addressed through the delegation or disbursement of duties. Also, ABC is in the process of updating its strategic plan and developing performance matrixes so that we can evaluate our staffing levels and classifications. During this process, we will be able to identify where we need to allocate the appropriate resources for succession planning to accomplish our administrative, licensing and enforcement functions.

Improve documentation of policies and procedures - A key control of this risk will be to increase the organizational maturity of ABC's key functions by creating policies, procedures and desk manuals to provide greater direction and training/resources tools for staff. This is a very labor intensive control that would likely need to coincide with a disbursement of duties as mentioned in the control above in order to make the documentation of each function a manageable workload.

Compliance- External- Complexity or Dynamic Nature of Laws or Regulations

Upon the repeal of Prohibition in 1933, California, like all other states, adopted a three-tier system of alcohol manufacture, distribution, and retail sale. This legal framework, known as "tied-house" laws, regulates both ownership interests across tiers and business dealings between tiers. A number of specific exceptions have been carved out by the Legislature in the intervening years in an effort to keep pace with industry trends, while at the same time maintaining the general concept of segregation of interests and influence. These exceptions are now numerous, creating a complex web of regulatory oversight, making it difficult for both ABC and licensees to navigate permissible conduct.

The rationale for the tied-house laws is difficult for the public, media, and even legislators to understand

in modern times. They are often viewed as outdated and anachronisms of a time in America's history that has long-since passed. This creates an environment in which ABC is often criticized for its enforcement of these laws, especially when it cannot be shown that there is an immediate or imminent risk to public health and safety. Indeed, it is not uncommon for the law to be changed following enforcement to permit the activities that were the subject of the enforcement action.

ABC will continue to suggest legislative changes to clarify inconsistencies and reconcile conflicts.

ABC will continue to engage stakeholders—industry, alcohol policy advocates, other state and local government agencies—to try to identify areas of concern and recommend reasonable solutions that balance all interests. This can be accomplished through proactive rulemaking to both amend existing regulations and propose new regulations to address particular industry practices.

ONGOING MONITORING

Through our ongoing monitoring processes, the Department of Alcoholic Beverage Control reviews, evaluates, and improves our systems of internal controls and monitoring processes. The Department of Alcoholic Beverage Control has not begun the process of formalizing and documenting our ongoing monitoring and as such, we have determined we do not comply with California Government Code sections 13400-13407.

Roles and Responsibilities

As the head of Department of Alcoholic Beverage Control, Timothy P. Gorsuch, Director, is responsible for the overall establishment and maintenance of the internal control system. We have identified Randy Deems, Division Chief, Headquarters, as our designated agency monitor(s).

Frequency of Monitoring Activities

ABC holds monthly Executive Staff meetings. Meeting topics include discussions on current control activities and any issues that need to be addressed to ensure we are taking the necessary steps to mitigate and identify potential control issues. During these meetings, each manager provides a status report of on-going monitoring activities with the entire team so that everyone is aware of the issues. In addition, these topics are discussed with regional district office managers at their scheduled quarterly meetings.

Reporting and Documenting Monitoring Activities

ABC requires reports from each unit or district office on a monthly basis. These reports keep management informed of the monitoring practices being conducted, improvements needed, and the overall monitoring success or weakness within each unit or district office.

ABC ensures all staff receives information vital to the effectiveness and efficiency of internal controls by requiring management to update their staff through updated policies, general orders and quarterly staff meetings. All staff are encouraged to report to their supervisor any issues that compromise the effectiveness of carrying out ABC's mission, goals and objectives.

Per ABC policy, each regional district office is audited on a biennial basis by key members of the department staff utilizing a pre-approved form to evaluate compliance with departmental policies, practices and desired outcomes. These reports, with the evaluator's findings, comments and recommendations are submitted to the executive staff and Director's Office for review.

Procedure for Addressing Identified Internal Control Deficiencies

Due to modest staffing levels, ABC utilizes an approach that encompasses a core group of leaders and key program personnel that periodically review, evaluate and identify control deficiencies and report them to the entire executive staff and Director. It is the policy and practice of ABC to promptly develop mitigating procedures and disseminate the necessary procedural changes to all staff upon completion of their development and testing.

CONCLUSION

The Department of Alcoholic Beverage Control strives to reduce the risks inherent in our work through ongoing monitoring. The Department of Alcoholic Beverage Control accepts the responsibility to continuously improve by addressing newly recognized risks and revising risk mitigation strategies. I certify our systems of internal control and monitoring processes are adequate to identify and address material inadequacies or material weaknesses facing the organization.

Timothy P. Gorsuch, Director

cc: Department of Finance
Legislature
State Auditor
State Library
State Controller
Secretary of Government Operations