Final Report

Department of Liquor Control Warehouse Inventory Management

from Product Receipt through Delivery

Report # OIG-15-005

February 19, 2015

Montgomery County Maryland

Office of the Inspector General

Report in Brief

Department of Liquor Control Warehouse Inventory Management

from Product Receipt to Delivery

February 19, 2015

What We Found

The Montgomery County Department of Liquor Control (DLC) internal controls over warehouse inventory need improvement. Various warehouse employees routinely use informal, handwritten notes to instruct DLC staff to change inventory quantities in the electronic perpetual inventory system. Although the adjustments are both positive and negative, the net adjustments resulted in significant decreases in the recorded quantities of warehouse inventories in FY2013 and FY2014. While there are many potential causes for such variations, DLC has done little to no investigation or analysis to determine why quantities of the physical warehouse inventory differ from those reflected in the electronic inventory. DLC's ability to track inventory is complicated by the omission of the actual physical location of all products within the warehouse from the electronic inventory records. This omission may increase the difficulty of researching variances, as well as the risk of errors and undetected losses of product. Although a July 2014 report by a consultant to the County Office of Internal Audits recommended that inventory records include all physical locations, as of the date of our review, no corrective actions have been taken.

Documented controls over the delivery process were well designed but in practice, procedures were not consistently followed or enforced. DLC had analyzed little of the information collected regarding reported inventory returns, incorrectly loaded delivery trucks, or product breakage, creating greater vulnerability to inaccurate or false reports of missing products. Recently, DLC has implemented several measures to improve the implementation of control procedures. However, an established, regular management reporting mechanism is needed to ensure that these procedures remain in effect.

In February 2015, DLC converted to a new Enterprise Resource Planning (ERP) electronic inventory system. While the new system is expected to provide scanning capability that should facilitate inventory management, it does not significantly modify procedures or internal information addressed in this report. In order to adequately track and investigate inventory variances and inaccuracies in loading delivery vehicles, DLC management would have to change the way in which they use the data that they already collect.

We noted that no formal productivity goals or performance metrics have been developed regarding warehouse and delivery operations. Without goals and metrics, DLC management cannot measure the efficiency of operations, productivity of staff, or the financial and labor resources needed.

We found that DLC's current policy of delivering special order product to the warehouse and then redistributing it to the customer placing the order increases DLC's cost and risk while delaying delivery to the customer. We believe DLC can avoid the cost and related risk while reducing customer delivery times by processing such orders as "drop shipments" in which orders placed through DLC are shipped directly to the customer from the distributor or direct supplier. DLC would continue to process the orders, control distribution, and receive payment from the licensee.

What We Recommend

1. DLC should at a minimum adopt the following practices:
    a. Maintain an electronic inventory system which accurately reports the quantity and type of product in each location within the warehouse.
    b. Mark physical product locations, including overflow areas, with the unique location code reflected in the electronic inventory system.
    c. Initiate a program of routinely performing physical inventory test counts on random samples of products by individuals whose responsibilities do not include general warehouse operations (i.e., handling or distribution of product inventory).
    d. Ensure that requested inventory adjustments are validated and that inventory variances above set thresholds are reviewed, investigated, and approved by an authorized individual outside of warehouse operations prior to adjustment of the electronic inventory system.
    e. Develop a process to log and research daily variances in order to implement corrective procedures.
2. DLC should revise written policies and procedures to reflect new warehouse operations, including proper documentation and justification for adjustments to the electronic inventory.
3. DLC should implement a routine management reporting mechanism to ensure that controls over the delivery process are consistently performed and remain in effect.
4. DLC should develop and implement a written, defined productivity measurement system including relevant performance metrics for the receiving, safeguarding, picking, loading, delivery, and return of warehouse goods as well as control of operating costs.
5. DLC should explore delivering special order product via drop shipment,[1] thus freeing up warehouse space and reducing the associated cost and risk to DLC.
6. DLC should employ a consultant with expertise in alcoholic beverage distribution systems to train and assist DLC managers in promptly implementing recommendations 1-5.

[1] The online Merriam-Webster Dictionary defines the term “drop-ship” as a transitive verb meaning, “to ship (goods) from a manufacturer or wholesaler directly to a customer instead of to the retailer who took the order.”

Table of Contents

Department of Liquor Control Warehouse Inventory Management

from Product Receipt to Delivery

Introduction

Since November 2013, the Office of the Inspector General (OIG) has received numerous complaints regarding warehouse and delivery operations at the Montgomery County Department of Liquor Control (DLC) including allegations of theft of product by DLC warehouse staff and delivery drivers. Because the Montgomery County Office of Internal Audit (IA) had previously contracted with Watkins Meegan to perform a related audit assessing the design and effectiveness of internal controls regarding DLC's inventory management, we delayed our project until the public issuance of their report in July 2014.[2]

Our review was conducted from July – December 2014 in accordance with the standards contained in *Quality Standards for Inspection and Evaluation* issued by the Council of the Inspectors General on Integrity and Efficiency (January 2012).

An Office of the Inspector General (OIG), Preliminary Inquiry Memorandum issued on December 23, 2014 regarding *Department of Liquor Control-Internal Control Matters* discusses our review of some of the allegations for which DLC management has taken some mitigating steps or which we did not substantiate. Appendix C includes a complete copy of the December 23, 2014 OIG memorandum including the response received from the Montgomery County Chief Administrative Officer.

This report expands upon the December 2014 memorandum and analyzes some of the broader issues and conditions found at DLC.

---

[2] Montgomery County, Maryland Office of Internal Audit Report, *Montgomery County Department of Liquor Control Inventory Management,* prepared by Watkins Meegan LLC, July 9, 2014.

Objectives, Scope, and Methodology

The objectives of our inquiry were to:

- Review those controls necessary to substantiate or refute certain allegations.
- Assess the vulnerability of warehouse and delivery operations to theft and product losses.

We interviewed numerous DLC staff, observed both day and night operations at the DLC warehouse, and reviewed and analyzed relevant policies and procedures, financial records, and agency records. Additionally, we reviewed the previously mentioned July 2014 IA report on DLC's Inventory Management[3] and the DLC *Comprehensive Long-Range Strategic Business Plan*.[4] To the extent practical, we avoided reviewing activities that would duplicate work performed by auditors and consultants in issuing these documents. Accordingly, unless specifically noted in our report, we neither endorse nor take issue with their findings and recommendations.

During the course of our review, we reviewed all available written policies and operating procedures and gained an understanding of the manner in which those policies and procedures have been implemented, primarily through interviews of DLC staff. Until February 1, 2015, DLC used a customized application of Application Excellence, a legacy program they call APPX to track the warehouse inventory from receipt through delivery. As part of a County-wide technology modernization capital project, DLC transferred its electronic inventory to Montgomery County's Enterprise Resource Planning System (ERP) and implemented a new Oracle-based inventory program on February 1, 2015. Where applicable, we note the impact the conversion to ERP is expected to have on our findings.

[3] Montgomery County, Maryland Office of Internal Audit Report, *Montgomery County Department of Liquor Control Inventory Management,* prepared by Watkins Meegan LLC, July 9, 2014.

[4] Montgomery County Maryland, Department of Liquor Control Comprehensive Long-Range Strategic Business Plan, Draft Final Report, issued by the PFM Group on July 11, 2014.

Background

Montgomery County, Maryland operates as a control jurisdiction for the distribution of alcoholic beverages. State law requires that in Montgomery County holders of certain alcoholic beverage licenses "may not sell any alcoholic beverages except those purchased from the Department of Liquor Control for the County."[5] As the wholesaler for County alcohol, DLC receives and holds products in inventory for distribution to 25 county-owned retail stores and approximately 1000 independent licensed establishments.

The County maintains a 210,000 square foot, climate controlled warehouse which houses the County's entire inventory of alcoholic beverages. Approximately $16 Million (at cost) in product is housed in the warehouse on any given day. On business days, DLC's fleet of delivery trucks is loaded with an average of $1 Million (invoiced amount) in product for delivery to independent licensees and DLC owned retail stores. Licensees also have the option of ordering product for pick-up at the warehouse. Since 2012, over $250 Million worth of product is annually delivered from the warehouse to licensees and County-owned retail stores. (See Figure 1.)

	Deliveries to Retail Stores	Deliveries to Licensees	Pickups by Licensees	Total
FY2013	$112,952,664	$133,130,119	$5,430,331	$251,513,114
FY2014	$119,316,190	$137,421,252	$5,174,308	$261,911,750

Figure 1: Warehouse Deliveries at Selling Price by Fiscal Year

County employees perform all warehouse inventory and receiving operations, with the exception of the loading of beer delivery trucks. DLC has contracted with an independent vendor for the loading of beer trucks. DLC delivery truck drivers and helpers are also County employees.

[5] Maryland Code, Alcoholic Beverages Article 2B § 12-216(a). See also Article 2B § 15-204(b) for the law applicable to other licensees.

Findings & Recommendations

Finding 1: Internal control of physical inventory needs improvement.

Policies and operating procedures for DLC warehouse operations, which would serve as the basis for any review of management controls, were either incomplete, not current, or not well documented.

A. Physical Storage Locations of Inventory Are Not Consistently Recorded

The DLC warehouse accepts, stores, and distributes liquor, wine, and beer. DLC receiving clerks work with suppliers to schedule the times for product receipts. In addition to those items normally carried in stock (stock items), the DLC warehouse accepts and redistributes non-stock items ordered in response to specific requests from customers and licensees (special orders).

Image 1: Warehouse assigned location numbers 101, 102, 103, & 104. (Primary product locations which match APPX assigned location)

All product is manually entered in the electronic perpetual inventory system by assigned product number upon receipt at the warehouse. Once product is invoiced for delivery or pick-up it is removed from the inventory records. Product breakage and returns to the manufacturer are subtracted from inventory records by DLC staff. A large portion of the warehouse floor is physically marked with location identifiers. The electronic records also contain a single location identifier for each product.

However, the location identifier in the electronic inventory system is often not the only physical storage location of the product on the warehouse floor. Each unique product is identified in the electronic inventory system as being located in only one physical location (referred to in this discussion as “primary location”). The primary locations of those stock item products that are sold in the largest quantities (high volume) can only accommodate a small portion of the quantities of those products on hand. Most of the high volume product inventory is immediately stored in areas farther from the primary location generally referred to as “overflow” areas and later moved to the primarily location as supplies in the primary location are shipped out. Consequently, the inventory records do not identify the physical location in which most of the warehouse inventory is stored.

Image 2: Overflow Areas for products with assigned primary location 102 and 103 within APPX. (Warehouse assigned location numbers do not match APPX location assignment.)

Further, although the electronic inventory system should contain an accurate record of the inventory stored in the warehouse, the absence of the physical storage location in the inventory records means that for many high volume and high turnover stock items, the inventory system cannot identify the inventory items, value, or quantity stored in most locations of the warehouse. The absence of this information can complicate inventory control, and increase the risk of errors in inventory records or undetected losses of products.

Inventory controls could be enhanced by recording the actual physical location in which each item is stored prior to being transferred to the primary location for that product. We received conflicting information regarding whether or not the APPX system could record multiple locations for the same items. We have been assured that the ERP can accommodate multiple locations for the same item. However, we have discussed that matter with DLC managers on several occasions, and it is not clear that a decision has been reached on how or whether that information will be collected and recorded now that the ERP has been implemented.

B. Some Warehouse Storage Locations are Unmarked

Inventory control is further complicated by the absences of any location markings in a significant portion of the warehouse overflow space. Different areas of the warehouse are assigned for liquor, wine, and beer and as overflow areas for those products. The overflow area for wine and liquor contains metal storage shelves (bins) marked with location numbers to facilitate the use of cubic space. For these areas the physical organizational system is already in place if DLC decides to accurately record product locations in the electronic inventory system. However, there are also many square feet of floor space, including the entire beer overflow area, that are not physically marked with any location identifier on which pallet loads of products are stored. DLC management relies exclusively on staff knowledge of product location to locate product within these areas. These areas would need to be physically marked with location identifiers in order to implement an electronic inventory system that correctly reports the location of product on the warehouse floor.

The July 2014 IA report also discusses the issues of unmarked warehouse locations and unrecorded physical storage locations. We agree with their findings and recommendation that "all physical storage locations in the warehouse facility should be clearly labeled and assigned a unique location code within the inventory management system." We also agree with their recommendation that new or changed locations be recorded as product is moved within the warehouse. Although the IA report was issued in July 2014, as of February 2015 no action had been taken on these important issues. Based on our discussions with DLC, it is not clear if or how they intend to address these issues.

C. Inventory Adjustments are Recorded without Researching Variances

Inventory records should provide both a means to facilitate fulfilment of orders and to prevent errors or theft by identifying and highlighting missing inventory. Frequent changes to the electronic inventory quantities are recorded as a result of differences between the electronic inventory and the product that is actually observed as available in the warehouse. DLC neither aggregates nor reports the magnitude of changes made and little attention is given to the underlying causes of the changes.

We analyzed detail records, DLC internal summary documents, and a sample of supporting documentation for the adjustments to the perpetual inventory records outside of normal receipt, delivery, and breakage transactions. There is no internal policy document addressing inventory adjustments. For example, we noted that many individuals from different DLC departments were able to adjust inventory almost daily without supporting documentation. A DLC staff member advised us that DLC has never analyzed the magnitude of these types of inventory adjustments.

We examined APPX detail records for inventory adjustments for the period of January 1, 2012 – November 7, 2014. Figure 2, compiled by OIG staff, summarizes the aggregate adjustments made as a result of observed differences between product recorded in the electronic system and the product observed on the warehouse floor during fiscal years 2013 thru 2015 to date. Although those variances are small relative to the size of the overall inventory, the magnitude of the variances and the fact they are consistently unfavorable indicates unexplained losses that should have triggered prompt implementation of remedial actions designed to improve accuracy and prevent further errors or losses.

Adjustment Code/ Reported Purpose	FY2013	FY2014	Partial FY2015
			(Jan. 1 - Nov 7, 2014)
97160 - Beer Daily Adjustment Code	$ (86,240.94)	$ (145,927.24)	$ (26,370.46)
97152 – Wine/Liquor Daily Adjustment Code	$ (149,732.78)	$ (60,854.36)	$ (26,871.92)
97101 - Wine/Liquor Physical Count Code on Count Dates	$ (714,911.80)	$ (66,877.05)	$ (36,285.12)
97101 - Wine/Liquor Outside Scheduled Counts	$ 50,213.02	$ (100,101.12)	$ (207,932.20)
97098 - Beer Physical Count Code on Count Dates	$ (359,560.11)	$ (68,496.37)	$ (31,773.30)
97098 -Beer Outside Scheduled Counts	$ 14,567.10	$ 158,528.89	$ 18,693.96
TOTAL	$ (1,245,665.51)	$ (283,727.25)	$ (310,539.04)

Figure 2: Cost of DLC Warehouse Inventory Adjustments Outside of Normal Purchasing, Sales, and Breakage

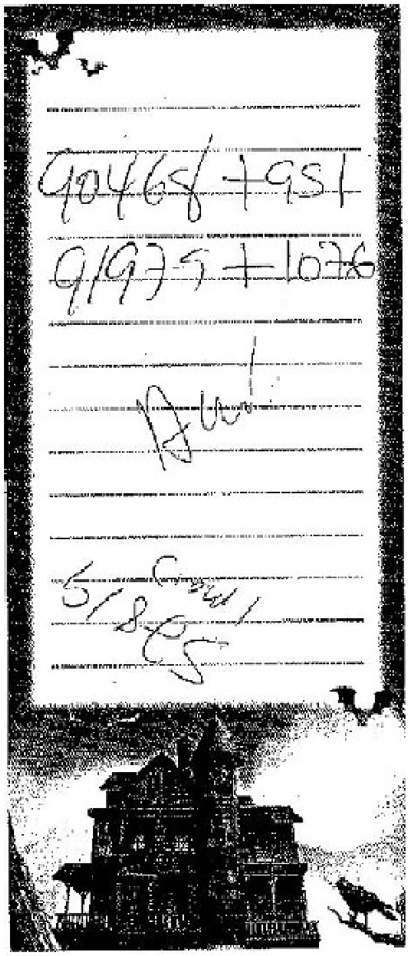
1. **Adjustments are made to the perpetual inventory system, often multiple times per day, by multiple staff members without investigation or documentation of the reasons for the variances.**

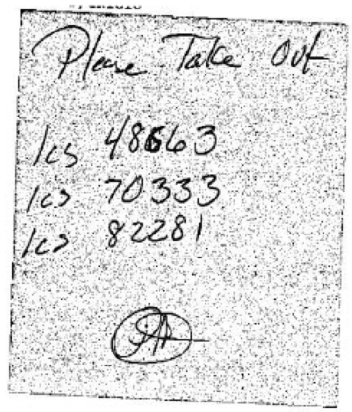
DLC permits staff to adjust the electronic perpetual inventory. These adjustments are not accomplished as part of an organized cyclical or annual process or effort to maintain an accurate inventory. Rather, adjustments occur as DLC warehouse staff either finds a product that was unanticipated or fails to find a product that was supposed to be there. On average, during FY2013 DLC adjusted the inventory by 103 cases of beer, wine, or liquor per business day.[6] Similarly, in FY2014, the perpetual inventory was adjusted an average of 154 cases per business day. While these codes were used to both add and remove product to/from the

[6] Calculations based upon an assumption that there are 260 weekdays per year. We did not adjust for holidays.

perpetual inventory, overall during FY2013 and FY2014 the aggregate of adjustments resulted in a decrease in the reported value of the product in the warehouse. (See Figure 2.)

We reviewed a sample of inventory adjustment requests, which were generally made in the form of informal notes, most often written on "post-it" note papers provided to a single employee indicating the product number, number of cases, and whether the product was to be added or subtracted from inventory. (See Figure 3.) Although each note was initialed by the requestor, neither the requestor's name nor the reason for the adjustment was present on any of the requests that we were shown. All of the paper requests that we reviewed were accurately reflected as adjustments in the APPX system. However, the accuracy of the observations which result in the adjustment request cannot be determined. The APPX system does not require a reason for the adjustment or reflect the name of the employee requesting the change. DLC reports that in the new ERP inventory system the name of the supervisor requesting the change will be recorded. However, a reason for the adjustment still will not be required.





Left: Resulted in an increase in the electronic perpetual inventory by 951 cases of product no. 90468 and 1,076 cases of product no. 91979. (Total Value: +$28,931.32)

Above: Resulted in a reduction in the electronic perpetual inventory by 3 cases, 1 each of products no. 48663, 70333, 82281. (Total Value: -$279.74)

Figure 3: Sample Daily Inventory Adjustment Requests

During our review, we saw instances of inventory being adjusted by removing and adding the same number of cases of another product. For example, On July 16, 2014, DLC decreased the inventory by 60 cases of "BUD 15/16 OZ WORLD CUP ALNR" and increased it by 60 cases of "PRESIDENTE 4/6 NR." This was likely the result of a data entry error made when the product was entered into APPX. When APPX is replaced with ERP, DLC intends to begin scanning many products into the perpetual inventory upon receipt, which should reduce these types of adjustments. However, many adjustments do not have a corresponding offsetting adjustment suggesting some other type of error or loss which may not be addressed by the implementation of the new ERP system.

2. Annual Physical Inventory Counts are used to "reset" the DLC perpetual inventory with no investigation of variances.

DLC conducts regular[7] inventory counts of products in the warehouse. At the conclusion of each count, the warehouse manager approves the variance report and the perpetual inventory in the warehouse is adjusted by the DLC finance office to reflect the numbers of product actually counted within the warehouse. While DLC may engage in "recounts"[8] in order to ensure that all product within the warehouse is counted, once the final inventory count is accepted by management, no investigation is performed to determine why the observed product differs from the product listed in the electronic records.

We obtained data from DLC for the inventory count adjustments for the past four fiscal years. (See Figure 4.) According to DLC, the summary data for the counts slightly differs from the physical count calculated for Figure 2 because the summary data included beer and wine keg variances that are not recorded in the adjustment code detail analyzed by the OIG. For each year, the counts resulted in an overall unexplained downward adjustment to the value of the warehouse inventory. Adjustments peaked in FY2013, when the physical inventory process resulted in a total downward adjustment over $1 million. In FY2014, the most recent fiscal year, the adjustment significantly decreased but was still negative. At times, a portion of product subtracted from the inventory records during inventory counts was located during a subsequent recount and adjusted back into the electronic inventory. Figure 4 does not include the adjustments as a result of recounts. Refer to Figure 2 for a more complete explanation of the magnitude of all adjustments made to the electronic inventory based of observations on the warehouse floor.

	FY2011	FY2012	FY2013	FY2014
Beer	($105,244)	($66,477)	($371,860)	($71,836)
Wine and Liquor	($152,771)	($244,718)	($714,942)	($66,967)
Total Adjustment	($258,015)	($311,195)	($1,086,802)	($138,803)

Figure 4: DLC Warehouse Inventory Adjustments as a Result of Physical Inventory Counts[9]

DLC staff report that implementation of the new ERP system will not substantially affect the physical count process. Investigation of reasons behind variances is also not aided by the ERP system. However, if the new ERP system is programmed to accurately report inventory locations, additional improvements and controls over the inventory physical count procedures could be implemented.

In FY2014, DLC began suspending warehouse operations on a quarterly basis to complete a wall to wall physical inventory count. Similarly, Virginia Department of Alcoholic Beverage

---

7 Currently, DLC generally conducts quarterly counts. Prior to FY2013, DLC conducted annual end of year counts only.

8 In cases where the count results in a large variance for a particular product a staff member is assigned to locate and "recount" all cases of that product.

9 Figure 3 contains information provided by DLC. Detail data for all years was not analyzed.

Control dedicates 2 days per quarter to conducting a complete physical inventory of its warehouse facility. Conversely, DLC retail stores engage in cyclical inventory counts[10] wherein a selection of products located within the store are inventoried on a daily basis by that store's staff. Regular, surprise counts of a selected sample of products are conducted by Field Supervisors. This serves as a control to ensure the accuracy of the counts.

As noted in the July 2014 IA[11] report, the same warehouse staff with daily responsibility for product were utilized to perform physical warehouse inventory counts. Until the current organizational system of the warehouse is changed, DLC must rely on the warehouse staff's knowledge of product location rather than a marked, recorded location. Therefore, an audit of only a selected sample of the warehouse inventory products by anyone who does not regularly work in the warehouse is likely not possible at this time.

DLC should work toward establishment of a new warehouse inventory count program which includes cyclical counts and could eventually serve in lieu of wall to wall counts. The objective of cyclical inventory counts is to enable DLC to consistently maintain more accurate inventory records. Implementation should allow DLC to minimize costly and disruptive wall to wall inventory counts.

[10] For cyclical inventory counts a subset of inventory, in a specific location, is counted at a preset interval to ensure counting of each item at least once in an accounting period. In contrast to traditional inventory counts which may require suspension of warehouse operations, cyclic count programs limit disruption to warehouse operations.

[11] Montgomery County, Maryland Office of Internal Audit Report, *Montgomery County Department of Liquor Control Inventory Management,* prepared by Watkins Meegan LLC, July 9, 2014.

Recommendations 1-2

1. DLC should at a minimum adopt the following practices:

    a. Maintain an electronic inventory system which accurately reports the quantity and type of product in each location within the warehouse.
    b. Mark physical product locations, including overflow areas, with the unique location code reflected in the electronic inventory system.
    c. Initiate a program of routinely performing physical inventory test counts on random samples of products by individuals whose responsibilities do not include general warehouse operations (i.e., handling or distribution of product inventory).
    d. Ensure that requested inventory adjustments are validated and that inventory variances above set thresholds are reviewed, investigated, and approved by an authorized individual outside of warehouse operations prior to adjustment of the electronic inventory system.
    e. Develop a process to log and research daily variances in order to implement corrective procedures.

2. DLC should revise written policies and procedures to reflect new warehouse operations, including proper documentation and justification for adjustments to the electronic inventory.

Finding 2: The DLC delivery process is well designed, but controls have been poorly implemented.

We found that although DLC has adequate internal controls, they were not always implemented effectively. While the system appears to be well designed, we found that in many cases DLC employees fail to perform their assigned function properly. At the same time, while data is collected that could be utilized to identify drivers who show a pattern of increased missing or broken product, the information is not aggregated or analyzed in a systematic way. In order to adequately track and investigate truck inaccuracies and inventory variances, DLC would have to change the way in which they use the data that they already have.

Licensees are able to place their orders online, via fax, or via phone. Each licensee is assigned a specific day each week for delivery of each type of product: beer, wine/liquor, and kegs. A licensee receiving all 3 types of product would have three separate weekly deliveries. Once an order is put in the electronic system it subtracted from the available inventory, and assigned for picking. The Router (a DLC employee) sets up the route for each driver and generates the printed pick lists for the next day's deliveries. For beer, wine, and liquor deliveries, a crew loads the truck for delivery the evening before based on the Router's picking lists. Special order product is staged for night loading by the day crew and loaded in the evening. Keg trucks are loaded by their driver in the morning. Once the truck is loaded, a supervisor prepares an invoice for each licensee with product on the truck. The act of invoicing creates a receivable within the electronic inventory system.

Generally, drivers have the same routes for each specific day of the week with some variation based upon operational needs. When the driver arrives he obtains his manifest and a double set of invoices for delivery. The driver makes each delivery and has the licensee sign each invoice to attest that the product was "received in good condition." The licensee retains one copy of the invoice and the driver returns the other, signed copy to DLC.

If the driver is missing a case of product that is listed on the invoice as on his truck (a short), he documents it on a credit form which is signed by the driver and licensee. The driver notes the missing product on the invoice and recalculates the amount owed. Customer returns are handled similarly, but are assigned a different "reason" code on the credit form. DLC credit forms include a numerical system delineating specific reasons for customer credits. (See Figure 5.)

REASON FOR RETURN	
(1) Breakage/Damage	(5) Customer Did Not Want
(2) Repack	(6) Customer Did Not Order
(3) Short on Truck	(7) ______________
(4) Out of Date	______________

Figure 5: Excerpt from DLC Credit Form – Reason for Return

At the end of each day, the driver returns to the DLC warehouse, unloads any product remaining in his truck, and is expected to be checked-in by a warehouse checker or supervisor. Checkers or a supervisor performing the check-in function are responsible for verifying any product brought back to the warehouse on the truck. Based upon his review of the returning truck contents and the credit sheets and invoices provided by the driver, a driver tally sheet is filled out to document returns, shorts, and overages. The checker signs the driver tally sheet to indicate that the return of product has been verified. The invoices, credit forms, and driver tally sheets are returned to the driver who takes them to the cashier's office.[12] Staff within the cashier's office process each day's paperwork and enter it into the APPX system, including any credits to the customer for shorts and product returns. Prior to the ERP implementation drivers were permitted to collect payments at the time of delivery which were also provided to the cashier's office along with the day's paperwork. Recently, DLC began requiring licensees accepting delivery to use the ACH payment system which electronically debits payment directly from the licensee's bank account.

A. Drivers and checkers fail to ensure that delivery trucks are properly checked in upon return to the warehouse.

In the December 2014, preliminary inquiry memorandum (Appendix C), the OIG reported that DLC delivery truck inventory was not properly inventoried upon return to the warehouse. After a truck returns to the warehouse, returning truck inventory should be reviewed by a DLC "checker" whose assignment is to observe, count, and compare the information included in that driver's paperwork with any product remaining on the truck. This serves as a control to ensure that drivers submit the proper paperwork and return broken, returned, or extraneous merchandise to the warehouse. During our preliminary inquiry we found that in many cases, trucks were not properly checked in upon arrival at the warehouse.

B. DLC does not analyze available information regarding reported inventory returns, shortages, overages, or breakage.

We analyzed the Wine/Liquor Driver Tally sheets for the month of June 2014. (See Appendices A-B for summaries of driver-reported truck accuracy by date and driver during June 2014.) Based on our limited analysis, drivers rarely report trucks as accurately packed. For 206 available driver tally sheets, only 9 were reported as accurately loaded (i.e., No product overages or shorts were reported by the driver.) However, driver-reported shorts, overages, and returns are not tracked, communicated to staff, or regularly investigated.

DLC employees told us that while supervisors have access to each driver's tally sheets, the information contained within them is not regularly shared with the staff involved in the truck loading process. Further, based on interviews with management on the night and day shifts, DLC rarely investigates the cause of shorted product. In the December 2014 preliminary inquiry memorandum (Appendix C), we reported that DLC information regarding driver reported shorts, overages, and returns was neither aggregated nor analyzed, leaving DLC vulnerable to drivers falsely reporting shorted product.

[12] DLC has recently begun requiring licensees to utilize an ACH payment system wherein payment will be transferred directly from the licensee's bank account to DLC. Drivers will no longer be permitted to collect payment.

Based on a similar but independent analysis of overage and returns documents by local television investigative news reporters, a November 2014 televised report[13] stated that over a six month period, certain DLC beer delivery drivers reported as many as three times the number of shorts[14] as compared to other drivers. According to the newscast, the drivers may be falsely reporting that their trucks have been shorted product in order to sell cases of beer under the table at a discount.

C. Drivers' returns and shorts are added back into the perpetual inventory system without assurance that the product is present in the warehouse.

As previously stated, DLC delivery drivers often report shorts and returns on their driver tally sheets. At the delivery location, drivers fill out a credit form for these items which is signed by both the driver and the licensee so that the licensee's account can be credited for the missing or returned product. Upon return to the warehouse, the credit forms are sent to an employee within the cashier's office who routinely processes the credit forms to return the product into the perpetual inventory system.[15] It is assumed that any shorts were not loaded on the truck and that all returns were properly returned to the warehouse floor. As previously stated, checkers do not adequately ensure that product is returned to the warehouse. Prior to November 2014, few investigations were being performed to determine whether the shorted product was initially loaded onto the truck, remained in the warehouse, or was lost during the delivery process.

The new ERP system will not allow a customer to be credited for returned or shorted product until the product is added back to the electronic inventory system. However, there is currently no documented process to ensure that product reported as short on truck is still present in the warehouse.

As previously reported in the December 2014 preliminary inquiry memorandum (Appendix C), during the course of our review, DLC stated they made the following changes:

- DLC requires drivers to be checked in by a manager rather than a checker upon arrival.
- Drivers and the manager assigned to check in returning trucks are no longer permitted to leave for the day until check-in is properly completed.
- DLC began recording shorts, overages, and returns in a spreadsheet organized by driver.
- DLC requires drivers to call and report discovered shorts from the delivery location.

---

[13] NBC Washington News 4 I-Team, *Beer Bust: Montgomery County Employees Accused of Skimming Cases,* published November 6, 2014 at http://www.nbcwashington.com/investigations/series/beer-bust/Beer-Bust-Montgomery-County-Employees-Accused-of-Skimming-Cases-281685501.html.

[14] In this repot the term "short" means a product was invoiced as being placed on the DLC delivery truck. However, the item could not be located at the time that the driver made delivery to the targeted customer.

[15] Unless specifically told otherwise by a manager.

- DLC repaired non-functional security cameras.

We did not test the implementation of these procedures. In the absence of required regular feedback to management on these procedures, there will be a temptation to discontinue them if they become burdensome.

Recommendation 3

DLC should implement a routine management reporting mechanism to ensure that controls over the delivery process are consistently performed and remain in effect.

Finding 3: DLC has no productivity goals or performance metrics over warehouse and delivery operations.

DLC's mission is to "provide licensing, wholesale and retail sales of beverage alcohol products, enforcement and effective education and training programs, while promoting moderation and responsible behavior in all phases of distribution and consumption."[16] Accordingly, DLC has identified ten key performance measures which include mission-related items such as gross profit margin, sales growth, customer and licensee satisfaction, enforcement activities, and targeted inventory levels. However, we did not find any documented productivity measures or performance goals for warehouse and delivery operations.

While the established performance metrics are clearly related to DLC's stated mission, they do not adequately address warehouse and delivery operations which represent approximately 26% of DLC's $56.3 million operating budget and should also be closely monitored.[17] Without clear measurement and goals for each stage of warehouse and delivery operations, DLC has no concrete way of determining efficiency of these operations, financial and labor resources needed, or the effectiveness of managers and their staff.

[16] Montgomery County Maryland, Department of Liquor Control Comprehensive Long-Range Strategic Business Plan, Draft Final Report, issued by the PFM Group on July 11, 2014, p2-3.

[17] Reflects DLC's approved operating budget for FY2015 as published on budget.data.montgomerycountymd.gov. Last accessed on February 3, 2015.

Recommendation 4

DLC should develop and implement a written, defined productivity measurement system including relevant performance metrics for the receiving, safeguarding, picking, loading, delivery, and return of warehouse goods as well as control of operating costs.

Finding 4: Receiving special order product at the warehouse prior to delivery to the licensee increases risk to DLC and adds time and administrative cost.

Although many of the local distributors utilized for special order products deliver directly to the licensee in surrounding counties, DLC currently receives special order product at the DLC warehouse and endures the added cost of storing and redistributing these products. Shipping such items through the warehouse may also delay the product's arrival to the end user (licensee) and assigns additional risk due to potential loss or breakage to DLC.

Licensees may "special order" products not carried as stock items in the DLC warehouse. Orders for special order product may be placed by the licensee or by a representative from the distributor or manufacturer on the licensee's behalf. Orders for such items must be placed through DLC and, under current practice, pass through the DLC warehouse.

In surrounding Maryland counties, which are not control jurisdictions, sales representatives from distributors and direct suppliers contact the licensee in order to sell their product. The licensee orders the product directly from the sales representative and product is shipped directly to the licensee. In Montgomery County, DLC inserts extra steps into the delivery process. Representatives may still contact the licensees to "sell" their products, but the licensee is not permitted to directly purchase product from the sales representative. All orders must be processed through DLC, who places an order with the distributor or direct supplier. Further, the product is delivered to the warehouse, who in turn delivers it to the licensee after applying the DLC mark-up to the price.

Unlike DLC stock items which generally come directly from the brewery, winery, or distillery (direct supplier), the vast majority of special order product is delivered to DLC by local distributors who carry a variety of product and regularly make deliveries in the area. Because special order product is ordered in smaller quantities than stock items, a direct supplier located out of the area may delay shipment until they have a full truck of goods to be delivered in the DC metro area. This may substantially delay shipment for special order items and make it impractical to utilize direct suppliers for many special order products. In order to avoid this delay, most special order product is provided by local distributors.

While the warehouse may keep an adequate supply of stock product on hand in the warehouse to meet expected customer demand, special order product is committed to a specific customer and generally remains on the warehouse floor for fewer than seven days. Product comes into the warehouse and is held until the next scheduled delivery for the ordering licensee. Most special order product is delivered to the warehouse during the first half of the week, and by Friday approximately 85% has been delivered to the licensee, freeing up warehouse space for the new incoming special order deliveries on Monday.

It is possible for licensees to return or refuse special order products. In such cases, the special order product is generally returned to the distributor or manufacturer after being brought back to the DLC warehouse. Because DLC charges no restocking fee for the return of product, they endure the costs associated with ordering, redistributing, and returning the product without realizing any of the profit associated with a sale.

Evidence of the potential risks associated with product passing through the warehouse was provided by two managers who told us that at times special order products reported by drivers as returned to the warehouse subsequently cannot be located on the warehouse floor. Based on interviews, we understand a clerk verifies physical receipt of the drivers' reported special order returns and overages every day. Based on this review process, the special orders section does not always receive the returned product as reported. Similarly, during a separate interview, we were told that each week, some special order product reported as returned is not found in the warehouse the following morning resulting in the loss of an estimated 2-3 cases of special order product each month.

Some of the challenges associated with DLC's current method of special order product management are highlighted in its *Long-Range Strategic Business Plan*[18] which states that "special order products currently demand more attention than their share of business profits…and can hinder storage and inventory management." This supports the OIG's concern that shipping special order product through the warehouse may result in additional cost and risk with no benefit to DLC or the customer.

There is potential that DLC could maintain control of special order product but substantially improve operations by allowing distributors and direct suppliers to deliver special order product via drop shipment.[19] This procedural change would only affect the delivery of the product. DLC would continue to process the orders, control distribution, and receive payment from the licensee. However, deliveries would be shipped directly from the

[18] Montgomery County Maryland, Department of Liquor Control Comprehensive Long-Range Strategic Business Plan, Draft Final Report, issued by the PFM Group on July 11, 2014, p.60.

[19] The online Merriam-Webster Dictionary defines the term "drop-ship" as a transitive verb meaning, "to ship (goods) from a manufacturer or wholesaler directly to a customer instead of to the retailer who took the order."

distributor or direct supplier to the licensee, reducing the risk and cost to DLC and enabling the licensee to receive orders more promptly.

In most cases state law requires that Montgomery County licensees purchase the alcoholic beverages they sell from the Department of Liquor Control. A legal opinion may be needed to determine whether a modification to state law is needed in order to permit delivery to licensees via drop shipment.

Recommendations 5-6

5. DLC should explore delivering special order product via drop shipment, thus freeing up warehouse space and reducing the associated cost and risk to DLC.
6. DLC should employ a consultant with expertise in alcoholic beverage distribution systems to train and assist DLC managers in promptly implementing recommendations 1-5.

Summary of the Chief Administrative Officer's Response

In response to the final draft report, the Montgomery County Chief Administrative Officer (CAO) stated, "*We agree with all the recommendations offered in this report and will certainly perform the necessary work and follow through to fully implement them."* The CAO's response to our findings and recommendations is included in Appendix D.

The CAO's response did not cause us to alter our findings or recommendations.

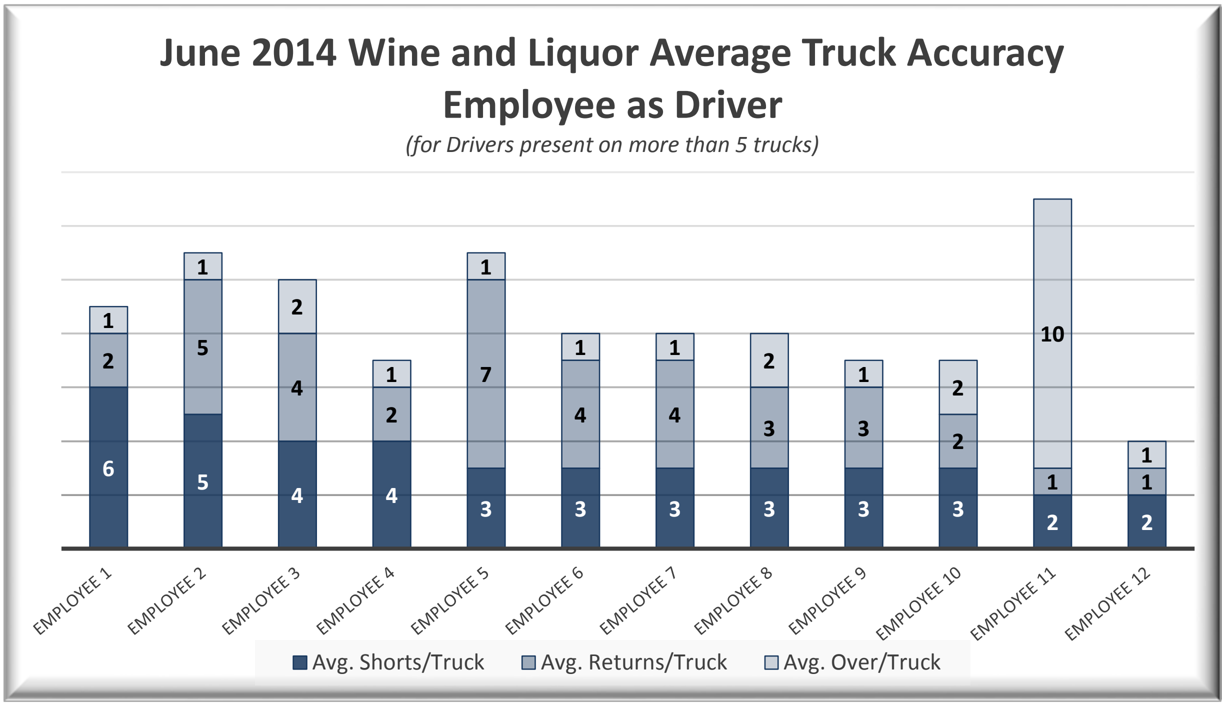
Appendix A: Daily Total DLC Wine/Liquor Truck-Loading Accuracy

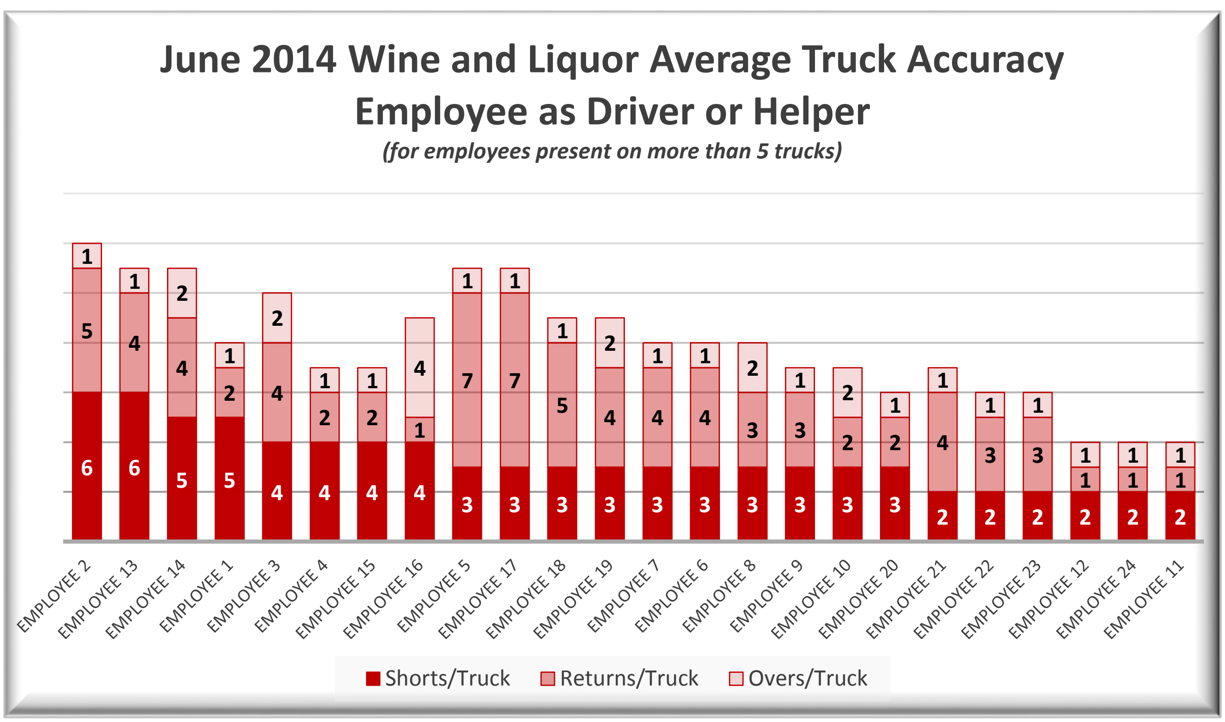
As Reported by Driver

Date	Short Cases	Return Cases	Over Cases	Trucks Driven
6/2/2014	51	8	8	10
6/3/2014	32	9	12	11
6/4/2014	41	73	5	9
6/5/2014	59	35	9	11
6/6/2014	29	39	13	9
6/9/2014	28	8	7	10
6/10/2014	36	6	5	10
6/11/2014	16	38	10	9
6/12/2014	32	52	9	11
6/13/2014	16	22	7	9
6/16/2014	48	41	10	10
6/17/2014	20	21	17	10
6/18/2014	35	35	12	9
6/19/2014	38	47	14	10
6/20/2014	27	27	13	9
6/23/2014	24	21	10	10
6/24/2014	27	13	8	10
6/25/2014	39	44	26	9
6/26/2014	22	87	26	11
6/27/2014	20	20	12	11
6/30/2014	23	11	9	10
Total	**663**	**657**	**242**	**208**
Average	**32**	**31**	**12**	**10**

Appendix B: Average DLC Wine/Liquor Truck-Loading Accuracy

As Reported by Driver





Appendix C: Preliminary Inquiry Memorandum

Department of Liquor Control Internal Control Matters

December 23, 2014

OFFICE OF THE INSPECTOR GENERAL

PRELIMINARY INQUIRY MEMORANDUM

December 23, 2014

TO:	Timothy L. Firestine Chief Administrative Officer
FROM:	Edward L. Blansitt III Inspector General
SUBJECT:	Department of Liquor Control – *Internal Control Matters* OIG PIM #15-003

This Preliminary Inquiry Memorandum (PIM) describes specific issues or complaints and the outcomes of limited procedures undertaken during a Preliminary Inquiry conducted by the Office of the Inspector General (OIG). Copies of this PIM along with your response, if any, will be provided to the members of the County Council and the County Executive within 10 business days of the date of this PIM.

Background and Summary of Complaints:

Since November 2013, the OIG received complaints concerning the Montgomery County Department of Liquor Control (DLC) that warranted our performance of preliminary inquiry procedures. We also observed conditions at the DLC warehouse that are addressed in this memo.

1. Multiple anonymous complainants alleged that a company owned by the spouse of the Division Chief of Licensure, Regulation, and Education (LRE Division Chief) was hired to cater DLC events. One complainant reported witnessing the spouse serving food at an event in September 2014.
2. An anonymous complainant alleged that some caterers operating in Montgomery County have been awarded a Montgomery County Beer, Wine, and Liquor Caterers License without paying the required county fee.
3. A DLC employee alleged that security cameras within the DLC warehouse are not operational and side doors are regularly left propped open, leaving the product stored within the warehouse vulnerable to theft.

51 Monroe Street, Suite 802 • Rockville, Maryland • 240-777-8240, 240-777-8254 FAX
email: ig@montgomerycountymd.gov

4. DLC staff reported that "checkers" within the warehouse were not properly checking the contents of returning DLC delivery trucks.
5. We observed that DLC driver paperwork containing relevant information regarding truck shorts, overages, breakage, and returns was collected but not aggregated or analyzed.

In performing preliminary inquiry procedures regarding these allegations, we interviewed numerous DLC employees, observed warehouse operations, and reviewed relevant financial and administrative records provided by DLC.

We reviewed each issue and discussed the information collected with DLC management. We have seen evidence that DLC has worked to address some of the issues raised within this memo and have been told that others are being addressed. This memo details DLC's efforts as reported to our office.

We expect to release a report of a comprehensive review of DLC warehouse and delivery operations later this fiscal year.

Potential Conflict of Interest regarding DLC Catered Events

Inquiry and Outcome:

Based on an internet search, we identified a local catering company whose website listed the spouse of the LRE Division Chief as a point of contact for information regarding catering and room rentals. Subsequently, we reviewed the records provided by DLC for catered events during the past 5 years and found 3 instances (totaling $3,052) where that particular catering company was contracted and paid by DLC. Two payments were for recent DLC events occurring in September 2014. We focused our efforts on those 2 events.

When interviewed, the LRE employee who booked the events and another LRE employee[1] who arranged payment for the services, told us that the LRE Division Chief neither pressured nor encouraged the employees to retain the services of this particular catering company. Neither recalled the LRE Division Chief playing a role in the decision. The employee booking the September 2014 events provided documentation indicating that she requested quotes from 2 caterers who had provided service to DLC in the past. The documents supported her statement that the company employing the spouse of the LRE Division Chief was hired because it quoted a lower price.

The LRE Division Chief acknowledged that 2 of her subordinates hired and paid the catering company that employs her spouse to cater DLC events. The LRE Division Chief stated that she had no involvement in the booking process, never saw the invoices and had

[1] All LRE employees fall below the LRE Division Chief in the chain of command.

not pressured anyone to hire her spouse. The LRE Division Chief explained that she had not realized that to some it may appear that it is a potential conflict of interest for this company to be utilized to cater DLC events and stated that she would make sure that the company would not be used for future events. We found no evidence conflicting with the statements made by the LRE Division Chief.

A LexisNexis search for information regarding the catering company did not return any results suggesting that the LRE Division Chief's spouse had ownership in the company.

Summary and Conclusion:

We substantiated that over the past 5 years a company employing the spouse of the LRE Division Chief was hired by LRE staff to cater 3 DLC events. However, we found no evidence that the LRE Division Chief's spouse had an ownership interest in the catering company. Additionally, we did not substantiate that the LRE Division Chief pressured or encouraged her subordinates to hire the caterer.

DLC Catering Licenses Issued without Payment

Inquiry and Outcome:

Based on documentation provided by a complainant and statements made by DLC employees, we verified that 2 local caterers were provided current DLC-issued Montgomery County caterer's (CAT) licenses without paying the annual license fee.[2] Based on information received from DLC, fewer than 5 caterers possessing Statewide Alcoholic Beverages licenses operate in Montgomery County. A notation in one of the files states:

> *This license was issued so that* [the caterer] *(which holds a state catering license) can order alcoholic beverages from* [DLC]. *Licensees have* ***not*** *appeared before* [the Board of License Commissioners] *nor have they been fingerprinted through our offices.*

According to information obtained from the Comptroller of Maryland website, both of the licensees reviewed possess active Statewide Alcoholic Beverages licenses. The LRE Division Chief stated that it was her understanding that caterers possessing a Statewide Alcoholic Beverages license are not required to obtain a County liquor license. She explained that, at some point in the past, the Office of the Comptroller of Maryland reached out to DLC to ensure that caterers with a Statewide Alcoholic Beverages license holding events in Montgomery County were purchasing alcohol from DLC. LRE made the decision

[2] Maryland Code, Article 2B § 6-706.1(a-c) sets the Montgomery County caterer's (CAT) annual license fee at $1,250.

to issue "dummy" licenses to caterers holding statewide licenses in order to facilitate their purchase of alcohol from DLC. These particular caterers are not charged a fee or required to appear before the Board of License Commissioners to obtain the license. According to the LRE Division Chief, these licenses are issued because they allow DLC to assign state-licensed caterers a DLC license number, which makes it easier for DLC Inspectors to verify that the caterers are purchasing alcohol for Montgomery County events from DLC. The LRE Division Chief stated that this was an internal decision and she did not believe anyone at DLC had consulted the Office of the County Attorney in making this decision.

Summary and Conclusion:

We verified that DLC issued at least 2 local caterers, already possessing an active Statewide Alcoholic Beverages license, a Montgomery County caterer's (CAT) license without requiring them to pay an annual license fee. We note that the amount waived by DLC is only $1,250 per year for each of the two licenses.

In response to an OIG request for guidance regarding whether the current procedures comply with the law, the Office of the County Attorney stated, "Article 2B (section 6-706.1(c)) and the Board's rules (Rule 2.3(e)) state that the annual fee for the County's CAT license is $1,250. There is no provision for or against waiving the fee."[3]

Lack of Physical Security at DLC Warehouse

Inquiry and Outcome:

During our observations of warehouse operations, DLC warehouse employees alleged that some of the security cameras functioned improperly. They also stated that staff members regularly used sticks or rocks to prop open perimeter fire doors within the warehouse. On October 16, 2014, the OIG informed the DLC Director of the allegations regarding the doors and cameras. Available documentation indicates that the DLC staff began working to address the allegations the following day.

We obtained documentation indicating that on October 17, 2014, DLC began working with a contracted security firm to repair or replace broken or poorly functioning cameras. Additionally, DLC has asked the contractor to install a feature wherein DLC management will be automatically notified when one of the cameras is not recording properly.

We did not verify whether or not doors had been left propped open at the DLC warehouse, but a policy memo was issued on October 17, 2014 counseling staff to, "Only use

[3] Maryland Code, Article 2B § 6-706.1(c) and *Rules and Regulations Board of License Commissioners of Montgomery County Maryland*, Section 2.3(e) - Effective January 1, 2007 and last amended May 2, 2013.

designated employee doors. All other doors should be treated as emergency exits only and should never be left open with a rock or piece of wood."

Summary and Conclusion:

The DLC director took remedial steps to resolve the issues. A contracted security firm replaced or repaired non-functional cameras. Additionally, DLC is working to implement a program wherein they will be automatically notified when a camera needs repair. DLC warehouse staff were provided a memo directing them not to leave doors propped open.

DLC Delivery Truck Content is not Properly Inventoried upon Return to the Warehouse

Inquiry and Outcome:

DLC staff told us that after a truck returns to the warehouse, drivers are to provide their paperwork, including credit forms, returned/received/exchange forms, and unresolved invoices to a "checker." At the same time, the driver unloads any product left in his truck for the checker to observe, count, and compare with the information included in that driver's paperwork. This serves as a control to ensure that drivers submit the proper paperwork and return broken, returned, or extraneous merchandise to the warehouse. According to a driver supervisor, regardless of whether a checker is present at the time the truck arrives, it is expected that drivers take responsibility for getting properly checked in by an assigned checker or member of the managerial staff.

Three warehouse managers reported that checkers fail to properly check trucks in upon return from their delivery route. During a site visit, an OIG staff member observed the return of 2 delivery trucks to the warehouse. No checker was present at the checking station during either delivery. In both cases, we observed a manager perform the checker's duties. Additionally, during a review of June 2014 driver paperwork, we found a significant number of trucks whose paperwork had no signature on the checker line, indicating that the contents of their truck had not been reviewed upon return to the warehouse. (See figure 1.)

	# Driver Tally Sheets	With Signature	Without Signature
Wine/Liquor	167	111	34%
Beer	357	280	22%

Figure 1: June 2014 Driver Tally Sheets with Signed Checker Line

Since our October 16, 2014 meeting with the DLC Director, DLC has changed its policy to ensure that all DLC delivery trucks are properly checked-in. Checkers no longer perform this function, which is now assigned to management.

An October 17, 2014 memorandum to all DLC delivery drivers states:

> *Upon returning from your route – you must be checked in by a member of management.*
>
> *They are the only staff authorized to sign off on your Drivers Tally Sheet. This must be signed off prior to you leaving for the day.*

Additionally, the Chief of Warehouse Operations informed the OIG that he had restructured the assignment of warehouse managers in order to assign a specific manager to the checker function. That manager is not permitted to leave the warehouse until all drivers return from their route.

Summary and Conclusion:

Our limited analysis of Driver Tally Sheets indicates that the content of DLC delivery trucks was not always properly reviewed upon return to the warehouse. DLC has issued new policy and restructured staff assignments in order to address the issue.

DLC does not Aggregate Information Regarding Driver Shorts, Overages, or Returns

Inquiry and Outcome:

DLC staff reported that the Driver Tally sheet and Credit Forms are the principle means of tracking delivery accuracy. The forms appear to adequately capture relevant information regarding driver-reported overages, shortages, breakage, and returns. However, driver-reported shorts, overages, and returns were not tracked, communicated to staff, or regularly investigated to determine the accuracy or cause of these deviations.

Timothy L. Firestine **OIG PIM #15-003**
December 23, 2014
Page 7

Based on our limited analysis, drivers frequently report trucks as not accurately packed. For 206 wine/liquor driver tally sheets available for trucks dispatched during June 2014, only 9 were reported as being accurately loaded. (i.e., no product overages or shorts reported by driver.)

A recent investigative news report[4] stated that over a six month period, certain DLC beer delivery drivers reported as many as three times the number of shorts[5] as compared to other drivers. According to the newscast, the drivers may be falsely reporting that their trucks have been shorted product in order to personally sell cases of beer. DLC informed us that subsequent to the newscast, several employees left their positions.

During the course of our preliminary inquiry, DLC began keeping a weekly log of shorts, overages, and returns by driver. Drivers are also now required to call and report discovered shorts from the field.

Summary and Conclusion:

Because available information regarding driver reported shorts, overages, and returns was neither aggregated nor analyzed, DLC was vulnerable to drivers falsely reporting shorted product. At this time, DLC has begun to aggregate and possibly evaluate the available data.

cc: George Griffin, Director, Department of Liquor Control

A preliminary inquiry is the first phase of each project the OIG performs in reaction to a complaint. A Preliminary Inquiry Memorandum (PIM) is appropriate in situations that do not warrant full inspections, investigations, or audits but in which we have gathered and assessed sufficient information for us to draw limited conclusions related to the specific complaint. We do not provide full findings and recommendations in PIMs. Instead, we may identify specific conditions, transactions, and events that management may want to continue to research from an investigative or policy standpoint.

[4] NBC Washington News 4 I-Team, *Beer Bust: Montgomery County Employees Accused of Skimming Cases,* published November 6, 2014 at http://www.nbcwashington.com/investigations/series/beer-bust/Beer-Bust-Montgomery-County-Employees-Accused-of-Skimming-Cases-281685501.html.

[5] At DLC the term "short" means that a product was invoiced as being placed on the DLC delivery truck. However, the item could not be located at the time that the driver made delivery to the targeted customer.

OIG PIM #15-003

Response to this Preliminary Inquiry Memorandum:

From Montgomery County Chief Administrative Officer:

On January 20, 2015, the office of the *Chief Administrative Officer* responded via email:

> *We agree with the report's Summary and Conclusion related to items #1, #3, #4 and #5, and as stated in the report, DLC has already instituted additional policies and procedures to address any concerns. However, regarding the Summary and Conclusion of item #2 (DLC Catering Licenses Issued without Payment) we must clarify the following point:*
>
> *Montgomery County is one of the few Maryland counties that offers a local "catering" alcohol license (MCAT license) for local businesses who may wish to only operate in Montgomery County. There also exists a statewide catering license (SCAT license) issued by the Maryland Comptroller to catering companies who may wish to operate in more than one jurisdiction in the state. Most companies, including several based in Montgomery County, hold this statewide license. The Maryland statewide license – by definition – supersedes any local licenses and allows the license-holder to operate throughout Maryland, including Montgomery County. <u>DLC has neither provided product to an unlicensed catering company, nor failed to charge a catering company for a required license.</u> The misunderstanding may have arisen due to the fact that SCAT licensees must be "enrolled" in the DLC system and identified as valid license holders in order to purchase products from DLC at the wholesale level. To accomplish this, DLC enrolls the SCAT license holder as a licensee at the time the statewide caterer initially makes a request to order product from DLC for an event to be held in Montgomery County. These particular SCAT licensees are not charged an additional local license fee, or required to appear before the Board of License Commissioners. To avoid any future misunderstanding, going forward DLC will refrain from using the term "dummy licenses" to refer to the internal process of enrolling these licensed caterers in its system.*

Appendix D: Chief Administrative Officer's Response

OFFICES OF THE COUNTY EXECUTIVE

Isiah Leggett
County Executive

Timothy L. Firestine
Chief Administrative Officer

MEMORANDUM

March 20, 2015

TO: Edward L. Blansitt III, Inspector General

FROM: Timothy L. Firestine, Chief Administrative Officer Timothy L. Firestine

SUBJECT: Inspector General Report – Department of Liquor Control Warehouse Inventory Management

I am in receipt of your report on Department of Liquor Control (DLC) Warehouse Inventory Management. I appreciate the work conducted by the Office of the Inspector General in issuing this report. We agree with all the recommendations offered in this report and will certainly perform the necessary work and follow through to fully implement them. As noted in the report, in some instances, the planning for these implementations has already begun and some of the work has been performed. Specific comments concerning some of the report's findings and recommendations are found below.

IG Finding #1A: Physical Storage Locations of Inventory Are Not Consistently Recorded

CAO Response: It should be noted that the APPX accounting and management system serving DLC for many years (until just a few weeks ago) would not allow for more than one physical warehouse location to be designated for each inventory item. The new Oracle ERP system does provide for multiple physical locations to be assigned to the same inventory items. Oracle ERP Warehouse Management electronic scanning of inventory from receiving through delivery should begin within approximately 30 – 45 days. This will facilitate the implementation of IG Recommendation #s 1 and 2.

IG Finding #1B: Some Warehouse Storage Locations are Unmarked

CAO Response: Some warehouse storage locations were unmarked frequently because product necessarily had to be temporarily stored in more than one location. As the report indicates, the overflow area for wine and liquor is already marked. The marking of the beer overflow area will be completed shortly.

101 Monroe Street • Rockville, Maryland 20850
240-777-2500 • 240-777-2544 TTY • 240-777-2518 FAX
www.montgomerycountymd.gov

montgomerycountymd.gov/311 MC311 ANSWERING TO YOU 240-773-3556 TTY

Edward L. Blansitt III, Inspector General
March 20, 2015
Page 2

IG Finding #1C2: Annual Physical Inventory Counts are used to "reset" the DLC perpetual inventory with no investigation of variances.

CAO Response: The discussion concerning the "Annual Physical Inventory Counts" requires some further explanation. The IG correctly notes the considerable variance noted in the FY2013 "Total Adjustment," which was an anomaly. The Fiscal Year End inventory count for FY13 was conducted using a new inventory format while DLC was relocating its operations into the Edison Park warehouse facility. The inventory count literally took place during the physical move. The total FY13 adjustment of $1,086,802 noted by the IG was a preliminary figure based on the initial inventory count. The second, follow-up inventory count captured an additional $425K of inventory reducing the final variance adjustment. We agree with the recommendation to conduct periodic cyclical inventory counts in addition to the audited year-end full inventory process.

IG Recommendation #2: DLC should revise written policies and procedures to reflect new warehouse operations, including proper documentation and justification for adjustments to the electronic inventory.
IG Recommendation #4: DLC should develop and implement a written, defined productivity measurement system including relevant performance metrics for the receiving, safeguarding, picking, loading, delivery, and return of warehouse goods as well as control of operating costs.
IG Recommendation #6: DLC should employ a consultant with expertise in alcoholic beverage distribution systems to train and assist DLC managers in promptly implementing recommendations 1-5.

CAO Response: DLC will employ a consultant with expertise in alcoholic beverage distribution systems to assist in implementing recommendations 2, 4 and 6. DLC will also engage the services of a management consultant (to coordinate with the distribution system expert) to assist DLC in revising, updating, and creating written policies and procedures, management reporting mechanisms, and productivity measurements. In addition, CountyStat is in the process of reassessing all DLC Headline Performance and Program Measures, and will soon develop additional performance metrics, dashboards, and DLCStat sessions.

IG Recommendation #5: DLC should explore delivering special order product via drop shipment, thus freeing up warehouse space and reducing the associated cost and risk to DLC.

CAO Response: We are currently exploring options and developing alternative scenarios to address the entire issue of special order items from both a management and logistical standpoint. The County is consulting with the Maryland Office of the Comptroller, the Attorney General, and others to ensure that any proposed changes (including drop shipment options) are legally

Edward L. Blansitt III, Inspector General
March 20, 2015
Page 3

permitted and feasible under Article 2B of the Maryland Code, and state trade practice and regulatory requirements.

If you have any questions, please feel free to contact me or Assistant Chief Administrative Officer Fariba Kassiri, who can be reached at (240) 777-2512 or Fariba.Kassiri@montgomerycountymd.gov.

TLF:gg

cc: Fariba Kassiri, Assistant Chief Administrative Officer
George F. Griffin, Director, Department of Liquor Control
David Gottesman, CountyStat Manager