

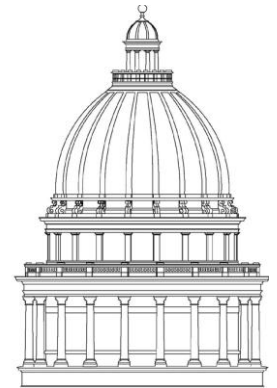
Office of the
LEGISLATIVE AUDITOR GENERAL
State of Utah

REPORT NUMBER 2011-04
May 2011

A Review of DABC Actions Regarding a \$300,000 Loss from a Package Agency

We completed a review of the Department of Alcoholic Beverage Control's (DABC) actions regarding an Eden, Utah package agency that was closed in July, 2010. At the time of its closing, \$298,177 in state funds/inventory was unaccounted for and still has not been recovered by the state. While this package agency was only operational for one year, significant losses occurred, and we are concerned that DABC's actions contributed to the state's financial loss. DABC management's decisions and actions that concern us are listed in the following bullets, with the corresponding pages of the report where those issues are discussed:

- Failing to report to the DABC Commission the issues surrounding this package agency and its termination (page 3).
- Failing to report the potential criminal activity of the Eden Package Agency operator to the Utah Attorney General (pages 3-4).
- Failing to ensure that payments were made in a timely manner in accordance with the contract (pages 5-7).
- Continuing to ship liquor to the package agency over many months, despite the store's growing debt (pages 7-9).



**\$300,000 in state liquor
inventory is
unaccounted for from a
closed package agency.**

We believe that the DABC exercised poor management because of many questionable decisions and actions regarding the Eden Package Agency.

- Failing to follow commission rules requiring audits of package agencies every six months (page 9).
- Continuing the shipment of liquor despite unaccounted funds/inventory identified by the DABC audit of the Eden Package Agency (pages 10-11).
- Increasing compensation to the Eden Package Agency operator retroactively to reduce debt, despite the unaccounted funds/inventory (pages 11-12).
- Sending the Eden Package Agency payments despite the unaccounted funds/inventory (pages 12-13).
- Waiving finance charges to the Eden Package Agency despite unaccounted funds/inventory (pages 13-14).
- Not complying with their own rules and contract terms concerning the type of package agency approved (pages 14-16).
- Failing to perform a criminal background check on the operator of the Eden Package Agency (pages 16- 17).

When considered together, these decisions and actions justify our assessment that the DABC exercised poor management of the Eden Package Agency.

DABC Failed to Report Issues to The Commission and Attorney General

We found that the DABC failed to inform the proper authorities about the concerns with the Eden Package Agency. While the DABC did refer the issue to the Division of Risk Management (whose role is to provide insurance coverage), we believe that the commission should have been informed, along with the Attorney General's Office. With approximately \$300,000 in funds/inventory unaccounted for, the Attorney General's Office should investigate to determine whether criminal proceedings are warranted. We believe that the DABC's failure to report this issue to the commission and the attorney general

We believe DABC's failure to report this issue to their commission and the attorney general could be an attempt to avoid bringing attention to poor management decisions.

could be an attempt to avoid bringing attention to poor management decisions.

DABC Management Did Not Report Package Agency to the Commission

DABC management failed to report the concerns with the Eden Package Agency to the DABC Commission. The chair of the commission told us he had no knowledge of the financial situation surrounding the Eden Package Agency or the termination of the contract.

The DABC's website describes the DABC Commission's responsibilities as follows:

The commission shall act as the general policymaking body on the subject of alcoholic product control. The commission sets policy and makes rules, and is responsible for the issuance of licenses and permits, and the suspension or revocation of existing licenses for infractions of the law. As a commission they act as a governing board in reviewing the activities of the staff on the day to day operations of the department.

Since the commission has oversight responsibility for the DABC it is reasonable to expect that the commission should have been notified. While statute and the contract are vague about an obligation to report such matters to the commission, as the policy body over the DABC, we believe the DABC Commission should have been informed of the issues leading to the termination of this package agency's contract and the losses in state funds.

DABC Management Did Not Report Potential Criminal Activity to the Attorney General's Office

While DABC management did report the issues surrounding the Eden Package Agency to the Division of Risk Management, they failed to properly report it to the Attorney General's Office. DABC told us they only report issues like this to Risk Management, but no written protocol exists. In terms of this case, Risk Management pursues civil action, not criminal action. Because a bankruptcy filing is involved, any civil judgment is less likely. The Division of Risk

We believe that DABC administrators had a responsibility to inform their commission of the issues leading to the termination of the Eden Package Agency.

Management's role is to provide insurance coverage, not to investigate potential criminal activities.

We believe that with \$300,000 in funds/inventory unaccounted for, DABC had a responsibility to promptly report the matter to the Attorney General's Office. *Utah Code* 76-8-403 states:

Every person who receives, safekeeps, transfers, or disburses public money who neglects or fails to keep and pay over the money in the manner prescribed by law is guilty of a felony of the third degree.

Further, the contract between the DABC and the Eden Package Agency stated:

The Package Agent shall at all times have the agency's liquor consignment or its equivalent cash value available for immediate return to the Department. . . . Should the Package Agent fail to maintain the agreed consignment or its equivalent cash value, or should he fail to return the liquor or pay its cash value to the Department upon its request, the Package Agent shall be subject to civil prosecution by the Department for the conversion of state property and/or criminal prosecution for the theft and misuse of state funds.

Whether or not the Eden Package Agency operator deliberately misappropriated state resources is a matter that should be investigated by the Attorney General's Office. The DABC has assigned legal counsel from the Attorney General's Office who is present at every DABC Commission meeting. This Assistant Attorney General told us that the DABC never informed her about the issues with the Eden Package Agency. We recommend that the Utah Attorney General investigate these issues to determine if criminal prosecution is warranted.

The Utah Attorney General should investigate these issues to determine if criminal prosecution is warranted.

DABC Actions Contributed to Increased Losses to the State

This section will discuss a number of management decisions related to the Eden Package Agency that contributed to the State's loss of nearly \$300,000. First, DABC management allowed the package

agency to accumulate large amounts of debt, even though the state contract with the package agency required payment within 30 days. Second, DABC management did not limit shipments of liquor despite the package agency's continued failure to pay invoices. Third, DABC failed to complete an audit, as required by rule within six months, when the package agency's unpaid charges were already \$227,000. Fourth, DABC management did not react quickly on the findings of the audit, but allowed the debt to grow without documented assurances that payments could be made. Other sections of this report address additional management decisions and actions that also concern us.

To allow some types of package agencies to start their business, the DABC provides liquor to stores on a consignment basis. There are currently 34 other package agencies with consignment arrangements. Eden was set up with a \$75,000 consignment. This consignment amount is the amount of liquor that a package agency can have on interest-free loan from the state and is not expected to be paid back until the store is closed down.

DABC Failed to Ensure Payments Were Made in a Timely Manner

We are concerned that the DABC failed to ensure payments were made by the Eden Package Agency in a timely manner. Instead, the DABC continued to ship liquor to Eden, despite the substantially increasing unpaid charges. In addition to the liquor received through consignment, the Eden Package Agency quickly accumulated large amounts of inventory and debt, as shown in Figure 1.

Figure 1. The DABC Allowed the Eden Package Agency to Accumulate Large Amounts of Debt. The DABC continued to ship the Eden Package Agency large amounts of liquor despite increasing debt.

The Eden Package Agency was allowed to continue operating despite increasing unpaid charges.

Month	Charges	Payments	Credits	Unpaid Charges*
July 2009	\$ 102,753	\$ 0	\$ 0	\$ 102,753
Aug	71,941	18,295	0	156,398
Sept	22,480	41,761	0	137,117
Oct	48,351	14,780	35	170,653
Nov	14,578	8,058	0	177,173
Dec	49,870	0	0	227,044
Jan 2010	64,699	25,554	0	266,188
Feb	147,582	45,437	0	368,332
March	72,252	45,860	0	394,725
April	28,613	14,821	0	408,517
May	59,415	193	60,475	407,264
June	25,602	7,326	7,854	417,686
July & Closing	(\$ 1,316)	1,299	116,894	\$ 298,177
Total	\$ 706,820	\$ 223,384	\$ 185,258	N/A

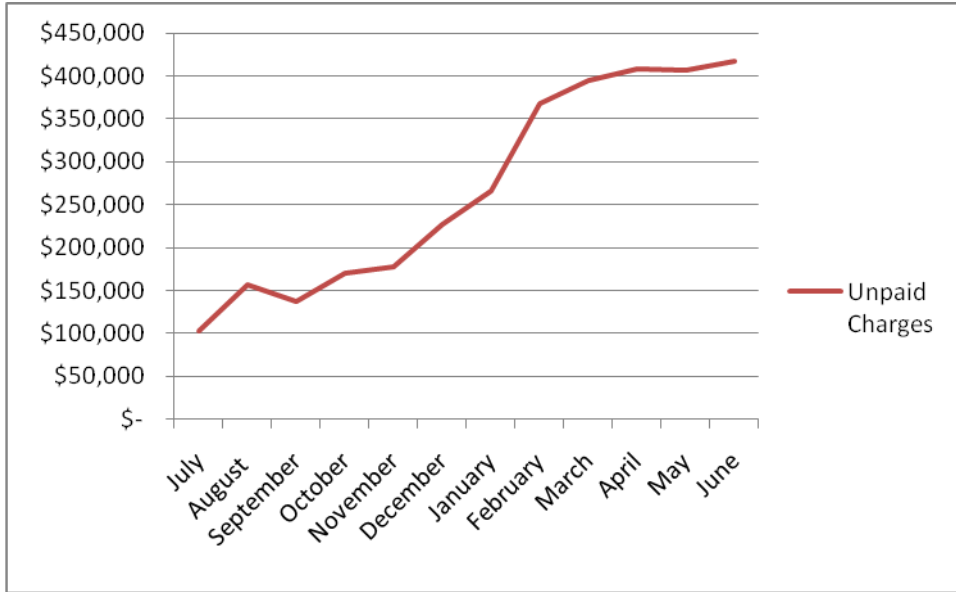
**Until closing, only unpaid charges in excess of \$75,000 consignment value are payable.*

Most credits applied in May 2010 were a result of DABC actions, not package agency payments.

As shown in Figure 1, the balance owed by the Eden Package Agency increased almost every month. In 11 of the 12 months of the package agency's operation, the DABC's charges for liquor exceeded the package agency's payments. In many months, the increasing unpaid charges were alarming. In the final two months of operation and after the store was closed, the package agency received a large number of credits. During this time, over \$8,000 of finance charges were waived and a \$28,000 credit was issued to retroactively increase the package agency's compensation. The package agency also began operating a state credit card machine. Payments made through the machine were received by the state, and the amounts were then credited to the package agency.

Figure 2 illustrates the growth in unpaid charges shown in Figure 1. In June of 2010, the Eden Package Agency had over \$417,000 in outstanding inventory, although \$75,000 of that amount represents the consignment that was not due until the store was closed. After closing the store, DABC recovered \$93,000 in inventory and stopped a number of shipments that had been in route to the package agency. The recovered inventory and issued credits resulted in a final ending balance owed of \$298,177.

Figure 2. The DABC Allowed the Eden Package Agency to Continue for 12 Months, Despite Increasing Unpaid Charges. The Eden Package Agency had over \$417,000 in unpaid charges (liquor that had not been paid for) when its contract was terminated in the beginning of July 2010.



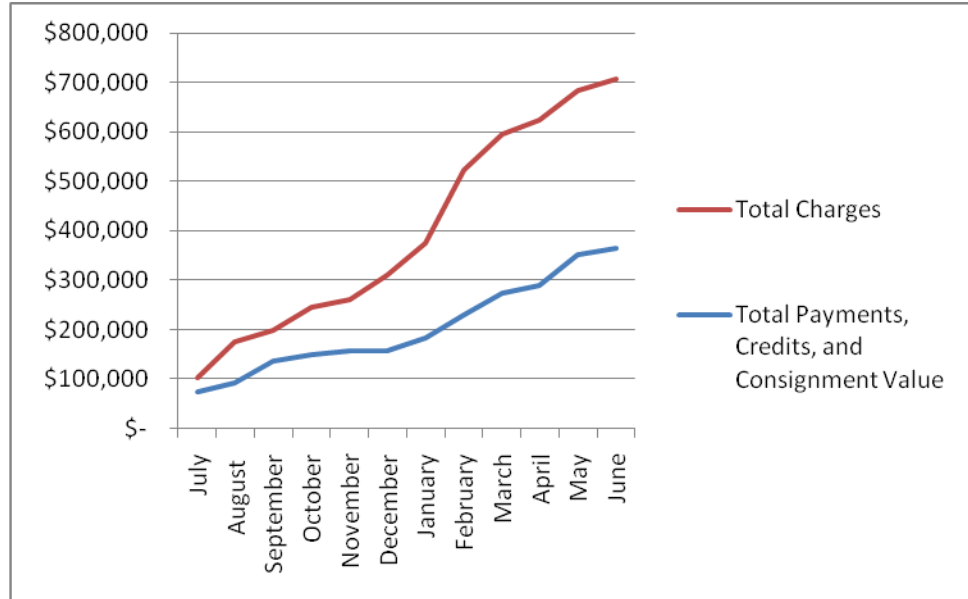
Unpaid charges grew at an alarming rate for the Eden Package Agency.

We are concerned that DABC management failed to ensure that payments were made in a timely manner and continued to ship the Eden Package Agency large amounts of liquor despite significantly increasing unpaid charges.

DABC Continued to Ship State Liquor Despite Large Debt

The DABC continued to ship the Eden Package Agency liquor despite mounting debt. DABC administrators explained to us that they were trying to help the Eden Package Agency be successful. They failed, however, to protect the state's resources and closely monitor this package agency. Figure 3 illustrates that from the first month of operation, total charges exceeded total payments, but the DABC continued to ship state liquor to the Eden Package Agency.

Figure 3. The Eden Package Agency Owed More than Was Paid from the First Month of Operation. While open for just one year (July 2009 to the first part of July 2010), the Eden Package Agency sold a lot of liquor, but total charges exceeded total payments from the beginning.



The Eden Package Agency was never current on their payments, yet the DABC continued to ship them liquor.

As illustrated in Figure 3, the Eden Package Agency was never current on payments, yet the DABC continued to ship liquor, increasing losses to the state. While the agency was operational (for one year), the amount of payments, credits, and consignment totaled about \$367,000 for over \$700,000 in liquor shipped. When the package agency was closed, about \$93,000 in inventory was recovered, but the \$75,000 for the consignment was also required to be repaid. After final credits and shipments were applied, the package agency owed the state \$298,177 for inventory received but never paid to the state.

By continuing liquor shipments to the Eden Package Agency, the DABC contributed to increased state losses.

The Eden Package Agency quickly became delinquent in its payments. After just two months of operation the package agency's unpaid charges were more than double its allotted consignment value. Prior to being shut down, the store averaged almost \$60,000 in liquor shipments, but only \$20,000 in payments each month. Only once in the year of operation were payments made in excess of the amount of inventory shipped, but those payments did not come close to eliminating the delinquent debt owed by this package agency. We found no evidence to suggest that the DABC limited shipments to the

package agency to safeguard state resources until the package agency was terminated in the first part of July 2010.

The package agency contract states:

Payments for liquor purchased by the Package Agent from the Department shall be remitted to the Department within thirty working days. . . . The Department shall have the right to refuse to deliver all liquor ordered by the Package Agent if any authorizations which are delinquent . . . remain on the Package Agent's account.

Notwithstanding this contract language, the package agency consistently had outstanding debt that was more than 30 days past due. Just before the DABC shut down the package agency the unpaid balance over 30 days old was \$310,000, with \$161,000 of that amount over 90 days old.

DABC Management Failed to Follow Rules In Auditing the Eden Package Agency

Despite large shipments and debt owed, DABC management failed to ensure that the Eden Package Agency was audited in a timely manner. *Administrative Rule* R81-3-17 sets forth rules for Consignment Inventory Package Agencies. In regards to audits of agencies with a consignment inventory, the rule states that:

The regional manager shall audit the package agency at least once every six months.

However, the first audit of the Eden Package Agency was not conducted until April 2010, 10 months into the operation of the agency. After six-months of operation, this package agency had over \$227,000 in unpaid charges, by April 2010 this package agency had unpaid charges of more than \$400,000. Given the high amounts of shipments and unpaid charges incurred by the Eden Package Agency, an audit seems to have been warranted well before the six-month period.

Unpaid charges should have been a red flag to DABC.

The DABC violated its own rules by not auditing this package agency sooner.

DABC Management Continued Liquor Shipments After Unaccounted Funds/Inventory Were Identified by Audit

After 10 months of operation, the audit of the Eden Package Agency identified funds/inventory that was unaccounted for. The results of the audit are shown in Figure 4.

Figure 4. A DABC Audit of the Eden Package Agency in April, 2010 Found a Significant Shortage. The April audit found over \$187,000 missing.

Unpaid Charges		\$ 314,419.03
Inventory in stock	\$ 106,033.69	
Amount in bank	\$ 20,768.07	
Less: Total Assets		\$ 126,801.76
Shortage		\$ 187,617.27

An April, 2010 audit by DABC identified over \$187,000 in funds/inventory that was unaccounted for.

As shown in Figure 4, the Eden Package Agency could not account for almost \$190,000. Any amount of deficit found in an audit raises serious red flags as to how well a package agency is safeguarding state resources. The liquor and sales proceeds are state property and the amount unaccounted for was very high. The collectability of this amount would be questionable; we believe the DABC should have sought legal counsel regarding a potential deliberate misappropriation of state resources.

Even with the large deficit, DABC shipped the Eden Package Agency \$85,000 worth of inventory after the audit and before the agency was shut down. During this time, the amount of money in the agency bank account decreased from almost \$21,000 to just \$6,000 on July 1, 2010 and \$0 on July 8, 2010. The funds withdrawn from the Eden Package Agency operator’s bank account were not paid to the DABC to help reduce the debt. Given the large debt and uneven payment history of the package agency, the decision to allow more liquor to be sent seems to be a serious mistake.

Despite being in debt to the state, money in package agency’s account went from \$21,000 to \$0 without the state being paid.

Following the audit, DABC management met with the Eden Package Agency operator, who informed DABC that the Eden Package Agency would have an investor who would reduce the debt. No record of this meeting exists, but DABC managers informed us that they gave the Eden operator more time in hopes of this investor

providing funding. The DABC made a business decision regarding this investor but never attempted to contact this investor to validate the potential. We contacted this potential investor and were informed that for an investment to be made, the Eden operator needed to do a number of things, which included providing a profit and loss statement. The statement was never provided.

While the audit showed about \$190,000 unaccounted for, the continued shipments and depletion of the bank account resulted in a final loss to the state of just under \$300,000. Poor controls and decisions by the DABC resulted in additional state funds being lost after the audit was conducted.

DABC Management Increased Compensation and Waived Finance Charges Despite Unpaid Charges

We are concerned that DABC management increased the package agent's compensation to almost \$8,000 per month (from \$1,000 per month) retroactively to reduce the debt after an audit identified nearly \$190,000 unaccounted funds/inventory without notifying the commission or amending the contract. We are also concerned that in connection with the compensation increase, DABC paid the agent almost \$16,000 for the last two months of service (after the audit) when his unpaid charges to the state was over \$400,000. Finally, DABC management waived most finance charges against the outstanding debt of this package agent.

DABC Management Increased Compensation Retroactively To Reduce Debt Despite Missing Funds/Inventory

In April of 2010, following the closure of another package agency, the compensation to the Eden Package Agency operator was changed to that of a Type-3 package agency. As will be discussed later, DABC management failed to amend the contract of the Eden Package Agency but still increased the compensation. Type-3 package agencies are reimbursed based on the volume of liquor ordered. The Eden Package Agency qualified for a reimbursement amount of \$7,941 per month, compared to the \$1,000 per month received as a Type-2 package agency. The payments for the switch to a Type-3 agency were made

It is concerning that the DABC continued to ship product despite missing funds/inventory identified in DABC audit.

Despite unaccounted funds/inventory, in April 2010, DABC increased compensation to the package agent from \$1,000 to almost \$8,000 per month retroactively to January.

retroactively to January, resulting in nearly \$28,000 which was taken as a credit against the outstanding balance.

DABC management should have been diligent in considering whether to increase the reimbursement for this agency, especially on a retroactive basis, given the large amounts of unpaid debt and the deficit discovered in the April audit. The decision not to bring this matter to the DABC Commission or amend the contract suggests that due diligence was not followed.

The Eden Package Agency contract, under payments to the commission, states in part:

Should the Package Agent at any time be thirty (30) days or more delinquent in his/her payments to the Department for liquor purchases, the Department may place the name of the Package Agent and the agency upon the agenda for the next Commission meeting for revocation of this contract and all permits authorizing the Package Agent to store, sell, and distribute liquor.

While the contract states that the department may place the agency on the commission agenda, in our opinion, this issue was so serious that it warranted commission involvement. While the contract allowed for termination by the DABC if payments were 30 days or more delinquent, the DABC took no corrective action, but instead started paying the package agency operator more.

Despite Unaccounted Funds/Inventory, DABC Management Sent Checks to the Eden Package Agency

In addition to increasing the package agency operator's compensation despite a poor payment history and the deficiency found in the audit, the DABC sent this package agent checks for the May and June payments. While the retroactive payment for January to April of \$28,000 was applied to package agency's account, this was not done with the nearly \$16,000 that was paid for May and June. This payment represents a significant oversight on the part of the DABC. To illustrate:

- On April 22, 2010, the DABC sent the Eden Package Agency operator a check for \$7,941 for May.

The issues surrounding the Eden Package Agency were serious enough that they warranted commission involvement.

Despite unaccounted funds/inventory, DABC sent almost \$16,000 in checks to the Eden Package Agency operator.

- On May 20, 2010, the DABC sent the Eden Package Agency operator a check for \$7,941 for June.

When these checks were sent, the package agency had unpaid charges of over \$400,000 to the state, and as the April DABC audit revealed, the package agency could not account for over \$187,000 in either funds or inventory. Sending the operator checks when funds/inventory are unaccounted for and large amounts of funds are owed, in our opinion, contributes to a series of poor management decisions.

Despite Unaccounted Funds/Inventory, DABC Management Also Waived Finance Charges to the Eden Package Agency

The Eden Package Agency's contract with the DABC stated that the DABC shall charge interest for unpaid shipments after 30 days. Despite this strong language in the contract, it is DABC's practice that interest is not charged to package agencies from November to February to allow stores to build up inventory for the holiday season. Finance charges are also not applied until invoices are 40 days old. The 10 day grace period is given to allow for the time it takes for a shipment to be delivered.

The majority of interest charges were waived for the Eden Package Agency in order to help manage the large debt levels. Figure 5 shows a breakdown of the finance charges including what was paid by the Eden Package Agency and what was waived by the DABC.

Sending checks when funds are unaccounted for and debt is substantially high contributes to a series of poor management decisions.

DABC waived over \$8,000 in finance charges to the Eden Package Agency.

Figure 5. The DABC Waived Most Finance Charges to the Eden Package Agency. Despite language in the contract that requires finance charges to be applied for debt beyond 30 days, the DABC decided to waive the finances charges for the Eden Package Agency.

Finance Charges Credited		Finance Charges Paid	
Date	Amount	Date	Amount
9/28/2009	\$ 35.48	11/18/2009	\$ 224.73
4/27/2010*	1,327.17	1/27/2010	325.33
4/27/2010*	1,457.36		
5/13/2010	2,045.24		
6/24/2010	1,285.73		
6/24/2010	1,957.26		
Total	\$ 8,108.24	Total	\$ 550.06

* Credited finance charges were reflected in the May invoice.

As shown in Figure 5, of the \$8,658 in finance charges, \$8,108 or 93.6 percent was waived while just \$550 was paid by the Eden Package Agency. Additionally, the vast majority of finance charges were waived after the audit was conducted on April 5th. The DABC was aware that the agency was well behind on payments and significantly short on the required funds/inventory, yet they waived over \$8,000 in finance charges. This allowed the package agency to use state funds without penalty for the entire time it was in operation.

The DABC Did Not Comply with Its Own Rules and Contract

The DABC allowed the Eden Package Agency to operate like a Type-3 package agency and increased the package agency operator's compensation, contrary to rules approved by the commission and their own contract. The Eden Package Agency was created by the DABC Commission as a Type-2 package agency but operated as a Type-3 package agency. The distinction between these types of package agencies is illustrated in Figure 6. Package agencies are defined by *Administrative Rule R81-3-1*, which states:

Package agencies are retail liquor outlets operated by private persons under contract with the department for the purpose of selling packaged liquor from facilities other than state liquor stores for off premise consumption.

Package agencies are retail liquor outlets operated by private persons under contract with the DABC.

There are five types of package agencies in Utah. For purposes of this report, Type-2 and Type-3 package agencies are pertinent and defined in Figure 6.

Figure 6. Utah Administrative Rule R81-3-1 Defines Type-2 and Type-3 Package Agencies. *Utah Administrative Rules* makes the distinction between Type-2 and Type-3 package agencies based on whether or not the primary source of income or the sole purpose of existence is for the sale of liquor. Compensation is determined by the package agency's contract.

Classification	Definition	Compensation
Type-2:	A package agency...which is in conjunction with another business where the primary source of income to the operator is not from the sale of liquor.	Set amount each month, as defined in the package agency contract.
Type 3:	A package agency...which is not in conjunction with another business, but is in existence for the sole purpose of selling liquor.	Based on volume sold.

On June 24, 2009, the DABC Commission unanimously approved a Type-2 package agency in Eden, Utah. While the package agency was approved as a Type-2 package agency, it always operated as a Type-3 package agency in that its primary purpose was for the sale of liquor.

The former operator of the Eden Package Agency told us that about 98 percent of his business was from the sale of liquor. Both the former operator and the DABC said that the intention was to always convert this package agency to a Type-3 when funding became available (when other Type-3 package agencies were closed). As was discussed in the previous section of this report, in April, 2010, the DABC began compensating the Eden Package Agency operator as a Type-3 agency and retroactively applied the increased compensation to January, 2010.

The DABC started compensating the Eden Package Agency operator as a Type-3 package agency without commission consent or amending the contract.

The contract between the DABC and the Eden Package Agency provided for monthly payments of \$1,000. The DABC increased the compensation to this package agent to just under \$8,000 per month without amending the agreement, even though the agreement stated that monthly payments “may be changed at any time if done by written supplement to this contract signed by both parties.” The DABC never amended the contract, but started paying the package agent significantly more even though the unpaid charges of this package agency were increasing.

Utah Code 32A-3-101 (1)(a) vests the authority to create a package agency with the DABC Commission, but DABC procedures allow package agency contracts to be amended by the department. It is currently unclear if the DABC can or should change a package agency’s type without commission approval. We believe that a significant change in a package agency such as altering it from a Type-2 to a Type-3 should be a decision of the commission. We therefore recommend that the DABC Commission review the rules regarding package agencies and require that significant changes to package agency contracts be reviewed and approved by the commission.

DABC Management Failed to Perform a Criminal Background Check on the Eden Operator

DABC management failed to perform the statutorily required criminal background check on the package agency operator in Eden, Utah. In reviewing the Eden Package Agency operator’s file, fingerprints were submitted, but no results of a criminal background check were found in the operator’s file. Officials for the DABC explained that it was an oversight on their part by not performing a criminal background check on the Eden Package Agency operator.

The statute requires the DABC to perform criminal background checks on applicants who apply to run a package agency. The Alcoholic Beverage Control Act, *Utah Code 32A-1-704(2)(a)* and (b) states the following about criminal background check procedures:

An oversight error resulted in DABC officials failing to perform a criminal background check on the Eden Package Agency operator.

(a) The department shall obtain information from a criminal history record maintained by the Utah Bureau of Criminal Identification pursuant to Title 53, Chapter 10, Part 2, Bureau of Criminal Identification, for a purpose outlined in Section 32A-1-703.

(b) An individual described in Subsections 32A-1-702(2)(b) [an individual applying to the commission to operate a package agency] shall pay to the department the expense of obtaining the criminal history record described in Subsection (2)(a).

According to statute, an individual applying to the commission to operate a package agency is not only supposed to have a criminal background check completed, but is also supposed to pay for that background check. We therefore recommend that the DABC ensures that all package agency operators have a proper criminal background check performed in accordance with the law.

The Office of the Legislative Auditor General's October, 2010 report on the performance audit of the DABC did not address package agencies. That audit focused on concerns involving the DABC Commission, retail operations of state-owned liquor stores, the licensing and compliance division of retail operators such as restaurants, and the quotas for liquor licenses. Because the concerns identified in this review are significant, we further recommend that the Legislative Audit Subcommittee consider prioritizing a full-scope audit of the oversight of package agencies throughout the state.

Recommendations

1. We recommend that the DABC Commission revise the rules regarding package agencies to require that significant changes to package agency contracts be reviewed and approved by the commission in an open meeting.
2. We recommend that the Utah Attorney General conduct an investigation of the issues surrounding the Eden Package Agency to determine if criminal prosecution should be pursued.

Statutory language requires the DABC to perform criminal background checks and have the applicants pay for it.

We recommend that the Legislative Audit Subcommittee consider prioritizing a full-scope audit of the oversight of all package agencies.

3. We recommend that the DABC ensure that all package agency operators and licensees have a criminal background check performed in accordance with the law.
4. We recommend that the Legislative Audit Subcommittee consider prioritizing an audit of DABC oversight of all package agencies in the state.

Agency Response

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State of Utah

DEPARTMENT OF ALCOHOLIC BEVERAGE CONTROL

State of Utah

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May 10, 2011

John M. Schaff, CIA
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Dear Mr. Schaff,

Yesterday the DABC Commissioners asked me, as Vice-Chairman, to draft a response to Report Number 2011-04, dated May, 2011. All Commissioners have read this response and unanimously approve it.

We respectfully request that this response be delivered to the four members of the Audit Subcommittee of the Legislative Management Committee tomorrow morning. The Commission also respectfully requests that the DABC response be delivered to all Legislators on May 17, 2011 prior to release to the public.

There was not a \$300,000 loss from the privately operated Eden package agency. At most, the DABC did not deliver to the general fund \$110,325, the "profit" lost from not having sold alcohol through the Eden package agency. All other funds were collected by DABC as proper insurance payments by Risk Management. Therefore, the DABC was made whole "at cost."

Each point is addressed below. There is not more detail as the numbered copies of your "draft copy" were not received by all Commissioners until yesterday at 2:00 p.m.

Commission Chair, Sam Granato, and Vice Chair, Gordon Strachan, knew of the Eden package agency issues beginning with the June 24, 2009 Commission meeting when the Commission unanimously approved the Type 2 privately operated package agency. Note the attached excerpt from the June 24, 2009 commission meeting:

“Good morning, we have an action item for a new agency in the Eden area. It’s a Type 2 agency. And we have had an application put in by the name of Bill Lyman. His application is complete, uh, everything is taken care of, and we feel that he would be a good uh good job in the area. And would also like to mention that we could probably support a Type 3 Agency in the area, and Bill is willing to take on a Type 2 now and would be willing to go to a Type 3 when funds are available. So, he is totally qualified for a Type 2 right now.”

“Commissioners, I might add the difference between a Type 2 and a Type 3 is the compensation. And the Type 2 being associated with a resort. The original package agency was at Wolf Creek, which they are no longer operating that package agency. The thing that may be a little interesting about this is that this is the only commercial liquor outlet in Ogden valley. And so, without this package agency, the citizens are having to drive down the canyon to a state liquor store. Just as an added note.”

One of the main reasons the Commission approved the private Type 2 agency, anticipating it would become a Type 3 agency, was the public safety concern of forcing Ogden valley residents, including two ski resort users, to drive approximately 30 miles down and up Ogden Canyon to the DABC store #24 on Patterson Avenue.

As a result of the closure of the Eden Package Agency, the DABC administration determined additional controls were needed in the package agency system. All Regional Managers were relieved of their package agency responsibilities so they could concentrate primarily on State Liquor and Wine Stores.

All package agency operational responsibilities were assigned in October 2010 to the new package agency audit manager, who now oversees all licensing, audits, consignment inventory, contracts and all other package agency functions. This move has added significant control to enable the DABC staff to better master and control the private sellers of alcohol.

Six months before the Legislative Auditor arrived at the DABC in March, 2011, the department administration had already changed the controls of the “privatized” package agency operations because of a weakness in the controls of the Eden package agency.

Both Legislative Auditors, Richard Coleman and Brian Dean, confirmed to all DABC Commissioners on May 9, 2011 that there was only a suspicion of potential criminal activity by the private businessman, Bill Lyman, now bankrupt. The Legislative Auditor General found no hint of any criminal or any other improper, unethical or suspect activity by any staff member of the DABC or the Commission. This conclusion of no basis for any criminal investigation of the DABC has been

confirmed by a review directed by Sheila Page, the Assistant Attorney General who advises the DABC and numerous other agencies. Ms. Page concurred with the Risk Management Assistant Attorney General's conclusion regarding referral of the individual private package agency operator for criminal investigation at the DABC's request. Ms. Page will submit this issue to the Criminal Review Committee within the Attorney General's office soon.

The Legislative Auditor General's report discloses that the DABC staff promptly reported the difficulties with the private Eden package agency to the State of Utah Risk Management insurance office, which after consultation with its own Assistant Attorney General, concluded that all claims for reimbursement of funds not properly accounted for by the private businessman at the Eden package agency, were fully reimbursable to the DABC as valid insurance claims. The DABC pays annually a premium to Risk Management for this insurance coverage.

Payments have been received from Risk Management. The DABC will recover all but \$110,325, a large amount, but it represents only the markup or profit the State did not collect on liquor that would have been sold, as Leonard Langford, Director of Finance, reported to the Commission during the April 28, 2011 meeting regarding this matter:

"That \$110,000 is 0.05% of retail sales YTD. In addition, the DABC also wrote off interest that was being charged to Mr. Lyman in the amount of \$23,000 because that interest will not be collected either as he filed for bankruptcy. The DABC and the citizens of Ogden valley need an agency up in Eden; it's a real public safety issue to have that closed."

The private operator did not timely pay all amounts due the DABC. The staff of the DABC tried to "work with the private operator" and one or two of his potential investors to keep this Eden package agency open for public safety reasons. Government servants should facilitate private business activities, especially during the very difficult times faced by all during the Great Recession. That was the directive of Governors Huntsman and Herbert and other responsible government leaders. That is exactly what the DABC did. Also, Rep. Gage Froerer had expressed to DABC staff his personal concern during the period when the private operator was having financial difficulties that the Eden package agency continue to operate in Ogden Valley. Rep. Froerer urged the DABC to use "good business practices" and "work with" the privatized liquor outlet. Rep. Froerer renewed this request for an operating privatized Eden package agency on March 30, 2011.

The amendment to the contract changing from a Type 2 to a Type 3 should have been changed during Spring 2010 before the DABC closed the Eden package agency for failure to comply with the existing contract in July, 2010. The management system for supervision of the privatized package agencies was

changed by DABC staff in October 2010, six months before the Legislative Auditor arrived to conduct the current audit.

Several of the Commissioners respectfully request the opportunity to appear personally at the May 17, 2011 meeting of the Audit Subcommittee of the Legislative Management Committee.

Very Truly Yours,



Gordon Strachan
Vice Chairman
Alcoholic Beverage Control Commission

cc: Commission Chairman, Sam Granato
Commissioner Jeffrey Wright
Commissioner Richard Sperry
Commissioner Kathleen McConkie Collinwood
Director, Dennis R. Kellen

GS/va

Excerpt from the June 24, 2009 Commission Meeting
Regarding the Eden Package Agency

Participants: Sam Granato, Liquor Commission Chairman
Maryann Mantes, Liquor Commission Vice-Chairman
Gordon Strachan, Commissioner
Bobbie Coray, Commissioner
John Freeman, Deputy Director
Ron Torres, Compliance Officer

Sam Granato Number 10 on our agenda, Type 2 Package Agency. Ron, thank you.

Ron Torres Good morning, we have an action item for a new agency in the Eden area. It's a Type 2 agency. And we have had an application put in by the name of Bill Lyman. His application is complete, uh, everything is taken care of, and we feel that he would be a good uh good job in the area. And would also like to mention that we could probably support a Type 3 Agency in the area, and Bill is willing to take on a Type 2 now and would be willing to go to a Type 3 when funds are available. So, he is totally qualified for a Type 2 right now.

John Freeman Commissioners, I might add the difference between a Type 2 and a Type 3 is the compensation. And the Type 2 being associated with a resort. The original package agency was at Wolf Creek, which they are no longer operating that package agency. The thing that may be a little interesting about this is that this is the only commercial liquor outlet in Ogden valley. And so, without this package agency, the citizens are having to drive down the canyon to a state liquor store. Just as an added note.

Bobbie Coray And where will this be located? Will it be in a separate building, or in the store?

Ron Torres Yes, uh huh. In the store.

Maryann Mantes I move we grant this Type 2 package agency.

Gordon Strachan Second.

Sam Granato It has been moved and seconded . . . all in favor?

Sam Granato,
Gordon Strachan,
Maryann Mantes,
Bobbie Coray

Aye (unanimous)

Sam Granato

Any oppose. Motion passes.

Ron Torres

Thank you.