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NO. 2003-0011-3S

INDEPENDENT STATE AUDITOR'S REPORT ON
CERTAIN ACTIVITIES OF THE
ALCOHOLIC BEVERAGES CONTROL
COMMISSION
JULY 1, 2001 TO OCTOBER 31, 2002

OFFICIAL AUDIT
REPORT
OCTOBER 15, 2003

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Chapter 6, Sections 43 and 44, of the Massachusetts General Laws establishes the powers and duties of the Alcoholic Beverages Control Commission (ABCC). The ABCC has general supervision of the conduct of the business of manufacturing, importing, exporting, storing, transporting, and selling alcoholic beverages in accordance with Chapter 138 of the General Laws and the quality, purity, and alcoholic content thereof. The ABCC is also responsible for issuing permits to retail establishments and distributors of alcoholic beverages; recording licenses for the sale and distribution of alcoholic beverages; and enforcing, overseeing, and regulating over 22,000 liquor licenses in the Commonwealth. The ABCC was an agency under the direction of the Office of Consumer Affairs and Business Regulations (OCABR), which is the state watchdog agency charged with educating, informing, and protecting consumers, until the passage of Chapter 26, Section 48, of the Acts of 2003. The language in this section provides the Treasurer of the Commonwealth with oversight responsibility for the ABCC.

Our audit was conducted with the specific objectives of (1) reviewing the ABCC's internal control structure; (2) reviewing ABCC activities, including, but not limited to, internal controls over receipts and expenditures, contract administration, use of consultants, and administrative costs; (3) reviewing and analyzing ABCC investigations, appeals, and hearing processes available to licensees and applicants; (4) determining whether the ABCC is efficiently and effectively managing these activities and are complying with applicable laws, rules, and regulations; (5) examining financial and program records to determine whether records are accurate, up-to-date, and maintained in accordance with established criteria; and (6) reviewing the ABCC's system for addressing complaints and determining whether they are handled in a proper and timely manner.

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Our audit disclosed that, contrary to Chapter 647 of the Acts of 1989, An Act Relative to Improving Internal Controls Within State Agencies, the ABCC did not document an internal control plan and a related risk assessment in accordance with the guidelines issued by the Office of the State Comptroller (OSC). Without a documented internal control plan and a related risk assessment, management cannot be assured that the ABCC's goals and objectives are being met or that resources entrusted to it to carry out programs are being safeguarded and expended in accordance with applicable laws, rules, regulations, and program requirements.

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Our review of the ABCC noted that, contrary to the OSC's Internal Control Guidelines and Chapter 647 of the Acts of 1989, written policies and procedures for receiving and processing complaints and investigations had not been documented. As a result, there is inadequate assurance that the ABCC will achieve its objectives efficiently, effectively, and

in compliance with applicable laws, rules, and regulations; maintain consistency in operations; and have the appropriate operational guidelines and information to provide guidance and facilitate training of new staff.

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Our audit indicated that, contrary to the OSC's Internal Control Guide for Commonwealth Departments, OCABR's Internal Control Plan, and Chapter 30, Section 27, of the General Laws, the ABCC does not deposit its cash receipts on a daily basis. During high-volume license renewal periods (November and December), the ABCC makes deposits on Monday, Wednesday, and Friday. Otherwise deposits are made only once a week. Receipts ranged from a low of \$9,215 for August 2002 to a high of \$479,181 for December 2002. Without adequate controls in place for daily deposits, the risk of loss, theft, or misuse of funds increases. Further, delays in revenue deposits inhibit the use of these funds by the Commonwealth.

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Our review noted that OCABR's Administrative Services Unit (ASU) (the unit responsible for reconciling the ABCC's financial activity) did not reconcile bank statements to the Massachusetts Management Accounting and Reporting System (MMARS) in a timely manner. Specifically, bank statements were reconciled to the department's cash records, but not to MMARS reports to ensure that department records agreed to those of the Commonwealth's accounting system. In fact, we found that the ASU was eight months in arrears in reconciling its bank statements to MMARS. Without timely reconciliations, there is inadequate assurance that funds are properly accounted for and that the department is receiving proper credit. Additionally, the risk of fraud, theft, and misuse increases. Further, the ASU was not recording Cash Transfer (CT) transactions on MMARS in a timely manner. Chapter 647 of the Acts of 1989 requires that "all transactions and other significant events are to be promptly recorded, clearly documented and properly classified" and that "documentation of a transaction or event should include the entire process or life cycle of the transaction or event." In addition, the OSC's Internal Control Guide for Commonwealth Departments, Chapter 3, Collected Revenue, states, in part: "Collected revenue should be reconciled monthly to the state accounting system records and to the monthly bank statement."

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The ABCC issued 18,400 licenses in fiscal year 2002, of which approximately 10,000 were non-retail licenses. Our audit revealed that the ABCC did not have adequate internal controls over the inventory, preparation, and distribution of non-retail licenses, permits, and certificates of compliance. Several types of licenses and permits were prepared manually, sequentially numbered, and signed by the Commissioner. A manual system does not have the same tracking mechanisms as a computerized system, and therefore increases the risk of fraudulent or unauthorized licenses being issued. Our audit also disclosed that improvements were needed regarding internal controls over licenses in the areas of segregation of duties, physical security, inventory procedures, written policies and procedures, and management oversight. Chapter 647 of the Acts of 1989 defines the standards for the minimum level of quality acceptable for internal

control systems. These standards address documentation of internal controls and policies and procedures, access to resources and records, and supervision. Also, the OSC's Internal Control Guide for Managers, Chapter 4, Internal Control Activities, sets forth controls relating to segregation of duties, inventories, control access to assets and resources and documentation of internal controls.

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Subsequent to the completion of our field work, it came to our attention that in August 2000, ABCC experienced the loss/theft of four laptop computers. During our follow-up interviews with ABCC personnel, they indicated that they located a memorandum regarding the stolen/missing laptop computers and that a report was filed with an unidentified party on August 31, 2000. However, the memorandum does not indicate who the report was filed with. The OSA has no record that the required report was received, and as a result, an investigation was not conducted to independently determine the internal control weaknesses that existed at the time of the loss.

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INTRODUCTION

Background

Chapter 6, Sections 43 and 44, of the Massachusetts General Laws establishes and sets forth the powers and duties of the Alcoholic Beverages Control Commission (ABCC) by stating, in part:

There shall be a commission to be known as the alcoholic beverages control commission, to consist of a commissioner and two associate commissioners appointed by the governor. Not more than two members shall be members of the same political party. The commissioner and one associate commissioner shall serve terms coterminous with that of the governor. One associate commissioner shall serve a four year term. The commissioner shall serve as chairman and shall devote his full time during business hours to his official duties. The positions of commissioner and associate commissioners shall be classified in accordance with section forty-five of chapter thirty and the salaries shall be determined in accordance with section forty-six C of said chapter thirty.

In addition, Chapter 26, Section 48, of the Acts of 2003 amends Chapter 10 of the General Laws by adding sections 70, 71 and 72. These sections transfer the oversight responsibility for the ABCC to the Office of the State Treasurer (OST) and state that the ABCC Commissioner and two Associate Commissioners will be appointed by the Treasurer; that the Commissioner's term will be coterminous with the Treasurer; and that the two Associate Commissioners serving on the ABCC as of May 1, 2003 will remain until January 2, 2005 and will thereafter be appointed by the Treasurer for terms of four years.

The ABCC has general supervision of the conduct of the business of manufacturing, importing, exporting, storing, transporting, and selling of alcoholic beverages in accordance with Chapter 138 of the General Laws and of the quality, purity, and alcoholic content thereof. Section 44 sets forth the powers and duties of the ABCC and its reporting responsibilities. The ABCC is the sole agency in Massachusetts responsible for directly licensing or permitting specific participants in the alcoholic beverages industry in Massachusetts. All manufacturers of alcoholic beverages, wholesalers and importers, out-of-state suppliers of alcoholic beverages, brokers, salesmen, warehouses, planes, trains, ships, ship chandlers, and most every motor vehicle transporting alcoholic beverages in Massachusetts require direct licensing from the ABCC. Approximately 10,000 such licenses and permits are issued by the ABCC each year.

The ABCC must also approve the granting of every retail pouring or packaging store license application allowed by city or town. There are approximately 10,000 annual retail pouring or

packaging store licenses in Massachusetts and approximately 2,000 seasonal retail pouring or packaging store licenses. The members of the ABCC's licensing division coordinate and process the annual renewals of these 12,000 retail licenses.

The ABCC is also responsible for issuing permits to retail establishments and distributors of alcoholic beverages; recording and approving licenses issued by local authorities for the sale and distribution of alcoholic beverages; and enforcing, overseeing, and regulating over 22,000 liquor licenses in the Commonwealth. The ABCC was an agency under the direction of the Office of Consumer Affairs and Business Regulations (OCABR), which is the state entity charged with educating, informing, and protecting consumers.

The ABCC responds to inquiries from local licensing boards, applicants, and citizens regarding the status of appeals or the process of obtaining an application for a license or permit. The ABCC issues non-retail permits and licenses, whereas the individual cities and towns issue retail licenses. The ABCC's investigative unit pursues complaints and potential violations relating to an establishment's sale and distribution of alcoholic beverages. In fiscal year 2002, the ABCC's appropriation was \$1,609,285 and its revenues totaled \$1,574,565. In fiscal year 2003, its appropriation was \$1,618,977 and its revenues totaled \$1,859,487.

The ABCC uses the Commonwealth's Information Technology Division (ITD) to provide third-party operational and software maintenance support for the ABCC's principal application, the License Tracking System. The License Tracking System allows the ABCC to process new and renewal retail permit and license applications. Annual renewal applications for retail licenses are mailed to cities and towns, which approve them and return them to the ABCC. Annual renewals for permits mailed on a calendar-year basis to brokers, wholesalers, and suppliers must be signed by the licensee and returned to the ABCC. In addition to using ITD to provide data processing support, the ABCC has a local area network (LAN) supported by a file server located at the Division of Banks. Further, the ABCC uses its own computer systems to process non-retail permits and to store certificate-of-compliance data regarding companies holding a permit to import alcoholic beverages into Massachusetts.

Audit Scope, Objectives, and Methodology

In accordance with Chapter 11, Section 12, of the General Laws, we conducted an audit of the ABCC for the period July 1, 2001 through October 31, 2002. Our audit was conducted in accordance with applicable generally accepted government auditing standards with specific objectives of (1) reviewing the ABCC's internal control structure; (2) reviewing ABCC activities, including but not limited to internal controls over receipts and expenditures, contract administration, use of consultants, and administrative costs; (3) reviewing and analyzing ABCC investigations, appeals, and hearing processes available to licensees and applicants; (4) determining whether the ABCC was efficiently and effectively managing these activities and was complying with applicable laws, rules, and regulations; (5) examining financial and program records to determine whether records are accurate, up-to-date, and maintained in accordance with established criteria; and (6) reviewing the ABCC's system for addressing complaints and determining whether they are handled in a proper and timely manner.

In conducting our audit, we (1) reviewed the ABCC's internal control procedures for the issuance of licenses; (2) reviewed license application files and investigation files; (3) reviewed time and attendance records; (4) reviewed internal controls over fixed assets; (5) reviewed fiscal and accounting controls and procedures for revenues and expenditures; (6) interviewed ABCC and OCABR officials; and (7) reviewed the ABCC's internal control plan and related risk assessment.

As a result of the transfer of the oversight responsibility for the ABCC to the Office of the State Treasurer, we met with OST officials to discuss our audit results and recommendations. The OST submitted a written response to our report, which is incorporated as an appendix to this report.

Except as discussed in the Audit Results of the report, our audit indicated that, for the areas tested, the ABCC has adequate internal controls over its fiscal, administrative, and programmatic operations and has complied with applicable laws, rules, and regulations.

AUDIT RESULTS

1. LACK OF AN INTERNAL CONTROL PLAN AND RISK ASSESSMENT

Our audit disclosed that, contrary to Chapter 647 of the Acts of 1989, An Act Relative to Improving Internal Controls Within State Agencies, the Alcoholic Beverages Control Commission (ABCC) did not document an internal control plan and a related risk assessment in accordance with the guidelines issued by the Office of the State Comptroller (OSC). Without a documented internal control plan and a related risk assessment, management cannot be assured that the ABCC's goals and objectives are being met or that resources entrusted to it to carry out programs are being safeguarded and expended in accordance with program requirements. Further, when changes in departmental or organization structure and responsibilities occur, the internal control plan is a vital tool that provides management with current information relative to the ABCCs' risks and related controls.

An internal control plan is essential to any financial operation in that it helps to identify areas of financial and operational risk that should be addressed through financial and operational policies and procedures. Chapter 647 of the Acts of 1989 (see Appendices I and II), An Act Relative to Improving the Internal Controls within State Agencies, establishes standards for maintaining internal controls over activities to provide accountability and prevent the misuse of Commonwealth funds. The Act establishes standards for internal controls and management's corresponding responsibilities, as follows:

Internal control systems of the agency are to be clearly documented and readily available for examination. Objectives for each of these standards are to be identified or developed for each agency activity and are to be logical, applicable and complete. Documentation of the agency's internal control system should include (1) internal control procedures, (2) internal control accountability systems and (3), identification of the operating cycles. Documentation of the agency's internal control systems should appear in management directives, administrative policy, and accounting policies, procedures and manuals.

The Act also requires each agency to maintain "written documentation of its internal accounting and administrative control system" and to "annually, or more often as conditions warrant, evaluate the effectiveness of the agency's internal control system and establish and implement changes necessary to ensure the continued integrity of the system." In addition, the OSC's Internal Control Guide for Departments and Managers provides specific objectives and activities to assist agencies in complying with the requirements of Chapter 647 of the Acts of 1989.

As part of an adequate internal control plan, the OSC requires all departments to prepare a department-wide risk assessment. OSC defines this risk assessment as “the identification and analysis of the high-level risks that could prevent the entire department from attaining its goals and objectives.” ABCC identification and analysis forms the basis for determining how the risks should be managed. A precondition to a risk assessment is the establishment of the organization’s missions and goals.

During our audit, we requested the ABCC’s internal control plan and department-wide risk assessment. They provided us with a general plan designed and implemented for the Office of Consumer Affairs and Business Regulations (OCABR), which oversees the operations of nine state agencies, including the ABCC, instead of documentation that was specific to the ABCC. As a result of interviews with senior management, we determined that a separate internal control plan and related risk assessment had not been prepared for the ABCC. The agency’s Commissioner and Executive Secretary, who have held their positions for less than a year, stated that they were not aware of the aforementioned requirement.

Without a documented internal control plan and related risk assessment, management cannot be assured that the ABCC’s goals and objectives are being met and that day-to-day operations are being managed efficiently, effectively, and in accordance with standardized policies and procedures.

Based on our discussions, the Executive Secretary later prepared and presented us with documents entitled “Summary of Risk Assessment, and “Internal Control Plan.” While we recognize and acknowledge this corrective action, both of these documents need improvement. Specifically, the “Internal Control Plan” provided a description of agency responsibilities, it did not contain the following elements required by the Office of the State Comptroller:

- A description of the control environment which sets the tone of an organization relative to risks and controls
- A risk assessment that includes an analysis and documentation of department-wide, high-level risks that may prevent the ABCC from achieving their mission and goals
- A description of control activities that includes the organizational structure, policies, and procedures to mitigate the risks as described in the risk assessment

- Information and communication directives, including informing staff of their duties and responsibilities, identifying expectations and reporting, and communicating the importance of the internal control system and conducting training
- A description of monitoring functions, including performance evaluations, ongoing supervision, and status reports

Moreover, the “Summary Risk Assessment” was not a high level, department wide summary of risks that could prevent the department from achieving their goals and missions. Further, the risks that are identified in the summary were not at a high level and do not match the mission and goals of the ABCC.

Recommendation

The ABCC should continue to develop and improve its internal control plan in compliance with Chapter 647 of the Acts of 1989 and the guidelines established by the OSC’s Internal Control Guide to ensure proper documentation of its internal control structure and related risks. In addition, when documenting risk and developing the internal control plan, the ABCC must ensure that changes in structure, reorganizations, and responsibilities are accurately reflected. Moreover, the ABCC should identify high-level, risk areas and develop an acceptable, department-wide risk assessment.

2. IMPROVEMENTS NEEDED OVER DOCUMENTATION OF POLICIES AND PROCEDURES

Our review noted that, contrary to the OSC’s Internal Control Guidelines and Chapter 647 of the Acts of 1989, the ABCC had not developed written policies and procedures for receiving and processing complaints and handling investigations. Without such documented policies and procedures in place, there is inadequate assurance that the ABCC will (a) achieve its objectives efficiently, effectively, and in compliance with applicable laws, rules, and regulations; (b) maintain consistency in operations; (c) make staff aware of their duties and responsibilities; and (d) have the appropriate materials to facilitate training of new staff.

The OSC’s Internal Control Guide for Managers, Chapter 4, Section D, indicates that documenting internal control policies and procedures is important because a written document informs staff of the specific requirements concerning their duties and responsibilities and the operational policies and procedures with which they are required to comply. The guide also states that Chapter 647 of the Acts of 1989 sets forth six standards that departments must

establish and incorporate in an internal control structure. Regarding the first standard, the guide states, in part:

Internal control systems of the agency are to be clearly documented and readily available for examination.

The ABCC's Investigative and Enforcement Division consisted of 14 special investigators, who perform a wide variety of functions. Their responsibilities include investigating all license applications via a computer-based system as well as all "operating under the influence" cases referred from the state. Furthermore, the ABCC received several hundred complaints in 2002, all of which had to be documented, assigned to an investigator, and appropriately followed up on. Finally, investigations sometimes resulted in hearings, which the investigators assigned to the case are required to attend. During interviews with key personnel, we were informed that although they performed very diversified and often complicated functions, none of their policies and procedures were documented since staffing levels were not adequate to do so.

The policies and procedures for the ABCC's Investigative and Enforcement Division should include, but not be limited to, the following:

- Methods and processes for receiving and documenting complaints
- Timeframes for processing complaints, including performance measures and detailed steps for performing investigations
- Processing and following up on complaints and performing investigations, including compliance requirements
- The process for hearings and appeals, including applicable laws, rules, and regulations
- Samples of all required documentation and forms

In March 2003, 11 of the 14 special investigators were laid off due to budget cuts. Without sufficient staff and adequate policies and procedures to handle complaints and investigations, the ABCC may not be fulfilling its mandate to ensure that it is conducting its general supervision over the manufacturing, importing, exporting, storing, transporting, and selling alcoholic beverages in a consistent and efficient manner.

Recommendation

The ABCC should develop comprehensive written policies and procedures that include documenting all aspects of the investigative process, including intake, investigation, follow-up actions, hearings, and any other required procedures. Moreover, the ABCC should ensure that all appropriate staff are made aware of these policies and procedures. Finally, all new staff members should also be properly trained to ensure that they are fully aware of and properly comply with these policies and procedures.

3. IMPROVEMENTS NEEDED OVER DAILY DEPOSITS OF REVENUE

Our review revealed that the ABCC does not deposit its cash receipts on a daily basis. The ABCC receives checks in the mail each day for licenses, permits, certification of compliance, etc. After the mail is opened and date-stamped, it is distributed by an Administrative Secretary/Receptionist. All checks are given to an Administrative Assistant, who prepares them for deposit by writing the appropriate ABCC revenue code on the check, copying the front and back, and distributing the copies to the proper department. During high-volume license renewal periods (November & December), the ABCC makes deposits on Monday, Wednesday, and Friday of each week. Otherwise, deposits are made only once a week. Our review indicated that receipts ranged from a low of \$9,215 for August 2002 to a high of \$479,181 in December 2002.

ABCC personnel stated that inadequate staffing prevents them from making daily deposits and that the employee who is assigned to recording and depositing their receipts has additional responsibilities that do not allow the time to prepare daily deposits. In addition, they stated, the volume of checks received is often too low to deposit each day.

The OSC's Internal Control Guide for Commonwealth Departments, Volume II, Chapter 3, Cash Receipts, requires that "all revenue collected on behalf of the Commonwealth must be recorded and deposited daily into a Commonwealth approved account." Further, the OCABR's Internal Control Plan, Section 7.2, states that "all revenue received should be deposited on a daily basis and within 24 hours of receipt." Additionally, Chapter 30, Section 27, of the General Laws states, in part, "Except as otherwise expressly provided, all fees or other money received on account of the commonwealth shall be paid daily into the treasury thereof." Without adequate controls in place for daily deposits, the risk of fraud, theft, and misuse of funds

increases. Further, delays of revenue deposits inhibit the use of these funds by the Commonwealth.

Recommendation

The ABCC should develop and implement policies and procedures to ensure that they deposit all checks received on a daily basis, in accordance with laws, rules, and regulations, in order to mitigate the risk of fraud, theft or misuse of funds.

4. IMPROVEMENTS NEEDED OVER RECONCILIATIONS TO MASSACHUSETTS MANAGEMENT ACCOUNTING AND REPORTING SYSTEM (MMARS)

The OSC's Internal Control Guide for Commonwealth Departments, Chapter 3, Collected Revenue, states, in part:

Collected revenue should be reconciled monthly to the state accounting system records and to the monthly bank statement.

However, our review noted that OCABR's Administrative Services Unit (ASU) did not reconcile bank statements to the Massachusetts Management Accounting and Reporting System (MMARS) 466C Report ("Cash Received by State vs. Cash Reported by Department") in a timely manner. Specifically, bank statements were reconciled to the ASU's cash records, but not to the MMARS 466C Report to ensure that department records agreed to the Commonwealth's accounting system. As of August 2002, the most recent bank statement reconciliation to MMARS occurred in April 2002, or eight months in arrears. Without timely reconciliations, there is inadequate assurance that all funds are properly accounted for and that the department is maintaining correct balances. Additionally, the risk of fraud, theft, and misuse increases.

The ABCC receives revenue in two ways. "Over-the-Counter" revenue is received directly at the ABCC, almost entirely through the mail. (Occasionally, the licensee pays in person.) This "Over-the-Counter" money is revenue that is sent to the bank in the form of a standard check deposit, as the ABCC does not accept cash. The ABCC also receives revenue through a bank lockbox for licensees who send their payments directly to a post office box at the bank. The bank transfers the total for each day into the ABCC's sweep account. Our review noted that OCABR's Director of Accounting processes a Cash Transfer (CT) transaction to record revenue on MMARS twice a month. This practice is not in compliance with Chapter 647 of the Acts of 1989, which requires the prompt recording of transactions, as follows:

All transactions and other significant events are to be promptly recorded, clearly documented and properly classified. Documentation of a transaction or event should include the entire process or life cycle of the transaction or event....

Processing CTs to record revenue only twice each month does not accurately or timely reflect the balances that should be recorded on MMARS.

According to OCABR's Director of Accounting, the ABCC's bank statements are reconciled both informally and formally. Informally, each month Fleet Bank sends an ABCC bank statement to OCABR, upon which a staff accountant compares the amount credited to the account with the amount recorded in that month's ABCC cash records. This comparison or review ensures that everything that was received is properly reflected on the bank statement.

The formal bank reconciliation, which is much more comprehensive, includes a review of the bank statement, the monthly cashbook, and the MMARS Report 466C. OCABR's Director of Accounting performs the following four-step reconciliation process.

1. Verify that all credits on the bank statement also appear as debits, which indicates that all deposits got swept.
2. Ensure that the credits on the statement also match ABCC cash records.
3. Ensure that all debits are properly credited to the ABCC's sweep account.
4. Compare year-to-date totals on the MMARS Report 466C to the year-to-date cash record totals by revenue source.

During our audit, OCABR's Director of Accounting stated that the formal bank reconciliation could not be performed until three to four weeks after the end of the month, as that is generally how long it takes the state to produce the MMARS Report 466C. The formal reconciliation is completed by reconciling the sweep account to zero.

OCABR's Director of Accounting attributes the delays in performing timely and comprehensive bank reconciliations to staff and time constraint issues. As a result of OCABR's untimely reconciliations, there is inadequate assurance that the bank has properly credited the ABCC for all of the revenue it receives and that the revenue reported on MMARS report 466C is accurate.

The OCABR Internal Control Plan, Section 7.4, Controls for Revenue Reconciliation, states, in part:

Revenue reconciliation for all revenues received by OCABR [should be] performed in a timely manner utilizing MMARS 466C Report....

Moreover, the OSC's Internal Control Guide for Commonwealth Departments, Chapter 3, states, in part:

Collected Revenue should be reconciled monthly to the state accounting system records and to the monthly bank statement.

Recommendation

The OCABR should develop and implement procedures to ensure that monthly bank statements, MMARS 466C reports, and the ABCC's cash records are reconciled on a monthly basis to ensure their accuracy and to mitigate the risk of loss, theft, or misuse of funds. Additionally, all CTs should be processed in a timely manner to accurately reflect all proceeds to the Commonwealth's General Fund.

5. IMPROVEMENTS NEEDED IN CONTROLS OVER NON-RETAIL LICENSES

The ABCC issued 18,400 licenses in fiscal year 2002, of which approximately 10,000 were non-retail licenses. Our audit revealed that the ABCC did not have adequate controls in place over the inventory, preparation, and distribution of non-retail licenses, permits, and certificates of compliance. Although licenses are sequentially numbered and signed by the Commissioner, several types of licenses and permits were prepared manually, which increases the risk of fraudulent or unauthorized licenses being issued. Additionally, a manual system does not have the same tracking mechanisms as a computerized system. Further, for certificates of compliance (a type of license that indicates who the product is being sold to that is issued to out-of-state suppliers who provide alcoholic products to Massachusetts wholesalers) the ABCC used labels that were manually generated and affixed to the certificates, which also increases the risk for fraud. Improvements were also needed in the following areas:

- Segregation of duties: The same employee is responsible for ordering/receiving blank forms, maintaining the inventory of blank forms, and issuing completed licenses.
- Physical security over licenses: There is unrestricted access to unissued licenses.
- Inventory procedures: An inventory and reconciliation of licenses on hand has never been performed, and there was inadequate supporting documentation to account for licenses issued or on hand as of a certain date.

- Written policies and procedures: No documentation exists to set forth procedures that should be followed for the issuance of licenses.
- Management oversight: There were no supervisory procedures in place to review or monitor the process for issuing licenses.

The ABCC maintains all license and permit information on a calendar-year basis. During 2002, the ABCC processed approximately 10,000 annual retail pouring or package store licenses, and approximately 2,000 seasonal retail licenses. Regarding non-retail licenses, all manufacturers of alcoholic beverages; wholesalers and importers; out-of-state suppliers; brokers, salesmen, and warehousemen; and owners of trains, planes, boats, and trucks who want to sell or transport alcohol within Massachusetts require direct licensing from the ABCC. Although the ABCC receives and processes all retail license applications, the local licensing boards where the pouring establishment or package store is located is responsible for issuing the license.

Our review of the policies, procedures, and controls for retail licenses revealed no major weaknesses. However, we noted the following deficiencies in the policies, procedures, and controls for its 16 types of non-retail licenses:

- The ABCC lacked proper inventory procedures to account for the number of licenses issued, the number of licenses on hand, and the location of the licenses. We interviewed key personnel and requested supporting documentation to determine the types and quantities of licenses and permits ordered and on hand at the beginning of the year. We also requested records detailing the quantities and types of licenses and permits issued during the year. However, the only supporting documentation that the ABCC was able to provide to us was a typed list that stated the type of license and quantity ordered. Moreover, the ABCC did not have records to account for the number of licenses issued or the number on hand as of any specific date. Finally, the ABCC did not conduct a license inventory or perform any reconciliations between licenses received, issued, and remaining on hand to determine whether all were properly accounted for.
- Some non-retail licenses/permits were manually prepared or utilized manually generated labels affixed to a blank license form, indicating the name and address of the licensee. Although the licenses are sequentially numbered and signed by the Commissioner, there is still the risk that fraudulent licenses can be prepared or that licenses can be altered once they have been signed.
- Access to licenses was unrestricted, and no individual was designated to monitor the license inventory. In addition, licenses and permits that had not been issued were kept in an envelope in an unlocked file cabinet that the entire staff had access to. We also found unrestricted access to the 2003 licenses and permits, as they were kept on the Administrative Assistant's desk in an open manila envelope. However, as a result of our audit, the

Executive Secretary implemented a policy whereby all blank licenses and permits would be kept in a locked cabinet allowing for very limited access.

- There was an inadequate segregation of duties with no supervisory review or management oversight. The same employee shared in all functions, including ordering/receiving the blank forms, maintaining the inventory of blank forms, and issuing completed forms to the licensees.

The lack of inventory controls creates the potential for licenses to be issued fraudulently and to unauthorized parties. Moreover, the lack of appropriate segregation of duties and oversight procedures creates the potential for errors to go undetected. Also, preparing licenses manually rather than through a computerized database increases the risk of fraudulent or altered licenses going undetected, and the lack of physical security increases the risk of loss, theft, and misuse of licenses.

Chapter 647 of the Acts of 1989 sets forth standards that departments must establish and incorporate in an internal control structure regarding documentation, segregation of duties, and supervision as follows:

- Documentation – “Departments must clearly document internal control systems and make those systems easily available for examination.”
- Segregation of duties – “Departments must establish a system to assign essential duties and responsibilities to a number of individuals.”
- Supervision – “Provide qualified and continuous supervision to all staff to ensure that internal control objectives are achieved.”

Moreover, the OSC’s Internal Control Guide for Managers, Chapter 4, Internal Control Activities, sets forth controls relating to segregation of duties, inventories, control access to assets and resources, and documentation of internal controls. In addition, OCABR’s Internal Control Plan, Section 7.2, states in part:

Agencies should maintain current inventory of all registrations, licenses, etc. ... for reconciliation with revenue receipts.

Recommendation

The ABCC should design and implement an adequate license control system that includes policies and procedures to prevent potential loss, theft, and misuse of all licensing activities as follows:

- Develop and maintain a computerized database to account for the number of licenses on hand by type, all future license forms purchased, and all distributions from the license and permit inventory to facilitate periodic inventories, and supervisory oversight.
- Collaborate with the Commonwealth's Information Technology Division to design a system whereby all licenses/permits are electronically prepared.
- Provide a secure storage area for all licenses and permits that have not been issued.
- Establish and document procedures for management to review, approve, and monitor the licensing process and inventory. These oversight procedures should be evidenced by sign-offs.
- Also, the ABCC should include in its internal control plan a reference to policies and procedures to be followed for the issuance of all licenses, adequate segregation of duties, and periodic management oversight.

6. NONCOMPLIANCE WITH REPORTING REQUIREMENTS OF CHAPTER 647 OF THE ACTS OF 1989

Subsequent to the completion of our field work, it came to our attention that in August 2000, ABCC experienced the loss/theft of four laptop computers. During follow-up interviews, ABCC personnel indicated that they located a memorandum indicating that the laptops were stolen/missing and that a report was filed with an unidentified party on August 31, 2000.

Chapter 647 of the Acts of 1989, an Act Relative to Improving the Internal Controls Within State Agencies, states in part:

"All unaccounted for variances, losses, shortages, or theft of funds or property shall be immediately reported to the state auditor's office, who shall review the matter to determine the amount involved which shall be reported to appropriate management and law enforcement officials. Said auditor shall also determine the internal control weaknesses that contributed to or caused the condition. Said auditor shall then make recommendations to the agency official overseeing the internal control system and other appropriate management officials."

The Office of the State Auditor (OSA) has no record of receiving the required report. ABCC personnel were unable to explain why the required report had not been filed with the OSA. None of the employees we interviewed worked at the agency when the loss occurred. By not submitting timely reports to the OSA as required by Chapter 647, the ability of the OSA to independently determine the internal control weaknesses that existed at the time of the loss and make recommendations to strengthen weaknesses in the agency's internal control system.

Recommendation

We recommend that ABCC establish policies and procedures to immediately file all required “Report(s) on Unaccounted for Variances, Losses, Shortages, or Thefts of Funds or Property” with the Office of the State Auditor to ensure that the internal control weaknesses that caused or contributed to the cited condition are identified in a timely manner and that appropriate corrective actions are implemented.

APPENDIX I

Chapter 647, Acts of 1989, An Act Relative to Improving the
Internal Controls within State Agencies

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Chapter 647

THE COMMONWEALTH OF MASSACHUSETTS

In the Year One Thousand Nine Hundred and Eighty-nine

AN ACT RELATIVE TO IMPROVING THE INTERNAL CONTROLS WITHIN STATE AGENCIES.

Be it enacted by the Senate and House of Representatives in General Court assembled, and by the authority of the same, as follows:

Notwithstanding any general or special law to the contrary, the following internal control standards shall define the minimum level of quality acceptable for internal control systems in operation throughout the various state agencies and departments and shall constitute the criteria against which such internal control systems will be evaluated. Internal control systems for the various state agencies and departments of the commonwealth shall be developed in accordance with internal control guidelines established by the office of the comptroller.

(A) Internal control systems of the agency are to be clearly documented and readily available for examination. Objectives for each of these standards are to be identified or developed for each agency activity and are to be logical, applicable and complete. Documentation of the agency's internal control systems should include (1) internal control procedures, (2) internal control accountability systems and (3), identification of the operating cycles. Documentation of the agency's internal control systems should appear in management directives, administrative policy, and accounting policies, procedures and manuals.

(B) All transactions and other significant events are to be promptly recorded, clearly documented and properly classified. Documentation of a transaction or event should include the entire process or life cycle of the transaction or event, including (1) the initiation or authorization of the transaction or event, (2) all aspects of the transaction while in process and (3), the final classification in summary records.

(C) Transactions and other significant events are to be authorized and executed only by persons acting within the scope of their authority. Authorizations should be clearly communicated to managers and employees and should

Chapter 647, Acts of 1989, An Act Relative to Improving the Internal Controls within State Agencies

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include the specific conditions and terms under which authorizations are to be made.

(D) Key duties and responsibilities including (1) authorizing, approving, and recording transactions, (2) issuing and receiving assets, (3) making payments and (4), reviewing or auditing transactions, should be assigned systematically to a number of individuals to ensure that effective checks and balances exist.

(E) Qualified and continuous supervision is to be provided to ensure that internal control objectives are achieved. The duties of the supervisor in carrying out this responsibility shall include (1) clearly communicating the duties, responsibilities and accountabilities assigned to each staff member, (2) systematically reviewing each member's work to the extent necessary and (3), approving work at critical points to ensure that work flows as intended.

(F) Access to resources and records is to be limited to authorized individuals as determined by the agency head. Restrictions on access to resources will depend upon the vulnerability of the resource and the perceived risk of loss, both of which shall be periodically assessed. The agency head shall be responsible for maintaining accountability for the custody and use of resources and shall assign qualified individuals for that purpose. Periodic comparison shall be made between the resources and the recorded accountability of the resources to reduce the risk of unauthorized use or loss and protect against waste and wrongful acts. The vulnerability and value of the agency resources shall determine the frequency of this comparison.

Within each agency there shall be an official, equivalent in title or rank to an assistant or deputy to the department head, whose responsibility, in addition to his regularly assigned duties, shall be to ensure that the agency has written documentation of its internal accounting and administrative control system on file. Said official shall, annually, or more often as conditions warrant, evaluate the effectiveness of the agency's internal control system and establish and implement changes necessary to ensure the continued integrity of the system. Said official shall in the performance of his duties ensure that: (1) the documentation of all internal control systems is readily available for examination by the comptroller, the secretary of administration and finance and the state auditor, (2) the results of audits and recommendations to improve departmental internal controls are promptly evaluated by the agency management, (3) timely and appropriate corrective actions are effected

Chapter 647, Acts of 1989, An Act Relative to Improving the Internal Controls within State Agencies

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by the agency management in response to an audit and (4), all actions determined by the agency management as necessary to correct or otherwise resolve matters will be addressed by the agency in their budgetary request to the general court.

All unaccounted for variances, losses, shortages or thefts of funds or property shall be immediately reported to the state auditor's office, who shall review the matter to determine the amount involved which shall be reported to appropriate management and law enforcement officials. Said auditor shall also determine the internal control weaknesses that contributed to or caused the condition. Said auditor shall then make recommendations to the agency official overseeing the internal control system and other appropriate management officials. The recommendations of said auditor shall address the correction of the conditions found and the necessary internal control policies and procedures that must be modified. The agency oversight official and the appropriate management officials shall immediately implement policies and procedures necessary to prevent a recurrence of the problems identified.

House of Representatives, December 21, 1989.

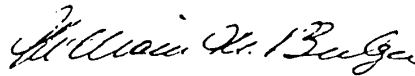
Passed to be enacted,



, Speaker.

In Senate, December 22, 1989.

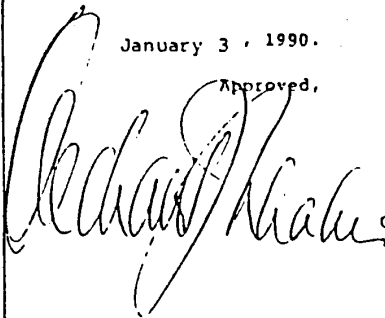
Passed to be enacted,



, President.

January 3, 1990.

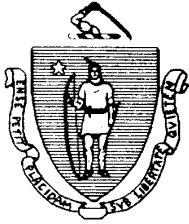
Approved,



Governor.

APPENDIX II

Chapter 647 Awareness Letter from the State Auditor and the State Comptroller



The Commonwealth of Massachusetts

Office of the State Auditor
State House
Boston, MA 02133

Office of the Comptroller
One Ashburton Place
Boston, MA 02108

September 19, 2000

Legislative Leadership
Judicial Branch Administrators
Elected Officials
Secretariats
Department Heads

The State Auditor and the Comptroller are both committed to departmental improvements in the Internal Control structure of the Commonwealth. A good system of controls, as you know, assists management in meeting objectives while avoiding serious problems. Chapter 647 of the Acts of 1989, *An Act Relative To Improving Internal Controls Within State Agencies*, establishes acceptable Internal Control systems for state government operations and constitutes the criteria against which we will evaluate internal controls. With the passage of this law, we began a campaign to educate all department staff on the significant role of internal controls in department operations.

In the past few years, departments have made significant progress in the area of internal controls. Every department has certified that they have documented internal controls in the form of an Internal Control Plan. In Fiscal Year 2001, we are focusing our Internal Control Campaign on the review of department risk assessments, as documented within the departments' internal control plans. Internal control plans must, of course, include all aspects of a department's business, programmatic operations as well as financial.

A major requirement of Chapter 647 is that "an official, equivalent in title or rank to an assistant or deputy to the department head, shall be responsible for the evaluation of the effectiveness of the department's internal controls and establish and implement changes necessary to ensure the continued integrity of the system". This official, whom we refer to as the Internal Control Officer, is responsible for ensuring that the plan is evaluated annually or more often as conditions warrant.

During this annual Statewide Single Audit, we continue with our review of the Commonwealth's internal controls. We analyze and evaluate information obtained during the audit process in our continuing effort to educate agencies regarding both the need for internal controls and the risks of not having adequate internal controls in place.

Chapter 647 Awareness Letter from the State Auditor and the State Comptroller

To assist departments with this effort, we provide the following support activities:

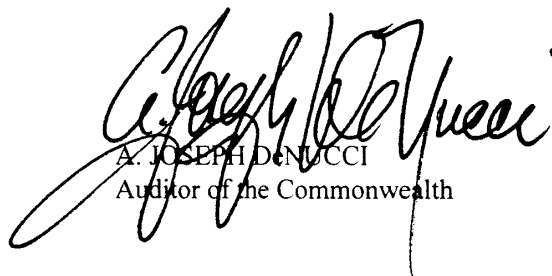
- ◆ The Office of the Comptroller offers departments free monthly training on internal controls. These classes are listed in the *OSC Training Bulletin*.
- ◆ The Office of the Comptroller provided a new document entitled the *Internal Control Guide for Managers* on the Office of the Comptroller's Web page:
<http://www.osc.state.ma.us/>. Part II of the guide will be available shortly and will replace the current *Internal Control Guide for Departments*, currently available on the Web.
- ◆ Upon request, the Office of the Comptroller provides assistance to departments in the process of redefining or reviewing their internal control plans.
- ◆ As part of the Statewide Single Audit, auditors will review and comment upon departments' internal control plans, risk assessments, and the reporting level of the Internal Control Officers.
- ◆ We have updated and automated the Internal Control Questionnaire (ICQ) for easier submission. These changes to the ICQ will enable OSA and OSC to evaluate department internal controls and monitor their progress.

Chapter 647 also requires that "all unaccounted for variances, losses, shortages, or thefts of funds or property be immediately reported to the Office of the State Auditor" (OSA). The OSA is required to determine the amount involved and the internal control weaknesses that contributed to or caused the condition, make recommendations for corrective action, and make referrals to appropriate law enforcement officials. In order to comply with this law instances must be reported on the *Report on Unaccounted for Variances, Losses, Shortages, or Thefts of Funds or Property* and be submitted to the OSA. Reporting forms can be obtained by contacting the Auditor's office, Room 1819, McCormack State Office Building, or Web Site:

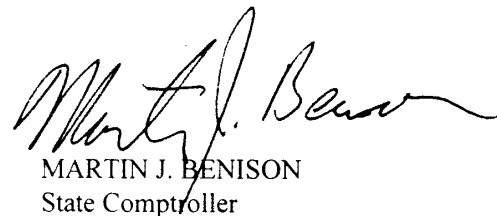
<http://www.magnet.state.ma.us/sao/>.

In conjunction with the above requirement, please note that management is responsible for financial records and systems and must inform, disclose and make representations to the auditors with regards to their management of funds, account activities, programs and systems.

The Offices of the State Comptroller and the State Auditor are committed to the goal of improving the Internal Control structure of the Commonwealth. Thank you for your cooperation and attention on this worthwhile task. Please do not hesitate to call upon the staff of either office for assistance.



A. JOSEPH D. NUCCI
Auditor of the Commonwealth



MARTIN J. BENISON
State Comptroller

APPENDIX III**Alcoholic Beverages Control Commission Audit Response**

COMMONWEALTH OF MASSACHUSETTS
DEPARTMENT OF THE STATE TREASURER
ROOM 227
STATE HOUSE
BOSTON MA 02133

TIMOTHY P. CAHILL
TREASURER AND RECEIVER GENERAL
TELEPHONE (617) 567-8900
FAX (617) 240-0372

October 5, 2003

A. Joseph DeNucci
Auditor of the Commonwealth
State House
Room 229
Boston, MA 02133

RE: Alcoholic Beverages Control Commission Audit Report

Dear Auditor DeNucci:

Thank you for providing me with the Audit Report ("the Audit") on Certain Activities of the Alcoholic Beverages Control Commission ("ABCC"). It is important to note that the audit was conducted for the period July 1, 2001 through October 31, 2002. At that time the ABCC was an agency under the direction of the Office of Consumer and Business Regulations, an Executive Department under the Office of the Governor. It is also important to note that in July 2003, the ABCC was transferred to the Office of the State Treasurer.

Since July, my staff and I have taken a close look at the operations of the ABCC, including licensing procedures, investigations, Commission hearings and day-to-day administrative operations. Furthermore, in August, I put together a transition team to conduct an independent analysis of the functions of the ABCC and submit their recommendations to me. It is significant to point out that the concerns presented in this report mirror those of my office and many, as a result, have already been addressed. Thus, I will present my comments in the same categories as the audit report, noting when a recommendation has already been adopted, or in other cases, our future plans for adopting a recommendation.

The ABCC lacks a sufficient internal control plan and risk assessment. We found that a documentation of controls and risk assessment exists, however does not pass the standard we use at the Treasury, as set forth by the Office of the State Comptroller. The Treasury recently hired a new internal auditor to focus on improving the internal code and risk assessment of all its departments. The Chairman of the ABCC shall define the mission and goals of the agency to assist the internal auditor with the preparation of these documents. Since 2001, the ABCC has undergone many personnel and organizational changes thus making any internal control and risk assessment outdated. Based on the definition of a mission, establishment of clear goals and staff

Alcoholic Beverages Control Commission Audit Response

re-organization, a new internal control and risk assessment will be written. In addition, the Chairman will focus on implementing new policies and procedures that are consistent with those of the Treasury, written job descriptions for all employees, training guidelines and regular performance evaluations.

As I mentioned, the ABCC is changing many of the policies and procedures from the past and replacing them with comprehensive, written guidelines that meet the standards of the Office of the State Comptroller. The Treasury's duty to support the ABCC in the areas of cash processing procedures, information technology, administration and finance and human resources will result in extensive changes to the day-to-day administrative operations of the ABCC. Our IT department is investing significant resources into a database that will record all licensing and investigative data, including complaints and intakes. Insufficient records currently exist because the ABCC has since relied on paper files with no ability to track employee efficiency. Our priority is to employ written policies and procedures that will ensure every correspondence with the ABCC, whether it pertain to licensing and/or enforcement, be electronically documented, investigated, followed up on and adjudicated properly and in a timely manner.

On September 22, 2003, 9 out of the 11 investigators who were laid off in February returned to work at the ABCC. The Chief Investigator presented a 6 week re-training schedule that included an in-house examination of all new policies and procedures, as well as a review of the *Alcohol Control Act* and MGL ch. 138. In addition, the investigators will undergo outside training administered by the Suffolk County Sheriff's Investigative Unit as well as annual instruction and certification at the Criminal Justice Training Council. The Chairperson, effective November 3, 2003, will work with the Chief Investigator to take advantage of alternative training opportunities and establish a final, comprehensive schedule that will be a requisite annually for each investigator.

Upon assuming oversight of the ABCC, Treasury required the daily deposit of all funds. Following discussions between ABCC staff and Treasury's Cash Management Division, a comprehensive cash processing policy was implemented, beginning on September 9, 2003. Under this policy all checks are linked to license applications by recording a unique log number on each document, and copies of all checks received are maintained in a binder. The breakout of revenue source codes paid by each check is recorded in a daily activity log spreadsheet, which is then compared to the totals contained on a daily deposit ticket.

As a longer-term solution to assure that all checks are deposited timely and without risk, all forms are being revised to include the address of the agency's lockbox, rather than its Causeway Street office. These forms will go into effect on October 24, 2003, kicking off the fall renewal period. All checks for license applications and/or renewals will go into a lockbox. The only checks received at the ABCC's office will be checks for fines paid in lieu of suspension, which must be approved by the Commission before being deposited, and checks for miscellaneous revenue for items such as copies, transcripts and other incidental charges. These checks will continue to be processed under the new cash processing procedures.

The audit report called for improvements over the reconciliation to Massachusetts Management Accounting and Reporting System ("MMARS"). State Treasury implemented new

Alcoholic Beverages Control Commission Audit Response

reconciliation procedures to comply with the standards set forth in Chapter 647 of the Acts of 1989. Currently, daily cash sheets are faxed from the ABCC to the Treasury revenue administrator, who inputs a daily Cash Transfer (CT) transaction. The CT transaction moves deposits from the ABCC sweep account to various revenue source categories. Already, this has resulted in greater efficiency and guarantees that all revenue will be transferred daily to the Commonwealth's general fund. A CT document is processed and approved by the Assistant Treasurer of Administration & Finance. In addition, the MMARS Report 466C will be printed at the close of every accounting period and reconciled by the Treasury revenue administrator. Said administrator will perform a "three way" reconciliation of the cashbook, bank statement and the MMARS Report 466C. It will be a written reconciliation that will be saved for monthly reference and for documentation of the reconciliation process.

The ABCC oversees the issuance of approximately 10,000 non-retail licenses per year. Historically, one person oversaw the ordering, receiving and inventory of blank forms, as well as the issuance of a completed license. State Treasury Information Technology personnel are currently analyzing the license tracking system. As a short term solution, a new, automated system is being developed that will eliminate any manual entering of state licenses. All alcoholic beverage licenses, including non-retail, will be on one computer system capable of generating numerous fields, including the names, addresses, payment information and tracking numbers of each licensee. Our long term goal is to collaborate with the Commonwealth's Information Technology Division and assimilate licensing forms and procedures.

The improvements made to the cash processing procedures automatically enhance the recording and tracking of all licensing procedures. Another change implemented, since the transfer to State Treasury, is that all non-retail licenses be generated by the Administrative Assistant, with approval signatures from the Program Administrator, Executive Secretary and Chairman. Unused license stock is now stored in a locked cabinet with access limited to supervisory personnel only. An inventory report that includes 1. the number of licenses ordered and issued and 2. the number of blank licenses in stock is submitted weekly to the Program Administrator and Executive Secretary until the above mentioned automated license tracking system is complete. The new ABCC internal control will include the audit's recommendation of defining policies and procedures for all inventory functions, adequate segregation of duties, and management oversight.

Finally, the audit noted a failure of the ABCC to submit appropriate reports to the Office of the State Auditor (OSA) upon realizing a loss/theft of equipment. Control of all inventory has since been shifted to the purview of the Executive Secretary and Treasury's Administration & Finance Department. As part of a much broader review of all ABCC policies and procedures, the ABCC will include all mandatory filings occur with appropriate state agencies and comply with Chapter 647 of the Acts of 1989.

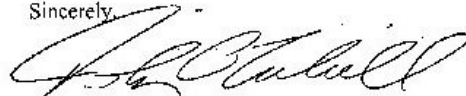
I take the operations of the Alcoholic Beverages Control Commission very seriously and look forward to installing strong leadership, better services to licensees and responsible investigative practices to this very important agency. I want to thank the Office of the State Auditor for the recommendations for improving the operations of the ABCC. I speak on behalf of new ABCC Chairman Eddie Jenkins, State Treasury and ABCC staff when I proclaim that we will work

Alcoholic Beverages Control Commission Audit Response

toward implementing these recommendations and systematically evaluating the activities of the ABCC, so as to meet the standards and goals of the Commonwealth of Massachusetts.

In closing, I respectfully request that this letter be included in the final Audit Report in its entirety.

Sincerely,



Timothy P. Cahill
Treasurer and Receiver General