

**Joint Legislative Committee on Performance
Evaluation and Expenditure Review (PEER)**

Report to
the Mississippi Legislature



The State Tax Commission's Office of Alcoholic Beverage Control: A Management Review and Policy Analysis

PEER conducted a management review of the State Tax Commission's Office of Alcoholic Beverage Control (ABC) and presents its conclusions in Part One of this report. PEER sought to determine whether ABC has the systems in place to direct and control the wholesale distribution of wine and spirits and to enforce the state's alcoholic beverage control laws.

PEER followed up on its 1989 review of the agency by assessing ABC's response to findings and recommendations from that review. Since 1989, ABC has addressed four of the six operational weaknesses PEER had identified, but has not addressed remaining weaknesses in internal audit and warehouse security.

Part One of this report also addresses ABC's wholesale operations, enforcement of state alcoholic beverage control laws, permit renewal process, and vehicle management. Although PEER found areas in which ABC could take specific management actions to assure accountability in warehouse operations, PEER found that the ABC has procedures in place with which to operate a successful wholesale alcoholic beverage distribution program. The ABC's Enforcement Bureau has a proactive enforcement system with the intelligence, investigative, and permitting functions in place to enforce the state's alcoholic beverage control laws.

In Part Two, PEER presents a policy analysis of the feasibility of privatizing all or part of the state's alcoholic beverage control program. PEER identified three privatization options and analyzed the feasibility of each option. Considering the state's current policy environment, PEER concludes that the only feasible option of those considered for privatization of alcoholic beverage control would be to contract out wholesale operations. However, the ultimate success of this option would be contingent on the ability to develop a contract that saves the state at least ten percent on operating costs while providing the same level of service as currently provided by ABC's recently renovated wholesale distribution system.

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The Committee assigns top priority to written requests from individual legislators and legislative committees. The Committee also considers PEER staff proposals and written requests from state officials and others.

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December 7, 2004

Honorable Haley Barbour, Governor
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Members of the Mississippi State Legislature

On December 7, 2004, the PEER Committee authorized release of the report entitled **The State Tax Commission's Office of Alcoholic Beverage Control: A Management Review and Policy Analysis.**

A handwritten signature in black ink, appearing to be "L. Posey", written over a faint horizontal line.

Senator Lynn Posey, Chair

This report does not recommend increased funding or additional staff.

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The State Tax Commission's Office of Alcoholic Beverage Control: A Management Review and Policy Analysis

Executive Summary

Introduction

The PEER Committee reviewed the State Tax Commission's Office of Alcoholic Beverage Control in response to citizens' complaints.

Part One of the report is the PEER Committee's management review of the State Tax Commission's Office of Alcoholic Beverage Control (hereafter referred to as ABC). PEER sought to determine whether ABC has the systems in place to direct and control the wholesale distribution of wine and spirits and to enforce the state's alcoholic beverage control laws. Part One begins with a follow-up assessment of ABC's response to PEER's findings and recommendations in the 1989 report *A Limited Operational Review of the Alcoholic Beverage Control Division*. Part One also addresses ABC's wholesale operations, enforcement of state alcoholic beverage control laws, permit renewal process, and vehicle management.

Part Two of the report is the PEER Committee's policy analysis of the feasibility of privatizing all or part of the state's alcoholic beverage control program. PEER identified three privatization options and analyzed the feasibility of each option in light of the state's current policy environment.

Background

In 1966, the Legislature re-announced prohibition of liquor and wine as the policy of the state in MISS. CODE ANN. Section 67-1-1 et seq. (1972), known as the Local Option Alcoholic Beverage Control Law. Although prohibition is the state's official policy, this law allows individual counties, judicial districts, and certain municipalities to opt for legal sales of liquor and wine within their legal boundaries.

In that same year, the Legislature created the Alcoholic Beverage Control Division of the State Tax Commission (Chapter 540, *Laws of 1966*), now known and referred to as the Office of Alcoholic Beverage Control. ABC's two main purposes are to supervise the distribution and sale of alcoholic beverages and to enforce the state's alcoholic beverage control laws.

ABC regulates and supervises the manufacture, sale, distribution, possession, and transportation of alcoholic beverages from the point at which the initial order is taken through delivery to the retail permittee. ABC bases its warehousing, sales, distribution, and transportation operations at the Distribution Center in Gluckstadt.

ABC also enforces alcoholic beverage control laws statewide, including both "wet" and "dry" jurisdictions.

Part One: Management Review of the Office of Alcoholic Beverage Control

Follow-up on ABC's Response to Conclusions of the 1989 PEER Report

Since PEER's 1989 review, the Office of Alcoholic Beverage Control has addressed four of the six operational weaknesses identified, but has not addressed remaining weaknesses in internal audit and warehouse security.

In 1989, PEER concluded that the State Tax Commission's lack of an internal audit function contributed to ABC's internal control weaknesses. Although the State Tax Commission established an internal audit function subsequent to PEER's 1989 review, the position does not currently comply with generally accepted internal auditing standards or the Mississippi Internal Audit Act. Thus, the STC does not provide the required level of internal oversight of ABC's operations.

PEER also concluded in 1989 that ABC's warehouse security devices did not safeguard against the unauthorized consumption or removal of alcoholic beverages. The Office of Alcoholic Beverage Control has not corrected all weaknesses in warehouse security at the distribution center, with components of the security system remaining inoperable. Also, ABC has not analyzed its current warehouse security needs to determine whether the original security system, if updated and optimized, would meet the needs of the facility.

Distribution and Sale of Alcoholic Beverages

Although PEER found areas in which ABC could take specific management actions to assure accountability in warehouse operations, the Office of Alcoholic Beverage Control has procedures in place with which to operate a successful wholesale distribution program.

PEER reviewed ABC's procedures for distribution and sale of alcoholic beverages and found order processing, shipping and

delivery, and pricing procedures to be basically sound. Further, through sampling, PEER found that ABC's inventory location plan, accounts payable, accounts receivable, and collection procedures function without significant error.

However, ABC does not: audit contractors' delivery notes, formally track loss or damage to warehouse inventory over time, employ proper internal controls over the warehouse petty cash fund or use it in a proper manner, have a formal training plan for non-enforcement employees, utilize a meaningful performance monitoring program, or ensure that distribution and sales policies are updated. Improvement in these specific areas of concern would reduce the risks inherent in any wholesale distribution operation and would improve ABC's already successfully functioning program.

Enforcement of Alcoholic Beverage Control Laws

The ABC's Enforcement Bureau has a proactive enforcement system with the intelligence, investigative, and permitting functions in place to enforce the state's alcoholic beverage control laws.

ABC has the organization, staffing, training, management information system, and financial management practices in place with which to accomplish its responsibilities. From January 1, 2003, through September 20, 2004, ABC's enforcement agents filed 1,421 charges; of those charges filed, 1,269 (89%) resulted in felony or misdemeanor convictions.

Deficiencies in the State Tax Commission's Oversight of ABC

Because the Office of Alcoholic Beverage Control is part of the State Tax Commission, the STC is ultimately responsible for ABC's implementation of the state's alcoholic beverage control policy. During the course of PEER's management review, the Committee noted the following areas of deficiency regarding the STC's oversight of ABC.

The State Tax Commission does not ensure that permittees continue to meet initial qualifications set forth in MISS. CODE ANN. Section 67-1-57 (a) (1972) as a condition of annual alcoholic beverage permit renewal.

State law sets regulations as to how, when, and under what circumstances alcoholic beverage permits will be issued or renewed and approves those permits. In conducting permitting activities, the ABC Enforcement Bureau implements the permitting regulations that STC adopts.

MISS. CODE ANN. Section 67-1-57 (a) (1972) sets forth requirements for alcoholic beverage permit applicants. The law requires that to receive a permit, an individual must be of "good moral character;" be a "peaceable, law-abiding" citizen; be at least twenty-one years old; and, must not have a federal or state felony

conviction. When individuals initially apply for permits, the bureau conducts criminal history checks on those individuals to ensure that they meet the requirements of the law. However, the STC does not require, prior to permit renewal, that the ABC determine whether permittees *continue* to meet all qualifications.

The State Tax Commission does not ensure that the ABC makes the most efficient and effective use of state-owned vehicles assigned to its administrative staff. Also, the ABC has not complied with some state laws regarding state-owned vehicles and has not properly addressed their taxability.

The STC has a documented vehicle management program for its enforcement vehicles, but not for its administrative vehicles. For vehicles assigned to the ABC Director and Warehouse Operations Manager, the State Tax Commission does not have written operational policies or procedures or a requirement for driver documentation or management reporting of vehicle use, mileage, and operating costs.

The STC has not complied with some state laws regarding state-owned vehicles. Because the ABC Director uses her unmarked state vehicle for purposes other than those approved by the Governor, her use of this state-owned vehicle does not comply with MISS. CODE ANN. Section 25-1-87 (1972). Also, the ABC Director and Warehouse Operations Manager use state-owned vehicles for commuting, a practice no longer allowed by state law.

The State Tax Commission has not properly addressed the taxability of the vehicles provided to its ABC Director or ABC Warehouse Operations Manager. As a result, based on PEER's interpretation of the Internal Revenue Code and regulations, these individuals could be liable for unpaid taxes on unreported income. Also, the STC and these individuals could be subject to interest and penalties.

PEER found that the management and use deficiencies of the two ABC vehicles also apply to the nine administrative vehicles of the State Tax Commission, since they were used in a similar manner.

Recommendations: Part One

1. ABC should formally reactivate its advisory group, made up of representatives of organizations such as the Mississippi Restaurant Association and Package Store Association, to receive input regarding its service to permittees.
2. Using existing resources, ABC should conduct a needs assessment and create a detailed warehouse security plan. ABC should include in the needs assessment a review of whether the costs would outweigh the benefits of operating and monitoring internal security cameras. A warehouse security plan that specifically lists the type of equipment needed, cost per equipment item, and the cost of additional personnel, if necessary, should be

included in any future funding requests to the Legislature.

3. ABC should seek to amend its contract with its distribution contractors (i.e., Shippers Express and M&J Transport) and should require in future contracts that both shipping companies obtain signatures and dates from retailers confirming the date of receipt of goods on the bill of lading and/or delivery notes. Also, ABC should periodically audit these dated delivery notes to ensure that shipping contractors are fulfilling their contractual obligation of next-business-day shipping.
4. ABC management should set a periodic policy review cycle and require all division directors to update policy and procedure manuals and log all changes and reviews pertaining to their respective divisions and present these revisions for ABC management approval. Division directors should also update policies as any changes in process occur.
5. ABC should develop a written, task-based inventory procedures manual to implement ABC's new warehousing and distribution system implemented in 2003.
6. ABC management should require ABC's Warehouse Operations Manager to prepare a damage loss report which details the number of damaged and repackaged cases by item number, item name, and value. The report should be produced on a weekly, monthly, quarterly, and annual basis and should be used to address security and management issues.
7. ABC should cease the use of its Warehouse Petty Cash Fund as presently operated and then choose one of the following options:

Option A

Obtain a procurement card and make all small purchases through the state purchasing system, using purchase orders.

or;

Option B

Make larger, recurring purchases through the state purchasing system and pay for such purchases through accounts payable. Retain the petty cash fund for the purchase of small items such as inspection stickers and postage, but reduce the amount maintained in the account from \$1,000 to an amount sufficient to meet minor expenditures of not more than two months (suggested amount: \$250). Operate the account as a checking account and authorize two individuals to make

purchases on the account using a debit card. Develop a formal, written policy for managing the fund.

Regardless of the option chosen, ABC should make all purchases in accordance with the *MAPP Manual*.

8. Should ABC choose Option B, the agency should improve its internal controls over petty cash, including arranging for signatures of two staff members on the petty cash account with a third party to administer it, write checks, maintain the account balance, and reconcile monthly bank statements against receipts and expenses.
9. Using existing resources, ABC should analyze training needs of ABC employees, addressing the training needs for each division or department and each job title. According to the training needs identified, ABC should make training available to all employees with the same job title. ABC should include cross-training in its analysis and document all cross training of employees. If training will not be provided internally, all employees should be made aware of the procedures to request training.
10. The Office of Alcoholic Beverage Control (ABC) should create and monitor performance measures that reflect program improvement from year to year, showing progress toward achieving the goals of the agency, instead of performance measures that count transactions performed or dollars collected. Examples of such desired performance measures would be: X% decrease in damage/loss rate, X% decrease in overages/shortages at inventory, X% decrease in orders taken that cannot be delivered because they are out-of-stock, X% increase in revenue transferred to the general fund relative to operating expenses, or X% increase in orders completed and delivered the next business day.
11. The State Tax Commission should comply with the requirements of MISS. CODE ANN. Section 25-65-1 et seq. (1972). If and when the agency fills its internal audit position, that individual's job duties should include ensuring that financial, compliance, electronic data processing, and operational and efficiency audits of the ABC program and other Tax Commission programs are conducted as authorized in MISS. CODE ANN. Section 25-65-13 (1972).
12. The State Tax Commission should revise its permit renewal application to obtain fingerprint cards from the permit renewal applicant in order to conduct a criminal history check for permit renewals of permittees to ensure that they continue to meet the initial permitting qualifications in MISS. CODE ANN. Section 67-1-57 (a) (1972). The State Tax Commission should determine whether the applicant's filing fee, set in MISS. CODE ANN. Section 27-71-5 (1972), is sufficient to cover the costs of

the applicant's permit renewal investigation. If it is not, the STC should seek a statutory amendment for the necessary amount.

13. The State Tax Commission should develop and implement a vehicle fleet management program to organize and operate its vehicles for official business while providing the management information necessary to operate the vehicles efficiently and effectively and in compliance with state and federal laws. Appendix F of the report contains a discussion of critical components of a model vehicle management system.
14. The State Tax Commission should perform a documented needs analysis with a breakeven cost analysis for the four individuals who commute in state vehicles. These analyses should determine whether the STC Commissioner, STC Deputy Commissioner, ABC Director, and ABC Warehouse Operations Manager have a compelling need for:
 - the assignment of a state vehicle on a seven-day per week, twenty-four-hour basis; and,
 - the most cost-efficient method for the state to reimburse these individuals for business trips after normal duty hours--i.e., to provide a state vehicle or to pay travel mileage.
15. Using existing resources, the State Tax Commission should ensure that the SABER System includes collection of the Fuelman operational costs in weekly reports in order to provide a total vehicle operational cost for its vehicles. This information could be used to conduct periodic performance audits to measure the effectiveness and efficiency of the system.
16. The State Tax Commission should comply with MISS. CODE ANN. Section 25-1-87 (1972) and use the two unmarked police vehicles exclusively for the gubernatorially approved function of law enforcement.
17. When the State Tax Commission has to purchase additional passenger automobiles for administrative use, it should purchase mid-size, fuel-efficient five-passenger automobiles.
18. Using existing resources, the State Tax Commission should develop a written policy and procedure that completely and specifically details the process of discounting ABC inventory, including the individual or individuals who have authority to discount products.
19. The Legislature should amend MISS. CODE ANN. §27-71-5 (g) to define wine for on-premises retailers as having *more than five percent alcohol by weight*, but not more than twenty-one percent alcohol by weight. MISS. CODE ANN. §27-71-5 (g) currently defines wine for on-premises

retailers as *more than four percent alcohol by volume*, but not more than twenty-one percent alcohol by volume. The proposed amendment would make the definition of wine in §27-71-5 consistent with MISS. CODE ANN. §67-1-5 that defines wine of *more than five percent alcohol by weight* as an alcoholic beverage.

Part Two: Policy Analysis of Options to Privatize Mississippi's Alcoholic Beverage Control Program

Considering the state's current policy environment, PEER concludes that the only feasible option of those considered for privatization of alcoholic beverage control would be to contract out wholesale operations. However, the ultimate success of this option would be contingent on the ability to develop a contract that saves the state at least ten percent on operating costs while providing the same level of service as is currently provided by ABC's recently renovated wholesale distribution system.

PEER analyzed whether it would be feasible to privatize all or part of the state's alcoholic beverage control system.

PEER developed three criteria to judge the feasibility of privatization options. PEER assumed that each option must have the potential to:

- generate at least the same amount of revenue to the state that is currently provided by ABC;
- not rely on increased alcohol consumption to generate enough revenue; and,
- provide at least the same level of service to permittees and consumers that ABC currently provides.

The options PEER analyzed were: fully divesting the state's wholesale distribution of wine and spirits; franchising the state's wholesale distribution; and, contracting out ABC's wholesale operations, including warehousing and order processing.

PEER analyzed the three options by determining other states' experiences with privatization and projecting each option's performance on the established criteria. Based on the criteria PEER developed, the only feasible option of the options studied for privatizing the state's wholesale distribution under the state's current policy environment is to contract out wholesale operations.

If this option is implemented, it should allow the current ABC operation to compete with private organizations through a request for proposals that outlines the most efficient organization and the necessary service provisions. As a general rule, privatization is not implemented unless a private organization can save the state at least 10% in operating expenses while providing the same service as the state.

Recommendations: Part Two

1. As long as the current policy environment of the state remains the same regarding alcoholic beverage control, the state should maintain control of wine and spirits wholesale, not privatizing through divestment or franchise of wine and spirits wholesale.
2. If the State Tax Commission wishes to determine the cost-savings potential of contracting out, it should publish a request for proposals for contracting out warehousing, order-taking, and purchasing to determine whether the state would realize operating cost savings by contracting out those functions.

In considering privatization, the State Tax Commission should require that:

- at minimum, the same level of quality of service (e.g., delivery time, flexibility in method of ordering) be delivered from contractors (quality levels should be specified in the request for proposals);
- contractors provide the same order-processing and delivery timeframe;
- the functions generate the same revenue collection and mark-up for the state;
- proposals from contractors compete with the operation currently in place at ABC; and,
- proposals only be considered if they can maintain the same level of service with at least a 10% operating cost savings to the state.

The State Tax Commission may wish to consider methods of privatization described in the PEER Committee report *The Privatization Potential of Mississippi's State Programs and Services* (Report #286; November 30, 1992).

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The State Tax Commission's Office of Alcoholic Beverage Control: A Management Review and Policy Analysis

Introduction

Authority

The PEER Committee reviewed the State Tax Commission's Office of Alcoholic Beverage Control in response to citizens' complaints. PEER conducted the review pursuant to the authority granted by MISS. CODE ANN. Section 5-3-57 et seq. (1972).

Scope and Purpose

Part One of this document is a report of the PEER Committee's management review of the State Tax Commission's Office of Alcoholic Beverage Control (hereafter referred to as ABC). PEER sought to determine whether ABC has the systems in place to direct and control the wholesale distribution of wine and spirits and to enforce the state's alcoholic beverage control laws. Part One begins with a follow-up assessment of ABC's response to PEER's findings and recommendations in the 1989 report *A Limited Operational Review of the Alcoholic Beverage Control Division*. Part One also addresses ABC's wholesale operations, enforcement of state alcoholic beverage control laws, permit renewal process, and vehicle management.

Part Two of this document is a report of the PEER Committee's policy analysis of the feasibility of privatizing all or part of the state's alcoholic beverage control program. PEER identified three privatization options and analyzed the feasibility of each option in light of the state's current policy environment.

PEER did not review the permitting or taxation of beer distributors or retailers. Beer regulation is a function of the Miscellaneous Tax Division of the State Tax Commission.

Method

In conducting this review, PEER:

- reviewed state laws relating to alcoholic beverage control, and ABC's rules, regulations, policies, and procedures;
- interviewed and observed ABC's personnel;
- analyzed ABC's records and financial information; and,
- interviewed and collected data from alcoholic beverage control agencies in other states and from national associations.

Background

State Policy on Legalization and Control of Alcoholic Beverages

Although prohibition is the state's official policy, state law allows individual counties, judicial districts, and certain municipalities to opt for legal sales of liquor and wine.

In 1966, the Legislature re-announced prohibition of liquor and wine as the policy of the state in MISS. CODE ANN. Section 67-1-1 et seq. (1972), known as the Local Option Alcoholic Beverage Control Law. Although prohibition is the state's official policy, this law allows individual counties, judicial districts, and certain municipalities to opt for legal sales of liquor and wine within their legal boundaries.

MISS. CODE ANN. Sections 67-1-11 through 67-1-15 (1972) provides procedures for these jurisdictions to opt out of prohibition. Under these sections, local referenda may be held in counties and judicial districts of counties if 20% of the qualified electors, or 1,500 qualified electors, sign a petition calling for an election to allow legal sales of liquor and wine. Section 67-1-14 allows such elections in certain municipalities specified in statute if 20% of the qualified electors call for an election. After an election on the subject of local option, the subject may not be placed on the ballot again for at least two years.

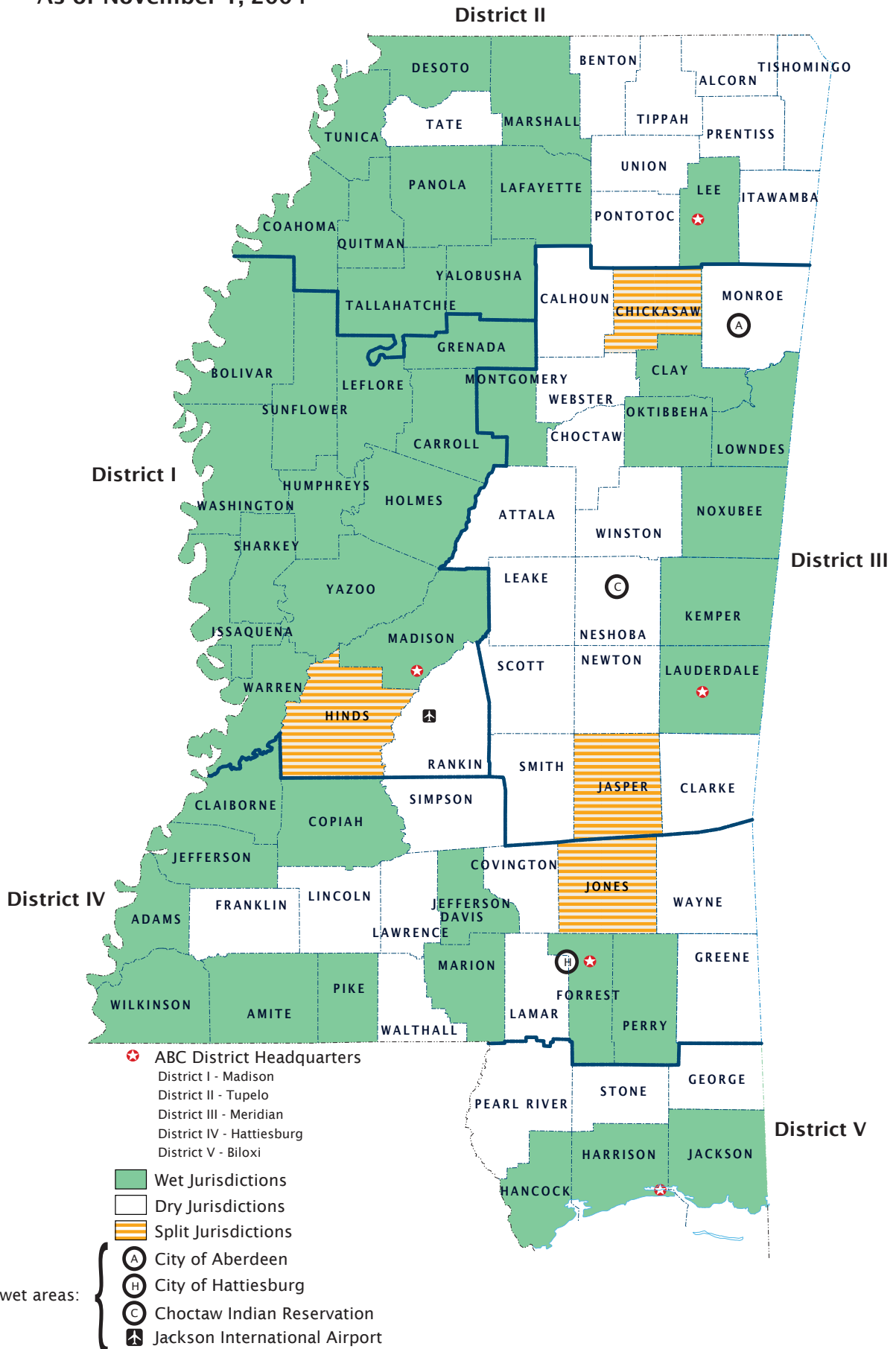
Thus Mississippi has "wet" counties (where sale and distribution of liquor and wine are legal), "dry" counties (where sale and distribution of liquor and wine are not legal), counties with two judicial districts that may be a combination of "wet" and "dry," and "dry" counties that may have a "wet" municipality. Exhibit 1, page 4, is a map of Mississippi showing the location of wet and dry jurisdictions.

Light wine and beer, unlike liquor and wine, are not subject to the general policy of prohibition and are legal throughout the state except in those counties or municipalities that choose to exclude their sale.

The legality of light wine and beer is not addressed in Title 67, Chapter 1 of the CODE. Section 67-3-1 et seq. (1972) controls the sale of these types of alcoholic beverages throughout the state. Light wine and beer, unlike liquor and wine, are not subject to the general policy of prohibition and are legal throughout the state except in those counties or municipalities that choose to exclude their sale.

Appendix A, page 67, contains a glossary of the legal definitions of selected varieties of alcoholic beverages, as taken from the MISSISSIPPI CODE.

**Exhibit 1: Mississippi's Wet and Dry Jurisdictions and ABC's Law Enforcement Districts
As of November 1, 2004**



SOURCE: Office of Alcoholic Beverage Control

Systems of Alcoholic Beverage Control in the States

State law provides the State Tax Commission with the sole authority to be the wholesale distributor and seller of alcoholic beverages, not including malt liquors, within Mississippi.

In the United States there are two major categories of regulation of alcoholic beverages, generally known as *licensing* and *control*. Licensing states regulate distribution through providing licenses to suppliers, wholesalers, and retailers of alcohol beverages and collecting taxes on those beverages. Control states also regulate through licensing and tax collection, but they also directly control alcoholic beverage distribution either by providing alcoholic beverages to consumers directly at retail or as wholesalers through private retail establishments. (See Exhibit 2 on page 6 for a description of alcoholic beverage control systems in the United States and a list of control and licensing states.)

MISS. CODE ANN. §67-1-41 (1) provides the State Tax Commission with the sole authority to be the wholesale distributor and seller of alcoholic beverages, not including malt liquors, within the State of Mississippi. Thus because the State of Mississippi directly controls alcoholic beverage distribution in the state through wholesale, Mississippi is considered a control state.

ABC's Role in Implementing the State's Alcoholic Beverage Laws

In 1966, the Legislature created the Alcoholic Beverage Control Division of the State Tax Commission (Chapter 540, *Laws of 1966*), now known and referred to as the Office of Alcoholic Beverage Control (ABC). ABC's two main purposes are to supervise the distribution and sale of alcoholic beverages and to enforce the state's alcoholic beverage control laws.

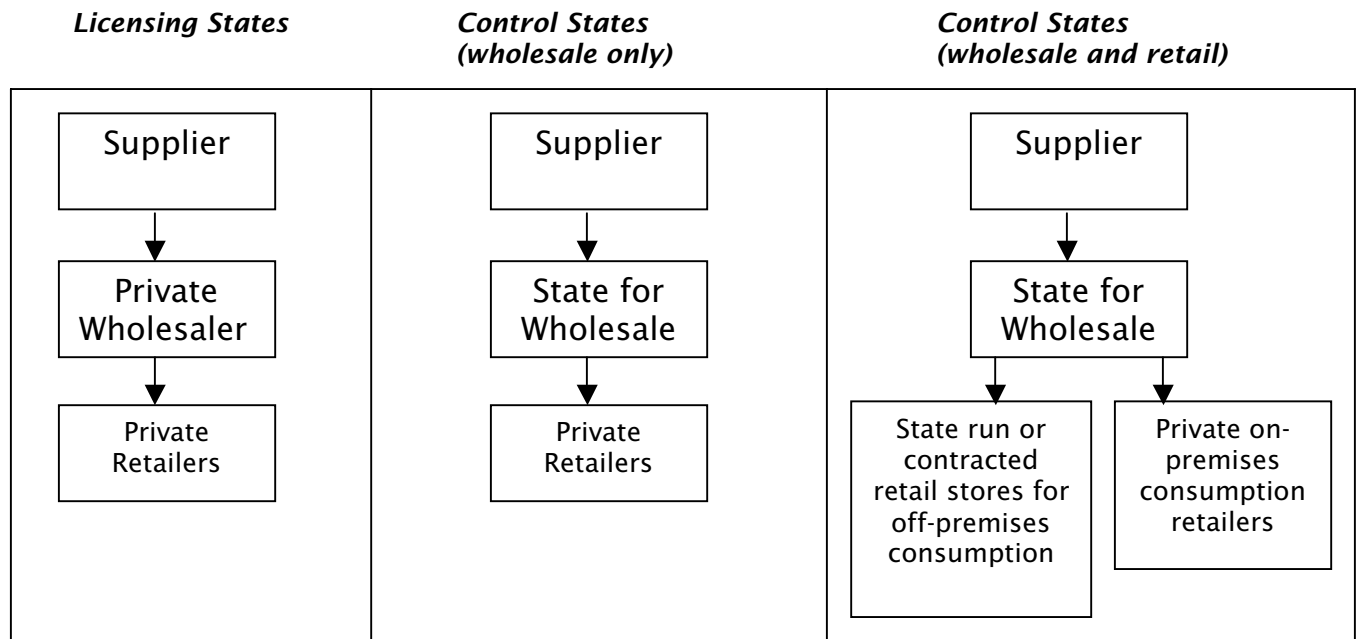
Distribution and Sale of Alcoholic Beverages

As distributor and seller of alcoholic beverages within the state, the State Tax Commission is authorized by CODE Section 67-1-41 (1) (1972) to:

. . . establish warehouses, purchase intoxicating liquors in such quantities and from such sources as it may deem desirable and sell the same to authorized permittees within the state. . . .

ABC regulates and supervises the manufacture, sale, distribution, possession, and transportation of alcoholic beverages from the point at which the initial order is taken through delivery to the retail permittee. ABC bases its warehousing, sales, distribution, and transportation operations at the Distribution Center in Gluckstadt.

Exhibit 2: States' Alcoholic Beverage Supply System



Licensing States

Alaska
 Arizona
 Arkansas
 California
 Colorado
 Connecticut
 Delaware
 District of Columbia
 Florida
 Georgia
 Hawaii
 Illinois
 Indiana
 Kansas
 Kentucky
 Louisiana
 Maryland
 Massachusetts
 Minnesota
 Missouri
 Nebraska
 Nevada
 New Jersey
 New Mexico
 New York
 North Dakota
 Oklahoma
 Rhode Island
 South Carolina
 South Dakota
 Tennessee
 Texas
 Wisconsin

Control States (wholesale of spirits)

Iowa
 Michigan
 Mississippi
 West Virginia
 Wyoming

Control State (wholesale of wine)

Mississippi
 Wyoming

Control States (wholesale and retail of spirits)

Alabama
 Idaho
 Maine
 Montgomery County, MD
 Montana
 New Hampshire
 North Carolina
 Ohio
 Oregon
 Pennsylvania
 Utah
 Vermont
 Virginia
 Washington

Control States (wholesale and retail of wine)

Pennsylvania
 New Hampshire
 Utah

Bailment Warehouse System

Bailment warehousing is a method whereby alcoholic beverages owned by vendors are stored in a central warehouse for subsequent shipment to retail permittees.

Prior to 1991, ABC purchased and owned its alcoholic beverage inventory based on estimates of demand. During that year, ABC began a bailment warehouse operation at its distribution center. Bailment warehousing is a method whereby alcoholic beverages owned by vendors are stored in a central warehouse for subsequent shipment to retail permittees. Although seven other control states charge their vendors bailment fees, Mississippi does not.

Under the bailment agreement between vendors and ABC, ABC uses its inventory first to fill orders. ABC's inventory comes from cases the agency purchases if damage occurs to an item within the case, from items seized by enforcement agents, and initially, from stock remaining from the period when ABC purchased all of the warehouse's inventory. After ABC's inventory is depleted, the agency uses the vendor's inventory to fill orders.

As of September 28, 2004, the ABC warehouse held 349,106 beverage cases and the value of the beverage inventory was \$23,776,653.

ABC must approve the removal of any product from the distribution center and requires that each vendor designate an agent to serve as the contact person. The agent contacts ABC in the event that the vendor wants to withdraw stock from the warehouse--e.g., if the product is not selling or to redistribute to other states. (Delisted items, as well as some items remaining from damaged cases, may be available occasionally through an ABC auction; see page 28.) ABC contacts the agent to purchase specific products from that vendor or if the agency plans to delist that vendor's product from the warehouse's regular inventory.

ABC does not insure the vendor's inventory in bailment and is not responsible for loss except for damages and shortages occurring while the inventory is held in bailment. ABC charges vendors for labeling and re-packing.

According to ABC staff, as of September 28, 2004, the warehouse held 349,106 beverage cases and the value of the beverage inventory was \$23,776,653.

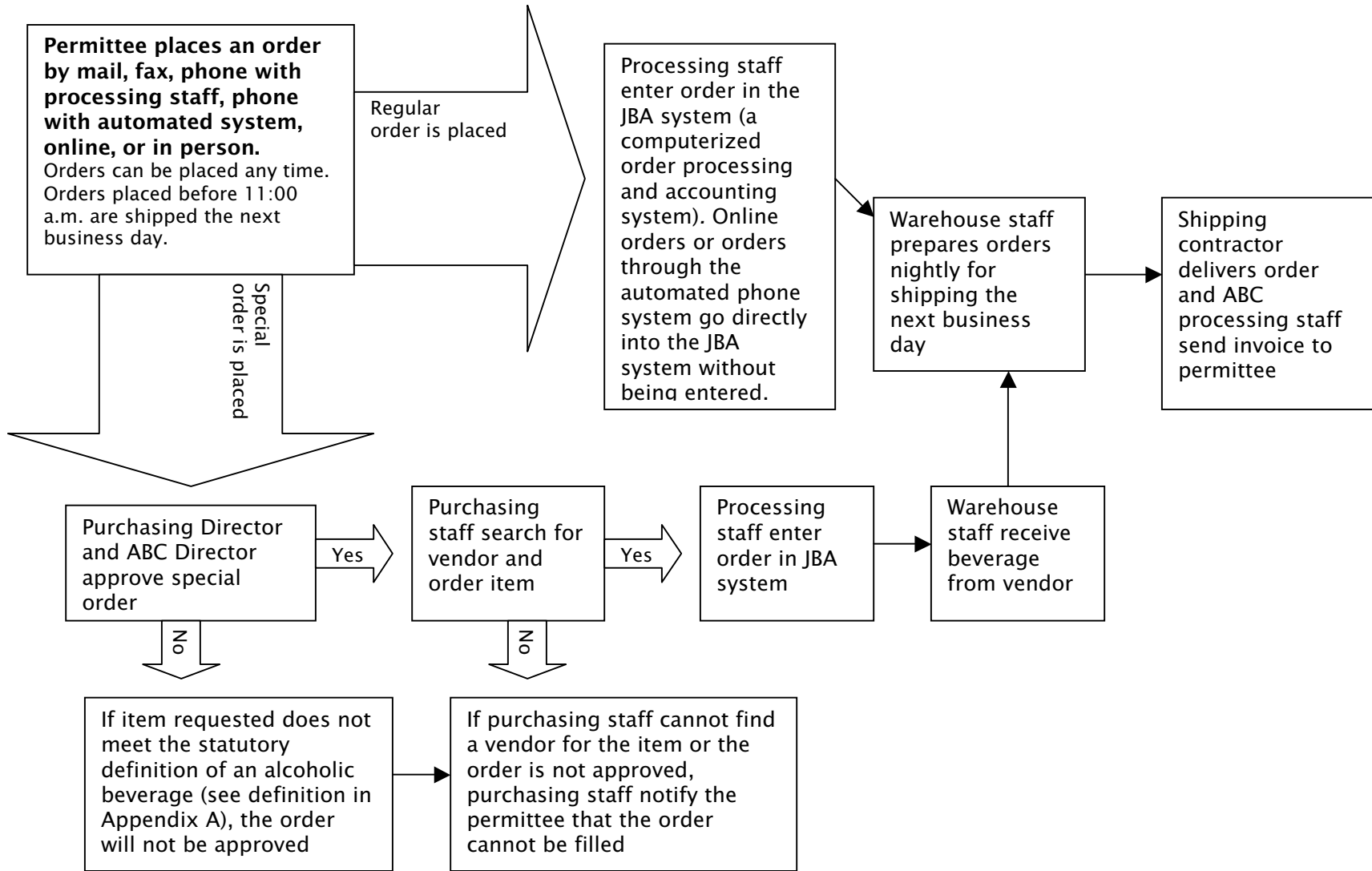
Ordering and Shipping Process

The ABC warehouse ships approximately 35,000 to 45,000 cases of alcoholic beverages per week, representing about 1,300 orders, with more during holiday seasons.

According to ABC staff, the ABC warehouse currently ships approximately 35,000 to 45,000 cases of alcoholic beverages per week, representing about 1,300 orders, with more during holiday seasons.

Exhibit 3, page 8, illustrates ABC's ordering and shipping process. Employees in ABC's Processing Department enter sales orders into the JBA System, a software system customized for ABC's warehouse operations. ABC provides same-day processing of orders taken until 11 a.m. each business day, with next-day processing of orders taken after that time. Exhibit 4, page 9, defines regular and special orders.

Exhibit 3: ABC's Regular and Special Order Process from Permittee Order to Delivery



Note: If a permittee places a regular order online or by phone and the product is out of stock, the permittee will receive immediate notification. If a permittee places an order by mail, fax, or in person, the out of stock product is deleted from the order without notification and the permittee must place an order for that product again. ABC staff report that they are planning to modify the automated system so that the out-of-stock product will not be deleted from the order and can be filled when the item is in stock.

SOURCE: PEER analysis of ABC's regular and special order process

Exhibit 4: Types of Orders Placed with ABC by Permittees

Regular Orders

A regular order is an order placed by a permittee for an item on the ABC Product List. Permittees may order any time, but orders are processed Monday through Friday. Permittees must order a minimum of five cases for each regular order. Items on the ABC Product List are items that are regularly held in ABC's warehouse.

Split Case Order

For most of the items on the regular ABC Product List, permittees must order a whole case of each beverage they order. For about 500 items on the product list, permittees may place an order for a split case as long as they order at least three bottles of each item and order enough split case items to make a whole case of twelve bottles. Permittees must pay a fee of \$.30 per bottle for split case items. Even if a permittee's order includes a split case, the minimum total order must still be at least five cases.

Special Order

If the item a permittee wants to order is not on the ABC Product List, a permittee may place a special order for any item available to ABC from its vendors. The minimum order for a special order is one case. If a special order is made, ABC will order the item from its vendor, if possible, and will deliver the item to the permittee when it arrives at ABC.

Methods of Ordering

Permittees may place an order online, by mail, by fax, in person, or by phone (either with processing staff or through an automated ordering system).

SOURCE: PEER analysis of ABC's policy and procedure and interviews with ABC staff.

Once orders are entered, the system searches the inventory list to locate each item. When the item is located on the inventory list, the system changes its designation from available inventory to allocated inventory. ABC's Warehouse Clerk prepares a report on the number of cases by routes and shipper and notifies the shipping contractors of the number of cases they must transport and the routes on which cases must be delivered.

The warehouse's night shift employees label cases and put them into the warehouse conveyor system. Conveyor software sorts the cases and sends them down the conveyor belt to be loaded into the shipping contractors' trucks. According to ABC staff, if an error occurs in a shipment, ABC has the items that were shipped in error picked up by courier or by the shipper.

ABC staff noted that permittees have opportunity to make complaints by direct call; ABC staff also stated that they have planned visits to some permittees to discuss areas of concern. In 2000 and 2001, ABC organized an advisory group with representatives of the Mississippi Restaurant Association, Package Store Association, and truck lines to provide input to ABC regarding its services. The group suspended its meetings when ABC became involved in renovations (see following section). However, some consumer representatives still meet with the State Tax Commissioner on an ad hoc basis.

Recent Shutdown and Improvements in Warehousing and Distribution

In October 2003, the ABC completed improvements to its warehouse and implemented a new conveyor system with bar code reading capability.

In the fall of 2003, the former STC Commissioner shut down the ABC Warehouse for two weeks in October 2003. During that time, ABC finalized construction of the 25,000-square-foot addition to cooler storage space, finished replacing the shelving in the existing warehouse (approximately 185,000 square feet), and transitioned from the old conveyor system to a new "state-of-the-art" conveyor system with bar code reading capability.

ABC chose to shut down operations because it had problems shipping orders while the improvements were being completed. According to ABC staff, they notified customers of the shutdown in advance so that they could order a sufficient quantity of items. During the shutdown, the vendor for the new conveyor system trained the ABC staff on the new system. The ABC staff reported that the new conveyor system has been in working order since November 1, 2003, but ABC was still working out minor problems with the new system until December 1, 2003. Soon after the new system was in place, ABC hired a new Warehouse Operations Manager.

Enforcement of Alcoholic Beverage Control Laws

MISS. CODE ANN. Section 67-1-37 (1972) empowers the State Tax Commission to promulgate rules and regulations necessary to carry out the functions of the Office of Alcoholic Beverage

Control. The commission, through ABC's Enforcement Bureau, enforces laws and regulations governing alcoholic beverages. Exhibit 5, page 12, lists and briefly describes the laws that ABC enforces.

To fulfill its enforcement responsibility, MISS. CODE ANN. Section 67-1-31 (1972) authorizes ABC's enforcement agents to bear arms; make arrests, searches, and seizures; and serve notices or orders issued by officers or courts concerning alcoholic beverage control laws. ABC enforcement agents also conduct permitting investigations of applicants. These investigations of individuals or businesses include new and transfer permittees, managers, and annual renewal permittees. ABC agents also perform annual renewal inspections of permittee operations and special internal investigations.

ABC's Enforcement Bureau has five statewide enforcement districts that include both dry and wet counties (see additional discussion on page 3). Exhibit 1, page 4, shows the status of each county in the state (wet or dry), the Enforcement Bureau's five districts, and the locations of the district offices.

ABC's Organization and Staffing

The Office of Alcoholic Beverage Control is governed by the State Tax Commission (see Exhibit 6, page 13.)

ABC is organized into sections according to function (see Exhibit 7, page 14). All of these functions support one or both of the main purposes of the office. The Warehouse Bureau, Purchasing Division, and Processing Department support ABC's function as the wholesaler of wine and spirits for the state. The Enforcement Bureau and Permitting Department enforce laws regarding alcoholic beverages and regulate retailers of alcoholic beverages. The Administration Office and Accounting Division support the operation of both the distribution and enforcement functions of ABC.

As of July 1, 2004, ABC had 131 full-time, permanent positions, 123 of which were filled.

MISS. CODE ANN. § 67-1-23 authorizes the Chairman of the State Tax Commission (i.e., the STC Commissioner) to appoint a director of the division and appoint or employ such agents, inspectors, clerks, and other employees as necessary to administer the state's alcohol and beverage control laws. As of July 1, 2004, ABC had 131 full-time, permanent positions, 123 of which were filled.

Revenues and Expenditures

The Office of Alcoholic Beverage Control is funded by the state general fund, but also collects revenue from the wholesale sale of wine and spirits and from retailers of alcoholic beverages through

Exhibit 5: Alcoholic Beverage Laws Enforced by ABC's Enforcement Division

MISS. CODE ANN. §67-1-1 et seq. - Local Option Alcoholic Beverage Control Laws. This chapter establishes the authorized locations and governing laws for the legal manufacture, sale, distribution, possession, and transportation of alcoholic beverages except for the transportation and possession of limited amounts of alcoholic beverages for the use of an alcohol processing permittee.

ABC's Enforcement Bureau has the authority and responsibility to enforce all laws in this chapter.

MISS. CODE ANN. §67-3-1 et seq. - Sale of Light Wine, Beer, and Other Alcoholic Beverages. This chapter legalizes the manufacture and sale of light wines and beer of an alcoholic content of not more than five percent by weight. It also regulates the business of manufacturing and of selling such liquors so as to prevent the illicit manufacture, sale, and consumption of liquors having an alcoholic content of more than five percent by weight.

ABC's Enforcement Bureau has the authority to enforce and responsibility to enforce only selected sections of this chapter--e.g., furnishing or selling beer or light wine to a person under twenty-one.

MISS. CODE ANN. §67-5-1 et seq. - Mississippi Native Wine Law of 1976. This chapter legalizes the production of native wine in Mississippi, including the production of non-alcoholic native wines and juices to be used for sacramental purposes and the sale of this wine within or without this state. This wine is subject to the gallonage excise tax that is levied in MISS. CODE ANN. Section 67-5-13 (1972).

ABC's Enforcement Bureau has the authority and responsibility to enforce all laws in this chapter.

MISS. CODE ANN. §67-9-1 et seq. - Possession or Transportation of Alcoholic Beverages, Light. This chapter makes it lawful for any person holding an alcohol processing permit to transport and possess alcoholic beverages, light wine and beer in any part of the state, for use in cooking, processing, or manufacturing products that contain alcoholic beverages as an integral ingredient. ABC establishes maximum allowable amounts for these beverages.

ABC's Enforcement Bureau has the authority and responsibility to enforce this law.

MISS. CODE ANN. §97-31-1 et seq. - Intoxicating Beverage Offenses. This chapter establishes laws governing intoxicating beverage offenses in dry counties. These laws cover alcoholic and ginger preparations; product delivery; denatured alcohol; manufacturing or distilling beverages; sale, possession, and use; transportation into or within state; and solicitation.

ABC's Enforcement Bureau has the authority and responsibility to enforce all laws in this chapter.

SOURCE: PEER analysis of MISSISSIPPI CODE ANNOTATED (1972).

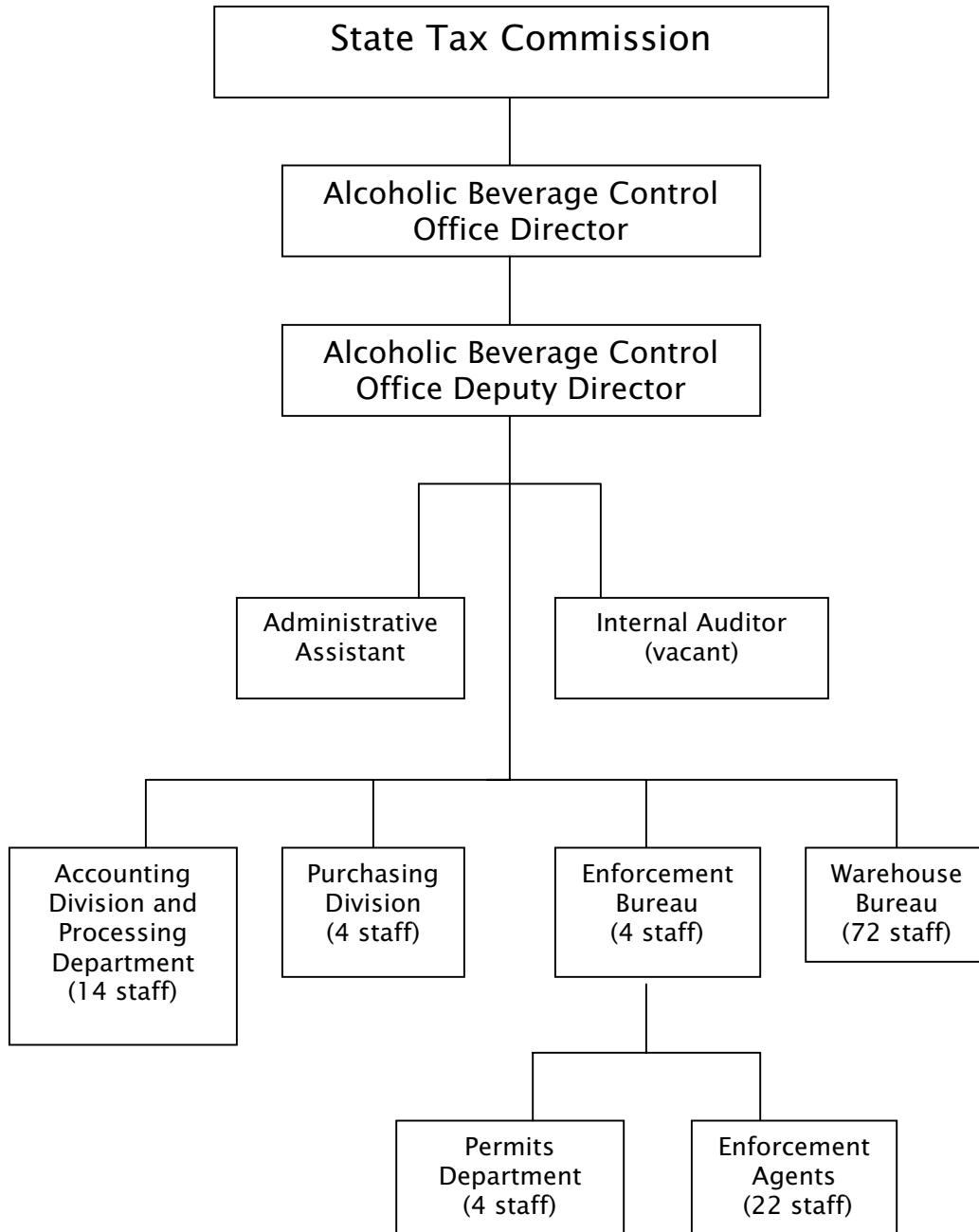
Exhibit 6: State Tax Commission: Members, Titles, Employment Status, Terms of Office, and Residences As of October 1, 2004

Member	Title (Employment Status)	Appointing Official (with Senate Consent)	Terms of Office	Residence
Joseph L. Blount	Chairman and Commissioner of Revenue (Full Time)	Governor	July 1, 2004, to June 30, 2010	Jackson
Donald L. Green	Associate Commissioner (Part Time)	Governor	July 1, 2002, to June 30, 2008	Clarksdale
Terry L. Jordan	Associate Commissioner (Part Time)	Governor	March 28, 2001, to June 30, 2006	Philadelphia

NOTE: All members of the State Tax Commission are appointed by the Governor, with the advice and consent of the Senate.

SOURCE: MISS. CODE ANN. Section 27-3-1 (1972)

Exhibit 7: Organization of the Office of Alcoholic Beverage Control of the State Tax Commission



SOURCE: PEER analysis of ABC's organizational chart and staff list.

NOTE: The number of staff refers to the number of positions filled as of July 1, 2004. Some of the divisions also have some vacant positions.

permitting fees. Exhibit 8 on page 16 shows the sources of revenue collected and distributed by ABC.

ABC wholesale revenue includes profit from the wholesale of wine and spirits, but ABC also collects sales, excise, and alcohol abuse taxes on the wine and spirits it sells.

ABC wholesale revenue includes profit from the wholesale of wine and spirits, but ABC also collects sales, excise, and alcohol abuse taxes on the wine and spirits it sells. The sales tax collected is distributed to the State Tax Commission while excise taxes are deposited into the general fund. Alcohol abuse taxes collected are distributed to a fund for the Department of Mental Health for service programs. ABC also receives permitting fees from retailers and other similar businesses. Appendix B, page 68, contains a list of the types of permits issued to retailers and a brief description of each. A portion of those fees is distributed to city and county governments, and the rest is deposited into the state's general fund. Appendix G, page 77, lists the permit fee amounts set by MISS. CODE ANN. Section 27-71-5.

Exhibit 9 on page 17 illustrates the positive net impact ABC had on the general fund in fiscal years 2000-2004. During each of those fiscal years, ABC deposited between \$34 and \$40 million above the general funds used for operating expenses. While operating costs of ABC are funded by the general fund, ABC deposited an average of 6.3 times the amount of general fund used back into the general fund between 1999 and 2003.

Exhibit 8: Sources of ABC Revenues, FY 2000-FY 2004

Source of Revenue	FY 2000	FY 2001	FY 2002	FY 2003	FY 2004
General fund appropriation	\$7,829,452	\$6,513,277	\$6,261,502	\$ 7,309,542	\$ 7,987,103
Profit from wholesale of wine and spirits	30,899,501	32,219,412	33,495,664	35,012,545	36,073,189
Excise tax collected	9,053,704	8,925,690	9,052,179	9,330,042	9,596,379
Sales tax collected	12,342,673	12,643,686	13,178,532	13,762,978	14,420,033
Alcohol abuse tax	3,884,495	4,042,894	4,038,797	4,308,763	4,521,670
Permitting fees and filing fees	3,996,505	4,246,400	4,272,785	4,326,205	4,580,100
Interest earned	2	2	88	3	48
Total	\$68,006,332	\$68,591,361	\$70,299,547	\$74,050,078	\$77,178,522

SOURCE: ABC's financial statements for FY 2000-FY 2004.

Exhibit 9: Net Impact of ABC on State General Fund, Fiscal Years 2000-2004

	FY 2000	FY 2001	FY 2002	FY 2003	FY 2004
Amount deposited to general fund	\$42,026,356	\$43,356,935	\$44,762,136	\$46,601,325	\$48,048,276
ABC operating expenses from general fund	(\$7,829,452)	(\$6,513,277)	(\$6,261,502)	(\$7,309,542)	(\$7,987,103)
Net impact on general fund	\$34,196,904	\$36,843,658	\$38,500,634	\$ 39,291,783	\$40,061,173

NOTE: ABC's operating expenses come from the State Tax Commission's appropriation from the general fund.

SOURCE: PEER analysis of financial information provided by ABC and the State Tax Commission for fiscal years 2000-2004.

Part One: Management Review of the Office of Alcoholic Beverage Control

As part of this review of ABC, PEER conducted a follow-up assessment of ABC's response to PEER's findings and recommendations in the 1989 report *A Limited Operational Review of the Alcoholic Beverage Control Division*.

PEER also conducted a management review of ABC's two main purposes: distribution and sale of alcoholic beverages and enforcement of the state's alcoholic beverage control laws.

Follow-up on ABC's Response to Conclusions of the 1989 PEER Report

Since PEER's 1989 review, the Office of Alcoholic Beverage Control has addressed four of the six operational weaknesses identified, but has not addressed remaining weaknesses in internal audit and warehouse security.

PEER conducted its 1989 review of the Office of Alcoholic Beverage Control in response to complaints that the ABC showed favoritism to certain vendors in the sale of alcoholic beverages and did not comply with some State Personnel Board regulations.

Appendix C, page 69, contains the executive summary of the 1989 report.

In the 1989 operational review of ABC, PEER cited weaknesses in:

- inventory procedures;
- personnel classification;
- segregation of duties in purchasing and receiving;
- security of cash receipts;
- internal audit; and,
- warehouse security.

PEER revisited these areas to see whether ABC had corrected weaknesses and whether concerns related to those issues are still relevant to ABC operations.

ABC has addressed the inconsistent inventory procedures, improper personnel classification and promotion, lack of segregation of duties in purchasing and receiving, and lack of security of cash receipts noted in the 1989 report. Weaknesses in internal audit and warehouse security have not been corrected and remain areas of concern relevant to ABC operations.

Internal Audit

Although the State Tax Commission established an internal audit function subsequent to PEER's 1989 review, the position does not currently comply with generally accepted internal auditing standards or the Mississippi Internal Audit Act. Thus, the STC does not provide the required level of internal oversight of ABC's operations.

Conclusions of the 1989 PEER Review

In 1989, PEER concluded that the State Tax Commission's lack of an internal audit function contributed to ABC's internal control weaknesses.

During its 1989 review of the ABC, PEER noted that the agency did not have an internal audit function. Because the ABC is part of the State Tax Commission, PEER concluded that the STC should take steps to ensure that the ABC spends funds in accordance with law and that it secures all revenue collections against misappropriation. The most logical method by which to ensure this would be to establish an internal audit position that would, as part of its responsibilities, oversee the ABC. At the time of the 1989 review, the Tax Commission's Deputy Commissioner told PEER that during the two prior years the commission had requested but had not received funds with which to establish an internal audit staff.

ABC's Response to PEER's 1989 Conclusions

The STC established an internal audit position in 1992 but reassigned the position to another function in 1998. The position has been vacant since October 2003.

According to the State Tax Commission's Deputy Commissioner, an internal auditor position for the commission was authorized in July 1992 and the STC hired an individual for that position the following December. Initially the responsibilities for the position included auditing with a focus on creating streamlined and more efficient work patterns in order to enhance the quality of service given to the public, a job duty in accordance with generally accepted internal auditing standards.

In 1998, the Commissioner reassigned that employee to oversee the Quality Management Team for the STC's State Tax Automated Revenue System (STARS) project. Then the individual was later reassigned to ABC to assist with the implementation of the JBA System and other special projects. The position became vacant in October 2003 and has remained vacant since that time.

After STC established the internal audit position, the Mississippi Internal Audit Act, which required STC to establish an internal audit position, came into effect.

Subsequent to STC's establishment of its internal audit position, the Legislature passed the Mississippi Internal Audit Act (MISS. CODE ANN. Section 25-65-1 through 25-65-33 [1972]), which

became effective July 1, 2003. The purpose of the act was to establish a full-time program of internal auditing to assist in improving operations of state agencies and educational institutions, to verify the existence of assets, and to identify opportunities for cost savings and revenue enhancement.

State law specifically lists the State Tax Commission as one of the agencies required to implement internal auditing.

The act listed the State Tax Commission as one of the agencies required to implement internal auditing. Section 25-65-9 requires that the agency employ, subject to specific funding being appropriated, a sufficient number of professional and support staff to implement an effective program of internal auditing. Further, this section requires internal audit to be established outside of the agency's staff or line management functions or units subject to audit and be free of operational and management responsibilities.

Section 25-65-13 sets forth the duties of agencies' internal audit directors, which include conducting financial, compliance, data processing, operational, and efficiency audits; reviewing and evaluating internal controls to ensure accountability; and, developing audit plans based on findings of risk assessments. Section 25-65-15 requires that audits be conducted in accordance with the Standards for the Professional Practice of Internal Auditing.

After the STC reassigned the position to another function in 1998, the individual in that position was not performing the job duties of an internal auditor as defined by generally accepted internal auditing standards. Also, the position was not established organizationally in a manner that complied with the Mississippi Internal Audit Act.

If the STC fills the internal audit position and if the position has the type of organizational status and job duties that were in effect as of October 2003, the agency's internal audit position will not be in compliance with either the Standards for the Professional Practice of Internal Auditing or the Mississippi Internal Audit Act.

When the individual occupying the internal audit position was reassigned to other job duties as described above, the State Tax Commission was not providing proper oversight of funds collected by the STC and ABC. After the position was reassigned, the new job duties were not in accordance with generally accepted internal auditing standards for an internal audit function. Standards for the Professional Practice of Internal Auditing require that an entity's internal audit program be designed to provide reasonable assurance regarding the reliability and integrity of financial and operational information, effectiveness and efficiency of operations, safeguarding of assets, and compliance with laws, regulations, and contracts.

Also, the new job duties were not in accordance with the requirements established for an internal audit program by the Mississippi Internal Audit Act (which became effective July 1, 2003). The act requires that an internal audit position be established outside of the agency's staff or line management functions or units subject to audit and be free of operational and management responsibilities. The responsibilities of the internal auditor relative to the STARS project and then implementation of ABC's JBA System involved the internal auditor in operational and managerial activities.

According to the Deputy Commissioner, the internal audit position was transferred back to the State Tax Commission in September 2004. If the STC fills the internal audit position and if the position has the type of organizational status and job duties that were in effect as of October 2003, the agency's internal audit position will not be in compliance with Standards for the Professional Practice of Internal Auditing or the Mississippi Internal Audit Act.

Warehouse Security

The Office of Alcoholic Beverage Control has not corrected all weaknesses in warehouse security at the distribution center, with components of the security system remaining inoperable. Also, ABC has not analyzed its current warehouse security needs to determine whether the original security system, if updated and optimized, would meet the needs of the facility.

Conclusions of the 1989 PEER Review

In 1989, PEER concluded that ABC's warehouse security devices did not safeguard against the unauthorized consumption or removal of alcoholic beverages.

During its 1989 review of the ABC, PEER noted that several components of the warehouse security system were inoperable. Several of the doors were not kept locked and, according to ABC personnel, the electronic access security door had been inoperable since 1988. Many of the monitoring cameras were inoperable, most had a poor resolution picture, and none could be remotely positioned. Alarms on several other doors were inoperable or did not elicit a response when activated. The sensor detector system was not working properly.

ABC's Response to PEER's 1989 Conclusions

The ABC continues to have weaknesses in its warehouse security system, including inoperable components and lack of security staff at some warehouse access points.

ABC still has weaknesses in its warehouse security system. Although ABC has repaired or replaced the alarms and sensors since PEER's 1989 review, the warehouse still has an inoperable electronic identification card access system and some inoperable cameras and monitors. PEER also observed that the ABC did not have security staff stationed at one of the warehouse's access points.

The ABC's managers have not analyzed the warehouse's security needs to determine whether the original security system, if updated and optimized, would meet the needs of the facility.

As noted above, some components of ABC's security system still are not working. The weaknesses in ABC's warehouse security

system result in a risk to the alcoholic beverage inventory through employee theft or consumption.

The weaknesses in ABC's warehouse security system result in a risk to the alcoholic beverage inventory.

ABC has not corrected these problems, nor have managers analyzed the facility's security needs to determine whether updating and optimizing the existing security system would be the best option or whether other options would be preferable given existing conditions. Further, ABC management has not addressed current security needs by developing a formal, written security plan for the facility.

Although ABC staff have estimated and requested the funding needed to replace inoperable equipment in the original security system, they have not estimated the amount of inventory lost due to lack of security in planning for or justifying improvements to the security system. While ABC management staff and State Tax Commission staff report that they have requested funding for a security system in their budget requests since FY 2001 (see next paragraph), they could not provide PEER with an itemized breakdown of their request according to equipment or personnel needs.

The agency's budget requests to the Legislature for FY 2001 through FY 2006 have not reflected specific requests for funds for the ABC warehouse security system.

Because the State Tax Commission's budget requests to the Legislature have not included specific requests for improvements to the ABC warehouse security system, the Legislature has not had all of the information it needs with which to make decisions regarding priorities in funding.

The State Tax Commission's Director of Administrative Services said that the agency received funding in FY 2001 for a fire alarm and security system. Subsequently, \$2 million was cut from the Tax Commission's 2001 general funds and the Tax Commission decided not to improve the security system. ABC managers reported to PEER that they had requested funding from the Legislature in the past for a security system, but the State Tax Commission's budget requests for FY 2001 through FY 2006 do not reflect specific requests for the ABC warehouse security system. The Director of Administration of the State Tax Commission said the requests for security system funds had been combined with other funding requests such as requests for general repair and maintenance and a fire alarm system.

Because the State Tax Commission's budget requests to the Legislature have not included specific requests for improvements to the ABC warehouse security system, the Legislature has not had all of the information it needs with which to make decisions regarding priorities in funding.

Distribution and Sale of Alcoholic Beverages

Although PEER found areas in which ABC could take specific management actions to assure accountability in warehouse operations, the Office of Alcoholic Beverage Control has procedures in place with which to operate a successful wholesale distribution program.

PEER reviewed ABC's procedures for distribution and sale of alcoholic beverages and found order processing, shipping and delivery, and pricing procedures to be basically sound. Further, through sampling, PEER found that ABC's inventory location plan, accounts payable, accounts receivable, and collection procedures function without significant error.

However, ABC does not: ensure that distribution and sales policies are updated, audit contractors' delivery notes, formally track loss or damage to warehouse inventory over time, employ proper internal controls over the warehouse petty cash fund, have a formal training plan for non-enforcement employees, or utilize a meaningful performance monitoring program. Improvement in these specific areas of concern would reduce the risks inherent in any wholesale distribution operation and would improve ABC's already successfully functioning program.

Order Processing, Shipping, and Delivery

ABC has order processing, shipping, and delivery procedures with which to operate a successful wholesale distribution program.

PEER reviewed ABC's order processing, warehousing, and shipping policies and procedures, interviewed and observed staff, and reviewed a limited purposive sample from order to delivery.

ABC has formal, written order processing and accounting procedures in place. ABC's management has not developed formal, written standard operating procedures for its new warehouse shipping operation (see page 10); however, PEER reviewed warehouse personnel job descriptions and interviewed ABC's Warehouse Operations Manager and select warehouse employees to determine the process of preparing for and performing nightly shipping duties. PEER also observed warehouse employees preparing cases for shipment to determine whether tasks were being performed as described in interviews.

The section "Ordering and Shipping Process," page 7 of this report, and Exhibit 3, page 8, describe ABC's sales order system.

PEER sampled fifty-six sales orders from FY 2004 (i.e., twenty-three regular orders and thirty-three special orders) to determine whether ABC had adequate order processing, shipping, and accounting procedures in place to ensure that orders are shipped to customers according to policy. (As noted on page 7, the ABC warehouse normally handles approximately 1,300 orders per

week.) PEER checked regular orders, invoices, delivery notes, and bills of lading to determine whether orders are processed, shipped, and delivered to customers according to policy and in a timely manner.

PEER checked twenty-three regular orders and determined that eighteen were shipped out the same day or the next day if received after the deadline for processing and shipping to customers on the same day.

PEER checked twenty-three regular purchase orders and invoice forms and determined that eighteen of the twenty-three regular orders were shipped out the same day or the next day if received after the 11 a.m. deadline for processing and shipping to customers on the same day. Five of the twenty-three regular orders were not shipped out according to policy.

PEER checked thirty-three special orders, for which ABC's Purchasing Division is responsible for ordering beverage items from suppliers for customers that are not in ABC's inventory. Special orders in the sample took from one to five months to get from suppliers to ABC. ABC's warehouse operations manager told PEER that when special orders are received into ABC inventory, they are shipped out to customers the next day and that any delays in shipping special orders are due to suppliers.

Of the twenty-three regular orders and thirty-three special orders PEER checked, only one was not delivered the next day after shipping out from ABC.

In addition to checking the recorded shipping date from ABC, PEER reviewed the delivery notes of transportation contractors to determine whether the orders were received by the retailer as expected. After orders are shipped from ABC they are delivered by one of the distribution contractors. PEER requested delivery notes from all fifty-six orders; however, the contract shippers (i.e., Shippers Express and M & J Transport) could not find nine of the fifty-six delivery notes (see following section).

Of the twenty-three regular orders and thirty-three special orders, only one was not delivered the next day after shipping out from ABC. It was delivered the second business day after shipping from ABC.

Because ABC does not have an audit procedure in place for contract shippers' delivery notes, ABC does not provide quality assurance for the entire process from shipping to the actual receipt of goods.

ABC does not require in contract that the delivery notes produced by the contract shippers be both dated and signed by the retailer upon receipt of goods. Currently, both transport companies print the date of delivery on the delivery notes, but only Shippers Express also requires the signature of the retailer to be hand-dated on the delivery note. Also, ABC does not conduct any type of audit to review the delivery notes kept by the contract shippers.

Because ABC does not require documentation of receipt in its contract with shippers, it cannot quickly identify emerging delivery problems.

Because ABC does not have an audit procedure in place for contract shippers' delivery notes, ABC does not provide quality assurance for the entire process from the shipping to the actual receipt of goods from the ABC warehouse to the retailer and cannot ensure that next day-delivery is achieved. Although PEER did not find significant shipping delays in its sample, the lack of an audit process and contractual mandates for ensuring that

delivery notes are signed and dated limits ABC's ability to identify quickly any emerging delivery problems.

Pricing

ABC complies with state law concerning markup of alcoholic beverages. Of the five states that control wholesale distribution without controlling retail sales, Mississippi had prices similar to or lower than wholesale prices of beverages sampled by PEER.

ABC marks up its prices on alcoholic beverages in accordance with MISS. CODE ANN § 27-71-11 (1972).

Prior to 1985, the Alcoholic Beverage Commission (the State Tax Commission) had the authority to set the state's alcoholic beverage mark-up. Chapter 649, *Laws of 1966*, stated:

The Commission shall add to the cost of all alcoholic beverages such various mark-ups as in its discretion will be adequate to cover the cost of operation of the State wholesale liquor business, yield a reasonable profit, and be competitive with liquor prices in neighboring states.

This section was repealed in 1985.

In 1985, the Legislature passed MISS. CODE ANN. § 27-71-11 (1972), which states:

...the commission shall add to the cost of all alcoholic beverages a markup of twenty-seven and one-half percent (27.5%), inclusive of the three percent (3%) markup imposed by Section 27-71-7(2). The commission shall sell alcoholic beverages at uniform prices throughout the State.

ABC also adds excise tax and freight costs to the price of products. The freight costs are currently \$3.30 per case, but can go up or down periodically based on fuel costs for shipping contractors.

PEER sampled records of the prices of the ten top-selling wines and spirits and found that all products were marked up the required twenty-seven and one-half percent.

PEER sampled records regarding the prices of the ten top-selling wines and spirits and found that all products were marked up the required twenty-seven and one-half percent. ABC's price calculations are performed automatically through its computer software. The software program uses data that is entered by personnel in the ABC Purchasing Division. The data entered includes total delivered cost, bottle size, number of bottles per case, product type, and period price is to be in effect. ABC uses consistent practices for procurement and pricing of wholesale products, complying with MISS. CODE ANN. § 27-71-11 (1972).

Of the five states that control wholesale distribution without controlling retail sales, from FY 2001 through FY 2004 Mississippi had prices similar to or lower than wholesale prices for the products in the sample.

PEER used price records from the National Alcohol Beverage Control Association for Mississippi's ten top-selling spirits to compare Mississippi's wholesale prices to those of other states that control wholesale distribution.

PEER used price records from the National Alcohol Beverage Control Association for Mississippi's ten top-selling spirits to compare Mississippi's wholesale prices to those of other states that control wholesale distribution. PEER calculated a modal price, or the price that occurred most frequently, for each fiscal year for each of Mississippi's top-selling beverages that was available for sale in each of the five states. PEER calculated modal price because the price records were missing some data from other states. PEER then compared the modal price for each of Mississippi's top selling spirits that were sold in the other states between FY 2001 and FY 2004.

The price comparison only includes spirits because, of the five states that control wholesale distribution without controlling retail sales, only Mississippi and Wyoming control wholesale of wine. The rest only control wholesale of spirits. Therefore, PEER used Mississippi's ten top-selling spirits for comparison to other states.

PEER found that wholesale prices on Mississippi's top-selling spirits were similar in Mississippi, West Virginia, and Wyoming from FY 2001 through FY 2004. In FY 2001 Mississippi's prices were similar to those of Iowa, but by FY 2004 Iowa's prices were higher than Mississippi's for all but one beverage, with a difference of between \$.25 and \$2.50 per bottle, depending on the beverage. From FY 2001 through FY 2004, Mississippi had a lower wholesale price on all of Mississippi's top-selling spirits available in Michigan with a difference of between \$1.00 and \$7.00 per bottle, depending on the beverage.

Inventory Location Plan

ABC has a warehouse inventory location plan in place and complies materially with that plan.

The ABC's managers have a warehouse inventory plan detailing the location of beverage items in the warehouse. If items are not physically located as noted on the plan, the wrong beverage may be selected to fill an order.

PEER sampled 240 items in ABC's warehouse and found only four (1.6%) in the wrong location.

On August 27, 2004, PEER obtained a list of beverage items with bin and bay locations in the warehouse and selected a random sample of 240 items to determine whether items were actually located in designated areas. Only four of 240 items, or 1.6% of the items sampled, were in the wrong row, bin, or bay location.

Accounting Procedures

ABC has the accounts payable, accounts receivable, and revenue collection procedures in place with which to operate a successful wholesale distribution program.

In order to verify that ABC had a proper financial accounting control process for accounts payable, accounts receivable, and revenue collection, PEER conducted a limited purposive sample of ABC's accounting operations. The samples consisted of two sample days per month for FY 2004, with the exception of electronic transfers, since they began in April 2004.

PEER conducted a limited purposive sample of ABC's accounting operations and found no inconsistencies in any of the sampled transactions.

PEER sampled twenty-four accounts payable transactions, twenty-four accounts receivable transactions, twenty-four bank deposits, forty-eight cash receipt transactions, and ten electronic transfer transactions. PEER found no inconsistencies in any of the sampled transactions.

Management Deficiencies

While ABC has procedures and systems in place to operate a successful wholesale distribution program, the agency could take specific management actions in certain areas to assure accountability in warehouse operations.

ABC does not ensure that its distribution and sales policies are updated periodically, does not formally track loss or damage to warehouse inventory over time, does not have sufficient internal controls over its petty cash fund, has no formal training plan for employees, and does not conduct meaningful performance monitoring.

Although PEER did not find, through the evaluation methodologies utilized, that these management deficiencies have resulted in efficiencies or inconsistencies in operation, addressing these concerns would better assure accountability in future warehouse operations.

No Formal Tracking of Damaged or Lost Inventory Over Time

Prior to July 1, 2004, ABC management did not produce reports of warehouse damage loss over time. The reports that ABC now produces do not track the value of inventory lost.

ABC's Regulation Number 53 (promulgated August 5, 1999) addresses ABC's liability regarding damaged alcoholic beverages:

The ABC shall not be liable for any loss or injury to alcoholic beverages stored however caused unless such loss or injury resulted from failure of the ABC to exercise such care in regard to the stored

alcoholic beverages as a reasonably careful person would exercise under like circumstances and the ABC is not liable for damages which could not have been avoided by such case.

The ABC agrees it will purchase any bairment stock which disappears or is broken by ABC employees while stored in the ABC distribution center.

Thus ABC is financially responsible for loss or damage to stock within the distribution center.

ABC is financially responsible for loss or damage to stock within the distribution center.

Bottles remaining from cases partially damaged are placed in a special area where they are repackaged into full cases and sold to permittees like regular inventory. Loose bottles that cannot be repackaged into full cases, along with delisted beverages not retained by vendors, are auctioned, usually twice per year, to permittees. ABC sends a letter to permittees listing the items that will be available for auction and permittees may submit bids for those items.

PEER sought to review how ABC management monitors loss of stock resulting from damage. PEER requested copies of ABC's warehouse damage loss reports from 2000 to 2004 to determine the extent of inventory loss resulting from damages to bottles and cases. ABC staff reported that prior to July 1, 2004, they only tracked daily damage loss information and did not compute a historical analysis of damage loss. The daily damage loss reports presented to management contain the item numbers, quantity, and unit cost of each item damaged that day. The damage loss reports also include information regarding how much was actually damaged and what can be re-packaged for sale.

ABC Warehouse Operations Manager began collecting damage loss information over time on July 1, 2004, and provided PEER with a copy of ABC's damage report for July 1, 2004, through September 14, 2004. The report contained the daily number of cases that were damaged that went into ABC's warehouse damage room and the daily number of cases that were repackaged and placed back on the warehouse floor, as well as the total number of cases shipped during the week. The damage loss report showed .157% of cases lost through damage, which was not a material number of cases. However, the damage loss report did not contain information on specific beverage items damaged by product name, item number, or value.

Without more specific information in its damage loss reports collected on a long-term basis, ABC's management cannot easily monitor patterns that may arise.

Without more specific information in its damage loss reports (i.e., item number, item name, and price) collected over a long-term basis, ABC management has limited information on potential problems arising from inventory damage and cannot easily monitor patterns that may arise. Also, ABC management lacks information concerning what items are damaged most frequently over time, the long-term dollar amount of inventory loss, and what factors may be contributing to inventory losses.

ABC staff report that they can produce reports of damage loss over time using the JBA computer reporting system, including the

value of damaged inventory, but they have not produced such reports for management purposes.

Improper Use of One Petty Cash Fund

ABC has not operated its warehouse petty cash fund in compliance with basic internal control principles.

ABC maintains two imprest (petty cash) funds to purchase goods and services for its warehouse and enforcement operations: the *purchase and evidence fund* (used primarily to pay informants and make undercover purchases) and the *warehouse petty cash fund* (used primarily to purchase lunches for MDOC inmates who work at the warehouse and for other small purchases such as postage).

While ABC operates its purchase and evidence fund in accordance with basic internal control principles, that is not the case with the warehouse petty cash fund, as discussed below.

- *ABC has not required division of duties in administering the fund.* ABC has given the Warehouse Operations Manager complete control over the fund's assets and expenditures except for preparation of the reimbursement requests. Therefore, he has control of on-hand cash balances, monthly expenditure receipts, internal fund audits, and fund reimbursement checks made out to him for cashing.

Even in preparing and processing the fund reimbursement requests, the Accounting Division does not verify the reported on-hand cash amount with a documented cash count or maintain duplicate copies of the expenditure receipts during the month to compare with the reimbursement request. The division merely organizes the receipts and prepares the reimbursement request for processing.

Lack of division of duties regarding a cash fund without a quality control or assurance check by other employees could increase opportunity for errors or fraud.

- *ABC has not established internal control procedures to decrease the probability of loss of cash.* For example:
 - The Warehouse Operations Manager allows two other individuals to have physical access to the stored cash. One of these individuals makes approximately ninety-nine percent of the purchases from the fund.
 - ABC staff members do not store the cash in a properly locked location.
 - When ABC staff members use cash from the fund, they do not properly document and account for the amount removed.

As a result, ABC cannot ensure that these funds are properly safeguarded.

ABC's use of the warehouse petty cash fund for large reimbursements is inappropriate, given the purpose of such funds as stated in state purchasing regulations.

According to Section 1.10.30 of the *MAPP Manual*, the purpose of an imprest (petty cash) fund is:

. . . to facilitate direct vendor payments of a minor amount. Imprest funds in some agencies may be used as a small change fund. It is requested that imprest funds be sufficient to meet minor expenditures of not more than two months.

Thus state regulations intend that petty cash funds be used for small expenditures whose size does not justify sending them through the state purchasing system.

State regulations intend that petty cash funds be used for small expenditures whose size does not justify sending them through the state purchasing system.

ABC maintains approximately \$1,000 in its warehouse petty cash fund. From December 31, 2003, through August 9, 2004, ABC expended approximately \$7,817 in total petty cash expenditures from this fund, 91% of which was for inmate meals. This amount of recurring expenditures is not a minor expense and thus exceeds the purpose of petty cash funds as stated in the *MAPP Manual*.

By handling these expenditures through a petty cash fund, the agency loses the greater degree of accountability available through the state purchasing system.

No Formal Training Plan for Employees

The ABC has not developed a formal training plan to ensure that all employees are adequately trained in the knowledge, skills, and abilities necessary to perform their job duties successfully.

Employee training develops, through planned activities, the knowledge, skills, and abilities that employees need to help them fulfill their job responsibilities.

According to the State Tax Commission's Director of Human Resources, the agency has no written policy or formal training program for ABC's employees. The Director of Human Resources said there are basic supervisory courses available through the Mississippi State Personnel Board for first-level managers. The commission's supervisors and managers can participate in the Certified Public Manager program. In 2003, the State Tax Commission started a new management development program for first-level and above managers. The Director of Human Resources said that ABC employees may request training.

According to the ABC's training records for the accounting, purchasing, and warehouse divisions for FY 2000 through FY 2004, of the current ninety-one employees, twenty (22%) had taken one or more training courses. Seventy-one (78%) of ABC employees had not taken a training course. For those employees

Without a training plan tailored to each employee's or job title's training needs, the lack of training for some employees cannot be explained or justified.

who had training, the number of hours of training per individual ranged from three to seventy-six hours.

ABC did not provide training to its warehouse clerks during the period of review. Of the fifty-eight employees currently employed in the warehouse clerk positions, only one had taken training courses. ABC provides training to some employees and not to others. This discrepancy in training has occurred even among staff with the same job title. While some employees may have different training needs than others, without a training plan tailored to each employee's or job title's training needs, the lack of training for some employees cannot be explained or justified.

ABC management reported that while they do not have formal training, they do conduct informal cross-training on other job functions. ABC does not have a written plan for cross-training and does not document who has been cross-trained on which job functions.

Lack of Meaningful Performance Monitoring

ABC does not use the resources of its management information to monitor systematically the performance of the agency's distribution and sales efforts.

Currently ABC has an internal management information system for wholesale operations (i.e., JBA) that collects comprehensive financial, purchasing, inventory, order processing, and transport planning information. This management information system allows ABC's management staff to produce reports regarding almost every aspect of the ABC's wholesale operation.

In addition to collecting information internally through the JBA system, ABC provides data to the National Alcohol Beverage Control Association on a daily basis. ABC uses this data to make decisions concerning inspection, stock on hand, comparisons and estimates, freight in/out, permittees and expiration dates, reviewing overages/shortages, and case sales. Also, ABC's standard operating procedures require that weekly bailment inventory restocking reports, monthly active permit lists, and sales quota reports be computer-generated.

The program performance measures tracked by ABC and included in its budget request are the number of alcoholic beverage accounts, the number of cases sold, and the revenue generated. The current budget request also includes program outcome information on the number of investigations for alcoholic beverage law violations and the number of confiscations of illegal alcoholic beverages.

According to ABC's staff, ABC's management uses the system's data for reporting on the performance standards required by the Legislative Budget Office for the annual budget request, for data sent to NABCA, and for nightly inventory reports. ABC does not use its management information system as a tool to measure performance improvements and to evaluate agency operations—for example, by measuring baseline data such as

number of cases sold and total dollar amount of revenue generated and comparing percentage increases or decreases each year. Another example of an area in which ABC could use the information is in tracking revenue generated. Instead of reporting only the dollar figure of revenue generated, ABC could report the ratio between revenue generated and operating expenses. That ratio would tell management about the efficiency of operations and would establish a baseline for future comparison. In addition, ABC could track the percentage of orders processed that are delivered the next day as required.

By not using the management information system to its full capabilities, ABC's management may be overlooking valuable information that could help the agency operate at a higher performance level.

Currently, ABC is also not tracking the percentage of orders taken that are out of stock and are thus not delivered to permittees. As shown in Exhibit 3 on page 8, in some cases the automated system deletes out of stock orders from the system without tracking the number of orders that are out-of-stock. ABC staff reported that they plan to modify the system so that out-of-stock orders are not automatically deleted. This would allow management to track the percentage of orders placed that are not delivered because they are out-of-stock.

By not using the management information system to its full capabilities, ABC management may be overlooking valuable information that could help the agency operate at a higher performance level. Also, by not having a baseline and measures that aim for an increase or improvement over previous years, employees may become complacent and lack motivation for improvement.

No Periodic Updates of Policies and Procedures

The Office of Alcoholic Beverage Control lacks a systematic review process for updating policy and procedure manuals. Thus ABC does not ensure that its policies and procedures reflect current or best practices or that employees are aware of those current or best practices.

The lack of a requirement to review periodically the written policies and procedures for each division creates the risk of ordering errors, inventory placement errors, or shipping errors.

In addition to the *State Employee Handbook*, ABC distributes policy and procedure manuals to employees in each division within ABC (e.g., Processing, Purchasing, Accounting, Warehousing) when they are hired. However, ABC division directors do not have a system or policy to ensure periodic review of policies and procedures. ABC's division directors do not document frequency of review or revisions to policy and procedure manuals. Some of ABC's policy and procedure manuals were last revised in 1994. Other manuals are not dated. According to ABC staff, should changes occur within a division's policy and procedures, it is up to the division director to see that the new policy or procedure is revised and included in the division's policy and procedure manual. ABC management does not require each division or bureau director to review manuals periodically and document revisions.

ABC lacks formal, written policies and/or procedures or needs an update of policies and/or procedures regarding discounting of products electronic deposits, and warehousing and inventory.

The following paragraphs contain brief discussions of the policy/procedure needs in each of these areas.

- *Discounting of products:* ABC discounts products that it has seized or purchased (e.g., if the case order is damaged in bailment, if a vendor does not remove a product that has been delisted, or if a special order is not purchased by the permittee that placed the order). ABC first lists the item at full mark-up, then discounts the item if not purchased. ABC discounted thirty-eight products in FY 2004, most at 20% to 60% below their usual wholesale prices.

ABC does not have written policies and procedures for discounting inventory. No law or State Tax Commission Policy specifically gives ABC the authority to discount products below the statutorily required 27.5% mark-up. Because ABC has no clearly defined written method for discounting products, the agency could be inconsistent in its discounting efforts and possibly treat some purchasers unfairly.

- *Electronic deposits:* ABC began using electronic transactions in April 2004. Daily deposits ranging from \$100,000 to \$1,000,000 occur via electronic transactions on any given day of operation within ABC, depending on the number of orders taken. According to the ABC's Accounting Director, the agency trains each accounting employee on how to handle electronic transactions.

At the time of PEER's fieldwork for this project, ABC had not implemented a written policy addressing electronic transfers. The lack of a written policy for handling electronic transfers could result in employees inadvertently mishandling funds.

Subsequent to PEER's fieldwork, on September 7, 2004, ABC revised its accounting policies and procedures to address the handling of electronic transactions. The revised policy and procedures implemented by the ABC Accounting Division are consistent with proper internal controls.

- *Warehousing and inventory:* At the time of PEER's review, ABC had an old warehouse and inventory policy and procedure manual in place that did not support the new inventory system installed in October 2003. ABC is in the process of developing a manual for the new inventory system.

While PEER did not observe such inconsistencies, the lack of a requirement to review periodically the written policies and procedures for each division creates the risk of future inconsistencies in operation. Such inconsistencies could include data errors, mishandling of money, order placement errors, inventory placement errors, or shipping errors.

Enforcement of Alcoholic Beverage Control Laws

The ABC's Enforcement Bureau has a proactive enforcement system with the intelligence, investigative, and permitting functions in place to enforce the state's alcoholic beverage control laws.

As noted on page 10, state law empowers the ABC Enforcement Bureau to enforce alcoholic beverage control laws and selected laws governing the control of light wine and beer and the establishments where they are served. To accomplish its responsibilities, the ABC Enforcement Bureau conducts intelligence activities to determine the need for an investigation, investigates possible violations, and conducts undercover operations to confirm illegal actions. The Enforcement Bureau also conducts permitting investigations of applicants.

Tools the Bureau Uses in Enforcement

Organization, Staffing, and Training

The ABC's five enforcement districts replaced its previous three enforcement regions, providing a smaller supervisory area and reduced span of control for agents in charge of enforcement.

The ABC Enforcement Bureau has established five enforcement districts. These districts replaced the bureau's previous three enforcement regions, providing a smaller supervisory area and reduced span of control for agents in charge of enforcement. These districts contain a district headquarters location and at least one other "post of duty" location (except District V on the Gulf Coast, which has only one). (See Exhibit 1, page 4.) In most cases, the ABC Enforcement district offices are co-located with the State Tax Commission district offices.

Each district has an agent-in-charge and at least two field agents. The Chief of Enforcement bases enforcement staff assignments on factors such as current workload, anticipated growth or decline in workload, and number of wet and dry counties in the district. The chief and the agents-in-charge make periodic adjustments to districts' and agents' workloads as needed.

The ABC's Enforcement Bureau has a full-time training officer who manages the training program, meets with permittees, and maintains agents' training records. ABC conducts an annual mandatory in-service training seminar during which enforcement managers and agents, who are also certified police officers, qualify with their firearms in accordance with state standards and receive training regarding alcoholic beverage laws and regulations, other related laws (e.g., drugs or gambling), and leadership skills. They also attend training at facilities such as the Mississippi Law Enforcement Officer Training Academy, Federal Bureau of Investigation, Regional Counter-Drug Training Academy, and the U.S. Attorney's Office.

Management Information System

The SABER System provides ABC's managers with real-time capability to evaluate statewide enforcement operations and their cost.

On January 1, 2003, the ABC Enforcement Bureau implemented the State Alcohol Beverage Enforcement Record System (SABER) to better document and manage its field activities in a uniform and standardized manner. This browser-based, internet-ready computerized recordkeeping system is used to support the day-to-day division operations through:

- standard reports (e.g., daily agent activities, equipment and weapon inventories, results of permit inspections);
- ad hoc reporting capability for agents-in-charge, the ABC Enforcement Chief, and his deputy;
- capability to collect and display digital pictures or scanned documents such as receipts or case evidence; and,
- electronic routing or reports for multi-level manager review and approval.

The SABER System provides managers with real-time capability to evaluate statewide enforcement operations and their field cost. The system can be used to manage individual agents or district offices. For example, ABC enforcement managers can use system reports with cost, time, and workload data for any period since January 1, 2003, to determine vehicle operations cost of an individual agent or enforcement district; the status of open investigations; or the number of completed inspections by an agent or district.

Financial Management Practices

PEER noted that the ABC's Chief of Enforcement has implemented the following financial management practices:

- Bureau managers maintain internal controls over purchases made with clothing allowance cards, from purchase and evidence funds, and for major vehicle repairs by collecting and analyzing expenditure data through the SABER System.
- Bureau managers review Fuelman and calling card billings to identify questionable mileage reimbursements, personal calls, or other inappropriate charges.
- Bureau managers review cell phone bills to identify agents who exceed their number of calling plan minutes. The bureau's policy requires that agents who exceed their calling plan minutes must personally pay the additional costs.
- Bureau managers randomly sample and verify agents' Daily Activity Reports.

Summary of Recent Enforcement Activities

Investigations

PEER reviewed the Enforcement Bureau's investigative actions for January 1, 2003, through September 20, 2004. During that period, ABC's enforcement agents filed 1,421 charges. Of those charges filed, 1,269 (89%) resulted in felony or misdemeanor convictions. The courts imposed fines totaling approximately \$269,894 on those individuals found guilty.

Permittee Inspections and Investigations

From January 1, 2003, through September 20, 2004, ABC's enforcement agents conducted 2,743 permitting inspections or investigations. The inspections included 1,711 renewal inspections, while the investigations included 212 new permits, 140 transfer permits, 616 manager applications, and 64 others (e.g., floor plan reviews or need for current bond). The investigations, along with some inspections, resulted in the Enforcement Bureau bringing regulatory violation charges against 105 permittees before the State Tax Commission. The commission took administrative action against sixty-six permittees that resulted in \$4,746 in fines.

Administrative Actions

From FY 2003 through August 20, 2004, the State Tax Commission took administrative action against ninety-one permittees who had charges filed against them by ABC's Enforcement Bureau. The commission used temporary permit suspensions as its primary disciplinary tool and collected \$20,800 in fines.

Deficiencies in the State Tax Commission's Oversight of ABC

The Tax Commission is ultimately responsible for ABC's implementation of the state's alcoholic beverage control policy.

As noted previously in this report, because the Office of Alcoholic Beverage Control is part of the State Tax Commission, the STC is ultimately responsible for ABC's implementation of the state's alcoholic beverage control policy. During the course of PEER's management review, the Committee noted three areas of deficiency regarding the STC's oversight of ABC:

- lack of compliance with internal audit requirements set in state law (previously discussed on pages 19 through 21);
- no assurance that alcoholic beverage permittees continue to meet requirements of state law prior to their permits being renewed; and,

- inadequate management of state-owned administrative vehicles.

The following sections discuss the latter two issues.

Permit Renewal

The State Tax Commission does not ensure that permittees continue to meet initial qualifications set forth in MISS. CODE ANN. Section 67-1-57 (a) (1972) as a condition of annual alcoholic beverage permit renewal.

State law sets permit requirements, the State Tax Commission sets policies and regulations for permitting and approves permits, and the ABC's Enforcement Bureau conducts permitting activities.

MISS. CODE ANN. Section 67-1-37 (h) (1972) empowers the State Tax Commission to control the manufacture, importation, transportation, distribution, and sale of alcoholic beverages, including native wines, whether intended for beverage or nonbeverage use. So that the STC can fulfill its responsibilities, MISS. CODE ANN. Section 67-1-51 (1972) empowers the State Tax Commission to issue permits and regulate individuals or partnerships that engage in the above-listed activities.

Thus the STC sets regulations as to how, when, and under what circumstances alcoholic beverage permits will be issued or renewed and approves those permits. In conducting permitting activities, the ABC Enforcement Bureau implements the permitting regulations that STC adopts.

As of August 12, 2004, Mississippi had 1,582 alcoholic beverage permittees.

CODE Section 67-1-51 also establishes nine categories of alcoholic beverage permits that an individual, partnership, or corporation may be issued and must possess prior to beginning an alcoholic beverage operation in the state. Appendix B, page 68, presents a short definition of each type of permit. As of August 12, 2004, Mississippi had 1,582 alcoholic beverage permittees.

MISS. CODE ANN. Section 67-1-57 (a) (1972) sets forth requirements for alcoholic beverage permit applicants. The law requires that to receive a permit, an individual must:

- be of "good moral character;"
- be a "peaceable, law-abiding" citizen;
- be at least twenty-one years old; and,
- not have a federal or state felony conviction.

The law also requires that a proposed applicant for a transfer of a package retailer's permit be a state resident. This additional qualification applies to an individual, each member of a partnership, or the designated manager of the corporation that seeks the permit.

STC does not ensure that permittees remain qualified prior to renewal of their alcoholic beverage permits.

When establishments initially apply for alcoholic beverage permits, the ABC conducts permitting investigations as required by STC regulations. When individuals apply for permits, the bureau conducts criminal history checks on those individuals and requires that they pay for and submit to fingerprint checks.

STC policy does not require ABC to conduct subsequent criminal history checks or fingerprint checks of individuals applying for permit renewal.

However, the STC does not require, prior to permit renewal, that the ABC determine whether permittees *continue* to meet all qualifications. STC policy does not require ABC to conduct subsequent criminal history checks or fingerprint checks of individuals applying for permit renewal.

MISS. CODE ANN. Section 67-1-63 (1972) states:

*Any permittee may renew his permit at the expiration thereof for an additional term of one (1) year, **provided he is then qualified to receive a permit** and the premises for which the renewal is sought are suitable for such purposes.*

[PEER emphasis added]

Because the STC has not established a policy to require reverification of qualifications, it cannot ensure that renewal permittees meet all requirements of law.

Thus state law requires STC to ensure that a permittee remain qualified to hold an alcoholic beverage permit prior to that permit being renewed. Because the STC has not established a policy to require reverification of qualifications, the STC cannot ensure that renewal permittees meet all requirements of law.

Circumstances of individuals and establishments may change quickly in a business environment. Because the State Tax Commission does not require ABC to conduct a criminal history or fingerprint check prior to permit renewal, the state may allow unqualified permittees to sell alcoholic beverages. This could increase risks to the public (e.g., sale of alcoholic beverages to minors, illegal gambling or drugs).

Vehicle Management

As of August 4, 2004, the State Tax Commission had fifty state-owned vehicles.

As part of its review, PEER conducted a management and use evaluation of state vehicles under ABC's control. PEER determined that all vehicles assigned to ABC are a part of the State Tax Commission's vehicle inventory, with management and use governed by the State Tax Commission's guidelines.

As of August 4, 2004, the State Tax Commission had fifty state-owned vehicles, including thirty-nine assigned to the Office of Alcoholic Beverage Control's Enforcement Bureau. Seven vehicles were awaiting disposal action.

The State Tax Commission does not ensure that the ABC makes the most efficient and effective use of state-owned vehicles assigned to its administrative staff. Also, the ABC has not complied with some state laws regarding state-owned vehicles and has not properly addressed their taxability.

The ABC has a documented vehicle management program for its enforcement vehicles, but not for its administrative vehicles.

The STC does not consider its assigned vehicles, including the ABC vehicles, as a system, or unit, and has not actively managed the use of its vehicle resources.

For vehicles assigned to ABC's enforcement agents, the STC has an organized, documented vehicle management program. The SABER system collects and tracks data on daily mileage and repair costs for each vehicle. However, the system does not capture Fuelman costs or provide a total vehicle operational cost for each vehicle. Also, STC does not have written criteria for decisions regarding vehicle disposal.

For vehicles assigned to the ABC Director and Warehouse Operations Manager, the State Tax Commission does not have a vehicle management program. For these administrative vehicles, STC has no:

- written operational policies or procedures;
- requirement for driver documentation or management reporting of vehicle use, mileage, and operating costs (except for the weekly Fuelman bills and the commission's annual report to the Office of the State Auditor);
- management analysis of vehicle use, mileage, and operating costs in the Fuelman reports;
- periodic needs analysis of fleet size and vehicle type; and,
- independent performance audit to measure the effectiveness and efficiency of vehicle use.

The STC does not consider its assigned vehicles, including the ABC vehicles, as a system, or unit, and has not actively managed the use of its vehicle resources.

One way to ensure efficient and effective use of a state-owned vehicle is for an agency to establish a fleet management program. As noted in the PEER Committee's 1993 report *A Performance Audit of State-Owned Vehicle Management*, the objectives of a fleet management program would include:

- ensuring that the organization operates its vehicle fleet with minimum input of public resources (efficiency);
- delivering the necessary transportation services at the required performance levels with the most appropriate method (effectiveness);
- achieving prudent management goals in vehicle acquisition, inventory, use and control, maintenance, and disposal; and,
- ensuring an annual independent performance audit of the program in order to measure its effectiveness and efficiency.

An effective fleet management program allows an agency the tools with which to monitor and control vehicle use and

expenditures and ensure that preventive maintenance is provided in a timely manner to extend the life of the vehicles.

The ABC has not complied with some state laws regarding the state-owned vehicle assigned to the ABC Director.

Because the ABC Director uses her unmarked state vehicle for purposes other than those approved by the Governor, her use of the state-owned vehicle does not comply with MISS. CODE ANN. Section 25-1-87 (1972).

The ABC Director uses her vehicle for administrative purposes and commuting, rather than for its approved use of law enforcement.

All agencies using state-owned vehicles must comply with state laws regarding marking of those vehicles. MISS. CODE ANN. Section 25-1-87 (1972) allows certain state agencies to operate unmarked vehicles if they are needed for confidential or undercover investigations and if the agencies receive written permission from the Governor. (See Appendix D, page 73, for the entire text of Section 25-1-87.)

In 2000, the STC requested and received permission from the Governor to operate one unmarked vehicle exclusively for law enforcement by the employees of the ABC. Governor Musgrove approved the exception based on STC's justification that the car would be used for confidential or undercover investigations.

However, the State Tax Commission has assigned the ABC Director this unmarked Ford Crown Victoria even though she has no law enforcement duties. She uses this vehicle for administrative purposes and for commuting from home to work five days per week. Therefore, ABC does not operate this unmarked vehicle in compliance with state law. (See Appendix D.)

The ABC Director and Warehouse Operations Manager use state-owned vehicles for commuting, a practice no longer allowed by state law.

The law allowing the STC's administrative personnel to commute in state vehicles was repealed in 2001.

MISS. CODE ANN. Section 25-1-85 (1972), enacted during the 2000 Regular Session, authorized thirty law enforcement vehicles and eight administrative vehicles to the State Tax Commission with the authority to allow:

. . . four (4) vehicles to be kept for use by administrative personnel whose principal duties are performed at State Tax Commission offices in Hinds County to commute to and from the residence of said personnel to the office at which such duties are regularly performed. . . .

However, this law was repealed in 2001.

The STC has continued to allow the ABC Director and the ABC Warehouse Operations Manager to commute in state vehicles.

Although MISS. CODE ANN. Section 25-1-85 (1972) allowing commuting authority for officials of the STC was repealed, the STC has continued to allow the ABC Director and the ABC Warehouse Operations Manager to commute in state vehicles. To justify this action, STC managers state that these employees must be “on call” to respond to any commission emergency requiring them to travel after normal business hours, on weekends, or on holidays. However, the ABC has not conducted a documented analysis of these individuals’ need for a state vehicle after normal duty hours or a breakeven cost analysis of using a state vehicle versus paying travel mileage for responding to agency emergencies.

Because the STC has continued to allow some of its officials to commute in state-owned vehicles even though the statutory exception for these officials was repealed, the ABC may be in violation of another state law that prohibits personal use of state-owned vehicles. According to MISS. CODE ANN. Section 25-1-79 (1972):

*It shall be unlawful for any officer, employee, or other person whatsoever to use or permit or authorize the use of any automobile or any other motor vehicle owned by the State of Mississippi or any department, agency, or institution thereof for any purpose other than upon the **official business of the State of Mississippi or any agency, department, or institution thereof.** [PEER emphasis added]*

The State Tax Commission has not properly addressed the taxability of the vehicles provided to its ABC Director or ABC Warehouse Operations Manager. As a result, based on PEER’s interpretation of the Internal Revenue Code and regulations, these individuals could be liable for unpaid taxes on unreported income. Also, the STC and these individuals could be subject to interest and penalties.

Based on PEER’s interpretation of Internal Revenue Code provisions and regulations, the vehicles that the STC provides to these individuals do not qualify as non-personal use vehicles.

As noted previously, the ABC Director and ABC Warehouse Operations Manager have received the benefit of using state-owned non-enforcement vehicles. These vehicles are:

ABC Director	2000 Ford Crown Victoria
ABC Warehouse Operations Manager	1997 Ford F-250

Under Internal Revenue Service regulations, a vehicle must be a “qualified non-personal use vehicle” in order for its use to be excluded from taxation. Qualified non-personal use vehicles are

vehicles that are not likely to be used more than minimally for personal purposes because of their design. Examples of qualified non-personal use vehicles include clearly marked police and fire vehicles, ambulances, and school buses.

Because these vehicles are used for personal commuting and are not qualified non-personal use vehicles, the employees have received a taxable fringe benefit, according to PEER's interpretation of IRS requirements.

If not a qualified non-personal use vehicle, the fair market value of the vehicle is taxable. Appendix E, page 75, discusses the methods discussed in Internal Revenue Service Publication 15-B for determining the amount taxable for employer-provided vehicles.

Because these vehicles are used for personal commuting and are not qualified non-personal use vehicles, the employees have received a taxable fringe benefit, according to PEER's interpretation of IRS requirements.

Because PEER believes that the value of the vehicles the STC has provided to these individuals is taxable and the STC has not reported this amount as income or withheld taxes on this amount, these individuals could be liable for unpaid taxes on unreported income and the STC and these individuals could be subject to interest and penalties.

PEER believes that the vehicles that the STC provides to the ABC Director and ABC Warehouse Operations Manager do not meet requirements of the Internal Revenue Service as being excludable from taxable income. The STC has not treated the use of these vehicles as taxable income and therefore has not withheld taxes from their compensation on these amounts. Thus the STC has exposed itself and these two individuals to possible tax liability.

The Internal Revenue Service could determine that the STC is subject to interest and penalties for not withholding and remitting taxes on the agency-provided vehicles on a timely basis. The IRS could also find these individuals liable for taxes on the value of the agency-provided vehicles for the current year or previous years, as well as interest and penalties.

Due to the unknown amount of taxes involved, the varying annual interest rates, and the complicated methods used by the Internal Revenue Service for calculating penalties, PEER cannot venture a reasonable estimate of the amount of interest and penalties that could be assessed by the IRS. (See the three potential methods for determining the amount taxable for employer-provided vehicles, Appendix E, page 75.)

In the case of the ABC Director's commission-owned vehicle, the cents per mile rule would not be applicable in the determination of the amount taxable because the value of the vehicle exceeds the maximum automobile value ceiling of \$15,400 (for the 2000 vehicle) established by the IRS in order for the cents per mile rule to be utilized. Therefore, the taxable value of the vehicle would be determined by either the commuting rule or the annual lease value rule.

In the case of the ABC Warehouse Operations Manager, the value of his 1997 vehicle did not exceed the IRS value ceiling, but the

driver of this vehicle does not maintain any travel logs relating to the use of the vehicle. Therefore, the taxable value of the vehicle would be determined by either the cents per mile rule, the commuting rule, or the annual lease value rule.

PEER could not calculate the taxable amount of these vehicles because the STC has not maintained the necessary records with which to calculate the taxable value.

PEER could not calculate the taxable amount of these individuals' vehicles under either of these rules because the STC has not maintained the necessary records with which to calculate the taxable value. Use of the commuting rule would require maintaining a log of the number of these individuals' one-way commutes and use of the annual lease value rule would require maintaining travel logs relating to business use of the vehicle. The commission has not maintained either type of record.

Should the Internal Revenue Service wish to pursue this matter, it would make the determination of how to calculate the taxable amount in the absence of the necessary records.

In addition to being liable for federal taxes, the STC is liable for state taxes because it did not withhold such from these employees' paychecks. The STC is responsible for ensuring compliance with *all* state tax laws, including those applying to its own employees.

PEER found that the management and use deficiencies of the two ABC vehicles also apply to the nine administrative vehicles of the State Tax Commission, since they were used in a similar manner.

While the PEER Committee evaluated the management and use of the ABC's vehicles, it found that the State Tax Commission had nine administrative vehicles that were managed in a similar manner to the two administrative vehicles of the ABC. These nine vehicles included a 2003 Dodge Durango for the Commissioner's use and a 2004 Ford Crown Victoria for the Deputy Commissioner's use. Thus, the management and operational deficiencies discussed on pages 38 through 43 apply to these nine vehicles.

The commuting and taxability issues also apply to the vehicles of the Commissioner and Deputy Commissioner. For example, in June 2003 and April 2004, the STC purchased a 2003 Dodge Durango for the Commissioner's use and a 2004 Ford Crown Victoria for the Deputy Commissioner's use. Using these two individuals' actual FY 2003 mileage to project estimated FY 2004 mileage, PEER determined that the agency could have saved \$56,513 in FY 2004 if it had reimbursed these individuals for the use of their private vehicles rather than purchasing the above-described vehicles. This unnecessary cost consisted of \$15,526 in operating costs and \$40,987 for two new vehicle procurements that were not justified by the individuals actual driving miles that did not reach the breakeven mileage point for providing and operating state vehicles. (PEER could not determine what portion of the FY 2003 mileage was for official business and what portion was for commuting, since these individuals were not required to maintain written records of their daily travel.)

PEER would note that the Commissioner, who was appointed effective July 1, 2004, has not yet been subject to a tax liability year. He also states that he is maintaining the necessary vehicle travel records for the 2003 Durango and will have the use value of the vehicle reported as income for federal and state income tax purposes.

Recommendations: Part One

ABC's Wholesale Operations

Ordering and Shipping Process

1. ABC should formally reactivate its advisory group, made up of representatives of organizations such as the Mississippi Restaurant Association and Package Store Association, to receive input regarding its service to permittees.

Warehouse Security

2. Using existing resources, ABC should conduct a needs assessment and create a detailed warehouse security plan. ABC should include in the needs assessment a review of whether the costs would outweigh the benefits of operating and monitoring internal security cameras. A warehouse security plan that specifically lists the type of equipment needed, cost per equipment item, and the cost of additional personnel, if necessary, should be included in any future funding requests to the Legislature.

Contract Management

3. ABC should seek to amend its contract with its distribution contractors (i.e., Shippers Express and M&J Transport) and should require in future contracts that both shipping companies obtain signatures and dates from retailers confirming the date of receipt of goods on the bill of lading and/or delivery notes. Also, ABC should periodically audit these dated delivery notes to ensure that shipping contractors are fulfilling their contractual obligation of next-business-day shipping.

Updating Policies and Procedures

4. ABC management should set a periodic policy review cycle and require all division directors to update policy and procedure manuals and log all changes and reviews pertaining to their respective divisions and present these revisions for ABC management approval. Division

directors should also update policies as any changes in process occur.

5. ABC should develop a written, task-based inventory procedures manual to implement ABC's new warehousing and distribution system implemented in 2003.

Damage Loss Reporting

6. ABC management should require ABC's Warehouse Operations Manager to prepare a damage loss report which details the number of damaged and repackaged cases by item number, item name, and value. The report should be produced on a weekly, monthly, quarterly, and annual basis and should be used to address security and management issues.

Warehouse Petty Cash Fund

7. ABC should cease the use of its Warehouse Petty Cash Fund as presently operated and then choose one of the following options:

Option A

Obtain a procurement card and make all small purchases through the state purchasing system, using purchase orders.

or;

Option B

Make larger, recurring purchases through the state purchasing system and pay for such purchases through accounts payable. Retain the petty cash fund for the purchase of small items such as inspection stickers and postage, but reduce the amount maintained in the account from \$1,000 to an amount sufficient to meet minor expenditures of not more than two months (suggested amount: \$250). Operate the account as a checking account, and authorize two individuals to make purchases on the account using a debit card. Develop a formal, written policy for managing the fund.

Regardless of the option chosen, ABC should make all purchases in accordance with the *MAPP Manual*.

8. Should ABC choose Option B, the agency should improve its internal controls over petty cash, including arranging for signatures of two staff members on the petty cash account with a third party to administer it, maintain the account balance, and reconcile monthly bank statements against receipts and expenses.

Training

9. Using existing resources, ABC should analyze training needs of ABC employees, addressing the training needs for each division or department and each job title. According to the training needs identified, ABC should make training available to all employees with the same job title. ABC should include cross-training in its analysis and document all cross training of employees. If training will not be provided internally, all employees should be made aware of the procedures to request training.

Performance Monitoring

10. The Office of Alcoholic Beverage Control should create and monitor performance measures that reflect program improvement from year to year, showing progress toward achieving the goals of the agency, instead of performance measures that count transactions performed or dollars collected. Examples of such desired performance measures would be: X% decrease in damage/loss rate, X% decrease in overages/shortages at inventory, X% decrease in orders taken that cannot be delivered because they are out-of-stock, X% increase in revenue transferred to the general fund relative to operating expenses, or X% increase in orders completed and delivered the next business day.

State Tax Commission

Internal Audit

11. The State Tax Commission should comply with the requirements of MISS. CODE ANN. Section 25-65-1 et seq. (1972). If and when the agency fills its internal audit position, that individual's job duties should include ensuring that financial, compliance, electronic data processing, and operational and efficiency audits of the ABC program and other Tax Commission programs are conducted as authorized in MISS. CODE ANN. Section 25-65-13 (1972).

Permit Renewal

12. The State Tax Commission should revise its permit renewal application to obtain fingerprint cards from the permit renewal applicant in order to conduct a criminal history check for permit renewals to ensure that permittees continue to meet the initial permitting qualifications in MISS. CODE ANN. Section 67-1-57 (a) (1972). The State Tax Commission should determine whether the applicant's filing fee, set in MISS. CODE ANN.

Section 27-71-5 (1972), is sufficient to cover the costs of the applicant's permit renewal investigation. If it is not, the STC should seek a statutory amendment for the necessary amount.

Vehicle Management

13. The State Tax Commission should develop and implement a vehicle fleet management program to organize and operate its vehicles for official business while providing the management information necessary to operate the vehicles efficiently and effectively and in compliance with state and federal laws. Appendix F, page 76, contains a discussion of critical components of a model vehicle management system.
14. The State Tax Commission should perform a documented needs analysis with a breakeven cost analysis for the four individuals who commute in state vehicles. These analyses should determine if the STC Commissioner, STC Deputy Commissioner, ABC Director, and ABC Warehouse Operations Manager have a compelling need for:
 - the assignment of a state vehicle on a seven-day per week, twenty-four hour basis; and,
 - the most cost efficient method for the state to reimburse these individuals for business trips after normal duty hours (i.e., to provide a state vehicle or to pay travel mileage).
15. Using existing resources, the State Tax Commission should ensure that the SABER System includes collection of the Fuelman operational costs in weekly reports in order to provide a total vehicle operational cost for its vehicles. This information could be used to conduct periodic performance audits to measure the effectiveness and efficiency of the system.
16. The State Tax Commission should comply with MISS. CODE ANN. Section 25-1-87 (1972) and use the two unmarked vehicles exclusively for the gubernatorially approved function of law enforcement.
17. When the State Tax Commission has to purchase additional passenger automobiles for administrative use, it should purchase mid-size, fuel-efficient five-passenger automobiles.

Discounting Policies

18. Using existing resources, the State Tax Commission should develop written policies and procedures that specifically detail the process of discounting ABC

inventory, the including individual or individuals who have authority to discount products.

Legislative Recommendation

19. The Legislature should amend MISS. CODE ANN. §27-71-5 (g) to define wine for on-premises retailers as having *more than five percent alcohol by weight*, but not more than twenty-one percent alcohol by weight. MISS. CODE ANN. §27-71-5 (g) currently defines wine for on-premises retailers as *more than four percent alcohol by volume*, but not more than twenty-one percent alcohol by volume. The proposed amendment would make the definition of wine in §27-71-5 consistent with MISS. CODE ANN. §67-1-5 that defines wine of *more than five percent alcohol by weight* as an alcoholic beverage.

Part Two: Policy Analysis of Options to Privatize Mississippi's Alcoholic Beverage Control Program

Considering the state's current policy environment, PEER concludes that the only feasible option of those considered for privatization of alcoholic beverage control would be to contract out wholesale operations. However, the ultimate success of this option would be contingent on the ability to develop a contract that saves the state at least ten percent on operating costs while providing the same level of service as is currently provided by ABC's recently renovated wholesale distribution system.

Overview

PEER analyzed whether it would be feasible to privatize all or part of the state's alcoholic beverage control system.

PEER developed three criteria to judge the feasibility of privatization options. PEER assumed that each option must have the potential to:

- generate at least the same amount of revenue to the state that is currently provided by ABC;
- not rely on increased alcohol consumption to generate enough revenue; and,
- provide at least the same level of service to permittees and consumers that ABC currently provides.

The options PEER analyzed were fully divesting the state's wholesale distribution of wine and spirits, franchising the state's wholesale distribution, and contracting out ABC's wholesale operations, including warehousing and order processing.

PEER analyzed the three options by determining other states' experiences with privatization and projecting each option's performance on the established criteria. Based on the criteria PEER developed, the only feasible option of the options studied for privatizing the state's wholesale distribution under the state's current policy environment is to contract out wholesale operations.

As a general rule, no privatization action should be implemented unless the private organization can save the state at least 10% in operating expenses while providing the same service as the state.

If this option is implemented, it should allow the current ABC operation to compete with private organizations through a request for proposals that outlines the most efficient organization and the necessary service provisions. As a general rule, privatization is not implemented unless a private organization can save the state at least 10% in operating expenses while providing the same service as the state.

The following sections present a detailed discussion of PEER's feasibility criteria, the options, and analysis of each option.

Approach to Privatization Feasibility

Categories of Privatization

In 1992 PEER completed a report entitled *The Privatization Potential of Mississippi's State Programs and Services*. In that report, PEER identified three categories of privatization--*delegation, divestment, and deregulation*, defined as follows:

- *Divestment*—The state turns over the ownership, control, financial responsibilities, and delivery of a public service to the private sector. Since the private organizations become the only producer and deliverer of the affected public services, the government no longer has any responsibility for carrying out this activity, except that it may retain a regulatory role and/or limited service delivery capacity.
- *Delegation*—Part or all of a function or service is assigned to the private sector, while the state retains responsibility of overseeing production and/or delivery. Franchising and contracting out both fall under the delegation category.
- *Deregulation*—The state replaces its regulatory requirements for a public service with either private sector regulation or no regulation of the service. The private sector controls, produces, and provides a service with no governmental involvement, with an end result of a demand-driven, market-based arrangement to satisfy unmet public needs.

For this report, PEER defined privatization of the alcoholic beverage control system as either fully divesting control of wholesaling, delegating operations through franchise agreements, or contracting out all wholesale operations but remaining the wholesaler by law—deciding which alcohol beverages to sell, and setting wholesale prices. PEER did not consider deregulation of alcoholic beverage control, considering the state's policy of prohibition by default and strict regulation of alcohol where it is allowed.

Privatization in Light of Mississippi's Public Policy Environment

The state's policy is prohibition by default, but to require strict regulation of alcohol where it is allowed.

PEER developed the criteria for the feasibility of privatization to reflect the current policy of the state regarding alcoholic beverage control and the budgetary concerns paramount in the current policy environment. PEER did not consider whether, as a matter of political policy, the state should control alcoholic beverage distribution or privatize. Many debates about privatization include philosophical discussions of whether a function is inherently governmental and should be performed by government. PEER did not include such discussion in the analysis

of the feasibility of privatization, but looked at whether it was feasible under the current policy environment.

When prohibition, in effect, ended in Mississippi in 1966, the Legislature re-announced prohibition as the law of the state but allowed local option. MISS. CODE ANN. §67-1-3 states:

The purpose and intent of this chapter is to vigorously enforce the prohibition laws throughout the state, except in those counties and municipalities voting themselves out from under the prohibition... and, in those counties and municipalities, to require strict regulation and supervision of the manufacture, sale, distribution, possession and transportation of intoxicating liquor. . . .

The state's policy is prohibition by default, but to require strict regulation of alcohol where it is allowed.

PEER developed the criteria for the feasibility of privatization to reflect the current policy of the state regarding alcoholic beverage control and the budgetary concerns paramount in the current policy environment.

Mississippi, by law, directly controls distribution of spirits and wine as the wholesaler from which all retail establishments that sell alcohol in the state must buy their alcoholic beverages. Some retail establishments have a license provided by the state to sell alcoholic beverages to other retail stores, restaurants, and bars. Mississippi's ABC wholesale operation, in accordance with the authority provided in state law, decides which alcoholic beverages to sell, sets wholesale prices, takes orders from retail establishments, stores and purchases beverages from suppliers, and ships beverages to retail establishments. Currently, Mississippi's ABC contracts out the delivery of wine and spirits from its wholesale warehouse to retail establishments.

Comparison of "Control" States

As noted on page 3, control states regulate through licensing and tax collection, but they also directly control alcoholic beverage distribution either by providing alcoholic beverages to consumers directly at retail or as wholesalers through private retail establishments. Exhibit 2 on page 6 describes alcoholic beverage control systems in the states and identifies control and licensing states.

Five of the control states, including Mississippi, control alcoholic beverages only through wholesale sales. The other twelve also control retail sales either by operating state retail stores or contracting out retail stores to private agencies. Five of the control states, including Mississippi, control sales of both wine and spirits, while the other thirteen states only control sales of spirits.

None of the states have changed their status between licensing and control states since their state lifted prohibition. Three control states--Maine, Ohio, and Michigan--have privatized their wholesale operations, either through contracting out or some

other arrangement. Iowa currently operates its wholesale system but had contracted out its wholesale operations between 1991-2004. Five states, including Mississippi, have contracted out some aspect of their wholesale operations, either distribution or warehousing.

The question of whether to privatize has recently been asked in many control states. State alcoholic beverage control agencies in Wyoming and Iowa studied privatization in their states in 1995 and 2002 respectively. Vermont has requested proposals for studying the feasibility of privatizing its alcoholic beverage control system. Maine's recent privatization of alcoholic beverage wholesaling in July 2004 has caught the attention of state lawmakers in other states. Maine contracted with a wholesaler to operate its wholesale system for the next 10 years, forgoing all wholesale markup revenue (generally about \$26 million a year) for an up-front payment of \$125 million. In Mississippi, Senate Bill 2722 in the 2004 regular legislative session proposed privatization of Mississippi's alcoholic beverage wholesaling operation through franchise agreements with private wholesalers. The bill died in committee.

Privatization Options

After learning about systems of alcoholic beverage control in operation in other states and recent privatization proposals, PEER analyzed three options for privatization of Mississippi's wholesale system. Those options are:

- fully divest wholesale alcoholic beverage sales, in essence becoming a licensing state;
- contract with private wholesale companies providing franchise rights as proposed in SB 2722; and,
- privatize wholesale alcoholic beverage operations through contracting out or another similar method, remaining the wholesaler by law, setting wholesale prices and choosing which products to sell.

Privatization Feasibility Criteria

PEER developed three main criteria in order to judge the feasibility of the three privatization options. Those criteria are:

- Each option should give the state the same amount, or more, revenue than it currently receives from the wholesaling of spirits and wine—either through a reducing operating cost, an increase of revenue collection, or both.
- Each option should not cause a significant increase in alcohol consumption in the state or rely on a significant increase in

alcohol consumption to meet the first criteria of revenue generation.

- Each option should provide retail establishments and consumers at least the same level of service through wholesale sales and distribution.

The first criterion, that each option should give at least the same amount of revenue, was included because of the current policy environment in which tight budget conditions call for policy changes that are at least revenue neutral.

The second criterion, regarding neutrality of consumption, was included because of the current state policy of prohibition by default and strict regulation of alcohol in localities that have lifted prohibition. The criterion was also included in the analysis because of the link between consumption of alcohol and social costs such as poor health and increased crime.

The third criterion, that at least the same level of service be provided to retail establishments or consumers, takes into account the probable success of each system in providing wholesale sales and distribution. PEER included issues of consumer price, selection, availability of stock, and delivery time in the analysis of this criterion. Law enforcement and quality assurance, while important to the success of any system, were not included in the analysis because PEER assumed that the privatization options included in the analysis would not change the state's ability to provide effective law enforcement or quality assurance as applicable.

Analysis of Privatization

The following sections describe each of the privatization options in detail, including each option's potential to meet the privatization feasibility criteria. PEER analyzed and scored each option to judge its feasibility.

Option One: Full Divestment

This option would fully divest the state of wholesale sales of wine and spirits. The state would provide licenses to wholesalers who would operate in the state and remit excise tax as a percentage of their sales. If this option were implemented, Mississippi would be a licensing state like thirty-two other states.

Method of Analysis

In order to determine the feasibility of this option, PEER analyzed Mississippi's current sales figures and tax collection rates to determine a baseline for consumption and what revenue would be needed by the state to meet the feasibility criteria.

PEER also studied the revenues and consumption of all fifty states to compare Mississippi and other control states' performance to licensing states. PEER used data from the Distilled Spirits Council of the United States, hereafter called DISCUS, and from interviews and data requests with state alcoholic beverage control and revenue agencies in other states to complete this analysis. Only revenue and consumption data from wine and spirits were used in the comparison because Mississippi controls both wine and spirits. Beer was not used because Mississippi does not control beer through wholesale (nor does any other state) and thus was not relevant to the comparison of state revenues and consumption. The analysis was completed using data from FY 1999 through FY 2002 because PEER was only able to obtain partial data for FY 2003 and FY 2004. PEER analyzed the more recent data received and determined that there were no changes that would alter conclusions.

Potential Effect on Revenues

If the divestment option were implemented, prices to consumers could increase, since private wholesalers would have to impose a mark-up to operate and the state would have to impose higher tax rates equal to the current mark-up to make up for lost revenue.

In order to meet the criteria PEER developed for feasible privatization, the franchise option would have to supply the state with the same amount of revenue. For FY 2004, the revenue generated by the ABC wholesale operation was \$36,067,706. If fully divested, the state would likely save an estimated \$4,065,991 per year (see discussion on page 55). Also, if fully divested, the state would have to get revenue solely through excise taxes and licensing fees. In FY 2004, ABC collected \$11,924,869 in excise tax and licensing fees and would have to collect \$43,926,584, a 268% increase, to make up for the lost wholesale revenue. The private wholesalers would also have to charge at least some mark-up to cover their costs and make a profit. This increase in excise tax revenue would include either an increase in prices for the consumer, over and above the wholesaler's mark-up, an increase in sales volume, or an increase in licensing fees to make up the lack of wholesale revenue for the state. Most likely, market conditions would not allow for such an increase in tax rates, sales volume, or licensing fees and the state would not collect as much revenue.

Potential Effect on Consumption

As discussed above, either tax rates or sales volume would have to increase for this option to meet the feasibility requirement for revenue. Thus, this option would likely rely on an increase in consumption to meet the revenue criterion.

Potential Effect on Service

If this option were implemented, the state would no longer be involved in the service delivery of wine and spirits. However, prices to consumers may increase if this option were implemented, since the private wholesalers would have to impose

a mark-up to operate and the state would have to impose higher tax rates equal to the current mark-up to make up for lost revenue and meet the revenue criterion for feasibility.

Potential One-Time Revenue and Cost Savings

If the state were no longer the wholesaler of wine and spirits, the state could receive one-time revenue from the sale of the warehouse. Also, the state could save some general fund dollars annually for the operating costs of ABC wholesale.

If the state were no longer the wholesaler of wine and spirits, the state could receive one-time revenue from the sale of the warehouse. Staff of the Department of Finance and Administration worked with an area real estate broker to determine an estimate of how much revenue the sale of building and grounds of the ABC warehouse could generate. They estimated the state could receive as much as \$6 million from the sale of the building and \$20,000 per acre for the land. The grounds of the warehouse are 20.9 acres and would by their estimate generate as much as \$481,000. However, DFA reported that the state might not receive as much as the building is worth because of competition in the area from other buildings for sale and from builders. They reported that a warehouse close to the ABC warehouse has been on the market for about a year and is listed at approximately \$5 to \$5.5 million. Its building has about 200,783 of warehouse and office space and is on 13.9 acres. The ABC building has about 203,000 square feet of warehouse and office space and is on 20.9 acres.

The state could also save some general fund dollars annually for the operating costs of ABC wholesale. In FY 2004, general funds provided about \$4,065,991 toward ABC's wholesale operations. This could be offset by the likely reduction in state revenue from the sale of wine and spirits. It might also be slightly offset by an increased need for enforcement and permitting of wholesale wine and spirits distribution.

Licensing States' Experience with Private Wholesale Distribution

No control state has fully privatized to become a licensing state. However, since this option would change Mississippi's system from control to licensing, PEER compared revenue generation and consumption of licensing states and control states.

Revenue

From 1999-2002, Mississippi ranked second of the fifty states in collection of revenue per gallon of wine and spirits.

PEER found that licensing states, on average, do not make as much revenue (including excise tax, sales tax, control state sales revenue, and permitting fees) as do control states. Between 1999-2002, licensing states collected an estimated average of \$5.55 per gallon of wine and spirits, while control states collected an estimated average of \$9.86 per gallon. Mississippi collected an estimated average of \$13.19 per gallon, ranking second among all fifty states in collection of revenue per gallon of wine and spirits over the period reviewed. See Exhibit 10 on page 57 for average revenue per gallon by state.

Consumption

From 1999-2002, Mississippi ranked forty-eighth in per capita consumption of wine and spirits with an estimated average of 2.42 gallons of wine and spirits consumed per adult.

Per capita consumption of wine and spirits is higher on average in licensing states, with an estimated average of 4.43 gallons per adult age 18 and older than in control states with an estimated average of 4.08 gallons per adult. Mississippi ranked forty-eighth in per capita consumption of wine and spirits with an estimated average of 2.42 gallons of wine and spirits consumed per adult. The per capita analysis included adults age eighteen and above in order to capture the impact of underage drinking. See Exhibit 11 on page 59 for average per capita consumption of wine and spirits by state.

Option Two: Creating Franchise Agreements

For this option, the state would contract with private entities for franchise rights for wholesale sales of wine and spirits in at least eight service territories in the state. The state would award franchise rights to at least two but not more than four private entities to a service territory. The franchisers would pay the state a negotiated amount of royalty payments of at least 10% of gross wholesale sales and would pay a licensing fee of \$1,800 per year to ABC. In addition, the franchisers might pay a negotiated amount to the state for franchise rights through a bid process. The bill proposing the franchise plan (SB 2722, 2004 Regular Session) did not contain any specifications regarding the franchise fee. Excise tax rates and the 3% mark-up for the Mental Health Programs Fund would remain the same under the proposed plan.

Method of Analysis

In order to analyze the feasibility of this proposal, PEER used a speculative model developed to meet both the criteria developed by PEER for feasible privatization and the specifications of the proposed plan outlined in SB 2722.

In order to meet the criteria PEER developed for feasible privatization, the franchise option would have to supply the state

Exhibit 10: Control vs. Licensing State Comparisons of State Revenue Per Gallon of Wine and Spirits Sold, 1999-2002

State	1999	2000	2001	2002	4 yr Average	Rank
Control						
Utah*	\$ 17.14	\$ 17.36	\$ 17.76	\$ 16.32	\$ 17.15	1
Mississippi	13.05	13.20	13.48	13.02	13.19	2
Pennsylvania	12.66	12.85	13.24	13.49	13.06	3
Alabama	13.01	12.89	12.73	12.16	12.70	4
Michigan	11.38	11.56	11.98	11.56	11.62	6
Washington	10.23	10.53	10.54	11.53	10.71	8
Iowa	10.63	10.65	10.41	10.75	10.61	9
Maine	10.64	10.47	9.81	9.81	10.18	10
Ohio	9.70	9.79	10.22	9.85	9.89	12
North Carolina	8.39	8.85	9.38	8.63	8.81	14
Virginia	8.33	8.45	9.12	9.07	8.74	15
New Hampshire	8.34	8.81	8.84	8.53	8.63	16
West Virginia	7.83	8.09	8.48	8.45	8.21	17
Vermont	7.50	7.88	8.11	7.87	7.84	19
Oregon	6.97	7.24	7.32	7.60	7.28	22
Montana	6.73	6.71	7.31	7.54	7.07	23
Wyoming	6.31	6.94	6.81	5.96	6.51	26
Idaho	4.67	4.56	4.83	7.32	5.35	33
Average	9.64	9.83	10.02	9.97	9.86	
Licensing						
Kansas	10.79	11.42	13.42	13.06	12.17	5
Texas	10.92	11.27	12.26	12.00	11.61	7
Florida	10.38	10.31	10.23	9.66	10.15	11
South Carolina	9.13	8.55	9.02	9.28	8.99	13
Oklahoma	8.04	8.10	8.34	7.85	8.08	18
Tennessee	7.64	7.72	7.73	7.37	7.61	20
Rhode Island	7.14	7.51	7.79	7.39	7.46	21
Kentucky	5.40	5.58	8.09	8.11	6.79	24
South Dakota	6.74	6.56	6.80	6.41	6.63	25
Minnesota	6.56	6.55	6.53	6.32	6.49	27
New Mexico	6.10	6.05	5.94	5.90	6.00	28
New Jersey	5.67	5.89	5.97	5.58	5.78	29
North Dakota	5.79	5.93	5.92	5.40	5.76	30
Nevada	5.74	5.82	5.90	5.23	5.67	31
Arkansas	5.73	5.56	5.59	5.49	5.59	32
Nebraska	4.88	5.07	5.20	4.89	5.01	34
Hawaii	4.74	5.07	4.92	4.66	4.85	35
New York	4.53	4.79	4.91	4.63	4.72	36
Connecticut	4.43	4.43	4.39	4.35	4.40	37
Georgia	4.34	4.29	4.45	4.46	4.39	38
Arizona	4.31	4.29	4.43	4.12	4.29	39
Wisconsin	4.50	4.55	4.08	4.01	4.29	40
Indiana	4.26	4.02	4.24	4.45	4.24	41
Illinois	3.36	4.52	4.69	4.36	4.23	42
Alaska	3.42	3.45	3.56	3.40	3.46	43
Colorado	3.38	3.32	3.27	3.10	3.27	44
Missouri	3.06	3.02	3.05	2.85	3.00	45
California	2.47	2.47	4.43	2.44	2.95	46
Louisiana	2.89	3.05	3.06	2.67	2.92	47
Maryland	2.44	2.42	2.43	2.46	2.44	48
Delaware	2.19	2.23	2.25	2.16	2.20	49
Massachusetts	2.19	2.12	2.23	2.24	2.20	50
Average	5.41	5.50	5.78	5.51	5.55	

Exhibit 10: continued

SOURCE: PEER calculation of DISCUS Public Revenues from Alcohol Beverages 1999-2002 data including consumption in gallons (fiscal year) and revenue data and PEER survey data from state offices. Total revenue was calculated based on excise taxes on wine and spirits, estimated state sales tax for wine and spirits, sales revenue for control states for wine and spirits, and permitting revenue.

NOTE: Source data from nine states are calendar year data for excise tax, and permitting data. Data from three states are alternative fiscal year data (not July 1-June 30). Sales tax data from ten states are calendar year data. Data for Minnesota includes calendar year tax data and fiscal year permitting data.

with the same amount of revenue and could not rely on increased consumption to supply the same amount of revenue. Also, in order to provide the same services to consumer, the wholesale price would not increase and delivery time would be the same.

Potential Effect on Revenues

For FY 2004, the revenue generated by the ABC wholesale operation was \$36,067,706, gross sales were \$193,518,058, and the ABC mark-up was 27.5%. If the franchise option were implemented, the state would likely save \$3,759,822 in general fund operating expenses (see discussion on page 60). If sales volume stayed the same, the state would receive \$19,351,805 from royalties, if the negotiated amount was the minimum of 10% of gross sales for royalties. Permit fees would range from \$28,000 with the minimum number of franchise holders (sixteen) and \$57,600 with the maximum number (thirty-two). In order to gain the same amount of revenue as in previous years (offset by potential operating cost savings), the state would then need to receive fees of between \$12,898,478 and \$12,927,278 annually for the franchise rights.

If the franchise option were implemented and sales volume, mark-up, and operating costs were exactly equal among the franchise holders, the leftover amount likely would not be enough for facilities, administration, and profit.

If the wholesale price remained the same with a total of 27.5% mark-up, the franchise holders would have 24.5% of the mark-up after the 3% alcohol abuse tax to pay the fee to the state for wholesale rights and the 10% royalty on gross sales and for their own operating costs, facilities, and profit. The operating costs of the wholesale operations at ABC (not including facilities or tax commission overhead) were \$4,065,991 for FY 2004. If the operating costs of the franchisers were the same, that would leave only \$668,225 for facilities, administration, and profit. If sales volume, mark-up, and operating costs were exactly equal among the franchise holders, the leftover amount would range from \$20,822 each for thirty-two franchise holders to \$41,764 for sixteen franchise holders. This would likely not be enough for facilities, administration, and profit for franchise holders.

Exhibit 11: Per Capita Consumption of Wine and Spirits in Gallons Per Person Age 18 and Older in Control and Licensing States, 1999-2002

State	1999	2000	2001	2002	4 yr Average	Rank
Control						
New Hampshire	9.26	9.10	9.40	10.08	9.46	1
Idaho	6.97	7.37	7.14	4.19	6.42	5
Vermont	5.60	5.52	5.50	5.64	5.57	12
Oregon	5.21	5.32	5.27	5.34	5.29	14
Washington	5.22	5.23	5.33	5.09	5.22	15
Maine	4.79	5.05	5.08	5.03	4.99	17
Montana	4.14	4.30	4.23	4.32	4.25	24
Wyoming	3.82	3.78	3.78	4.21	3.90	26
Virginia	3.64	3.90	3.92	4.00	3.87	27
Michigan	3.70	3.84	3.80	3.87	3.80	28
North Carolina	3.38	3.28	3.21	3.44	3.33	35
Pennsylvania	2.86	2.96	2.98	3.05	2.96	39
Ohio	2.84	2.97	2.93	3.07	2.95	40
Alabama	2.53	2.70	2.75	2.91	2.72	41
Iowa	2.32	2.41	2.62	2.47	2.46	47
Mississippi	2.42	2.38	2.37	2.53	2.42	48
Utah	1.94	1.93	1.96	2.24	2.02	49
West Virginia	1.74	1.80	1.79	1.81	1.79	50
Average	4.02	4.10	4.12	4.07	4.08	
Licensing						
Nevada	9.18	8.76	8.46	8.02	8.61	2
Delaware	6.55	6.78	6.66	6.90	6.72	3
Massachusetts	6.31	6.51	6.37	6.53	6.43	4
Connecticut	6.29	6.08	6.12	6.21	6.17	6
Alaska	6.13	5.95	5.76	5.98	5.95	7
New Jersey	5.63	5.83	5.81	5.91	5.79	8
Rhode Island	5.95	5.69	5.61	5.92	5.79	9
Colorado	5.29	5.69	6.14	5.71	5.71	10
California	5.42	5.55	5.65	5.66	5.57	11
Florida	5.48	5.39	5.47	5.51	5.46	13
Hawaii	4.81	4.84	4.99	5.34	5.00	16
New York	4.75	4.68	4.52	4.75	4.67	18
Arizona	4.64	4.66	4.51	4.56	4.59	19
Wisconsin	4.20	4.58	4.72	4.77	4.57	20
Minnesota	4.64	4.50	4.49	4.60	4.56	21
Maryland	4.43	4.52	4.46	4.51	4.48	22
Illinois	4.71	4.20	4.42	4.41	4.43	23
Georgia	4.00	4.04	3.84	3.82	3.93	25
Louisiana	3.88	3.69	3.57	3.91	3.76	29
New Mexico	3.78	3.74	3.75	3.62	3.72	30
Missouri	3.52	3.67	3.68	3.74	3.65	31
South Carolina	3.58	3.75	3.52	3.45	3.58	32
North Dakota	3.35	3.34	3.34	3.51	3.39	33
Indiana	3.29	3.38	3.33	3.32	3.33	34
Texas	3.12	3.12	3.00	3.12	3.09	36
South Dakota	3.00	3.15	3.06	3.14	3.09	37
Nebraska	3.05	3.02	2.94	2.99	3.00	38
Kansas	2.74	2.71	2.62	2.62	2.67	42
Tennessee	2.59	2.59	2.52	2.70	2.60	43
Kentucky	2.55	2.53	2.51	2.62	2.55	44
Oklahoma	2.49	2.51	2.44	2.65	2.52	45
Arkansas	2.49	2.41	2.46	2.62	2.50	46
Average	4.43	4.43	4.40	4.47	4.43	

Source: PEER Calculation of U.S. Census Bureau Population Estimates and DISCUS Public Revenues from Alcohol Beverages 1999-2002 consumption data.

Potential Effect on Consumption

Because current sales volume and price would not likely allow the franchisers enough funds to operate with a profit and provide the needed revenue to the state, franchisers would likely rely partially on an increase in consumption to increase sales volume and profits.

Potential Effect on Service

Another consideration of this option according to our criterion regarding service delivery is whether the franchise holders would deliver within the same time frame. Currently, even though ABC operates out of one central warehouse, deliveries are made the next day if orders come in by 11:00 am. Senate Bill 2722 proposed that franchise holders be required to deliver within three days of order.

Potential One-Time Revenue and Cost Savings

If the franchise option were implemented, administration costs would still be necessary to manage the franchise agreements for quality assurance.

As discussed on page 55, if the state were no longer the wholesaler of wine and spirits, the state could receive a one-time revenue from the sale of the warehouse of up to \$6,481,000 but might receive less with market competition. If the franchise option were implemented, the state could also save some general fund dollars annually for the operating costs of ABC wholesale. In FY 2004, general funds provided about \$3,759,822 toward ABC wholesale operations, not including costs for administration. The estimated cost savings does not include administration because administration would be necessary to manage the franchise agreements for quality assurance. This might be offset by the likely reduction in state revenue from the sale of wine and spirits. It might also be slightly offset by an increased need for enforcement and permitting of wholesale wine and spirits distribution.

Maine's Experience in Creating Franchise Agreements

Maine has recently implemented a similar option. While Maine did not set up franchise agreements, in July 2004, the state sold the rights to wholesale operations for a ten-year period to one company to serve the entire state. Maine's privatization is dissimilar to this option in that there is only one company with wholesale rights, but it is similar to the option in that the state sold the wholesale rights to a private agent for a specific period of time in which the state will relinquish all revenue from wholesale operations except a percentage of profit. Maine's royalty agreement only goes into effect if the agent makes over a certain amount of profit, unlike the proposed franchise plan in Mississippi. The agent would have to make more profit than the state was making in order to pay any royalty. Also, in its

agreement, Maine still sets retail and wholesale prices. Maine sold its wholesale rights for ten years for an up-front fee of \$125 million. With this fee, negotiated through a bid process, Maine received less up front than the state likely would have generated annually through wholesale sales (about \$26 million annually). Maine did not own its warehouse and thus did not receive a one-time revenue from the sale of its facilities.

Option Three: Contracting Out

In this option, the state would contract out wholesale operations including warehousing, ordering, and purchasing but would remain the wholesaler by law, would set prices, and would still receive the sales revenue. Revenue collection and service delivery requirements would be set in the state's contracts with the private contractors.

The state would collect the mark-up and taxes from the contractors who would simply house inventory, take orders, process, and deliver the orders. The state would likely pay a contractor a per-case fee for order processing, warehousing and distribution.

If this option were implemented, the state would request proposals from potential private contractors. Private contractors would submit proposals telling the state what the state would have to pay them to provide the services under the conditions provided by the state. The current ABC operations would be, in essence, competing with these private contractors. The state would then determine which organization could provide the services required most efficiently. As a general rule, the state would not contract out services unless the proposed contractors could save the state at least 10% of the costs of the current operation.

Method of Analysis

In order to judge the feasibility of contracting out, PEER also determined how contracting out would have to be designed in order to meet the privatization feasibility criteria.

PEER also gathered information from the control states that have privatized either through contracting out or a similar privatization method.

Iowa, Ohio, and Michigan have all implemented some measures in which they have maintained wholesale rights by law, set wholesale (or retail) prices of beverages, and still receive revenue from wholesale (or retail) sales, while wholesale operations are handled by private agents paid by the state. As discussed on page 51, some other control states, including Mississippi, contract out part of their wholesale operations. Mississippi contracts out its distribution of alcoholic beverages from the ABC warehouse to retail stores. PEER collected information from the state alcoholic

beverage control agencies in Iowa and Michigan, both wholesale control states, regarding their experience with contracting out. PEER was unable to collect detailed information regarding Ohio's wholesale contracting.

Potential Effect on Revenue

If the state contracted out wholesale operations, it could potentially structure its contract to receive the same amount of revenue as the current ABC operations. The state would still set the prices of wine and spirits. Thus, the state would still have the mark-up from wine and spirits sales, excise taxes, sales tax, and alcohol abuse taxes.

Potential Effect on Consumption

In this option, the state would still be the wholesaler by law, regulating and directly controlling wine and spirits distribution even though the wholesale operations are contracted out. Consumption would likely not change if this option were implemented.

Potential Effect on Service

The contracts designed to implement this option could specify service delivery requirements, as it does currently in its delivery contracts. The state would still be responsible for product selection and would provide quality assurance to contractors in service delivery areas.

Regarding service delivery in other states that have contracted out, Mississippi's wholesale operation is about the same or better in product selection and delivery time than Iowa, Michigan, and Ohio. All the states except Michigan have roughly the same number of products available for regular order (between 1,150 and 1,450) and do not limit the number of products available through special order. Michigan has almost 5,000 products available through regular order but does not allow special order.

Michigan requires delivery within three days of order and allows retailers to order one day per week. Mississippi provides next day delivery and allows retailers to order up to five days per week. The delivery requirements and number of orders per week is unknown for Iowa and not applicable for Ohio, which controls retail operations.

Potential One-Time Revenue and Cost Savings

If the contracting out option were implemented, instead of selling the building, the state could choose to lease the building to the contractor or allow use of the building as part of the contract.

As discussed on page 55, if the state were no longer the wholesaler of wine and spirits, the state could receive a potential one-time revenue from the sale of the warehouse of up to \$6,481,000 but may receive less with market competition. Instead of selling the building, the state could choose to lease the building to the contractor or allow use of the building as part of the contract. If the contracting option were implemented, the state could save some general fund dollars annually for the operating costs of ABC wholesale. In FY 2004, general funds provided about \$3,759,822 toward ABC's wholesale operations, not including costs for administration. The potential cost savings would not include administration because administration would be necessary to manage the contractors for quality assurance. This operating cost savings would likely be mostly, if not all, offset by the fees paid to contractors. Potential operating costs savings are unknown. The state would have to request proposals from potential contractors with their fee requirements in order to know what the cost savings of this option would be.

Other States' Experiences with Contracting Out

Iowa

Iowa contracted out its warehousing and delivery operations from 1991 to 2004. State personnel still take orders for, purchase, and collect revenue for the alcoholic beverages they control. In 2004 the warehousing and distribution contractor went bankrupt and the state resumed all wholesale operations. The contractor was a large company providing many other services than providing warehousing and distribution for the Iowa Alcohol Beverage Control Division. Staff of the Iowa Alcohol Beverage Control Division do not think that the company's bankruptcy was directly related to the Iowa contract. Staff of the Iowa Alcohol Beverage Control Division also reported that they intended to send out requests for proposals to compare the costs of current state operation to the cost of contracting out by the end of calendar year 2004.

Michigan

For 2000-2004, Mississippi ranked fifth among control states for the estimated average amount of gross profit generated for every dollar of operating expenses.

Michigan has created agreements with Authorized Distribution Agents who take orders, warehouse, distribute beverages to retail stores, and collect revenue. These agreements have been in place since 1997. The state of Michigan pays a fee per case to the beverage suppliers, who then pay the Authorized Distribution Agents the state's fee plus a small fee themselves. Since 1997 the fee per case paid by the state has ranged between \$5.42 per case in 1997 to \$6.52 in 2004. If Mississippi made the same types of agreements with the same fee per case (\$6.52), the state would

have paid \$14,262,350 in FY 2004 instead of the FY 2004 ABC wholesale operating costs of \$8,992,051 or \$4.11 per case, including distribution.

Iowa, Ohio, and Mississippi all ranked in the top five among control states for the estimated average amount of gross profit generated for every dollar of operating expenses in 2000-2004. This is a measure of operational efficiency for wholesale operations. Iowa ranked first, Ohio ranked fourth, and Mississippi ranked fifth. Michigan ranked eighth among control states.

Conclusion

Considering the state's current policy environment, PEER concludes that the only feasible option of those considered for privatization of alcoholic beverage control would be to contract out wholesale operations. However, the ultimate success of this option would be contingent on the ability to develop a contract that saves the state at least ten percent on operating costs while providing the same level of service as is currently provided by ABC's recently renovated wholesale distribution system.

PEER scored each privatization option on the privatization feasibility criteria discussed on page 52.

PEER scored options based on the criteria using a positive, negative, or neutral scale. PEER considers options with a negative score in one of the criteria as not being feasible.

As shown in Exhibit 12 on page 66, the only feasible option for privatization is contracting out wholesale operations. The Legislature and stakeholders should study this option further before implementation. The option may or may not provide cost savings to the state.

Recommendations: Part Two

1. As long as the current policy environment of the state remains the same regarding alcoholic beverage control, the state should maintain control of wine and spirits wholesale, not privatizing through divestment or franchise of wine and spirits wholesale.
2. If the State Tax Commission wishes to determine the cost-savings potential of contracting out, it should publish a request for proposals for contracting out warehousing, order-taking, and purchasing to determine whether the state would realize operating cost savings by contracting out those functions.

In considering privatization, the State Tax Commission should require that:

- at minimum, the same level of quality of service (e.g., delivery time, flexibility in methods of ordering) be delivered from contractors (quality levels should be specified in the request for proposals);
- contractors provide the same order-processing and delivery timeframe;
- the functions generate the same revenue collection and mark-up for the state;
- proposals from contractors compete with the operation currently in place at ABC; and,
- proposals only be considered if they can maintain the same level of service with at least a 10% operating cost savings to the state.

The State Tax Commission may wish to consider methods of privatization described in the PEER Committee report *The Privatization Potential of Mississippi's State Programs and Services* (Report #286; November 30, 1992).

Exhibit 12: Privatization Feasibility Criteria Scoring Table

	Revenue		Consumption		Service Provision		Feasibility Summary	One time cost savings or revenue
Option 1: Privatize and become licensing state	Would likely not generate enough revenue	-	Would likely rely on increased consumption to generate enough revenue	-	Some service provision would no longer be applicable because would be provided by market; prices for consumers may rise to generate enough revenue	=/-	Not Feasible	Yes, sale of facilities and operating costs of wholesale operations
Option 2: Franchise wholesale rights	Would likely not generate enough revenue	-	Would likely rely on increased consumption to generate enough revenue	-	Some service provision would no longer be applicable because would be provided by market; prices for consumers may rise to generate enough revenue	=/-	Not Feasible	Yes, sale of facilities and operating costs partially offset by management costs for monitoring franchises
Option 3: ABC contracts wholesale operations	Potential to generate same revenue	=	Neutral	=	ABC could require the same level of service provision of its contractors	=	Feasible	Yes, sale of facilities; operating costs savings would be mostly offset by fees to contractor and management of contracts

Symbol Key	
=	Neutral score on criterion
+	Positive score on criterion
-	Negative score on criterion

SOURCE: PEER analysis

Appendix A: Glossary of Legal Definitions of Alcoholic Beverages

Alcoholic Beverage means any alcoholic liquid, including wines of more than five percent (5%) of alcohol by weight, capable of being consumed as a beverage by a human being, but shall not include wine containing five percent (5%) or less of alcohol by weight and shall not include beer containing not more than five percent (5%) of alcohol by weight, as provided for in Section 67-3-5, Mississippi Code of 1972, but shall include native wines. The words "alcoholic beverage" shall not include ethyl alcohol manufactured or distilled solely for fuel purposes.

Beer means a malt beverage containing not more than five percent (5%) of alcohol by weight.

Wine means any product obtained from the alcoholic fermentation of the juice of sound, ripe grapes, fruits or berries and made in accordance with the revenue laws of the United States.

Light Wine means wine containing five percent (5%) or less of alcohol by weight.

Native Wine shall mean any product produced in Mississippi for sale having an alcohol content not to exceed twenty-one percent (21%) by weight and made in accordance with revenue laws of the United States, which shall be obtained primarily from the alcoholic fermentation of the juice of ripe grapes, fruits, berries or vegetables grown and produced in Mississippi; provided that bulk, concentrated or fortified wines used for blending may be produced without this state and used in producing native wines. The commission shall adopt and promulgate rules and regulations to permit a producer to import such bulk and/or fortified wines into this state for use in blending with native wines without payment of any excise tax that would otherwise accrue thereon.

Distilled Spirits or Spirits means any beverage containing more than four percent (4%) of alcohol by weight produced by distillation of fermented grain, starch, molasses or sugar, including dilutions and mixtures of these beverages.

SOURCE: MISS. CODE ANN. §67-1-5

Appendix B: Type and Number of State Permits Issued to Individuals or Partnerships for Alcoholic Beverage Operations As of August 12, 2004

1. *Manufacturer (1)* - Permits the manufacture, importation in bulk, bottling, and storage of alcoholic liquor and its distribution and sale to manufacturers holding permits within the state, to statutorily authorized persons outside the state, to sell exclusively to the commission. This permit includes three classes of operations: (Class 1) distiller and/or rectifier operations, (Class 2) wine manufacturer, and (Class 3) native wine producer.
2. *Package Retailer (613)* - Authorizes the operation of a store exclusively for the retail sale of alcoholic beverages, including native wines, which are to be consumed off the store premises. It may also sell at retail prices corkscrews, wine glasses, soft drinks, ice, juices, mixers and other beverages commonly used to mix with alcoholic beverages. Nonalcoholic beverages must be consumed off premises. *The total number of retailers includes 14 military package stores plus 101 package stores that have a federal wholesale permit and approval of the State Tax Commission in accordance with Local Option Regulation Number 48 to sell alcoholic beverages to other package retailers.*
3. *On-Premises Retailer (940)* - Authorizes the sale of alcoholic beverages, including native wines, for consumption on the licensed premises only. Eligible permittees include qualified hotels, restaurants, clubs, common passenger carriers with adequate facilities, and resort areas, whether inside or outside of a municipality.
4. *Solicitor (20)* - Authorizes the individual holder to act as salesman for one state-permitted manufacturer or wholesaler of alcoholic beverages, to solicit alcoholic beverage orders on behalf of his employer, and to promote his employer's products in a legitimate manner. However, the State Tax Commission may also issue this individual additional permits to represent other principals. This permit can only apply to one principal employer.
5. *Native Wine Retailer (1)* - Authorizes a permitted Class 3 manufacturer to make retail sales of native wines to consumers for consumption on-premises (by the glass) and off-premises at an establishment located on its premises or in its immediate vicinity (in originally sealed and unopened containers).
6. *Temporary Retailer* - Permits the purchase and resale of alcoholic beverages, including native wines, during legal hours on the premises described in the temporary permit only. This permit includes two classes of operations: (Class 1) one-day permit for the sale of alcoholic beverages, including native wine, for consumption on the premises at a bona fide nonprofit civic or charitable organization event and (Class 2) up to a seventy-day permit for prospective permittees seeking to transfer a package store or on-premises retailer permit. *Due to the temporary nature of the permits, ABC does not track the number of existing Class I and Class II permits.*
7. *Caterer (4)* - Permits caterers to purchase alcoholic beverages for their businesses as well as to sell alcoholic beverages in conjunction with their catering businesses.
8. *Research (1)* - Authorizes the holder to operate a research facility for the professional research of alcoholic beverages. In this capacity, the permittee may import and purchase limited amounts of alcoholic beverages from the commission or from importers, wineries and distillers of alcoholic beverages.
9. *Alcohol Processing (2)* - Authorizes the holder to purchase, transport, and possess alcoholic beverages for the exclusive use in cooking, processing, or manufacturing products that contain alcoholic beverages as an integral ingredient. It does not authorize the sale of these alcoholic beverages on the premises of this person.

SOURCE: MISS. CODE ANN. Section 67-1-51 et seq. and ABC records

Appendix C: Executive Summary of the PEER Committee's Report #227, A Limited Operational Review of the Alcoholic Beverage Control Division, November 28, 1989

BACKGROUND

The Legislature established the Alcoholic Beverage Control Division in 1966 (Chapter 540, *Laws of 1966*) as a result of Mississippi's decision to permit counties and municipalities to allow the sale and possession of alcohol within their boundaries. Under MISS. CODE ANN. Section 67-1-19, the State Tax Commission is vested with all authority to administer the provisions of Title 67, Chapter 1, MISS. CODE ANN., through the ABC. The Alcoholic Beverage Control Division makes all wholesale acquisitions of liquor and wine from private distributors and sells to licensed retail package stores and on-premises permittees. The ABC is also the state's liquor law enforcement agency and is responsible for investigating all complaints against permit holders and complaints relative to the illegal sale or distribution of alcohol in all counties.

Overview

This review identified internal control and warehouse security/management weaknesses. In particular, ABC has inconsistent inventory procedures, unsupported inventory adjustments, inadequate controls over receipt of goods information, and a lack of security over cash receipts. ABC also has not maintained warehouse security devices in proper working order. Some ABC personnel practices are not in accordance with the State Personnel Board's policies and procedures, including the Tax Commission's classification of warehouse workers and the promotion of certain classifications of employees.

FINDINGS

The ABC lacks proper internal controls to protect inventories and cash.

As the only legal wholesaler of liquor in the state, the ABC Division has charge of a large amount of physical inventory and cash. During fiscal year 1989, the division had liquor sales of over \$111 million and a profit exceeding \$22 million. The value of ABC's distilled spirits and wines inventory during an average month amounts to \$12,515,976.

Despite this significant financial responsibility, ABC has not established proper internal controls over its inventory and cash, as detailed below.

- *Inconsistent inventory procedures and unsupported adjustments of stock counts*—During ABC's monthly inventory, teams of warehouse employees take actual counts of each of the approximately 1,760 types of wine and liquor in the warehouse. ABC management has not developed written, task-based procedures to govern employee responsibilities related to stock inventories. Counting methods vary from team to team, with some teams estimating cases in stock by counting rows and columns of boxes, and some actually counting boxes or at least ensuring that their row and column counts are correct. By allowing these various counting methods, ABC management has no assurances of a correct inventory count.

ABC resolves discrepancies between the actual count figure and the base inventory figure by adjusting the inventory base count without a thorough investigation regarding the reasons for the difference. During the six inventory periods reviewed by PEER, ABC made approximately 2,007 inventory base count adjustments, which resulted in a net reduction of \$11,585.09 in ABC's average monthly inventory base of \$12,515,976.

- *Purchasing personnel's control over the receipt of goods information*—ABC allows purchasing personnel to control the entry of goods received information into the agency's inventory data base. Generally accepted auditing standards require that internal controls be established to ensure that no one person could conceal error or fraud. Allowing purchasing personnel to control the flow of information relative to received goods inventory creates an environment in which the purchasing agent could delay entry of a record into the inventory data base. Such delays could prevent the entire group of ABC customers from acquiring a particular item when needed because the automated inventory system was not updated as soon as wine or

liquor was received. By allowing the purchasing agent to be involved in both the purchasing and receiving functions, ABC management has increased the possibility that the purchasing agent could conceal purchasing irregularities. An unscrupulous purchasing agent and distributor could arrange to defraud the state through shorted deliveries or some other such scheme.

- *Lack of security over cash receipts*—A permittee may arrive at ABC offices and present an order and a payment in person. ABC personnel review the order, count the cash, provide a receipt, and place the cash in a cabinet prior to its being deposited. ABC personnel keep the key to the cabinet in an unlocked desk drawer which any knowledgeable employee could open if he or she wished to take cash from the cabinet. While cash transactions do not make up a large proportion of ABC's daily transactions, during some days of peak months the agency receives as much as \$3,700 in currency and checks per day. Generally accepted auditing standards require all entities to develop practices and procedures to safeguard assets of the organization.

The Tax Commission's lack of an internal audit function contributes to ABC's internal control weaknesses.

MISS. CODE ANN. Section 67-1-19 (1972) states that the ABC is a division "*within and as part of, the State Tax Commission.*" Therefore, the Tax Commission has a responsibility to audit and oversee the ABC Division. Because the Tax Commission has no internal audit function, the agency has not provided the proper oversight regarding ABC operations. If the Tax Commission had a functioning internal audit unit, the ABC internal control weaknesses identified by PEER probably would have been identified earlier in-house.

Often major state agencies surveyed by PEER, seven had internal audit units. Since the Tax Commission is also a major state agency with statutory responsibilities for collecting state tax dollars (\$1,571,967,160 during FY 1988), prudent financial management principles dictate that the agency have an internal audit function.

ABC warehouse security devices do not safeguard against the unauthorized consumption or removal of liquor by warehouse employees.

The ABC warehouse has security devices designed to protect against unauthorized entry and consumption of alcohol by ABC employees or other persons. The security devices include: a security door with electronic access code control; television cameras which monitor the warehouse and its workers; battery-operated alarms on warehouse doors; a sensor system which detects the presence of persons in the warehouse; and contract security personnel located at strategic doors.

ABC's security system has serious deficiencies which limit its effectiveness, as listed below.

- The electronic access security door is not locked and, according to ABC personnel, has been inoperative since 1988.
- Of the twenty cameras monitoring the warehouse, five were inoperative on September 4, 1989. An additional camera was pointed toward the ground, providing no useful coverage of the warehouse. (On September 14 eight of the cameras were not working.) Fourteen of the fifteen operable cameras produce a poor resolution picture.
- On July 14, a door linking the outside of the building to a hallway located between the security door and the warehouse was open.
- Of the warehouse's six doors leading to the outside, two door alarms did not activate on the doors or in the dispatch office and four did not activate on the doors when tested by PEER.

ABC's security system weaknesses could allow persons in the warehouse to remove alcohol from the building or consume it there without detection. PEER staff noted on several occasions liquor and wine cartons which had been torn open and one to two bottles removed, presumably by warehouse employees. PEER also observed empty or half-empty liquor bottles sitting on cartons in secluded areas of the warehouse suggesting that warehouse employees had consumed the liquor.

The Tax Commission's classification of warehouse workers does not ensure that positions essentially alike are included in the same occupational class.

Currently, ABC classifies twenty-seven warehouse employee positions as warehouse clerks and thirty-five as general service employees. Individuals in these two job classifications perform essentially the same tasks, duties, and responsibilities. For example, both a General Service Employee II and a Warehouse Clerk II have the responsibility of placing labels on boxes prior to the shipment of alcoholic beverages to permittees. In addition, both General Service Employees and Warehouse Clerks work on the pick line, selecting items for shipment. Job content questionnaires for both warehouse clerks and general service employees contain the same type of responsibilities, to perform various tasks as assigned by supervisors.

ABC management personnel state that they utilize the warehouse clerk position as a career path for general service employees. However, for such a career path to be legitimate and meaningful, there should be significant differences in job responsibilities as well as rate of pay.

The Tax Commission did not comply with State Personnel Board regulations relevant to the promotion of Senior Clerks to Data Entry Operators.

By agreement between the State Personnel Board and the Tax Commission, Senior Clerk positions are exempted from the State Personnel Board's competitive selection process. From 1987 to 1989 ABC hired eight temporary clerks. ABC promoted these individuals to Senior Clerk positions after completing two months of employment. ABC then promoted two individuals to Data Entry Operator I positions after completing only one month in Senior Clerk positions. The Data Entry Operator I position is not exempt from SPB's selection process; consequently, employees promoted non-competitively should have completed at least six months of employment or be selected from certificates of eligibles. Neither of these two individuals who had only one month's service was a candidate on the list of eligibles. Therefore, the Tax Commission did not

adhere to the State Personnel Board regulation requiring employees who are promoted within a six-month time frame to be selected from a list of eligibles.

RECOMMENDATIONS

1. ABC should devise a uniform method of conducting inventories and task-based procedures which would insure that each person or team counts stock the same way. Additionally, ABC should require that all persons performing these inventories should be trained in the procedures before being allowed to perform inventory counts. ABC should also require that before adjusting an inventory base count, that inventory counters provide two separate counts verifying the adjusted inventory count before the staff makes an adjustment.
2. ABC should remove the purchasing office and its personnel from the process of reviewing reports of received goods. The oversight of this operation should be placed in either the processing or accounting office.
3. With its existing resources, the State Tax Commission should establish an internal audit function within its main office. The internal audit unit should be responsible for monitoring all financial and inventory activities of ABC as well as other responsibilities assigned by the Tax Commission.
4. ABC should review its security procedures and either repair inoperative equipment or consider acquiring newer, more cost-effective technology. Should ABC require additional funding, it should request that such be provided through the appropriations process.
5. ABC should develop policies and procedures governing the maintenance, operation and monitoring of security systems. These procedures should address: the routine repairs and maintenance required to keep the system operable, such as the regular insertion of batteries into door alarms; the appropriate staff response to daytime alarms; and the responsibility for monitoring the television screens at all times during working hours.

6. The State Personnel Board and the Tax Commission should review the classification of warehouse workers to ensure that positions essentially alike are included in the same occupational class.

7. The Tax Commission should comply with State Personnel Board regulations concerning certificates of eligibles and non-competitive promotional consideration.

For More Information or Clarification, Contact:

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Appendix D: Unmarked State Vehicle Law

§ 25-1-87. Marking publicly owned or leased vehicle; exceptions; effect of noncompliance.

All motor vehicles owned or leased by the State of Mississippi or any agency, department or political subdivision thereof, which shall include counties and municipalities, when such agency or department or political subdivision, which shall include counties and municipalities, is supported wholly or in part by public taxes or by appropriations from public funds, shall have painted on both sides in letters at least three (3) inches in height, and on the rear in letters not less than one and one-half (1 1/2) inches in height, the name of the state agency or department, or political subdivision, which shall include counties and municipalities, in a color which is in contrast with the color of the vehicle; provided, however, that a permanent decal may be used in lieu of paint, and provided further, that any municipality may affix a permanent decal or design at least twelve (12) inches in height and twelve (12) inches in width on both sides of the vehicle with the name of the municipality within or across the permanent decal or design, and the permanent design or decal shall be in a color or colors which are in contrast with the color of the vehicle. No privilege license tag shall be issued for such vehicle until the name has been painted thereon or a permanent design or decal affixed thereto as required by this section. A permanent decal may be used in lieu of paint. The provisions of this paragraph shall not apply to vehicles used by the Chief Executive of the State of Mississippi, to vehicles owned or leased by the Department of Economic and Community Development, to vehicles owned or leased by the Office of the Attorney General, to not more than one (1) vehicle owned or leased by the Department of Finance and Administration for use by the Capitol Police, to vehicles owned or leased by the Mississippi State Board of Medical Licensure and used only by the Investigative Division of the board, to one (1) vehicle owned or leased by the Executive Director of the Department of Mental Health, to not more than one (1) vehicle owned or leased by the Mississippi Division of Medicaid, to one (1) vehicle owned or leased by the State Department of Rehabilitation Services, to one (1) vehicle owned or leased by the Mississippi Department of Transportation, to one (1) vehicle owned or leased by the Commissioner of the Mississippi Department of Corrections, to not more than three (3) vehicles owned or leased by the Department of Corrections and used only by Community Services Division officers, to not more than one (1) vehicle owned or leased by the Mississippi Department of Transportation and used only by an investigator employed by the Mississippi Department of Transportation, to not more than two (2) vehicles owned or leased by the Mississippi Department of Marine Resources, or to **not more than one (1) vehicle owned or leased by the Mississippi State Tax Commission**; and upon receipt of a written request from the State Adjutant General, the Commissioner of Public Safety, **the Director of the Alcoholic Beverage Control Division of the Mississippi State Tax Commission**, the Executive Director of the Mississippi Department of Wildlife, Fisheries and Parks, the Director of the Bureau of Narcotics, the Executive Officer of the Board of Pharmacy, the Executive Director of the Mississippi Gaming Commission, the State Auditor or a president or chancellor of a state institution of higher learning, the Governor may authorize the use of specified unmarked vehicles only in instances where such identifying marks will hinder official investigations, and the governing authorities of any municipality may authorize the use of specified, unmarked police vehicles when identifying marks would hinder official criminal investigations by the police. The written request or the order or resolution authorizing such shall contain the manufacturer's serial number, the state inventory number, where applicable, and shall set forth why the vehicle should be exempt from the provisions of this paragraph. In the event the request is granted, the Governor shall furnish the State Department of Audit with a copy of his written authority for the use of the unmarked vehicles, or the governing authority, as the case may be, shall enter its order or resolution on the minutes and shall furnish the State Department of Audit with a certified copy of its order or resolution for the use of the unmarked police vehicle. The state property auditors of the State Department of Audit shall personally examine vehicles owned or leased by the State of Mississippi or any agency, department or commission thereof and report violations of the provisions of this paragraph to the State Auditor and the Chairman of the Joint Legislative Committee on Performance Evaluation and Expenditure Review. Any vehicle found to be in violation of this

paragraph shall be reported immediately to the department head charged with such vehicle, and five (5) days shall be given for compliance; and if not complied with, such vehicles shall be impounded by the State Auditor until properly marked or exempted.

Upon notification to the State Tax Commission by the State Auditor that any municipality or political subdivision is not in compliance with this section, the State Tax Commission shall withhold any sales tax due for distribution to any such municipality and any excise tax on gasoline, diesel fuel, kerosene and oil due any such county and for any months thereafter, and shall continue to withhold such funds until compliance with this section is certified to the State Tax Commission by the State Department of Audit.

County-owned motor vehicles operated by the sheriff's department shall not be subject to the provisions of this section, but shall be subject to the provisions of Section 19-25-15. County-owned motor vehicles operated by a family court established pursuant to Section 43-23-1 et seq., shall not be subject to the provisions of this section.

State-owned or leased motor vehicles operated by the Department of Mental Health or by facilities operated by the Department of Mental Health and used for transporting patients living in group homes or alternative living arrangements shall not be subject to the provisions of this section.

Up to four (4) passenger automobiles owned or leased by economic development districts or economic development authorities shall not be subject to the provisions of this section.

State-owned or leased motor vehicles operated by the Agricultural and Livestock Theft Bureau of the Department of Agriculture and Commerce and used to investigate livestock theft shall not be subject to the provisions of this section.

Up to three (3) motor vehicles owned or leased by the Pascagoula Municipal Separate School District for use by district security officers shall not be subject to the provisions of this section.

Up to three (3) motor vehicles owned or leased by the Department of Human Services for use only by the Program Integrity Division and the executive director shall not be subject to the provisions of this section.

Up to three (3) motor vehicles owned or leased by the Department of Insurance for use by the State Fire Marshal's Office shall not be subject to the provisions of this section.

The motor vehicles of a public airport shall not be subject to the provisions of this section upon a finding by the governing authority of such airport that marking a motor vehicle as required in this section will compromise security at such airport.

SOURCE: MISS. CODE ANN. Section 25-1-87 (1972)

Appendix E: Methods of Calculating Federal Income Tax Due on Non-Qualified Non-Personal Use Vehicles

Concerning the exclusion of employer-provided vehicles from taxation, IRS Publication 15-B notes that *qualified* non-personal use vehicles are not taxable. Qualified non-personal use vehicles are vehicles that are not likely to be used more than minimally for personal purposes because of their design. Examples of qualified non-personal use vehicles include clearly marked police and fire vehicles, ambulances, and school buses.

If *not* a qualified non-personal use vehicle, the fair market value of the vehicle is taxable. IRS Publication 15-B lists three potential methods for determining the amount taxable for employer-provided vehicles:

- cents per mile rule;
- commuting rule; and,
- annual lease value.

To be able to utilize the **cents per mile** rule in determining the taxable amount, the vehicle in question must have a fair market value of less than \$15,400 for 2004 vehicles. Under the **commuting** rule, the value of the vehicle is determined by multiplying each one-way commute by \$1.50. Under the **annual lease value** rule, the taxable amount is the vehicle's annual lease value less the portion of the vehicle's use that was related to business use of the vehicle.

The value of vehicles that are not "qualified non-personal vehicles" should be reported by the employer as taxable income.

SOURCE: Internal Revenue Service Publication 15-B, "Employer's Tax Guide to Fringe Benefits for Benefits Provided in 2004." (PEER consulted this publication for 2004 automobile value ceilings. Other IRS publications would contain information on automobile value ceilings for other years.)

Appendix F: Critical Components of a Model Vehicle Management System

1. *Use and Control of Passenger Vehicles* – The fleet management program should have a designated vehicle program manager and:
 - written policies, regulations, or rules that define legitimate vehicle use; describe all maintained records and the responsible party; identify any permanently assigned vehicles; address monitoring the continued need for permanent vehicle assignments; establish motor pools and their pooled vehicles; authorize commuting, including the need, other criteria and distance limitations; and, any IRS tax or individual reimbursement liabilities.
 - vehicle records with the purpose of vehicle use, a needs justification for vehicle use, the name of the vehicle operator, and the agency program incurring the vehicle operating cost.
 - historical data records for each vehicle including daily trip logs and actual operating costs (fuel, oil, routine maintenance, and emergency repairs) that are used to produce exception reports for vehicle operational and maintenance problems as well as periodic management summary reports for vehicle assignments, use, maintenance, and total operating costs.
 - a periodic post-audit inspection of the vehicle management system by an internal or external auditor.
2. *Maintenance of Passenger Vehicles* – The fleet management program should have:
 - written policies, regulations, or rules for vehicle maintenance that include limiting the dollar amount of emergency repairs that may be performed without supervisory approval.
 - a preventive vehicle maintenance program based on manufacturers' recommendations.
 - a centrally managed or individual user program for initiating and scheduling preventive maintenance.
3. *Procurement of Passenger Vehicles* – The fleet management program should have written policies, regulations, or rules addressing a needs justification for increasing, decreasing, or replacing the number and vehicle types that includes a break-even analysis of privately owned vehicle reimbursement costs versus the cost of operating a state vehicle.
4. *Disposal of Passenger Vehicles* – The fleet management program should have written criteria for disposal of a vehicle that considers a minimum use of miles, years, and repair cost as a percentage of the original purchase price. The agency should conduct a periodic break-even analysis of privately owned vehicle reimbursement costs versus the cost of operating a state vehicle to determine the need to continue to maintain a vehicle in the agency fleet.
5. *Inventory of Passenger Vehicles* – The fleet management program should have written policies, regulations, or rules governing its inventory, detailed inventory data records for each vehicle, and an annual internal inventory of its vehicles.

SOURCE: *A Performance Audit of State-Owned Vehicle Management*, December 14, 1993

Appendix G: Permit Fees Charged by ABC for Manufacturers and Retailers of Alcoholic Beverages as Directed in Statute

Type of Permit	Annual Fee
Manufacturers	
Manufacturer—Class 1 Distiller	\$4,500
Manufacturer—Class 2 Winery	\$1,800
Manufacturer—Class 3 Native Winery	\$10 per 10,000 gallons produced
Off-Premise Retailers	
Package Retailer	\$900
Native Wine Retailer (on and off premises)	\$50
On-Premise Retailers	
On-premises Retailer	\$450 minimum and \$225 extra on purchases exceeding \$5,000 for each additional \$5,000 sold or fraction thereof
On-premises (of wine more than 4% but not more than 21% alcohol by volume only)	\$225 minimum and \$225 extra on purchases exceeding \$5,000 for each additional \$5,000 sold or fraction thereof
On-premises retailer's permit for clubs	\$225 minimum and \$225 extra on purchases exceeding \$5,000 for each additional \$5,000 sold or fraction thereof
On-premises retailer's permit for common carriers, per car, plane, or other vehicle	\$120
Temporary retailer—Class 1 One Day	\$10 minimum and \$225 extra on purchases exceeding \$5,000 for each additional \$5,000 sold or fraction thereof
Temporary retailer—Class 2 70 days	\$50 minimum and \$225 extra on purchases exceeding \$5,000 for each additional \$5,000 sold or fraction thereof
Caterer's permit	\$600 minimum and \$250 extra on purchases exceeding \$5,000 for each additional \$5,000 sold or fraction thereof
Caterer's permit for on-premises retailer permit holder	\$150 minimum and \$250 extra on purchases exceeding \$5,000 for each additional \$5,000 sold or fraction thereof
Other	
Solicitor's permit	\$100
Research permit	\$100
Filing fee for each application	\$25

See Appendix B for the descriptions of the types of permits listed in this table.

Note 1: Some Class 1 manufacturers with limited production capacity that produce a product using a majority of ingredients produced in Mississippi have a special permit with a fee of \$10 per 10,000 gallons or part thereof produced.

Note 2: The definition of wine in MISSISSIPPI CODE ANN. §27-71-5 for on-premises retailers for wine is wine of more than 4% and not more than 21% alcohol by volume. However, MISSISSIPPI CODE ANN. §67-1-5 states that wine is not considered to be an alcoholic beverage if it is less than 5% of alcohol by weight.

SOURCE: MISSISSIPPI CODE ANN. §27-71-5

Agency Response

Joseph L. Blount, *Chairman
and Commissioner of Revenue*

Terry L. Jordan
Associate Commissioner

Donald L. Green
Associate Commissioner



MISSISSIPPI

STATE TAX COMMISSION

November 9, 2004

Executive
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Raymond, Mississippi 39154

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Dr. Max Arinder, Executive Director
Joint Legislative Committee on Performance Evaluation and Expenditure Review
501 North West Street
Woolfolk Third Floor
Jackson, Mississippi

Dear Dr. Arinder,

My staff and I have received the draft executive summary and have reviewed it and the draft report of your staff's evaluation of our Alcoholic Beverage Control operations and Tax Commission management of same. I trust you have an interest in improving the operations of state government, as do I. We have responded to the recommendations found in the draft executive summary as follows:

RECOMMENDATIONS – PART ONE:

Recommendation 1. ABC should reactivate its advisory group, made up of representatives of organizations such as the Mississippi Restaurant Association and Package Store Association, to receive input regarding its service to permittees.

Response: We agree that ongoing communication between Mississippi's wholesale liquor distribution staff and its industry/customer representatives is beneficial. ABC has continuous active relationships with the Mississippi Restaurant Association, the Mississippi Hospitality/Beverage Association, and the Mississippi Alcoholic Beverage Brokers/Representatives Association.

Recommendation 2. Using existing resources, ABC should conduct a needs assessment and create a detailed warehouse security plan. ABC should include in the need assessment a review of whether the costs would outweigh the benefits of operating and monitoring internal security cameras. A warehouse security plan that specifically lists the type of equipment needed, cost per equipment item, and the cost of additional personnel, if necessary, should be included in any future funding requests to the Legislature.

Response: Although current and past budget requests for the ABC operations have included requests for security cameras for the warehouse, until a detailed security

study is funded and performed, we have no realistic idea how much a state-of-the-art security system will cost to install and operate, and therefore, we have no way to determine in advance whether such a system would be cost beneficial.

Recommendation 3. ABC should seek to amend its contract with its distribution contractors (Shippers Express and M&J Transport) and should require in future contracts that both shipping companies obtain signatures and dates from retailers confirming the date of receipt of goods on the bill of lading and/or delivery notes. Also, ABC should periodically audit these dated delivery notes to ensure that shipping contractors are fulfilling their contractual obligation of next-business-day shipping.

Response: Our current contract with Shippers Express requires immediate reporting of product for which it is unable to make delivery, or for which delivery is delayed. Further, the contract requires diligent cooperation between the carrier and ABC to resolve all delivery shortages and overages, and this successfully occurs on an on-going basis. In addition, our customers do not hesitate to call us if an order is not delivered timely.

Recommendation 4. ABC management should set a periodic policy review cycle and require all division directors to update policy and procedure manuals and log all changes and reviews pertaining to their respective divisions and present these revisions for ABC management approval. Division directors should also update policies as any changes in process occur.

Response: We concur with this recommendation; however, budgetary constraints limit this effort. Up to date policy manuals would benefit any organization.

Recommendation 5. ABC should develop a written, task-based inventory procedures manual to implement ABC's new warehousing and distribution system implemented in 2003.

Response: We concur with this recommendation; however, budgetary constraints limit this effort. Procedures manuals would benefit any organization.

Recommendation 6. ABC management should require ABC's Warehouse Operations Manager to prepare a damage loss report which details the number of damaged and repackaged cases by item number, item name, and value. The report should be produced on a weekly, monthly, quarterly, and annual basis and should be used to address security and management issues.

Response: ABC management, including the Warehouse Operations Manager and the ABC Director, review the losses from damaged product on a daily basis, from a report which is generated daily. This daily review provides a mechanism to correct any problems immediately (next day), rather than at periodic times such as monthly or annually. A cost accounting of loss and damage is reconciled during physical inventory.

Recommendation 7. ABC should cease the use of its Warehouse Petty Cash Fund as presently operated and then choose one of the following options:
Option A

Obtain a procurement card and make all small purchases through the state purchasing system, using purchase orders.

Or;

Option B

Make larger, recurring purchases through the state purchasing system and pay for such purchases through accounts payable. Retain the petty cash fund for the purchase of small items such as inspection stickers and postage, but reduce the amount maintained in the account from \$1,000 to an amount sufficient to meet minor expenditures of not more than two months (suggested amount: \$250). Operate the account as a checking account, and authorize two individuals to make purchases on the account using a debit card. Develop a formal, written policy for managing the fund.

Regardless of the option chosen, ABC should make all purchases in accordance with the MAPP Manual.

Response: Our petty cash fund is the personal responsibility of our Warehouse Operations Manager and is used primarily to purchase noon meals for inmates who handle the janitorial duties at the ABC administrative offices. This arrangement saves the state the cost of these janitorial services each year, while only costing three fast-food lunches daily. We will continue to be diligent with the safeguarding of the state's money.

Recommendation 8. Should ABC choose Option B, the agency should improve its internal controls over petty cash, including arranging for two signors on the petty cash account with a third party to administer it, write checks, maintain the account balance, and reconcile monthly bank statements against receipts and expenses.

Response: See the response to recommendation 7.

Recommendation 9. Using existing resources, ABC should analyze training needs of ABC employees, addressing the training needs for each division or department and each job title. According to the training needs identified, ABC should make training available to all employees with the same job title. ABC should include cross-training in its analysis and document all cross training of employees. If training will not be provided internally, all employees should be made aware of the procedures to request training.

Response: We concur that training and formal training analysis would benefit ABC, as it would any organization. Budgetary constraints have restricted formal training efforts in recent years, however, training is taking place or employees would not be able to perform their job tasks under our new system.

Recommendation 10. The Office of Alcoholic Beverage Control (ABC) should create and monitor performance measures that reflect program improvement from year to year, showing progress toward achieving the goals of the agency, instead of performance measures that count transactions performed or dollars collected. Examples of such desired performance measures would be: X% decrease in damage/loss rate, X% decrease in overages/shortages at inventory, X% decrease in orders taken that cannot be delivered because they are out-of-stock, X% increase in revenue transferred to the general fund relative to operating expenses, or X% increase in orders completed and delivered the next business day.

Response: While not in the same manner this recommendation envisions, the ABC currently tracks and monitors damage/loss inventory, inventory shortages/overages, out-of-stock items, general fund revenues, operating expenses, and other measures, especially those relating to improving customer service. We will address these performance standards monitoring recommendations.

Recommendation 11. The State Tax Commission should comply with the requirements MISS. CODE ANN. Section 25-65-1 et seq. (1972). If and when the agency fills its internal audit position, that individual's job duties should include ensuring that financial, compliance, electronic data processing, operational and efficiency audits of ABC program and other Tax Commission programs are conducted as authorized in MISS. CODE ANN. Section 25-65-11 (1972).

Response: We agree with the need for a robust internal audit function within the Tax Commission and we have previously taken steps to address this need by establishing and filling the position, Director of Communication and Internal Audit, reporting directly to the Chairman. Additional resources will be assigned to the function as they become available.

Recommendation 12. The State Tax Commission should revise its permit renewal application to obtain fingerprint cards from the permit renewal applicant in order to conduct a criminal history check for permit renewals of permittees to ensure that they continue to meet the initial permitting qualifications in MISS. CODE ANN. Section 67-1-57 (a) (1972). Applicants should pay the filing fee, set in ABC Local Option Regulation Number 4, each year to reimburse ABC for investigating their qualifications for permit renewal.

Response: There are roughly 1500 ABC permit holders who each met the criminal history check when they received their initially ABC permit. ABC enforcement officers make routine checks on all ABC permit holders and are also involved with the local law enforcement agencies on an ongoing basis. Although it is possible for a permit holder to be convicted of a felony without this information being available to the ABC, we believe the likelihood of this happening is very low and that the cost benefit of requiring a full criminal history check each year for all 1500 permit holders is questionable. As a minimum, the legislature would need to authorize a significant increase in the annual \$25 renewal fee to cover these additional costs since the current fee doesn't even reimburse the State for the work that it currently performs.

Recommendation 13. The State Tax Commission should develop and implement a vehicle fleet management program to organize and operate its vehicles for official business while providing the management information necessary to operate the vehicles efficiently and effectively and in compliance with state and federal laws. Appendix F, page --, contains a discussion of critical components of a model vehicle management system.

Response: ABC enforcement has existing policies and procedures for vehicle use and this use is monitored through various methods such as Fuelman reports. We agree that a vehicle management policy for all Tax Commission vehicles should be established.

Recommendation 14. The State Tax Commission should perform a documented needs analysis with a breakeven cost analysis for the four individuals who commute in state vehicles. These analyses should determine if the STC Chairman, STC Deputy Commissioner, ABC Director, and ABC Warehouse Operations Manager have a compelling need for:

- the assignment of a state vehicle on a seven-day per week, twenty-four hour basis; and.
- the most cost efficient method for the state to reimburse these individuals for business trips after normal duty hours, i.e., to provide a state vehicle or to pay travel mileage.

Response: The four individuals in the Tax Commission who are assigned vehicles have twenty-four hour a day, seven days a week management responsibilities within the Tax Commission. The ABC warehouse manager oversees two work shifts that often work 20 hours a day. The Director of ABC not only oversees the warehouse operations but is also responsible for all ABC law enforcement personnel and activities. The Deputy Commissioner is responsible for all ABC operations as well as all tax collections and field audit functions, including the oversight of nine district offices throughout Mississippi. In addition to the Deputy Commissioner's administrative responsibilities, this job also requires frequent trips to Jackson from the Clinton office to meet with members of the legislature and representatives from state agencies. The Chairman of the Tax Commission is specifically authorized by state law to drive a state owned vehicle.

Recommendation 15. Using existing resources, the State Tax Commission should ensure that the SABER System includes collection of the Fuelman operational costs in weekly reports in order to provide a total vehicle operational cost for its vehicles. This information could be used to perform periodic performance audits to measure the effectiveness and efficiency of the system.

Response: Vehicle operational costs reports created in the Fuelman system are reviewed monthly by ABC law enforcement management. The collection of Fuelman data into the SABER system would require software changes. Funding to make this possible is not currently available.

Recommendation 16. The State Tax Commission should comply with MISS CODE ANN. Section 25-1-87 and use the two unmarked police vehicles exclusively for the gubernatorial-approved function of law enforcement.

Response: The individuals who drive these vehicles, i.e. the Director of the ABC and the Deputy Commissioner of the Tax Commission, have direct line responsibility for the ABC law enforcement functions and personnel. Years ago the decision was made to purchase police vehicles for use by these two individuals so they could serve as backup vehicles for the enforcement group if needed and could also be rotated into the enforcement fleet as new vehicles were purchased. If the vehicles were marked with external lettering they would have no value as undercover enforcement vehicles unless they were repainted before being used for direct police work.

Recommendation 17. When the State Tax Commission has to purchase additional passenger automobiles for administrative use, it should purchase mid-size, fuel-efficient five-passenger automobiles.

Response: As explained above, we believe it is prudent to continue our policy of using the “administrative” use vehicles as feeders for our police functions and we believe this is cost effective.

Recommendation 18. Using existing resources, the State Tax Commission should develop a written policy and procedure that complete and specifically details the process of discounting ABC inventory, including individual or individuals who have authority to discount products.

Response: We agree that a written procedure should be developed for discounting ABC products for sale to our customers.

RECOMMENDATIONS – PART TWO:

Recommendation 1. As long as the current policy environment of the state remains the same regarding alcoholic beverage control, the state should maintain control of wine and spirits wholesale, not privatizing through divestment or franchise of wine and spirits wholesale.

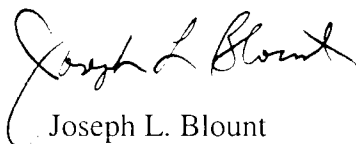
Response: Policy decisions relating to privatization of all or part of the ABC operations fall under the purview of the Mississippi Legislature. While we have the task of being the state’s wholesaler of alcoholic beverages, it is our responsibility to provide the best service possible to all customers in an economical manner.

Recommendation 2. If the State Tax Commission wishes to determine the cost-savings potential of contracting out, it should publish a request for proposals for contracting out warehousing, order-taking, and purchasing to determine whether the state would realize operating cost savings by contracting out those functions.

Response: The Tax Commission continually strives to monitor cost of operations while providing increased levels of customer service to our permittees. We also recognize the criticality of collecting funds for the State of Mississippi, and take these responsibilities very seriously. We will participate in any study the Legislature deems prudent to evaluate the operations of the ABC.

We appreciate the opportunity to respond to these findings and recommendations.

Respectfully,



Joseph L. Blount

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