

PERFORMANCE AUDIT

**DEPARTMENT OF LIQUOR LICENSES AND CONTROL**

Report to the Arizona Legislature  
By the Auditor General  
November 1988  
88-9

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November 14, 1988

Members of the Arizona Legislature  
The Honorable Rose Mofford, Governor  
Mr. Hugh Ennis, Superintendent  
Department of Liquor Licenses and Control

Transmitted herewith is a report of the Auditor General, A Performance Audit of the Department of Liquor Licenses and Control. This report is in response to a June 2, 1987, resolution of the Joint Legislative Oversight Committee.

We found the Department of Liquor Licenses and Control's compliance process, which constitutes 85 percent of the Department's disciplinary actions, needs greater controls to reduce the risk of abuse. In addition, the Department has not adequately controlled the licensing process, resulting in special handling of some applications and improper license issuance of others. The report also identifies problems in enforcing license renewals and addresses weak cash-handling procedures which contributed to two thefts of State monies.

My staff and I will be pleased to discuss or clarify items in the report.

Sincerely,



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## SUMMARY

The Office of the Auditor General has conducted a performance audit of the Department of Liquor Licenses and Control (DLLC), in response to a June 2, 1987, resolution of the Joint Legislative Oversight Committee. The performance audit was conducted as part of the Sunset Review set forth in Arizona Revised Statutes §§41-2351 through 41-2379.

### Greater Controls Are Needed Over The Compliance Process To Reduce The Risk Of Abuse And To Ensure Equitable Treatment Of Licensees (see pages 11 through 17)

DLLC's compliance process, which constitutes more than 85 percent of the Department's disciplinary actions, lacks adequate controls. The process places much authority and responsibility in the hands of essentially one person, with no guidelines and little supervisory review.

Compliance actions occur after a private meeting between the licensee and the Department's compliance officer. The penalties imposed as a result of these meetings range widely, with little or no documentation to support variations in penalties. For example, a licensee was cited for serving to a minor and fined \$500. A second violation resulted in a warning, and a third violation resulted in a \$250 fine. In contrast, another licensee who had no prior violations received a \$1,000 fine for the same offense.

The lack of documentation regarding penalties, coupled with a lack of written guidelines and no effective supervisory review, creates an opportunity for collusion between the compliance officer and the licensee. Requiring documentation of factors that justified the penalty imposed, such as prior violations and any mitigating or aggravating circumstances, as well as establishing written penalty guidelines, would facilitate adequate reviews of penalties and reduce the risk of abuse.

### DLLC Has Not Adequately Controlled The Licensing Process, Resulting In Special Handling Of Some Applications And Improper License Issuance (see pages 19 through 27)

DLLC needs to strengthen controls over the licensing process. Although

most applicants are handled according to Department policy, we identified several cases where it appears that some applicants were afforded special treatment which allowed them to begin operating sooner than normal. Also, DLLC has transferred liquor licenses to several applicants who did not meet statutory and Departmental requirements. In fact, several of the transfers were made to individuals who were judged to be unqualified on the basis of background investigations that revealed criminal information. Recent legislative changes governing license transfers should prevent such problems in the future.

**DLLC Internal Controls Do Not Adequately Safeguard State Revenue And Impounded Evidence** (See pages 29 through 34)

DLLC needs to improve controls over cash and evidence to reduce the risk of theft and loss. DLLC's failure to properly secure cash contributed to the theft of more than \$2,400 in state monies. In addition, numerous other control weaknesses offer significant opportunity for additional theft or misuse of funds. For example, no supervisory approval was required when almost \$13,000 was subtracted from cash register tape totals from March through August of 1987. The \$13,000 subtraction was apparently made so the tape totals would match the actual cash on hand for deposit.

**Board Duties And Responsibilities Need Clarification To Improve DLLC Operations** (see pages 35 through 39)

Current statutes do not delineate duties of the DLLC Board and the Superintendent. Overlapping duties and responsibilities have led to disputes over authority. Until 1983, the roles of the Superintendent and the Liquor Board were clearly defined. However, statutory changes made in 1983 and in 1985 suggest that the Board and Superintendent share responsibilities in some areas. As a result, several 1987 decisions concerning liquor licenses were made over Board objections.

**The State Should Strengthen Laws And Procedures Governing Liquor License Renewal** (see pages 41 through 44)

Control over the renewal process for liquor licenses is very weak. Current statutes are more lenient than those in some other states in

allowing the sale of liquor for 60 days after the license renewal date. However, some licensees sell liquor even beyond 60 days. This occurs because DLLC does little follow-up on expired licenses. In fact, DLLC did not even inform its own investigators of expired licenses prior to August 1988.

Low statutory penalties also do little to encourage prompt renewal of licenses. The Legislature should strengthen controls over the renewal process by prohibiting liquor sales by licensees who do not renew by their renewal date and by automatically revoking the licenses 60 days after the renewal date.

**Records Section Needs Better Control  
Over Licensing Files** (see pages 45 through 48)

DLLC needs to improve records management to ensure that essential records are protected against loss. Lacking a microfilming program, DLLC staff and the public regularly use original copies of irreplaceable records. In addition, DLLC fails to adequately restrict and supervise access to the records.

**Statutes And Regulations Governing  
Special Event Licenses Are Not Clear** (see pages 49 through 51)

Arizona law and DLLC regulations are unclear on special event licenses. Liquor statutes do not clearly define what groups are eligible for special event licenses nor what criteria organizations must meet to be considered legitimate. Also, neither local governments nor DLLC appear to carefully evaluate the qualifications of these organizations.

DLLC should also consider increasing the number of days for which qualified organizations may obtain special event licenses. The current two-day limit is too short to cover many of the special events for which permits are sought.

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## INTRODUCTION AND BACKGROUND

The Office of the Auditor General has conducted a performance audit of the Department of Liquor Licenses and Control (DLLC) in response to a June 2, 1987, resolution of the Joint Legislative Oversight Committee. The performance audit was conducted as part of the Sunset Review set forth in Arizona Revised Statutes §§41-2351 through 41-2379.

### History

Liquor has been taxed or otherwise regulated in Arizona since the late 19th century. The 1864 Howell Code, Arizona's first law compilation, provided for liquor taxes for vendors of wines and distilled spirits. In 1919 the 18th amendment to the United States Constitution created a national Prohibition, which eliminated the need for liquor regulation. Upon the repeal of Prohibition in 1933, the authority to license and regulate the manufacture and sale of liquor was placed in the Temperance Enforcement Commission under the State Tax Commission. In 1939, the Arizona Legislature established the Department of Liquor Licenses and Control, and vested responsibility for the administration and enforcement of liquor laws in the Superintendent. A three-member State Liquor Board was added in 1967, and the number of Board members was later increased to five and then to seven.

The Department is responsible for: 1) licensing alcohol beverage suppliers, wholesalers and retailers; 2) assisting State officials and political subdivisions in collecting liquor related taxes; 3) investigating compliance with liquor laws, and assisting State and local law enforcement agencies in liquor law enforcement; and 4) conducting hearings and imposing sanctions for violations of liquor laws. The types and numbers of licenses issued as of July 1988 is listed in Table 1.

Duties of the Board include: 1) granting and denying applications for licenses; 2) adopting rules and regulations to carry out the provisions outlined in Title IV; and 3) holding hearings and hearing appeals. Recent

additions to the Board statutes established a Liquor Panel. The Panel is appointed by the chairman of the Board and consists of not less than three Board members. The Panel may take action that the Board authorizes pursuant to Title IV.

Duties

Both the Superintendent and the Board members are appointed by the Governor. The Superintendent serves concurrently with the Governor, while Board members serve three-year terms.

TABLE 1

ACTIVE LIQUOR LICENSES ISSUED AS OF 7-1-88

<u>License Type</u>	<u>Number of Licenses Issued</u>
Beer and Wine Store	1,691
Bar - Quota	1,568
Liquor Store - Quota	1,491
Beer and Wine Bar - Quota	1,341
Restaurant	1,160
Special Events	789 (a)
Club	303
Out-of-State Producer	162
Out-of-State Importer/Exporter	159
Hotel/Motel	145
Arizona Wholesaler	72
Government - County, City, or Town	29
Conveyance - Airlines, Boats, and Trains	16
Domestic Farm Winery/Microbrewery	7
In-State Producer	1
<b>TOTAL</b>	<b><u>8,934</u></b>

(a) Special Event Licenses are issued to individual qualifying organizations. The criteria for licensing is established in A.R.S. §4-203.02. The license is only valid for a specific event and is limited to two, two-day events per year.

Source: Department of Liquor Licenses and Control.

## Personnel and Budget

DLLC receives a General Fund appropriation. Revenues are generated from license fees, fines and other miscellaneous sources, and deposited into the General Fund. The Department's revenues and expenditures for fiscal years 1986-87 through 1988-89 are shown in Table 2.

DLLC is divided into four divisions: Administration, Licensing, Enforcement and Judicial. DLLC employs 59 people statewide to administer and enforce liquor laws.

Administration Division - The Administration Division consists of the Superintendent and immediate staff. This includes the Assistant Superintendent, accounting personnel, Liquor Board secretaries and other clerical staff, for a total of nine employees.

Licensing Division - The Licensing Division is comprised of three sections: Licensing, Data Processing and Records. The Division's major responsibility is to process applications and transfers for liquor licenses. The Data Processing and Records sections maintain up-to-date records for approximately 9,000 active licensees. In addition, the sections provide information for the public and the Department regarding licensee status and business history. This Division has 18 employees.

Enforcement Division - The Enforcement Division is the investigative/enforcement arm of the Department, which is a duly authorized criminal justice agency. Investigators are fully certified peace officers in accordance with the Arizona Law Enforcement Officers Advisory Council (ALEOAC) requirements and standards. Investigators function statewide from duty assignment stations in Phoenix, Tucson and Flagstaff. The Division's principal objective is to ensure that liquor licensees and their employees comply with all liquor laws and rules. Twenty-three investigators and clerical staff are employed to perform this function.

**Judicial Division** - The Judicial Division consists of the Compliance and Hearing Sections. The Compliance Section negotiates consent agreements with licensees who have been cited for liquor related violations. The Compliance Section also reviews reports of violence or police intervention at licensed establishments to determine whether Department action is warranted. The Hearing Section was established in 1985 to provide the Department an independent process to review matters that were too complex or difficult for the Liquor Board or Superintendent to adjudicate. Currently, the section reviews matters assigned to it by the Board and Superintendent, in addition to administrative complaints, tax complaints and license transfers. The Judicial Division has nine employees.

TABLE 2

DLLC REVENUES, EXPENDITURES AND FTE POSITIONS  
FISCAL YEARS 1986-87 THROUGH 1988-89  
(unaudited)

	<u>Actual 1986-87</u>	<u>Actual 1987-88</u>	<u>Estimated 1988-89</u>
FTEs	<u>60.5</u>	<u>59</u>	<u>60.5</u>
Revenues	<u>\$3,391,100</u>	<u>\$3,146,714</u>	<u>\$3,714,600</u>
Expenditures:			
Personal Services	\$1,160,500	\$1,179,524	\$1,194,700
Employee Related	251,200	249,184	255,100
Professional and Outside Services	46,400	69,372	85,800
Travel:			
In-State	85,300	81,607	113,200
Out-of-State	2,300	1,658	7,000
Other Operating	300,200	391,797	383,200
Equipment	<u>56,500</u>	<u>20,005</u>	<u>10,800</u>
TOTAL	<u>\$1,902,400</u>	<u>\$1,993,151</u>	<u>\$2,049,800</u>

Source: Interviews with DLLC and JLBC staff, and Budget Documents fiscal years 1986-87 through 1988-89.

## Audit Scope and Purpose

This audit was conducted to evaluate the adequacy of regulation by the DLLC, focusing on these specific areas.

- The adequacy of controls over the Compliance Section.
- Whether the Department has given special treatment to some potential licensees.
- Whether DLLC needs to strengthen controls over cash and seized property.
- Whether statutes governing the duties and responsibilities of the Board and Superintendent conflict.
- The adequacy of DLLC's enforcement of statutes and rules and regulations governing license renewals.
- Whether controls over the Department's liquor files are sufficient to protect their contents.
- Whether the special events statutes need to be modified.

In addition, we addressed the 12 statutory Sunset Factors. This report also contains Other Pertinent Information regarding Investigator Activity and organizational climate at DLLC.

This audit was conducted in accordance with generally accepted governmental auditing standards.

The Auditor General and staff expresses appreciation to the Liquor Board, Superintendent and staff of DLLC for their cooperation and assistance during the course of our audit.

## SUNSET FACTORS

In accordance with A.R.S. §41-2354, the Legislature should consider the following 12 factors in determining whether the Department of Liquor Licenses and Control should be continued or terminated.

1. Objective and purpose in establishing the agency

The courts and the Legislature have stated that the objective and purpose for establishing the Department center on protecting the public health, safety and welfare. Before 1984 Arizona law did not define legislative intent for the DLLC.

In 1984 Arizona's session laws defined the purpose of the DLLC as follows: ". . . to regulate the liquor industry through the license control process, collect fees and taxes for the maintenance of government and enforce statutes in order to maintain the health, and welfare of the community."

2. The effectiveness with which the agency has met its objective and purpose and the efficiency with which it has operated

The Department's effectiveness in meeting its objective and purpose has been hampered because licenses and interim permits were issued to apparently unqualified individuals (see Finding II, page 19). In addition, the Department has exercised weak and poor controls over its compliance process (see Finding I, page 11).

3. The extent to which the agency has operated in the public interest

Besides problems that have negatively impacted the Department's effectiveness in meeting its objective, the Department has not acted in the public interest by failing to properly control cash, which has resulted in the theft of public monies.

4. The extent to which rules and regulations promulgated by the agency are consistent with the legislative mandate

In 1986 DLLC attempted a major revision of its rules and

regulations. The Department submitted 19 rules to the Attorney General's Office for certification, but only one was certified. The others were withdrawn due to deficiencies. In December 1987 DLLC resubmitted 15 rules. According to the Department's Attorney General representative, all 15 will be denied certification because of the long delay between public participation and input.

The Superintendent informed our Office that the Department will attempt to recodify its statutes in the upcoming legislative session. After this process is complete, the Department will submit whatever rule changes are necessary so the rules will conform with statutes.

5. The extent to which the agency has encouraged input from the public before promulgating its rules and regulations and the extent to which it has informed the public as to its actions and their expected impact on the public

The Department held public meetings the last time it promulgated rules, in 1986. However, when the Department resubmitted the rules after changes were made, no public meetings were held. Because of the long delay after public input, the Attorney General's Office will not certify rules the Department now has pending.

6. The extent to which the agency has been able to investigate and resolve complaints that are within its jurisdiction

DLLC's enabling statutes establish a formal complaint review process. In addition, statutes mandate that certain types of violations must be investigated by the Department. Our review of DLLC's complaint process found that local law enforcement agencies did not report violations in a timely manner, the Department took no action on many of those violations, and when the Department did act the disposition was questionable. DLLC is currently working with local law enforcement agencies in attempts to reduce the number of unactionable complaints. In addition, the Department is establishing a new process for internal review of outside complaints. The Department expects that the new system will better resolve complaints by ensuring that the necessary evidence is identified and obtained.

7. The extent to which the Attorney General or any other applicable agency of State government has the authority to prosecute actions under enabling legislation

A.R.S. Title 4 sets forth civil penalties for liquor related violations. Statutes allow the Superintendent and the Liquor Board to impose penalties. The penalties range from \$200 to \$3,000, and according to DLLC, any amount of suspension time that is deemed appropriate. During the hearing process the Attorney General's Office represents the Department.

8. The extent to which the agency has addressed deficiencies in its enabling statutes which prevent it from fulfilling its statutory mandate

In recent years several bills have been introduced and passed that were designed to clarify A.R.S. Title 4 and increase penalties for liquor related violations. For example, DLLC successfully sought legislation during the 1988 session giving the Department more flexibility in evaluating requests for license transfers. Also, the Department obtained legislation prohibiting the consumption of alcohol at unlicensed commercial businesses where food or beverages are sold and entertainment is provided.

9. The extent to which changes are necessary in the laws of the agency to adequately comply with factors listed in the Sunset law

Based on our audit work, we recommend that the Legislature consider the following changes to DLLC's statutes.

- Amend A.R.S. §§4-112 and 4-210 to clearly delineate authority between the Superintendent and the Liquor Board (see Finding IV, page 35).
- Amend A.R.S. §4-209.01 to automatically revoke unrenewed liquor licensees 60 days after the license renewal date, and establish stiffer penalties (including mandatory license revocation) for persons who sell liquor after their licenses expire (see Finding V, page 41).

- Amend A.R.S. §4-203.02 to clearly define the criteria for qualification as a charitable organization under the Department's special event procedures (see Finding VII, page 49).

10. The extent to which the termination of the agency would significantly harm the public health, safety, or welfare

Regulation of the liquor industry is necessary for the protection of public health, safety and welfare. The need for control over the sale of liquor is well established. All 50 states regulate the liquor industry, although regulatory structures vary dramatically. Terminating DLLC could impact the health, safety and welfare of the public, and would probably require that local governments assume the responsibility for regulation.

11. The extent to which the level of regulation exercised by the agency is appropriate and whether less or more stringent levels of regulation would be appropriate

Our audit work suggests that the level of regulation is appropriate.

12. The extent to which the agency has used private contractors in the performance of its duties and how effective use of private contractors could be accomplished

DLLC currently contracts for court reporters. In the past, the Department has contracted for hearing officers, court reporters and interpreters.

Although the Department feels that some of the past contracts were not cost effective, it plans to continue contracting for court reporting services. In addition, due to an anticipated backlog in judicial hearings, DLLC plans to contract for hearing officers from the private sector when necessary.

## FINDING I

### GREATER CONTROLS ARE NEEDED OVER THE COMPLIANCE PROCESS TO REDUCE THE RISK OF ABUSE AND TO ENSURE EQUITABLE TREATMENT OF LICENSEES

Inadequate control may reduce the integrity of the Department of Liquor Licenses and Control (DLLC) compliance process. Most of the Department's discipline is handled by one compliance officer whose actions receive little review. Penalties imposed by the compliance officer appear inconsistent and are not documented. More thorough documentation and guidelines for imposing penalties would enable the Department to more adequately guard against potential abuse and ensure fair treatment of all licensees.

#### Compliance Officer Determines Most Enforcement Actions

Although the compliance section was established in 1985 to help alleviate a backlog of cases awaiting hearings, it has become the Department's main disciplinary process. The goal of the compliance section (which is essentially one person)<sup>(1)</sup> is to resolve alleged violations by liquor licensees without going through the formal hearing process. During 1987 more than 85 percent of the Department's administrative disciplinary actions against liquor licensees were generated by the compliance section. This section issued 447 warning letters to licensees and entered into 469 consent agreements in 1987. In contrast, the Department's hearing section issued only 132 administrative reports and recommendations during the same period.<sup>(2)</sup>

The compliance officer has extensive authority to make decisions in cases involving liquor law violations. Prior to June 1988 the compliance officer reviewed police reports of alleged liquor violations and determined whether disciplinary action against a licensee was warranted.

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(1) There is one permanent compliance officer position and three clerical staff. Recently, an additional employee was temporarily assigned to work compliance cases.

(2) The State Liquor Board rarely handles disciplinary cases. The majority of its caseload consists of original applications and nonuse of licenses.

Now, DLLC investigators initially review the reports and recommend action. However, the compliance officer still determines whether action should be taken. In most cases that warrant action, the compliance officer then meets with the licensee for an informal, off-the-record discussion. The compliance officer is the Department's only representative in this meeting, and in practice is solely responsible for judging the evidence in the case and determining the penalty to be imposed. Further, this penalty can vary substantially - from \$200 to \$3,000. <sup>(1)</sup>

In most cases on which the compliance officer decides to take action, a consent agreement listing the violation, date of violation, and the penalty agreed upon is the only documentation of what transpired during this informal conference; no other record of discussion is available. The written agreement is signed by both the licensee and the compliance officer. Although the consent agreement is later reviewed and signed by the Superintendent or Assistant Superintendent, no documentation of what transpired during the conference is provided to the reviewers, and the terms of the agreement are rarely changed as a result of their review. Thus, the compliance officer's decisions serve as the Department's response in most disciplinary actions.

If a licensee refuses to meet informally or if an agreement cannot be reached between the compliance officer and the licensee, the matter is referred to a formal administrative hearing. However, less than 15 percent of licensees are referred from the compliance section for a hearing.

#### Penalties Appear Inconsistent

Disciplinary actions by the compliance section do not appear to be consistent. Overall, we found a wide range of penalties imposed. Although the Department contends that the variation is justified by the facts in each case, the compliance officer provided little documentation to justify the differences in penalties for the cases observed in our sample.

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(1) This section collected \$181,775 in fines in fiscal year 1987-88.

Wide range of penalties imposed - Our sample of 193 consent agreements showed that penalties vary greatly among licensees.<sup>(1)</sup> Some licensees receive relatively minor penalties while others are subject to much more severe punishment. For example, licensees cited for selling to underage persons<sup>(2)</sup> were assessed fines ranging from \$200 to \$3,000. Table 3 further illustrates the range of penalties imposed for those violations that occurred most often in our sample.

TABLE 3

RANGE OF PENALTIES IMPOSED FOR MOST FREQUENT VIOLATIONS<sup>(a)</sup>

<u>Violations in Sample</u>	<u>Violation Type</u>	<u>Range of Fine</u>	<u>Fine Most Often Imposed</u>	<u>Range of Suspension</u>
93	Sell or provide liquor to a minor	\$200-\$3,000	\$500	2-5 days
13	Sell or provide liquor to intoxicated or disorderly person	\$500-\$2,000 <sup>(b)</sup>	\$1,000	3-7 days
11	Employee consuming or buying liquor	\$200-\$750	\$200	2-4 days
10	Minor on premises without a guardian	\$200-\$1,000	<sup>(c)</sup>	3 days

(a) This table includes only those violations that appeared at least ten times in the sample.

(b) Four licensees received a combination of three-day suspension and \$1,000 fine.

(c) Fine amounts of \$200 and \$500 were imposed equally often.

Source: Auditor General sample of 193 consent agreements from the period of April 1, 1987 through March 31 1988.

(1) A statistically valid sample of 193 was randomly selected from the population of 388 consent agreements for the period April 1, 1987 through March 31, 1988. The sample had a reliability of plus or minus 5 percent at the 95 percent confidence level.

(2) Violations for selling or providing liquor to an underage person (A.R.S §4-244.9) account for approximately half of the cases handled by the compliance section.

Although some consistency in fines was evident in the cases we reviewed, it was not always apparent from the file why one licensee was fined more harshly than another for the same violation. For example:

- One licensee cited for two counts of selling to a minor was fined \$1,000; while another, also cited for two counts of selling to a minor, was suspended for 10 days (the equivalent of a \$2,500 fine, according to the compliance officer). Neither licensee had any prior liquor violations.
- One licensee was fined \$200 for failing to notify the Department of an act of violence on the premises. Another licensee cited for the same offense was fined \$500. Neither licensee had any prior liquor violations.

The above cases illustrate the variance in penalties imposed for similar violations. However, our review also indicated no consistent pattern supporting increased penalties for licensees with prior liquor violations.<sup>(1)</sup> We also identified cases where licensees with prior liquor violations were fined less than or the same as first time offenders. Although prior violation information is one of the few factors that is documented in the licensee file, its impact on penalties imposed was not evident in all cases.

- In August 1986 a licensee was fined \$500 for allowing a minor on the premises without a guardian. Seven months later the licensee was given a warning for the same violation. A third violation resulted in a \$250 fine in February 1988. In contrast, another licensee who had no prior violations was fined \$1,000 in April for the same offense.
- In September 1986 the compliance officer imposed a fine of \$1,000 on a licensee for serving alcohol to a minor. Eight months later a second violation resulted in a \$500 fine. The same fine was imposed on another licensee for serving to a minor, and this licensee had no previous violations.
- On December 13, 1986, a licensee was cited for serving to a minor and fined \$500. Nine months later the licensee was again cited for the same violation but fined only \$200.

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(1) Our analysis only considered prior violations that occurred within two years of the current violation. A similar criterion is used by DLLC's hearing officers.

The compliance officer contends that penalties vary because the factors in each case are different. However, the lack of documentation in licensee files limited our ability to determine whether the Department is dealing with violators systematically and consistently.

No documentation to support penalty variations - Although penalties varied widely, the consent agreements and licensee files did not document why the different penalties were imposed. The Department does not require supporting documentation for penalties imposed through the compliance process. Lack of documentation limits the Department's control over the compliance process.

The lack of supporting documentation prevents adequate review of the consent agreement. Although every consent agreement must be approved by the Superintendent or Assistant Superintendent, in most cases all this official sees is the actual consent agreement and the associated police report on the violation. Neither the consent agreement nor any other information provided to the reviewer indicates what factors affected the penalty imposed. Reviewers are not regularly informed of factors such as prior violations or the strength of the evidence against the licensee.

The lack of documentation reduces control over the compliance process and creates the opportunity for collusion between the compliance officer and licensees. The compliance process is essentially handled by one person from start to finish, with no written standards to guide decisions and no effective review of those decisions. Although we found no evidence of collusion, the compliance officer's authority to take action without documenting his decisions and the significant financial consequences these decisions can have for licensees necessitate strong control.

In contrast, the hearing process provides a more detailed record of decisions and ensures greater control. When a licensee goes to hearing, the hearing officer uses the information gathered during the hearing to prepare a report of the facts and circumstances and the reasons for the decision, including any recent prior violations, as support for the

recommendations for action. Although this much in-depth detail may be too cumbersome for the compliance process, a brief synopsis of the factors influencing the decision would show why certain penalties are imposed. For example, New Mexico has a compliance process similar to Arizona's, but New Mexico's liquor regulations require written findings of fact and specific grounds for any decision made regarding a violation.

**Lack Of Compliance Guidelines  
Increases Possibility For Abuse**

Discrepancies in penalties may also result from the lack of Departmental policy for penalizing violators. The lack of guidelines and limited documentation to support penalties may increase the risk of abuse in compliance decisions and actions. Other states have established penalty guidelines to ensure consistent actions against violators.

**Lack of accountability may increase possibility of abuse** - As noted previously, most of the Department's discipline is handled by the compliance officer under conditions that increase the possibility for abuse. Penalty guidelines would reduce the risk of abuse. However, neither the statutes nor regulations provide specific penalties or ranges for various types of violations. Also, neither the Superintendent nor the compliance officer have adopted formal guidelines for determining penalties. Therefore, the compliance officer has extensive discretion to apply whatever penalty he feels is appropriate, within the broad statutory limits.

Despite this wide discretion, the compliance officer's criteria are not well defined. The compliance officer originally stated that he has a standard "in his head" to determine the proper penalty. Later he indicated that his decisions may be based on such factors as the age of an individual or the person's participation in an industry sponsored alcohol management course. All factors used to consider the compliance officer's penalties were disclosed only after repeated attempts by audit staff to get the Department to explain the large differences in similar decisions and actions.

Standard written penalty guidelines would establish expectations, and promote consistency and equity among penalties imposed against

licensees. Guidelines would also increase Departmental control over the compliance process by establishing expected penalties for specified violations. Deviations from the guidelines would be readily apparent. DLLC does not see a need for specific penalty guidelines, arguing that each case is different and should be considered individually based on the merits of that case. However, a lack of formal guidelines fosters broad discretionary powers, which reduces the Department's control over the compliance process and may result in inconsistent and inequitable treatment of licensees.

Other states have formal penalty guidelines - Several states have established more specific guidelines - either in regulations or agency policy - for taking disciplinary action against licensees. The Texas Alcoholic Beverage Commission uses a "Standardized Penalty Chart" to determine appropriate penalties. The chart lists suspension ranges for each of 61 different violations. These ranges escalate for subsequent offenses. For example, the first offense of selling to a minor will result in a 5 to 10 day suspension, and the second offense will result in an 11 to 15 day suspension. <sup>(1)</sup> Tennessee, California and New Mexico also specify ranges or specific fines for various types of violations. California's penalty schedule allows variations from the established fine amounts, with supporting written documentation.

#### RECOMMENDATIONS

1. DLLC should establish a schedule of expected penalties for violations to promote consistency and equity among licensees penalized.
2. DLLC should require documentation of factors that impact penalties imposed, to ensure that the reviewer has all the necessary information in order to evaluate the appropriateness of the consent agreement.

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(1) For some violations a licensee has the choice of converting the suspension to a fine at the minimum rate of \$150 to \$750 per day of suspension. Thus, a five-day minimum suspension for the first offense would convert to at least a \$750 fine. This minimum fine amounts to more than DLLC fines most licensees for this same violation.

## FINDING II

### DLLC HAS NOT ADEQUATELY CONTROLLED THE LICENSING PROCESS, RESULTING IN SPECIAL HANDLING OF SOME APPLICATIONS AND IMPROPER LICENSE ISSUANCE

The Department of Liquor Licenses and Control (DLLC) needs to strengthen controls over the licensing process. Although it appears that most applications are handled properly, the Department seems to process some applications more expeditiously than others. Statutes governing license transfers have been applied in a manner that has allowed apparently unqualified individuals to obtain liquor licenses. In addition, the Department's Licensing Division has issued temporary permits to persons whose applications for liquor licenses are under protest by the DLLC enforcement division.

#### DLLC Appears To Handle Some Applications In A Special Manner

DLLC does not process all applications for liquor licenses in the same manner. Although our review indicates that most applications are handled according to Department policy, several cases suggest that DLLC can be pressured into expediting some applications. This special processing tends to favor selected applicants by allowing them to begin operating sooner than the norm.

Department procedures require that persons seeking liquor licenses submit certain information in their applications. Required information includes legible fingerprints, histories of all persons associated with the business seeking licensure, adequate bonding for some licenses, and all sales tax information. The Department has established procedures to ensure the orderly processing of liquor applications. These include: accepting only fully completed applications, requiring fingerprints for some original applicants, requiring background approval before license issuance, and collecting the proper bond.

During the course of our audit numerous allegations were received by our office regarding DLLC's improper licensing practices. As a result, our office conducted a random sample of original license applications to test controls of the licensing process. In addition, we investigated specific allegations. A sample of original license files found that all applicants met A.R.S. or DLLC requirements, and State background checks were completed on all applicants prior to license issuance. However, the sample identified one application that was processed even though it was incomplete.

### Example 1

- An application for a new license was received on October 27, 1987. DLLC documentation indicates that the licensing examiner was concerned about accepting the application because it was incomplete. The licensing examiner was requested by her supervisor to accept the application, and an interim permit was issued October 27. The licensing supervisor could not explain why this application was accepted.

In following up on the specific allegations, we found that three licensees did in fact receive special treatment. The Department did not follow its normal practices in issuing the licenses, and may have broken the law in one case.

### Example 2

- An original license application was received on February 2, 1987. Although an interoffice memorandum indicates the application was not correct and was incomplete, it was still processed. The application lacked corporate officers' fingerprints, and complete personal and business histories. In addition, the applicant did not supply sufficient information regarding license ownership.

The Department received several requests from prominent public officials to expedite this application. An employee said phone calls were received supporting this application. A DLLC supervisor indicated that the requests had an influence on DLLC to process and approve the application despite its incompleteness. (All officials involved in issuing the license are no longer employed by the Department.) Eventually all the background information was received. DLLC approved the license on February 20, 1987, 18 days after receiving the application. The State background investigation was not completed until February 25, five days after the application was approved.

### Example 3

- An application was received by the DLLC on April 6, 1988. The licensing examiner was requested to accept and process the application on April 15, even though it was incomplete. Fingerprint cards were provided on April 20. All the other information was submitted by April 27. A Superintendent's Order was issued on April 28 approving the application and the license was issued.

DLLC issued this license 13 days after accepting the application on April 15. This compares with an average time of 100 days when applicants are required to provide fingerprints. According to the Superintendent, the applicant thought that no license was required since the establishment was located on Indian land. When informed to the contrary, the licensee submitted an application only two weeks prior to scheduled opening. Although DPS completed the background check in less than two weeks, the license was not approved in time for the scheduled opening. The applicant solicited several qualifying organizations to obtain special event licenses so the establishment could open as scheduled and operate until the new license was approved. DLLC agreed to this arrangement on the assumption that the proceeds would be given to the appropriate organizations.

DLLC's actions in these cases suggest that some applicants can obtain special treatment. In several of these cases, applicants were represented by attorneys who were knowledgeable about licensing requirements and were thus able to reduce the time needed to provide complete information to the Department. However, these cases also show that DLLC made exceptions to its stated requirement that applications be complete prior to acceptance for processing. These exceptions occurred despite clear evidence that the applications were not complete.

Special handling is also evident in one case in which the Department permitted a former licensee to renew a license that had been cancelled for nearly 11 months.

### Example 4

- On November 21, 1986, a licensee surrendered a license to the Department and filed a "Surrender of License" form. The license was cancelled. On October 15, 1987, the former licensee requested DLLC to "reactivate" the license. DLLC renewed the cancelled license on October 19 without requiring a new application, thus bypassing the licensing process. The request to reactivate the license was submitted so an applicant, who was seeking a license for the same location, could obtain a temporary license (interim permit) while waiting for license approval from the DLLC. DLLC's

approval of this request appears improper because there are no statutory provisions that give the Department the authority to reissue the cancelled license.

DLLC's actions in these cases suggest that some applicants receive special treatment, particularly in accepting incomplete applications and issuing licenses prior to completing background checks. Although these cases represent only a small portion of liquor license applications, they raise questions about the integrity of the licensing process. Individuals may be able to prod the Department into issuing licenses without reviewing all relevant information to determine if they are qualified. Even if these individuals are qualified to hold liquor licenses, the special treatment described above is unfair to the many other applicants who comply with the law and Department procedures.

**Licenses Have Been Transferred  
To Potentially Unqualified Applicants**

DLLC has approved applications for transfer of liquor licenses to applicants who appear unable to meet statutory or Departmental requirements. Although recent legislation may address the Department's problem relating to license transfers, DLLC may not be able to revoke licenses transferred to these individuals.

**Licenses issued to individuals not meeting requirements** - Based on allegations and concerns by some DLLC personnel and other individuals suggesting that the Department may be abusing its authority in regards to certain license transfers, we reviewed recent Department activity in this area. We found DLLC transferred liquor licenses to several applicants who did not meet A.R.S. and Departmental requirements. The Department approved the transfers on the basis of a written memo from its Attorney General representative. However, background investigations revealed that the applicants had a history of liquor law or criminal violations that investigators felt should disqualify them from obtaining a license.

Because of a legal interpretation from its Assistant Attorney General, DLLC approved requests for license transfers if the Department had held the application for more than 90 days. A.R.S. §4-267 states that applications for acquisition of control [transfers] are deemed approved after 90 days if not acted upon by the Superintendent. The Department's

Assistant Attorney General advised DLLC that failure to act within the allotted time period or to obtain a consensual extension of time would result in automatic approval of the application. Merits of the application were not considered once the 90 days had passed.

However, other options may have been available to DLLC both before and after the expiration of the 90-day period. For example, the Assistant Attorney General told us that the Department could have set the application request for hearing any time prior to the 90th day. This would allow the Department an opportunity to prepare documentation needed to protest the license. Such a procedure would have allowed the Department to deny the license even if the applicant had not been to hearing before the 90-day statutory deadline. In addition, after the license was issued, the Department could possibly revoke the license if the applicant failed to disclose past criminal history. The Attorney General representative did not discuss either option with DLLC. He asserted that DLLC did not request his opinion for any options, and he does not normally offer advice unless requested.

Our review identified seven cases in which the Department approved license transfers to individuals judged to be unqualified on the basis of background investigations. Below are three examples illustrating applicants who were potentially unqualified to hold a liquor license.

#### Example 5

- An application was received on November 10, 1987. The applicant was granted an interim permit, which allowed the business to operate up to 105 days. A second interim permit was granted on February 22, 1988. On March 3, 1988, a "Statement of Opposition" was filed against the application by the Enforcement Section of the DLLC, asserting that:
  1. The applicant pled guilty to the sale of alcohol to a minor on March 31, 1987.
  2. A criminal case was pending against the applicant for sale of alcohol to a minor.
  3. The applicant failed to disclose a citation for sale of alcohol to a minor.
  4. The applicant failed to disclose an indictment by a Federal Grand Jury for forcible rescue of a seized automobile.

5. On June 11, 1987, the applicant accepted a two-day suspension of the liquor license.

According to a DLLC staff member, this file had been locked in a supervisor's file cabinet for an undetermined length of time, and was not discovered until February 16, 1988. It was later determined the 90-day period had lapsed on February 9. Thus, the Department felt it was required to approve the application. The license was issued on March 24, 1988.

#### Example 6

- An application was received by DLLC on September 28, 1987. A report was submitted by a DLLC investigator on December 11, 1987, protesting the application due to the past hidden ownership, numerous tax and liquor complaints, questions about the applicants' reliability and capability to hold a liquor license in the past, and criminal histories and driving histories of the two individuals applying for the license. The file contains a handwritten note dated March 1, 1988, stating: "since it was over 90 days the license had to be issued."

#### Example 7

- An application was received on January 5, 1988, and an interim permit issued. A report and protest was filed by a DLLC investigator on March 24, 1988, recommending that the application be denied ". . . due to this applicant's failure to disclose a 1985 arrest and 1986 conviction for assault." The application was approved on May 19, 1988, because of the Department's failure to act on the application within 90 days. The investigator submitted the report questioning the applicant's qualifications 79 days after the original application was made to the Department. However, the Department failed to act on the investigator's report during the 11 days remaining in the review period.

One problem hindering the Department's approval of these transfers has been its inability to track the applications to ensure action within the legal time frame. In one case, the Department was well beyond the 90-day limit when it received a background report questioning the applicant's qualifications. However, in the two other cases DLLC appears to have had all necessary information to disapprove the applications, but failed to act before the 90-day period ended.

Recent legislation eliminates automatic approval - Legislation enacted by the 1988 Legislature has changed the requirements governing license transfers. House Bill 2417, which became effective on July 8, 1988, strikes the language that an application for license transfer "is deemed approved by the Superintendent" if not acted upon within a specified time

frame. The "deemed approved" clause has been deleted from the law. In addition, the new law provides 105 days for Departmental action and gives the Department the option to extend the period for an additional 105 days. These provisions place applications for license transfers under the same requirements that apply to applications for new licenses. Thus, the problems that occurred in the cases cited above should be avoided in the future.

However, the new law does not address the fact that liquor licenses have been issued to unqualified applicants. Although DLLC issued licenses to persons it had deemed to be unqualified, the orders granting the licenses were worded in a manner that may make it difficult or impossible to revoke the license. A Superintendent's order was issued in each of these cases stating that the applicant had complied with all or parts of A.R.S. §§4-201, 4-202 and 4-203. Despite the Superintendent's language, these applications and others were not approved based on the applicants' compliance with statute, but rather on the lack of timely review by the Department. However, by formally stating that the requirements had been met, the Department may have forfeited its right to revoke licenses issued to unqualified individuals.

#### Interim Permits Allow Unqualified Applicants To Sell Spirituous Liquors

DLLC's policy of issuing interim permits while the Department reviews applications for licenses has allowed unqualified individuals to sell liquor for periods up to one year. The Department has routinely issued interim permits to persons applying for license transfers and for some categories of new licenses. However, interim permits have been issued even when the Department had plans to oppose the applications.

A.R.S. §4-203.01 authorizes the Superintendent to issue interim permits which allow an applicant to operate a business on a temporary basis for up to 105 days while waiting for approval of an application. Interim permits are available for same location, same series, license transfers, and all hotel/motel and restaurants. An interim permit is a conditional permit, and authorizes the holder to all the privileges of the retail license for which the application has been filed with the Department. An applicant may be granted two consecutive interim permits.

However, as the following case shows, even when DLLC staff have documented evidence to protest the issuance of a liquor license, an applicant may be permitted to sell spirituous liquor under an interim permit.

### Example 8

- An application was submitted on June 3, 1987, and an interim permit issued. A second interim permit was granted on October 7, 1987. An investigative report was issued by a DLLC investigator on October 23 protesting the application ". . . due to the constant repetition of the nature of the liquor violations and due to the amount of violations and suspensions . . ." The report also noted that the applicant ". . . only disclosed one liquor suspension when indeed there were nine . . ." The application was denied on January 25, 1988.

On February 2, 1988, the applicant was permitted to reapply and was issued another interim permit. A second interim permit was granted on May 11, 1988. The second application was denied on May 26, 1988. Through the use of interim permits, the applicant was allowed to operate and sell spirituous liquors for seven months while having two applications denied.

Five of the six other states we contacted do not issue interim permits. When an individual seeks to transfer a license in those states, the applicant must either wait for license approval or work as an employee under the old license until the new one is approved. According to the DLLC Superintendent, Arizona's interim permit policy allows the Department to hold the applicant responsible for ensuring compliance with the law during the period before the new license is approved. However, the Department's policy of routinely approving interim permits and its failure to withdraw the permits if it decides to protest the application reduces its ability to ensure that only individuals meeting the qualifications established by law sell alcohol in Arizona.

DLLC recently adopted an informal policy of denying interim permits to applicants when the Department has information that would lead the Department to oppose the application for licensing. For example, four applicants were denied interim permits at the time of application because the Department opposed the license application based on available information. However, DLLC has not established a formal, written policy that would ensure that interim permits are not issued to applicants when the Department questions their applications.

## RECOMMENDATIONS

1. DLLC should establish and adhere to clear written policies and procedures for all license applications. Incomplete applications should not be accepted. All applications should include all components necessary for processing, as described by DLLC policy.
  
2. The Department should establish the following policies for issuing interim permits.
  - Refuse to issue interim permits if the Department has reason to question the applicant's qualifications or plans to protest the application.
  
  - Under authority granted in A.R.S. §4-203.01, DLLC should cancel interim permits when the Department plans to protest a license because of unfavorable background investigation.

## FINDING III

### DLLC INTERNAL CONTROLS DO NOT ADEQUATELY SAFEGUARD STATE REVENUE AND IMPOUNDED EVIDENCE

Poor internal controls have resulted in improper handling of cash and evidence. Weak cash-handling procedures, which increase the potential for abuse and decrease accountability, contributed to the theft of state monies. In addition, impounded evidence is not adequately monitored.

The Department of Liquor Licenses and Control (DLLC) handles large amounts of cash. Payments for registration, renewals and other fees, and assessed fines are received by mail and over-the-counter. In fiscal year 1988, license fees and fines totaled more than \$3.1 million. One-third of the license fees collected are paid to the appropriate counties with the remaining balance deposited into the state General Fund. In addition, the Department refunds fees associated with withdrawn or denied applications.

The Department also maintains a storage area to retain evidence of liquor violations. DLLC investigators confiscate items such as liquor and cash to use as evidence of violations. The Department auctions or destroys evidence when it is no longer needed. Recently, an auction of confiscated evidence associated with several licensees raised almost \$900.

#### Cash Routinely Handled Inappropriately

Control procedures are weak in all areas of the Department where checks, money orders and currency are received and handled. We found deficiencies throughout the process, from the time cash enters the system until it is ultimately deposited. In addition, it appears that petty cash funds have been used inappropriately.

Weak controls have resulted in at least two thefts in the past 18 months.

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(1) According to DLLC, the two thefts are still under active investigation by the Department.

- Clerks routinely leave cash in an unlocked safe. In June 1987, \$2,414 in cash disappeared from the DLLC licensing section, which routinely takes in large amounts of cash. A DLLC licensing clerk received \$1,600 and \$814 on two separate occasions, placed the money in envelopes, and left it in a safe that is kept unlocked during the day. The safe is in an unsecured area and is accessible to at least five employees. The lack of security and accessibility of the safe along with the poor cash receipt process prohibited the Attorney General's Office from determining who was responsible for the missing money.
- Employees routinely leave cash on or in unlocked desks. In March 1988, \$40 was taken from an envelope containing \$7,581 that was to be deposited. The envelope was left unattended on an employee's desk. An investigation of the incident revealed it was not uncommon for the clerk to leave deposit monies unattended and unsecured. Other employees also leave cash in unlocked desks, sometimes for weeks or months.

Further, other control weaknesses offer significant opportunity for additional theft or misuse.

- Little control is maintained over the Department's cash register. At one point 11 employees had authorized access to the cash register; however, the actual number of employees with access is unknown since personal identification numbers, which allow access to the register, were not kept confidential.<sup>(1)</sup> In addition, there is no approval process for adjustments to cash register transactions. Almost \$13,000 was subtracted from cash register tapes from March through August 1987. Apparently, the \$13,000 was subtracted so that the register tape totals would match the actual cash on hand for deposit. No supervisor approved the adjustments and there is no documentation for why the adjustments were made. Therefore, the validity of those adjustments is questionable and suggests the possibility of theft.
- Improper segregation of duties further reduces control over cash. One person closes out the cash register, reconciles the cash register tape to the cash, posts the cash receipts, prepares the deposit slip and makes the deposit. This employee also had access to the Department's safe. The same employee should not perform tasks that provide opportunities for stealing cash receipts and concealing the theft. Cash-handling and record-keeping duties should be separated.
- Various problems associated with cash receipts were identified. For example, the licensing section accepts large dollar amounts of cash

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(1) The Department says that only six employees currently have access to the cash register.

over-the-counter. However, no receipts were provided unless requested.<sup>(1)</sup> In addition, the Department's compliance division received payments for fines and maintained receipt books on these collections. However, a review of receipt books revealed several pages of missing receipts. Also, in some instances the Department's copy of a receipt was blank, although the top copy of the receipt was missing. Furthermore, one receipt book covering a five-month period could not be located. The lack of receipts and missing receipts increases the possibility of fraud and abuse.

- A Department secretary opens all the mail for the Department. Much of the mail contains checks since most renewals (approximately 800 per month) are paid by mail. However, no listing is kept of mail cash receipts and the checks are not restrictively endorsed. Restrictively endorsing checks prevents unauthorized persons from cashing the checks. In addition, listing mail cash receipts facilitates tracking of receipts and establishes a method to verify receipt of payment.

Problems with petty cash - A recent financial audit of the Department also revealed "a total breakdown of internal controls" over the petty cash fund, including failure to adequately monitor reimbursements, employees unfamiliar with authorized fund amounts, and improper bank reconciliations. The following cases illustrate several questionable payments from petty cash, and indicate the potential for abuse.

- \$66 for an employee's psychological counseling was paid for out of petty cash despite a letter from the Arizona Attorney General's Office advising that this was improper.
- In October 1987 the Department paid \$261 from petty cash for an investigator's eye exam and glasses. Since petty cash fund expenditures should be limited to normal business operation expenses, it would have been more appropriate to pay the claim directly through the State Compensation Fund.

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(1) The Department now requires cash register receipts to be given for every cash transaction. Handwritten receipts are issued only if the register is not functioning.

Evidence Is Not  
Adequately Controlled

Evidence is not sufficiently safeguarded or accounted for. A recent DLLC inventory of its evidence room revealed impounded evidence with no property slips, no Departmental report numbers, and no investigator identified. As a result, some confiscated evidence cannot be traced to a specific case. For example, 11 bottles of liquor had no property slip, no report number, and no indication of the investigator responsible. Consequently, we could not determine where the bottles came from, when they were taken, or why they were confiscated.

In addition, confiscated cash is not adequately safeguarded or receipted.<sup>(1)</sup> Confiscated money from illegal gambling in liquor establishments is placed in the DLLC property room. The money is not deposited or placed in the safe. Since the money is not all receipted, it is impossible to tell whether it is all accounted for. However, a recent DLLC memo addressed management's concern regarding the accountability of evidence, and established a procedure for handling cash seized.<sup>(2)</sup>

Furthermore, DLLC does not monitor the property room. Although we identified no cases of missing evidence, there is an obvious potential for items to disappear. The property room, which is located in the basement of the Industrial Commission building, is accessible to at least 14 DLLC employees. (In addition, the room is located off a hallway which is accessible to the public.) Although a log is used to identify who was in the evidence room and what evidence was brought in or taken out, no one monitors the log and employees frequently fail to sign it.<sup>(3)</sup>

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- (1) A recent inventory identified less than \$200 in cash in the property room. However there is no way to verify whether any cash was taken prior to the inventory.
  - (2) As of July 25, 1988, all cash seized as evidence will be impounded in the safe.
  - (3) Auditor General staff accompanied investigators to the property room on several occasions and never observed any of them signing the log. In addition, an investigator who recently frequented the property room for inventory purposes never signed the log.

In addition to potential theft, failure to control access to the property room may affect the Department's ability to prosecute cases. Currently, DLLC cannot ensure that evidence placed in the room has not been tampered with. This could result in evidence necessary to prosecute a case being determined inadmissible.

### RECOMMENDATIONS

1. DLLC management should establish and maintain the following internal accounting and administrative control systems.
  - Written cash receipts procedures, such as immediately processing cash receipts through the cash register, listing all mail cash receipts immediately upon opening, and immediately restrictively endorsing checks.
  - Written procedures for handling all cash register overages, shortages and voids, which address investigation of material differences between cash receipts and the daily cash register tapes, supervisor approval for any adjustments, and documentation of the reasons for adjustments.
  - Procedures that adequately safeguard cash to reduce the temptation for theft.
  - Attempt to secure reimbursement for questionable disbursements from petty cash and implement procedures to guard against further inappropriate disbursements.
  - Segregation of cash-handling and record-keeping duties.
2. DLLC should formally adopt policies and procedures to ensure accountability for confiscated evidence.
  - Specify mandatory information that must be captured on property slips and require supervisory sign-off to ensure that all information is identified.

- Designate one person accountable for the property room. This person should log in evidence, place it in the property room and retrieve it when necessary, and track the movement of evidence when it is checked out of the property room.
- Establish a verifiable log of evidence in the property room to facilitate periodic inventory checks and track evidence.
- Conduct periodic reviews and inventory of evidence to maintain accountability.

## FINDING IV

### BOARD DUTIES AND RESPONSIBILITIES NEED CLARIFICATION TO IMPROVE DLLC OPERATIONS

Overlapping duties and responsibilities of the Department of Liquor Licenses and Control (DLLC) Board and the Superintendent have led to disputes over authority to regulate liquor in Arizona. Current statutes appear to give similar authority to both the Superintendent and the Board. Changes in statutory provisions would clarify duties and improve the working relationship between the Board and Superintendent.

#### The Board And Superintendent Have Overlapping Responsibilities

Overlapping responsibilities and disputes over authority indicate a need for statutory changes. In the past, the roles of the Board and Superintendent were clearly defined. However, recent changes in law suggest that the Board and Superintendent share responsibilities in some areas. As a result, decisions are being made in spite of Board objections.

Roles were clearly defined - Historically, the roles of the Superintendent and the Liquor Board were clearly defined. Before 1967 DLLC was directed by a Superintendent with no Board. In response to allegations of abuse of power by the Superintendent, a Liquor Board was established and given the sole authority to issue, renew, transfer and revoke liquor licenses. The Board's powers and authority were further clarified in 1972 when the Attorney General's Office issued an opinion stating that the Superintendent's functions related to administrative and enforcement procedures only. The opinion further stated that the Board functions "are quasi-judicial in nature." However, because of a backlog in cases set before the Board, statutes were amended in 1983, giving the Superintendent equal authority with the Board to issue, revoke and renew licenses. State laws were further amended to allow the Superintendent to handle all license transfers. Both changes gave the Superintendent authority over areas that were once strictly Board responsibilities.

**Recent changes create dual responsibilities** - Existing statutes result in dual responsibility for many liquor functions. Changes to A.R.S. §§4-112, 4-201 and 4-210 eliminated the Board's "sole" power to act in specific instances. Current laws give the Superintendent and the Board shared responsibility for the regulation of liquor licenses. According to the Superintendent, under the present system the Board acts as a check and balance against a Superintendent who may want to usurp Board powers. But the Superintendent, some Department officials and Board members identified serious problems that can arise under the present system. For example, the Superintendent can issue licenses and make decisions without the Board's knowledge. In addition, disputes can develop between the Board and Superintendent over which has the overall responsibility for particular licensing decisions. The Department's Attorney General representative points out that under the present law the Board has the ultimate authority on licensure decisions, but the Superintendent can manipulate or circumvent the Board by not communicating with them. In addition, Board members indicate that without clear delineation of authority the Board and the Superintendent rely on unwritten policies, communication and trust. This may have put the Superintendent in a position to abuse his authority, whether intentional or not.

**Decisions made in spite of Board objections** - The Liquor Board has taken exception to the Superintendent's actions in several cases for which members feel the Board should have authority. Under A.R.S. Title 4, the State Liquor Board is responsible for certain activities. In instances where the law has established shared responsibility, as in the case of license issuance, suspension, revocation and renewal, a policy has been established through verbal agreement. For example, according to Board Members, the Board and Superintendent agreed that all liquor licenses pertaining to swap meets were to be handled by the Board. However, this agreement was not followed, as shown in the following example.

**Case 1**

The Superintendent granted a restaurant liquor license to a swap meet without informing the Board. The license area encompassed approximately 13 acres of land. Liquor Board members say they would have denied the license on the basis of a 1972 Attorney General's Opinion stating that a liquor license must be bound by the immediate premise of the restaurant itself.

Comment: The Board was upset that the Superintendent did not adhere to a verbal policy agreement that the Board would review all swap meet liquor license applications. Because the Board was not aware of the swap meet license until after it was issued, the Board could not protest or revoke the license.

In another case, the Superintendent made a major decision without the Boards' knowledge in an area for which the Board feels responsible.

## Case 2

On August 2, 1985, the Board revoked a liquor license. The licensee appealed the revocation to the Superior Court, which referred the case back to the Board based on a legal technicality. On July 10, 1987, the Board assigned the case to a hearing officer. On November 13, 1987, the Superintendent removed the case from the hearing officer, combined the Board's case with two other outstanding disciplinary cases against the licensee, and entered into a consent agreement without the Board's knowledge. The three cases had a total of 18 counts of alleged violations. The Superintendent's consent agreement ordered the licensee to pay a \$1,000 fine and serve a one-week suspension. The fine was paid on November 24. The one-week suspension was completed on December 8.

The hearing officer scheduled to handle the cases was notified of the Superintendent's decision shortly before the hearing, and on December 8, 1987, received a memo from the Superintendent's Office informing him that the case was no longer under his jurisdiction. This was the same day the licensee's suspension ended. The Board could not reverse the decision of the Superintendent because the suspension had already been completed.

Comment: The Assistant Superintendent who entered into the agreement with the licensee said he thought the action taken was authorized by A.R.S. §4-210.A, which gives the Superintendent as well as the Board the power to act in disciplinary matters. However, based on the Board's reaction, he said the Department action was a mistake and the case should have been adjudicated through the Liquor Board.

Interviews with the Board members revealed several other cases where they feel the Superintendent took actions that usurped the Board's authority. However, the Board did not have the opportunity to hear or respond to these cases before the Superintendent took action.

### Changes In Statutory Provisions Could Improve Working Relationship

Changes in statutory provisions could create better working relationships, reduce overlap and guard against potential abuses. The Legislature has several different alternatives to better define Superintendent and Board roles.

The Legislature could modify statutes to clearly identify the responsibility of the Board and the Superintendent. According to the Superintendent and members of the Board, clarification is definitely needed. DLLC's Superintendent feels the Superintendent should have the authority to revoke, suspend and issue licenses, subject to an appeal before the Liquor Board. The appeal process would allow the Board to hear any cases where the licensee felt the Superintendent's action was unjustified. A former Superintendent for DLLC feels the Board should be the final authority for all Departmental action.

In addition, to ensure against potential abuse the statutes could require that the Superintendent inform the Board of all decisions within a reasonable time frame. The decisions should remain temporary until Board ratification. Such a law would reduce the likelihood that a Superintendent would exceed his authority. This process is used in some other states we surveyed.

In areas where legislative clarification is not practical, such as training for Board members or updating members on new legislation, the Legislature should require formal agreements to be promulgated in DLLC's rules and regulations. With the assistance of the Attorney General's Office, the Board and Superintendent could clarify the necessary areas and adopt the rules needed to administer them.

### RECOMMENDATIONS

1. The Legislature should consider amending A.R.S. §§4-112 and 4-210 to clearly delineate authority between the Liquor Board and Superintendent. It should eliminate overlapping responsibilities by identifying the specific duties and authorities of both the Superintendent and the Board.

2. The Superintendent and Board should establish agreements in rules and regulations to clarify the remaining areas of uncertainty, with the assistance of the Attorney General's Office.

## FINDING V

### THE STATE SHOULD STRENGTHEN LAWS AND PROCEDURES GOVERNING LIQUOR LICENSE RENEWAL

The Department of Liquor Licenses and Control (DLLC) fails to adequately control liquor license renewal. The Department does not enforce the law that requires businesses to stop selling liquor after their licenses expire. Neither State law nor Departmental policies provide incentives for prompt renewal. The Legislature should strengthen penalties for late renewal and failure to renew.

#### DLLC Allows Licensees To Sell Liquor After Their Licenses Expire

Many licensees sell liquor illegally after their licenses expire. Statutes mandate that the sale of liquor is illegal after license expiration, which occurs 60 days after the renewal date. According to a Legislative Council memorandum, if a licensee does not submit a license fee to DLLC within 60 days of the renewal date, the license expires.

Our review of the Department's license renewals found that many licensees did not renew until after their expiration dates, and some licensees continued to serve liquor even though their licenses had expired. The review showed that of 6,218 renewals due between July 31, 1987 and March 31, 1988, 109 licenses were renewed after they had expired. Auditor General staff identified 24 Phoenix area businesses operating on expired licenses.<sup>(1)</sup>

Licensees can continue to sell liquor because the Department does little follow-up when a license expires. According to licensing personnel, DLLC

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(1) The percentage of incidences we identified is high enough to cause concern about illegal liquor sales, but low enough to suggest that Department investigators could call or visit each establishment. Checking on expired licenses appears feasible. Working from a printout of nonrenewed licenses, auditors telephoned and visited 121 establishments in about 18 hours and found 24 operating illegally. These results demonstrate that DLLC investigators could profitably spend a few hours each month making similar inquiries. Concentration on bars and restaurants would be most productive, since they accounted for almost 80 percent of renewals after expiration.

mails letters to licensees ordering them to cease-and-desist, and sends copies to all parties with a financial interest in the license. It cancels the license by releasing any bonds, issuing any refunds, archiving the computer records, and moving the master file folder to a bottom shelf. However, until recently the Department did nothing to ensure compliance with the cease-and-desist order. It did not notify wholesalers about expired licenses and still does not notify city or county law enforcement agencies or the Department of Public Safety-Investigations and Liquor Enforcement Division (ILED).<sup>(1)</sup> Prior to August 1988, DLLC did not even inform its own investigators when licenses expired.

**Neither Statutes Nor Department Policies Encourage Prompt Renewal**

Arizona statutes provide low penalties and little risk for licensees who fail to renew in a timely manner. DLLC further weakens the State's position by allowing licensees to renew long after licenses expire. Other states have stronger controls over renewals.

Statutes provide little incentive for licensees to renew on time. Currently, licensees have a 60-day grace period during which they may sell liquor and renew their licenses.<sup>(2)</sup> Further, if a licensee can demonstrate "good cause" the Superintendent may renew a license after 60 days. Penalties for late license renewals are based on 20 percent of the annual license renewal fee, and range from \$10 to \$100. This penalty is relatively minor for businesses worth thousands of dollars with a potentially high profit margin.

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(1) Notification would allow other agencies to assist DLLC in its enforcement efforts. Liaison personnel within local law enforcement agencies should be alerted to the possibility of illegal liquor sales in their jurisdictions. Wholesalers can also assist in preventing illegal sales because they are prohibited from selling to customers whose licenses are invalid. The Superintendent has recently emphasized wholesalers' responsibility to sell only to valid licenseholders and informs our office that he has already seen positive results. The Department plans to provide computerized information on expired licenses to all wholesalers so they can identify customers whose licenses are no longer valid.

(2) Renewal is permitted at any time during the 60-day grace period. Although statutes say that unrenewed licenses are subject to revocation, the law does not require revocation and DLLC has never revoked a license during this period.

In addition, present DLLC policies do not encourage prompt renewal. For example, DLLC routinely accepts weak documentation as "good cause" for late license renewals. The Department rarely refuses to renew expired licenses. According to the licensing supervisor, no licensee was denied renewal until 1988 when the Department refused to renew an expired license of an individual with an eight-year history of liquor violations, and pending charges for trafficking in stolen property, possession of marijuana and disorderly conduct.

Because Arizona does not adequately control the license renewal process, it could have lost up to \$1 million last year by renewing expired quota licenses in Maricopa and Pima counties instead of reselling them. These bar and liquor store licenses are issued at market value. Last year, five licenses valued at \$34,250, 29 valued at \$25,450, one valued at \$25,050, three valued at \$22,450, and 26 valued at \$1,575 were renewed after expiration.

In contrast, other states have stronger control over renewals. A survey of other states found that California, Colorado, Texas and Tennessee automatically revoke licenses on the day renewal becomes overdue. In addition, some states send liquor department agents to visit premises and make sure they are not operating, California notifies local police to assist with compliance, and Tennessee sends reminders before a license is due for renewal. <sup>(1)</sup>

### **Legislature Should Strengthen Penalties**

Licensees should not be allowed to sell liquor for 60 days after their renewal date. The present statute allowing licensees to sell after their renewal date is outmoded and should be eliminated.

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(1) Arizona's preventive measures appear insufficient compared to those of other states. DLLC mails out renewal applications 60 days in advance, and has no further contact with licensees until mailing cease-and-desist orders. Based on our review, cease-and-desist orders have been mailed as early as 16 days and as late as 98 days after renewal dates.

Because the number of quota licenses is controlled by the State, once a license expires a licensee may not be able to obtain another. Therefore, the Legislature may want to continue to provide a 60-day grace period, but licensees should not be allowed to continue sales during this period. If a 60-day grace period is continued, then licenses should automatically be revoked if not renewed within that time frame.

The present statutory provisions allowing licensees to sell liquor for 60 days after their renewal date serves no purpose. According to Department and industry spokespersons, the provision was probably intended to allow for the slow manual processing of renewals when all licenses were due at the same time. However, the current automated system of staggered renewals has eliminated much of the delay in processing renewals. As a result, a representative from the liquor industry and the Superintendent agree that the provision is no longer needed.

#### RECOMMENDATIONS

1. The Legislature should consider amending A.R.S §4-209.01 to:
  - End permission to sell liquor after the license renewal date.
  - Mandate license revocation 60 days after the renewal date and place any revoked quota licenses back into the license lottery.
2. DLLC should supply a list of nonrenewed licenses to wholesalers, local law enforcement agencies liaisons, and the DPS ILED unit at least once a month.
3. Department investigators should visit establishments with expired licenses to verify that they are not selling liquor.

## FINDING VI

### RECORDS SECTION NEEDS BETTER CONTROL OVER LICENSING FILES

The Department of Liquor Licenses and Control (DLLC) needs to improve records management to ensure that essential records are protected against loss. The Department maintains many unique records that contain important information for controlling liquor sales in the state. However, current procedures for handling records do not provide adequate protection. DLLC could improve records management in several ways.<sup>(1)</sup>

DLLC maintains more than 9,000 active licensee master files that document the chronological history of each establishment since its inception. The files also contain information on the licensee, the establishment, financial interests and liquor law violations. Complaints and police reports are kept in an envelope inside the file.

DLLC's files are irreplaceable, since they contain the only copy of most documents. Although some current licensee information is in the Department's computer database, the files are the Department's only written record and the only source for licensee background and establishment history.

#### Control Over License Files Is Inadequate

The Department's procedures do not protect license files. During the course of our audit we learned that some files were missing, documents had apparently been removed from others, and files were casually left lying on desks.<sup>(2)</sup>

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(1) We requested a review of fileroom procedures and security by the State Department of Library, Archives and Public Records. Records Management staff identified several problems and recommended improvements.

(2) We discussed some of these problems with DLLC personnel. As a result, DLLC instituted some new policies to improve control. Our recommendations are based on the new policy, which still does not go far enough toward file security.

- Restaurant audit documents, which reportedly showed liquor revenues of approximately 81 percent of the gross (legal maximum is 60 percent), were missing from a licensee file when we attempted to verify the allegation.
- One licensee file has been missing for weeks. Fileroom staff have new material to add to the file, and have conducted repeated unsuccessful searches for it.
- Envelopes containing complaints and other documents on each licensee's liquor law violations, which are used by the compliance officer in determining penalties for repeat offenders, were incomplete in many files.

These conditions exist partly because employees have unsupervised access to the files. Department staff may enter the fileroom and pull files, take them to their offices, and hold them for up to a week at a time. Employees are instructed to leave "out" cards in place of the files, but do not always do so.

Problems also exist with public access to the files. We saw many people given files to view without showing the required picture identification. Although fileroom staff insist that they can watch people as they use the files, we observed groups of people sitting so the folders were hidden from view, and on one occasion saw a member of the public leave the room with a file.

Finally, according to the Department of Library and Archives, documents within the files should be numbered in such a way that missing documents can be identified. Documents can be removed from files and no evidence of the removal will remain. An allegation was made that some former staff members shredded documents that would reflect poorly on the Department's decisions. It is impossible to confirm or deny the charge because no record of the documents in the file were kept.

#### DLLC Could Improve Records Security In Several Ways

The Department could reduce the potential for lost documents by establishing some simple, low-cost controls. For long-term security, microfilm copies would both provide backup and eliminate the need for staff and the public to handle original documents.

Immediate improvements could be made in three areas. First, file protection could be improved by placing the fileroom off-limits to most staff and enforcing the picture identification requirement for public access. Second, the need for file access could be limited by adding more information to the computer database so staff can use their terminals instead of the files. For example, investigations in progress, bonding and other information could all be incorporated into the database. Finally, problem detection could be improved by numbering documents within files to identify missing pages, and by establishing a manual or computerized file-tracking system.

Because the documents are irreplaceable, DLLC should strongly consider a microfilm system. Employees and the public could view the microfilm copies instead of the original files, which would protect original documents against theft or loss. According to Library and Archives officials, such a system costs approximately \$30,000, and would enable DLLC personnel to film records. The initial filming of existing records would probably have to be contracted out, at a cost of about \$40 per 1,000 pages for an approximate total cost of \$10,000.

#### RECOMMENDATIONS

1. DLLC should microfilm records to protect the originals against loss or theft.
2. The Department should adopt the following controls to prevent and detect problems in the original files.
  - Sequentially number all documents to alert staff to missing pages and deter theft or destruction of file contents.
  - Place the fileroom off limits to all personnel except fileroom staff.
  - Improve computer usage to reduce the need for pulling the original files. Investigations in progress (coded for security), bonding, tax liens, and other items could all be incorporated into the database.

- Install a file-tracking system, either manual (filing a copy of each out card by a suspense date) or computerized.
3. DLLC should work with the Library and Archives staff to establish file controls and set up the microfilm system.

## FINDING VII

### STATUTES AND REGULATIONS GOVERNING SPECIAL EVENT LICENSES ARE NOT CLEAR

Arizona law and Department of Liquor Licenses and Control regulations on special event licenses are unclear. Current provisions defining groups eligible for these licenses are ambiguous. In addition, current limits on the total number of special event days may be overly restrictive.

#### Statutes And Rules Are Ambiguous

Requirements defining who may obtain special event licenses are unclear. In addition, local authorities do not verify that organizations are qualified for such licenses.

Special event licenses are temporary permits that allow qualifying organizations to sell liquor for on-premises consumption. The law specifies several types of qualifying organizations such as charitable, civic, political and religious groups; and fraternal organizations in existence for more than five years. DLLC's rules limit each organization to two, two-day licenses per year. DLLC allows different chapters of the same organizations to be counted as separate organizations, thereby increasing the two license limit.

License requirements are unclear - Statutes do not clearly define what groups are eligible for special event licenses. This ambiguity is especially notable compared to other statutes defining charitable organizations.

A.R.S. §4-203.02 defines what entities may obtain special event licenses. Although the law generally describes eligible groups, it does not specifically identify criteria all organizations must meet to be considered legitimate. In contrast, A.R.S. §5-401 (State Amusements and Sports Statutes) more clearly defines what criteria must be met to

qualify for a bingo permit, and makes reference to A.R.S. §43-201 which states requirements to qualify for tax exemption. This law is less subject to arbitrary interpretations than is A.R.S. §4-203.02. For example, A.R.S. §5-401.B defines a charitable organization as:

" . . . any organization including not more than one auxiliary of the organization, not for pecuniary profit, which is operated for charitable purposes within the state and which has been so engaged for two years prior to making application for license . . . ."

This law specifically defines other entities such as fraternal organization, qualified organization, religious organization and veterans' organization. The law even addresses the length of time each organization must exist to qualify, what constitutes auxiliary membership, and lawful use and purpose of the entity.

Limited review of organizational qualifications - Neither local governments nor DLLC appear to carefully evaluate qualifications of organizations applying for special event licenses. Although initial approval for a special event license must be provided by the locality where the event will occur, local governments depend on DLLC to ensure that individuals who apply for special event licenses meet statutory requirements. A survey of local government officials responsible for processing special event license applications found that the majority depend on DLLC to ensure proper compliance with the law. Consequently, the cities or counties rarely deny a license application unless local law enforcement officials object, leaving the decision for license issuance to the Liquor Department. However, DLLC maintains that it usually approves all license requests certified by cities and counties. Because neither local governments nor DLLC sufficiently ensure compliance with the law, licenses may be issued to unqualified organizations.

#### Limits May Be Too Restrictive

Current limitations for special event licenses may be too restrictive. A.R.S. §4-203.02.D allows the Superintendent to implement rules limiting the number of times during the year that a qualified organization may apply for and be issued a liquor license. DLLC rules limit organizations to two, two-day events per year. However, many times events sponsored by

charitable organizations, such as golf tournaments and art festivals, last more than five days or happen more than once a year. Documents and license requests reviewed by our Office indicate that some organizations want more than four days for their events. Therefore, these organizations may seek licenses for themselves and auxiliary groups to obtain the needed permits for liquor sales. For example, one group obtained special event permits allowing eight days of liquor sales by applying under four different groups. According to a Legislative Council memorandum, the broad definition of organizations under the special event law makes this practice legal.

In contrast, other states surveyed allow more special licenses or provide alternative methods when an applicant needs a liquor license for special events. For example, Colorado allows ten days per year and Tennessee allows 12. California has no limit except on certain organizations named in statute. In addition, Texas and New Mexico have no limit on the number of times an organization may hire a regular licensee to obtain a permit and serve liquor at its events. This practice is illegal in Arizona.

#### RECOMMENDATIONS

1. The Legislature should consider amending A.R.S. §4-203.02 to clearly define the criteria for qualifying as a charitable organization eligible for special event licenses.
2. Once the criteria are clarified, DLLC should adopt rules and regulations to assist cities and counties in reviewing applications for special event licenses. These rules and regulations should provide guidance as to the circumstances that would warrant disapproval.
3. DLLC should review the qualifications of applicants approved by localities to ensure that approvals meet established criteria.
4. DLLC should consider increasing the number of days qualified organizations may obtain special event licenses.

## OTHER PERTINENT INFORMATION

During the audit, other pertinent information was developed on the investigation section and the organizational climate at the Department.

### DLLC Lacks Information To Evaluate Investigator Activities

DLLC investigative staff has grown from seven investigators in 1983 to 21 in 1988. Investigators' primary activities are to conduct routine inspections of liquor establishments and investigate complaints against licensees. However, the lack of useful management reports prohibited auditors from evaluating the effectiveness and efficiency of the investigator's activities.

Currently, oversight of investigators is limited because there is no detailed and analytical information about how investigators spend their time. Although monthly activity reports and weekly time reports are generated, no one analyzes the information by activity to show how investigators' time is spent. For example, monthly reports indicating the number of inspections, complaints assigned and completed, and citations issued are produced autonomously by the Department's northern and southern districts; however no cumulative totals are kept nor is the information compiled to form one report for the section. Also, no analysis is done to determine any trends or to compare activities between the two districts. In addition, no attempt is made to determine the time spent on each type of activity or to identify trends in how investigators' use their time.

Although DLLC management has not analyzed or compiled any information to determine how investigator time is spent, 21 additional investigator positions have been requested for fiscal year 1989-90. However, there is no information compiled to document that staff is performing at optimal efficiency or to support the need for additional staff. In fact, a cursory review of the southern district's monthly activity reports for the period January 1988 through June 1988 revealed dramatic productivity

declines in all activity areas. For example, the number of complaints completed per month dropped 68 percent since January, while the number of liquor inspections dropped 56 percent.

In addition, the Department is not using all allocated investigative positions for enforcement functions. The section has three investigative personnel assigned to noninvestigative duties.<sup>(1)</sup> Also, one position has gone unfilled for more than five months. Furthermore, the section is top heavy, with a ratio of almost one supervisory position for every two investigators.

#### Employees Identified Upper Management Problems

Due to allegations of illegal acts and employee dissatisfaction, our office conducted a staff survey of DLLC in May 1988.<sup>(2)</sup> As a result, several incidents of potential illegal acts were documented. All information was evaluated by the audit staff, and some of the results are contained within several of the earlier audit findings.

The survey of DLLC employees and Board members also disclosed that personnel working in the Liquor Department are dissatisfied with several aspects of their work environment. Employees expressed the most concern with management instability, personnel policies, cooperation within the Department, and insufficient resources to do their work.

As part of our audit, we administered an organizational climate survey to solicit employee attitudes and concerns that could impact DLLC's efficiency and effectiveness.<sup>(3)</sup> Employees were asked to express agreement or disagreement with 20 statements about the work environment at DLLC. An opportunity for open-ended comments was also provided.

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- (1) An additional investigator has been on sick leave for more than two months and recently retired.
- (2) A new Superintendent was confirmed the same month the survey was conducted. As a result, some survey responses may indicate attitudes about the former administration.
- (3) See Appendix I.

Sixty DLLC employees and Board members were surveyed, including all employees except the current and former Superintendents and the Assistant Superintendent. Thirty-four (57 percent) responded to the survey.

Responses to the questionnaire indicated employee dissatisfaction and concern in the following areas.

- Cooperation and communication - Employees tended to feel that departments do not work well together, and there seemed to be a lot of friction between individual employees. This was particularly true in the enforcement section.

Some members said communication between the Department and the Board was unsatisfactory. (This comment reflects Board members' feelings before the new Superintendent joined the Department.)

- Insufficient resources - Many employees cited the lack of needed equipment as a hindrance in their jobs. Again, enforcement employees were the most discontented. They felt their needs for cameras, tape recorders, transportation and operating funds were not being met.
- Management instability - More than half the employees responding to the survey complained about chaotic working conditions. They referred to the environment as "crisis management." However, they expected improvement under the new Superintendent.
- Personnel practices and policies - Employee responses indicated dissatisfaction with Department personnel policies, and a limited knowledge of grievance procedures. Some described Departmental policy as "good old boy" politics, and criticized appointments of exempt positions under the former Superintendent.



State of Arizona  
Department of Liquor Licenses and Control

800 W. Washington, Fifth Floor

Phoenix, Arizona 85007

(602) 542-5141

November 7, 1988

Rose Mofford  
Governor

Hugh Ennis  
Superintendent

Douglas R. Norton  
Auditor General  
Office of the Auditor General  
2700 North Central Avenue  
Phoenix, Arizona 85004

Dear Mr. Norton:

Attached are responses from the Arizona State Department of Liquor Licenses and Control to the audit conducted by your Department.

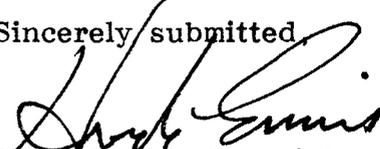
It is my belief that the audit was completed by a very good team of professional state employees under your direction. This Department went out of its way to provide every piece of documentation they requested.

I would like to explain my position to you. During the past four years the Department of Liquor Licenses and Control has undergone a series of changes of leadership. I am the fifth Superintendent since 1984. Many of the changes were brought about because of a change of Governors and their appointees. This produced considerable instability in the Department and changes of direction. Also, in 1986, the Liquor Department moved from 1645 West Jefferson to our present site at 800 West Washington resulting in many records being moved to dead files or lost. All of these events occurred prior to my becoming Superintendent on April 1, 1988.

I have included the Current Mission Statement which is supported by our Budget Request for FY 1989-90. You will also find in our response several areas of concern that need to be clarified by Legislative action.

In summary, I am not pleased by the Audit Report, however, I accepted full responsibility for the Department of Liquor in April of this year. Many of the deficiencies noted were corrected prior to your audit report being received since they were items that needed correction. Policies have been written and a new attitude has been instilled in all employees and we are looking forward to a period of stability and growth.

Sincerely submitted,

  
Hugh Ennis, Superintendent

HE/slh

## DEPARTMENTAL MISSION STATEMENT

The mission of the State Department of Liquor Licenses and Control is to provide the State of Arizona with a system that effectively integrates and utilizes departmental, civic and community resources to ensure responsibility within the liquor industry through the enforcement of liquor laws and regulations, the screening of applicants for liquor licenses, inspections of existing licenses, liaison with local law enforcement agencies and the investigation of complaints pertaining to licensees from law enforcement agencies and the community.

To achieve our mission, the values and beliefs of the Department of Liquor Licenses and Control are focused in the following areas:

1. Education:

It is the department intent to promote responsible business practices and informed industry through education by supplying information and personal contact with manufacturers, wholesalers and retailers doing business in the State of Arizona.

2. Regulations:

It is the department's intent to insure that we are proactive as well as reactive to the needs of the industry and community.

A. Proactive:

1. Those applying for liquor licenses will be guided and closely scrutinized to insure that they are properly licensed and that they are properly structured to conduct their business. Every effort will be made to insure that those who should not be in the industry are stopped prior to becoming a problem.
2. Information will be made available to the industry on changes in the law as well as decisions made by the Superintendent of Liquor Licenses and Control.
3. Increased liaison and training of local law enforcement agencies will remain a priority. This will enhance our ability to better service the local communities and properly deploy and direct our resources to the benefit of the State and industry.

4. Close contact by Investigators with retail licensees will detect potential and existing problems, educate licenses, serve to prevent problems and promote voluntary compliance with liquor laws and regulations.
5. A major emphasis will continue to be placed on preventing any element with an illegal or corrupt design from entering the industry.

B. Reactive:

1. The Department will deal swiftly, firmly and surely with those in the industry who choose not to obey the law, encourages the abuse of alcohol or who sell to minors and underage persons.
2. Utilizing the Compliance and Hearing Sections of the Department as well as the criminal justice system, the Department will take strong measures to eliminate the profitability of those licensees who choose to improperly or illegally conduct their business.
3. Complaints relating to licenses received by the Department from the community and law enforcement agencies will be promptly investigated and the appropriate action taken.

Utilization of Resources:

The Department's most valuable resource is its people.

It's the Department's intent to provide a quality environment for its employees to work, that enhances their well being, promotes good moral, instills confidence and pride and promotes a harmonious work environment.

Through good management and the proper utilization of resources, the Department will maximize its efficiency, reduce waste in Government, utilize its resources in the most cost-effective and productive way to insure quality service.

The Department will consistently demand the highest degree of integrity and professionalism from all it's employees.

The nature of our business particularly the unique authority and responsibility held by our personnel, creates an absolute need to insist upon the highest standards of performance. We will accept nothing less than strict compliance with all appropriate rules, regulations, policies and procedures by our employees. The public trust is one of the most sacred in our society and we will never condone or accept it's violation.

## FINDING I

In response to Finding I we agree that we need a better documentation of the Compliance process. We do feel that there has not been abuse of the process however this is difficult to determine because of the lack of documentation.

We will carry out the following steps to improve this process.

1. Formal guidelines (Policies and Procedures) for the Compliance section will be developed establishing the scope, process and responsibilities of the Compliance section to reduce the appearance of abuse and insure equitable treatment.
2. All Compliance cases will state specific reasons for the level of Compliance action taken. This will include past history of licensee.
3. A comprehensive system of review and approval is being developed to insure openness of the process.
4. A flexible fine schedule has been developed that provides levels of Compliance action rather than specific fines.

## FINDING II

All of the practices described took place prior to the present Superintendent. The following steps will be taken to insure integrity of the process.

1. The application process has been strengthened and policies regarding acceptance are being developed. No incomplete applications will be accepted or processed. All applications will be treated the same in accordance with Title 4 requirements; however, it should be recognized that the use of an attorney or other knowledgeable person will cause more rapid processing of applications since many of the delays are caused by lack of knowledge or timely action on the part of uninformed applicants. Priority will be given to processing licenses for applicants who are not contributing to the State revenue base by conducting business by virtue of an original application or denied interim permit.
2. Almost immediately upon my assuming control of the Department of Liquor Licenses and Control, a policy was established of denying interim permits to those individuals who we are aware have backgrounds we would oppose as licensees. My reading of A.R.S. Section 4-203.01(A) governing the issuance of interim permits makes it permissive for the Superintendent on issuance of an interim permit. There is divided opinion among Deputy Attorney Generals as to whether this statute is mandatory or permissive. Clear guidance has been given on the issuance of a second interim permit if the time is extended under A.R.S. Section 4-203.01(D) which makes mandatory the second interim permit unless good cause is shown. Good cause must be established in a Superintendent's hearing and the applicant afforded due process prior to denial of the ability to continue in business. The same advice regarding due process has been given by the Deputy Attorney Generals regarding A.R.S. Section 4-203.01(E) which allows summary suspension of those operating with an interim permit.

### FINDING III

The following steps are being taken in response to this finding.

#### CASH HANDLING:

Procedures for handling cash have been formulated and officially are in effect. The Department agrees that inappropriate procedures were being followed in regard to accounting for cash receipts; however, new Policies and Procedures for Receiving and Receipting Revenues have been implemented which address all concerns of the Auditor General.

In addition to these procedures, the accountant has been given a desk and file cabinet that lock and a lock has been placed on the office door. This provides short term security should the accountant, while preparing a deposit, need to leave the office.

We concur with the Auditor General that there was no approval process for adjustments to cash register transactions, but a review of the register tapes disclosed that, in most cases, the error (void) was followed by the correction so it is unlikely any monies are missing. The fact that the programming on the cash register recorded voids as negative totals (IRTM - 1 Returned Monies) under MEMO ITEMS and recorded change given as a negative cash receipt on the CASH REPORT further distorted the appearance. The cash register has been reprogrammed and voids must be approved by 3 employees.

The Department was allocated funds to purchase a new cash register for FY 1989. It is anticipated the new register will connect directly to the computer and programming can be devised so that cross-referencing will assist in monitoring receipts; duplicative efforts will be minimized and the number of persons handling funds will be reduced. Tying the issuance of licenses, interim permits, etc. to register transactions will assure revenues are receipted prior to document issuance and will be verified daily by reconciling the monies and entries.

All incidents of alleged theft are under investigation at this time. Every means will be exhausted to bring these cases to a conclusion, to identity and prosecute those persons responsible.

A mail system procedure has been developed to insure integrity to the mail procedures.

PETTY CASH:

The petty cash has been reconciled and methodology established for reconciling to the authorized fund amounts.

The \$66.00 expenditure was authorized by the Superintendent in 1987 and appears to have been contrary to procedure. This was an examination ordered pursuant to Personnel Rules and should be covered by Risk Management. This source of reimbursement is being pursued.

The employee was never paid by workmen's compensation for an eye exam and glasses. Petty cash was reimbursed by a warrant and when the check for workmen's compensation was received it was deposited to petty cash instead of being used to reimburse the Department's appropriated funds. This error has been corrected. The court has now ordered payment by the party creating the disturbance in the bar where the investigator was injured and the check has been forwarded to the State Compensation Fund.

EVIDENCE:

We are currently drafting a policy that will correct any past problems in handling evidence.

It should be noted that past problems have been handled with the offending employees and corrective action taken in all documented instances.

The policy being developed provides for a property custodian that will have full responsibility for the receipt, impounding of evidence, retention, release and destruction or disposition of all evidence received.

This will limit access to one individual and a designated alternate in the custodian's absence.

Further, quarterly audits will be performed and an annual audit will be conducted at the end of each fiscal year. Management reports will be submitted on each of these audits to the Superintendent.

It should be noted that the completion of this policy has been impaired due to the failure of the Attorney General's office to respond to our request for assistance.

On June 28, 1988 we submitted a written request to the Attorney General's office requesting assistance in the area of the policy dealing with the destruction and disposition of seized evidence other than liquor.

Since June 28, 1988, we have made two additional follow up requests to which we have received no response to date.

The evidence room will be hardened by physical modification to insure security.

#### FINDING IV

The overlapping responsibilities between the Board and Superintendent have come about due to the continued modification and shifts of emphasis by the legislature. The recommendation to amend A.R.S. Sections 4-112 governing the powers and duties of the Board and the Superintendent and 4-210 governing grounds for revocation, suspension and refusal to renew; notice; complaints; hearings; appeals from superintendent clearly lie outside this agency and with the legislature to implement.

The communication between the Superintendent and the Board has improved dramatically and the functioning of the Board was the subject of a special meeting of the Board on November 2, 1988. The Superintendent is present at Board meetings to insure open communication and understanding.

## FINDING V

We have some serious difficulties with the opinion by Legislative Counsel on the sale after expiration date on the liquor license. This is diametrically opposed to advice given by the Attorney General.

The Department of Liquor Licenses and Control is complying with A.R.S. Section 4-209.01 governing penalties by adding a 20% penalty to the license renewal fee for those licensees who fail to renew within the mandatory period. Cease and desist orders are issued within 20 days of non-renewal and sent to the licensees by certified mail. A copy of this list is being furnished to wholesalers on a weekly basis and action against wholesalers who deliver to unlicensed businesses has been instituted. This has created a situation whereby the wholesalers in effect act as an extension of the Department to insure that licenses are renewed or delivery of spirituous liquor will be curtailed.

After the 60 day period has elapsed a list of non-renewed licenses is being furnished to the Investigations Section for follow-up. However, inadequate manpower exists to do a complete follow up and this inadequacy has been addressed in our FY 1989-90 budget request. It is not necessary, practical or cost effective to send these lists to each law enforcement agency however, we will provide these lists to the Department of Public Safety ILED units.

## FINDING VI

The Department of Liquor Licenses and Control has included in the FY 1989-90 budget a request for microfilming equipment and services to protect original license documents. In the interim we have instituted a security policy that restricts access to the fileroom and data processing center through the use of color coded identification badges and required the return of all files for updating at least once a week. The sequential numbering of documents suggests that staff would be available to review each file as it is turned in each and every time. This is neither cost effective nor practical since the files contain documents of numerous sizes and types and certain documents move from file to file as licenses change. The Department will work with the Library and Archives staff to establish cost effective file control systems.

The Department is considering a closed circuit video tape of persons viewing public files. This tape would provide documentary evidence of removal of contents from the file. This will be subject to bugetary restraints.

## FINDING VII

The Department of Liquor Licenses and Control is operating under A.R.S. Section 4-203.02 governing Special Event licenses and has considerable difficulty determining what organizations are qualified to receive Special Event licenses. Subsection B provides that virtually any event can qualify for a Special Event license and there are no legal requirements for disposition of the proceeds. With the lack of statutory mandates in this area it is impossible for the Department to police or prevent abuses of this process. The term in A.R.S. Section 4-203.02(B) "an organization formed for a specific charitable or civic purpose" is so broad and vague that almost any event can be included in this definition. The Department lacks statutory authority to refuse applications. The recommendations for legislative review of this law and correction of these defects must precede any DLLC rule making efforts.

At the present time when a special event application is received we check the applicant organization against a computer printout that shows all special events for the calendar year sorted by organization. If it is clear that the applicant organization has not used up the two special event opportunities, then the application is processed for approval/disapproval. If there is some question, we counter-check previous applications and/or contact the applicant for clarification.

## OTHER PERTINENT INFORMATION

Due to the massive nature of the personnel and policy review and change the efforts undertaken did not start to show results until after completion of the audit.

### Information to evaluate Investigators activities.

1. We have just completed the staffing on a revision of officers' weekly logs.

The changes will allow us to better capture what the investigators do and how they spend their time.

This will allow us to develop a computer entry and retrieval program that will assist managers in evaluating time spent on task, productivity of individual investigators, effectiveness of liaison contacts and utilization and deployment of our resources.

A monthly management report will be generated from each region.

This will present individual and group data that will allow managers to analyze the activity in each region and compare both regions.

2. We've completed the Departmental Mission Statement which is included in the annual report and focuses the direction of the Department.

We have also created an Investigations Division list of priorities. This is currently being staffed and will be finalized soon.

This will act as a guideline for the utilization of our resources and allow us better to evaluate the performance of investigators.

3. We have developed a case management system that allows supervisors to keep track of the cases assigned to each investigator and each investigative unit.
4. We are currently evaluating and developing the structure of the Investigations Division and bringing it in line with acceptable organizational structure.
5. We will put this information into a PC data base which will allow analysis of activities of investigators and trends.

### Upper Management Problems

1. Management Instability:

This is a valid concern. Stability at the top of the organization can be obtained by stabilizing the leadership of the Department by reducing political impact.

This will do much to eliminate the problem of constant political turnover, restructuring, inconsistency of management, lack of stability and confusion as to task and direction of the agency.

This should positively enhance moral and give the Department head the opportunity to evaluate employees and develop their talents within the Department.

It will also do much to eliminate the transient nature of Policies in the agency.

2. With the institution of the Department's Conduct policy, all allegations of misconduct are investigated and documented.

The policy also deals with citizen's complaints and internal allegations of employee misconduct. All complaints are logged and listed numerically by year.

Personnel policies of the Department have been reviewed and approved by the Attorney General's office.

3. Internal cooperation is being improved through regular management meetings and group staff meetings.

The Investigations Division is also formulating a management information system where information will be passed from the top down and issues and concerns of employees can be passed up through the chain of command.

4. We are attempting to resolve the inadequate resources issued by obtaining additional personnel and equipment through the budgetary process.

The concerns of the employees are valid in this area.

5. The current administration is very familiar with grievance procedures and what has been referred to as "Good old boy" politics is not a practice today.

6. While we cannot guarantee that every employee will agree with the Superintendent's selection of personnel to fill exempt positions, we can guarantee that appointments under this administration will be based on merit and benefit to the agency.

Further, those hired in covered positions will also be selected on their individual merit.

We expect workers to work, supervisors to supervise and managers to manage.

7. Policies are constantly being implemented and evaluated to insure that they suit the needs of the Department in reaching it's goals and objectives as well as providing guidance and stability.

8. We are formulating a comprehensive policy in the Investigations Division that will capture the extent of training and satisfy A.L.E.O.A.C. requirements.

In addition we are currently building the A.L.E.O.A.C. files to bring them into compliance with the A.L.E.O.A.C. standards. The process will be completed within the next 60 days.

## APPENDIX I

### SURVEY OF DLLC EMPLOYEES

#### METHODS

The population consisted of all employees and Board members, with a sampling frame of 60 Department personnel. Their names were compiled from DLLC payroll records as of April 1, 1988. The present and former Superintendents and the Assistant Superintendent were excluded. Questionnaires were mailed to home addresses to encourage anonymity and confidentiality of responses. Thirty-four employees and Board members returned the questionnaires, for a response rate of 57 percent.

Scales for questions were coded:

- 1 = Agree strongly
- 2 = Agree somewhat
- 3 = Not sure/unfamiliar
- 4 = Disagree somewhat
- 5 = Disagree strongly

Questions with mean scores greater than 2.5 indicate a problem (to achieve this mean would require at least one "disagree" for every two "agree somewhat" responses). "Not sure" responses were omitted from the calculation of mean scores. Respondents were stratified according to three primary characteristics.

1. Department of employment (Administration, Enforcement, Licensing, Judicial, Other)
2. Job classification (Management, Clerical, Enforcement Officer, Other)
3. Employment tenure (less than six months, six months to two years, two to five years, more than five years, no longer employed at DLLC)

#### ANALYSIS

The questionnaires were studied from a variety of analytic perspectives, including frequency distribution, descriptive statistics, and qualitative inspection of open-ended questions.

The various methods of analysis led to similar conclusions. The following issues emerged as major areas of concern to DLLC employees: cooperation and communication, lack of resources, management instability, and personnel practices and policies.

Cooperation and communication: Problems in cooperation and communication consistently emerged from the various analyses. Specifically, employees expressed dissatisfaction with the amount of cooperation among departments within the agency. Employees also tended to feel that they do not receive enough information from upper management and that management does not listen to the recommendations of qualified staff personnel. The cooperation problems may result from the lack of communication. The problems are illustrated by employees' disagreement with the following Work Environment questions.

Q 4. There is cooperation between my section and other sections within DLLC (Mean = 3.167).

Q 7. Top management listens to the recommendations of qualified staff personnel (Mean = 2.840).

Q 9. We receive enough information from top management to do our jobs well (Mean = 2.815).

Q 11. DLLC units or divisions coordinate activities and communicate well with each other (Mean = 3.586).

Q 13. Management encourages our suggestions and complaints (Mean = 2.643).

Questions 4, 11 and 13 show that those employees most dissatisfied with communication and cooperation were enforcement officers and employees categorized as "other" (includes Board members, Board section employees, and data processing personnel). In addition, employees with longer tenure expressed more disagreement with the statements. However, employees of more than five years expressed less disagreement with questions 7, 9 and 13.

Seventeen open-ended comments (50 percent of responses) also addressed the cooperation and communication problem. The following are typical answers to the question: "What do you consider the biggest problem on your job?"

- Lack of cooperation with other areas.
- Intrasectional uncooperativeness.
- Do not work as a team.
- Communication between departments.
- We need communication up and down the ladder.
- Constant battles between employees.

Seven employees used the questionnaire as an opportunity to express animosity towards other employees. A larger group (12 employees) said that backstabbing and other problems between employees was the biggest problem on the job.

Lack of resources: Employees were asked several questions about whether they had adequate equipment and training to perform their jobs. Responses indicated dissatisfaction with equipment and on-the-job training, particularly in the enforcement area. Following are examples of questions which tapped these issues of discontent.

- Q 3. My supervisor sees to it that we have the things we need to do our jobs (Mean = 2.346, 3.333 for Enforcement Officers).
- Q 12. I have enough equipment and resources to do my work (Mean = 3.241, 4.600 for Enforcement Officers).
- Q 17. I receive adequate in-service training for my needs (Mean = 2.846, 3.545 for Enforcement Officers).

The following were typical of the 11 open-ended comments (32 percent of responses) in this area.

- To work undercover, you need binoculars, body bug tape recorders, cameras, and undercover money. The department has not supplied any of these items. I have never been qualified by this department with my firearm. I have never been to any school to broaden my law enforcement knowledge or survival skills.
- My work environment is totally unacceptable. No office, no desk, no telephone, and very little equipment. Little to no in-service training is provided.
- Poor radios. No weapons qualifications since being hired.
- Not enough work space and equipment to do a really good job.

**Management instability:** Nineteen responses (56 percent of total) to open-ended questions indicated employee discomfort with the rate of change in management and policies before the new Superintendent was appointed in March. The survey was administered in May before he was confirmed by the Legislature. Employees have adopted a "wait and see" philosophy or are optimistic since the appointment. Examples of employee comments follow.

- Management style used in the past has been to keep everyone in the dark and make up rules as something pops up. The new Superintendent is moving rapidly to correct this.
- We have gone through some very difficult times in the last eighteen months. During this time the Department deteriorated in almost every aspect due almost entirely to the choice of Superintendents. I feel we now have a Superintendent who is capable and is in the process of rebuilding a sound organization.
- The constant change causes confusion and gives me the feeling of instability for the whole Department.

- Organization has been undergoing administrative shock. New administration has provided no guidance, direction, or communication. Department is still operating as 4 to 5 separate agencies.
- Unpredictable - constantly changing rules/regulations on how to do the job. We've had too many changes in the past 14-16 months to operate smoothly. It seems as if management tries to keep a wedge in the different areas - tries to stop the Department from working together as a team.
- Policies are constantly changed. Standards are in constant change. When political pressure is applied, that is the direction that management moves.
- The only thing that is constant at the Liquor Department is change.

Personnel practices and policies: Several questions about personnel practices and management at DLLC were included in the questionnaire. Grievance procedures, fairness and honesty in management, and the performance reviews used at DLLC were identified as problem areas. Employees who were with the Department between two and five years were the most dissatisfied. The following questions illustrate these problems.

Q 10. I have confidence in the fairness and honesty of management (Mean = 2.769, 3.538 for two to five year workers).

Q 16. DLLC's grievance procedures are adequate for handling my problems or complaints (Mean = 2.778, 3.750 for two to five year workers).

Q 19. The employee performance review process as practiced at DLLC is an effective and useful management tool (Mean = 2.680, 3.545 for two to five year workers).

The interesting point about the grievance procedures question is that the answer with the greatest frequency is "not sure."

Twenty-two employees (65 percent of those responding) made strong statements about personnel policies and management practices at DLLC. Their comments included the following.

- I am required to perform exactly the same work as someone a grade higher.
- Bad employees have been kept in their positions just because no one wanted to fire them and good employees have left because no one showed them any reason to stay.
- Supervisors who are double dippers . . . don't work to better anything, are uninterested in problems, and are extremely paranoid of anyone who works hard because it makes them look bad.
- My supervisor has singled out another employee in an attempt to force him out of the agency or get him fired.
- It's hard to maintain a positive attitude when at other agencies officers are making \$8,000 to \$10,000 more per year and doing the same work.
- Reallocate personnel and positions. Positions have been jockeyed around to make uncovered positions ["uncovered" means exempt from state personnel requirements] . . . for friends of the former Superintendent, and have been kept in place.
- Eliminate unproductive and counterproductive personnel.
- Low pay, very little chance for advancement.
- The Department discriminates against minorities.

#### SUMMARY

The Auditor General's survey of DLLC employees and Board members has indicated numerous issues of concern. The most prominent issue is the

lack of cooperation. The closed-ended and open-ended questions suggest that communication may be a contributing factor to the dissatisfaction of many employees. Employees said they were generally satisfied with their jobs (mean = 1.862) despite the hostile working environment.

Personnel problems and management issues often appear as employee concerns. Many of the comments directed attention to the behavior of management personnel as a source of dissatisfaction. There is a great deal of friction within the Department. Our survey was conducted too early to fully measure the impact of the new Superintendent's appointment, but questionnaires turned in after his confirmation indicated that the friction has not yet been eliminated.

APPENDIX II

LEGISLATIVE COUNCIL OPINIONS

# ARIZONA LEGISLATIVE COUNCIL

## MEMO

June 2, 1988

TO: Douglas R. Norton, Auditor General  
FROM: Arizona Legislative Council  
RE: Request for Research and Statutory Interpretation (0-88-2)

This memo is sent in response to a request made on your behalf by William Thomson in a memo dated May 9, 1988.

### FACT SITUATION:

Based on an interpretation from their attorney general representative, the department of liquor licenses and control (DLLC) has awarded liquor licenses to applicants who have been convicted of felonies and violations of Arizona Revised Statutes (A.R.S.) title 4. These awards were based on A.R.S. section 4-261 which is commonly referred to as the acquisition of control statute. This acquisition of control statute addresses the necessary mechanisms for the department "to approve a license transaction where a person obtains, directly or indirectly, control of an in-state licensee or controlling person and includes a transfer of a bar or liquor store license to another person" (memo from attorney general representative to DLLC) and the specific time frame allotted for the particular transaction to take place.

In several cases reviewed by the auditor general's office, the superintendent of DLLC has awarded licenses to individual applicants even though the department had evidence that applicants had prior criminal convictions or had previous liquor law violations. The licenses were awarded because the department had not taken action to accept or deny the license transfer within the specific mandated time frame. According to the department's attorney general representative "the Superintendent has 90 days from the date of the filing of a complete application, as defined in A.R.S. section 4-267(B), to either approve an application to acquire control or to schedule a hearing on the application" as provided in A.R.S. section 4-267, subsection A. The attorney general representative further points out that "the failure to act within the allotted time period, or to obtain a consensual extension of time will result in the approval of the application by the operation of law" as provided for in A.R.S. section 4-267, subsection A. As a result of the elapsed time frame and the department's failure to act promptly, the license transfers were approved.

However, several state statutes within A.R.S. title 4 appear to be very specific in the language used to address Arizona's desire to ensure that persons with certain unlawful characteristics do not receive or maintain a liquor license. A.R.S. section 4-202, subsection D clearly states that the department shall not issue to or renew a license of persons who have been convicted of a felony within five years prior to the application date. In fact, the statute

even goes further in defining the department's role in obtaining criminal background information regarding the licensee, so that DLLC can use that information as basis for accepting or rejecting an applicant.

In addition, this subsection states that "n/o license shall be issued to any person who, within one year prior to application, has violated any provision of as spirituous liquor license issued or has had a license revoked." Further, this matter is addressed in A.R.S. section 4-203, subsection H. It states that "n/o spirituous liquor license shall be asigned, transferred or sold, except as provided for in this title."

Moreover, A.R.S. section 4-266 states that:

With respect to the proposed acquisition of control of an in-state licensee or controlling person, the superintendent shall deny an application if he finds any of the following:

1. The person who would acquire control fails to demonstrate that he meets the requirements for licensure.
2. The applicant neglects, fails or refuses to furnish to the superintendent any information required by the superintendent.
3. It is contrary to law.  
(Emphasis added.)

These statutes appear to indicate that no one may receive an original license or a license on transfer without qualifying.

#### QUESTIONS PRESENTED:

1. Does the acquisition of control statute mandate the issuance of a license to applicants with known criminal backgrounds and previous A.R.S. title 4 violations because a specific time frame has elapsed?
2. What remedy does DLLC have in cases in which a license was granted because it had not acted within the statutory time frame?
3. Does DLLC's approval of acquisition of control guarantee licensure, or does the applicant still have to meet all other licensing mandates?

#### DISUSSION:

The Arizona acquisition of control statutes, A.R.S. title 4, chapter 2, article 5, make it unlawful to acquire control of an in-state liquor licensee or a person controlling a liquor wholesaler or retailer without prior approval by the superintendent. For the purposes of this article, an in-state licensee means a person issued an in-state producer's, wholesaler's, bar, beer and wine bar, liquor store, beer and wine store, hotel-motel, restaurant or domestic farm winery license.

A.R.S. section 4-264 prohibits a person from making offers to acquire securities which would result in the acquisition of control that requires prior approval by the superintendent unless such prior approval has been obtained. A.R.S. section 4-266 specifies the grounds upon which the superintendent must deny an application. One of these grounds is if the person who would acquire control fails to demonstrate that he meets the requirements for licensure. For example, if the applicant attempting to acquire control is a convicted felon or is associated in business dealings with known criminals, the superintendent must deny the application. In addition, the superintendent must deny the application if the applicant has refused to provide required information or if the acquisition would violate other laws such as federal or state antitrust laws. In addition, the acquisition of control statutes provide that if the superintendent has not acted on the application within ninety days the application will be deemed approved as a matter of law. A.R.S. section 4-267.

The relationship between the acquisition of control statutes and those statutes prescribing the issuance or transfer of liquor licenses is not expressly provided. A.R.S. section 4-202, subsection D prescribes the requirements for obtaining a liquor license in the state. This subsection provides that a license shall not be granted to a person who, within one year prior to application, has violated any provision of an issued liquor license or has had a license revoked. Additionally a license may not be issued or renewed to a person who, within five years prior to application, has been convicted of a felony. A.R.S. section 4-203, subsection F relates to the person-to-person transfer of a bar or a liquor store license and provides that such a transfer will be allowed if, among other requirements, the transferee is qualified to be a licensee and if the transfer meets the acquisition of control requirements.

There are two possible interpretations in evaluating the relationship between the acquisition of control statutes and the statutes relating to the issuance or transfer of liquor licenses. One interpretation would take the plain meaning of the statutes and conclude that the acquisition of control procedures specifically apply to obtaining prior approval for such acquisition and are separate from the procedures for obtaining a license or a transfer of a license.

The second interpretation, and the one adopted by the department, views the acquisition of control procedures to include all things necessary to effectuate the transfer of control of a licensee. Since the grounds for obtaining approval for acquiring control of a licensee are that the transferee meet the requirements for an original license, and this same requirement is made for a transfer of a bar and liquor store license, it appears that the legislature intended that the procedures were to take place simultaneously. Moreover, an interpretation that requires that the procedures under the acquisition of control statutes be separate from the issuance of a new license or a transfer of certain existing licenses renders the acquisition of control process meaningless since the identical grounds are used as the basis for whether or not the approval is granted or the bar or liquor store license will be transferred.

Generally an administrative construction of a statute is entitled to great weight, especially if the statute has two or more possible interpretations. If the administrative interpretation is a reasonable one, that interpretation should be controlling. Sutherland, Statutes and Statutory Construction sections 49.03 and 49.04 (4th ed., Sands, 1972).

The acquisition of control statutes do not mandate that a liquor license be issued. However, when the department approves an acquisition of control application, the assumption is that there are no grounds under A.R.S. section 4-266 for denial of the application and that therefore the applicant meets the licensure requirements for a liquor license. Thus, the approval of the acquisition of control application could also be considered as approval for issuance or transfer of the liquor license. However, in enacting the acquisition of control statutes, the legislature also provided for approval of the application by a specified period of time. A.R.S. section 4-267. In answer to your first question, although the acquisition of control statutes do not require that DLLC issue a license to an applicant whose application has not been acted upon within a specified statutory time frame, one could conclude that the department's action in issuing the license was reasonable since the legislature provided that the application was deemed approved by operation of law.

In answer to your third question, it is reasonable to conclude that approval of the acquisition of control application is also approval for issuance or transfer of the liquor license since one of the grounds for denial of the application is that the person who would acquire control fails to demonstrate that he meets the requirements for licensure. However, A.R.S. section 4-267 has the unfortunate consequence of allowing the issuance of a license to a person with a known criminal background or previous liquor violations simply because the department failed to act on the application within a reasonable period of time.

For this reason we recommend that the legislature revisit the acquisition of control statutes and clarify the relationship between these statutes and the statutes relating to issuance and transfer of liquor licenses. At the least, the legislature should repeal A.R.S. section 4-267 and remove the provision that an application for acquisition of control that is not acted upon after ninety days is approved by operation of law.\*

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\*The procedure to follow in those cases in which the department is dilatory in acting upon an application is prescribed in A.R.S. section 4-201.01. That section provides that an applicant may file a demand that the department take action within fifteen days after the demand if the applicant feels that the department is not acting in a timely manner. The section also provides that the superintendent may extend the time limits for action by up to one hundred five days if such extension is in the public interest. Proposed amendments to the one hundred five day extension period by S.B. 1238, 38th Legislature, second regular session, clearly provide that this procedure applies to the acquisition of control statutes.

Handwritten notes: "Cox" and "Cox" with arrows pointing to the top left of the page.

Attorney General

1215 WEST WASHINGTON

Phoenix, Arizona 85007

Robert R. Cochran

MEMORANDUM

TO: Hal Pershall  
Assistant Superintendent

FROM: Harvey M. Yee *HY*  
Assistant Attorney General

DATE: February 3, 1988

RE: Acquisition of Control

Feb 3 6 57 AM '88

AZ. LIQUOR FEEL

A.R.S. § 4-203(F) and A.R.S. §§ 4-261 et seq. vest the Superintendent with the responsibility and authority to make initial decisions on any direct or indirect change of ownership of a liquor license or business which owns a liquor license. These statutes, adopted or amended in 1985, 1986 and 1987, have the effect of making the term "person transfer" technically obsolete, and removing from the Board any jurisdiction except appellate jurisdiction over transactions involving ownership changes resulting in a change of "control". See A.R.S. § 4-101(7) (definition of "control").

The acquisition of control statutes, combined with A.R.S. § 4-203(F), thus require the Superintendent to make the initial determination in all transactions in which:

a person obtains, directly-or-indirectly, control of an in-state licensee or controlling person and includes a transfer of a bar or liquor store license to another person but does not include a transfer to a new location if there is no change of control.

A.R.S. § 4-261(1); cf. A.R.S. § 4-263 (exempt transactions). The Superintendent has 90 days from the date of the filing of a complete application, as defined in A.R.S. § 4-267(B), to either approve an application to acquire control or to schedule a hearing on the application. A.R.S. § 4-267(A). The failure to act within the allotted time period, or to obtain a consensual extension of time will result in the approval of the application by operation of law. A.R.S. § 4-267(A).

Any hearing held to determine whether to grant an application for acquisition of control must be held before the superintendent or a hearing officer for the superintendent in conformance with A.R.S. § 4-268 and the adjudicative proceedings

Boehnell  
January 3, 1988  
Page 2

article of the administrative procedures act, A.R.S. § 41-1061  
et seq. The focus of the hearing may be only those issues  
addressed in A.R.S. § 4-266, grounds for denial.

In view of the applicability of the acquisition of  
control statutes to those transactions formerly categorized as  
person transfers, the Board is no longer the proper body to hear  
and determine these transactions, except as appeals from  
Superintendent's decisions.

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cc: Thad Curtis  
Darryl Dobras

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# ARIZONA LEGISLATIVE COUNCIL

## M E M O

July 11, 1988

TO: Douglas R. Norton, Auditor General  
FROM: Arizona Legislative Council  
RE: Request for Research and Statutory Interpretation (O-88-3)

This memo is sent in response to a request made on your behalf by William Thomson in a memo dated June 8, 1988.

### FACT SITUATION A:

The Department of Liquor Licenses and Control (department) currently allows individuals to continue selling alcohol after their licenses have apparently expired. In some cases the licensees continue alcohol sales for only a few days after the license renewal date has passed while others continue for three months or more before obtaining a new license. Presently, the department takes no action until a license has gone sixty days beyond the renewal date. After sixty days the department mails the licensee a letter requiring they "cease and desist" all liquor sales if his license has not been renewed.

Neither Arizona Revised Statutes (A.R.S.) section 4-209.01 or any other title 4 statutes specifically indicate whether continued liquor sales after the renewal date are against state law. The Auditor General has received complaints from the liquor industry that some wholesalers are being cited for illegally supplying liquor to establishments after the establishment's license renewal date had passed. However, these licensees were still selling liquor to the public. In addition, members of the Auditor General staff have contacted licensees with unexpired licenses and found that they are still selling liquor to the public.

A.R.S. title 4 does not clearly define when a license expires with regard to the authority to sell liquor. A.R.S. section 4-209.01 states that the license of a licensee who fails to renew such license after the payment is due as prescribed by A.R.S. section 4-209 shall be subject to revocation. In addition, section 4-209.01 mandates that a liquor license expires "sixty days after the payment of the fee is due". However, both of these provisions appear to relate to the right of the licensee to renew his license within a reasonable time frame. This time to renew is critical because, under the quota system, a surrendered or revoked license is placed back into the lottery for reissuance to another party.

### QUESTIONS PRESENTED:

1. May liquor licensees legally continue to sell liquor after their license renewal date?
2. If licensees may continue to sell liquor beyond their renewal date, how long may they do so?

## FACT SITUATION B:

A.R.S. section 4-209.01 states that a licensee who fails to renew his license within thirty days as prescribed by law "shall be subject to a penalty of twenty per cent of the licensee fee . . .". A.R.S. section 4-209 provides for two license fees: an original license fee specified in A.R.S. section 4-209, subsection B and annual fees specified in A.R.S. section 4-209, subsection D. The department interprets A.R.S. section 4-209.01 to imply that the licensee must pay twenty percent of the annual fee as the penalty.

## QUESTION PRESENTED:

1. Does A.R.S. section 4-209.01 refer to the original license fee or the annual renewal fee, when the law states the penalty shall be "twenty per cent of the licensee fee . . ."?

## DISCUSSION:

Generally, a person may not, with impunity, engage in the business of selling liquor without obtaining a license in compliance with the liquor laws. 48 C.J.S. section 102; A.R.S. section 4-244, paragraph 1. The duration of a liquor license is usually fixed by statute. 48 C.J.S. section 138. In this state, A.R.S. section 4-209.01 indicates clearly and unambiguously the penalty for failure to renew a liquor license by the end of a year. That section states that:

A licensee who fails to renew his license within thirty days after the payment of the fee is due as prescribed by section 4-209 shall be subject to a penalty of twenty per cent of the license fee, which shall be paid with the license fee. The license of a licensee who fails to renew such license after the payment of the fee is due as prescribed by section 4-209 shall be subject to revocation. If a license is not renewed within sixty days after payment of the fee is due it shall expire. Such expired license may be renewed by the superintendent if good cause is shown by the licensee.

Thus, it is clear that a liquor license which is not renewed within sixty days after payment of the fee due expires and the holder of the license may not continue to sell liquor after that date. Moreover, the license, and the privilege to sell liquor, may also be revoked before this sixty day period if the department chooses to revoke the license pursuant to the provisions of A.R.S. section 4-209.01.

A.R.S. section 4-209 sets forth three types of fees for a liquor license. Subsection A of that section prescribes a one hundred dollar application fee. Subsection B of that section provides for issuance fees for various types of original licenses. Subsection D of that section provides for annual fees for the various types of licenses.

It is a well established principle of statutory interpretation that the law favors rational and sensible construction. Sutherland, Statutes and Statutory Construction section 45.12 (4th ed., Sands, 1972). The issuance fees prescribed by A.R.S. section 4-209, subsection B are imposed once when the original licenses are issued. The fees prescribed

by A.R.S. section 4-209, subsection D are imposed annually. Therefore, it is a reasonable interpretation that the twenty percent penalty on the license fee for late renewals prescribed by A.R.S. section 4-209.01 should be imposed only on the annual fee prescribed by A.R.S. section 4-209, subsection D.

CONCLUSIONS:

Fact Situation A:

1. Liquor licensees may legally continue to sell liquor after their license renewal date.

2. Without having his license renewed, a liquor licensee may continue to sell liquor until sixty days after his renewal date unless the department revokes the license before this period of time.

Fact Situation B:

1. The late penalty of twenty percent of the license fee prescribed by A.R.S. section 4-209.01 can reasonably be interpreted to apply to only the annual renewal fee.

cc: William Thomson, Director  
Performance Audit Division

