

EXECUTIVE DIGEST

MICHIGAN LIQUOR CONTROL COMMISSION

INTRODUCTION

This report contains the results of our financial audit* of the Michigan Liquor Control Commission (MLCC), Department of Consumer and Industry Services (CIS), for the period October 1, 1996 through September 30, 1997.

AUDIT PURPOSE

This financial audit was conducted as part of the constitutional responsibility of the Office of the Auditor General. Financial audits are conducted at various intervals to permit the Auditor General to express an opinion on the State's financial statements.

BACKGROUND

MLCC is governed by Sections 436.1 - 436.58 of the *Michigan Compiled Laws* (Act 8, P.A. 1933, the Michigan Liquor Control Act). MLCC consists of five members appointed by the Governor with the advice and consent of the Senate, each for a term of four years. The responsibilities of MLCC include the oversight of alcoholic liquor distribution within the State; licensing of the manufacture, importation, and sale of liquor; levy and collection of excise and specific taxes on liquor, beer, and wine; and enforcement of the Michigan Liquor Control Act. MLCC is organizationally located within CIS.

During fiscal year 1996-97, MLCC privatized the liquor inventory warehousing and distribution function, which

required extensive revision to the process in which liquor products were ordered, purchased, stored, and delivered to the retailers.

On October 1, 1996, prior to privatization, MLCC had 532 employees. As of September 30, 1997, after privatization, MLCC had 152 employees. During fiscal year 1996-97, MLCC issued 31,593 retail liquor licenses and 1,990 manufacturer/wholesaler licenses. The Liquor Purchase Revolving Fund's total revenue for the fiscal year was approximately \$114.6 million and total expenses and operating transfers were approximately \$25.4 million.

**AUDIT OBJECTIVES
AND CONCLUSIONS**

Audit Objective: To assess the adequacy of MLCC's internal control structure*.

Conclusion: Our assessment of MLCC's internal control structure disclosed two material weaknesses* :

- MLCC's internal control structure did not adequately separate duties related to the administration and distribution of the State's liquor inventory (Finding 1).

MLCC responded that it agrees that proper and sound internal controls are necessary. Beginning in October 1997, MLCC established numerous business operating procedures to improve and strengthen internal controls. Among the many procedures is one where, on a regular basis, MLCC reviews a sample of signed licensee invoices compared to sales as reported by authorized distribution agents. This procedure is designed to help ensure that all orders have been reported to MLCC. MLCC has been

working with the Department of Treasury since before the audit began to implement an electronic transfer of funds program for liquor sales proceeds.

- MLCC's control procedures did not ensure the accurate preparation and presentation of its statement of cash flows consistent with the *State of Michigan Comprehensive Annual Financial Report (SOMCAFR)*. As a result of the errors noted, we expressed a qualified opinion on MLCC's statement of cash flows. (Finding 2)

MLCC responded that it agrees that there should be consistency between the *SOMCAFR* and its statements. It is important to point out that the bottom line of the statement of cash flows (cash and cash equivalents), as reported by MLCC, was correct and consistent with the *SOMCAFR*. There was no loss of funds involved in this presentation of the statement of cash flows. The difference between the statements is one of presentation. MLCC has now established a procedure to meet with Department of Management and Budget (DMB) staff each year to jointly review the statement of cash flows to ensure consistent presentation.

We also noted reportable conditions* related to the reconciliation of liquor sales, liquor inventory controls, and the distribution of tax revenue (Findings 3 through 5).

Audit Objective: To assess MLCC's compliance with applicable statutes, the *Michigan Administrative Code*, State procedures, and CIS policies and procedures.

Conclusion: Our assessment of MLCC's compliance with laws and regulations disclosed an instance of noncompliance that had a material effect on MLCC's financial statements. As reported in Finding 2 under our internal control objective, MLCC's control procedures did not ensure the accurate preparation and presentation of its statement of cash flows consistent with the *SOMCAFR*. As a result of MLCC's material noncompliance with Act 431, P.A. 1984, as amended (Sections 18.1101 - 18.1594 of the *Michigan Compiled Laws*), we expressed a qualified opinion on MLCC's statement of cash flows.

Audit Objective: To audit the financial statements of the Liquor Purchase Revolving Fund as of and for the fiscal year ended September 30, 1997.

Conclusion: We expressed an unqualified opinion on MLCC's balance sheet and statement of revenues, expenses, and changes in retained earnings and a qualified opinion on its statement of cash flows. As reported in Finding 2 under our internal control objective, our audit disclosed a material weakness in that MLCC's internal control structure did not ensure the accurate preparation and presentation of its statement of cash flows.

Audit Objective: To assess MLCC's effectiveness in closing the State liquor stores and warehouses and disposing of related equipment inventory.

Conclusion: We concluded that MLCC was generally effective in closing the State liquor stores and warehouses and disposing of related equipment inventory. However, as reported in Finding 4 under our internal control objective, we noted a reportable condition related to a

liquor inventory shortage disclosed during the closing of the State liquor stores and warehouses.

Audit Objective: To examine the propriety of the Commissioners' expenses.

Conclusion: We concluded that, generally, the expenses incurred by the Commissioners were appropriate and associated with operations of MLCC. However, we noted reportable conditions related to telephone usage and payroll and travel expenses (Findings 6 and 7).

AUDIT SCOPE

Our audit scope was to examine the financial and other records of the Michigan Liquor Control Commission for the period October 1, 1996 through September 30, 1997. Our audit was conducted in accordance with generally accepted auditing standards and *Government Auditing Standards* issued by the Comptroller General of the United States and, accordingly, included such tests of the records and such other auditing procedures as we considered necessary in the circumstances.

**AGENCY RESPONSES
AND PRIOR AUDIT
FOLLOW-UP**

Our audit report contains 7 findings and 11 corresponding recommendations. MLCC's preliminary response indicated that MLCC either has complied with or will comply with the 11 recommendations.

MLCC had complied with 2 of the 7 prior audit recommendations. Because of the privatization of the liquor distribution system, the remaining 5 prior audit recommendations are no longer applicable.