OLO Report No. 90-7 Montgomery County Government June 4, 1991

DESCRIPTION AND EVALUATION OF INVENTORY ACCOUNTABILITY AND CONTROL FOR THE MONTGOMERY COUNTY ALCOHOLIC BEVERAGES WAREHOUSE OPERATION

Office of Legislative Oversight

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Page

LISTING OF CHARTS AND TABLES

Charts

Tables

I. SUMMARY OF MAJOR CONCLUSIONS AND RECOMMENDATIONS

The Department of Liquor Control (DLC) has substantially improved control over its wholesale and delivery operations in the past decade. In 1980, the Council engaged the consulting firm of Touche Ross and Company to perform an operational study of the Department of Liquor Control (DLC). In their report of January 23, 1981, Report on the Operations Review of the Montgomery County Department of Liquor Control, the consultants offered many recommendations to improve control and accountability of inventory at the DLC warehouse. During the 1980s, DLC implemented most of the Touche Ross recommendations, improved security at the warehouse, and worked on improving computer capabilities to enhance inventory management and control. Although significant decreases in inventory shrinkage in recent years attest to the effectiveness of controls which have been instituted, further improvements and efficiencies can be attained in the following areas:

1. **Warehouse Capacity.** A proliferation of beer products available for sale has placed a strain on storage space in the beer section of the DLC warehouse, and quantities of many inventory items that must be carried to meet demand are such that wide use of rack storage would not be efficient. Consequently, the storage configuration in the beer section of the warehouse cannot be as efficiently managed as the liquor/wine section, and the liquor/wine section must be used on occasion to accommodate overflow storage of beer products. Therefore, DLC should re-evaluate the inventory storage needs of the two separate sections of the warehouse with a view to freeing up space for additional storage of beer products.

2. **Free Delivery.** DLC provides free delivery of products, and licensees pay for this service indirectly through mark-ups on products sold by DLC. In 1981, Touche Ross and Company recommended that DLC increase the minimum order quantity to ensure free delivery of products to licensees, but the minimum order quantity was not increased and has not been changed in at least ten years. The current minimum order quantities are: five cases of any combination of liquor or wine products to liquor/wine license holders; three cases of wine products to other license holders; or ten cases of beer to any license holder. DLC should increase the minimum order quantities for free delivery of liquor and wine products from three/five cases to ten cases, as recommended by Touche Ross in 1981, and examine the feasibility of establishing fees to recover the cost to deliver smaller quantities, should licensees desire the service.

3. **Credit to Licensees.** DLC currently allows purchases of liquor and wine products on credit to holders of liquor licenses. No credit option is currently available to beer/wine license holders. The practice of extending credit to licensees transfers risk to the County for a licensee's investment in inventory, and initially frees up a significant amount of cash for a licensee. However, the DLC is denied an opportunity to use the money or invest it for the benefit of the County. Monthly accounts receivable balances carried by DLC for credit extended to licensees currently averages $250,000 to $270,000. The combined effect of inflation in the 1980s, recent tax increases imposed on alcoholic beverages, and the current economic climate resulting in business failures, translates to higher financial risk to the County. Therefore, DLC should consider discontinuing the credit option for licensees, or examine other measures to lessen the County's risk for bad accounts and strengthen control over credit.

4. **Truck Fleet.** DLC currently owns 50 delivery trucks, of which, an average of 32 vehicles are needed for deliveries on any given day. This generally leaves 18 vehicles for backup. Even during the DLC's busiest seasons, no more than 40 delivery trucks are expected to be needed, leaving ten vehicles for backup. This number of backup trucks may exceed the DLC needs, and while sale of excess trucks may not bring a very high return to DLC, other County departments or agencies may have uses for DLC's excess trucks. Therefore, DLC should review its need for 50 delivery trucks, and make any surplus vehicles available for use by other County departments and agencies.

5. **Policies and Procedures.** DLC policies and procedures are not always stringently enforced, and some policies and/or procedures may need to be updated. Although DLC has standardized and documented significant policies and procedures, several of the written policies and procedures pre-date 1985. To promote effective and efficient management, the DLC should review and update its policies and procedures at least every five years and consistently enforce them.

6. **Assignment of Drivers.** DLC does not currently utilize a simple and effective internal control procedure of randomly assigning drivers, helpers, and delivery trucks. A policy of routinely rotating drivers among delivery trucks and helpers among drivers would increase internal control over the loading and delivery operations by discouraging collusion among loaders, drivers, and helpers. DLC should institute such a policy to enhance internal control.

7. **Product Committee.** Membership on the product listing/de-listing committees is heavily weighted toward the retail end of DLC's business. The procedures for listing/de-listing products offered by DLC specifies committee membership to include four persons from the Retail Operations Division and one person from the Financial Management Division. DLC should add one person from the Wholesale Operations Division and one person from the Financial Management Division to its product listing/de-listing committees to round out the membership.

8. **Customer Ordering System.** Based on the results of a survey of licensees, approximately one-half of the respondents indicated an unwillingness to use the Telephone Order Processing System (TOPS) which DLC is currently testing. DLC should inform licensees of its intention to implement the automated telephone ordering system and should provide licensees with educational information on the uses and benefits of the system.

9. **Inventory Breakage.** Significant changes in inventory write-offs indicate breaches in internal control may be occurring and should be investigated as a matter of policy. The reasons for substantial changes in inventory write-offs of breakage which have occurred since FY88 have not been investigated by DLC. Inventory breakage for the DLC operation increased about $27,000 (44 percent) from the $62,000 reported for FY88 to $89,000 reported for FY89. Although breakage decreased slightly in FY90 to about $83,000, the FY90 write-off remained $21,000 (34 percent) higher than the FY88 level. Data received from the control States of Pennsylvania, Virginia, and West Virginia indicate that DLC write-offs for breakage are high in relation to its cost of goods sold when compared with breakage write-offs for these other control jurisdictions. The reported increases in breakage written off by DLC in FYs 89 and 90 should be fully examined to identify reasons for the substantial changes which have occurred, and to provide a basis for developing corrective measures, if necessary. OLO recommends that an internal audit of breakage and other inventory adjustments be conducted by the appropriate Executive branch department.

II. AUTHORITY, SCOPE, METHODOLOGY, AND ACKNOWLEDGEMENT

A. Authority

Council Resolution No. 11-1907, CY 1990 Work Program of the Office of Legislative Oversight, adopted March 13, 1990.

B. Scope

In the late 1970's, a number of allegations were made concerning management practices of the Department of Liquor Control (DLC) operations and lack of control and accountability over inventory flow. As a result, a number of studies were conducted: a special consultant was engaged by the Executive Branch, and the Departments of Finance and Economic Development conducted in-house studies; a committee of volunteers was formed by the Chamber of Commerce and assisted by the Office of Legislative Oversight (OLO), and the County Council engaged a consultant (Touche Ross and Company). Studies conducted by the Executive Branch were mainly concerned with DLC overall management practices and retail operations, and Council-sponsored studies were primarily directed at DLC wholesale operations.

Throughout the 1980s, the Council continued its interest in DLC management, especially wholesale operations and inventory accountability. After several years of monitoring DLC management practices, the Council instructed OLO to evaluate improvements to accountability and control of inventory received, stored, and distributed from the DLC warehouse.

C. Methodology

This project was conducted by Joan M. Pedersen, assisted by Robert Heckman, III, Public Administration Intern, from late December 1990 through mid-March 1991. Research for the evaluation consisted of a variety of fact-finding techniques including:

- Review of Article 2B, Annotated Code of Maryland and the Montgomery County Code for references pertaining to the regulation and control of alcoholic beverages; and review of applicable laws and County legislative files, including minutes of Committee and full Council work sessions, and transcripts of public hearings and budget sessions;

- Review of public documents relating to warehouse security and inventory control and accountability of DLC warehousing and delivery operations, including memoranda, studies, reports, and budget documents;

- Interviews with management and staff of Executive departments (Liquor Control, Finance, and Management and Budget); staff of the Board of License Commissioners; and Council staff; and,

- Review of written procedures and observation of activities related to order taking, purchasing, receiving, loading, shipping, and accounting for and verifying inventory quantities.

D. Acknowledgements

The Office of Legislative Oversight (OLO) acknowledges the prompt and courteous cooperation received from management and staff of the Department of Liquor Control and other Executive departments, the Board of License Commissioners, the County Council, current and former members of the Alcoholic Beverages Advisory Board, and licensees.

III. BACKGROUND

This section of the report describes the legal framework under which Montgomery County exercises control functions over the distribution and sale of alcoholic beverages, and traces the history of the Department of Liquor Control (DLC).

A. Control of Sale and Distribution of Alcoholic Beverages

Since the Prohibition Act was repealed in December 1933, Federal, state and local governments have adopted various methods to control the manufacture, distribution, and sale of alcoholic beverages. The widest variance is illustrated by differences in jurisdictions using the "control" method of operation and those using the "open" method. Thirty-two states and the District of Columbia exercise the "open" method of control by licensing retailers and wholesalers to distribute and sell alcoholic beverages. The remaining 18 states and Montgomery County use the "control" method under which they buy and sell liquor at wholesale. Except for Iowa, Michigan, Mississippi, West Virginia, and Wyoming, these states and Montgomery County also sell alcoholic beverages in retail operations.[1]

Article 2B, Alcoholic Beverages, of the Annotated Code of Maryland, 1987 declares that it is the policy of the State that, "to obtain respect and obedience for the law and to foster and promote temperance: it is necessary for the State to regulate and control the manufacture, sale, distribution, transportation, and storage of alcoholic beverages." To carry out this policy, the State empowered various State agencies, local commissioners and councils, local liquor boards, enforcement officers, and the judges and clerks of the courts of the State with authority to administer and enforce the provisions of the alcoholic beverages laws, rules and regulations. In addition, the State granted to itself authority to tax alcoholic beverages and to impose fees for various permits and licenses associated with importation, manufacture, wholesale distribution, storage and retail sale of alcoholic beverages.

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[1] The 18 control States are: Alabama, Idaho, Iowa, Maine, Michigan, Mississippi, Montana, New Hampshire, North Carolina, Ohio, Oregon, Pennsylvania, Utah, Vermont, Virginia, Washington, West Virginia, and Wyoming.

Under Article 2B, the State authorizes all counties and the City of Baltimore to limit economic competition in the distribution and sale of alcoholic beverages. In addition, Section 162 of Article 2B provides that, in Montgomery County, the Department of Liquor Control (DLC) shall have an absolute monopoly over the distribution and sale of liquor, wine, and beer. The monopoly power over wholesale distribution and sale of alcoholic beverages is reiterated in the Montgomery County Code. Code Appendix D, Section 6.17 states that a license holder shall not sell or store any alcoholic beverages except those purchased from the DLC.

Under these State and County authorities, DLC has assumed total and exclusive control over the importation, storage and wholesale distribution of all alcoholic beverages, and the retail sale of liquor by the bottle. Further, the County regulates the retail sale of beer, wine, and liquor by the drink through a licensing, inspection and enforcement system operated under the authority of the Board of License Commissioners. (See OLO Report No. 87-4, A Description and Evaluation of the Montgomery County Board of License Commissioners, for more detailed information regarding the County's alcoholic beverage licensing, inspection and enforcement system.)

B. History of the Department of Liquor Control

A Liquor Control Board was established in Montgomery County on December 5, 1933, shortly after the end of nationwide prohibition. State law gave the Board monopoly power for the issuance of liquor, wine, and beer licenses in the County; the distribution of alcoholic beverages at the wholesale level so that all licensees operating in the County had to buy from the Board; and the retail sale of liquor package goods for off-premise consumption.

The Department of Liquor Control (DLC) was created by Section 159 of Article 2B of the Annotated Code of Maryland, effective July 1, 1951. The new department was assigned the wholesale and retail control powers of the previous Liquor Control Board as defined in State Code, and the Montgomery County Board of License Commissioners, created as a separate entity, assumed the authority to issue all types of licenses for the retail sale of liquor, wine, and beer within the County. Further legislative action by the State in the early 1980s established criteria for an advisory board for Montgomery County to report to the County Executive at least quarterly on recommendations for the improvement of the alcoholic beverages control and enforcement activities of the County and the operations of DLC from the standpoint of efficiency, service, and convenience to the public.

IV. DESCRIPTION OF THE DLC WAREHOUSE/DELIVERY OPERATION

This chapter of the report provides information on Executive branch control exercised over the Department of Liquor Control (DLC), and the relationship of DLC to other County departments, offices, boards, commissions, and committees. The organizational structure and scope of DLC operations relating to warehousing and delivery of alcoholic beverages in Montgomery County are also discussed in Section B of this chapter.

A. Organization Structure

Under the general supervision of the County Executive, the DLC functions as a department of the Montgomery County Government. The Director of DLC reports to the County's Chief Administrative Officer, who reports to the County Executive.

Although physically located adjacent to the administrative offices of DLC, the Office of the Board of License Commissioners (License Commissioners) is a separate legal entity which performs the licensing and enforcement functions of liquor control in the County. The License Commissioners is responsible for granting retail licenses and inspecting licensed premises for possible violations of the law.

DLC and the License Commissioners are aided by an Alcoholic Beverages Advisory Board (ABA Board), established under State statute to advise the County Executive on DLC operations and licensing and enforcement of the alcoholic beverage laws. By statute, this latter group is comprised of five members, appointed by the County Executive and approved by the Council. The membership must include one holder of a Class B or C beer, wine, and liquor license, and one holder of any other class of license. In addition, the chairman of the License Commissioners, the Director of DLC, and the Superintendent of Police are designated as ex-officio members of the ABA Board.

DLC is also assisted by a Liquor Control Policy Committee (Policy Committee), created by the County in 1981 in response to a recommendation resulting from a Touche Ross and Company operational study of DLC. This committee was established to assist DLC with developing department policies for operations affecting licensees and County citizens. The Policy Committee is comprised of the Director of Finance, an Assistant to the County Administrative Officer, and the Director of Liquor Control, with the Council Staff Director designated as an ex-officio member.

The Department of Transportation (DOT) provides direct services to DLC. Maintenance and repair of the DLC delivery fleet is performed by the Maintenance Section of DOT, and DLC pays for services rendered. As a department of the Executive Branch, the DLC also receives indirect support from other Executive departments and offices, such as Procurement, Facilities and Services, Personnel, and the County Attorney. Chart 1 shows these direct and indirect relationships.

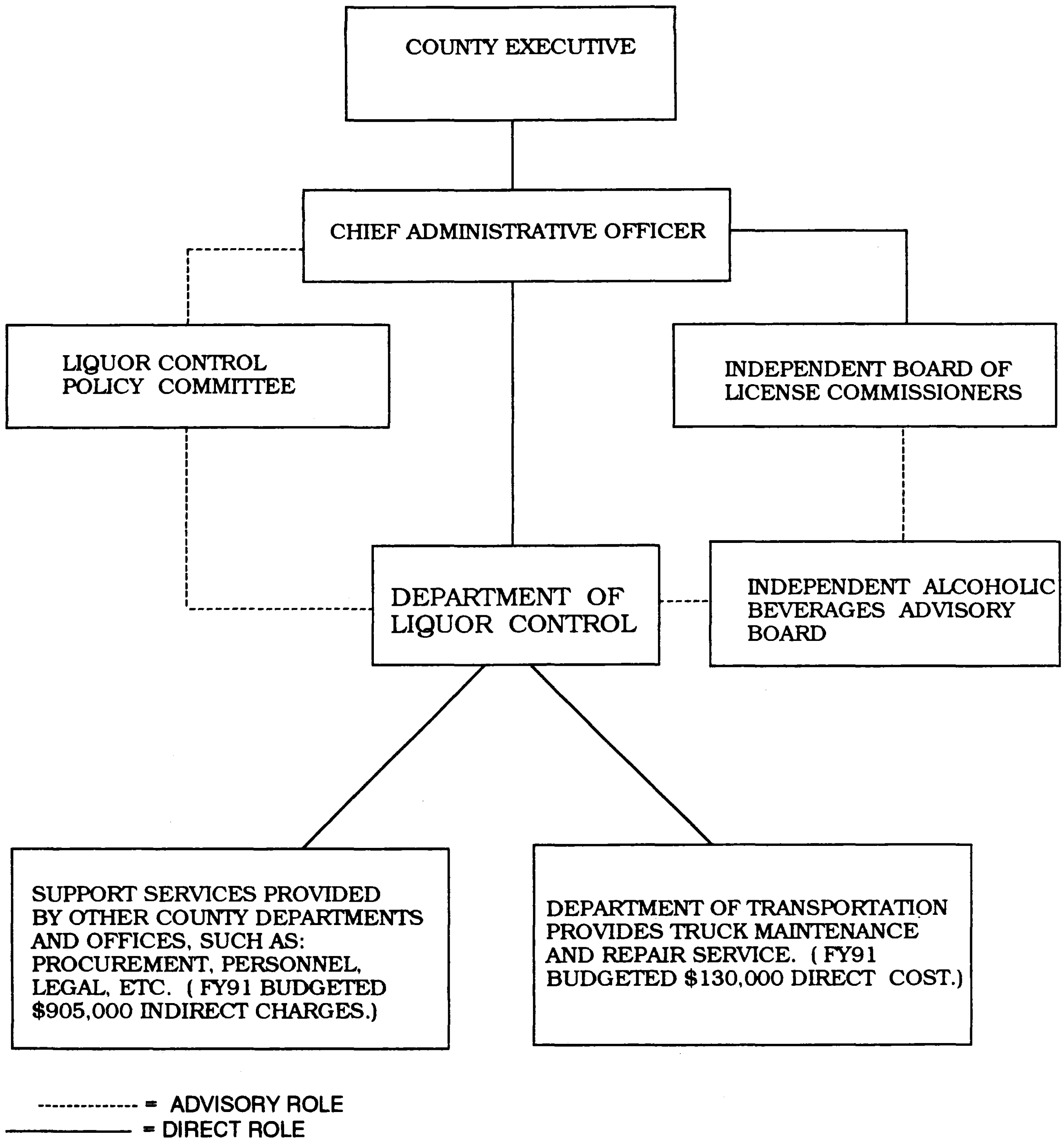
B. Scope of Operations

Other than in country clubs, alcoholic beverages may not be sold at any place of business in the 12th electoral district (Damascus) and the towns of Barnesville, Laytonsville, Kensington, and Washington Grove. Aside from these exceptions, the DLC serves the entire County.

All alcoholic beverages sold by the County are received and stored at a single warehouse which is owned and operated by the DLC. In addition, DLC sells alcoholic beverages at retail through operation of 24 dispensaries (retail stores) located throughout the County.

Chart 1

INTER-RELATIONSHIP CHART BETWEEN DLC AND COUNTY AGENCIES, BOARDS AND COMMISSIONS



DLC administrative headquarters are located above the warehouse at 16650 Crabbs Branch Way in Rockville. The DLC wholesale operation is a monopoly, created under State law and reaffirmed in the County Code, which provides service to the 24 DLC retail stores and a variety of licensees, including: restaurants, hotels, wine and cheese shops, beer/wine stores, country clubs, and fraternal/veteran organizations. With the exception of a limited number of purchases picked up by licensees, all merchandise is delivered in DLC-owned and operated delivery trucks.

The DLC warehouse is approximately 163,000 square feet, which includes loading, receiving, and administrative office areas. The inventory storage area is physically divided by a chain link fence into two sections, a beer section and a liquor/wine section. Access between the two sections is limited, and each section is treated as a separate operation with dedicated staff and delivery trucks. The area within each section is further divided by storage configuration or activity. Each section has a bulk storage and picking area, as well as a merchandise receiving and delivery truck loading area. In addition, the liquor/wine section has a special order storage area and a mechanics' room, whereas the beer section has a keg storage area, a breakage room, and a returnable container storage area.

Two shifts work in each warehouse section. Generally, receiving and shipping of beer merchandise is performed by the day shift, with delivery trucks loaded by a contracted crew at night for next day delivery. Receiving and picking of liquor/wine items is also performed during the day shift, with trucks loaded by the DLC afternoon shift for next day delivery.

The Wholesale Division is staffed by 133 full-time personnel who oversee and/or perform warehousing and delivery functions. Support to the Wholesale Division is provided by a Customer Service Section, staffed by four full-time and two part-time personnel, which is organizationally located in the Retail Division. The Wholesale Division is further assisted by the Purchasing Section (staffed by four full-time personnel) and a cashiering activity (staffed by two full-time personnel), with both activities organizationally located in the Financial and Systems Management Division. Five full-time positions for programming, maintaining, and operating the DLC's mini computer systems are located in the Director's Office. Although these supporting activities are conducted to benefit both the retail and wholesale operations of the DLC, they are examined and discussed in this report only as they relate to the wholesale and delivery operations. See Chart 2 for a breakdown of warehouse personnel.

As stated earlier, because Montgomery County exercises monopoly control over the wholesaling of alcoholic beverages, all alcohol products must pass through the DLC warehouse. For purposes of the OLO evaluation, the wholesale operation begins with taking orders from licensees and ceases at delivery, whether merchandise is sold to a licensee or transferred to a County-owned store. Besides the 24 County-owned retail stores, DLC sells at wholesale to approximately 750 permanent licensees and 220 temporary licensees. Following is a list of outstanding permanent licenses issued as of January 1991. (All licenses were issued for sale of alcoholic beverages for on-premises consumption unless otherwise noted.)

Chart 2

DEPARTMENT OF LIQUOR CONTROL

WAREHOUSE OPERATIONS

WHOLESALE OPERATIONS DIVISION

ADMINISTRATION

1 Chief, Warehouse Division
1 Mechanic Supervisor
2 Mechanic II
2 Office Services Manager
1 Route Inspector/Expeditor

7 FULL-TIME

LIQUOR AND WINE SECTION

1 Warehouse Supervisor
2 Assistant Warehouse Supervisor
1 Senior Supply Clerk
11 Truck Driver/ Warehouse Worker
13 Warehouse Equipment Operator
1 Workforce Leader I
4 Supply Clerk II
15 Truck Driver Hlpr/Whse Worker

48 FULL-TIME

BEER SECTION

1 Warehouse Supervisor
1 Assistant Warehouse Supervisor
32 Truck Driver/ Warehouse Worker
5 Warehouse Equipment Operator
1 Workforce Leader I
5 Supply Clerk II
33 Truck Driver Hlpr/ Whse Worker

78 FULL-TIME

DIRECT SUPPORT

DIRECTOR'S OFFICE

COMPUTER SUPPORT ACTIVITY

1 Automated Systems Manager II
1 Computer Analyst/Programmer III
3 Computer Operator II

5 FULL-TIME

FINANCIAL AND SYSTEMS MANAGEMENT

CASHIER ACTIVITY

2 Principal Administrative Aide

PURCHASING ACTIVITY

4 Buyer II

6 FULL-TIME

RETAIL OPERATIONS DIVISION

CUSTOMER SERVICE ACTIVITY

1 Liquor Order Assistant
3 Principal Administrative Aide

2 Principal Administrative Aide P-T

4 FULL-TIME
2 PART-TIME

Table 1

Permanent Alcohol Beverage Licenses Outstanding
(As of January 1991)

CLASS	TYPE		ISSUED
A	W	Off Sale	1
A	BW	Off Sale	184
B	BW	On/Off Sale, Hotel/Restaurant	83
B (H/R)	BWL	Hotel/Restaurant, 2/1 Food/Beverage Ratio	262
B (H/M)	BWL	Hotel/Motel, 50/50 Food/Beverage Ratio	17
C (FV)	BWL	Clubs, Fraternal/Veteran	20
C (CC)	BWL	Country Clubs	18
D	BW	On Sale Generally	49
H	BW	Hotel/Restaurant	109
H	B	Hotel/Restaurant	5
		Alcoholic Beverage Consumption Licenses	2
		Total Licenses	750

KEY TO LICENSE TYPE: W = Light Wine
BW = Beer & Light Wine
BWL = Beer, Wine & Liquor

Source: Board of License Commissioners.

DLC currently stocks approximately 2,060 different items at its warehouse, with a different size or packaging of one brand identified by a separate DLC code and counted as a different item. For example, the 12 ounce size of a product brand would be counted as a separate item from the 16 ounce size of the same brand, and the 12 ounce size packaged in bottles would be counted as a separate item from the 12 ounce size of the same brand packaged in cans. The current product mix carried at the warehouse includes:

600 liquor items
950 wine items
450 beer items (cases)
60 beer items (kegs)

Items not carried in stock at the DLC warehouse may be special ordered. DLC provides licensees and dispensaries with a listing of products available for special order. The current special order listing contains approximately 6,000 items of beer, wine, and liquor which are available for order. The majority of all special orders are placed by licensees for specialty wines. (There are at least two retail licensees who specialize in carrying special order items). However, a retail customer may place an order directly through a dispensary for one or more cases of special order products. Dispensary managers are discouraged by DLC management from special ordering merchandise to be stocked, displayed, and sold through the DLC stores.

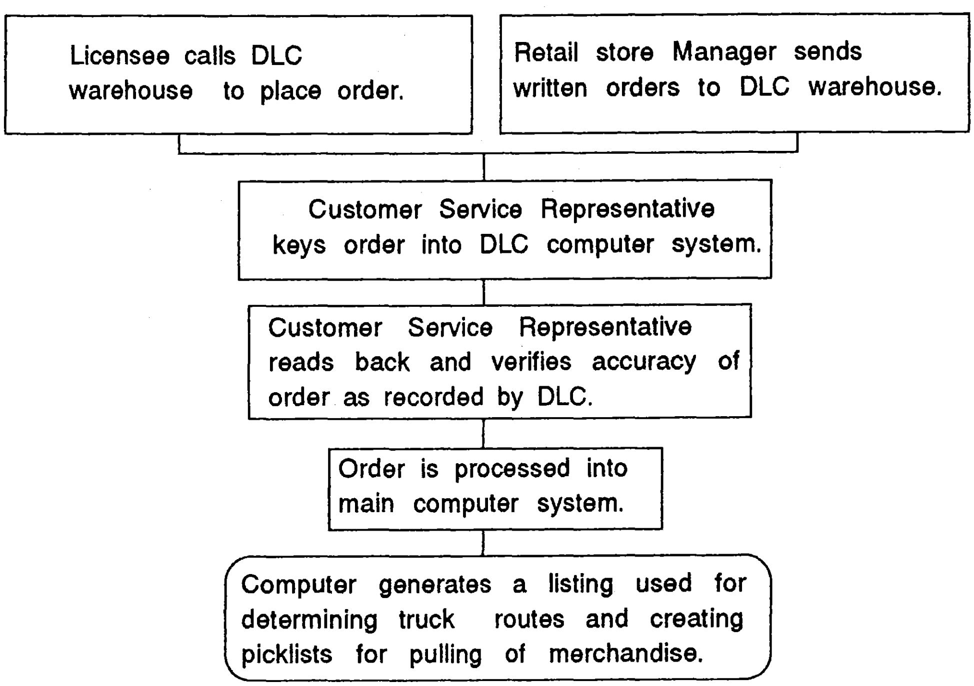
V. ACCOUNTABILITY AND CONTROL OVER PHYSICAL INVENTORY

This chapter of the OLO report examines accountability and control over the purchase and movement of inventory through the Department of Liquor Control (DLC) warehouse to the point of delivery to licensees and DLC retail stores. OLO has identified six activities as relevant to accountability and control over the movement of physical inventory: order taking, purchasing, receiving, storing, moving and loading, and delivery of products. Each of these activities was examined by Touche Ross and Company in 1980 and certain recommendations for improvement were presented in their January 23, 1981, Report on the Operations Review of the Montgomery County Department of Liquor Control. The status of implementing the Touche Ross recommendations relative to accountability and control over the DLC wholesale and delivery functions is included in discussion of the activity to which the recommendation applies.

A. Order Taking

The Customer Service Section serves as the direct line of communication between licensees and the DLC. This section is organizationally located within the Retail Operations Division and is responsible for receiving and recording all orders placed by DLC retail stores and individual licensees. The section is currently staffed by one supervisor, two full-time order takers, and one part-time order taker. A seven-line telephone system has been set up to handle the flow of incoming orders. Each order taker has access to the DLC mini computer system and uses an on-line terminal to enter licensee and retail store orders for delivery. The order takers manually enter DLC assigned item code numbers into the system as customers read the information over the telephone. Approximately 350 orders are placed on a daily basis. This flowchart of the order taking activity will assist in visualizing the process.

Chart 3



* Picklist: Picking list: listing of products to be drawn from inventory to fill an order.

The Touche Ross report contained one recommendation relating to the DLC customer service activity (Relative Importance rankings are by Touche Ross):

	Recommendation	Relative Importance	Implemented?
WO #10	**The Customer Service Center should increase the level of service to wholesale customers**	**Medium**	**Partly**

Relevant details offered by Touche Ross on how to achieve an increased level of service to wholesale customers, and the status of implementing each recommendation follows:

> **"Service Center personnel would be provided with information on outstanding merchandise orders and expected delivery dates."**

This recommendation has been partially implemented. Currently, information is provided to Customer Service regarding items out of stock, outstanding orders, and expected delivery dates for high demand beer products. Inquiries relating to regular stock liquor/wine merchandise and lower demand beer products are referred to the DLC buyers. Special orders for liquor/wine products are handled by the two DLC buyers assigned to handle special orders, who have information readily available regarding expected delivery dates. A report on outstanding merchandise orders and expected delivery dates will be made available upon full implementation of the computer application for purchasing which the DLC is in the process of installing.

> **"Customers interested in certain merchandise would be called upon receipt as a service to the customer. This would end the current practice of licensees and dispensary managers making repeat calls for information on the status of out-of-stock items."**

This recommendation has been partially implemented. Upon request, Customer Service personnel will call a licensee when the desired merchandise arrives at the warehouse. Customers may then place an order to receive the product with their next scheduled delivery.

> **"In order to consolidate all customer ordering and customer service activity, special orders would be placed through the Service Center, and the Service Center would notify licensees upon receipt of special order merchandise and discuss delivery options."**

This recommendation has been partially implemented. Responsibility for all beer orders has been consolidated in the Customer Service Section of DLC. However, responsibility for taking orders and purchasing special order liquor/wine products is assigned to two buyers organizationally located in the Financial and Systems Management Division. Licensees are not notified upon receipt of special order merchandise since DLC automatically schedules delivery for the licensee's next assigned day to receive liquor/wine products. When the procedure to notify licensees and discuss delivery options was recommended by Touche Ross, special orders were delivered separately from regularly scheduled liquor/wine deliveries.

"Responsibility for driver settlements and cash handling would be transferred to an in-house accounting section."

This recommendation has been fully implemented. In FY82, the Liquor Accounting Section was physically transferred from the Department of Finance to DLC administrative offices to provide increased accountability over the wholesale and delivery functions. Responsibility for driver settlements and cash handling was then moved out of the Customer Service Center and assigned to a cashiering activity contained in the Financial and Systems Management Division of the DLC.

"Dispensaries would send in - not call in - wine/liquor orders. This would allow work load balancing within the Service Center and eliminate the need for a dispensary manager to spend one to two hours on the phone."

This recommendation has been fully implemented. As a further improvement to customer service, a new customer order processing system has been acquired and is currently being tested by four DLC retail stores.

The Telephone Order Processing System (TOPS) is an integrated computer application that will extend DLC services by giving customers the option to use a touch tone phone to place an order electronically, without the need to talk directly to an order taker. When fully operational, this system will extend customer ordering times to evenings, weekends, and holidays, and will allow for additional efficiencies among current DLC staff. TOPS is discussed in more detail in Part VII, <u>ACCOUNTING AND COMPUTER SUPPORT</u>.

Additional DLC internal controls over the order taking activity include the following:

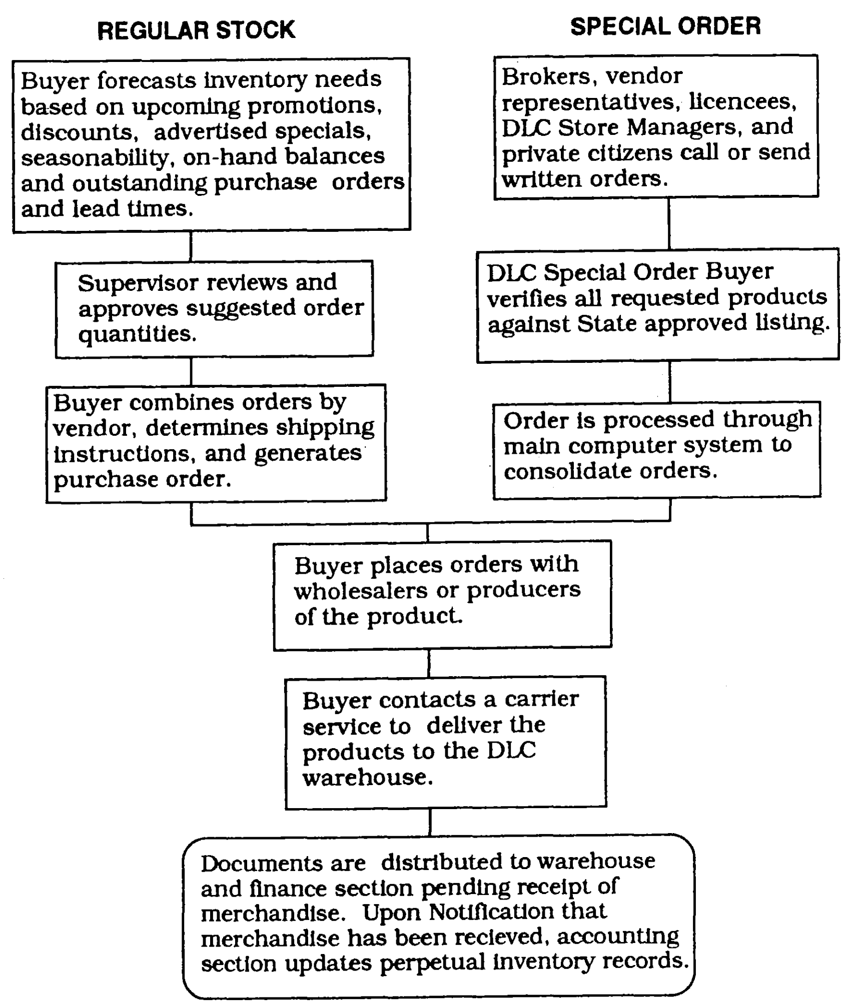
- Licensee numbers are assigned by DLC and established in the computer applications only upon notification by the Board of License Commissioners.
- Board of License Commissioners notifies DLC directly of any licenses suspended or revoked.
- Computer file must contain a valid licensee number to accept an order for delivery.
- Computer file contains code for type of license issued and the order entry application will only accept orders for products authorized by the type of license.
- Valid orders create picklist suspense files and order takers cannot generate invoices, debits, or credits.
- Outstanding picklists are reviewed and cleared periodically by a supervisor.
- Responsibility for adjusting the perpetual inventory records is segregated from responsibilities for receiving orders or adjusting picklists.

B. Purchasing

The Financial and Systems Management Division of the DLC has the direct responsibility for purchasing merchandise which is either requested for special order or is needed to replenish the warehouse inventory. The purchasing activity is divided into three areas of responsibility, handled by a staff of four DLC buyers. Purchases of liquor and wine for regular inventory stock are handled by one buyer, and purchases of beer products for regular inventory and special order are handled by a second buyer. The two remaining buyers are responsible for purchases of special order liquor and wine products. Approximately 150 purchase orders are placed monthly by the DLC buyers for liquor and wine products, and 240-320 purchase orders are placed for beer products.

The buyers responsible for special orders are concerned only with products specifically requested by licensees or customers of the retail stores which are not carried as regular stock in the DLC warehouse, whereas the two buyers responsible for replenishing regular inventory stock must monitor the flow of products with various forecasting procedures to determine order quantities. This flowchart of the purchasing activity will assist in visualizing the process.

Chart 4



The Touche Ross report contained three recommendations relating to the DLC purchasing activity:

	Recommendation	Relative Importance	Implemented?
WO #3	**DLC should use expected demand for five months to determine direct import purchases**	**Low**	**Yes**
WO #4	**DLC should pay more attention to freight rates, load size, and shipper selection**	**Medium**	**Yes**
WO #5	**Backup personnel should be cross trained to perform purchasing activities**	**High**	**Yes**

Additional internal DLC controls over the product purchasing activity include the following:

- Suggested order quantities are generated by computer applications.
- Outstanding purchase orders are reviewed by buyers and considered when determining order quantities.
- Order quantities are adjusted whenever possible to achieve full railcar or truck loads.
- Recommended order quantities for replenishing regular stock are reviewed by a supervisor prior to placing orders.
- Receiving documents are compared with purchase orders and discrepancies are brought to the attention of a supervisor.
- Responsibility for adjusting the perpetual inventory records for products received is segregated from responsibilities for ordering or receiving merchandise.
- Accounting duties and activities are segregated from purchasing and receiving activities and duties.
- A purchase order must be prepared and approved by a supervisor for any quantities of product received and kept by the DLC in excess of the original order.

C. Receiving

The Department of Liquor Control receives all incoming merchandise by either truck or railcar. Until recently, DLC preferred rail transport because the large shipment sizes allowed for lower transportation costs per unit. However, the DLC shifted its preferred transportation mode to trucks because of a change in rail service. Railcars were previously staged in small lots (two or three cars) and forwarded almost daily from the Washington Grove railyard. Staging now occurs in Baltimore and forwarding can be delayed several days until a group of seven to ten cars has been assembled. Thus, DLC has found truck transport to be more timely and predictable.

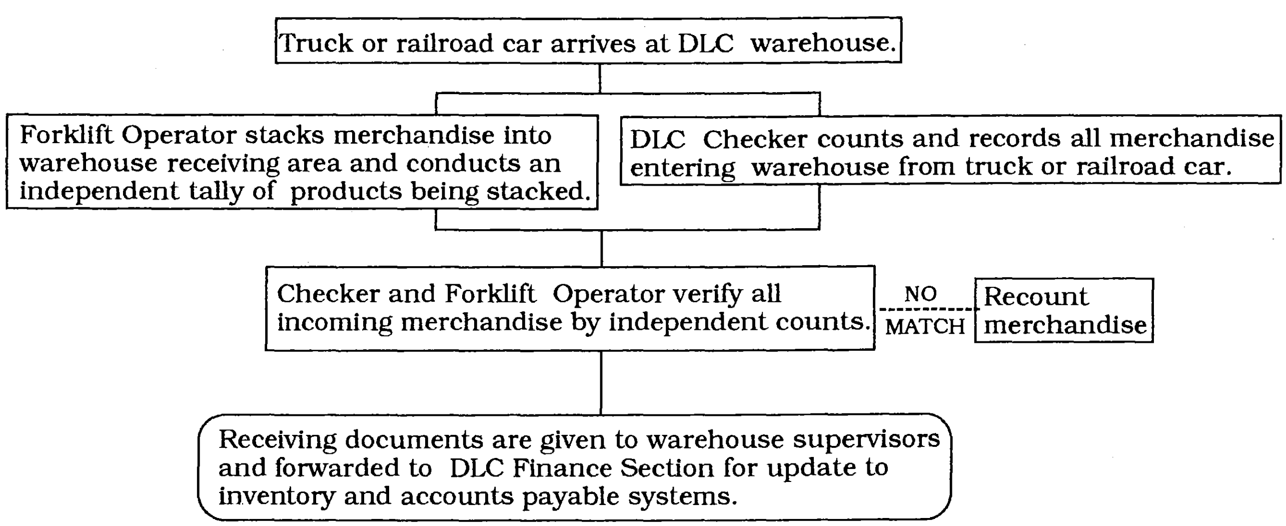
The DLC has several receiving and unloading areas: five railcar receiving doors are located at the rear of the warehouse and four truck receiving doors are located at the front of the warehouse. The rear receiving area has the capacity to receive and store as many as 10 railroad cars until unloaded into the warehouse. The current average number of railroad cars received per month is six for liquor and wine products and 18 for beer. Three railcar receiving doors service the liquor/wine section and two receiving doors service the beer section.

Truck deliveries are received and unloaded at the front of the warehouse for both liquor/wine and beer products. Each section of the warehouse (liquor/wine and beer) has two bays which were specifically designed for receiving and unloading trucks. In addition, these receiving bays are enclosed by chain link fences with electronic gates to control the flow of trucks entering and leaving the warehouse loading and unloading areas.

On average, the beer section receives and unloads nine truck loads of products per day. The liquor/wine section receives and unloads six truck loads of regular stock products and four truck loads of special order merchandise.

The DLC written receiving procedures require unloading one truck or railroad car at a time and conducting two independent counts to verify the correctness of quantities and items of incoming merchandise. Warehouse personnel rely on heavy equipment such as forklifts and pallet loaders to quickly unload incoming merchandise into a receiving area. This flowchart of the receiving activity will assist in visualizing the process.

Chart 5



The Touche Ross report contained one recommendation relating to the DLC product receiving activity:

	Recommendation	Relative Importance	Implemented?
WO #12	**Controls over receiving should be improved**	**Medium**	**Partly**

Specific control weaknesses identified by Touche Ross, and steps taken by the DLC to improve control over receiving activities follows:

> **"Because of the amount of merchandise stored in the warehouse, the receiving areas lack sufficient space for the staging area in which to segregate goods being received. Merchandise is often moved directly from a truck or railroad car into warehouse storage. This makes it difficult to establish responsibility for short shipments when they occur."**

DLC receiving procedures require that two independent counts be conducted prior to moving incoming merchandise to assigned storage areas within the warehouse. The procedure cannot always be followed at those times when stored inventory levels are at peak due to seasonal demand. During these periods, inventory storage space demands infringe upon receiving and staging areas. This condition is generally confined to the beer section of the DLC warehouse, where inventory quantities may increase by as much as 50 percent during peak seasons. Since beer products are generally dated, recounting of quantities can be performed, if necessary to reconcile the two counts, after products have been moved to main storage.

> **"The shipping docks in the wine/liquor section are fenced, and shipping and receiving are usually done at different times. However, in the beer section, shipping and receiving are done in close proximity at the same time. This makes it difficult to identify an irregularity in progress (i.e., any DLC uninvoiced goods being placed on a truck making a delivery to DLC)."**

This recommendation has been implemented. The shipping docks in the beer section have been fenced to separate the receiving and shipping activities. Since completion of the DLC warehouse expansion, two additional separate bays are available for receiving empties and returns to the warehouse.

> **"The warehouse does not use numerically controlled receiving logs. This makes proper inventory cutoffs difficult and hinders effective follow-up on missing receiving reports."**

Inquiry of DLC revealed that this recommendation has been implemented. Currently, adjusted copies of pre-numbered purchase orders which do not show quantities ordered are used for recording merchandise received into the warehouse. Supervisors sequentially number these "forms" using a hand stamp, record the assigned number and vendor in a receiving log, and issue the receiving forms to the employees assigned to check in the merchandise. While this method of control is not as rigorous as using pre-numbered blank forms, DLC considers its method to be adequate and more efficient than requiring employees to record product information already contained on the purchase orders.

Additional DLC internal controls over the product receiving activity include the following:

- Receiving bays are physically segregated from main storage areas and loading bays.
- Duties of purchasing, receiving, and accounting activities are segregated.
- Personnel unloading and checking in merchandise have no access to purchase orders, and do not know quantities purchased.
- Independent dual counts are conducted for merchandise received and differences are reconciled.
- Merchandise is to be moved to central part of the warehouse immediately after counts are reconciled.
- Receiving documents are reviewed by a supervisor and forwarded to buyers and Finance Section for review and comparison to purchase orders. If differences exist due to shortage, accounts payable records are modified and vendor is notified. If differences exist due to damaged merchandise attributable to the carrier, an accounts receivable is created and the carrier is notified.
- Update of perpetual inventory records is performed by an employee not associated with purchasing or receiving activities.
- Electronically controlled gates restrict access to receiving docks.
- Security cameras are in place to monitor truck unloading activities.

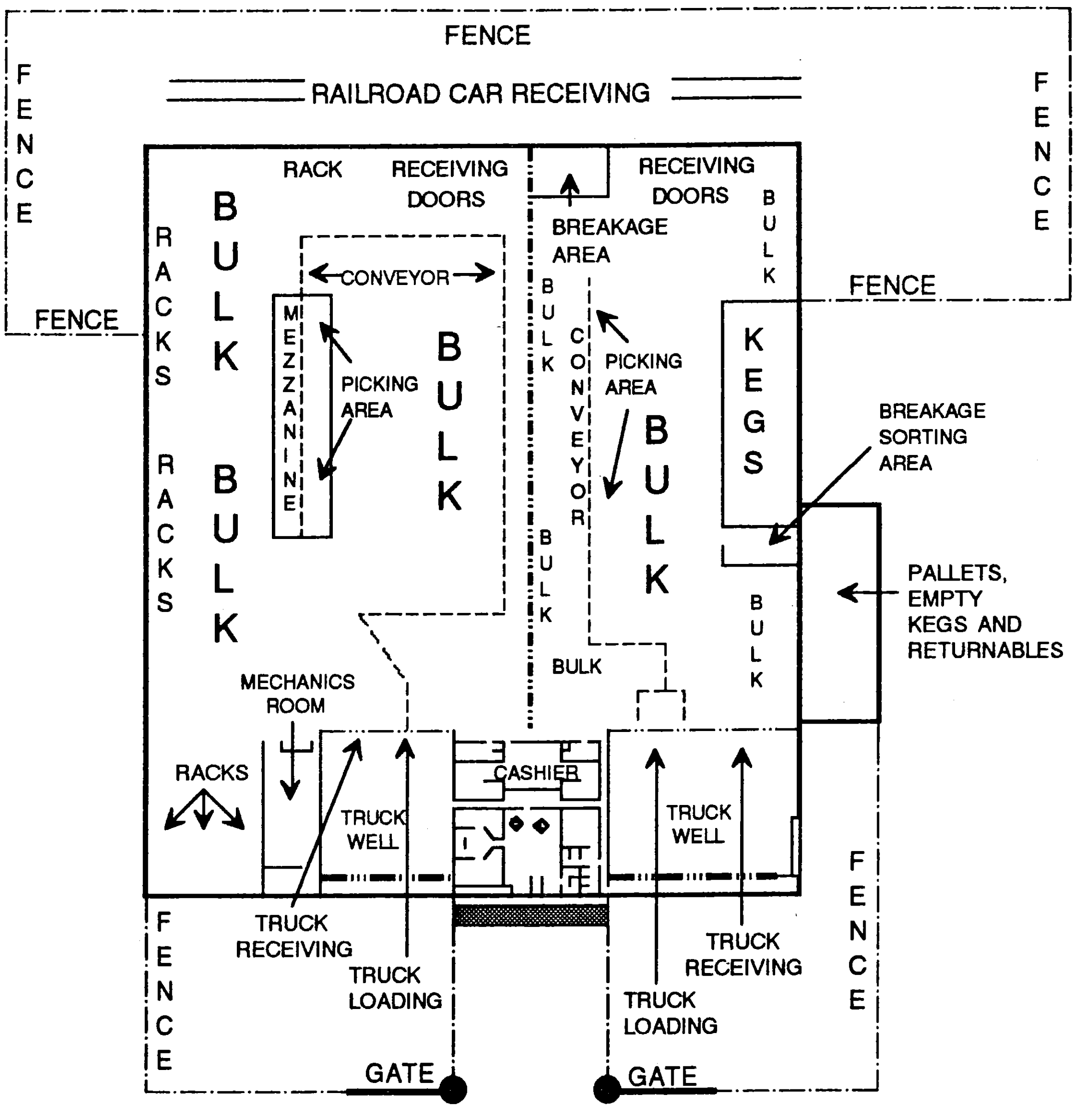
D. Storing

DLC owns and operates one warehouse, at which all alcoholic beverages coming into Montgomery County are received and stored until shipped by DLC to County-owned retail stores or businesses licensed to sell alcoholic beverages in the County. The warehouse storage area is approximately 140,000 square feet, which is physically divided into two sections by a chain link fence. This barrier was installed to allow for separate flow and control of liquor/wine products from beer products.

To provide for a maximum utilization of space, a multiple level stacking system is utilized in the liquor/wine section of the warehouse. This system allows for pallets of different products to be stacked in five-tier metal shelf units located throughout the liquor/wine section. Some areas of the liquor/wine section have obstacles such as low beams or pipes which only permit stacking up to three shelves high. The liquor/wine section has a two level mezzanine picking area, which permits pallets to be stacked efficiently for the picking operation.

The inventory volumes and turnover rates of most products stored in the beer section do not justify an extensive use of storage racks, and none are currently used in this section of the DLC warehouse. Beer products are stacked directly on the floor up to three pallets high and up to five stacks deep with little space between the stacks. Rotation of stock requires pulling pallet stacks out of the location to store newly arrived merchandise at the rear of the assigned location. Special imported beers are stacked in a single concentrated area across from the supervisor's office. A cold box is used for kegs and other beer items requiring storage in controlled temperatures. The cold box has a capacity to hold approximately 2,500 kegs. Finally, there is a room in which empty bottles and kegs, unused pallets, and separators are stored until returned to vendors. This drawing of the DLC warehouse will assist with visualizing the layout and storage configurations.

Chart 6



(Drawing is not to scale.)

Product listing and de-listing decisions are made by a Product Committee, subject to approval by the Director of the DLC. There are estimated to be in excess of 12,000 alcoholic beverage items available from vendors throughout the world (including various sizes or packaging of a product brand) which may be sold through the DLC. It would not be good business practice to stock every item in the DLC warehouse, since demand would not support the cost of maintaining a warehouse large enough to regularly stock all items. Nor would it be efficient to list and offer items for purchase through the special order process for which there is no demand.

In making listing decisions, the DLC Product Committee reviews any available sales experience in neighboring jurisdictions and/or other areas of the country, and considers whether listing of the product as a special item or carrying the item in inventory would provide for an increased range of choices for customers. In making de-listing decisions, sales quantities for individual products are reviewed periodically to determine whether sales activity supports the cost of carrying the items in inventory, and whether de-listing of a product would in any way curtail competition. The Product Committee is comprised of the following DLC employees:

Chief, Retail Operations Division (Chair)
Program Manager II, Retail Division
Representative from DLC Purchasing Section
Two dispensary managers (designated by the Chair)

The DLC Product Committee did not meet during the period of the OLO evaluation. However, DLC management has assured OLO that the written listing and de-listing procedures, as endorsed by the Liquor Control Policy Committee, are being followed.

Inventory Shrinkage

When physical counts are conducted of the products stored at the DLC warehouse, adjustments to the perpetual inventory records may be necessary to bring the records into conformance with actual inventory on hand. These adjustments represent corrections for previous errors and/or loss of inventory due to shrinkage or pilferage. As reported by the DLC, net write-offs of inventory for the past five fiscal years were:

FY86	$178,565.67	(0.27% of goods sold and transferred to stores)
FY87	133,396.71	(0.20% of goods sold and transferred to stores)
FY88	145,183.81	(0.20% of goods sold and transferred to stores)
FY89	119,257.02	(0.16% of goods sold and transferred to stores)
FY90	49,147.61	(0.07% of goods sold and transferred to stores)

Net adjustments for shrinkage of DLC warehouse inventory have decreased substantially since FY86. The most significant improvement occurred in the liquor/wine category, from approximately $72,000 written off in FY86 to $9,000 in FY90. Write-offs for the beer category were $106,000 in FY86 versus $40,000 in FY90. DLC management attributes these decreases to a combination of factors: installation of cameras and other warehouse security devices, enhanced inventory accountability made possible by the new computer applications, and more conscientious enforcement of written policies and procedures.

Although inventory shrinkage for FY86 through FY89 appears to be high for DLC when compared to information received from other control jurisdictions in the mid-Atlantic region, the considerably smaller number reported for FY90 appears more reasonable. For FY90, the State of Virginia, with a sales volume of approximately $300 million, reported shrinkage of 0.04% of its cost of goods sold, and Pennsylvania, having a sales volume of approximately $800 million, reported shrinkage of 0.10% (see Note below). The percentage for inventory shrinkage reported by DLC for FY90 is midway between the percentages reported by Pennsylvania and Virginia.

Inventory Breakage

DLC does not account for inventory breakage by location or activity. Thus, it is unknown how much breakage occurs at the warehouse versus the retail stores. Inventory write-offs attributable to breakage for the entire DLC operation over the past five fiscal years were:

FY86	$55,377.04	(0.09% of the cost of goods sold)
FY87	62,122.41	(0.09% of the cost of goods sold)
FY88	61,913.47	(0.09% of the cost of goods sold)
FY89	88,915.79	(0.12% of the cost of goods sold)
FY90	82,967.82	(0.11% of the cost of goods sold)

For FY90, Pennsylvania reported breakage of 0.02% of its cost of goods sold for its entire operation, and Virginia reported a rate of 0.07% (see Note below). Breakage for the DLC operation exceeded these percentages during all five years, as shown above, with substantial increases reported for FYs 89 and 90. The majority of breakage reported for FY90 relates to liquor/wine products valued at approximately $73,000, with breakage in beer products accounting for about $10,000 of the total. Upon inquiry, OLO learned that DLC has not investigated possible reasons for these increases.

Sales and case depletion activities shown in the following two tables provide some perspective regarding the yearly inventory write-offs in relation to the levels of business conducted from the DLC warehouse.

Note: The State of West Virginia, with a sales volume of approximately $54 million, was not able to differentiate between write-offs for shrinkage versus other reasons, but reported an overall rate of 0.07% for inventory write-offs and adjustments for FY90.

Table 2

Montgomery County Department Of Liquor Control
Schedule of Income and Expenses for Wholesale Operations
By Fiscal Year as of June 30th

	FY 86		FY 87		FY 88		FY 89		FY 90	
Gross Sales	54,165,792	97.3%	59,672,112	99.0%	62,521,889	99.7%	63,149,032	99.8%	63,794,228	100.0%
Plus Container Tax	1,614,954	2.9%	1,701,145	2.8%	1,756,996	2.8%	1,712,407	2.7%	1,688,997	2.6%
Adjusted Gross Sales	55,780,746	100.2%	61,373,257	101.8%	64,278,885	102.5%	64,861,439	102.5%	65,483,225	102.6%
Minus Discounts	(103,171)	-0.2%	(1,085,169)	-1.8%	(1,571,087)	-2.5%	(1,593,664)	-2.5%	(1,681,153)	-2.6%
Net Sales	55,677,575	100.0%	60,288,088	100.0%	62,707,798	100.0%	63,267,775	100.0%	63,802,072	100.0%
Cost of Goods Sold:										
Beginning Inventory	7,116,809	12.8%	6,911,772	11.5%	8,149,884	13.0%	7,214,738	11.4%	7,233,694	11.3%
Purchases	64,140,390	115.2%	69,570,880	115.4%	71,378,023	113.8%	73,143,490	115.6%	74,428,374	116.7%
Minus Transfers to Stores	(20,687,721)	-37.2%	(21,799,256)	-36.2%	(23,438,245)	-37.4%	(23,705,188)	-37.5%	(24,169,011)	-37.9%
Goods Available for Sale	50,569,478	90.8%	54,683,396	90.7%	56,089,662	89.4%	56,653,040	89.5%	57,493,057	90.1%
Minus Ending Inventory	(6,911,774)	-12.4%	(8,149,884)	-13.5%	(7,214,738)	-11.5%	(7,233,694)	-11.4%	(8,393,352)	-13.2%
Cost of Goods Sold	43,657,704	78.4%	46,533,512	77.2%	48,874,924	77.9%	49,419,346	78.1%	49,099,705	77.0%
Gross Profit from Operations	12,019,871	21.6%	13,754,576	22.8%	13,832,874	22.1%	13,848,429	21.9%	14,702,367	23.0%
Minus Operating Expenses	(4,944,918)	-8.9%	(5,149,764)	-8.5%	(5,621,786)	-9.0%	(5,937,638)	-9.4%	(6,356,614)	-10.0%
Income From Operations Before Depreciation	7,074,953	12.7%	8,604,812	14.3%	8,211,088	13.1%	7,910,791	12.5%	8,345,753	13.1%
Minus Depreciation	(381,782)	-0.7%	(386,112)	-0.6%	(415,051)	-0.7%	(478,500)	-0.8%	(507,173)	-0.8%
Net Operating Income	6,693,171	12.0%	8,218,700	13.6%	7,796,037	12.4%	7,432,291	11.7%	7,838,580	12.3%
Other Income:										
From Investments	361,239	0.6%	245,330	0.4%	136,136	0.2%	67,406	0.1%	29,120	0.0%
Miscellaneous	24,016	0.0%	39,472	0.1%	30,108	0.0%	35,074	0.1%	6,866	0.0%
Total Other Income	385,255	0.7%	284,802	0.5%	166,244	0.3%	102,480	0.2%	35,986	0.1%
Minus Other Expenses Interest Paid on Bonds	(70,498)	-0.1%	(56,794)	-0.1%	(42,162)	-0.1%	(27,588)	0.0%	(15,814)	0.0%
Net Income	$7,007,928	12.6%	$8,446,708	14.0%	$7,920,119	12.6%	$7,507,183	11.9%	$7,858,752	12.3%
% of Net Income to Net Sales	12.59%		14.01%		12.63%		11.87%		12.32%	

Source: Department of Liquor Control

Table 3

Montgomery County Department of Liquor Control
Movement of Cases of Product Through the Warehouse
By Fiscal Year as of June 30th

	FY86	FY87	FY88	FY89	FY90	Increase or (Decrease) From FY86 Cases	Value $$$
LIQUOR PRODUCTS:							
Licensees	50,438	51,958	52,033	45,344	41,504	(8,934)	(646,822)
DLC Stores	259,452	256,858	260,694	251,955	243,605	(15,847)	(1,147,323)
Totals	309,890	308,816	312,727	297,299	285,109	(24,781)	(1,794,144)
WINE PRODUCTS:							
Licensees	377,525	421,787	412,771	380,003	352,692	(24,833)	(717,674)
DLC Stores	170,184	174,032	184,441	194,134	192,333	22,149	640,106
Totals	547,709	595,819	597,212	574,137	545,025	(2,684)	(77,568)
BEER - RETURNABLES:							
Licensees	133,007	131,018	128,143	126,863	119,503	(13,504)	(114,784)
DLC Stores	46,031	38,542	39,115	36,003	26,699	(19,332)	(164,322)
Totals	179,038	169,560	167,258	162,866	146,202	(32,836)	(279,106)
BEER - NON RETURNABLES:							
Licensees	3,321,097	3,504,050	3,633,725	3,539,483	3,486,097	165,000	1,402,500
DLC Stores	66,581	74,857	82,242	97,043	90,963	24,382	207,247
Totals	3,387,678	3,578,907	3,715,967	3,636,526	3,577,060	189,382	1,609,747
BEER KEGS:							
Licensees	85,878	88,714	88,711	86,990	83,262	(2,616)	(100,978)
SPECIAL ORDERS:							
Licensees	53,501	57,817	52,751	55,048	60,404	6,903	296,829
NON-ALCOHOL BEVERAGES:							
Licensees	0	0	0	0	4,965	4,965	24,329
DLC Stores	0	455	317	599	1,425	1,425	6,983
Totals	0	455	317	599	6,390	6,390	31,311
Grand Totals	4,563,694	4,800,088	4,934,943	4,813,465	4,703,452	139,758	(313,909)
Increase (Decrease) From Prior Fiscal Year		236,394	134,855	(121,478)	(110,013)		

* Average costs per case for products used to determine estimated value:

Liquor	$72.40	Kegs	$38.60
Wine	28.90	Special Orders	43.00
Beer-Returnables	8.50	Non-Alcohol	4.90
Beer-Non Returnables	8.50		

Source: Department of Liquor Control

The Touche Ross report contained three recommendations relating to control of the DLC warehouse inventory:

	Recommendation	Relative Importance	Implemented?
WO #1	**DLC should reduce inventory levels, particularly of liquor items**	**High**	**Partly**
WO #2	**DLC should convert slow moving items from regular stock to special order**	**High**	**Yes**
WO #11	**DLC should improve the security of the warehouse**	**High**	**Yes**

Specific suggestions offered by Touche Ross for reducing inventory levels in the DLC warehouse, and the status of implementation by the DLC follows:

> **"The average liquor/wine inventory at the warehouse is approximately 7-8 weeks. DLC should reduce this to 4-5 weeks."**

This recommendation has been partially implemented. Currently, DLC averages about 6-7 weeks of inventory in the warehouse. The average inventory is influenced by safety stock levels and order lead times, which are reviewed by DLC management periodically.

> **"The number of listed items should be reduced. A large number of listed items accounts for a small percentage of sales."**

This recommendation has been implemented. DLC controls the number of items listed as regular stock through its listing and de-listing procedures.

Additional DLC internal controls over storing merchandise in the warehouse include the following:

- Items are stored in pre-determined labeled locations.
- Access to inventory storage areas is restricted to those employees assigned to duties for the shift and management personnel carrying security access cards.
- Any visitors to the inventory storage areas must be escorted by DLC supervisory personnel.
- Customers picking up orders are allowed only in the outside area adjacent to the loading dock.
- Supervisors periodically patrol the warehouse storage areas.
- Contract employees are restricted to a certain area of the warehouse and are supervised during dinner break.

- Security personnel are on duty 18 hours weekdays to restrict or prevent access to the warehouse.

- Security personnel patrol the warehouse periodically throughout the day and evening hours.

- The warehouse alarm system is de-activated only for certain doors during business hours and re-activated for additional after-hours security.

- The receiving and loading dock areas are protected by fencing with the gates locked at night to prevent access.

- The exterior of the building is lighted at night.

- The beer warehouse section is physically separated from the liquor/wine warehouse section and access between the two sections is restricted.

- Storage of special order merchandise is physically segregated from storage of regular order merchandise and access to the special order area is restricted.

- Formal listing and de-listing procedures are followed to prevent carrying of low or no demand items in regular inventory.

- Stock depletion reports are reviewed to identify any remaining de-listed stock on hand for shipment to DLC stores, or return to suppliers for refund.

- Keg beer and other dated products are monitored and rotated to ensure oldest stock is shipped out first.

- Inventory counts are conducted monthly and the perpetual records are reconciled.

- State auditors participate in year end inventory verification for the liquor/wine section of the warehouse.

- As part of the County's annual audit, independent outside auditors sample year end inventory counts and perform cutoff testing of DLC records.

E. Moving and Loading

Moving and loading of products for delivery involves both personnel and heavy equipment. Two separate conveyor systems have been set up in the warehouse to efficiently move merchandise for loading into delivery trucks. The beer section conveyor system consists of a low level ground track. The conveyor system in the liquor/wine section consists of a two level track system running through the mezzanine picking area with the remainder suspended from the ceiling to maximize warehouse space. The conveyor systems are used to move merchandise from the picking areas of the warehouse forward to the loading bays.

Liquor/Wine

Moving and loading of liquor/wine products and special orders for delivery is accomplished by two DLC-employed daytime crews using a combination of conveyor system, forklifts, and order selectors. The average daily volume of liquor/wine merchandise loaded is 3,500 cases. This volume consists of approximately 3,000 cases of high demand products drawn from a mezzanine picking area, and 500 cases of lower demand products (picked as oddballs) from storage areas throughout the warehouse. The lower demand products are referred to as "oddballs" by DLC.

In the liquor/wine section, forklifts are used to move high demand products from the general storage areas to pallet roller tracks which have been set up in the mezzanine picking area next to the conveyor. The forklift operators deposit merchandise three pallets deep on the metal roller tracks. Pickers can pull products from the pallets closest to the conveyor, remove empty pallets, and roll full pallets forward by hand along the roller tracks. Stock is replenished by forklift as pallet space becomes available on the roller tracks. The lower demand products which are to be loaded for delivery are pulled early in the morning from various storage locations throughout the liquor/wine section and deposited on the floor adjacent to the picking area.

Liquor/wine products are pulled from the mezzanine picking area based on preprinted picklists and manually placed on the conveyor track. The picklists are arranged in reverse order of the truck route stops. A console operator compares products traveling along the conveyor to copies of the picklists and adjusts orders or picklists as necessary prior to products being loaded on delivery trucks. Products are manually loaded on trucks, and trucks are locked and sealed. Loaded delivery trucks are generally secured within the inner and outer doors of the shipping/receiving bays, and the truck keys are turned over to the DLC supervisor. Current staffing for the liquor/wine section crews consists of:

<u>Early Shift (7:30 a.m.-4:00 p.m.)</u>

2 Supervisors
2 Forklift Operators (full case replenishment)
1 Forklift Operator (special orders)
3 Order Selector Operators (oddball picking)
1 Console Operator (checker)
2 Supply Clerks (callers/checkers)
1 Warehouseman (Special Orders)

12 Total

<u>Late Shift (10:00 a.m.-5:30 p.m.)</u>

2 Supervisors
1 Forklift Operator (full case replenishment)
1 Forklift Operator (flow rack replenishment)
3 Supply Clerks (callers/checkers)
5 Pickers (mezzanine/floor)
2 Loaders

14 Total

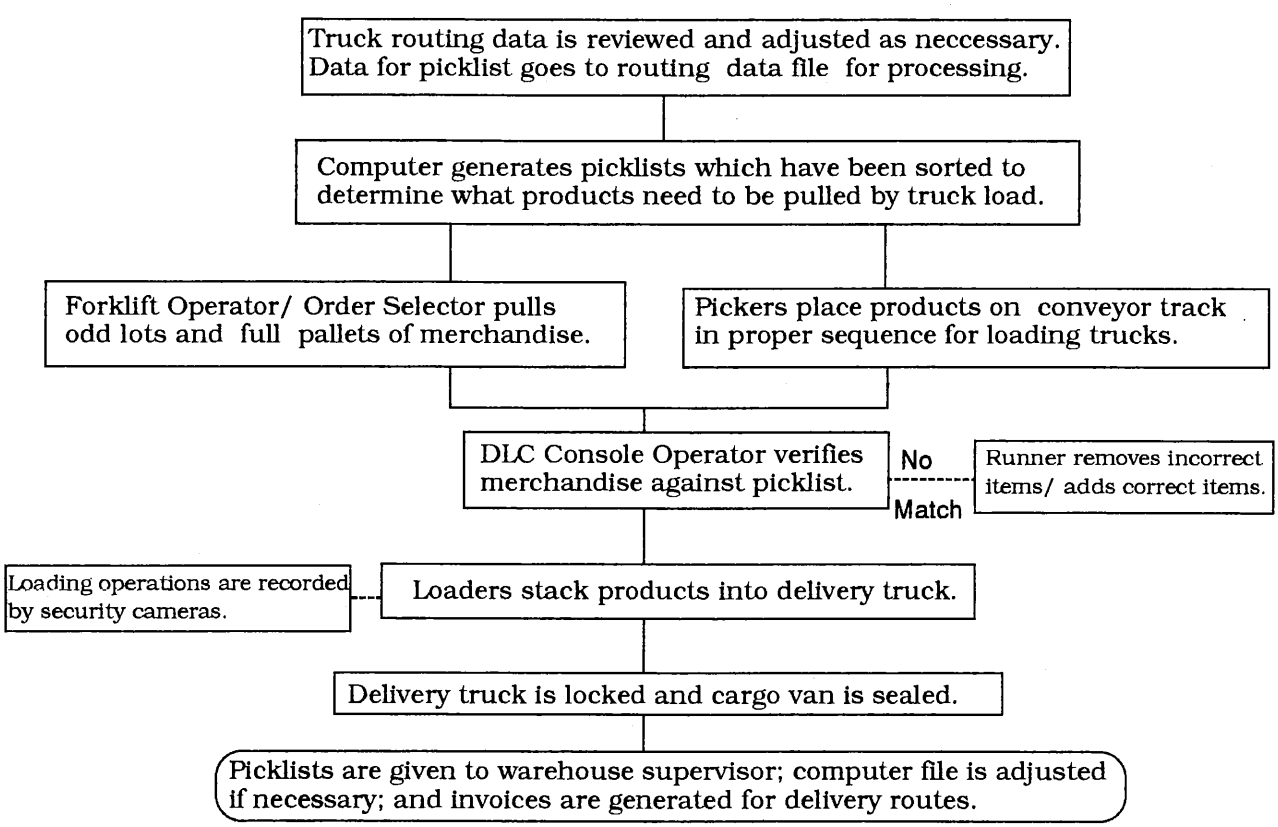
Beer

The beer loading operation is conducted during evening hours predominantly by a contracted crew of 13-26 persons who move products via a combination of conveyor system and forklift. A DLC-employed supervisor is on duty during the shift to oversee control of the loading activity and to supervise two DLC forklift drivers who assist with replenishing picking lines. The night crew productivity averages approximately 1,800 cases per hour, or 13,000 to 16,000 cases of merchandise per evening.

Beer products are pulled from main storage and arranged at a picking area alongside the conveyor line for the convenience of those pulling products to fill orders. Pallets of beer products are stacked on the floor in a picking area which is in close proximity to the conveyor track, and stacks are replenished by forklift as needed. As with the liquor/wine loading activity, beer products are pulled by hand from the picking area based on preprinted picklists and placed on the conveyor track. A counter verifies products pulled to copies of the picklists and adjusts orders/picklists as necessary, prior to products being loaded on delivery trucks. Products are manually loaded into delivery trucks, which are then locked, sealed, and secured within the inner and outer doors of the loading/receiving bays until morning. Truck keys are turned in to the DLC supervisor and retained in the office until assigned to a driver.

This flowchart of the loading activity will assist with visualizing the process.

Chart 7



Additional DLC internal controls over moving and loading products onto delivery trucks include the following:

- Pre-printed picklists determine the loading sequence and products to be placed on each truck.
- The truck loading areas are physically segregated from the receiving areas.
- Duties related to pulling products are segregated from loading responsibilities, and neither crew has access to the other's area.
- Independent comparison is made between the picklists and the products pulled and corrections are made, if necessary, prior to loading products on the delivery trucks.
- A counting devise integral to the liquor/wine conveyor system records the number of cases passing to the loading area.
- TV surveillance cameras allow for monitoring of picking lines.
- Security cameras record products being loaded onto trucks.
- Truck cargo vans are sealed immediately after loaded.
- Upon completion of the loading activity, the trucks are locked, parked within the loading bays, and the outer doors to the warehouse are closed and locked.
- Only supervisory personnel can adjust the computer's picklist files and authorize generation of customer invoices.
- Invoices are generated by computer from the adjusted picklist files.
- Case totals per picklists are compared to case totals on invoices to detect errors and omissions.
- Periodically, trucks are selected at random, unloaded, and the loads are compared and verified to the invoices accompanying the loads.

During observation of the loading activity, OLO noted that delivery truck drivers are not present and do not certify the contents of the trucks prior to the cargo vans being sealed. DLC does not use this process because, in DLC's judgment, it would be an inefficient use of resources and the expense in drivers' salaries to have them observe the loading of the trucks would be prohibitive. DLC believes that existing internal controls over the truck loading operation are adequate and cost effective.

F. Delivery

Currently, DLC owns 50 diesel powered delivery vehicles, acquired over the last 14 years, and having an original cost to the DLC of about $2.5 million. Except for two step vans, each delivery truck has a 20-foot cargo van with a capacity to carry 900 cases of beer, 450 cases of liquor/wine, or 70 kegs. The two step vans are used for delivering products in areas where parking is a problem and/or on streets where larger trucks are prohibited. Each delivery truck is assigned one driver and one helper, except for the step vans which are assigned only a driver. Deliveries are made daily, Mondays through Fridays, except for those days on which a County holiday occurs.

DLC has an authorized delivery fleet of 40 vehicles, of which 38 trucks and two step vans are less than 10 years old. These are the delivery vehicles used on a regular basis by DLC, with the excess trucks used as reserve or back-up vehicles. Seven of the DLC reserve trucks are planned for phase-out; i.e., DLC will continue to budget for regular maintenance and minor repairs, but will retire any trucks when major repairs become necessary. Following is a list of delivery vehicles currently owned by DLC:

Table 4

Listing of DLC Delivery Vehicles

Number	Year	Description	DOT Mileage Last Recorded
5	1991	Ford Tandem	Less than 1K
1	1990	Ford Tandem	5K
2	1990	GMC Step Van	1K
13	1989	Ford Tandem	10K - 15K
1	1989	Ford Tandem Refrigerated	5K
4	1987	Ford Tandem	20K - 27K
8	1985	GMC Tandem Refrigerated	29K - 46K
2	1983	GMC Tandem	51K - 53K
4	1982	Ford Tandem	31K - 43K
2	1979	Ford Tandem	38K
6	1978	Ford Tandem	12K - 102K
2	1977	Ford Tandem	24K - 25K
50			

For beer products, the average truck load is approximately 70 kegs or 900 cases. During the off seasons, the average daily sales volume for beer is 12,500 cases of products delivered in 14 trucks. During high demand periods, the average daily sales volume increases to as much as 19,500 cases of products delivered in 22 trucks. An average daily volume of 280 kegs is delivered in four trucks.

The average truck load for liquor/wine products is 440 cases. During off seasons, the average daily sales volume for the liquor/wine operation is 2,600 cases of products delivered in six trucks. During high demand periods, the average daily sales volume increases to as much as 4,000 cases of products delivered in 10 trucks For wine kegs, an average volume of 50 kegs is delivered in one truck on Fridays of each week.

Currently, 86 full time DLC positions (approximately 63 percent of all DLC warehouse positions) are assigned to the delivery function. This includes 43 truck drivers, 42 truck driver helpers, and one position for a truck router. The truck driver and driver helper positions are classified as combination classes; that is they can also perform duties as warehouse workers and helpers.

As a rule, DLC generally does not have more than 32 delivery crews operating at any one time. Separate delivery trucks are routed daily for delivery of beer by the case, keg beer, and a combination of liquor/wine and special orders. One additional separate truck load of keg wine is delivered on Fridays of each week. The typical daily operating pattern is twenty vehicles assigned for case beer deliveries, four vehicles for keg beer deliveries, and eight vehicles for delivery of liquor/wine and special order merchandise. Including keg wine deliveries, a licensee could possibly receive four DLC deliveries in one week or even one day.

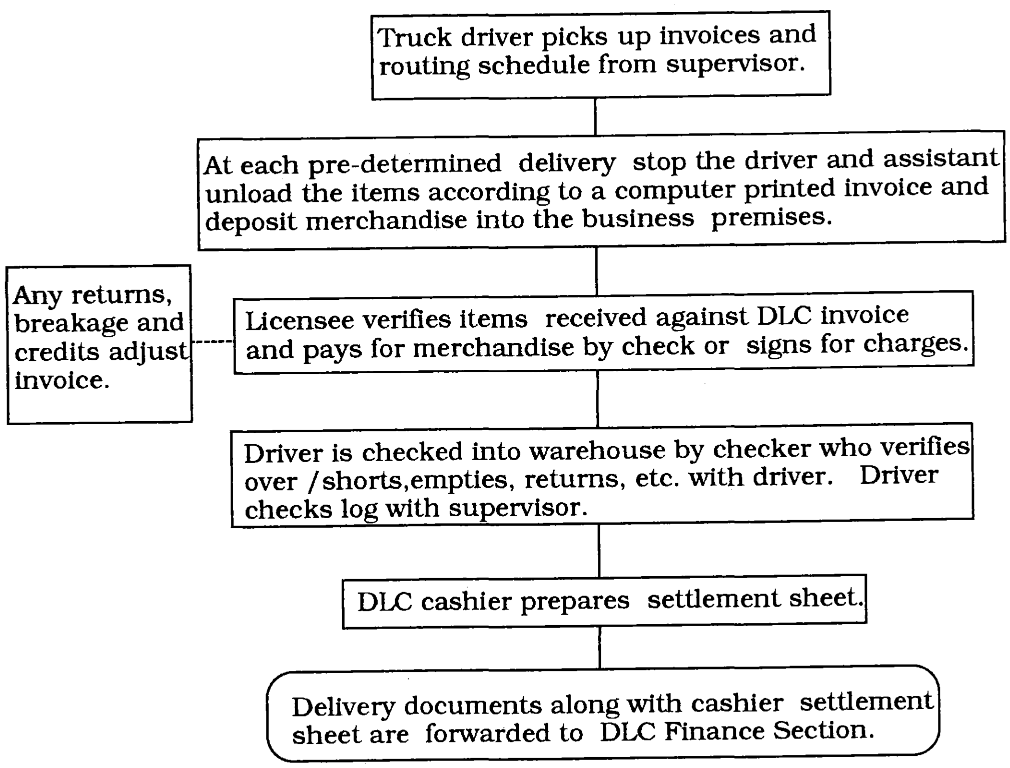
Whenever possible, DLC's policy is to honor licensee preferences for delivery times (e.g., no deliveries to restaurants at lunch time). A few licensees receive two weekly deliveries of case beer products due to the volume of their orders. One licensee provides for pick up of beer merchandise and receives a ten cent discount per case for picking up. This option is available to all licensees who are willing to provide their own transportation if the licensee's vehicle can be loaded by the pallet using a forklift. The ten cent discount is not available for product pick ups which require hand loading of the merchandise in a vehicle.

OLO's review of the delivery activity revealed that, although driver assignments are routinely rotated among routes, driver assignments are not rotated among trucks, and driver helper assignments are not rotated among drivers. Random assignment of drivers among trucks and helpers among drivers would increase internal control of the delivery activity.

DLC feels that efficiencies are attained by regularly assigning a driver to a particular truck and assigning helpers to drivers which ensure delivery teams that work well together. Therefore, DLC prefers not to randomly assign drivers to trucks based on the assumption that drivers are more likely to better maintain trucks to which they are regularly assigned, and driver helpers are not rotated among drivers because some teams seem to work together better than others.

This flowchart of the delivery activity will assist with visualizing the process.

Chart 8



The Touche Ross report contained several recommendations relating to the DLC delivery activity:

	Recommendation	Relative Importance	Implemented?
WO #13	**DLC should review its budget request for eight new trucks**	**High**	**Yes**
WO #14	**DLC should review the specifications for its new truck purchases to ensure that they are cost effective**	**Low**	**Yes**
WO #15	**DLC should develop a multi-year plan for periodic vehicle replacement**	**Low**	**Yes**
WO #16	**DLC should increase the minimum order size for free delivery of wine and liquor items**	**Medium**	**No**
WO #17	**DLC should eliminate all separate routine deliveries of special orders**	**Medium**	**Yes**
WO #18	**DLC should reduce the crew size on beer deliveries**	**Low**	**Yes**
WO #19	**DLC should prepare formal, written, on-site work rules**	**Low**	**Yes**

The only Touche Ross recommendation from this list which has not been implemented by DLC relates to the minimum order size for free delivery of wine and liquor items. Touche Ross specifically recommended that DLC increase the minimum order size to ten cases for free delivery of these products and suggested that:

"Licensees in the practice of placing small orders could:

- **Pay an additional surcharge;**
- **Make the purchase at a dispensary or DLC's warehouse; or**
- **Order less frequently in order to reach the minimum order size for DLC delivery."**

This recommendation has not been implemented by DLC, and minimum order quantities have not been adjusted in at least ten years. Currently, the minimum order to ensure free delivery service is:

Liquor/wine	5 cases to liquor/wine license holders
Wine	3 cases to wine only license holders
Beer	10 cases to any license holder
Kegs	2 kegs to any license holder

The Director of DLC recently announced to the Alcoholic Beverages Advisory Board (ABA Board) that the Department may soon raise the minimum order quantity to five cases for wine orders. DLC is also examining the feasibility of placing a surcharge on orders of five to seven cases of products, and adding a small handling charge to special order items to help offset the additional administrative costs associated with separate handling of these orders.

Additional DLC internal controls over the delivery activity include:

- Duties related to delivery are segregated from truck loading responsibilities.

- Straps and load control bars help prevent products from shifting or falling during transport to licensees.

- Generally, two employees are assigned to each truck.

- Pre-printed and pre-numbered customer invoices accompany each truck load.

- Distribution of truck keys is controlled by a DLC supervisor.

- Drivers verify security seals have not been tampered with prior to leaving DLC premises.
- Customers check in the orders and note any shortages.
- Shortages, returned merchandise, empties, etc. are noted on the invoices and deducted from amounts due.
- Customers sign invoices, agreeing with any adjustments thereto, and stating that merchandise was otherwise received in good condition.
- Driver completes a customer return form for empties, damaged merchandise, etc., and provides copy to customer.
- Upon return to the warehouse, a warehouseman checks in any empties or other returns and prepares a driver return form.
- Supervisors review and compare customer return forms to driver return forms.
- Drivers turn in invoices, checks, and customer return forms to DLC cashier office.
- Cashier deposits receipts daily, prepares settlement sheet for each driver, and forwards deposit slips and driver settlement sheets to the Accounting Section.
- Over and short accounts created through driver settlement process stay open until debit or credit memos adjust to zero, or money is collected to zero the account.
- Customer return forms are the basis for creating debit or credit memos to adjust inventory and accounts receivable balances.
- New drivers and helpers are provided with an orientation packet which includes the DLC written policies and procedures relating to the delivery activity.
- Computerized device (tachograph) records truck movement throughout the route, including times, speed, and number of stops.
- Dispatcher maintains a log book of routes by driver, including number of cases delivered and time to complete the day's deliveries.

VI. ACCOUNTING AND COMPUTER SUPPORT

Accounting and computer support for the DLC wholesale and delivery operations are closely related to each other and provide tools for management and control of the movement of products in and out of the warehouse. The Touche Ross report contained several recommendations relating to accounting and computer support for DLC warehouse operations, as follows:

	Recommendation	Relative Importance	Implemented?
ACCOUNTING SUPPORT			
FA #7	DLC should reconcile the Daily Invoice Register to the invoices on the Daily Sales Summaries	High	Yes
FA #8	Controls over inventory records should be improved	High	Yes
FA #9	Written procedures should be developed	Medium	Yes
FA #10	DLC receipts should be deposited daily and Sales Summaries and deposit slips forwarded to Accounting daily	Medium	Yes
FA #11	DLC should strengthen controls over cash	Medium	Yes
FA #12	Controls over breakage should be improved	Medium	Yes
COMPUTER SUPPORT			
FA #1	Data processing support should be upgraded - which may require a mini-computer based system	High	Yes*
FA #2	DLC should automate the merchandise reorder process	High	Yes*
FA #3	Automated reports should be developed to support inventory management	High	Yes*
FA #4	DLC should develop a manual backup procedure to the on-line system	Low	Yes
FA #5	DLC's financial management support should be significantly improved	High	Yes
FA #6	A cost accounting system should be developed and implemented	High	No

* Implementation of these recommendations is in progress.

Except for the last recommendation contained in the above list, all recommendations relating to accounting and computer support either have been fully implemented by DLC, or are in the process of being implemented. DLC has substituted a general ledger application in place of the recommended cost accounting system.

As an immediate response to the recommendations relating to computer support, Touche Ross and Company was contracted to assist DLC in identifying system requirements of the operation. Thus, in the early 1980's, the consultants assisted DLC to identify and define the information system needed to provide the County with computer support necessary to efficiently manage the DLC operation. As a result of this exercise, Touche Ross recommended acquisition and modification of seven computer applications for placement either on the County's mainframe computer or a mini-computer based system to be located at DLC. The computer applications recommended by Touche Ross included the following:

Accounts Receivable
Purchase/Reorder
Accounts Payable
Inventory Control
Order Entry
Cost Accounting
Driver Settlement

In its report, Montgomery County Department of Liquor Control System Requirements, Touche Ross not only identified DLC system requirements, but defined each data element needed and provided cross references of the data elements among the recommended computer applications. The contents of the Touche Ross report were used to develop an Expression of Interest and three Requests for Proposals for combinations of the desired computer applications. The results of these endeavors were unsatisfactory to DLC, and no contracts were issued.

In FY85, a committee was formed to evaluate the mainframe liquor system and identify deficiencies. The committee was comprised of representatives from DLC and Management Information Services (MIS).* From the review process, it was determined that the existing liquor system had a solid foundation from which to build.

The order entry and inventory management subsystems of the mainframe liquor system were found to meet 70-80 percent of the functional requirements identified in the Touche Ross report, over 61 percent of the major system outputs requirements, and 100 percent of the preventive controls. As a result of this exercise, the committee proposed a third option to DLC management. This concept consisted of linking, through telecommunications, the mainframe liquor system with a mini-computer system installed at the DLC administrative offices.

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* A reorganization in FY88 removed this division from the Office of Management and Budget and established it as the Department of Information and Telecommunication Systems (DIST).

Based on these findings, the project was extended to provide additional resources from MIS/DIST to pursue the options; the first of which was to explore available IBM software and hardware. This alternative proved to be undesirable, as both IBM hardware and software were deemed inadequate for the DLC purposes.

At this point, DLC used information contained in the Touche Ross report to evaluate existing software packages, and identified two which closely met the Touche Ross requirements. An in-depth review by the committee of these two packages was conducted by loading each of the respective software on a loaned WANG VS15 computer. This enabled the committee to test data typifying DLC's normal operations in a "live" environment to determine whether the packages satisfied the DLC system requirements.

As a result, the committee determined that, although either package would satisfy a majority of DLC's system requirements, one of the packages appeared to meet the needs more closely than the other. However, an on-site visit to a user of this package revealed that the application lacked sufficient accounting controls and audit trails, and the vendor was not providing adequate software support. A further inquiry into the capabilities of the second package was conducted, and it was found that the package provided desired accounting procedures and controls, sufficient audit trails, tight system security, and adequate vendor support and training. Therefore, it was the consensus of the committee to recommend the purchase of the TOM SPEED II Business Applications and to make necessary modifications to bring them into accord with the Touche Ross requirements.

The applications recommended by Touche Ross as compared to those being developed by DLC follows:

Applications Recommended	Applications Purchased
Accounts Receivable	Accounts Receivable
Purchase/Reorder	Purchase Orders
Accounts Payable	Accounts Payable
Inventory Control	Inventory Control
Order Entry	Order Entry
Cost Accounting	General Ledger
Driver Settlement	Driver (Routing) Settlement

Another application the DLC is implementing to offer improved service to customers is a Telephone Order Processing System (TOPS). This application will extend ordering hours by permitting licensees to place orders by touch tone telephone directly to DLC's mini computer seven days a week.

These computer applications are in various stages of implementation. Since each of the individual applications interfaces with one or more of the other applications, related applications must also be modified and tested to ensure desired records are passed accurately between them. The process leading to full implementation of an application may require six months to a year to complete. Several testing and modification periods are performed prior to full implementation of each application, such as:

- Initial review to determine if modifications are necessary to provide desired features, and identify modifications to other applications which may be necessary to pass or receive records.

- Programming of modifications identified in the initial review phase.

- Initial testing of all affected applications in a simulated live environment and further programming to modify affected applications, as necessary.

- Final testing of all affected applications in parallel mode, and further modifications as necessary. This phase would be repeated until all applications are deemed satisfactory.

The capabilities and status of implementing each application are described below.

Order Entry Application

The order entry application has been installed on the DLC mini computer system and is fully operational at that level. However, DLC is awaiting programming at the mainframe level to allow for integration of this application with the existing liquor system housed on the mainframe. When all DLC applications are fully installed and integrated, this application will receive data from the telephone order processing system, be fully integrated with the inventory control application, and pass data to the accounts receivable and general ledger applications. When mainframe programming is completed, the order entry application will receive invoice records from the mainframe and process them to update various accounts and files with either dollar and/or unit values. The various accounts and files include customer and vendor files in accounts receivable, product files in inventory control, and real and nominal accounts in general ledger. Outputs include data journals, error reports, record control and accountability reports, and a variety of user reports. DLC estimates that this application is 75% complete and will be fully implemented by the end of FY92.

Accounts Receivable Application

The accounts receivable application has been fully implemented and all affected employees have been trained in its use. This application provides a control in the order entry application, in that a valid customer account must have been established and on file in accounts receivable for an invoice record to be processed by the order entry application. The accounts receivable application also provides data entry functions for cash receipts and necessary account adjustments. Data journals must be processed and the files corrected so that data is free of errors prior to updating of any account balances or general file activity through the posting function. Daily aging schedules are produced for monitoring the accounts receivable activity for C.O.D, escrow, and charge customers. Claims to vendors for damaged merchandise, returned pallets, empty kegs, etc. has recently been implemented and is now included in the accounts receivable function.

Monthly billing statements are available for mailing by the second or third working day of the month following the month being billed. This is a dramatic improvement over the previous billing method which could be as much as 15-20 days after close of the billing period. On-line inquiry is also available to the users and is very beneficial in providing information to customers on a demand basis. Other features include the capability to establish individual customer credit limits, generate necessary customer dunning letters, and automatically activate customer cut-off.

Prior to implementing this application, a manual system was used whereby journal entries were prepared by DLC personnel for posting from a clearing account in the County's financial accounting system on the mainframe to various customer account records. Because aging of the various receivable accounts was also performed manually, the activity could not be performed daily.

Inventory Control Application

The inventory control application has been fully implemented and is currently in production. Its purpose is to maintain and provide accurate and timely information on inventory status. Journals generated through the order entry application reflect data provided by the inventory control application including selling prices, cost of goods sold, product inventory balances, and product size and description information. On-line inquiry, as well as hard copy reports are available. The local inventory control system maintains a check and balance control with the mainframe inventory control system. Detected errors are analyzed and corrected. The local application contains many more edits and controls than the mainframe application, and will eventually be used as the point of entry for establishing new inventory items as well as necessary changes to existing records.

This application forms the backbone of the operation in that it has the capability to maintain product related data, such as: sales, receivings, transfers, adjustments, wholesale and retail selling prices, promotional prices, products on order, inventory balances, and additional information for the warehouse and each DLC retail outlet. This application will also be a vital part of the re-ordering cycle once the purchase order application is fully implemented and integrated with the inventory control application. The local inventory control application will provide pertinent information relative to stock replenishment, such as products on hand, products on order, and suggested re-order quantities. The system would determine re-order amounts based on a mini-max concept, number of days sales in inventory, or other criteria which may be developed. DLC estimates this application will be fully operational by the last quarter of FY92.

Purchase Orders Application

Initial testing of this application has been conducted, desired modifications have been incorporated, and the application is ready for re-testing. When fully implemented, the purchase order application will utilize the inventory control application to determine suggested purchase re-order quantities. Individual worksheets will identify the vendors and products which meet pre-determined criteria for re-ordering. Suggested quantities for vendors would be reviewed by the DLC buyers and the computer file would be adjusted as necessary based on the current market situation (i.e., is the vendor offering a purchase allowance, depletion allowance, or is the product on the DLC weekly special list in the near future). These adjustments would then be entered on-line using the purchase order application. The DLC will have the option to produce another worksheet or generate a final purchase order. Special order items can be incorporated into this process, eliminating the necessity of preparing separate purchase orders. DLC estimates this application will be fully operational by the last quarter of FY92.

Accounts Payable Application

A preliminary review of the accounts payable application has been performed and the application is ready for initial testing. Since it is anticipated that only a few minor modifications will be needed, these will be programmed in conjunction with any modifications identified through the initial testing phase. This application will be used to automate the process for recording accounts payable transactions, currently manually maintained in ledgers. The system will receive data from the inventory control application and will automatically compare merchandise received to the original purchase orders as to price and quantity, a tedious process currently performed manually. In addition, many edits and controls exist in the package which will minimize potential errors. Similar to the other applications, the data journals must be run and contain no errors before the posting function can be performed. Once the posting process is activated, appropriate general ledger accounts will be updated to reflect the current day's accounts payable activity. In addition to the daily journals, exception reports and monthly summaries can be produced. DLC estimates this application will be fully implemented by the end of FY92.

General Ledger Application

The general ledger application has been reviewed and modified, and is being run in a parallel mode with the current manual system. The general ledger is strictly an accounting application, but ties the individual accounting and business applications into a complete financial system. In addition to maintaining account balances that are automatically updated through the posting process of the other applications, monthly financial statements are also available. These statements include both budgetary and financial data and can be customized by the user. DLC estimates this application will be fully operational by the end of FY93.

Driver (Routing) Settlement

The driver tracking system, which includes driver routing and driver settlement was designed by DLC personnel and Information Management Consultants. The consultants were contracted to write the basic software application in SPEED II, which made the programming compatible with the other applications purchased. The package was then enhanced by DLC personnel.

The driver (routing) settlement application is currently in production. The routing portion of the application receives all picking list records from the mainframe. The route coordinator may then select the desired records for a particular day's delivery from the customer delivery file. This file contains customer names, addresses, and delivery days for each product type. Outputs consist of worksheets to allow modification to route sequence, which may be based on truck case capacity, etc. These modifications, when entered, will update appropriate delivery files from which the picking lists are generated. These documents are sorted in reverse delivery sequence order prior to printing. Thus, the last picklist for a route represents the first delivery stop.

The picklists are then issued to warehouse personnel and used in the truck loading operation. Once the loading operation is completed, the picklist is used to update the picking record on the mainframe, changing its status from picking list to invoice. The invoice record is then downloaded to the local system and processed through the order system application. The process also establishes an accounts receivable balance by truck number. The route coordinator then makes the driver assignment to each truck.

Upon the drivers' return to the warehouse, DLC cashiers settle each driver's account by individual invoice number, recording amounts collected and "adjustment" amounts which represent items being returned, such as empty kegs, refused merchandise, etc. Generally these amounts have been deducted by the driver from the delivery invoice and the check received represents payment of the net amount due. The system compares line item entries with the net amount of the appropriate invoice and calculates an over or short amount.

The process is identical for all customers whether their payment type is C.O.D., escrow, or charge. During the posting process, only the amounts collected on C.O.D orders are recorded in customers' accounts. "Adjustment" amounts are transferred to the credit adjustment file and offset by credit memos issued for the returns. Erroneous "adjustments" or credits are retained in the driver settlement system as open items until resolved through the settlement process in the future. Many reports are available to the user to identify the status of each daily delivery invoice.

Telephone Order Processing System

Another application the DLC is implementing to offer improved service to customers is a Telephone Order Processing System (TOPS). This system permits a customer with a DLC assigned identification and password to access TOPS. Once access has been achieved, the caller is led step by step through a menu selection process until the desired ordering selection is reached. Detailed instructions are continuously given throughout the ordering process. When the order is completed, additional options are available to the caller, such as reviewing the order, changing the order, or processing the order and exiting the system.

The system, when fully operational, will provide additional ordering hours to DLC customers. TOPS will be available to customers from 5:00 p.m. each day until 5:00 a.m. the next day, augmenting the regular call-in hours of 8:00 a.m. to 4:00 p.m. Monday through Friday. The benefits to DLC customers will be in the form of potentially lessening the hours between order placing times and delivery times. Presently, customers must place their orders on day one for delivery on day three.

The TOPS application is being tested prior to offering the service to retail licensees. Four DLC stores are currently using the system to place their orders. However, these orders are not being passed through to the mainframe for processing. DLC is waiting for the DIST mainframe programmer to initiate testing of DLC records through the upload programs. Once this has been accomplished, additional tests can be performed to determine if any adjustments need to be made to the hours TOPS will be available. When all necessary testing is completed, DLC will offer formal training of store personnel and licensees. Ordering through TOPS is a rather simple process and can probably be mastered in a very short time period. However, a minor concern centers around the fact that many DLC customers do not speak or read English. Enhancements to TOPS are available which may solve this potential problem. DLC estimates this application will be fully operational by the second quarter of FY92.

Additional DLC internal controls achieved through accounting activities and computer applications include the following:

- Accounting duties and activities are segregated from purchasing, receiving, and other warehousing duties and activities.
- Driver settlement sheets are reviewed, and over and short accounts are created for differences between invoices and amounts collected from licensees.
- Debit or credit memos are authorized by warehouse supervisors to offset over and short accounts.
- The status of customer over and short accounts is reviewed daily.
- Product receiving reports are reconciled to purchase orders and payable accounts are adjusted for vendor-related differences or receivable accounts are established for carrier-related differences.

- Receivable accounts are reviewed and evaluated daily.
- All discounts offered by vendors are taken by the DLC.
- Receipts are deposited daily.
- An accounting manager supervises the physical inventory counting activity, analyzes adjustments needed to update perpetual inventory records, verifies adjustment of perpetual records, and prepares inventory overage/shortage reports for administrative review.
- All invoices are pre-numbered and accounted for as reflected on the daily journal.
- Access to various computer files and applications is restricted to certain individuals having authorized identification codes.
- Access to computer files or portions of files is only permitted on the basis of need. (Example: A warehouse supervisor would have access to picklist files but not the perpetual inventory file).
- Standard procedures and approvals are in place for requesting, authorizing, and creating access identification codes.
- Computer applications contain programmed edits to identify and minimize input errors.
- Computer applications produce exception reports to identify errors needing correction.
- Run-to-run totals are provided for verifying account balances or totals.

When all DLC applications are fully implemented and integrated, purchase orders will be entered into a computer holding file and received quantities will be automatically compared to ordered quantities; exception reports will be produced by the computer. Purchase orders are currently manually produced and compared to receiving reports.

VII. SURVEY OF LICENSEES

As part of the evaluation, OLO conducted a survey of 80 licensees to determine whether inventory availability, ordering, and delivery services provided by DLC are generally viewed as satisfactory. The number to be surveyed was determined by randomly selecting at least ten percent of the licensees from each license class category. Overall, the results of the survey indicate that licensees have few problems with inventory availability and are generally satisfied with ordering and delivery services provided. The results of the survey follow:

Question 1: How long have you been dealing with the DLC?

Purpose: To determine the depth of experience responders had in dealing with the DLC.

Responses:

Less than one year	18	23%
One to two years	12	15%
Three to five years	22	27%
Six to ten years	19	24%
Eleven to fifteen years	4	5%
More than fifteen years	5	6%
	80	100%

Question 2: What are your normal delivery days as assigned by the DLC?

Purpose: To determine that a fair cross section had been achieved and responses would not be skewed based on a predominance toward a certain delivery day. (Since beer products are delivered separately from liquor/wine products, many licensees had more than one delivery day assigned by the DLC.)

Responses:

Monday	22	15%
Tuesday	22	15%
Wednesday	35	24%
Thursday	35	24%
Friday	31	21%
Picks up own products	1	1%
	146	100%

Question 3: How would you rate the overall delivery service on a scale of one (as being the lowest rating) to five (as being the highest rating)?

Purpose: To determine whether licensees are generally satisfied with the DLC delivery service.

Responses:

Five - totally satisfied	13	16%
Four - very satisfied	41	51%
Three - satisfied	18	23%
Two - mildly satisfied	5	6%
One - not satisfied	2	3%
Not applicable	1	1%
	80	100%

Question 4: How would you characterize DLC delivery service employees?

Purpose: To more specifically identify problems with DLC delivery service personnel which licensees may be experiencing.

Responses:

Very helpful	47	59%
Helpful	16	20%
Somewhat helpful	12	15%
Not helpful	4	5%
Not applicable	1	1%
	80	100%

The majority of respondents indicated overall satisfaction with the DLC delivery service, and commented that the personnel are generally quick, efficient, courteous, and friendly. Two licensees commented that mud had been tracked into their establishments by delivery personnel, and one licensee stated that the DLC personnel delivered the merchandise through a door other than the one which had been preferred by the licensee.

Question 5: How would you rate inventory availability on a scale of one (as being the lowest rating) to five (as being the highest rating)?

Purpose: To determine whether DLC inventory management is generally adequate for meeting the needs of licensees.

Responses:

Five - totally satisfied	4	5%
Four - very satisfied	18	23%
Three - satisfied	34	42%
Two - mildly satisfied	21	26%
One - not satisfied	3	4%
	80	100%

Question 6: Have you experienced specific problems with inventory availability?

Purpose: To more specifically identify problems with DLC inventory availability which licensees may be experiencing.

Responses:

No	60	75%
Yes	20	25%
	80	100%

Question 7: Have you experienced specific problems with seasonal availability of inventory?

Purpose: To determine whether DLC management of seasonal variances in inventory demand is generally adequate for meeting the needs of licensees.

Responses:

No	67	84%
Yes	13	16%
	80	100%

Licensees were more critical of DLC in the area of inventory availability because of a general feeling that, as a sole supplier, DLC should always be able to provide products as needed by licensees. In addition, some licensees felt that there are a number of special order items which should be carried as regular stock at the DLC warehouse. Those licensees who experienced problems with seasonal availability of products indicated that, although the incidence has been decreasing in recent years, certain products may be in short supply in the summer months and the Christmas/New Year holiday season.

Question 8: How would you rate the special order process on a scale of one (as being the lowest rating) to five (as being the highest rating)?

Purpose: To determine whether the special order process meets licensee needs and is generally accepted by licensees.

Responses:

Five - totally satisfied	9	11%
Four - very satisfied	24	30%
Three - satisfied	39	49%
Two - mildly satisfied	5	6%
One - not satisfied	3	4%
	80	100%

Question 9: Have you experienced specific problems with the special order process?

Purpose: To more specifically identify problems with the special order process which licensees may be experiencing.

Responses:

No	72	90%
Yes	8	10%
	80	100%

Licensees who place special orders on a regular basis commented that the length of time to receive orders should be shorter for some items which are carried by other independent wholesalers in the State. The current process from order to delivery can take from one to eight weeks, depending on the product requested. Several licensees stated that if turnaround times cannot be improved upon, then more products should be carried by the DLC as regular stock.

Question 10: How would you rate the overall ordering process on a scale of one (as being the lowest rating) to five (as being the highest rating)?

Purpose: To determine whether licensees are generally satisfied with the ordering process as established by the DLC.

Responses:

Five - totally satisfied	7	9%
Four - very satisfied	23	29%
Three - satisfied	37	46%
Two - mildly satisfied	9	11%
One - not satisfied	4	5%
	80	100%

Question 11: How would you characterize the order takers?

Purpose: To more specifically identify problems with DLC customer service personnel which licensees may be experiencing.

Responses:

Very helpful	15	19%
Helpful	40	50%
Somewhat helpful	23	29%
Not helpful	2	2%
	80	100%

A number of licensees expressed dissatisfaction with their assigned days for placing orders. Most licensees would like to be able to order and receive additional shipments, if needed, after the weekend sales activity has been determined. Some licensees wanted to be able to call in orders anytime, rather than being assigned a certain day. Several responders who speak foreign languages expressed difficulty in communicating with order takers.

Question 12: If DLC were to implement an alternate ordering system which would extend the hours for placing orders and allow for licensees to call in orders on weekends and holidays, would you use it?

Purpose: To determine whether some of the dissatisfaction expressed by licensees would be alleviated with implementation of the Telephone Order Processing System (TOPS) and the potential use of the system by licensees.

Responses:

No	44	55%
Yes	36	45%
	80	100%

Most of the respondents had heard rumors that DLC is implementing an automated ordering system, but were unfamiliar on how it would work. Many licensees said they would be uncomfortable placing an order directly into a machine. A few licensees had experience with ordering other commodities via a computerized ordering system, and found these systems to be time consuming and not particularly efficient for placing large orders. Second language responders expressed the highest interest in using such an arrangement.

VIII. RELATED MATTERS

Touche Ross and Company made a number of recommendations as a result of its review of DLC operations which related to the organizational structure of DLC, wholesale pricing, and customer credit. While several of these recommendations could have indirect impact on inventory accountability and control, discussion of these recommendations does not fall logically within the activities examined elsewhere in this report.

Organizational Structure

The Touche Ross report contained several recommendations relating to the organizational structure of DLC:

	Recommendation	Relative Importance	Implemented?
O #1	**A "Liquor Control Policy Committee" should be established**	**High**	**Yes**
O #2	**DLC should be restructured into three major divisions: Wholesale, Retail, and Finance and Administration**	**High**	**Yes**
O #3	**All functions related to the wholesale side of the business should be consolidated into the Wholesale Operations Division**	**High**	**Yes***
O #4	**All functions related to the retail side of the business should be consolidated into the Retail Operations Division**	**High**	**Yes***
O #5	**All finance and administrative functions should be consolidated into a third division, including transferring accounting and data processing functions from other County Departments to DLC**	**High**	**Yes***
O #6	**The people appointed to fill the four key management positions should be seasoned management professionals**	**High**	**Yes**

* DLC was reorganized during FYs 82-83 to fully implement all of the Touche Ross recommendations. Since that time, however, responsibility for certain activities has been reassigned to achieve greater separation of duties and more effective spans of control. Touche Ross recommended the following organizational structure for DLC:

Wholesale Operations
Purchasing unit
Customer services
Warehousing (beer & liquor/wine)
Fleet administration

Retail Operations
Retail stores
Merchandising

Finance & Administration
Accounting unit
Cashiering unit
Data processing support
Office services

Current Organizational Structure

Wholesale Operations
Beer warehousing
Liquor/wine warehousing
Fleet administration

Retail Operations
Retail stores
Merchandising
Customer services

Finance & Administration
Accounting unit
Purchasing unit
Cashiering unit

Office of the Director
Central administration
Data processing support
Office services

The current organizational structure of DLC provides for a more evenly distributed span of control within divisions. Responsibilities for taking orders and for purchasing merchandise have been removed from Wholesale Operations. The layout of administrative offices at the warehouse is such that neither of these activities could be physically located near the administrative offices of the Wholesale Operations Division. In addition, the current placement of these two activities allows for a greater separation of oversight responsibility between taking orders from customers, purchasing merchandise from vendors, and receiving merchandise into the warehouse.

Wholesale Pricing and Customer Credit

As a result of the operational review of the wholesale activities of DLC, Touche Ross offered four recommendations relating to DLC wholesale pricing and customer credit:

	Recommendation	Relative Importance	Implemented?
WO #6	**DLC should establish separate wholesale prices for each product line**	**High**	**Yes**
WO #7	**DLC should terminate the practice of having the Department of Finance suggest wholesale beer prices**	**Low**	**Yes**
WO #8	**DLC should routinely sample the cost files**	**Medium**	**Yes**
WO #9	**Credit should be available to all licensees on a non-discriminatory basis**	**High**	**No**

Except for the recommendation to extend credit to all license classes, these recommendations have been fully implemented by DLC. At the time of the Touche Ross study, DLC's business practice was to require payment on delivery for beer purchases by holders of all license classes. Businesses holding liquor licenses (restaurants, hotels, and clubs) were eligible to arrange for credit with DLC to charge liquor and wine purchases. All other classes of license holders were required to pay COD or establish an escrow account with DLC. The result of this policy was that businesses holding only beer and/or wine licenses were not eligible to establish credit lines with DLC. Touche Ross recommended that all classes of license holders be made eligible to purchase wine on credit and that DLC consider extending credit on beer deliveries as well. Neither recommendation was implemented.

The consultants acknowledged that the County could not, at that time, accommodate additional credit accounts and would need an automated software package to service a significantly increased level of accounts receivable. Now that the DLC accounts receivable application has been fully implemented, the Department Director is reviewing DLC policies regarding escrow and credit accounts. Of the 317 license holders eligible to establish credit lines with DLC, 170 license holders currently take advantage of such arrangements. DLC's monthly accounts receivable balance averages $250,000 to $270,000 for these accounts. Extending the credit option to all license holders could easily increase the average accounts receivable carried by DLC to $1 million or more.

IX. CONCLUSIONS

1. The inventory storage configuration in the beer section does not appear to be as efficiently allocated as that in the liquor/wine section.

This OLO evaluator was an internal auditor from 1978 to 1983 and visited the DLC warehouse on numerous occasions while participating in year-end inventory counts and reconciliations. Changes which have been made to the warehouse storage configuration since that time are impressive, especially in the liquor/wine section of the warehouse. Increasing racks from three to five tiers has allowed for more efficient use of overhead space and released a considerable amount of floor space for other uses; elimination of the need for a bottle room (previously used to pack mixed cases) has made the space available to store special orders in a more secure area; and extension of the mezzanine has allowed for more efficient picking lines.

Changes to the beer section of the warehouse, completed in 1988, included an expansion of the keg storage area and a small addition on the side of the building for storing empties, pallets, and other returnable materials. With removal of returnable materials from the bulk storage area, some additional floor space was gained for storage in the beer section. However, a proliferation of beer products available for sale has placed additional strain on storage space in the beer section of the warehouse, and quantities of many inventory items that must be carried to meet demand are such that wide use of rack storage would not be efficient. Consequently, the storage configuration in the beer section of the warehouse cannot be as efficiently managed as the liquor/wine section, and the liquor/wine section must be used on occasion to accommodate overflow storage of beer products.

2. **The minimum order quantity to ensure free delivery of products to licensees does not appear to have any relationship to the cost of delivering small orders.**

The minimum order quantity to ensure free delivery of products to licensees has not been changed in at least ten years. The current minimum order quantities are: five cases of any combination of liquor or wine products to liquor/wine license holders; three cases of wine products to other license holders; or ten cases of beer to any license holder. The DLC is currently considering an increase to the minimum order quantity for wine only orders to match the five case minimum requirement for liquor/wine license holders.

As a result of the operational study conducted by Touche Ross in 1980, the consultants recommended increasing the minimum order quantities for liquor/wine products to ten cases. Touche Ross suggested that licensees could adjust to the new minimums by changing their ordering patterns, purchasing from DLC stores, or paying a surcharge for delivery of a fewer number of cases. Failure to implement the Touche Ross recommendation appears to have been based on considerations relating to conveniences for licensees rather than the cost to the County for delivering small orders. All licensees pay for delivery service indirectly through mark ups on products sold by the DLC. DLC management is reviewing the possibility of instituting a surcharge for delivery of small quantities.

3. **In light of the County's current economic climate, the DLC credit policies appear to be lenient.**

DLC currently extends a credit option for purchases of liquor and wine only to holders of liquor licenses. Licensees are required to pay for the month's deliveries by the 15th of the following month; only upon failure to pay by the end of that month is the licensee cut off from future deliveries.

Touche Ross recommended that all classes of license holders be made eligible to purchase wine on credit, and that the DLC consider extending credit on beer deliveries as well. Neither recommendation was implemented. The total monthly accounts receivable balance carried by the DLC for credit extended to licensees currently averages $250,000 to $270,000. Extending the credit option to all license classes for all products could result in an increase of DLC's investment in accounts receivable to $1 million or more.

The practice of extending credit to licensees transfers risk to the County for a licensee's investment in inventory, and initially releases a significant amount of cash for the licensee. In addition, the DLC is denied an opportunity to either use the money or invest it for the benefit of the County.

With the combined effect of inflation in the 1980s and tax increases imposed on alcoholic beverages, the cost of DLC products has been increasing annually, and potential financial losses to the County have been increasing proportionately. Also, the current economic climate may increase the risk of business failures, and result in higher risk to the DLC. The reserve for bad debts maintained by DLC for the past three years has averaged $33,000, with $24,300 written off against the account so far in FY91.

4. DLC has more delivery trucks than are currently needed to effectively conduct delivery activities.

DLC currently owns 50 delivery trucks, of which, an average of 32 vehicles are needed for deliveries on any given day. This generally leaves 18 vehicles for backup. Even during DLC's busiest seasons, no more than 40 delivery trucks are expected to be needed, leaving 10 vehicles for backup. This number of backup trucks may exceed DLC needs, and while sale of excess trucks may not bring a very high return to DLC, other County departments or agencies may have uses for DLC's excess trucks.

5. DLC policies and procedures are not always stringently enforced, and some policies and/or procedures may need to be updated.

Based on review of documented operating procedures and observation of DLC activities, OLO noted that:

- There is a need for DLC to more stringently enforce documented policies and procedures. For instance, DLC procedures require that DLC-employed warehouse personnel be supervised and restricted from storage areas during lunch break, but the procedure was not followed on at least one occasion when OLO visited the warehouse to observe DLC operations.

- Although DLC has standardized and documented significant policies and procedures, several of the written policies and procedures pre-date 1985. DLC does not currently have a policy in place which would require periodic review and updating of documented policies and procedures. (DLC management has indicated that policies and procedures are currently under review.)

6. DLC does not currently utilize a simple and effective internal control procedure of randomly assigning drivers, helpers, and delivery trucks.

A policy of routinely rotating drivers among delivery trucks and helpers among drivers would increase internal control over the loading and delivery operations by discouraging collusion among loaders, drivers, and helpers.

7. Membership on the product listing/de-listing committees is heavily weighted toward the retail end of DLC's business.

The procedures for listing/de-listing products offered by DLC specifies committee membership to include four persons from the Retail Operations Division and one person from the Financial Management Division. Although the retail portion of the business may be most familiar with customer demand for certain products, additional input from the wholesale and financial management portions of the business may be of value to these committees.

8. **Based on responses to a survey conducted by OLO, licensees are generally satisfied with inventory availability, ordering and delivery services provided by DLC.**

OLO surveyed 80 licensees (10 percent of outstanding licenses for each license class) to determine whether DLC inventory availability, ordering, and delivery services are generally viewed as satisfactory. More than 85 percent of the respondents expressed satisfaction with ordering and delivery services provided by DLC, whereas, 70-75 percent were generally satisfied with inventory availability. Licensees appeared to be more critical regarding inventory availability because of a general feeling that, as a sole supplier, DLC should always be able to provide products as needed by licensees. Most respondents were aware that DLC is planning to implement an automated Telephone Order Processing System (TOPS). Because the licensees had little information on how using TOPS might benefit them, 55 percent expressed an unwillingness to use the system.

9. **The reasons for substantial changes in inventory write-offs for breakage have not been investigated by DLC.**

Inventory breakage for the entire DLC operation increased about $27,000 (44 percent) from the $62,000 reported for FY88 to $89,000 reported for FY89. Although breakage decreased slightly in FY90 to about $83,000, the FY90 write-off remained $21,000 (34 percent) higher than the FY88 level of $62,000. Data received from the control States of Pennsylvania, Virginia, and West Virginia indicate that DLC write-offs for breakage are high in relation to its cost of goods sold. For FY90, the DLC reported inventory breakage at 0.11 percent of its cost of goods sold, whereas Pennsylvania reported 0.02 percent and Virginia reported 0.07 percent. The State of West Virginia reported combined inventory write-offs for shrinkage, spoilage, and breakage of 0.07 percent of its cost of goods sold. Upon inquiry, OLO learned that DLC does not routinely investigate significant changes in inventory write-off activity.

X. RECOMMENDATIONS

1. In light of changing market conditions, DLC should re-evaluate the inventory storage needs of the beer and liquor/wine sections of the warehouse with a view to gaining additional storage space of beer products. The DLC should give consideration to:

   - installing a limited number of racks in the beer section to accommodate single pallets of products which are currently taking up valuable floor space;

   - installing a two level mezzanine and conveyor system similar to that currently utilized in the liquor/wine section; and/or,

   - moving the fence which separates the beer section from the liquor/wine section.

2. DLC should increase minimum order quantities for free delivery of liquor and wine products from three/five cases to ten cases, and examine the feasibility of establishing fees to recover the cost to deliver smaller quantities, should licensees desire the service.

3. DLC should review its credit policies to identify options which will lessen financial risk to the County, to include:

   - Eliminating County risk by phasing out the credit option;

   - Charging interest on average credit balances in accordance with prevailing commercial rates for similar accounts receivable;

   - Placing licensees on COD immediately for those who have not paid their accounts by the 15th of the month;

   - Establishing maximum credit limits; and

   - Establishing a probation period for new businesses before extending the credit option.

4. DLC should evaluate its need for 50 delivery trucks, and surplus vehicles should be made available to other County departments and agencies.

5. To promote effective and efficient management, DLC should review and update its policies and procedures at least every five years and consistently enforce them.

6. To increase internal control over loading and delivery activities, DLC should randomly assign drivers, helpers, and delivery trucks.

7. DLC should add one person from the Wholesale Operations Division and one person from the Financial Management Division to its product listing/de-listing committees to round out the membership.

8. DLC should inform licensees of its intention to implement an automated telephone ordering system and provide licensees with educational information on the uses and benefits of the system.

9. Substantial changes in inventory write-offs indicate breaches in internal control may be occurring and should be investigated as a matter of policy. If DLC is not able to examine the reasons internally, the Auditing Section of the Department of Finance should be requested to assist. The reported increases in inventory breakage written off by DLC for FYs 89 and 90 should be fully examined to identify reasons for the significant changes which have occurred, and to provide a basis for developing corrective measures, if necessary. OLO recommends that an internal audit of breakage and other inventory adjustments be conducted by the appropriate Executive branch department.

XI. DEPARTMENT AND AGENCY COMMENTS

On April 4, 1991, OLO circulated a draft of this report to the County's Chief Administrative Officer, the County Attorney, appropriate Executive branch departments, and the Staff Director of the County Council. All technical corrections received either orally or in writing have been incorporated into this final report. Written comments are included in their entirety beginning on page 50. Page references in the comments refer to the draft report and may differ in the final version.

During the period of this evaluation, OLO attempted to locate industry standards for liquor wholesale operations, but found that current information was not readily available. Consequently, in late March, OLO inquired directly of other control jurisdictions in the mid-Atlantic region to obtain comparative data regarding inventory write-offs and adjustments. This data was not obtained by OLO until after the draft report had been circulated for comment. Based on information received from the control States of Virginia, Pennsylvania, and West Virginia, additional information was incorporated into the final report on pages 17 and 18. Also, a ninth conclusion and recommendation relating to DLC inventory write-offs for breakage was added to the report. As a result, the attached comments to the OLO draft report do not address the discussion of breakage contained in the final report.

Montgomery County Government

ROCKVILLE, MARYLAND 20850

MEMORANDUM

April 25, 1991

TO: Andrew Mansinne, Jr., Director
Office of Legislative Oversight

FROM: William H. Hussmann
Chief Administrative Officer

SUBJECT: DRAFT OLO Report #90-7, A Description and Evaluation of the Inventory Accountability and Control for the Montgomery County Alcoholic Beverages Warehouse Operation

Thank you for the opportunity to comment on the Draft OLO Report #90-7, A Description and Evaluation of the Inventory Accountability and Control for the Montgomery County Alcoholic Beverages Warehouse Operation.

This report provides a comprehensive and in-depth analysis of certain aspects of the Department of Liquor Control. The comments from the Department of Liquor Control (2 memos) and the Office of Management & Budget are attached. The County Attorney's Office did not submit comments.

It should be noted that the Department of Liquor Control (DLC) provides the following responses to the OLO recommendations:

1. As part of the development of a five year business plan, DLC will review the configuration of the liquor/wine sections of the warehouse, conveyor system, and racks.

2. DLC has adopted an increased minimum order size effective June 3, 1991.

3. DLC has adopted a new payment policy effective June 3, 1991 requiring either an escrow account or a. C. O. D. payment from the licensee.

4. DLC will review the fleet size during the next budget cycle.

5. DLC concurs with the OLO recommendation for a five year policy and procedures review plan.

6. DLC will evaluate the assignment methodology for drivers, helpers, and delivery trucks.

7. DLC disagrees with the OLO recommendation for changing the membership and size of the listing/delisting committee. The current size and representation of the committee is appropriate.

8. DLC will develop a an orientation program for licensees when the automated telephone ordering system is implemented in the fourth quarter 1991.

The Executive Branch looks forward to discussing OLO Report #90-7 upon its release by the County Council. Thank you again for the opportunity to comment.

Attachments

Montgomery County Government

1991 APR 15 11:10:11

M E M O R A N D U M

April 15, 1991

TO: Phil Marks, Management and Budget Specialist
Management Improvement Unit, Office of the CAO

FROM: Jerome I. Baylin, Director
Department of Liquor Control

SUBJECT: Response to OLO Report No. 90-7

Attached please find our response to draft OLO Report No. 90-7. As agreed in our recent meeting, please review the attached and contact this office with your comments at your convenience.

Thank you for both your time and input at our meeting this past Friday. If you have any questions regarding our response, please do not hesitate to call upon us.

JIB:kz

Attachment

Department of Liquor Control
16650 Crabbs Branch Way, Rockville, Maryland 20855-2297, 301/217-1900, FAX 217-1962

Montgomery County Government

M E M O R A N D U M

April 15, 1991

TO: Andrew Mansinne, Jr. - Director, Office of Legislative Oversight

FROM: Jerome I. Baylin - Director, Department of Liquor Control

SUBJECT: Response to April 4, 1991 Memorandum - DRAFT OLO Report No. 90-7, Description and Evaluation of Inventory Accountability and Control for the Montgomery County Alcoholic Beverages Warehouse Operation

The purpose of this memorandum is to acknowledge receipt of your Draft OLO Report No. 90-7, Description and Evaluation of Inventory Accountability and Control for the Montgomery County Alcoholic Beverages Warehouse Operation, and to respond to the recommendations contained therein.

1. In light of changing market conditions, DLC should re-evaluate the inventory storage needs of the beer and liquor/wine sections of the warehouse with a view to gaining additional storage space of beer products. The DLC should give consideration to:

   - installing a limited number of racks in the beer section to accommodate single pallets of products which are currently taking up valuable floor space;

   - installing a two level mezzanine and conveyor system similar to that currently utilized in the liquor/wine section; and/or,

   - moving the fence which separates the beer section from the liquor/ wine section.

   1. The DLC is aware of the changing market conditions relative to the product mixes and their effect on sales, inventory, etc. The DLC is currently working on a 5-year business plan which includes identifying, analyzing and evaluating market conditions and changes thereto. Once the detailed study has been completed, perhaps additional beneficial recommendations will be forthcoming. At that time, a ranking of all recommendations will be prepared, including cost and time estimates. A determination will then be made to implement the most beneficial changes at the least cost to the County.

Department of Liquor Control

16650 Crabbs Branch Way, Rockville, Maryland 20855-2297, 301/217-1900, FAX 217-1962

2. DLC should increase minimum order quantities for free delivery of liquor and wine products from three/five cases to ten cases, and examine the feasibility of establishing fees to recover the cost to deliver smaller quantities, should licensees desire the service.

2. The DLC has been looking into this recommendation since January 1991 and in fact has prepared a notification to all licensees of the revision made to minimum quantities for delivery. The notification was sent the week of 4/15/91.

3. DLC should review its credit policies to identify options which will lessen financial risk to the County, to include:

- Eliminating County risk by phasing out the credit option;
- Charging interest on average credit balances in accordance with prevailing commercial rates for similar accounts receivable;
- Placing licensees on COD immediately for those who have not paid their accounts by the 15th of the month;
- Establishing maximum credit limits; and
- Establishing a probation period for new businesses before extending the credit option.

3. The DLC has been evaluating the current credit policy for the last several months and has determined that credit should be eliminated for those few licensees to whom the policy applies. As an alternative, <u>all</u> licensees will again be given the opportunity to establish escrow type accounts. A notification of this policy change is planned for mailing the week of 4/15/91. Incidentally, the DLC had been working on each of these last two points prior to the beginning of the OLO review process.

4. DLC should evaluate its need for 50 delivery trucks, and surplus vehicles should be made available to other County departments and agencies.

4. The DLC reviews its delivery fleet requirements each year in preparation of the DLC budget. The current fleet size of 50 trucks will be reviewed in preparation of the FY '93 budget.

5. To promote effective and efficient management, DLC should review and update its policies and procedures at least every five years and consistently enforce them.

   5. The recommendation to review policies and procedures at least every 5 years is an excellent one and one that the DLC supports and will implement immediately. As to the consistent enforcing of same, it is the policy of the DLC that all policies and procedures be followed by all employees and enforced whenever violations are identified. Since only one incident was identified in the report, it appears to speak as to how well the DLC does in fact enforce its policies and procedures.

6. To increase internal control over loading and delivery activities, DLC should randomly assign drivers, helpers, and delivery trucks.

   6. This recommendation seems reasonable and the DLC will evaluate it as it relates to helpers only. However, it should be noted that employees' morale may be affected as a result, since the team concept may be weakened.

7. DLC should add one person from the Wholesale Operations Division and one person from the Financial Management Division to its product listing/ delisting committees to round out the membership.

   7. After evaluating the recommendation, the DLC believes that the current make-up of the listing/delisting committees is adequate.

8. DLC should inform licensees of its intention to implement an automated telephone ordering system and provide licensees with educational information on the uses and benefits of the system.

   8. DLC intends to notify licensees of the fact that we are implementing an automated telephone ordering system. Further, the DLC intends to describe fully the benefits that can be derived from use of the system. The DLC also intends to offer training and education information to all licensees on the proper uses of the T.O.P. system when the system has been fully implemented, successfully tested and is ready and available for production use.

JIB/ec

Montgomery County Government

M E M O R A N D U M

April 22, 1991

TO: Phil Marks, Management and Budget Specialist
Management Improvement Unit, Office of the CAO

FROM: Jerome I. Baylin, Director
Department of Liquor Control

SUBJECT: Follow-up Questions to OLO Report No. 90-7

I would like to thank you for your inquiries surrounding our responses to OLO Report No. 90-7 that you discussed with Bill Williams this morning.

I have enclosed some additional material that was accidentally omitted from our original submission. These items deal with notification, via memorandum, that was given to our licensees concerning a change in delivery minimums and a change in our policy concerning credit terms. In the first memorandum, the minimum case delivery amounts were determined after I reviewed a history of customer orders and the number of cases actually being ordered. The second memorandum established that, effective June 3, 1991, all deliveries will be made on a C.O.D. basis unless an escrow account is established. These are the only two approved methods of payment. Credit accounts will be abolished as of June 3, 1991.

After discussion with my staff, I feel that the responses to the other recommendations, as set forth in my original memorandum, are appropriate.

If you have any further questions, please do not hesitate to call upon us.

JIB/ec

Enclosures

Montgomery County Government

MEMORANDUM

April 9, 1991

TO: All Licensees

FROM: Jerome I. Baylin, Director
Department of Liqour Control

SUBJECT: Change on Delivery Order Minimums

As you are well aware, Montgomery County, like many municipalities, is undergoing a severe fiscal crisis. This situation has led the Department of Liquor Control to review, in depth, its existing financial policies and practices regarding the wholesale sale of beer, wine, and spirits.

In light of this review and the recommendation of an operational study by a leading accounting firm, please be advised that effective June 3, 1991 the following minimums will be established for ordering and delivery purposes.

TYPE OF ORDER	MINIMUM CASE DELIVERY
Beer	10
Combination Liquor/Wine	10
Wine	5
Liquor	5

These changes are being instituted in lieu of adding a delivery surcharge to all cases being delivered. There will be <u>NO MINIMUMS</u> on orders picked up at the warehouse.

We regret having to make these changes and would respectfully suggest that you evaluate your buying patterns to accommodate your weekly or biweekly needs.

Thank you for your understanding.

JIB:kz

Montgomery County Government

MEMORANDUM

April 9, 1991

TO: ALL LIQUOR LICENSEES

FROM: Jerome I. Baylin, Director
Department of Liquor Control

SUBJECT: Change in Financial Policy/Practice

As you are well aware, Montgomery County, like many municipalities, is undergoing a severe fiscal crisis. This situation has led the Department of Liquor Control to review, in depth, its existing financial policies and practices regarding the wholesale sale of beer, wine, and spirits.

In light of this review, please be advised that <u>effective June 3, 1991</u> <u>ALL</u> deliveries of beer, wine and spirits will be on a cash on delivery (C.O.D.) basis. All accounts outstanding <u>must</u> be paid prior to that date.

If you choose you may elect to establish an escrow account for your purchases as some licensees have done in the past. This will enable you to have a delivery charged to your escrow account the day of delivery. Your account <u>must</u> <u>be</u> replenished monthly. Please call Mr. Andrew Brown, 217-1950, if you have an interest in establishing an escrow account.

Thank you for your understanding.

JIB:kz

Montgomery County Government

MEMORANDUM

April 18, 1991

TO: Andrew Mansinne, Jr., Director
Office of Legislative Oversight

FROM: Robert K. Kendal, Director
Office of Management and Budget Robert K. Kendal

SUBJECT: DRAFT OLO Report No. 90-7, Description and Evaluation of Inventory Accountability and Control for the Montgomery County Alcoholic Beverages Warehouse Operation

Thank you for the opportunity to respond to this DRAFT evaluation report. Ms. Pedersen has provided a useful follow-up and extension of the 1981 study by Touche-Ross. OMB has just a few comments, which follow.

Random Assignment of Drivers Among Trucks and Helpers Among Drivers:

This section would benefit from additional discussion of how random assignment would enhance internal control of the delivery activity. On page 46, Conclusion 7 states that a policy on this issue would discourage collusion among loaders, drivers, and helpers. The reasons for changing the current practice are not entirely clear from the description of the delivery function on page 24. While the Department's reasons for the current policy are presented, additional discussion would clarify whether such a policy is warranted because of identified problems or because it is a proven business practice.

On a related matter, the last sentence in paragraph 5 on page 24 reads, "Random assignment of drivers among trucks and helpers among drivers would increase internal control of the delivery activity." The sentence goes beyond the description of the function and draws a conclusion that more appropriately appears under Conclusion 7 on page 46.

Evaluation of Need for 50 Delivery Trucks/Possible Availability of Surplus

I agree that the Department should evaluate its level of need for delivery trucks. Based on the OLO recommendation (Recommendation 4), I asked my staff to review FY 92 vehicle requests to see if the Department's vehicles might meet present needs elsewhere. While it does not appear that DLC's trucks would meet current needs elsewhere, I encourage the Department to check with the Department of Transportation's Division of Equipment Management and with other agencies (especially the Montgomery County Public Schools) about the possible use of surplus trucks.

Office of Management and Budget
Director's Office/Interagency Analysis & Review Division/Budgets Division

Minimum Order Quantities and Feasibility of Fees for Small Deliveries

The issue of minimum order quantities and fee feasibility for small deliveries merits further analysis and evaluation by the Department. To ensure costs are recovered associated with minimum quantity orders, the Department should analyze the cost per unit item for deliveries (including overhead), and any future changes in the minimum order quantity or the addition of fees for small deliveries should be grounded in such analysis.