



# Oregon

Theodore R. Kulongoski, Governor

**Liquor Control Commission**

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SECRETARY OF STATE  
DIVISION OF AUDITS

James E. Scott, Audit Manager  
Office of the Secretary of State  
Audits Division  
255 Capitol St. NE, Suite 500  
Salem, Oregon 97310

Dear Mr. Scott:

Thank you for this opportunity to comment on the broad-based risk assessment you recently completed at the Oregon Liquor Control Commission. The OLCC appreciates your identifying risks to our programs so that we may give these areas our attention. Please find below my observations on your findings and recommendations, in the interest of improving our mutual understanding of the issues.

**Risk Assessment Recommendation No. 1 – General Operations**

***OLCC needs to consider additional steps to mitigate potentials risks that may emerge from its current strategic management initiatives. Examples of risks include less than optimal utilization of resources, unnecessary disruption of agency operations, and misalignment of mission, objectives, goals and functions.***

The executive staff of OLCC agree and appreciate the importance of a clear, aligned, and well-communicated strategic initiative. We also appreciate our responsibility in optimally using resources, explaining decisions and applying change management strategies to enable staff to function optimally in a transparent environment.

Since your review in September 2006, the liquor commissioners have approved staff's updated strategic plan. The new executive director (appointed permanently August 18, 2006) revisited the plan that was in development, applying a new vision of systems thinking to the agency's purpose and operations. Through a series of work sessions with individual agency executives and their staff, the common goals of OLCC's interrelated, interdependent programs were uncovered and made explicit. A draft plan was sent to each OLCC employee for comment. The updated plan expresses the relationships between the OLCC mission and the governor's guiding principles, as well as between the agency mission and program purposes.

The current OLCC leadership is committed to more transparent decision-making processes and more (and more productive) communication internally and with external stakeholders. For example, additional staff have been included in the regulatory

decision-making meetings, to gain perspectives and to disseminate rationales. The executive director has initiated debriefs with staff after executive committee meetings as well as more ongoing briefings with commissioners. As we develop our information technology projects – for the licensing and Distilled Spirits Program areas -- we are closely reviewing business processes with staff.

Thank you for reinforcing the importance of applying these management principles in mitigating potential risks. We will take your specific recommended mitigating actions under advisement and review them diligently.

**Risk Assessment Recommendation No. 2 – Distilled Spirits Program**

***By better balancing repack labor costs, store level inventory, and out-of-stock rates, OLCC may be able to reduce operational costs and increase funds available for distribution.***

As the risk assessment observes, the careful balancing of policy development and enforcement, monitoring activity, meeting consumer demand, and managing inventory levels determines the effectiveness of a product distribution system, such as the Distilled Spirits Program. Effective customer service creates consumers and stakeholders satisfied with the system. However, customer service comes with a price and must be balanced for reasonableness and cost effectiveness.

The distilled spirits product line has become more complex in recent years due to the changing marketplace, coupled with OLCC's desire to provide excellent customer service. We are aware that the citizens of Oregon are the ultimate "stockholders" of the distilled spirits system, and the OLCC is responsible for managing it cost effectively while providing wide product choice through the liquor stores. The repack service provides liquor stores with product in less-than-full case quantities. On one hand, this reduces inventory investment that would result from shipping full cases when only a handful of bottles are needed. On the other hand, physically breaking apart and repacking cases is labor intensive and can erode savings gained from reducing inventory investment by shipping only the product immediately needed. The alternative, reducing the variety of products carried in liquor stores, would result in lost sales and customers unhappy with a narrow product line.

In the past, OLCC would repack any distilled spirits item if requested by a liquor agent. To gain efficiencies, OLCC began excluding the more popular items from repacking services. OLCC continually adds items to its "full-case only" list as sales volumes increase for items; currently more than 100 items are on the list. OLCC has also experimented with other policy changes, such as charging fees for excessive repack requests from liquor stores. OLCC discovered that simply warning agents of this new policy was effective in curtailing agents' most inefficient use of the repack service. We also decided that while the marketplace was in rapid change, the agent often was in the best position to assess what products and quantities might be most appropriate for the

store. This market expansion is the basis for being less aggressive in our developing and enforcing more stringent repack criteria.

Meanwhile, in accordance with your recommendations, OLCC will more closely monitor agents' effective inventory management as part of their annual evaluations. But for the OLCC office to significantly improve inventory management and establish effective agent ordering policies, OLCC needs more product sales information, in a more timely fashion, and to acquire more storage space. To that end, OLCC is working more closely with suppliers to better understand and project usage patterns. We are negotiating for additional warehouse space so we can avoid stock shortages. And, we are getting closer to implementing the distilled spirits sales data information technology project we have been developing this biennium. That project gives us the potential to collect more timely and detailed product sales information from participating agents, which is key to improving the sophistication of our inventory management practices.

We appreciate the auditors' recognition of the importance of effective inventory management control and liquor store product ordering policies for OLCC to meet consumer demand and provide excellent customer service while being a responsible steward of state resources.

**Risk Assessment Recommendation No. 3 – Distilled Spirits Program**

***Adequate consideration of store level product sales and total product costs in OLCC's product selection strategy may provide greater assurance that funds otherwise available for distribution are not reduced.***

As described in OLCC's response to recommendation no. 2 above, OLCC works to balance the Distilled Spirits Program. Our goal is to optimize return, meeting customer demand efficiently, but without compromising making product reasonably available. The Distilled Spirits Program's components work to reinforce and balance the factors that enable growth with those that limit growth (such as finite resources). Achieving a stable yet growing system is a delicate management process, requiring continual responsiveness to and evaluation of both the market and budgeting/resource concerns.

As our understanding of market forces grows in sophistication, OLCC appreciates the significance of product turnover to measure effectiveness in product management – going beyond strict inventory levels as measurements. We look forward to gaining more sales and inventory information with improved technology to capture the raw data. When the new Distilled Spirits Program sales data project begins capturing information from participating liquor stores, OLCC management will be better able to monitor retail sales at the store level and gain efficiencies by managing the product line with greater sophistication.

**Risk Assessment Recommendation No. 4 – Public Safety Services Program**

***OLCC management may benefit from improved governance processes over the licensing function.***

OLCC agrees with the potential mitigating actions the auditors identified to help OLCC manage this risk. OLCC is focusing on this area to complete successfully the licensing information technology project, evaluate outcomes from the project, and to use organization structure and communication channels to improve the licensing and Public Safety Services Program performance. We will continue to work on this important area.

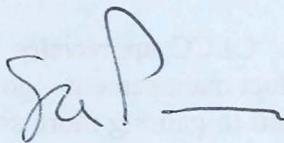
**Risk Assessment Recommendation No. 5 – Public Safety Services Program**

***By evaluating and monitoring the mission and goals of the Alcohol Education Program, OLCC may be able to obtain greater assurance that alcohol server education providers are consistently meeting Commission expectations reflected in Oregon statutes and OLCC administrative rules.***

The Alcohol Server Education Program is another prime area for OLCC's management's attention. We appreciate your identifying potential mitigating actions we can take for this program. The liquor commissioners have focused on evaluating how education and training is delivered to this segment. They recently approved giving applicants the choice of taking training courses either online or in the classroom (in-person classroom training has been the only option). OLCC will continue to look for more and better ways to monitor and assess performance in this important program.

Mr. Scott, we appreciate your staff's utmost professionalism while conducting this assessment. Thank you for your thoughtful risk assessment report, giving OLCC important feedback about the potential risks it faces, and strategies to use to mitigate the risks.

Sincerely,



Stephen A. Pharo  
Executive Director

SAP:BEB/bb

cc Michael O'Connor, OLCC