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Statement of Position
Internal Controls for Municipal Liquor Stores

Municipal liquor stores are a cash business. As a result, they present financial risks that other city functions may not. To reduce those risks, special attention must be paid to internal control procedures. Management is responsible for establishing, monitoring, and evaluating internal controls.

Segregation of Duties

One of the most basic and effective controls is to segregate duties. Simply put, segregation of duties means that no employee should be in a position to both commit an irregularity and cover it up. Since many municipal liquor stores are small businesses, it may be difficult to fully segregate duties. But even small businesses can take certain reasonable steps.

For example, the number of employees authorized to run control key access functions on a cash register ("X" and "Z" functions) should be limited. The summary tapes that zero-out a day's sales on a cash register (the "Z" function) should be submitted to the city along with the daily deposit documentation. The summary tapes often contain sequential numbers that the city's finance officer can monitor to confirm that all register sales have been reported to the city and deposited in the city's account. These tapes also permit the city's finance officer to compare the time the summary tapes were run with the liquor store's closing times.

Cash Registers

Many cash registers have features that will monitor whether payments were made by cash or check. By using the cash vs. check feature on the cash register, a city can compare the cash and check amounts deposited in the city's account, with the cash and check amounts reflected on the cash register tapes. Any differences should be investigated and documented.

Some cash registers offer perpetual inventory features. Any inventory reductions entered into these registers should be approved by a supervisor or another third party. Other registers record broad categories of products sold. To make the most of this feature, the "miscellaneous" category on a cash register should be used sparingly.

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We recommend that all voided and over-rung transactions be initialed and explained by the employee responsible for the transaction, reviewed by a supervisor for appropriateness, and retained as documentation to explain the differences between the cash register's sales tapes and daily cash balances. Voids and refunds should be reconciled to supporting documentation as part of the daily internal sales audit procedures.

Additional Receipts and Disbursements

In addition to sales, some liquor stores take in receipts from other areas, such as rentals and vending machines. We have also seen disbursements from liquor store cash registers, including payments for entertainment and promotional items.

All receipts should be rung into the cash register when the receipts are received; alternatively, documentation of miscellaneous receipts could be maintained in a pre-numbered receipt book, with one copy of the receipt given to the customer/vendor and one to the city. If pre-numbered receipts are used, the city's finance officer could then review that all receipted funds were deposited into the city's account by comparing the sequential numbers found on the receipts with the deposits.

Some cities rent their liquor store facilities for dances, weddings, and similar events. The city council should establish the rental rates for these events. The city's finance officer should monitor that the full amount for the rentals was deposited in the city's account.

Cash from liquor store sales should not be used for hiring temporary staff for city celebrations, karaoke vendors, bands, and the like. To comply with Minnesota law, city checks should be used for these disbursements. Vendor invoices should be submitted or contracts with the city should be entered before a check is issued to a band performing at a city facility. Paying bands from cash in the registers is not only contrary to Minnesota law, it makes it hard to verify the amount paid to the band, and reduces the cash available to the liquor store for remaining transactions. At a minimum, all such disbursements should be documented on reports submitted to the city.

Liquor stores may need to refund patrons for the loss of money from vending machines located at the liquor store--refunds that are later reimbursed by the vending company. To balance funds collected from sales, we recommend that any refunds to patrons, and subsequent cash replacements from the vending company, be separately documented.

If promotional items are sold or given away, we recommend that the items be documented. This way management can make decisions regarding promotional items from a financial and budget perspective.

Check Handling Procedures

We recommend that cities prohibit the cashing of personal or third-party checks for employees and customers at liquor stores, and limit the amount for which checks may be written over the purchase amount. Otherwise, cities may be susceptible to losses incurred from checks returned due to insufficient funds, increasing the related costs of collection. These practices also increase the cash balance needed at the liquor store, and preclude the city from earning interest on the additional funds. Cities may wish to explore the installation of an automated teller machine (ATM) at the liquor store if customers need access to cash.

All checks received at the liquor store should be made payable to the liquor store. Checks made out to "cash" or with no payee increase the risk of potential misappropriation. Upon receipt, we recommend that all checks be endorsed with a "for deposit only" stamp, reducing the likelihood that the checks will be cashed if lost or stolen. If employees initial all checks upon receipt, a mechanism exists for reviewing whether employees are handling checks in accordance with city policies and procedures. Employee initials on checks potentially provide valuable evidence should checks received in one register be placed in another register, or in a different day's deposit.

Lack of collection on not sufficient funds (nsf) checks deprives the city of a source of funds. For that reason, cities should adopt nsf check policies that include steps to collect nsf checks in a timely manner.

Deposits

Timely daily deposits decrease the risk of potential misappropriation or loss of funds and increase investment earnings. The city's finance officer should regularly review the timeliness of deposits and the city should take appropriate action if the deposits are late.

We have seen instances where cash was given back during deposits of liquor store receipts. Returning cash during a bank deposit transaction increases the risk of loss of funds through misappropriation. Instead, cities may want to require that each deposit be made intact, and to direct the city's bank that cash should not be returned during a deposit into a city account.

Additional Safeguards

Some cities have asked whether municipal liquor stores can offer "charge accounts" or "bar tabs" to either their employees or their patrons. We know of no authority that allows a city to give what is, in effect, a loan of public funds to employees or patrons. In addition, the use of a "charge account" or "bar tab" (other than a tab that is paid up at the end of the night) is not good management practice.

Cities may want their auditors to include a detailed review of city operations where cash receipts are prevalent, including municipal liquor stores. By including an on-site review of internal control procedures during the city audit, city officials can have greater confidence that the financial information upon which their decisions are based is accurate.

Some cities have determined that the installation of video cameras offers protection to both the liquor store's customers and employees. If properly installed, video cameras may also offer the city additional protection against loss of funds and product.

Liquor stores should prohibit employees from ordering products directly from suppliers for personal use. Instead, employees should be required to follow the same purchasing procedures as any other liquor store customer. In addition, employees should not be allowed to ring up their own personal sales.

Conclusion

City officials are responsible for the sound operation of municipal liquor stores. To meet this responsibility, cities should actively monitor liquor store operations and investigate discrepancies between actual performance and anticipated results. If gross profits are lower than intended and there is no apparent reason for the decrease, theft or excessive breakage of inventory may be responsible.

When considering what internal controls to implement, the costs of the control procedure must be weighed against its benefits. We hope that cities will conclude that some of the procedures we have suggested are economical control procedures worthy of implementation.