

PERFORMANCE AUDIT



Office of the
Washington
State Auditor
Pat McCarthy

Evaluating Washington State Oversight of the Cannabis Industry: Follow-up issues

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Executive Summary

State Auditor's Conclusions (page 27)

When Washingtonians authorized growing and selling cannabis for recreational purposes in 2012, they did so through an initiative that also promised tight control of a newly legal market. In 2018, we found that a robust, computerized tracking system then under development would allow the Washington State Liquor and Cannabis Board (LCB) to track any plant or product, ensure licensee compliance, and prevent diversion to the illegal market.

With the present audit, however, we discovered that the cannabis tracking system subsequently failed. Facing the need to replace other aging information technology systems, LCB does not expect to fully implement a more efficient tracking system until 2031 – nearly 20 years after the legal recreational cannabis market was authorized by voters.

In my view, this performance audit offers two important benefits. First, we do make recommendations intended to help LCB make the best use of the tracking tools at its disposal today.

Second, this report serves as an important status update to elected leaders, including legislators and the governor. A robust, “seed-to-sale” tracking system has been under development for 12 years but has yet to be fully realized. The recreational cannabis market has changed throughout those years. At this time, I believe this report can serve as an important framework through which state leaders can engage with LCB to establish clear goals for ensuring accountability in our modern recreational cannabis system.

Background (page 6)

LCB is responsible for ensuring a well-regulated cannabis market. The regulations it enforces have three essential goals: prevent diversion to illegal distribution, ensure products are safe and collect taxes.

The agency takes multiple steps to minimize the risks posed by illegal or unsafe activities in the cannabis industry. Its enforcement and education division staff conduct inspections of licensees and follow up on complaints the agency receives from the public. Its finance division audit team conducts revenue audits, including audits of cannabis licensees to confirm they have paid all necessary taxes. Both teams are supported by data specialists.

Our 2018 performance audit recommended that LCB use its cannabis tracking system for a data-driven, automated approach to enforcement. However, when we prepared to conduct a follow-up audit to see how the agency fared at implementing our recommendations, we learned that it currently lacks a data tracking system that easily and reliably tracks cannabis products. For these reasons, this audit sought to find out why and what LCB does instead to identify risky transactions and prioritize its activities.

Historical project management problems, compounded by leadership turnover, left LCB with less effective data tools to manage risk

(page 12)

Today's LCB leaders inherited historical problems in project management, following significant turnover in multiple essential roles since our 2018 performance audit, but are making strides to improve. Our 2018 audit concluded with recommendations that LCB maximize the analytical value of its cannabis data-tracking system; agency managers in charge at the time said LCB's new tracking system, LEAF, would have these capabilities. The agency launched LEAF in 2018, but it ultimately failed due to project management and vendor issues. After deeming LEAF too unreliable, LCB deployed a stopgap data reporting system known as CCRS (the Cannabis Central Reporting System) in 2021, which had its own significant limitations. For example, enforcement officers lack real-time tracking information, and limited data input protections mean the agency relies heavily on licensees to report accurate and complete information. Additionally, licensees cannot easily access or correct their data after they upload it, and the lack of a single identification number makes it difficult to track products for quick product recalls.

LCB's agencywide project to replace legacy information technology (IT) systems has taken priority over replacing CCRS, delaying full implementation until 2031. Continuing to address project management issues will help ensure future project success.

LCB has made improvements to its enforcement processes, but is still limited in its ability to efficiently address risks (page 24)

LCB improved how it prioritizes enforcement, but additional alerts and updating policies can further its efforts. Recent steps such as regularly conducting proactive "premises checks" and updating processes to triage complaints have helped

helped LCB more strategically address risks. Additionally, LCB implemented some automated alerts, but they do not fully address the previous performance audit's recommendations. Enforcement efforts were also limited by reduced staffing.

Recommendations (page 28)

We made a series of recommendations to LCB to help it improve licensee data, ensure likelihood of future project success through addressing project management issues, and improve its efforts to prioritize and tend to risks in cannabis transactions.

Next steps

Our performance audits of state programs and services are reviewed by the Joint Legislative Audit and Review Committee (JLARC) and/or by other legislative committees whose members wish to consider findings and recommendations on specific topics. Representatives of the Office of the State Auditor will review this audit with JLARC's Initiative 900 Subcommittee in Olympia. The public will have the opportunity to comment at this hearing. Please check the JLARC website for the exact date, time, and location (www.leg.wa.gov/JLARC). The Office conducts periodic follow-up evaluations to assess the status of recommendations and may conduct follow-up audits at its discretion. See **Appendix A**, which addresses the I-900 areas covered in the audit. **Appendix B** contains information about our methodology.

Background

Washington's Liquor and Cannabis Board is responsible for ensuring a well-regulated cannabis market

In 2012, Washington voters approved a ballot measure that legalized cannabis for recreational use. Its intent was to take cannabis out of the hands of illegal drug organizations and bring it under a tightly regulated, state-licensed system similar to that for controlling alcohol. Subsequent state law tasked the Washington State Liquor and Cannabis Board (LCB) with regulating all aspects of the newly legal cannabis industry and collecting excise taxes on retail sales of recreational cannabis. State law also required the agency to develop and adopt rules necessary to implement a regulatory structure. The agency is led by a board appointed by the governor, and employed about 370 people in 2024.

LCB's responsibilities for cannabis regulation require it to:

- Grant three types of licenses to businesses that grow, process and sell cannabis products
- Enforce state laws and agency rules when licensees violate them, and ensure licensees know how to comply
- Monitor and inspect licensed businesses for compliance

The agency's monitoring activities include requiring licensees to load certain business data into an LCB data system; staff then compare licensee data to lab processes and onsite inventory observed during inspections to help ensure compliance.

Cannabis regulations have three essential goals: Prevent diversion to illegal distribution, ensure products are safe and collect taxes

LCB designed regulations to help prevent cannabis from being diverted out of the legal marketplace. The agency initially aligned its regulatory goals with eight priorities set out in a 2013 federal memo (since rescinded) to states that legalized cannabis. Among the most important priorities in the memo were actions to prevent: 1) distribution of cannabis to minors, 2) cannabis products and revenue from reaching criminals or funding their activities, and 3) drugged driving and other adverse health consequences. In practice, these regulations mean that only people who meet licensing criteria can grow, process and sell cannabis products,

Washington State Liquor & Cannabis Board's stated mission

"Promoting public safety, public health, and trust through fair administration, education and enforcement of liquor, cannabis, tobacco, and vapor laws"

www.lcb.wa.gov

and that only people of legal age can purchase them. Illegally grown cannabis, or cannabis diverted out of the regulated market and into illegal markets, is more likely to find its way into the hands of underage buyers and to other states where it is not legal.

LCB also acts to ensure safe cannabis products. To address one of its foremost goals, LCB's regulations help ensure cannabis production and sales remain within state supervision so that only safe products reach consumers. Monitoring cannabis as it moves within the regulated marketplace should also allow LCB to recall unsafe products.

Finally, state law made LCB responsible for collecting applicable excise taxes, currently a 37% excise tax. The agency collected almost \$500 million in 2023. The resulting revenue is earmarked for a variety of purposes, including education, cannabis research and state health funds; a portion also contributes to the state general fund and LCB operations.

LCB takes multiple steps to minimize the risks posed by illegal or unsafe activities in the cannabis industry

To reduce the risks of cannabis being diverted to illegal sales or distribution, uncollected revenue and unsafe products, LCB established two internal teams to help ensure its rules are properly followed. Each has its own responsibilities and authority.

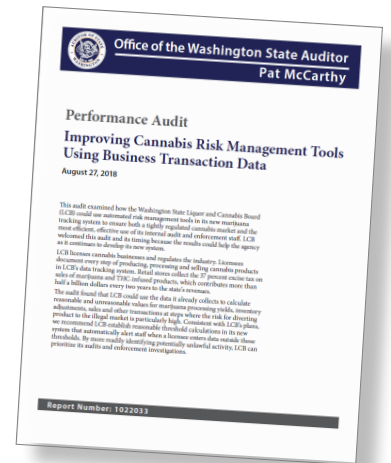
- 1. Cannabis enforcement and education division** – This group's twofold responsibilities are reflected in staff roles and assignments. For regulation of cannabis, the director of enforcement oversees 28 commissioned staff, who are law enforcement officers with authority to enforce some laws and regulations; and 15 compliance consultants, who offer licensees educational corrections. Both commissioned staff and compliance consultants spend the greater part of their time in the field, conducting inspections of licensees and following up on complaints. In cases where they identify a violation, either commissioned staff or compliance consultants can offer educational corrections, or, if they observe a public safety violation that was not corrected, they can recommend the license be suspended.
- 2. Finance division audit team** – This group, overseen by the chief financial officer, consists of two supervisors and 11 staff members. This team conducts revenue audits, including audits of cannabis licensees to confirm they have paid all necessary taxes. Auditors forward the results to enforcement personnel, who will follow up on any issues found. Enforcement staff will also request special audits when they deem it necessary.

These two teams are supported by data specialists, called examiners, who can produce specific reports from agency data.

Our 2018 audit recommended LCB use its cannabis tracking system for a data-driven, automated approach to enforcement

In 2018, six years after recreational cannabis was legalized in Washington, our Office conducted a performance audit to examine how LCB could use automated risk management tools to ensure both a tightly regulated cannabis market and the most efficient and effective use of its staff. At the time, LCB had few models on which it could base a regulatory structure, and there were no risk management standards specific to this new industry. The 2018 performance audit sought practices LCB could apply to help ensure a tightly regulated cannabis market.

The audit identified three areas of particular risk for diversion of cannabis into illegal hands or inaccurate reporting for tax purposes, illustrated in **Exhibit 1**. We also found opportunities for the agency to focus its approach to handle risk more effectively and efficiently.



Read the report on our website: portal.sao.wa.gov/ReportSearch/Home/ViewReportFile?arn=1022013&isFinding=false&sp=false

Exhibit 1 – The 2018 performance audit identified three areas of risk in cannabis transactions

When licensees adjust data		
	<p>Cannabis licensees adjust the quantity and weight of items in their inventory for any number of reasons.</p>	<p>For example, a licensee may need to adjust inventory because product was lost or stolen, due to data entry or other errors when information was originally reported, or for product destructions, for example when plants die.</p>
	<p>Multiple inventory adjustments, or inventory adjustments that add up to a large amount, may indicate an effort to divert product or revenue from the legal market.</p>	
When product changes form		
	<p>Cannabis changes form at many stages in the production process.</p>	<p>For example, from plant to wet flower, to usable cannabis, and to intermediate or end products. Each step also creates waste, which is excess plant material that is not valuable.</p>
	<p>Each time a change in form occurs, including when it is converted to waste, there is a risk that product will be diverted from the legal market.</p>	
When product changes hands		
	<p>Cannabis products change hands when they are sold between licensees, when they are sold from retail licensee to consumer, and when samples are sent for testing, educational purposes or to retail employees.</p>	<p>The audit identified two areas of risk associated with retail or consumer transactions: sales to consumers for too low a price and excessive donations to medical cannabis patients or providers.</p>

The audit reviewed LCB's data-management processes, including its software system for tracking and monitoring cannabis activity, BioTrack. (Note: The 2018 report referred to this as the "traceability system.") The agency did not use BioTrack or the data it contained to focus its enforcement efforts through a risk-based approach, but rather relied on complaints from the public and its own observations of licensees. We identified ways LCB could leverage its existing data and software to perform automated analyses that could highlight actual transactions or licensee data presenting the greatest risk of illegal activity. The results of such analyses, bolstered by an automated alerting function, would have allowed the agency to target its enforcement activities strategically, making better use of its staff resources. To act on our recommendations, LCB's data system needed to be able to deliver three components.

- 1. Tracking cannabis products from seed to sale.** This capability follows cannabis products at every stage of growth, processing and distribution, every time it changes hands or changes form. This data can help LCB track any plant or product, ensure licensee compliance and prevent diversion to the illegal market. It also facilitates product recalls, since seed-to-sale tracking relies on the use of a single identification number for each plant, allowing LCB staff to readily determine the origin of any final product.
- 2. Consistently reliable and current data,** to ensure the recommended analyses can accurately identify risks of diversion. Actively identifying problematic transactions or behavior helps enforcement officers to use their time more effectively.
- 3. Automated alerts.** Programming the tracking software to automatically alert LCB staff when risk-based calculations identify areas of concern means officers can address problems more rapidly. Because enforcement officers do not have to comb through data looking for potential problems, they are more efficient and can actively select licensees for audits or enforcement efforts.

LCB currently lacks a data system that easily and reliably tracks product, so this audit sought to find out why and what LCB does instead to identify risky transactions and prioritize its activities

Washington's legal cannabis marketplace is now an industry that employs more than 100,000 people, and the opportunities for illegal trade at any point in the process remain real. Our Office decided to follow up with LCB to determine how the agency was managing that risk.

However, preliminary discussions with LCB officials revealed that the agency did not fully address the audit recommendations that called for specific enhancements to its cannabis tracking software. Indeed, the agency had struggled to launch the

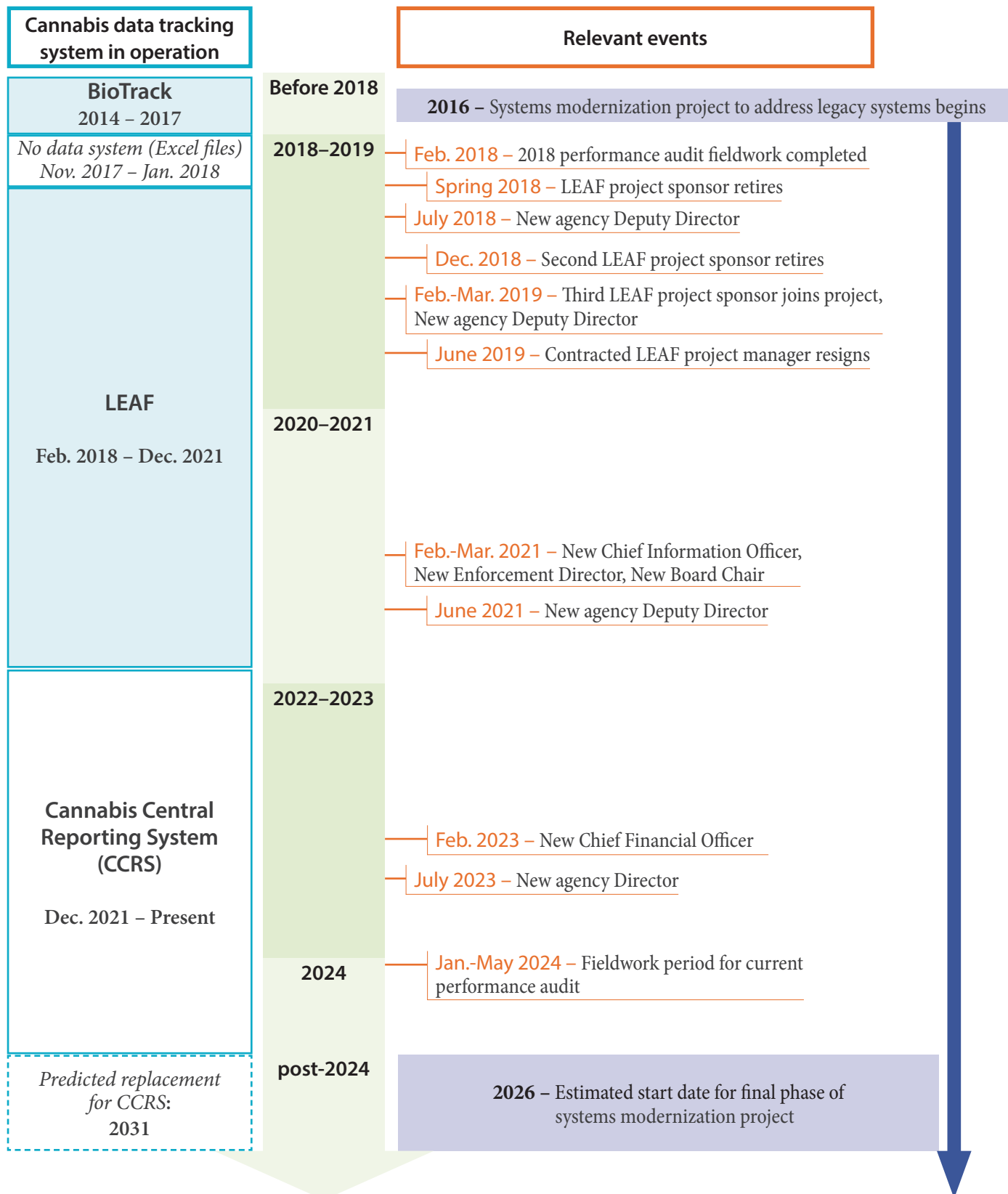
replacement tracking system that was supposed to integrate many of the functions we suggested. Our work for this follow-up audit included consideration of the causes for problems developing the replacement system in addition to examining how the agency has chosen to address previously identified risks in the legal cannabis marketplace.

This follow-up audit sought to answer the following questions:

1. What, if any, barriers have the Liquor and Cannabis Board faced in implementing effective risk management methods to reduce risks identified during the previous audit?
2. What methods has the agency used to ensure it effectively prioritizes its enforcement activities?

The timeline on the following page sets out the various software LCB has had in place to track and monitor the numerous daily transactions taking place between 2014 and 2031, the planned date for a new tracking system. It shows the two performance audit fieldwork periods, as well as changes in LCB management that affected the progress and success of the agency's efforts to replace BioTrack, the software evaluated in our 2018 audit.

Timeline of Cannabis Data Tracking Systems



Source: Auditor developed based on review of HRMS data, past reports and interviews with LCB staff.

Audit Results

Historical project management problems, compounded by leadership turnover, left LCB with less effective data tools to manage risk

Results in brief

Today's leaders at the Washington State Liquor and Cannabis Board (LCB) inherited historical problems in project management, following significant turnover in multiple essential roles since our 2018 performance audit, but are making strides to improve. Our 2018 audit concluded with recommendations that LCB maximize the analytical value of its cannabis data-tracking system; agency managers in charge at the time said LCB's new tracking system, LEAF, would have these capabilities. The agency launched LEAF in 2018, but it ultimately failed due to project management and vendor issues. After deeming LEAF too unreliable, LCB deployed a stopgap data reporting system known as CCRS (the Cannabis Central Reporting System) in 2021, which had its own significant limitations. For example, enforcement officers lack real-time tracking information; additionally, limited data input protections mean the agency relies heavily on licensees to report accurate and complete information. Additionally, licensees cannot easily access or correct their data after they upload it, and the lack of a single identification number makes it difficult to track products for quick product recalls.

LCB's agencywide project to replace legacy IT systems has taken priority over replacing CCRS, delaying full implementation until 2031. Continuing to address project management issues will help ensure future project success.

The 2018 performance audit concluded with recommendations that LCB maximize analytical value of its new tracking system

Our 2018 performance audit work at LCB examined the agency's risk-analysis practices and the software then in place, BioTrack. Although BioTrack had several problems, it allowed LCB to track cannabis from seed to sale on the retail shelf – a tracking requirement set out in LCB's own rules for licensees. LCB's contract with

the BioTrack vendor concluded just as audit fieldwork also drew to a close. The agency's contract solicitation for replacement software required a system that would support:

- Tracking cannabis from production to retail
- Compliance reports
- Publicly available data

The functions LCB requested for its new system would have allowed LCB to fulfill the audit recommendations around developing a data-driven automated approach. Indeed, LCB staff members told the previous audit team that they expected “the new system [to be] more flexible... able to accommodate automatic notices or flags based on recommended threshold calculations.” Knowing that a new tracking system was imminent, as the agency completed its transition plans, the audit report recommended:

1. Develop reasonable ranges for data at the higher-risk transactions of the cannabis production, processing and retail processes
2. Establish automatic notifications into its new tracking system that will alert staff when data at those higher-risk transactions fall outside established ranges, indicating potential data entry errors or product diversion

In the agency's response to the audit, dated August 1, 2018, the then-director said the new software would be fully able to do all we suggested. After stating that a “contract was awarded in July 2017 and the new traceability system was implemented on February 1, 2018,” the letter went on as shown in **Exhibit 2**.

Exhibit 2 – Excerpt of LCB response to the 2018 audit

The functionality of the new system is aligned with the recommendations in this report. While the system today has the ability to analyze data for compliance, it will provide much greater capacity and functionality to assist with auditing functions when it is complete. Additionally, the system customer support functions, such as troubleshooting for licensees using the system, are now contracted with the vendor, allowing select WSLCB staff to devote more resources to data analysis.

Although the audit response suggested the new system (unnamed in the response, this software was LEAF) was fully operational, this proved to not be the case, as we discuss further in this chapter. Managing the introduction and revision of new, essential, operational software can be tricky even for consistent managerial oversight to resolve. Unfortunately, consistent leadership is what LCB lacked at many points in the subsequent six years.

Current LCB leadership inherited historical issues following significant turnover in multiple essential roles but are making strides to improve

Consistent leadership helps ensure agency goals and project plans are executed as intended with minimal disruption or changes in vision. Between July 2018 and July 2023, LCB saw turnover in a half dozen executive positions, including people in roles that were responsible for LEAF, the tracking software that replaced BioTrack. As of July 2024, nearly all leadership at LCB is new within the last three years. Many of these leadership changes are shown in the timeline on page 11, and listed in **Exhibit 3**.

Such turnover often contributes to diminished organizational performance and can directly affect specific project performance. In the case of LCB, leadership changes took place after the procurement of LEAF, during that software’s troubled period as the agency’s primary cannabis tracking tool, and long after decisions had been made about plans to update overarching agency systems. The negative consequences of leadership turnover were far-reaching. In some cases, current leadership could only continue on paths determined by previous management, for example regarding which IT projects to prioritize. In other cases, new leaders indicated they were not made aware of the existence of the previous performance audit and a lessons learned report from a past project that would have been helpful information to consider during current project planning.

This follow-up performance audit was concerned with the cannabis tracking system, but as we learned during the course of fieldwork, multiple barriers have prevented LCB from implementing an effective tracking system. Below, we discuss the problems leading to the failure of LEAF, the issues with its current replacement, and the reasons why the agency has been unable to implement a successful tracking system with the analytical and enforcement capabilities envisioned in LCB’s response to our previous audit.

Exhibit 3 – Leadership turnover at LCB and responsibilities concerning software projects

Turnover in role	Responsibilities of the role
Board president	Accountability; final approvals on major decisions
Agency director	Ensures board concerns are addressed; participates in budget development and approval; ultimate authority in prioritizing projects. LEAF project was housed within the director’s office.
Deputy director (2)	Policy setting; participates in budget development and approval; holds considerable authority in prioritizing projects. Project sponsor for LEAF.
Chief information officer	Oversees and provides core IT services to agency and individual projects. Historical project manager for LEAF; owner of SMP project; developer and manager for CCRS.
Enforcement director	Oversees enforcement and education division. Sponsor for new traceability system project.

Source: Auditor prepared based on HRMS data, LCB documentation and interviews with LCB staff.

LEAF, the replacement system launched in 2018, failed due to project management and vendor issues

Our 2018 performance audit did not examine LCB's procurement for the new cannabis tracking software, known as LEAF, or the contract LCB concluded with the vendor. However, Washington's Office of the Chief Information Officer (OCIO) did discuss the LEAF implementation with LCB employees involved in the project, and issued a detailed lessons learned report in 2020. It described multiple failings at many points in the procurement and implementation of LEAF.

Among the project management shortcomings the OCIO's report outlined were:

- Expedited procurement
- Insufficient expertise
- Lack of scope buy-in from users and subject matter experts
- Focus on deadlines over deliverables
- Lack of accountability and contract management issues

Each of the five issues individually could derail a major software purchase and rollout; taken together, they contributed to more than three years of insufficiencies in LCB's primary cannabis tracking tool. As the OCIO's report indicated, staff and management turnover compounded the problems.

Expedited procurement left little time to conduct robust planning

Procurement for the tracking software to replace BioTrack began in 2017, but with the deadline of BioTrack's contract expiration looming, LCB rushed to obtain a new vendor and replacement software. To ensure licensees did not experience problems completing their data-tracking responsibilities, LCB sought to procure and implement an off-the-shelf system that would be in compliance with Washington's regulations and federal guidance in place at the time. While the goal of minimizing gaps in data tracking systems was commendable to ensure licensees could continue to track their product, it left the agency little time to conduct robust project planning. Once contracts were complete with bid processing, the chosen vendor had 110 days to launch a tracking system. Despite these efforts, licensees had to resort to uploading Excel spreadsheets to record required transactions for about three months at the start of 2018.

Insufficient expertise

The LCB managers who led the project at the time lacked expertise in the agency's cannabis tracking responsibilities, leaving them without important insights into essential system features. Although the lack of expertise by project leaders can be mitigated by working closely with subject matter experts, LCB also struggled to ensure LEAF project managers gathered insight from agency experts. For example, LCB staff that participated in the project said that subject matter experts were not originally included in discussions, sometimes attending meetings uninvited. Furthermore, they said they were excluded from meetings if they disagreed with decisions project leaders had made. The OCIO's report also stated that subject matter experts were insufficiently consulted.

Lack of scope buy-in from subject matter experts and users

What advice project managers *did* obtain from subject matter experts was sometimes contradictory. This suggests that the scope of work had not been fully agreed upon or communicated during project planning.

Focus on deadlines over deliverables

Under pressure from BioTrack's imminent shut-down, LCB leaders focused more on meeting project deadlines rather than on ensuring project deliverables were met. According to the OCIO's report, "none of the documented objectives [in the project] ... were achieved." These incomplete objectives included complying with all state network requirements while also reducing the time staff spent providing licensee support for system issues, making system changes and answering public records requests.

Lack of accountability and contract management issues

Finally, agency leaders did not hold project team members accountable to agreed-upon roles and responsibilities. Those tasked with managing the vendor contract with LEAF did not adequately manage the contract nor hold the vendor accountable for deliverables in the contract.

As LCB's response to our 2018 audit indicated, agency leaders at the time were committed to launching the LEAF tracking system in February 2018, despite concerns raised about its shortcomings. The results of software testing before the launch remained poor. LCB staff, project staff and licensees expressed concerns throughout development and the testing process, but leadership did not want to postpone implementing the new system and leave licensees even more exposed through inadequate manual reporting.

Almost immediately after LEAF's launch, serious glitches caused licensees to lose system access, which meant they could not conduct their business. For example, licensees said they could neither make nor report sales. The contractor had changed the database structure without approval, resulting in loss of functionality for parts of the system that worked before the launch.

LCB repeatedly asked the vendor to fix this and other issues, but requests were either ignored or updates caused more problems and functionality remained poor. Enforcement staff could not use the system for their work, and grew increasingly concerned about data inaccuracies. Each attempt at improvement to the system only resulted in more problems. Having lost trust that the vendors were capable of repairing the system, LCB dropped further efforts at improving LEAF in June 2020.

Despite agency assurances that LEAF could already produce alerts, and that other proposed functions were within the software's capacity, the software ultimately did not fulfill any of the audit recommendations. Agency leaders at the time abandoned attempts to implement them in LEAF. Instead, they considered an entirely different approach to recording and tracking cannabis data.

After deeming LEAF too unreliable, LCB deployed a stopgap data reporting system in 2021, which had its own significant limitations

Concerned that LEAF would fail entirely before replacement tracking software could be procured, LCB decided in 2021 to deploy a contingency system that would capture data as required by agency rules. The Cannabis Central Reporting System (CCRS) was designed to serve as a backup repository for licensee data only until LCB had a new system in place, which agency managers believed would be perhaps just one year. Furthermore, CCRS was not designed to eliminate the need for a full-service tracking system.

However, LCB leadership realized procurement and rollout of a replacement tracking system would take several years to complete, and they repositioned CCRS as a long-term solution. IT personnel made some minor updates to the data repository to enable it to run certain reports and export data.

During the audit, representatives from other states highlighted key data system elements that allow enforcement staff to efficiently track cannabis from production through processing to sale – essentially a seed-to-sale tracking system. Indeed, the majority of states that have legalized recreational cannabis use such a seed-to-sale tracking system. For example, most other states with legal recreational cannabis have a system that takes steps to ensure quality tracking by providing access to real-time data, the ability for licensees to update their own data directly, and single identifiers for efficient seed-to-sale tracking.

Devised as an interim data warehouse, with few if any analytical or reporting features, CCRS proved unable to deliver this essential function without staff taking manual steps to review additional documentation from licensees. But its limitations go further, and affect almost all aspects of LCB's cannabis tracking responsibilities. Among the software's most significant problems:

- Enforcement officers lack real-time tracking information
- Limited data input protections offer little assurance licensees' self-reported data is accurate
- Licensees cannot easily access or correct their data after they upload it
- The lack of a single identification number makes it difficult to track products for quick product recalls

Each of these four issues presents real barriers to LCB's efforts to manage its regulatory responsibilities.

Enforcement officers lack real-time tracking information

Unlike BioTrack, CCRS was not designed to include live views of data until very recently. Instead, staff and consultants had to ask LCB staff to produce data reports in advance, providing the context for the type of inventory that should be present during inspection. The lag between the time a licensee has entered inventory data and staff have run these data reports means data and inventory could be considerably different, potentially wasting both LCB staff and licensee time and causing unnecessary hardships for the licensee. For example, we were told by an integrator – a person who contracts with licensees for data support – that due to the inability of enforcement officers to view live data in the system, licensees have had to request their data from LCB after an enforcement visit to identify the cause of any data discrepancies. The integrator said that in at least one instance, LCB placed an administrative hold on a licensee's products that lasted until the licensee could resolve the data discrepancy. Such problems could be compounded if the licensee loads data weekly, making it more difficult to know if discrepancies are simply due to data delays or actual problems. An enforcement director from Massachusetts told us that it is best practice to look at updated data on a daily basis because data is likely to have changed even as little as 72 hours later.

However, during the audit, LCB implemented a software interface that enabled enforcement officers to access CCRS data in the field. By at least eliminating the step of running data reports, officers should now have access to data as currently reflected in the system, although it may still often be a week behind because licensees only have to report data weekly.

Limited data input protections offer little assurance licensees' self-reported data is accurate

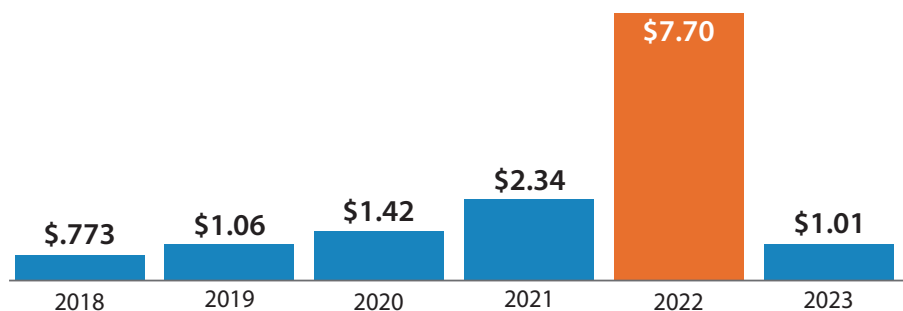
LCB relies heavily on licensees to report accurate and complete information. When licensees are ready to report their required data, they use a dedicated link to the CCRS database where licensees upload their own basic spreadsheet. The process provides very few controls to help ensure data is correct or complete: CCRS will accept most data. For example, while data in date fields are required to be dates, any date is accepted. The Government Accountability Office (GAO) recommends federal systems have controls to help ensure “input data are validated to provide reasonable assurance that erroneous data are prevented or detected prior to processing.” For example, a data-input protocol might prohibit entering a date of sale that is in the future or before a specific date, or require additional information before allowing the data to upload. LCB takes additional steps to verify information during site visits, as further outlined in Chapter 2.

LCB is aware of these limitations and gave us examples of known data issues. We also reviewed data reported to LCB over several years, which included a total of roughly 96 million records for sales, product and plant information, and plant destructions. Our analyses identified a variety of possible data issues, including inappropriate values and missing information. For example, when licensees report sales of cannabis, they report the quantity sold, the unit price of each item, discounts applied and applicable taxes collected. Based on our analysis of about 70 million sales records, reported from July 2022 through August 7, 2023, we identified about 1.6 million instances in which licensees reported negative amounts for this information, and about 2.5 million instances where a null or zero-value was reported. LCB managers said that negative and zero values are how licensees report returns and samples but without researching each one, there is no way to ensure they are all appropriate; however, large or out of the ordinary values may prompt licensee follow-up or referral to enforcement.

LCB managers also described an extensive problem in reported sales information, involving misplaced decimals in the reported sales price of individual products. As a result, reported sales in CCRS were greatly overstated for a period of time,

most noticeably in 2022. As Exhibit 4 shows, based on information provided by LCB, 2022 annual reported sales in CCRS were almost \$8 billion. The Department of Revenue, however, estimated sales for the same time period to be about \$1.3 billion, based on separate reporting for sales tax purposes that also includes non-cannabis sales, such as for paraphernalia.

Exhibit 4 – Problems in data reporting meant reported sales in CCRS were periodically overstated, most noticeably in 2022
Dollars in billions



Source: Auditor summary of LCB data.

Our analysis identified additional possible issues. For example, our analysis of product, plant and plant destruction data reported to CCRS through August 7, 2023 (about 25 million records), included numerous records reflecting dates from before cannabis was legalized, including almost 60,000 products with reported dates ranging from 1899-2003. We also identified about 600,000 reported dates that were in the future, including for harvests and plant destructions.

An important consideration with the issues we found in our data reliability review: every time cannabis changes hands or changes form, it generates a record. That means LCB is responsible for storing, tracking and monitoring millions of records annually. The current gaps in the CCRS system's ability to handle comprehensive records management expose the agency to more risk that transactions worth scrutiny will go undetected.

As noted on page 19, the GAO recommends government agencies take steps within their data systems to prevent user errors in data entry by adding input controls in an interface between the user entering data and the database. CCRS lacks a user interface, relying as it does on unvetted spreadsheet uploads. Without sufficient protections validating the data licensees enter, the likelihood of inaccurate entries increases. Data that is not consistently reliable makes it harder for enforcement officers to identify likely indicators of diversion. However, recognizing the limitations with CCRS and the data it stores, LCB managers said that they have planned enhancements to CCRS functionality.

Licensees cannot easily access or correct their data after they upload it

Licensees receive an automated email from the CCRS system to let them know whether or not their data uploaded; if there's an error, it also notifies them which type of error may have occurred. However, licensees cannot view the data in CCRS themselves to confirm correct data submission or identify a specific error. To examine the data they submitted, they must ask LCB staff to send them a copy of it. This multistep process introduces delay while LCB staff assemble the records and makes it difficult to correct data entry errors. While LCB managers said live data access is not a goal of the system, GAO's guidance suggests that government systems "facilitate timely resubmission of corrected data, including real-time on-line edits and validations."

The lack of a single identification number makes it difficult to track products for quick product recalls

BioTrack, a previous iteration of LCB's cannabis tracking system, accommodated one identification number – a "single identifier" – for each plant, the product produced from it and the final package on the retail shelf. The piecemeal nature of CCRS means that as cannabis moves through the system and changes form, each

business gives it a new unique number rather than applying the number assigned by the grower when the plant enters the pipeline. This can make it very difficult, or at the least time consuming, to recall contaminated product. For example, in 2023, lab testing found unacceptable levels of chemicals related to DDT, a synthetic pesticide banned half a century ago, in cannabis on the market for consumption. LCB data staff were able to develop reports using dates of sale matched with likely processing time that eventually led them to the likely plants of origin, but it took longer than leadership wanted. The agency resorted to manual methods to fully track down all the tainted product and remove it from the market, and still had no way to guarantee all the affected products had been recalled.

While LCB managers said the responsibility for tracking product and performing recalls ultimately lies with licensees, having a more efficient data system to track product would help LCB better meet its regulatory responsibilities.

Recognizing that the agency will have to rely on CCRS for several more years, the agency has begun to develop some additional functions, such as alerts when there are anomalies in some of the data. However, without consistently reliable data, LCB cannot identify or prioritize risks as effectively as it could. We cover this issue in more depth in Chapter 2.

LCB's agencywide project to replace legacy IT systems has taken priority over replacing CCRS, delaying full implementation until 2031

LCB managers acknowledge that despite its many drawbacks, they will need to keep CCRS operational until a new tracking system can be procured and fully implemented. Managers said the likely completion date for all project phases is several years away, in 2031. Recognizing resource limitations, the agency has prioritized a competing IT project – designed to modernize many of its core systems.

The systems modernization project is no small undertaking: most LCB IT personnel and other key employees are involved in its delivery. The project will replace 40-year-old systems used for core agency functions, such as licensing and enforcement, which are nearing the end of their life cycles. Phase 2 of this extensive, four-phase project was completed in April 2024, almost a year after the originally planned completion date. Indeed, LCB has experienced several delays on this major project, which means it will be that much longer before it has the resources available to fully implement a new tracking system.

The systems modernization project itself is on its third iteration, with the first attempt starting in 2016. A 2018 report issued by the OCIO stated that, historically, it suffered from some of the same project management difficulties as the LEAF project, including:

- Project scope was not well defined, and requirements were not communicated across all groups involved on the project
- Insufficient definitions for roles, responsibilities, accountability and authority
- The plan detailing vendor management was incomplete

LCB leadership is taking steps to improve its systems modernization project management. For example, an OCIO 2024 quality assurance report said that LCB has developed a plan to address concerns by improving role clarity, communication, vendor management, schedule publication and data migration.

Continuing to address project management issues will help ensure future project success

In addition to pursuing improvements outlined in the OCIO's April 2024 report, LCB can take steps to prevent similar issues from recurring when it develops the CCRS replacement system. This audit considered four areas of leading practices that could help LCB improve the likelihood of success in replacing CCRS with a fully functional cannabis tracking system in the future.

Address the lack of agencywide project management guidance

While LCB's IT department has IT-specific project management policies, as of June 2024, LCB still lacks such policies for managing other types of projects throughout the agency. Policies should also be supported by guidance, including advice on project management tools.

In 2021, LCB hired a project manager to oversee projects within the enforcement and education division, who found there were no relevant tools or guidance and had to develop their own. Leading practices recommend that leadership and managers ensure project management guidance is readily available and accessible to all employees who could be tasked with leading a project. New employees in particular should be able to find this guidance and recognize it as relevant to the work they conduct. Having widely available guidance can also help mitigate the effects of staff turnover. LCB managers said they have plans to develop a program management office, through which the agency could pursue implementing formal agencywide policies and guidance.

Address problems in gathering requirements from all interested parties and defining project scope

In July 2023, LCB issued a Request for Information (RFI) for possible existing software that could meet its needs and implement the previous audit's recommendations. During the RFI process, agency leadership learned that what was needed in a new system was still not clear, particularly as the industry continues to change and grow. This discovery effectively means the project manager must return to gathering user views and developing buy-in on the project's goals before the project can move forward. User feedback on which features will be most useful in a new system should inform both the procurement and delivery requirements for the proposed system. Gathering this information often requires several meetings, not only with different groups but also to consolidate opinion and obtain agreement on the final decisions. This is particularly important since state law does not specify what is required in a tracking system. LCB has begun holding meetings with users of the system, and will continue to gather additional information about elements to include in the system.

Define unclear roles and accountability paths

Both on the LEAF project and earlier phases of the systems modernization project, LCB struggled with a lack of clarity in roles and accountability. Problems on LEAF were likely exacerbated by threefold turnover in project leaders over the course of the project. Leading practices recommend that project leaders define, document and obtain agreement on roles and responsibilities among key project participants. Further, once agreed, people must be held accountable to fulfill them. The executive sponsor should document the rationale for the project, what agency need it fulfills and its goals. The project manager must then ensure all work is completed and meets the needs outlined by the sponsor.

Remedy insufficient time allotted to staff for project work

LCB staff said that, given current employee workloads, they were not sure how assigned project staff would find sufficient time to be successful on the upcoming project to replace CCRS. Management should ensure staff on the project have the necessary capacity to properly attend to the project. The Project Management Institute, an organization that provides certification for project managers, says that when employees are asked to continue doing their daily jobs while also dedicating time to a project, they can be set up for potential failure in both responsibilities.

LCB has made improvements to its enforcement processes, but is still limited in its ability to efficiently address risks

Results in brief

LCB improved how it prioritizes enforcement, but additional alerts and updating policies can advance the agency's efforts. Recent steps such as regularly conducting proactive "premises checks" and updating processes to triage complaints have helped LCB more strategically address risks. Additionally, LCB has implemented some automated alerts, but they do not fully address the previous audit's recommendations. Enforcement efforts were also limited by reduced staffing.

LCB improved how it prioritizes enforcement, but additional alerts and policies can advance the agency's efforts

The 2018 performance audit found that LCB's processes to identify businesses for an enforcement visit was primarily reactive, and we recommended the agency take a more automated approach using data. While LCB planned to incorporate this approach in LEAF, implementation of that system failed. Despite LEAF's failure, LCB has taken steps since then to proactively address risks. However, creating or updating policies around these efforts and further automating identification of possible risks could help these efforts.

Recent steps have helped LCB more proactively address risks

Since the last audit, LCB made changes to help ensure it addresses complaints that pose the greatest risk to public health and safety. To help address workload issues for its enforcement officers, LCB updated its processes for prioritizing complaints. Complaints that involve the most threat to public health and safety are addressed first, while those that are regulatory in nature are managed by compliance consultants instead of enforcement officers. However, if compliance consultants identify a prioritized threat, they elevate the complaint and an enforcement officer will investigate further.

LCB also began using compliance consultants to regularly conduct proactive “premises checks” at licensed businesses. LCB uses such site visits to confirm that businesses are following requirements, to provide educational opportunities, and to identify possible signs of diversion. If compliance consultants identify possible issues related to public health or safety during a proactive premises check, they then follow the complaints process so enforcement can follow up.

Such changes can help LCB focus its enforcement efforts, but they are not yet documented. LCB managers said they are developing policies and procedures for the updated triaging process. They acknowledged that existing policy and related procedures guide premises checks but do not reflect the recent changes to such checks.

LCB has made other organizational changes to improve proactive enforcement efforts

In response to legislation and a 2019 report on the LCB enforcement division, LCB shifted its focus to better address education of its cannabis licensees. Report authors recommended that instead of focusing primarily on enforcement, LCB should also emphasize prevention and do more to help licensees comply with law and regulations. As a result, LCB reported they made multiple changes, including updating its policies as well as its enforcement training plan and manual.

LCB also added compliance consultants to the enforcement division – unarmed staff whose main task is licensee education rather than enforcement. Compliance consultants now perform the annual, proactive premises checks and respond to regulatory complaints, meaning complaints that do not pose an immediate threat to public health or safety. LCB managers said that this additional organizational change designed to help the agency actively identify risks was to move its data specialists – the examiners – from within the LCB director’s office to the enforcement and education division. As a result, LCB managers said they are now able to use the examiners more effectively, including to produce more useful reports and to better understand the data.

LCB has implemented some automated alerts but they do not fully address the previous audit’s recommendations

During the current audit, LCB was in the process of instituting some new automated alerts in CCRS, to notify LCB staff if certain conditions exist in the data. The alerts include when certain licensees do not report any activity and for failed lab tests. Upon receiving an alert, LCB staff review existing information for a licensee and determine if additional follow up is necessary.

While the alerts will help LCB focus its enforcement work, they do not fully address both the risks of lost tax revenue and diversion identified in the 2018 performance audit. As the sidebar recaps, that audit identified three primary areas of risk. An appendix in the report offered detailed calculations and approaches to data analyses that could address these areas of risk, from weight yields that are too low for the volume of cannabis reported as processed to abnormally large reports of waste resulting from form conversions. The new alerts do not address most of the risks our earlier audit identified; for example, they notify LCB staff if a business does not report sales but do not alert them to sales at prices that are too low.

The 2018 audit also recommended LCB analyze reported data to determine the thresholds that could indicate potential diversion. The resulting thresholds, programmed into the cannabis tracking system, could produce alerts that would automatically notify LCB staff if a reported amount was outside the designated threshold. For example, the audit suggested that LCB analyze reported weight yields from harvests to determine a reasonable range, and then set a threshold that would alert LCB when reported weight yields were outside this range.

However, LCB managers said that thresholds used in the new alerts were arbitrarily chosen. Further, since the alerts rely on reported data with known issues, as discussed in Chapter 1, the alerts may reflect reporting issues as opposed to actual issues. However, LCB staff said they hope the alerts will help clean up the data. We also found that LCB has not yet developed policies and procedures for the new alerts.

The 2018 audit identified the riskiest steps in the cannabis marketplace as:

- When someone makes an adjustment in the data, such as to correct an error in product weight
- When cannabis changes form, such as from flower to oil
- When cannabis changes hands, such as when a grower sells to a processor

See Exhibit 1 in the Background for additional details.

Enforcement efforts were also limited by reduced staffing

Despite the recent changes made by LCB, the agency's efforts have been constrained by high staff turnover and reduced staffing in enforcement officer positions. Not having enough staff, or experienced staff, limits the amount of work the agency can conduct. In 2022 and 2023, average annual turnover for cannabis enforcement officers was about 50%. At the same time, LCB said it had extensive vacancies; for example, on November 1, 2023, about one-third of the 26 enforcement officer positions were vacant. The agency filled all but four positions by April 1, 2024.

Due in part to these staffing issues, LCB did not meet some of its internal performance goals related to enforcement processes in 2023, which were to conduct premises checks at 100% of locations and close 90% of complaints within 60 days. LCB reported that it conducted premises checks at 89% of licensees; staff said it closed only 59% of complaints within 60 days.

State Auditor's Conclusions

When Washingtonians authorized growing and selling cannabis for recreational purposes in 2012, they did so through an initiative that also promised tight control of a newly legal market. In 2018, we found that a robust, computerized tracking system then under development would allow the Washington State Liquor and Cannabis Board (LCB) to track any plant or product, ensure licensee compliance and prevent diversion to the illegal market.

With the present audit, however, we discovered that the cannabis tracking system subsequently failed. Facing the need to replace other aging information technology systems, LCB does not expect to fully implement a more efficient tracking system until 2031 – nearly 20 years after the legal recreational cannabis market was authorized by voters.

In my view, this performance audit offers two important benefits. First, we do make recommendations intended to help LCB make the best use of the tracking tools at its disposal today.

Second, this report serves as an important status update to elected leaders, including legislators and the governor. A robust, “seed-to-sale” tracking system has been under development for 12 years but has yet to be fully realized. The recreational cannabis market has changed throughout those years. At this time, I believe this report can serve as an important framework through which state leaders can engage with LCB to establish clear goals for ensuring accountability in our modern recreational cannabis system.

Recommendations

For the Liquor and Cannabis Board

To address inaccurate licensee data, as described on page 17, we recommend:

1. Continue to identify and implement improvements to CCRS to make it as functional as possible to aid enforcement actions until a new system can be procured. For example:
 - Evaluate the highest risk data fields that are necessary to ensure public safety
 - Design controls to help ensure data in these fields are accurate while operating with CCRS. These could be input controls, or, if not possible, mitigating controls that would help ensure data accuracy in those fields.

To increase the likelihood of success for future projects and address project management issues, as described on page 21, we recommend:

2. Identify and incorporate leading practices that can help it more effectively manage agency projects, including the project to implement a new tracking system. Formalize these practices, as well as those practices already in place, and make them available as agencywide guidance to anyone in charge of managing projects. By following these guidelines, the agency can help ensure project leaders:
 - Consult system users and incorporate their feedback as much as possible
 - Obtain user buy-in at the start of the project
 - Ensure project staff have sufficient capacity to be successful on the project
 - Make lessons learned and other key documents centrally available, and advise staff to consult them before starting new projects

To improve the agency's efforts to prioritize and address risks in cannabis transactions as described on page 24, we recommend:

3. The agency develop more formal guidance for prioritizing risk, such as policies and procedures around triaging complaints
4. Consult 2018 audit recommendations on risks and thresholds when developing future alerts

Agency Response



STATE OF WASHINGTON

October 9, 2024

Honorable Pat McCarthy
Washington State Auditor
P.O. Box 40021
Olympia, WA 98504-0021

Dear Auditor McCarthy:

Thank you for the opportunity to review and respond to the State Auditor's Office (SAO) performance audit report, "*Evaluating Washington State Oversight of the Cannabis Industry: Follow-up issues.*"

This audit is a follow-up to the 2018 SAO performance audit that was in response to a request for assistance by the Washington State Liquor and Cannabis Board (LCB). In 2016, the LCB requested the SAO's assistance to further enhance the analytical and technical aspects of the auditing and enforcement efforts of the agency. The LCB's engagement with the SAO continues to be helpful as we strive to improve operations and achieve our goals of public safety and public health.

While we appreciate the SAO's interest in supporting the implementation of a successful traceability system, our concern is that readers of this audit report may incorrectly infer that the agency has not prioritized the traceability or regulatory functions that are enacted in law. This could not be further from the truth. The LCB's Enforcement and Education Division, especially in the cannabis program, has changed significantly. More than ever, the agency prioritizes public safety and health in the cannabis industry. Our triage processes have been reviewed and improved to ensure the highest level of public safety. In addition, the LCB has incorporated system alerts, as previously recommended by the SAO, into our current system to aid in identifying potential areas of investigation and will continue to incorporate additional alerts.

At the time of the 2018 audit, the LCB was undergoing the implementation of LEAF, a traceability system developed by a contracted third party. The LCB moved to LEAF when the contract with the previous system, BioTrack, expired. The agency's goal at the time was to provide a comprehensive traceability system with the anticipation that there would be a minimal time gap between replacing BioTrack with LEAF. Unfortunately, there were many issues with the LEAF vendor and the LCB had to devise an alternative for licensees to report basic information. The LCB decided that the quickest solution was to use a reporting system that was built as a backup during the 2016 implementation of BioTrack. At that time, the system was called the Cannabis Contingency Reporting System (CCRS). When LEAF began to fail, the agency redesigned CCRS to meet legislative requirements and relaunched the system in December 2021. It was subsequently renamed the Cannabis Central Reporting System (CCRS).

The CCRS data model was purposefully made for unformatted data intake which enabled a variety of data formats from external systems. Additionally, the CCRS data model was developed to comply solely with WAC 314.55.083, which limited the scope of data intake. WAC 314.55.083 states that record keeping is the responsibility of licensees and limited the data that had to be reported, hence less prescriptive data validation. A major update to CCRS was completed in January 2023 that included manifest intake to track distribution but did not impact nor increase data validation rules. CCRS continues to be updated to meet the needs of the agency, as witnessed by the SAO and documented in this report.

The current traceability product roadmap, which began in November 2023, starts with a community and industry stakeholder outreach program that will culminate in robust requirements for a comprehensive solution. In addition, a market analysis of systems that could be used to develop a more comprehensive traceability solution

Page 2 of 2

will be conducted simultaneous to the outreach. A decision package to support this effort has been submitted for the 2025-27 biennium. The solution framework is based on three “trace gates,” each developed in independent phases. This approach enables elements of the traceability system to be implemented over time, based on core system modernization projects and capacity planning to ensure the agency can absorb the change without delays.

The SAO acknowledges that traceability is not achieved through a single system and CCRS is not a long-term solution. The LCB concurs with this conclusion and has plans in place to address the SAO recommendations. The agency is already preparing for a comprehensive traceability solution and expects to have the completed system in place by 2031.

As mentioned previously, the LCB has several high-level, complex projects underway and on the horizon. These are all mission-critical projects that impact both internal operations and how the public and licensees interact with and report to the agency. The LCB recently created an enterprise project management office to manage our complex, agency-wide projects and deliver them within budget and on schedule.

There is more to regulation of the cannabis industry than traceability. The Enforcement and Education Division has taken action to prioritize public safety and be responsive to legislative and industry changes:

- The examiners unit is responsible for evaluating cannabis licensee data to prioritize collaborative investigative work with a focus on identifying and addressing diversion and inversion of cannabis.
- The chemist team provides subject matter expertise to improve pesticide and other chemical investigations.
- The LCB’s education team, initially focused on the cannabis industry, works with licensees to achieve compliance in all areas of cannabis regulation.
- Preventing youth access to cannabis is a key focus, and the compliance rate is consistently above 95%.
- Prioritization of diversion and inversion is clear in the seizing of cannabis products at 39 locations in 2023 and 38 locations in 2024 thus far.

Other independent studies and research also show that the LCB, the industry, and the prevention and public health interests have created a safe system for adult use of recreational cannabis. As a result, the state has avoided much of the negative impacts opponents had warned about.

Ensuring a tightly regulated, legal cannabis marketplace is central to our public safety mission. The LCB is committed to the continuous improvement of our systems and processes to enable our ability to meet the needs of a dynamic regulatory environment.

Sincerely,



Pat Sullivan
Director
Office of Financial Management



William Lukela
Director
Liquor and Cannabis Board

cc: Joby Shimomura, Chief of Staff, Office of the Governor
Kelly Wicker, Deputy Chief of Staff, Office of the Governor
Rob Duff, Executive Director of Policy and Outreach, Office of the Governor
Mandeep Kaundal, Director, Results Washington, Office of the Governor
Tammy Firkins, Performance Audit Liaison, Results Washington, Office of the Governor
Scott Frank, Director of Performance Audit, Office of the Washington State Auditor

OFFICIAL RESPONSE TO PERFORMANCE AUDIT ON EVALUATING WASHINGTON STATE OVERSIGHT OF THE CANNABIS INDUSTRY: FOLLOW-UP ISSUES – OCTOBER 9, 2024

The Liquor and Cannabis Board (LCB) and Office of Financial Management (OFM) provide this cabinet response to the State Auditor’s Office (SAO) performance audit report received on September 11, 2024.

SAO PERFORMANCE AUDIT OBJECTIVES

The SAO’s performance audit addressed two questions:

1. What, if any, barriers have the Liquor and Cannabis Board faced in implementing effective risk management methods to reduce risks identified during the previous audit?
 2. What methods has the agency used to ensure it effectively prioritizes its enforcement activities?
-

Recommendations 1-4 to the Liquor and Cannabis Board in brief:

SAO Recommendation 1: To address inaccurate licensee data, continue to identify and implement improvements to the Cannabis Central Reporting System (CCRS) to make it as functional as possible to aid enforcement actions until a new system can be procured. For example:

- Evaluate the highest risk data fields that are necessary to ensure public safety.
- Design controls to help ensure data in these fields are accurate while operating with CCRS. These could be input controls, or, if not possible, mitigating controls that would help ensure data accuracy in those fields.

STATE RESPONSE: Although a series of improvements have been made to CCRS, the LCB recognizes that additional enhancements may be needed to aid in the enforcement of public safety and health. The agency is committed to reviewing the need for increased data controls and implementing them as possible.

Action Steps and Time Frame

- Review internal program and prioritize highest risk data fields. *By November 15, 2024.*
 - Develop a plan and schedule to address highest risk data fields. *By December 15, 2024.*
-

SAO Recommendation 2: To increase the likelihood of success for future projects and address project management issues, identify and incorporate leading practices that can help it more effectively manage agency projects, including the project to implement a new tracking system. Formalize these practices, as well as those practices already in place, and make them available as agencywide guidance to anyone in charge of managing projects. By following these guidelines, the agency can help ensure project leaders:

- Consult system users and incorporate their feedback as much as possible
- Obtain user buy-in at the start of the project
- Ensure project staff have sufficient capacity to be successful on the project
- Make lessons learned and other key documents centrally available, and advise staff to consult them before starting new projects

STATE RESPONSE: The agency has established the operating principles for a project management office (PMO) in the Director’s Office. A senior IT project manager has been hired to support the effort and focus on traceability as the first major initiative. This effort is part of a larger strategic portfolio management and

intake process that enables the executive leadership to prioritize initiatives (projects) to address the changing business and political landscape more quickly. At both the PMO and IT project management level, project management standards based on the PMBOK and Agile principles have been adopted to ensure the proper rigor is brought to bear for every level of initiative.

In addition to the PMO and Strategic Portfolio Management, the LCB has established a product management group in the Information Technology Services organization, which has drafted and adopted business requirement standards and product management principles. The product management group has also put systems in place to plan product roadmaps and define product features that enable projects, including prioritized strategic initiatives, to move forward without blockers. This process creates a feedback loop to LCB leadership so they can evaluate, support and promote initiatives in an organized manner and address resource constraints that may delay related projects.

Action Steps and Time Frame

- Conduct information sharing and collaboration sessions to learn more about project management. *By January 30, 2025.*
- Construct intranet SharePoint website for project management repository. *By March 30, 2025.*
- Research and develop agency-wide policies and procedures for project management. *By June 30, 2025.*

SAO Recommendation 3: To improve the agency’s efforts to prioritize and address risks in cannabis transactions, develop more formal guidance for prioritizing risk, such as policies and procedures around triaging complaints.

STATE RESPONSE: Enforcement and Education Division leaders prioritize issues relating to public safety for enforcement efforts, triaging incoming complaints to ensure officers are first addressing those with the highest impact on public safety. In addition, traceability alerts have allowed staff to identify flags for inversion, diversion, and other violations electronically rather than manually; this process should be formalized.

Action Steps and Time Frame

- Memorialize the cannabis case prioritization process. *By December 30, 2024.*
- Formalize licensee education framework and procedures related to traceability alerts. *By April 30, 2025.*
- Track diversion and inversion cases not involving licensees. *By June 30, 2025.*

SAO Recommendation 4: Consult 2018 audit recommendations on risks and thresholds when developing future alerts.

STATE RESPONSE: As the SAO states in this audit report, the recreational cannabis market has changed since legalization. While the 2018 report is useful in understanding the need for regulation and control of the market, further research should be conducted to ensure that the recommendations are still relevant today and for the future regulation of the market.

Since the previous audit, the LCB has made efforts to decrease risk and identify possible diversion through data enhancements and utilization efforts. Those efforts include:

- System Alerts – The building and implementation of system alerts allows monitoring for missed reporting, entry errors, and other reporting issues to detect possible diversion and facilitate prioritization of enforcement. This was a recommendation in the 2018 audit.

- Financial Audits – Revenue auditors perform audits based on the data either entered or not entered. This allows them to identify possible reporting and diversion issues to enforcement for investigation.
- Data Dictionary Enhancements – Enhancing the data dictionary by tying an articulated business value to the data as it is stored on the back end. This will lead to faster response times and reduce staff hours needed to pull or evaluate data.
- Future Enhancements – The LCB’s application team is exploring many other data and reporting enhancements in CCRS for future implementation.

Action Steps and Time Frame

- Review future enhancement and system alerts lists for integration. *By December 30, 2024.*
 - Review data dictionary enhancements. *By December 30, 2024.*
 - Identify and document process to perform audits based on traceability data. *By June 30, 2025.*
-

Appendix A: Initiative 900 and Auditing Standards

Initiative 900 requirements

Initiative 900, approved by Washington voters in 2005 and enacted into state law in 2006, authorized the State Auditor’s Office to conduct independent, comprehensive performance audits of state and local governments.

Specifically, the law directs the Auditor’s Office to “review and analyze the economy, efficiency, and effectiveness of the policies, management, fiscal affairs, and operations of state and local governments, agencies, programs, and accounts.” Performance audits are to be conducted according to U.S. Government Accountability Office government auditing standards.

In addition, the law identifies nine elements that are to be considered within the scope of each performance audit. The State Auditor’s Office evaluates the relevance of all nine elements to each audit. The table below indicates which elements are addressed in the audit. Specific issues are discussed in the Results and Recommendations sections of this report.

I-900 element	Addressed in the audit
1. Identify cost savings	No.
2. Identify services that can be reduced or eliminated	No.
3. Identify programs or services that can be transferred to the private sector	No.
4. Analyze gaps or overlaps in programs or services and provide recommendations to correct them	No.
5. Assess feasibility of pooling information technology systems within the department	No.

I-900 element	Addressed in the audit
6. Analyze departmental roles and functions, and provide recommendations to change or eliminate them	No.
7. Provide recommendations for statutory or regulatory changes that may be necessary for the department to properly carry out its functions	No.
8. Analyze departmental performance data, performance measures and self-assessment systems	Yes. The audit reviewed performance measures and results related to cannabis enforcement work.
9. Identify relevant best practices	Yes. The audit identified leading practices related to project management.

Compliance with generally accepted government auditing standards

We conducted this performance audit under the authority of state law (RCW 43.09.470), approved as Initiative 900 by Washington voters in 2005, and in accordance with generally accepted government auditing standards as published in *Government Auditing Standards* (July 2018 revision) issued by the U.S. Government Accountability Office. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

The mission of the Office of the Washington State Auditor

To provide citizens with independent and transparent examinations of how state and local governments use public funds, and develop strategies that make government more efficient and effective. The results of our work are widely distributed through a variety of reports, which are available on our website and through our free, electronic [subscription service](#). We take our role as partners in accountability seriously. We provide training and technical assistance to governments and have an extensive quality assurance program. For more information about the State Auditor's Office, visit www.sao.wa.gov.

Appendix B: Objectives, Scope and Methodology

Objectives

The purpose of this performance audit was to follow up on our 2018 performance audit to see how the Washington State Liquor and Cannabis Board (LCB) had fared at implementing the audit's recommendations and how the agency was managing identified risks in the legal cannabis marketplace. The audit addressed the following objectives:

1. What methods has the Liquor and Cannabis Board used to ensure it effectively prioritizes its enforcement activities?
2. What, if any, barriers have the agency faced in implementing effective risk management methods to reduce risks identified during the previous audit?

For reporting purposes, the audit results have been organized into key findings. The messages relate to the original objectives as follows:

- Project management problems, compounded by leadership turnover, left LCB with less effective tools to manage risk (pages 12-23) – This finding addresses Objective 1 and 2.
- LCB has made improvements to its enforcement processes, but is still limited in its ability to effectively address risks (pages 24-26) – This finding addresses Objective 1.

Scope

The audit reviewed changes to LCB processes to prioritize enforcement activities since the 2018 performance audit. We also considered barriers the agency faced in implementing the 2018 audit recommendations, which included a review of cannabis data. We focused on data reported to the agency in its Contingency (later Central) Cannabis Reporting System (CCRS), from its implementation in 2021 through August 7, 2023, with the exception of sales data. For sales data, our review focused on data reported to CCRS between July 2022 and August 7, 2023.

Methodology

We obtained the evidence used to support the findings, conclusions and recommendations in this audit report during our fieldwork period (January to May 2024), with some additional follow-up work afterward. We have summarized the work we performed to address each of the audit objectives in the following sections.

Objective 1: What methods has the Liquor and Cannabis Board used to ensure it effectively prioritizes its enforcement activities?

To address this objective, we interviewed relevant LCB management and staff, and reviewed related documentation to confirm the information obtained. Specifically, we reviewed policies and procedures to learn how it prioritized cannabis enforcement activities, and performance measurement documentation to understand goals and results related to enforcement activities. We also reviewed reported cannabis data to CCRS to confirm information reported to us regarding the reliability of the data, as well as HRMS payroll information to determine turnover in related leadership and enforcement officer positions.

Objective 2: What, if any, barriers has the agency faced in implementing effective risk management methods to reduce risks identified during the previous audit?

To address this objective, as part of the interviews conducted for Objective 1, we also asked about and identified barriers to implementing the last audit's recommendations. Much of those barriers were corroborated by a lessons learned report by Washington's Office of the Chief Information Officer, which included views from LCB representatives. Further, we reviewed agency policies and project management documentation.

The audit results for both objectives reflect much testimonial evidence, however, in many cases we were able to corroborate information received. In cases where we rely solely on testimonial evidence, the audit results specify that the information was reported to us. LCB also reported significant issues with the cannabis data, as described in the Audit Results, but we did not rely on this data to inform any of our conclusions. Rather, our analysis of the data was limited to data reliability testing to confirm these issues and help inform recommendations. Any information reported based on our data reliability work specifies that the information is as reported to CCRS.

Work on internal controls

Internal controls were significant within the context of the audit objectives. We evaluated whether LCB had designed processes to prioritize cannabis enforcement activities, including related control activities and performance measures. We interviewed LCB personnel and reviewed documents such as policies and procedures, reports, and performance measures to determine implementation of the controls. We did not assess the operational effectiveness for these controls. Further, we evaluated the controls on LCB's data reporting system and conducted data reliability to evaluate the effects on the lack of controls within that system.



“Our vision is to increase **trust** in government. We are the public’s window into how tax money is spent.”

– Pat McCarthy, State Auditor

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