



# Audit Report



OIG-18-001

REVENUE COLLECTION AND INDUSTRY REGULATION

Opportunities Exist To Enhance TTB's COLAs and Formulas Online Programs

October 3, 2017

Office of  
Inspector General

Department of the Treasury

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## Abbreviations

ALFD	Advertising, Labeling and Formulation Division
COLA	Certificate of Label Approval
JAMES	Joint Audit Management Enterprise System
OIG	Office of Inspector General
TTB	Alcohol and Tobacco Tax and Trade Bureau

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*The Department of the Treasury  
Office of Inspector General*

October 3, 2017

John J. Manfreda,  
Administrator  
Alcohol and Tobacco Tax and Trade Bureau

This report presents the results of our audit of Alcohol and Tobacco Tax and Trade Bureau's (TTB) Certificates of Label Approval (COLAs) Online and Formulas Online. TTB is the Federal agency responsible for carrying out provisions of the Federal Alcohol Administration Act that protects consumers from deceptive practices and ensures that labeling and advertising of alcohol beverages provide adequate information on the identity and quality of the product.<sup>1</sup>

Our audit objective was to determine whether TTB's COLAs and Formulas Online are working as intended to improve processes and meet the growth of TTB's alcohol-related regulated industries. To accomplish our objective, we interviewed officials from TTB's headquarters and laboratory, as well as representatives from the alcohol beverage industry who use the COLAs and Formulas Online. We also reviewed applicable documentation for COLAs and Formulas Online. We conducted fieldwork from September 2014 through July 2015 with subsequent follow up made through June 2016 to obtain the status of TTB's initiatives related to the COLAs and Formulas programs. In February 2017, we also followed up on TTB's analysis of processing of COLA and formula applications as a result of discussions during the November 2016 exit conference with TTB management. Appendix 1 contains a more detailed description of the audit objective, scope, and methodology.

This audit also considered the Committee on Appropriations fiscal year 2015 report on the Financial Services and General Government Appropriations Bill, whereas the Committee expressed concern over TTB's ability to maintain efficient operations at a time

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<sup>1</sup> Public Law 74-401, 49 Stat. 977 (August 29, 1935).

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when the alcohol industry, by TTB accounts, is experiencing exponential growth.<sup>2</sup> Acknowledging TTB efforts to use technology to modernize the label and formula approval process, the committee recommended that TTB identify ways to streamline its processes, including increased flexibility in staffing. Furthermore, TTB's fiscal year 2016 appropriation included \$5 million for TTB to accelerate the processing times for label and formula applications.<sup>3</sup>

## Results in Brief

Despite TTB's efforts to improve the COLA and formula application processes by decreasing the need for certain application approvals and promoting the use of electronic filing, processing times of COLA and formula applications have increased. This is due, in part, to industry growth and the substantial volume of electronic applications resubmitted after correcting errors. The resubmitted applications have increased TTB's workload by as much as 45 percent. Further, TTB's electronic resubmission policy has the unintended consequence of increasing processing times for the majority of electronic applicants that submitted error-free applications. We also found, at the time of our audit, that TTB had obsolete performance standards and most Advertising, Labeling, and Formulation Division (ALFD) specialists were not cross-trained to work in other areas of the division.<sup>4</sup>

We found that TTB's guidance for ALFD specialists to process COLA and formula applications could be improved to ensure consistency in TTB's label and formula reviews. Additionally, TTB had not performed quarterly quality assurance reviews of formulas to ensure consistent processing of applications.

Accordingly, we are making five recommendations to improve TTB's COLAs and Formulas Online: (1) evaluate the current electronic resubmission policy to determine the impact on COLA and Formulas Online and the benefit to industry members; (2) continue to cross-train staff in order to address fluctuations in workload, reduce COLA and formula application processing times,

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<sup>2</sup> House of Representatives Report 113-508 (July 2, 2014).

<sup>3</sup> Consolidated Appropriations Act, 2016, Appendix (Public Law 114-113; December 18, 2015).

<sup>4</sup> ALFD specialists include both Labeling and Formula Specialists. Labeling Specialists process COLA applications, and Formula Specialists process formula applications.

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and ensure continuity of operations; (3) update application processing standards for specialists to assist in determining staffing needs; (4) review TTB's guidance for processing label and formula applications and update as needed to provide a consistent methodology for processing applications; and (5) establish and document quality assurance reviews for formula applications to monitor the consistency and accuracy of all specialists' formula approvals.

In its management response, overall TTB agrees that opportunities exist to enhance its COLAs and Formulas Online Programs as well as the associated label and formula review processes. TTB responded that it may re-evaluate the current electronic submission policy to assess its ongoing impact and relevance when certain levels of compliant applications and processing times are achieved. Also, TTB will continue cross-training ALFD employees and already implemented new specialist processing standards in May 2017. Regarding its guidance for processing applications, TTB began modifying ALFD specialists' manuals for more consistency. Additionally, TTB has begun conducting quality assurance reviews of formula applications. We found that TTB management's response meets the intent of our recommendations, and the response is summarized in the recommendation sections of this report. TTB management's response, in its entirety, is included as appendix 2. TTB will need to record the estimated date for completing its planned corrective actions in the Joint Audit Management Enterprise System (JAMES), Treasury's audit recommendation tracking system.

## **Background**

### **Legal Authority and Responsibilities**

The labeling provisions of the Federal Alcohol Administration Act require TTB to issue COLAs to prevent the introduction of mislabeled alcohol beverage products into interstate commerce.<sup>5</sup> Regulations require TTB to process COLA applications within

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<sup>5</sup> Under 27 U.S.C. §205(e), a COLA authorizes the certificate holder to bottle and remove or import alcohol beverages that bear labels identical to those shown on the certificate of label approval.

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90 days.<sup>6</sup> The initial part of the review, referred to by TTB as a Pre-COLA Product Evaluation, is conducted based on the product's formulation and origin. As part of the evaluation, TTB ensures that an alcohol beverage is correctly classified for product type and tax rate.

### **Advertising, Labeling, and Formulation Division**

Before an alcohol beverage product can be sold in the United States, ALFD reviews and approves the product's formula and label.<sup>7</sup> The formula is reviewed to ensure the product meets regulatory and tax requirements, and the product label is reviewed to ensure that it meets all regulatory requirements, and is not misleading to the consumer.

ALFD prevents consumer deception on alcohol beverage products by ensuring that labels provide consumers with adequate information and that the product formula does not contain prohibited ingredients. Additionally, ALFD educates and provides guidance to the alcohol beverage industry and general public on laws and regulations.

ALFD's responsibilities include administering the processing of COLA and formula applications. Its Formula Specialists review formulas for all three alcohol beverage commodities: distilled spirits, wine, and malt beverages. ALFD Labeling Specialists who review COLA applications are assigned to specialize in one of the three alcohol commodities.

### **COLAs Online and Formulas Online Systems**

To comply with the Government Paperwork Elimination Act,<sup>8</sup> TTB launched COLAs Online in 2003. This web-based application

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<sup>6</sup> Under 27 C.F.R. §13.21, TTB must provide notification of COLA approval or denial within 90 days of application. TTB may extend notification another 90 days for unusual circumstances. No regulation mandates a time limit for processing formula applications.

<sup>7</sup> Certain alcohol beverage products must undergo product evaluation to determine whether their proposed label identifies the product in an adequate and non-misleading way. TTB requires a review of some products' ingredients and formulation. TTB may also require laboratory analysis of the product.

<sup>8</sup> Government Paperwork Elimination Act (Public Law 105-277, October 21, 1998) required Federal agencies to allow individuals or entities the option to submit information to agencies and maintain records electronically, when practicable, by October 21, 2003.



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system allows alcohol industry members to electronically submit and track their COLA applications. This system provides information to TTB's Public COLA Registry providing the general public the ability to access detailed information on approved COLAs, along with a printable version of the approved COLAs. The system also serves as the ALFD's database used to track work-related documentation, including all COLA application submissions received.

Prior to issuing a COLA, TTB is required to review and approve certain alcohol beverage formulations for regulatory and tax compliance. In 2011, to promote compliance with Paperwork Reduction Act of 1995,<sup>9</sup> TTB launched Formulas Online, a web-based system used by alcohol industry members for drafting, submitting, and tracking formula and sample submissions for domestic and imported alcohol beverages and non-beverage products.<sup>10</sup> Formulas Online is integrated with the COLAs Online system, allowing alcohol producers and importers to connect approved formulas with their associated label applications.

According to TTB, the intent of the COLAs and Formulas Online systems is to provide TTB personnel and alcohol industry members with a streamlined, expedient, online paperless process to provide and obtain label and formula approval. Both the COLAs Online and Formulas Online systems were intended to improve processing times, in part, through the use of system validations to prevent or eliminate incomplete or erroneous information from being submitted and provide applicants the ability to make corrections to their application electronically.<sup>11</sup> However, it takes the same amount of time for a TTB Labeling or Formula Specialist to review and process a paper or an electronic application.

To promote the use of COLAs Online and Formulas Online by alcohol industry members, TTB allows electronic applications to be

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<sup>9</sup> Public Law 104-13 (May 22, 1995)

<sup>10</sup> Alcohol used in the production of a food, flavor, medicine, or perfume that are determined by TTB to be unfit for beverage purposes are considered to be a non-beverage product.

<sup>11</sup> Examples of system validations include: (1) in the field for alcohol content, a percentage of 0–100 must be entered; (2) for the image on the label, if the height and width dimensions entered by industry members do not meet requirements, an error message is generated; and (3) for the formula identification number, a valid number is provided from a drop-down menu on the entry screen.

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resubmitted with corrections multiple times. Resubmitted applications receive priority processing over new applications. By contrast, incorrect paper applications are rejected outright and must be resubmitted as a new application. No fees are charged to any applicants, domestic or foreign, for any part of the label or formula application process, including lab analysis.

## Audit Results

### **Finding 1 COLA and Formula Application Processing Times Have Increased and ALFD Specialists Need Updated Performance Standards and Cross-Training**

Despite TTB's efforts to improve the COLA and formula application processes by decreasing the need for certain application approvals and promoting the use of electronic filing, the processing times of COLA and formula applications have increased. The increase is due, in part, to increase in industry growth and a high volume of electronic applications resubmitted with corrections. Also TTB's electronic resubmission policy has the unintended consequence of increasing processing times for the majority of electronic applicants that submitted an error-free application.

Additionally, TTB's ALFD specialist performance standards were obsolete and most ALFD specialists were not cross-trained to work in other areas of ALFD.

#### Application Submissions Increased Despite Attempts by TTB To Reduce Submissions

As a result of industry growth, the number of label and formula applications submitted has increased since TTB launched the COLAs Online and Formulas Online systems.

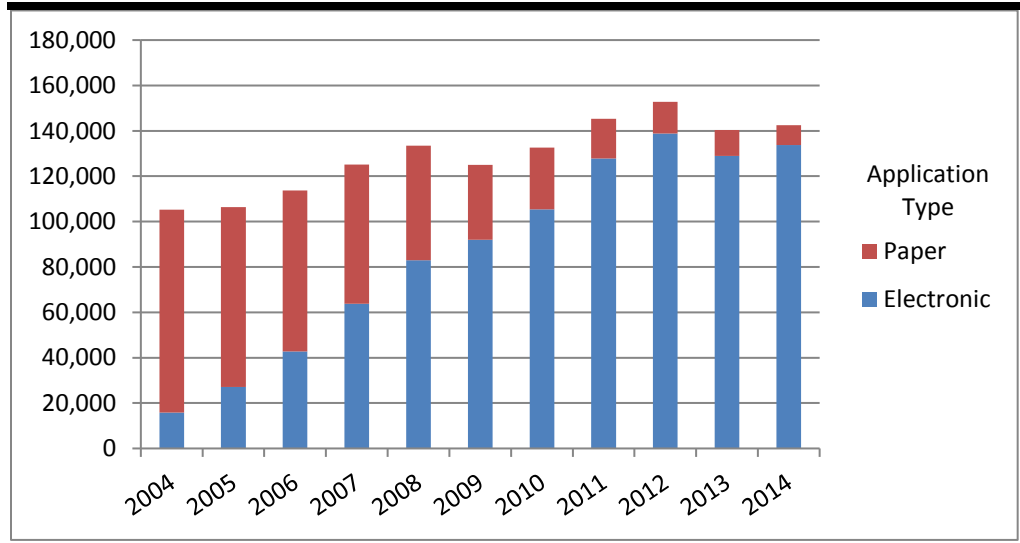
In fiscal year 2012, TTB revised its COLA application requirements with the goal of decreasing the number of applications required to be submitted. TTB increased the number of changes, called "allowable revisions," that an alcohol industry member could make

to a previously approved COLA without having to submit a new application.<sup>12</sup>

According to TTB officials, allowable revisions are changes determined to pose low risk to compliance, consumer information, or safety. Allowable revisions are intended to improve processing time by reducing the number of applications submitted and the ALFD specialists' workload.

Figure 1 provides the totals for paper and electronic COLA applications submitted to TTB since the first complete year the electronic label application system was available. The figure shows that total applications increased from approximately 105,000 to 142,000 which is over 35 percent from fiscal year 2004 through fiscal year 2014.

**Figure 1: Annual COLA Applications by Filing Method, Fiscal Years 2004–2014**



Source: OIG analysis of historical data from ALFD's Dashboard report.

According to TTB officials, allowable revisions resulted in COLA application submissions declining by approximately 7 percent in fiscal year 2014 compared to a peak of more than 152,000 COLA

<sup>12</sup> TTB Public Guidance G 2012-2, "Updated Certificate of Label Approval Application Form Expands List of Allowable Changes" (July 12, 2012). In fiscal year 2012, TTB increased the number of allowable revisions to 28. TTB further increased allowable revisions to 34 during fiscal year 2014 and there have been no additional changes to allowable revisions. Types of allowable revisions included changes to alcohol content, vintage date, and the deletion or reposition of graphics on the labels.

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applications submitted in fiscal year 2012.<sup>13</sup> However, TTB officials stated that continued industry growth would cause the number of applications to rise again. TTB intends to consider additional allowable revisions in the future, however, at the time of our audit, TTB was not able to determine to what extent this would be possible.

As the result of industry growth, formula application submissions have also increased over the years. Since the launch of Formulas Online, submissions have grown more than 50 percent—from approximately 9,000 in fiscal year 2011, when the program began, to 14,000 in 2014.

In fiscal year 2014, TTB attempted to reduce submissions of formula applications through a new ruling that eliminated the need to submit formula applications for malt beverages when certain ingredients or production processes are used.<sup>14</sup> According to TTB’s fiscal year 2015 Annual Report, the number of malt beverage formula applications submitted in fiscal year 2015 declined by approximately 28 percent compared to the previous year. However, this reduction was entirely offset by an increase in wine and distilled spirit formula application submissions.<sup>15</sup> In fiscal year 2016, TTB continued its attempt to reduce formula application submissions with the publication of two rulings that eliminated formula filing requirements for certain wine and distilled spirit products.<sup>16</sup>

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<sup>13</sup> TTB reported in its fiscal years 2013 and 2014 Annual Reports that allowable revisions resulted in 8 percent fewer label applications in fiscal year 2013 than fiscal year 2012, and 7 percent fewer in fiscal year 2014.

<sup>14</sup> TTB Ruling 2014-4, “Ingredients and Processes Used in the Production of Beer Not Subject to Formula Requirements” (June 5, 2014). This ruling was superseded in fiscal year 2016 with TTB Ruling 2015-1 “Ingredients and Processes Used in the Production of Beer Not Subject to Formula Requirements” (December 17, 2015).

<sup>15</sup> According to TTB’s fiscal year 2015 Annual Report, wine and distilled spirits formula application submissions had increased by 27 and 16 percent, respectively.

<sup>16</sup> TTB Ruling 2016-2, “TTB Approves General-Use Formulas for Certain Agricultural Wines” (September 29, 2016) and TTB Ruling 2016-3, “TTB Approves General-Use Formulas for Certain Distilled Spirits Produced Using Harmless Coloring, Flavoring, or Blending Materials” (September 29, 2016).

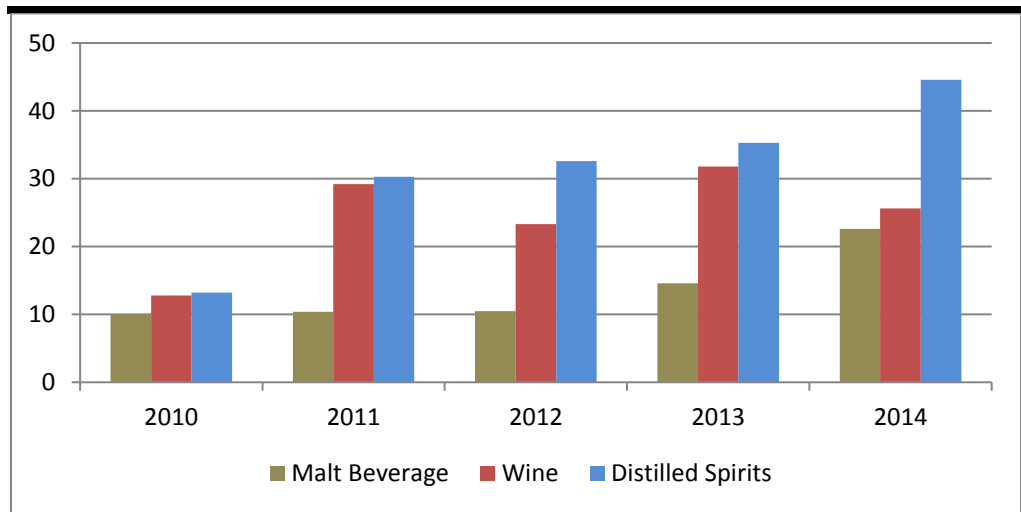
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## Electronic Filings and Application Processing Times Have Increased

In its fiscal year 2014 Annual Report, TTB reported that in fiscal year 2014 most alcohol industry members used electronic filing for COLA applications (94 percent) and formula applications (84 percent). Totals for applications filed through the COLAs Online and Formulas Online systems exceeded TTB's performance measure target of 92 percent at 93 percent.<sup>17</sup>

According to TTB officials, electronic applications were intended to reduce processing times by eliminating the problems and time delays associated with mailed paper applications, instituting system validations aimed to eliminate erroneous information or incomplete applications, and providing the ability to electronically correct and resubmit an application. However as shown in Figure 2, the processing times for COLAs for all three alcohol beverage commodities have increased since fiscal year 2010, with the most substantial increase occurring in distilled spirits. Time to process COLA applications for that commodity increased from about 2 weeks in fiscal year 2010 to 6 weeks in fiscal year 2014.

**Figure 2: Average Days To Process Label Applications by Commodity, Fiscal Years 2010–2014**



Source: OIG review of TTB's historical analysis of label applications processed.

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<sup>17</sup> TTB uses the combined electronic filing rates for COLAs Online and Formulas Online as a performance measure as shown in TTB's *Annual Report Fiscal Year 2014*.

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Similarly, the average processing time for formulas has increased from a little over a week in fiscal year 2011, when electronic filing began, to almost 9 weeks in fiscal year 2014.

TTB officials attributed the increase in processing times for COLA applications and formula applications to several factors. These included industry growth with existing staffing levels and an exceptionally high volume of applications being resubmitted by applicants after correcting errors.<sup>18</sup>

TTB officials stated that the increased processing times disrupted the business operations of alcohol beverage producers and importers and posed a potential barrier to commerce. According to a group of alcohol industry members—particularly distilled spirit producers and importers—the increase in processing time is viewed as a significant obstacle to bringing products to market.<sup>19</sup> For example, we found the combined processing times for COLA and formula approval for a distilled spirit product measured in October 2015 could take, on average, up to 14 weeks.<sup>20</sup>

#### Application Error Rate Caused Processing Times To Increase

According to TTB's fiscal year 2014 Annual Report new industry members add to application processing times because they often require extensive assistance during the application process and frequently submit applications that require correction.<sup>21</sup> TTB officials stated that new industry members are primarily responsible for increased error rates because they are unfamiliar with regulations and need better guidance for completing label applications. A May 2015 analysis conducted by TTB showed a statistically significant relationship between permit age and errors

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<sup>18</sup> TTB Memoranda: (1) *Analysis of Reasons That Label Applications Are Sent Back for Correction* and (2) *Analysis of Reasons That Formula Applications Are Sent Back for Correction* (March 31, 2015).

<sup>19</sup> On September 5, 2014, a coalition of 10 alcohol beverage trade associations, representing all three commodities, collectively wrote a letter to Congress voicing their concern that TTB lacked the resources to handle the growing alcohol beverage industry, leading to longer delays in getting products to the marketplace.

<sup>20</sup> On October 23, 2015, TTB reported on its web site that the average processing time for a distilled spirit formula was 71 days and the average for a distilled spirit COLA was 30 days, and if handled consecutively the combined time would be a total average of 101 days to clear the approval process.

<sup>21</sup> TTB defines new industry members as those with a permit to operate that is less than a year old.

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upon initial submission for electronic COLA applications.<sup>22</sup> Our review of TTB data found that new industry members had a higher-than-average error rate, but only minimally higher than that of experienced industry members. We found that new industry members submitted 15 percent of electronic COLA applications in fiscal year 2014 and were responsible for 18 percent of COLA applications returned for correction.

Nonetheless, the substantial volume of application errors has resulted in increased workload for the ALFD specialists and a commensurate increase in processing times. According to TTB's *Balanced Scorecard Executive Quarterly Report*, specialists were handling 42 percent of electronic COLA applications and 34 percent of electronic formula applications that required correction on first submission in fiscal year 2014. Alcohol industry members submitted more than 142,000 COLA applications to TTB, but TTB specialists processed over 207,000 COLA applications (an additional 45 percent). The increase in processing is due to industry members resubmitting corrected electronic applications to TTB for reprocessing.

An ALFD specialist described a situation that happened regularly in which an industry member would link a COLA application to a formula, anticipating that the label would be returned for correction because the corresponding formula had not yet been approved. This label would be considered a resubmitted application once the industry member received an approved formula, and it would go to the front of the line for processing.

TTB reported in its *Balanced Scorecard Executive Quarterly Report*, February 2015, that 58 percent of COLA electronic applications and 66 percent of electronic formula applications were approved by ALFD specialists on first submission during fiscal year 2014. Among electronic COLA applications returned for correction in fiscal year 2014, 69 percent were approved on the first resubmission, twenty-one percent were approved on the second

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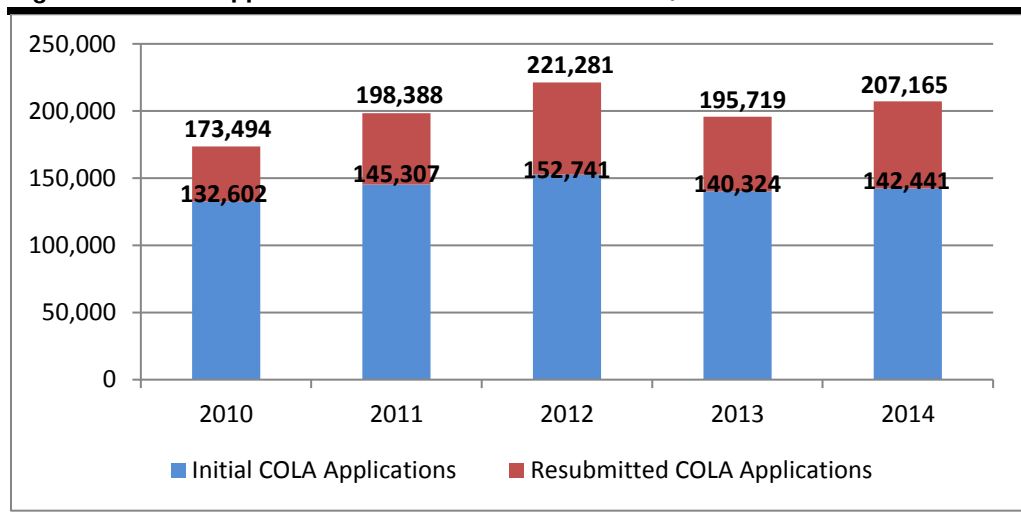
<sup>22</sup> TTB noted in its analysis that there are several complexities in the data relating to industry member operations and production patterns that may limit the utility of the analysis and qualify its conclusions. For example, existing permit holders may start producing new products and are new to the application process for formulas and/or labels so the age of these applicants is not a true indicator of the likely compliance rate of these industry members' formula and label applications.

resubmission, and approximately 10 percent were either approved or rejected after three or more resubmissions. According to TTB’s Memorandum, *Analysis of Reasons That Label Applications Are Sent Back for Correction*, the following three reasons accounted for approximately 50 percent of all distilled spirit and malt beverage combined labeling errors: (1) the label contained misleading information; (2) the label conflicted with the associated formula; and (3) the Health Warning Statement contained punctuation or style errors.

According to TTB officials, COLA applications are eventually rejected by TTB if they are resubmitted three times with errors or they are not resubmitted within 30 days of being sent back for correction. Issues involving a label image are allowed four resubmissions. In fiscal year 2014, TTB rejected approximately 7 percent of COLA and 6 percent formula electronic applications. TTB officials stated that resubmitted electronic applications increased the workload of ALFD Labeling Specialists by approximately 45 percent and ALFD Formula Specialists by 30 percent in fiscal year 2014, which contributed to increased processing times.

Figure 3 shows the number of COLA applications initially received and the number of applications processed.

**Figure 3: COLA Applications Received and Processed, Fiscal Years 2010-2014**



Source: OIG analysis of historical data from ALFD’s Dashboard report and TTB officials.



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TTB officials and ALFD specialists stated that resubmitted applications take the same amount of time to review and process as a new application because the entire application must be reviewed for any additional changes. Often applications are returned and resubmitted multiple times. An ALFD specialist told us that days can be spent processing resubmitted applications.

In an effort to promote electronic filing, TTB set a policy to process resubmitted electronic applications before processing new applications. However, we found that the policy had produced a bottleneck. It had the unintended consequence of increasing processing time for the majority of electronic applicants, who submitted an error-free application on the first submission.

TTB's resubmission policy does not support the purpose of an "electronic government" as stated in E-government Act of 2002. The purpose of an electronic government, that uses information technologies, combined with processes that implement these technologies, is to bring about improvements in government operations that may include effectiveness, efficiency, and service quality. The implementation of TTB's COLAs and Formulas Online systems has led to an increase in electronic filings; however, TTB's application resubmission policy now results in longer processing times that impacts the service quality for the majority of applicants.

TTB collected data on COLA and formula application errors to identify common trends.<sup>23</sup> TTB officials stated that TTB planned to address the common errors with system enhancements and to conduct outreach to educate industry members. According to TTB's Chief Information Officer (the authority responsible for maintaining and deploying changes to the COLA and Formulas Online systems), the benefits from enhancements should be considered in conjunction with whether processing times would be best improved by adding staff to process applications.

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<sup>23</sup> TTB Memorandum: (1) *Analysis of Reasons That Label Applications Are Sent Back for Correction* and (2) *Analysis of Reasons That Formula Applications Are Sent Back for Correction* (March 31, 2015).

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### ALFD Staff Were Not Cross-trained

We found that at the time of our review, most ALFD specialists were not cross-trained to process both COLA and formula applications, resulting in inconsistent and inequitable use of resources for processing labels and formulas. According to TTB officials, TTB identified the need to cross train formula and labeling specialists in fiscal year 2012, but had suspended its efforts due to the increased workload caused by the volume of applications and existing staffing levels.

During fiscal years 2011 through 2014, the workload for malt beverage label applications rose 50 percent and formula applications rose 91 percent.<sup>24</sup> During the same time period, the number of specialists processing those applications remained relatively the same. ALFD's sole specialist assigned to malt beverage COLA applications told us that he worked 7 days a week to try to keep processing times from rising. Another specialist stated that she was "burned out" from processing high volumes of applications.

This specialist also stated, COLAs occasionally require a formula application, and cross-training would help specialists to better understand that aspect of the process. One ALFD Program Manager did not know how an ALFD specialist was fully capable of processing a COLA application without having the knowledge and understanding of the formula application process.

In its *Standards for Internal Control in the Federal Government*,<sup>25</sup> the Government Accountability Office (GAO) provides that effective management of an organization's workforce is essential to achieving results and an important part of internal control. As part of its workforce planning, management must continually assess the knowledge, skills, and abilities needed to achieve organizational goals and consider how best to maintain a continuity of those skills and abilities.

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<sup>24</sup> TTB could only provide the last 9 months of data on the number of formula applications processed in fiscal year 2011. A 12-month extrapolation from the 9 months of data was used to project total formula applications processed for fiscal year 2011.

<sup>25</sup> GAO, "Standards for Internal Control in the Federal Government" (GAO/AIMD-00-21.3.1; issued Sept. 2014).

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ALFD management stated that cross-training could allow more equitable distribution of work among the commodity specialists. In July 2015, TTB officials stated that ALFD specialists were being cross-trained once they had mastered processing for one commodity. Following this, the specialist would begin to learn to process applications for other commodities.

#### Specialist Processing Standards Were Obsolete

TTB's processing standards for its ALFD Specialists need to reflect the specialists' actual workload. Realistic standards for the number of labels and formulas that can be processed by staff should be established to assist TTB in determining the number of staff needed to meet the growing demand or to support its requests for additional staff to process applications and reduce processing times.

Our review of the fiscal year 2014 applications processed by ALFD specialists found that the processing standards were set significantly lower than what ALFD specialists were achieving. For example, the sole Malt Beverage Specialist processed more than 33,000 applications—almost four times the amount that the specialist is required to process. TTB requires a labeling specialist to process 700 malt beverage applications monthly, for an annual total of 8,400 applications. Four Formula Specialists processed more than 18,000 formulas in fiscal year 2014. TTB requires each of its four Formula Specialists to process 110 formula applications per month, for an annual total of 5,280 applications processed. If those specialists had worked to the current standards, fewer than 5,300 formula applications would have been processed.

According to TTB officials, processing standards used to measure specialist performance have not been updated since 2007 and do not adequately reflect current workload.

According to Office of Management and Budget (OMB) Memorandum, *Delivering an Efficient, Effective, and Accountable Government* (M-11-31; August 17, 2011), on the agency level, performance goals and measurements are powerful tools to advance the effectiveness of programs "when the agencies

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regularly collect and analyze performance data to inform decisions”.

GAO’s *Standards for Internal Control in the Federal Government* requires management to design and validate individual performance measures as well as compare actual performance to planned or expected results throughout the organization and analyze significant differences. Furthermore, the Office of Personnel Management’s *Handbook for Measuring Employee Performance*, provides that on the employee level, performance plans should establish elements and standards that address accomplishments that lead to achieving organizational goals. All ALFD specialists have, as part of their performance evaluations, processing standards that measure their processing volume and accuracy.

At the time of our audit, TTB was working to update specialist performance standards. We believe that updated standards will allow TTB to more accurately determine the number of staff needed to meet the growing demand and to support its requests for additional staff to reduce processing times.

#### Other Improvements Are Planned

In September 2014, TTB submitted its proposed rulemaking for modernization of alcohol beverage labeling to Treasury’s Office of Tax Policy for review. The proposed rulemaking is intended to clarify and consolidate TTB’s regulations and policies with regard to the labeling of alcohol beverages, thus providing clearer and more consistent guidance for industry members. As of June 2016, TTB’s Director of ALFD stated that the proposed rulemaking was in the final stages of review by Treasury.

#### **Recommendations**

We recommend that the Administrator of TTB do the following:

1. Evaluate the current electronic resubmission policy to determine the impact on COLA and Formulas Online and the benefit to industry members.

#### Management Response

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Management considered, but has decided not to revise the electronic resubmission policy at this time. When TTB's current improvement initiatives to facilitate the submission of compliant applications are complete, management may re-evaluate changing the resubmission policy. TTB believes the majority of noncompliant application submissions are due to industry's misunderstanding of TTB's regulations and/or inadvertent errors, and the intentional submission of noncompliant applications as a placeholder was prompted by TTB's increasingly lengthy processing times over the past several years.

OIG Comment

TTB's response meets the intent of our recommendation. Although TTB has decided not to revise the electronic resubmission policy at this time, TTB has recognized the need to facilitate the process for submitting compliant applications, and will continue to assess its application resubmission policy. This effort should help ensure that TTB operations remain effective and efficient, and improve service quality to its stakeholders. TTB will need to record its planned corrective action in JAMES.

2. Continue to cross-train staff in order to address fluctuations in workload, reduce COLA and formula application processing times, and ensure continuity of operations.

Management Response

Management agrees with the recommendation and will continue to cross-train ALFD employees. According to management, AFLD's cross-training protocol has resulted in lower application processing times and has ensured continuity of operations across application types and commodities.

OIG Comment

TTB's response meets the intent of our recommendation. TTB will need to record its planned corrective action in JAMES.

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3. Update application processing standards for ALFD specialists to assist in determining appropriate staffing needs.

#### Management Response

Management concurs with the recommendation. According to management, this recommendation was addressed with new specialist processing standards that were implemented in May 2017. TTB stated that it recognizes that application processing standards should be reevaluated as program improvements are made (e.g., technological and other system improvements) and other factors are changed that would support revisions to processing standards. TTB developed a workload model in fiscal year 2016 and intends to continue using this model to evaluate its resource needs, target productivity levels, and address turnaround time standards for labels and formulas.

#### OIG Comment

TTB's response meets the intent of our recommendation. TTB will need to record its corrective action in JAMES.

## **Finding 2**

### **ALFD Specialist Guidance Could Be Improved and Quality Assurance Reviews Are Needed**

TTB established formal written procedures for its ALFD specialists to follow when processing COLA and formula applications in May 2015.<sup>26</sup> We found that TTB guidance for its ALFD specialists could be improved to ensure consistency in label and formula reviews. Additionally, TTB had not performed quarterly quality assurance reviews for formulas to ensure consistent processing of applications.

#### ALFD Specialist Guidance Could Be Improved

According to both TTB staff and alcohol beverage industry members who we interviewed, there were inconsistencies in the

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<sup>26</sup> TTB issued two standard operating procedures in May 2015: SOP ALFD S 5190.4, "Alcohol Beverage Label Application Review" (May 5, 2015), and SOP ALFD S 5190.5, "Pre-COLA Evaluation Standard Operating Procedures" (May 21, 2015).

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processing of applications among specialists and specialists had different interpretations of the regulations that affected the determination of application approval. For example, formula specialists were not categorizing the reason an application was returned for correction in a meaningful manner for approximately half of the applications processed in 2014. They grouped these applications into one of two generic categories: "Missing Information" or "Other."<sup>27</sup> These broad categories did not provide useful data about the problems encountered with applications or provide TTB sufficient information to address the problems with industry members to reduce errors.

According to TTB officials, ALFD specialists rely on guidance that includes federal regulations, TTB standard operating procedures, TTB training manuals, industry circulars, rulings, and other guidance documents along with professional judgement in determining application approval. During our audit, TTB formalized its standard operating procedures for processing COLA and formula applications in May of 2015. We found that guidance to ALFD specialists could be improved to incorporate a consistent methodology for ALFD specialists to follow when processing applications with errors. We believe a consistent methodology would improve the data and provide TTB's management a means to make more informed decisions and improve processes.

We also found that TTB's guidance did not have criteria for ALFD specialists to use in determining when applications should be rejected during multiple resubmissions. According to a labeling specialist, ALFD specialists use their own discretion when deciding to reject an application, typically after three submissions.

#### Quality Assurance Reviews Are Needed

According to TTB officials, ALFD Quality Assurance Specialists are responsible for reviewing the quality of work performed by the Labeling and Formula Specialists and for training new specialists. ALFD Quality Assurance Specialists are to provide quarterly quality assurance reports to ALFD's Assistant Directors. TTB officials stated that the work of the ALFD specialists who exceeded the

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<sup>27</sup> TTB Memorandum, "*Analysis of Reasons That Formula Applications Are Sent Back for Correction*" (March 31, 2015).

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acceptable application processing error rate of 15 percent were subject to increased quality assurance reviews until error rates decreased. However, TTB could not provide us with quarterly quality assurance reports for Formula Specialists because quarterly quality assurance reviews were not conducted.

According to OMB Circular No. A-123, *Management's Responsibility for Internal Control*, December 2004, monitoring is an internal control required of government managers. Continuous monitoring should be reported on periodically, and assessments should be integrated as part of management's continuous monitoring of internal control. The absence of Quality Assurance Specialists to perform oversight of Formula Specialists diminishes TTB's ability to effectively monitor performance in approving formulas and to identify opportunities for process improvement and training.

### **Recommendations**

We recommend that the Administrator of TTB do the following:

1. Review TTB's guidance for processing label and formula applications and update as needed to provide for a consistent methodology for processing applications.

### **Management Response**

Management concurs with the recommendation that TTB's guidance for ALFD specialists should be reviewed and updated as needed to ensure consistency in label and formula reviews, which is consistent with several ongoing efforts by TTB to improve ALFD specialist guidance materials.

TTB responded that in fiscal year 2017, TTB began implementing recommendations from a fiscal year 2016 contractor process review, which are intended to result in greater consistency in label and formula application reviews, including creating application review checklists and streamlining the reasons that a specialist may select when returning an application for correction. When complete, these materials will also be incorporated into the specialist manuals.



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OIG Comment

TTB's response meets the intent of our recommendation. TTB will need to record its corrective action in JAMES.

2. Establish and document quality assurance reviews for formula applications to monitor the consistency and accuracy of all specialists' formula approvals.

Management Response

Management agrees with the recommendation that quality assurance reviews are needed for formula approvals and has implemented a process for reviews. TTB stated that following fiscal years 2016 and 2017 dedicated funding to accelerate label and formula reviews, TTB was able to hire an Assistant Director for Formulation, who now consistently conducts quality assurance reviews for all formula specialists.

OIG Comment

TTB's response meets the intent of our recommendation. TTB will need to record its corrective action in JAMES.

\* \* \* \* \*

We appreciate the cooperation and courtesies extended to our staff by TTB personnel. If you have any questions, please contact me at (617) 223-8638 or Ken O'Loughlin, Audit Manager, at (617) 223-8624. Major contributors to this report are listed in appendix 3 and the distribution list for this report is included as appendix 4.

/s/  
Sharon Torosian  
Director

Our objective was to determine whether the Certificates of Label Approval (COLAs) Online and Formulas Online administered by the Alcohol and Tobacco Tax and Trade Bureau (TTB) were working as intended to improve processes and meet the growth of alcohol-related industries regulated by TTB.

To accomplish our objective, we interviewed managers and staff members from TTB's Advertising, Labeling and Formulation Division (ALFD) at headquarters in Washington, D.C. and at TTB's Scientific Services Division laboratory in Beltsville, MD.

External to TTB, we interviewed representatives from alcohol beverage trade associations and state alcohol beverage regulatory agencies to obtain their views on TTB's COLAs Online and Formulas Online programs. These included the Beer Institute, National Association of Beverage Importers, Distilled Spirits Council of the United States, Presidents' Forum of the Distilled Spirits Industry, Wine America, Wine Institute, and Massachusetts Alcohol Beverage Commission.

We also reviewed information provided on TTB's public website, including its Annual Reports, the COLAs Online and Formulas Online programs, Online Public COLA registry, rulemakings, the Code of Federal Regulations, and other label and formula material.

We reviewed prior Office of Inspector General and Government Accountability Office reports. We also reviewed legislation and congressional materials, Treasury Orders and Directives, and government-wide guidance related to TTB and its COLAs Online and Formulas Online programs. We reviewed TTB's analyses of these programs as well as related data. We requested from TTB and reviewed any reports, studies, assessments, and initiatives related to these programs, as well as any TTB policies, procedures, and guidance on the COLAs Online and Formulas Online programs.

We performed our fieldwork from September 2014 through July 2015 with subsequent follow up made through June 2016 to obtain the status of TTB's initiatives related to the COLAs and Formulas programs. In February 2017 we also followed up on documentation as a result of discussions during the November 2016 exit conference with TTB management.

We conducted this performance audit in accordance with generally accepted government auditing standards. 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.

Appendix 2  
Management Response



ADMINISTRATOR

DEPARTMENT OF THE TREASURY  
ALCOHOL AND TOBACCO TAX AND TRADE BUREAU  
WASHINGTON, D.C. 20005

September 25, 2017

Ms. Sharon Torosian  
Director, Eastern Field Audit Office  
Office of Inspector General  
Department of the Treasury  
408 Atlantic Ave., Suite 330  
Boston, MA 02110

Dear Ms. Torosian,

Thank you for giving the Alcohol and Tobacco Tax and Trade Bureau (TTB) an opportunity to respond to the Office of Inspector General's (OIG's) draft audit report *Opportunities Exist To Enhance TTB's COLAs and Formulas Online Programs*, provided September 19, 2017. TTB appreciates your audit efforts and is pleased that the OIG acknowledges the significant industry growth that has affected these important programs. Furthermore, TTB is pleased that the OIG's draft report noted instances where TTB self-identified needed improvements to specific areas within these programs.

Overall, TTB agrees that opportunities exist for TTB to enhance the COLAs Online and Formulas Online (FONL) programs, as well as the associated label and formula review processes, and acknowledges that it faced programmatic challenges during the period under audit. Specifically, as noted in the OIG's draft report, TTB faced significant industry growth during a period of sustained budget restrictions. As a result, TTB was unable to increase its staffing levels to address the additional workload demands stemming from industry growth, which resulted in lengthy processing times for label and formula applications. During this period, the available staff were primarily dedicated to reviewing the growing number of label and formula applications, which required delaying TTB's self-identified program improvements and other corrective actions.

TTB would also like to highlight that, at the time of the issuance of the OIG's audit report, TTB's programmatic performance has significantly<sup>1</sup> improved, with current label and formula approval times generally below TTB's FY17 10-day turnaround target, representing an approximate 86 percent improvement for formula approvals and 67 percent improvement for label approvals as compared to the average processing times cited in the report. These improvements are the culmination of TTB's multiyear effort to address its performance challenges in timely issuing label and formula approvals. Recognizing the declining performance trend in these areas, as well as the extent to which noncompliant submissions increase TTB's overall workload, TTB independently initiated and conducted an analysis in FY14-15 to assess the most frequent reasons why label and formula applications were returned for correction. In FY15, TTB used

<sup>1</sup> Significance is defined as the relative importance of a matter within the context in which it is being considered, including quantitative and qualitative factors, paragraph 6.04 of Government Auditing Standards, [GAO-12-331G](#) (Washington, D.C., Dec. 2011).

[www.TTB.gov](http://www.TTB.gov)

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these findings to create a detailed action plan to improve the compliance of initial applications through a series of system enhancements and improved guidance. Also in FY15, TTB conducted a staffing analysis to project the number of Advertising, Labeling and Formulation Division (ALFD) staff that would be needed to achieve a 10-day service standard, which TTB determined would better meet industry needs. After receiving \$5 million in dedicated funding<sup>2</sup> for these programs in FY16, which was continued in FY17, TTB has been able to implement most of the planned improvements and is executing its staffing plan<sup>3</sup> consistent with the FY15 analyses. As a result of these combined efforts, TTB is now achieving the new 10-day service standard for the majority of label and formula applications.

TTB thanks the OIG for its review and acknowledgement of TTB's ongoing efforts to provide improved service to the alcohol beverage industry through the timely approval of label and formula applications. TTB's responses to the OIG's specific findings and recommendations are as follows:

#### **Management Response to Finding 1**

##### **1. Evaluate the current electronic resubmission policy to determine the impact on COLA and Formulas Online and the benefit to industry members.**

Although TTB agrees with the OIG's assessment that industry growth has had a significant impact on label and formula application processing times, TTB disagrees with the OIG's conclusion that TTB's current electronic resubmission policy was a significant factor contributing<sup>4</sup> to the increased processing times of error-free applications. As noted above, increased processing times in recent years were primarily driven by an increase in initial application volume, with a proportional number of resubmissions, without an equivalent TTB staffing increase. With regard to the recommendation, TTB recently considered whether to change the current electronic resubmission policy but opted against revising it at this time for two primary reasons.

First, TTB believes that the majority of noncompliant submissions are due to industry misunderstanding of TTB's regulations and/or inadvertent errors rather than an intentional submission of noncompliant applications. As such, and given the longstanding nature of TTB's resubmission policy, TTB's current corrective actions are focused on reducing the number of resubmissions rather than changing the order in which they are processed, which could unduly disrupt industry operations. To this end, TTB has recently deployed a series of enhancements to COLAs Online and FONL to

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<sup>2</sup> TTB's FY16 enacted appropriation included \$5 million in dedicated funding to accelerate the processing times for alcohol beverage label and formula applications (FY 2016 Consolidated Appropriations Act, H.R. 2029, P.L. 114-113). This funding was also included in TTB's FY17 enacted appropriation (FY 2017 Consolidated Appropriations Act, H.R. 244, P.L. 115-31).

<sup>3</sup> After receiving dedicated funding in FY16, TTB began executing its staffing plan for ALFD, which included hiring 13 additional label and formula specialists and 2 supervisory specialists. Given that the review and approval of label and formula applications require the support of other TTB programs, this funding also supported the hiring of 6 chemists, an alcohol policy advisor, an industry outreach program manager, and an attorney as well as system enhancements to COLAs Online and FONL programs.

<sup>4</sup> The cause identifies the reason or explanation for the condition or the factor or factors responsible for the difference between the situation that exists (condition) and the required or desired state (criteria), which may also serve as a basis for recommendations for corrective actions, paragraph 6.76 of Government Auditing Standards, [GAO-12-331G](#) (Washington, D.C., Dec. 2011).



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prevent application errors, such as improving embedded help features and replacing text entry fields with drop down menus, and is currently improving web guidance relating to label and formula requirements to improve application compliance. TTB believes that this series of actions will decrease the percentage of noncompliant label and formula submissions by the end of FY18.

Second, to the extent that some industry members may have intentionally submitted noncompliant applications as a placeholder for an eventual resubmission upon being returned for correction by TTB,<sup>5</sup> this practice was prompted by TTB's increasingly lengthy processing times over the past several years. As TTB's processing times continue to improve, the incentive to engage in this practice will be eliminated, which should result in increased initial application compliance.

When the current improvement initiatives to facilitate the submission of compliant applications are complete, and after TTB has demonstrated to industry the sustainability of its significantly improved processing times, TTB may re-evaluate the current electronic submission policy to assess its ongoing impact and relevance.

**2. Continue to cross-train staff in order to address fluctuations in workload, reduce COLA and formula application processing times, and ensure continuity of operations.**

TTB agrees with the OIG's recommendation to continue cross-training ALFD employees, and has done so over the past two years. As noted in the OIG's draft report, ALFD identified the need to cross-train specialists nearly five years ago in a concept paper dated November 13, 2012 (provided to the OIG on February 14, 2017). To implement ALFD's proposed changes, TTB began cross-training activities in 2012-13, although they were temporarily stalled due to budget constraints prior to being resumed in 2015.

Of the 13 employees who have been onboard for two or more years, eight employees (or 62 percent) are currently cross-trained and deployed to cover areas where there is a need due to submission increases and/or employee absences. Further, ALFD was able to hire 13 new specialists as a result of \$5 million in dedicated funding in FY16-17 to accelerate label and formula application reviews. Ten of those employees are currently on board and being trained in the particular commodity area for which they were hired. After reaching full proficiency, employees will be cross-trained to work in other areas. Thus far, ALFD's cross-training protocol has resulted in lower application processing times and has ensured continuity of operations across different application types and commodities.

**3. Update application processing standards for ALFD specialists to assist in determining appropriate staffing needs.**

TTB concurs with this recommendation, but TTB disagrees with the OIG's characterization of ALFD's total processing levels in FY14 as the appropriate baseline point of comparison for acceptable processing standards.

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<sup>5</sup> Although the draft report cites to an interview in which a specialist described this situation as "happen[ing] regularly," TTB notes the absence of data or other supporting evidence indicating the frequency with which industry members may have intentionally submitted a noncompliant application.

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As communicated to the OIG on February 14, 2017, with appropriate supporting documentation, TTB recognized the need for increased processing standards in 2013, prior to the OIG's audit, and has since followed the appropriate procedures to update them. A memorandum of understanding between TTB and the National Treasury Employees Union summarizing the new standards was signed on March 30, 2017, and the new standards went into effect on May 1, 2017. Therefore, this recommendation has been addressed.

TTB finds the OIG's use of ALFD's total processing levels in FY14 as the baseline for acceptable processing standards to be mistaken, however, because it does not recognize the extent to which overtime and other unsustainable operating procedures were used. TTB recognizes the extraordinary effort of its staff during this timeframe and, all other things being equal, understands that using the total productivity level during this period as the baseline would be inappropriate and could result in staff burnout. In fact, in setting the new performance standards, ALFD management assessed the FY16 productivity level and then subtracted hours attributable to overtime and other premium pay situations to develop a baseline productivity level. Nonetheless, TTB recognizes that these standards should be reevaluated as program improvements are made (e.g., technological and other system improvements) and other factors are changed that would support revisions to processing standards.

Moreover, as shared with the OIG, TTB developed a workload model in FY16 that allows ALFD management to project anticipated turnaround times based on a number of variables, including the volume of initial applications, the volume of resubmissions, and the number of specialists processing applications. This model has also provided TTB with the ability to estimate the number of specialists needed (with a corresponding level of productivity) to achieve a given average turnaround time across each commodity and application type. Going forward, and consistent with the OIG's recommendation, TTB intends to continue using this model evaluate its resource needs, target productivity levels, and turnaround time standards for labels and formulas.

#### **Management Response to Finding 2**

##### **1. Review TTB's guidance for processing label and formula applications and update as needed to provide for a consistent methodology for processing applications.**

TTB concurs with the OIG's recommendation that TTB's guidance for ALFD specialists should be reviewed and updated as needed to ensure consistency in label and formula reviews, which is consistent with several ongoing efforts by TTB to improve ALFD specialist guidance materials.

In FY17, TTB began implementing recommendations from an internal FY16 Lean Six Sigma process review, which are intended to result in greater consistency in label and formula application reviews, including creating application review checklists and streamlining the reasons that a specialist may select when returning an application for correction. When complete, these materials will also be incorporated into the specialist manuals.

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**2. Establish and document quality assurance reviews for formula applications to monitor the consistency and accuracy of all specialists' formula approvals.**

TTB agrees with the OIG that quality assurance reviews are needed for formula approvals and has already implemented a process for these reviews.

As TTB noted during the OIG's review, the position of quality assurance specialist for formulation was converted (along with its responsibilities) to a program manager position in 2004. From 2004-16, the program manager had been responsible for conducting quality assurance reviews for new formula specialists within the first year. Following the FY16-17 dedicated funding to accelerate label and formula reviews, however, TTB was able to hire an Assistant Director for Formulation, who now consistently conducts quality assurance reviews for all formula specialists.

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TTB would like to thank your office and audit team for auditing these important programs, especially as TTB continues to implement needed program improvements relating to the review and approval of label and formula applications, including the COLAs Online and FONL programs, to better serve the expanding alcohol beverage industry. TTB recognizes the important role of the OIG, and TTB appreciates the OIG's recommendations to improve these mission-critical programs.

Sincerely,

/s/ John J. Manfreda

John J. Manfreda  
Administrator



Appendix 3  
Major Contributors to This Report

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Ken O'Loughlin, Audit Manager  
Timothy Cargill, Auditor-In-Charge  
Patrick Arnold, Auditor-In-Charge  
Andrew Morgan, Referencer

**The Department of the Treasury**

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Fiscal Assistant Secretary  
Office of Strategic Planning and Performance Improvement  
Office of the Deputy Chief Financial Officer, Risk and Control  
Group  
Deputy Assistant Secretary, Tax, Trade, and Tariff Policy

**Alcohol, Tobacco, Tax and Trade Bureau**

Administrator

**Office of Management and Budget**

OIG Budget Examiner

**U.S. Senate**

Chairman and Ranking Member  
Committee on Appropriations

Chairman and Ranking Member  
Subcommittee on Financial Services and General Government  
Committee on Appropriations

Chairman and Ranking Member  
Committee on Finance

Chairman and Ranking Member  
Committee on Health, Education, Labor, and Pensions

**U.S. House of Representatives**

Chairman and Ranking Member  
Committee on Appropriations

Chairman and Ranking Member  
Subcommittee on Financial Services and General Government

Committee on Appropriations

Chairman and Ranking Member  
Committee on Ways and Means

Chairman and Ranking Member  
Committee on Energy and Commerce



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