



## 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

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  
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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

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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.

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## 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?
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## 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.*
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**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.*
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**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.*
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**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.*
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