STATE OF NEW HAMPSHIRE
LIQUOR COMMISSION

MANAGEMENT LETTER
FOR THE FISCAL YEAR ENDED JUNE 30, 2022

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To The Fiscal Committee Of The General Court:

We have audited the financial statements of the New Hampshire Liquor Commission as of and for the fiscal year ended June 30, 2022 and have issued our report thereon dated December 20, 2022.

This management letter, a byproduct of the audit of the New Hampshire Liquor Commission for the fiscal year ended June 30, 2022, contains our auditor's report on internal control over financial reporting and on compliance and other matters and related audit findings. The current status of prior audit comments, beginning on page 11, provides a summary of the status of observations presented in the fiscal year 2021 and fiscal year 2020 Liquor Commission management letters.

The New Hampshire Liquor Commission's fiscal year 2022 Annual Comprehensive Financial Report can be accessed online at: https://www.gencourt.state.nh.us/lba/auditreports/financialreports.aspx

Office of Legislative Budget Assistant

Office Of Legislative Budget Assistant

December 20, 2022

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* Comment suggest legislative action may be required.

Abbreviations Used

ACFR	Annual Comprehensive Financial Report
AAPTF	Alcohol Abuse Prevention and Treatment Fund
COBOL	Common Business Oriented Language (computer coding)
Commission	New Hampshire Liquor Commission
DoIT	Department of Information Technology
ERP	Enterprise Resources Planning system
GASB	Governmental Accounting Standards Board
MAPPER	Current front and back office, point of sale information system
NextGen	New ERP system, including point-of-sale, E-commerce, warehouses, and back office financial systems
NHFirst	New Hampshire state government accounting system

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Independent Auditor's Report On Internal Control Over Financial Reporting And On Compliance And Other Matters Based On An Audit Of Financial Statements Performed In Accordance With *Government Auditing Standards*

To The Fiscal Committee Of The General Court:

We have audited, in accordance with the auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States, the financial statements of the New Hampshire Liquor Commission (Commission) which comprise the Statement of Net Position as of June 30, 2022 and the related Statements of Revenues, Expenses, and Changes in Net Position and Cash Flows for the fiscal year then ended, and the related notes to the financial statements, which collectively comprise the Commission's basic financial statements, and have issued our report thereon dated December 20, 2022.

Internal Control Over Financial Reporting

In planning and performing our audit of the financial statements, we considered the Commission's internal control over financial reporting (internal control) as a basis for designing audit procedures that are appropriate in the circumstances for the purpose of expressing our opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the Commission's internal control. Accordingly, we do not express an opinion on the effectiveness of the Commission's internal control.

A *deficiency in internal control* exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct, misstatements on a timely basis. A *material weakness* is a deficiency, or a combination of deficiencies, in internal control such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented, or detected and corrected, on a timely basis. A *significant deficiency* is a deficiency, or a combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance.

Our consideration of internal control was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control that might be

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material weaknesses or significant deficiencies and therefore, material weaknesses or significant deficiencies may exist that were not identified. Given these limitations, during our audit we did not identify any deficiencies in internal control that we consider to be material weaknesses. We did identify certain deficiencies in internal control, described in Observations No. 1 through No. 3, that we consider to be significant deficiencies.

Report On Compliance And Other Matters

As part of obtaining reasonable assurance about whether the Commission's financial statements are free from material misstatement, we performed tests of its compliance with certain provisions of laws, rules, regulations, and contracts, noncompliance with which could have a direct and material effect on the financial statements. However, providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such an opinion. The results of our tests disclosed an instance of noncompliance or other matters that is required to be reported under *Government Auditing Standards* and which is described in Observation No. 4.

Liquor Commission's Responses To Findings

Government Auditing Standards require the auditor to perform limited procedures on the Commission's responses to the findings identified in our audit and described in the accompanying observations. The Commission's responses to the findings identified in our audit are included with each reported finding. The Commission's responses were not subjected to the auditing procedures applied in the audit of the financial statements and, accordingly, we express no opinion on them.

Purpose Of This Report

The purpose of this report is solely to describe the scope of our testing of internal control and compliance and the results of that testing, and not to provide an opinion on the effectiveness of the Commission's internal control or on compliance. This report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the Commission's internal control and compliance. Accordingly, this communication is not suitable for any other purpose.

Office of Legislative Budget Assistant

Office Of Legislative Budget Assistant

December 20, 2022

INTERNAL CONTROL COMMENTS

SIGNIFICANT DEFICIENCIES

Observation No. 1

Ongoing Delays To Replace Legacy Computer System Poses Significant Risks

The Commission's implementation of its NextGen system to replace its legacy system (MAPPER) has not been timely, resulting in a strain on staff resources, increased project costs, and an increased risk to operations.

The Commission's endeavor to replace its 35-year-old MAPPER system, with a new system NextGen began in fiscal year 2016 with an estimated 24-month timeframe for completion. NextGen, a fully integrated enterprise resources planning (ERP) system is intended to support all aspects of the Commission's activities, including financial accounting and reporting. The go-live date has continuously been postponed, and as of the date of this report the Commission stated that it will not go-live in February 2023 as most recently planned. According to the Commission, the risks of moving forward with the implementation of the NextGen system are greater than the risks of continuing operations with its current MAPPER system. The Commission reports that there are numerous issues preventing the implementation of the NextGen system, and it cannot move forward until those issues have been resolved; and therefore, a new expected go-live date is unknown. Due to these unforeseen delays the Commission intends to amend its contract with the current software vendor to extend the period of the contract.

During the past six years the Commission's implementation of the NextGen system has been plagued by many complications, such as changes in vendors and lead IT project managers, discontinuance of consultant services, employee turnovers, and lack of effective resources. Recent challenges causing further delays include:

- issues with the vendor's mandatory upgrades that broke functionality,
- the need for additional testing,
- bug fixes requiring resolution,
- incompatibility issues between NextGen and NHFirst (State accounting system), and
- time constraints for system integration testing due to NHFirst blackout periods and the Commission's high-volume sales periods.

Significant risks resulting from ongoing delays to replace the MAPPER system include:

1. Continued dependency on MAPPER to fulfill its business needs. MAPPER runs on Common Business Oriented Language (COBOL) computer code and the system is no longer vendor-supported and has become obsolete. The Commission is dependent upon limited staff with institutional knowledge, consisting of three retired employees, two who are currently employed on a part-time basis by the Commission, to provide the expert level support to keep the system running and resolve system disruptions.

2. Time, costs, and resources used to address the NextGen system implementation detract from all other Commission activities.

As of June 30, 2022, the Commission reported $20.2 million in Software in Progress, for its work to date on the implementation of the NextGen system.

Similar comments related to the Commission's exposed risks from reliance on its MAPPER system appeared in the 2015, 2016, 2019, and 2021 Management Letters.

Recommendation:

The Commission should:

1. **Consider and respond to risks posed by its reliance on its limited retired staff resources with the knowledge to support its legacy system while continued delays and other issues are resolved with its implementation of the NextGen system.**

2. **Seek additional resources to fulfill its information technology needs and ensure that it is receiving and acting upon the best available advice in the implementation of the NextGen system. Commission management should ensure individuals with knowledge and experience in the industry are involved at all levels, and appropriate consideration is given to alternatives in the implementation that are the most responsive to the State's and Commission's structure and needs. If it is determined the implementation of the entirety of the ERP project is not feasible, the Commission may consider implementing certain segments of the NextGen system.**

Auditee Response:

We concur, in part.

The Commission considers and responds to risks that arise in both the legacy system (MAPPER) and NextGen project.

While the Commission had anticipated that the NextGen system would be implemented in February 2023, there have been numerous delays that were outside the control of the Commission. First, prior to the June 2020 contract with Blue Horseshoe Solutions, Inc. (now Accenture, LLP), the Commission had a previous vendor, but the contract was ended prior to completion. The COVID-19 pandemic slowed the implementation progress, and the Commission accelerated the deployment of online ordering to allow curbside and in-store pickup options. There have also been unprecedented staffing shortages with the Department of Information Technology (DoIT), which resulted in insufficient State resources to complete implementation. Also, platform updates from Microsoft complicated development. Moreover, there are NHFirst blackout periods and sales periods where implementation cannot occur.

It should be noted that there is an Executive Committee that assists in overseeing the project, which consists of officials from the Commission, DoIT, Department of Administrative Services, and the

Department of Safety. The critical decisions, including timelines for implementation, are made in consultation with the Committee.

Most recently, DoIT has solidified the Commission's NextGen team. The NextGen project has also progressed further in recent months. Most specifically, the team is currently doing performance testing, end user testing, day in the life testing, and system integration testing. Based on the information provided above, it is anticipated that the project will be implemented in fiscal year 2024.

In considering the overall risks between the legacy system and NextGen, the Commission cannot put revenue at risk by implementing NextGen prior to successful testing. If the NextGen system is imprudently implemented, it could be catastrophic to revenue.

Responses to specific recommendations:
Recommendation 1. Retired staff continue to be utilized as they are familiar not just in general, but specifically with the operations of the Mapper system. Replacing the retired staff is not entirely feasible as anyone new to system requirements would not have the depth of skills or know the specifics of the Commission operations or financial information flow.

The information inherent to the retired personnel is being transferred to the Commission project team through documentation and testing and transferred to supervisors. With both the project team and supervisors, it is believed if there was a "sudden need," generalists could be brought in, working in conjunction with the project team and supervisors.

Recommendation 2. Regarding additional resources, the Commission views this as having dual components: personnel and financial resources. As mentioned in the response to recommendation 1., hiring people "in-house" to assist with the project is either cost prohibited or disallowed.

Looking to the outside and contracting third parties is how this project was started and has remained in progress. Accenture is recognized as a leader in projects such as the NextGen project at the Commission and has been noted as a world leader for more than 30 years.

The Commission would like to point out that the scope and scale of the system being replaced is extremely large with a multitude of complex, interacting software and hardware components that represent 35 years of being custom built, upgrading, and aligned with technology changes that came about and are considered "common place" today. The Commission is in constant contact with Accenture, relying on their expert advice as to how to address each stage of the project and staff the project as best possible.

The issue of financial resources ties most of the issues together. While completing the task of replacing a custom-built in-house system, the Commission is required to continue operations under its charter of optimizing profit for the benefit of the State. What also must be considered regarding financial resources is that the new system must be accurate and reliable. System integrity has a cost of both time and money.

We would like to emphasize that the scope and scale of this project cannot be looked at in a summary fashion. Instead, every single component and small detail of the existing system must be replicated with accuracy and integrity.

Observation No. 2

Formal Risk Assessment Procedures Should Continue To Be Developed

The Commission has not updated its business-risk assessment process, originally established in fiscal year 2017. While certain components of a risk assessment have been performed including: conducting a risk assessment for the Commission's Division of Enforcement and Licensing, and developing a Strategic Plan with identified risks, none of these tasks were performed as part of an agency-wide formal risk assessment process to identify and evaluate risks over the Commission's financial accounting and reporting processes, information technology functions, and overall business operations.

Management's assessment of and response to risks facing an organization is an integral component of internal control. The purpose of an entity's risk assessment effort is to identify, analyze, and respond to risks that could affect the entity's ability to achieve its objectives.

A formal and well-planned risk assessment process increases the likelihood that the appropriate balance between the costs and benefits of controls can be understood and become the basis for controls put into operation. As risks change over time due to changes in processes, information technology, and environment, controls intended to mitigate risk may become inefficient and ineffective. Without ongoing risk assessment processes, the identification and response to risk often occurs in a reactive mode, after a risk had been realized and a loss incurred.

Periodic monitoring of the Commission's processes and activities using a risk-based mindset promotes effective planning and assists in resource allocation-based decision making.

A similar comment was issued in the 2020 Liquor Commission Management Letter.

Recommendation:

We recommend the Commission continue to develop formal and documented risk assessment procedures for recognizing, evaluating, and responding to risks that could affect its ability to achieve its financial accounting and reporting, information technology, and overall business operation objectives. Risks identified should be analyzed to determine whether current internal controls mitigate risk to a level desired by management or if further actions are required in response to risks. Commission employees with specific areas of expertise should participate in the review to ensure details of operations that may not be obvious to management are appropriately considered.

A periodic, documented review of the risk assessment by management should be incorporated into the process.

Auditee Response:

We concur.

The Commission started an Enterprise Risk Management (ERM) program in the fiscal year 2021 that continued into fiscal year 2022, with the focus on the Enforcement Division. There was a need to apply risk management to the operational needs of the Enforcement Division in response to a performance audit received in February 2021.

One of the reason the ERM program is not further developed is due to a staff change. In late 2022, both the employee selected to carry out the duties of the risk program, and the Chief Operating Officer, to whom the risk officer reported, left the Commission.

While the Chief Operating Officer position was filled, there remains the task of finding a person with the knowledge of internal controls, risk management and knowledge of the Commission operations, and procedures to carry out the continuation of such a large undertaking.

It is still the Commission's view that much of the continued development of ERM is contingent on NextGen implementation for this to be effective and efficient. As referenced in Observation No 1., the Commission's legacy system is in the process of being replaced. It continues to be impractical to invest large amounts of staff time and resources to implementing an ERM program under a system that is planned for obsolescence. The Commission believes it is more responsible to build and analyze a risk review system on the new system that will impact the core of the Commission's operations and finances moving forward.

Observation No. 3

Internal Audit Function Should Be Established

The Commission has not fully developed and implemented an internal audit function appropriate for the size and complexity of its operations. The Commission is a $775 million a year business, operating sixty-six stores with $77 million of products in inventory. The Commission's financial operations involves wholesale, retail, licensee, and enforcement activities.

The Commission's current internal audit function does not appear to perform duties consistent with internal audit in the traditional sense such as identifying risks, monitoring controls, or ensuring that management's objectives are being carried out throughout the organization by performing internal audits. Rather the Commission's internal auditor performs tasks assigned to agency accounting staff such as the duties related to store operations and warehousing including; planning and overseeing physical inventory, and interpreting the operational policies, procedures, and guidelines as they relate to inventory control, and agency wide assets. The Commission could benefit from instituting an internal audit structure that focuses on risk mitigation, strengthening controls, and generally functions more like internal audit in the traditional sense.

According to the Institute of Internal Auditors, internal auditing can help an organization "accomplish its objectives by bringing a systematic, disciplined approach to evaluate and improve the effectiveness of risk management, control, and governance processes." A critical aspect of the internal audit function includes reporting issues and challenges identified and making recommendations to address these problems. Internal auditors typically issue reports at the end of each audit summarizing their findings, recommendations, and any responses or action plans from management. Internal audit should be all encompassing and include the whole organization including the Division of Administration, Division of Enforcement and Licensing, and Marketing operations.

This comment was originally reported in the Commission's 2019 Management Letter and as of the date of this report has not been fully resolved.

Recommendation:

We recommend the Commission revamp its current internal audit roles and work towards the implementation of a traditional internal audit function that performs audits and focuses on risk mitigation and strengthening internal controls for the organization. The internal audit function should include a formalized process, including planned procedures, the reporting of weaknesses in internal control and noncompliance, and recommendations to address the deficiencies noted. Internal auditors should have the appropriate training, education, and professional background to perform internal audit activities.

Auditee Response:

We concur.

The Commission recognizes the need to revamp the internal audit role and work towards traditional internal audit function; however, we would like to note that the tenants of both Observation No. 1 and Observation No. 2 cannot be separated from the implementation requirements of this Observation—particularly Observation No. 2. An Enterprise Risk Management plan needs to be outlined to delineate internal controls and risks within defined areas and procedures. The plan will further allow for the restructure of the internal audit function, giving form to the charter and mission of a revamped internal audit structure, and provide for direction for the development of procedures.

The Commission will revamp existing internal audit function as soon as Observation No. 1 and 2. Can be suitably addressed.

STATE COMPLIANCE COMMENT

Observation No. 4

Transfers To The Alcohol Abuse Prevention And Treatment Fund Should Be In Accordance With Statute

The Commission did not compute its fiscal year 2022 transfer to the Alcohol Abuse Prevention and Treatment Fund (AAPTF) in accordance with statute.

RSA 176:16, III, states "Five percent of the previous fiscal year gross profits derived by the [liquor] commission from the sale of liquor shall be deposited into the alcohol abuse prevention and treatment fund established by RSA 176-A:1. For the purpose of this section, gross profit shall be defined as total operating revenue minus the cost of sales and services as presented in the state of New Hampshire comprehensive annual financial report, statement of revenues, expenses, and changes in net position for proprietary funds."

The Commission fiscal year 2022 transfer of $10.3 million to the AAPTF was calculated based on the Commission's fiscal year 2020 gross profit, rather than the fiscal year 2021 gross profit, resulting in an understatement in the amount transferred by $1.2 million. The Commission reports the fiscal year 2021 State Annual Comprehensive Financial Report (ACFR) was not available at the time it computed the fiscal year 2022 transfer amount and, in consultation with the Department of Administrative Services and other State agencies agreed to this methodology to have funds available in the AAPTF at the beginning of the fiscal year.

While the State's audited financial statements are typically not available until the end of December, RSA 176:16, III, is silent with respect to the timing of the transfer, the Commission completed its fiscal year 2022 transfer to the AAPTF in two separate transactions. The first transfer transaction, in the amount of $10 million, occurred on August 2, 2021, and the remaining balance was transferred to the AAPTF on February 9, 2022, after the fiscal year 2021 audited financial statements were available.

Recommendation:

We recommend the Commission comply with RSA 176:16, III in its computation of its transfer to the AAPTF. If the AAPTF is in need of funds at the beginning of the fiscal year then the Commission should consider performing the initial transfer to the AAPTF based on an estimate, and a final accounting transaction be performed once the previous fiscal year's audited gross profits from sale of liquor becomes available.

The Commission should transfer an additional $1.2 million to the AAPTF to comply with RSA 176:16, III.

If the Commission believes its current practice of using audited gross profit from two fiscal years prior is a better alternative to determine its transfer, it should seek statutory revision.

<u>Auditee Response</u>:

We concur, in part.

The Commission agrees that the language in RSA 176:16 is not clear on the timing of the calculation, and we understand that RSA 176:16 states previous fiscal year gross profits, but it also references "as presented in the state of New Hampshire comprehensive annual financial report, statement of revenues, expenses, and changes in net position for proprietary funds," which is not officially available until December.

In consultation with Administrative Services, we do not see the value in changing current practice. We continue to do our best to satisfy the legislative intent and, in this case, we consulted with Department of Administrative Services, Health and Human Services and the Legislative Budget Assistant on how to calculate the transfer to make sure that we are recognizing the legislative intent. For the reasons outlined in the Observation, and the Commission's response, the Commission will seek a revision of RSA 176:16.

Current Status Of Prior Audit Findings

The following is a summary of the status, as of December 20, 2022, of the observations contained in the New Hampshire Liquor Commission's Management Letters for the fiscal years ended June 30, 2021 and 2020. Those reports can be accessed at, and printed from, the Office of Legislative Budget Assistant website: www.gencourt.state.nh.us/lba/auditreports/financialreports.aspx

		Status	
	2021 Audit Comment ***Internal Control Comment***		
Significant Deficiency			
2021-1	**Establish Formal Policies And Procedures Over Adjustments Made To System Accounting Records** *Formal policies and procedures for adjusting system accounting records should be established detailing the processes to be performed, who performs each process, and adequately documents the errors and corrective actions. All adjustments should be reviewed and approved by an appropriate level of management independent of the posting and correction process.*	●	○
	2020 Audit Comments ***Internal Control Comments***		
Material Weakness			
2020-1	**Implement And Staff A Financial Accounting And Reporting Structure Appropriate For The Commission's Size And Complexity** *Establish a senior-level management unclassified position such as a Director of Finance responsible for heading the Commission's financial accounting and reporting activities. Continue efforts to establish written policies and procedures for all significant financial accounting and reporting activities, including high-level financial statement processes in order to support the responsibilities of key employees, and to provide for continuity of operations in the event of employee turnover.*	●	●
Significant Deficiencies			
2020-2	**Seek Additional Resources To Fulfill Information Technology Needs** *Seek additional resources to fulfill information technology needs including the remaining development, deployment, and maintenance of NextGen information technology system to ensure a smooth transition from the legacy system. (See current year Observation No. 1)*	●	○

		Status	
2020-3	**Re-Establish A Formal Risk Assessment Process** *Re-establish a formal and documented risk assessment process for recognizing, evaluating, and responding to risks that could affect the ability to achieve its financial accounting and reporting objectives. The process should include an information technology security risk assessment component to ensure the Commission's information systems are adequately protected.(See current year Observation No. 2).*	●	○
2020-4	**Capitalized Costs Should Be Properly Evaluated For Impairment Under GASB No. 42** *Coordinate with the vendor to help determine what capitalized assets continue to have service utility in accordance with guidelines provided in GASB Statement No. 42. A formal evaluation should be completed to support the assessment of the capitalized assets, including support for the reduction in the carrying value of those assets determined to be impaired.*	●	●
2020-5	**Liquor Stock Payables Reconciliation Control Should Be Improved** *Continue to develop formal policies and procedures for the performance of complete and accurate monthly reconciliations of all applicable MAPPER activity to NHFirst. Periodic and timely reconciliations should be performed by someone knowledgeable of the activity, but independent of the recording and posting processes. The reconciliations should be reviewed and approved by management to ensure timely and accurate performance.*	●	●
2020-6	**Procedures To Ensure Complete Reporting Of Capital Assets Should Be Strengthened** *Strengthen procedures to ensure all charges, including those that are incurred in the Capital Projects Fund and Liquor Fund accounts are appropriately identified and reported as capital assets.*	●	●

Status Key	Status		Count
Resolved	●	●	4
Remediation In Process (Action beyond meeting and discussion)	●	○	3
Unresolved	○	○	0