STATE OF NEW HAMPSHIRE
LIQUOR COMMISSION

MANAGEMENT LETTER
FOR THE FISCAL YEAR ENDED JUNE 30, 2016

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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, 2016 and have issued our report thereon dated January 27, 2017.

This management letter, a byproduct of the audit of the New Hampshire Liquor Commission for the fiscal year ended June 30, 2016, contains our auditor's report on internal control over financial reporting and on compliance and other matters and related audit findings. The appendix, on page 23 of the management letter, provides a summary of the status of observations presented in the fiscal year 2015 management letter of the Liquor Commission.

The New Hampshire Liquor Commission's fiscal year 2016 Comprehensive Annual Financial Report can be accessed online at:

http://www.gencourt.state.nh.us/LBA/AuditReports/FinancialReports/pdf/Liquor_2016_CAFR.pdf

Office of Legislative Budget Assistant

Office Of Legislative Budget Assistant

January 27, 2017

STATE OF NEW HAMPSHIRE
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No audit comments suggest legislative action may be required.

This report can be accessed in its entirety on-line at:http://www.gencourt.state.nh.us/LBA/AuditReports/financialreports.aspx

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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, 2016 and the Statements of Revenues, Expenses and Changes in Net Position and Cash Flows for the year then ended, and the related notes to the financial statements and have issued our report thereon dated January 27, 2017.

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) to determine the 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.

Our consideration of internal control was for the limited purpose described in the preceding paragraph and was not designed to identify all deficiencies in internal control that might be material weaknesses or significant deficiencies and therefore, material weaknesses or significant deficiencies may exist that were not identified. However, as described in the following observations, we identified certain deficiencies in internal control that we consider to be a material weakness and significant deficiencies.

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. We consider the deficiency described in Observation No. 1 to be a material weakness.

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. We consider the deficiencies described in Observations No. 2 through No. 14 to be significant deficiencies.

Compliance And Other Matters

As part of obtaining reasonable assurance about whether the Commission's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, rules, regulations, contracts, and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. 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 no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards.*

Liquor Commission's Responses To Findings

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 Liquor 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

January 27, 2017

Internal Control Comments
Material Weakness

Observation No. 1: Strengthen Core Financial Accounting And Reporting Resources

Observation:

Management letters from fiscal year 2013 through 2015 reported material weaknesses in the Commission's core financial accounting and reporting resources. The Commission's inability to meet financial statement reporting deadlines and goals in preparing its 2016 financial statements indicates a continuing problem in its fundamental financial accounting and reporting structure and process.

1. The lack of sufficient financial reporting expertise in the Commission's financial reporting structure and process, combined with limited assistance received from the Department of Administrative Services, contributed to the Commission not meeting its statutory financial reporting deadlines. The significance of the delays in the preparation of the financial statements and the nature of the difficulties the Commission experienced in producing the fiscal year 2016 financial statements, if unaddressed, raise concerns about the Commission's ability to meet its fiscal year 2017 financial reporting responsibilities.

2. As noted in the prior management letter, at its base, financial reporting should be a routine process. That is, the process and experience of one year should be understood and incorporated into the financial reporting of the following year. Accounting policies and practices, including how to arrive at ending balances, where amounts are found in the accounting records, what amounts are based on estimates and how those estimates are made, and what amounts have a direct effect on the subsequent period and how those affected accounts are reflected, should all be identified, discussed, and supported in the accounting records. This ensures that the financial activity, and the results of that activity, are consistently reported and flow from the financial statements of one period to the next. The appropriate levels of understanding, documentation, and due care needed in the performance of the financial accounting and reporting processes appears to be missing at the Commission. While the Commission has made improvements in documenting job responsibilities with policies and procedures for certain key employees in the business office, and employees have been cross-trained in certain sections, as identified in other observations in this letter, errors and other difficulties in processing and recording transactions and compiling financial statements in accordance with generally accepted accounting principles continued to plague the Commission in fiscal year 2016.

Recommendations:

1. The Commission should enhance its financial accounting staff with additional staff that have financial accounting and reporting expertise appropriate for the scope and complexity of the Commission's operations. As the Commission has struggled in recent years to prepare timely accounting and financial reporting, it should be clear that additional expertise is required.

While additional financial-analyst level staff may also be needed, the Commission needs staff that has higher-level experience in managing complex financial accounting and reporting activities.

2. The Commission should establish comprehensive and documented policies and procedures for all critical financial accounting and reporting activities in order to support the responsibilities and activities of key employees. All financial transactions should be sufficiently supported and documented to allow for an understanding of the transactions, both for the current accounting and reporting period and for effects on future accounting periods. As recommended in Observation No. 2, the Commission should ensure that available system documentation contains the standard accounting schema for all financial transaction types.

   The Commission should continue with its efforts to establish written policies and procedures to support all significant financial accounting and reporting activities, including high-level financial statement preparation processes. Included in the documented policies and procedures should be a documented knowledge-based and experienced review and approval control for all significant transactions.

   Employees performing nonroutine transactions, including year-end transactions, should be encouraged to regularly reference the policies and procedures documentation to ensure they are performing their responsibilities as intended, and that the policies and procedures remain relevant to their activities. Regular training, including cross-training, should occur so the Commission can operate in a controlled and efficient environment, even when there is turnover in key employee positions.

3. The Commission should consider whether compiling and reporting a more complete set of periodic interim financial statements would be beneficial, both to provide better current operating information to management and also to more regularly and timely address what have proven to be financial statement challenges, such as accruals.

Auditee Response:

Concur in part.

The Commission agrees that an additional high level person is needed that understands complex financial accounting and reporting given the hundreds of millions of dollars that flow through this department. Other positions at a lower level will be staffed to help with the constant workflow that may affect timeliness of transactions and reporting.

It is important to note that over the last three years the Liquor Commission's finance department experienced turnover in a number of key critical finance positions. The top two financial positions, CFO and comptroller, are two of the positions. The individuals in these positions have only been in their positions for a short-time, one for less than two years and the other a little over two years whereas their predecessors had been in their positions for over ten years each.

The Commission concurs that it is important to continue to document processes, policies and procedures. Over the last year the finance department has made this a priority and during this audit the roles and responsibilities for all key employees were provided along with approximately 75% of the documented procedures for both routine and critical tasks. The Commission believes that great progress has been made considering that two years ago there was very little formalized documentation on both routine and non-routine tasks.

The management letter states that financial reporting should be routine, however, it is impossible to have a routine until you have the processes and workflow documented and completed for more than one year. The finance department applied the procedures and experiences from fiscal year 2015 which was the start of documenting all procedures and incorporated and continued to document them into the financial reporting of fiscal year 2016. The department continues to update and revise as needed the accounting policies and practices.

Department Of Administrative Services Response:

Concur in part.

The Department of Administrative Services (DAS) acknowledges there is a continuing problem in the fundamental financial accounting and reporting structure and process within the Liquor Commission. However, the use of the word limited in describing the assistance provided by the DAS to the Commission has the potential to be interpreted subjectively by the reader of this report so we feel compelled to clarify.

Per RSA 21-1:8, II(b), DAS is charged with "Assisting the department of transportation turnpike system, liquor commission, and lottery commission in the completion of separate, stand-alone financial statements for the preceding fiscal year". This requirement exists absent any direct authority over the management of each agency's financial reporting staff or practices, or availability of sufficient DAS resources to augment financial accounting staff within these agencies. Despite this, in fiscal year 2016 a disproportionate amount of DAS's time and resources were consumed by the Commission as part of DAS efforts to comply with the requirements of 21-1:8 II(b).

Additionally, much of the Commission's financial reporting data is uploaded into the State's accounting system from information technology systems contained within and operated by the Commission. Accordingly, DAS' ability to assist the Commission with their separate, standalone financial statements is inherently "limited" by the Commission's ability to produce the necessary data to meet financial statement reporting deadlines and goals. DAS believes the recommendations made in this finding to the Commission would significantly improve the quality and timeliness of the Commission's financial reporting.

Significant Deficiencies

Observation No. 2: Receive And Act Upon The Best Available Advice In The Planning, Development, And Implementation Of New Information System

Observation:

During fiscal year 2016, the Commission was in the initial stages of replacing a legacy information system that provided the base information technology support for the Commission's inventory, purchasing, sales, and other financial and operational activities. The new information system will support essentially all aspects of the Commission's activities, including financial accounting and reporting.

During fiscal year 2016, the institutional knowledge of the operation of the legacy system rested primarily with two part-time, retired Commission employees. These employees provided the expert-level support for the Commission's operation of the system, including understanding the logic, programming, and transaction processing of the system and researching and resolving problems and other disruptions with the system's operation. The experience and knowledge of these two key employees have proved critical to the Commission's continuing ability to retrieve, review, and interpret transactions captured and recorded in the legacy system.

The successful design and implementation of the Commission's new information system will depend upon a full and nuanced understanding of current Commission operations, including financial accounting and reporting operations, as well as a reasonable consideration of anticipated future system needs. With the replacement of any information system, there is the risk that the new system will be designed to recreate current methods and processes. Given the Commission's current limited financial accounting and reporting expertise, as discussed in Observation No. 1, there is increased risk that the full potential, and optimal design and implementation of the new information system will not be fully explored and realized.

Recommendation:

The Commission should ensure that it is receiving and acting upon the best available advice in the planning, development, and implementation of its new information system. Commission management should satisfy itself that individuals with knowledge and experience in industry are involved at all levels, and appropriate planning and consideration is given to alternatives in the implementation that are the most responsive to the State's and Commission's structure and needs for an information system. The Commission should also ensure, through consultation with the Department of Administrative Services, that the State's financial reporting needs will be appropriately addressed in the design and operation of the new information system, including ensuring that available system documentation contains the standard accounting schema for all significant financial transaction types.

Auditee Response:

Concur in part.

The Commission concurs that it is crucial that the Commission receive and act upon the best available advice in the planning, development, and implementation of its new information system; however, the Commission disagrees that a deficiency exists in this area.

The Commission concurs that the operational knowledge of the legacy system rests primarily with two part-time, retired Commission employees; although there are other DoIT employees on site who also have extensive knowledge of the legacy systems. These two valued Commission employees were hired back from retirement due to the Commission's desire to ensure its due diligence and for the purpose of assisting the Commission with this project specifically. One of the many reasons that the legacy system is being replaced is that it is more than 30 years old and has become obsolete in today's fast-paced on-demand times. The Commission sees it as a significant strength that it was able to hire back these two employees to add their expertise to this project through to implementation. These employees continue to provide the expert-level support for the Commission's operation of the legacy system and will be important in assisting the NHLC contractors with the effective and safe migration of data from the legacy system to the new system.

In addition to these two part-time employees, the Commission is in the process of hiring a dedicated a full-time NHLC employee to manage this project in conjunction with Berry Dunn McNeil LLP, an independent quality assurances firm that has been involved since the inception of this project, and with whom the Commission has a contract to offer professional and experienced project oversight and management during the entire implementation.

The Contract Evaluation Committee, after a comprehensive evaluation and analysis, recommended a 10 year contract with AlfaPeople, Incorporated, a Microsoft Gold Partner, to implement Microsoft Dynamics as the Commission's new ERP and POS system.

The Commission has ensured that the appropriate stakeholders from the various business process areas of the New Hampshire Liquor Commission, the Department of Information Technology, the Lottery Commission, and the Department of Administrative Services have all been involved from the outset of the RFP and have participated in the implementation to ensure that the proper integrations exist with systems from all involved agencies. The NHLC, DAS, DOJ and DoIT management teams were provided the Statement of Work and contract documents and reviewed and approved such prior to the contract being submitted to Governor and Council and approved on June 29, 2016.

The Commission believes that the above-referenced facts demonstrate its commitment to receive and act upon the best available advice in the planning, development, and implementation of its new information system.

Observation No. 3: Enact Chip-Card Point Of Sales Devices As Soon As Practical To Minimize Losses

Observation:

The Commission's point of sale system was noncompliant with the payment card industry chip-card standards during the last nine months of fiscal year 2016. As a result, the Commission could not challenge the reversal and loss of approximately $171,000 of sales revenue from card holders who claimed charges to their accounts were fraudulent.

Between August 2011 and June of 2012, the major credit card companies announced a liability shift for point of sale terminals effective October 1, 2015. Beginning in October of 2015 the liability shifted to merchants for transactions completed with counterfeit, fraud, and stolen cards, unless the merchant had upgraded their card acceptance and processing systems to chip-enabled devices and applications to process payment transactions.

As a result, effective October 1, 2015, when a chip-card holder contacted the credit card company to dispute a charge on their credit card account for a purchase at a Commission store, the card company routinely deducted the disputed charge from the Commission's sales balance. During the nine months of fiscal year 2016 that the Commission was not compliant with the chip technology, the Commission lost approximately $171,000 from disputed and reversed liquor sale transactions. The Commission reports that it typically does not have sufficient evidence to independently pursue collections on reversed sales resulting from claims of fraudulent charges.

As of January 27, 2017, the Commission stores continued to use card-swipe technology and reported chargebacks during the first six and a half months of fiscal year 2017 totaled approximately $270,000.

Recommendation:

The Commission should enact chip-card point of sales devices as soon as practical to lessen unnecessary losses from the use of non chip-enabled sales terminals.

Auditee Response:

Concur.

The Commission is in the process of becoming EMV compliant. EMV (Europay, MasterCard and Visa) is a global standard for credit cards that uses computer chips to authenticate and secure chip-card transactions. In fiscal year 2017, the Commission entered into an amended contract with ACR in order for them to write the code necessary for the POS [point of sale system] to communicate with new VeriFone pin pads that are enabled to accept the new chip technology on credit and debit cards. The Department of Information Technology (DoIT) is handling the upgrade. Once Verifone has received the software upgrade from ACR and once Verifone has uploaded the software onto the pin pads and ships the units to the Commission, DoIT will work quickly to install these units in the stores. Because many retailers are moving toward EMV compliance, ACR and Verifone have had difficulty keeping up with the high demand for their services and equipment. Nonetheless, the project is targeted for completion by June 30, 2017.

Observation No. 4: Establish Controls To Regularly Monitor And Reconcile The Cash Balances In The Liquor Fund

Observation:

The Commission does not have a control in place to regularly monitor and reconcile the cash balances in the Liquor Fund as recorded in the general ledger.

1. The Commission ended fiscal year 2016 with a $11.6 million negative cash balance reported in the State's general ledger. The negative balance was largely due to the Commission having increased its accounts receivable by approximately $5.3 million and its inventory by $4.0 million and decreased its accounts payable by $3.0 million from the prior fiscal year-end. The reported $0 balance of cash reported on the Commission's June 30, 2016 financial statements reflected a financial statement reclassification of approximately $4.1 million of accounts receivable to cash and a $7.5 million temporary loan from other State funds. While the Commission may make a business case for its increasing inventory and reducing accounts payable, the Commission did not appear to consider the resulting effects on its cash balance. The Commission became fully aware of its negative cash position during the preparation of the year-end financial statements. Prior to that time, the Commission did not confer with the Department of Administrative Services or State Treasury about the Commission's authority to, and the appropriateness of, operating with a significant negative cash balance.

2. The primary available resource for the Commission to monitor its cash position is the NHFirst trial balance report. The trial balance reports general ledger account balances by State fund, including a cash balance for the Liquor Fund. The cash balance reported in the trial balance is an aggregation and netting of several separate cash accounts including "interfund" cash accounts. An unnecessarily confusing aspect of the trial balance reporting of cash accounts is that the trial balance reports the sum of all cash activity in the accounts since the inception of NHFirst. In order to determine the actual reported cash balance, multiple accounts need to be added together (netted). For example the Commission's Cash With Treasurer account had a $4.4 billion ending balance for fiscal year 2016. This was largely offset with an Interfund Cash – General Fund account with an ending balance of negative $4.4 billion. The need to net overstated balances in 11 Liquor Fund cash accounts on the trial balance to arrive at the actual cash balance in the Fund, complicates the regular review and monitoring of the reported fund cash balance and detracts from agencies ability to use the trial balance to efficiently review and monitor financial operations.

3. While the State Treasury has the primary responsibility for reconciliation of the State's bank accounts, the Commission does not regularly request, and is not regularly provided with, bank balance information related to the Liquor Fund. The State Treasury generally "pools" cash from multiple agencies and funds into common bank accounts. The periodic reconciliations prepared by the State Treasury reconcile a pooled Treasury "book balance" to

cash in the bank but they do not reconcile the "book balance" of the individual State funds. As a result, the reconciliations prepared by the Treasury do not provide periodic review and support for "book balance" of the Liquor Fund pooled in the bank account.

Recommendation:

The Commission should establish controls to regularly monitor and reconcile the cash balances in the Liquor Fund as recorded in the general ledger.

1. The Commission should review its business decision-making process to ensure that business decisions that affect financial operations included consideration of available funding. The Commission should actively monitor its available cash and make business decisions that will be supported by available and anticipated cash and cash flows.

2. The Commission should regularly monitor its cash balance in the general ledger as reported in the trial balance. The Commission should request the Department of Administrative Services (DAS) review the need and rational for the trial balance to report cash account balances accumulating from the start of the State's use of the NHFirst accounting system.

3. The Commission should work with the State Treasury to obtain timely information of the reconciliation of the Commission's cash balance in State bank accounts.

Auditee Response:

Concur.

The Commission has been reviewing cash accounts and making business decisions that take into account the effect on cash flow. The Commission has reached out to Treasury regarding reconciliation information and discussions have started with DAS on the rationale for carrying balances in these accounts.

Department of Administrative Services Response:

Concur in part.

The Department of Administrative Services (DAS) acknowledges that trial balance activity in the "interfund" cash accounts is complicated. However, the NHFirst system was implemented based on the State operating in a pooled cash environment. As noted, State Treasury is tasked with reconciling the statewide pooled cash "book balance" to the cash in the bank, and DAS is tasked with reconciling the pooled cash "book balance" to the NHFirst general ledger. Because of the nature of interfund cash, this general ledger reconciliation can only be performed at a statewide level, as cash book balances are not available for individual funds. Therefore, from the perspective of DAS, we believe that the Commission should work with State Treasury to determine if the Commission's cash accounts could be separated from pooled cash, similar to how other state enterprise funds operate, and DAS could assist the Commission in transitioning the account balances in the general ledger. If this were to occur, the Commission would be responsible for all cash account reconciling procedures within the Liquor Fund.

Observation No. 5: Review Annual Physical Inventory Process

Observation:

Lack of communication of clear physical inventory count procedures contributed to the Commission deciding to perform a second, complete physical inventory count during fiscal year 2016.

The Commission performs three complete physical inventories and counts of all saleable product in its stores annually in October, January, and April. The inventory generally is performed after store hours, over a several day period. The Commission also performs physical inventories and counts of all saleable product in its Concord warehouse in January and April. The Commission uses the results of the inventories to adjust its perpetual inventory records for errors in shipping and shrinkage that occur in the normal course of business. Auditors have historically observed the inventories performed in April by Commission personnel at a sample of the Commission's 79 stores.

During the inventory performed in April of 2016, auditors noted that three of the 10 auditor observed stores received deliveries of product on the days of the count, but did not include that delivery in their count of product on hand. The Commission also determined that during the inventory count period, product may have been shipped from the Concord Warehouse to be "cross-docked" with the Commission's commercial warehouse vendor, and that this product may have also been improperly excluded in the count. As a result of the uncertainty related to the accuracy of its inventory procedures, the Commission decided to re-perform the physical inventory count in May 2016.

According to the Commission, the problems with the April inventory occurred as a result of the warehouses failure to stop shipping during the physical inventory count. While the inventory instructions and calendar were widely distributed to Commission managers prior to the first inventory, no one recognized that the instructions pertaining to the warehouse were unclear. The Commission's failure to effectively communicate clear procedures resulted in both warehouses continuing to ship product during the physical inventory counts.

Recommendation:

The Commission should review its controls over the annual physical inventory process to ensure inventories are well planned, and instructions are clear, concise, comprehensive, and appropriately communicated to employees responsible for performing the inventory.

Part of the control procedure must include adequate supervision to ensure that the counts are being performed in accordance with the instructions, in a manner to achieve accurate and consistent results, and that anomalies in the process are brought to management's attention timely in order to allow for resolution in an efficient and effective manner.

Auditee Response:

Concur.

The Commission has reviewed and revised its year end physical inventory count process. Roundtable discussions were held for Finance, Marketing, Store Operations, and Concord Warehouse to revise the process. The Commission has also worked with the DHL warehouse to fine-tune their year-end physical inventory count process to guarantee there is no "cross-docked" during inventory and both warehouses have agreed to not ship to any store on the day they are counting to insure all product will be received in and put away before each store takes inventory. Store Operations is working with Regional and Store Managers to ensure that each store follows the year end physical inventory count process.

Observation No. 6: Improve Control Over The Recording And Reporting Of Capital Assets

Observation:

During fiscal year 2016, the Commission did not have an established process, with supporting policies and procedures and controls, to accurately and efficiently account for and report capital assets.

The Department of Administrative Services' *Fixed Asset Accounting Manual (Manual)* provides standard policy and procedure guidance for State agencies. However, by itself, the *Manual* does not provide the level of detailed policies and procedures necessary for the Commission to design and operate a process that accurately accounts for and reports capital asset activity.

Insufficient policies and procedure guidance at the Commission has contributed to inconsistent and untimely recognition and recording of capital asset transactions. Weak review and approval controls have also challenged the Commission's ability to consistently and accurately record and report the Commission's capital asset transactions.

Examples of weakness in the Commission's capital asset processes and controls, and errors in related records, include:

- Some adjusting entries recorded by the Commission intended to correct prior errors were not sufficiently documented.
- Duplicate postings of capitalized amounts were recorded.
- Adjustments made to the capital assets reporting (Exhibit E) could not be traced to the Master List spreadsheet to support the need for the adjustment.
- Lack of segregation of duties/review and approval control over adjustments made to the Commission's capital asset records.
- Depreciation was not consistently calculated accurately.
- Over time, the Commission has used different information systems to account for and record capital asset activity. In prior years, a database that provided capital asset information by individual asset was used. However, due to difficulties in producing reports from the

database, compounded by lack of system documentation and changes in key staff, the Commission in more recent years has used more summary-level spreadsheets to record capital asset activity.

- There was inconsistent identification and categorization of transactions and assets to be capitalized. In some instances, assets were individually identified; and in one instance, assets that individually did not meet capitalization thresholds were grouped in order to meet the thresholds for reporting as capital assets.
- Apparent errors on the equipment listing, including equipment no longer in the possession of the Commission (breathalyzers) being included on the listing and equipment owned by the Commission being excluded from the listing (approximately 38 handguns are separately accounted for, but not reported on the Commission's equipment listing).

Recommendation:

The Commission must improve its control over the recording and reporting of capital assets.

The Commission should establish:

- Policies and procedures that supplement the *Manual* and reflect the particular accounting and reporting requirements of the Commission's activities, including multiple, and changing, owned and leased capital assets.
- A recording and reporting system that is sufficient to appropriately and consistently account for and report its capital assets, including equipment, land and land improvements, buildings and building improvements, construction in progress, and depreciation on relevant assets. The system should be robust and sufficiently well designed to serve its purpose going forward.
- Appropriate segregation of duties and effective review and approval controls. All entries and all adjustments should be fully supported and documented, allowing for a reasonable and effective review and approval control.
- Policies and procedures for an annual physical equipment inventory observation and count. The results of the physical inventory observation and count should be reflected in adjustments to the equipment records when appropriate.

Auditee Response:

Concur.

The Commission is reviewing and revising its capital asset policies and procedures to ensure it covers all of the Commission's activities. The Commission is also working on implementing a database system to track capital asset with our new software system. This software is still in the development stage and will be put into use once the system is up and running.

Observation No. 7: Resolve Issues Causing Difficulties In Processing Accounts Receivable

Observation:

Errors in the Commission's initial recording of fiscal year 2016 year-end accounts receivable transactions indicate a lack of clarity of process, and due care in practice, in the Commission's recording of the transactions.

- The Commission initially recorded the June 30, 2016 beer tax receivable in an incorrect account. The error was subsequently corrected.
- The Commission's initial reclassification of accounts receivable - credit card cash-in-transit to cash was understated by $864,027. Upon auditor inquiry, the Commission corrected the transfer amount.
- The Commission did not initially record accounts receivable - credit and debit card in the correct receivable account. As the balance was subsequently reclassified as cash on the financial statement, the initial posting error had no financial reporting effect.

As noted in Observation No. 1, at its base, financial reporting should be a routine process. That is, the process and experience of one year should be understood and incorporated into the financial reporting of the following year. Accounting policies and practices, including how to arrive at ending balances, where amounts are found in the accounting records, what amounts are based on estimates and how those estimates are made, and what amounts have a direct effect on the subsequent period and how those affected accounts are reflected, should all be identified, discussed, and supported in the accounting records and in policies and procedures that can provide a roadmap for a consistent processes from one year to the next.

Recommendation:

The Commission should review the difficulties it experienced in processing fiscal year 2016 year-end accounts receivable to determine the cause and reasonable solution to those difficulties. The Commission should ensure that there is a review and approval control in place and performed by personnel with sufficient knowledge, experience, and information to be able to recognize and prompt corrections to errors when they are presented.

Along with policies and procedures, the Commission should establish tools that outline standard processing steps to remind and guide employees in performing their activities, especially activities that may occur routinely but not frequently.

Auditee Response:

Concur.

The Commission had some difficulties in processing accounts receivable at the end of fiscal year 2016. The Commission is working on reviewing and revising its account receivable year end processes. Also, the Commission has hired additional staff to help prepare the year end entries to allow Senior Management to analyze, review and approval.

Observation No. 8: Expand Policies And Procedures And Consistently Perform Intended Refund Controls

Observation:

The Commission has not implemented controls to effectively mitigate a weakness that was exploited in a fiscal year 2014 credit card refund fraud.

While the Commission expanded refund controls in fiscal year 2015 to include additional pre-disbursement review and approval controls for credit card refunds originating from store operations and a post-disbursement control for all refunds, the design of the pre-disbursement controls did not address refunds initiated at the Concord business office. The post-disbursement controls were not evidenced as being in place in any of the ten fiscal year 2016 refund transactions judgmentally selected for testing.

According to the Commission, an undocumented version of the control was performed during fiscal year 2016, however auditors were not provided evidence to support the claim that the alternative control was authorized by management and in place during fiscal year 2016.

In June 2016, the Commission issued additional policies and procedures addressing controls over refunds originating in stores, but the issued policies and procedures do not appear to address refunds on licensee orders originating at the Concord business office.

Recommendation:

The Commission should expand the design of its controls and establish reasonable control activities over all refunds, including refunds originating at the Concord business office.

The Commission should establish control monitoring activities to monitor compliance with intended controls, and to ensure that controls are operating as designed and remain responsive to the understood risks.

Auditee Response:

Concur.

The audit finding was correct in stating that at the time of the transaction the Commission did not have an effective work flow in place. It was communicated to the auditors that the process had been identified and corrected before the audit took place.

Observation No. 9: Review And Expand Accounts Payable Policies And Procedures

Observation:

Errors identified in the Commission's accrual of current liabilities at June 30, 2016 indicate weaknesses in the accrual process, including lack of reasonable and clear policies and procedures, due care, and effective review and approval controls.

- The Commission's process for estimating the June 30, 2016 liability for future redemption of issued promo cards[1] used assumptions about redemption patterns established at the start of the Commission's promo-card program. The Commission has not reviewed the process and the assumptions to determine the redemption patterns and estimates used continue to reasonably reflect actual redemption activity experience.
- A review of the June 30, 2016 Payment Trial Balance Report (a report run from the Commission's information system used to report liquor stock accounts payable balances) identified several significant accounts payable balances that were unusual, as they were greater than one year old. Upon further review, it was determined that the Payment Trial Balance Report did not reflect previous adjustments that had been made to these balances, resulting in a $440,000 overstatement of the June 30, 2016 accounts payable balance reported on the Commission's financial statements.
- A review of amounts reported as due to other state agencies identified an overstatement in the amount due to one agency resulting from the Commission having continued to carry forward an incorrect balance.

Recommendation:

The Commission should review and expand its accounts payable policies and procedures to ensure direction provided to staff promotes the accurate accrual of liabilities in accordance with State and Commission policy, and the proper basis of accounting. Specifically, policies and procedures should be expanded to include:

- Reporting liabilities related to issued and outstanding promo cards. The Commission should regularly analyze trends in the issuance and redemption of promo cards. The Commission should establish policies and procedures that reasonably estimate the value of promo cards that will ultimately be redeemed by customers to purchase product. The Commission should periodically review, and revise as appropriate, the assumptions and factors used in the estimates to ensure they continue to reflect actual and expected redemption experience. The policies and procedures should be documented and consistently performed.
- Increased maintenance of information systems to ensure that adjustments to account activity are reflected in related systems and reports.
- Reviewing data supporting reported balances for reasonableness. Anomalies, such as data from unexpected reporting periods, should be subject to identification, review, and resolution.

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[1] Gift-type cards for dollars off a future purchase given to customers who purchase over a specified value of product during a promotional period. Promo cards have no time expiration.

Auditee Response:

Concur.

The Commission is still reviewing and revising its payment trial balance policy. A committee has already been formed with employees from Accounts Payable, Accounts Receivable and Internal Audit to review the payment trial balance often. Prior to the close of fiscal year 2016, the Accounts Payable Supervisor had investigated many anomalies that were not already addressed. The Commission is also looking into separating promo cards from the accounts payable accounts. This will allow the Commission to easily identify any issues in the accounts that need to be addressed.

It is important to note that this section underwent significant disruption over the past couple of years due to the loss and/or promotion of staff in this section.

Observation No. 10: Support And Perform Key Reconciliation Controls

Observation:

The Commission did not perform certain key reconciliations during fiscal year 2016, which allowed differences in account balances to go unrecognized prior to the audit. Had the reconciliations been prepared, the following errors may have been noted prior to the audit.

1. The Commission maintains an inventory of gift bags, glasses, and other non-liquor accessory items that are sold in the Commission's stores. The Commission did not reconcile accessory inventory transactions in its inventory management system, LIDS, to similar information in the NHFirst State accounting system during fiscal year 2016.

   An unintended consequence of a fiscal year 2016 change in process intended to correct a problem identified by the fiscal year 2015 audit, resulted in the shipments of accessory inventory from the warehouse being inaccurately recorded as accessory "purchases" in the Commissions inventory system, effectively double counting the purchase of accessory inventory. The overstatement of purchases of accessory inventory was not identified until a reconciliation was performed after the close of fiscal year 2016. The Commission made an adjustment to the financial statements to correct the overstatement of inventory purchases.

2. The Commission did not reconcile depletion allowances in "MAPPER", the Commission's internal information system, to similar information in NHFirst during fiscal year 2016. Depletion allowances are broker discounts based on actual sales, and are reported as reductions to cost of goods sold on the Commission's financial statements. There was an unexplained $1.57 million difference between depletion allowances recorded in MAPPER versus NHFirst during fiscal year 2016.

Recommendation:

The Commission should review its current control structure. Controls such as reconciliations of key accounts in comparable information systems should be supported by written policies and procedures. Policies and procedures should include an appropriate monitoring process to ensure controls are in place and functioning as designed. Alerts should be built into the controls to prompt management when controls are not performed.

Responsible and knowledgeable staff should periodically review key accounts such as inventory purchases for reasonableness and consistency. Corrections to accounting information flowing from reconciliations should only be made after a complete understanding of errors are obtained and correcting entries are reviewed and approved by knowledgeable supervisors.

Auditee Response:

Concur.

The Commission is reviewing and revising its policy and procedures on key accounts. The Commission is also reviewing the flow of the accounts from MAPPER to NHFirst to make sure everything is recorded correctly. The Commission has been reviewing all accessories that the Commission buys and sells.

Observation No. 11: Establish Policies And Procedures For The Routine Review Of The Accuracy Of Vendor Invoicing And Commission Payments

Observation:

There are limited controls to ensure that vendor invoicing and Commission payments are in compliance with contract provisions. Commission staff appear to process payments based on an assumption of accurate vendor invoicing. Instances were noted during the audit where the Commission staff processed vendor payments that were not in compliance with contract provisions.

- The Commission's calculations of lease payments for one Commission store were incorrect, resulting in the Commission underpaying the lessor more than $8,000 over a several year period.
- An incorrect vendor invoice resulted in the Commission overpaying the vendor $150 for a contracted service during the month tested. The service was a monthly service during fiscal year 2016.
- A transportation vendor incorrectly determined a fuel charge adjustment. For the two monthly invoices tested, the Commission was overcharged $755 and $865. It appears the Commission accepted the accuracy of the vendor-determined amount without consideration of the contract terms.

As of January 27, 2017, it was unclear whether the Commission would act to correct the identified erroneous payments.

Recommendation:

The Commission should establish policies and procedures for the routine review of the accuracy of vendor invoicing and Commission payments to ensure that they comply with contracts and other agreements. The Commission should ensure that staff responsible for making and approving vendor payments have the information and training requisite to determine the accuracy of vendor invoicing prior to issuing payment.

The Commission should work with the affected vendors to correct for the identified erroneous payments.

Auditee Response:

Concur.

The Commission is reviewing and revising its policy and procedures on paying vendor invoices. The Commission is also in the process of hiring a new in-house Internal Auditor to audit these process and procedures.

It is important to note the Commission processes $5.4 Million in lease payments annually. One store's lease payments were underpaid $930 a year for several years which is an error rate of 0.017%.

Observation No. 12: Develop And Provide An Electronic Beer Tax Filing System

Observation:

Payers of the State's beer tax file monthly paper-based tax returns, often with up to seven supporting schedules. The use of paper-based returns and supporting schedules appears inefficient for the taxpayer to prepare and file and inefficient for Commission staff to process, review, and audit. The paper-based returns do not allow the Commission to efficiently use computer assisted techniques to check for completeness, consistency, and accuracy of the returns and to efficiently use submitted data for monitoring of tax compliance.

The Commission reported that it collected $12.9 million of beer tax during fiscal year 2016. Most of the beer tax collected was paid by eight wholesale distributors who filed monthly returns with seven supporting schedules. Liquor Enforcement Division employees, including liquor examiners and other available staff, trace and agree amounts reported on the beer tax returns to the supporting schedules accompanying the returns. Employees involved in the review process reported that information on the beer tax returns generally is agreed to information on three of the seven submitted schedules and cross checked against sales and returns reports received from the beverage manufacturers and vendors and, generally, the remaining schedules are not included in review. The employees also reported that none of the information on the returns or schedules is regularly checked for clerical accuracy.

Audit tests identified minor errors on three of the four tax returns judgmentally selected for testing. The errors included insignificant math errors and an incorrectly recorded rate that was not included in a calculation.

In addition, one of the four related daily deposit approval documents prepared by the Commission did not include the signature of the depositor, contrary to Commission policy and procedure.

A similar comment was also reported in the fiscal year 2015 management letter.

Recommendation:

As recommended in our fiscal year 2015 comment, the Commission should develop and implement an electronic beer tax filing system. An electronic process for filing beer tax returns would allow for greater efficiency to taxpayers in filing returns and greater efficiency in the Commission's processing, reviewing, and auditing of the filed returns.

Auditee Response:

Concur.

An electronic system would be the preferred method over a paper-based system; however, a system change would require a capital appropriation for software and hardware upgrades. Upgrades are required throughout the spectrum of services provided, including license applications and approvals and the collection of other fees. Beer tax is one functional area of a larger mission. The Commission has chosen to expend limited funds on upgrades to its licensing software which is a higher priority to its thousands of licensees but acknowledges that an additional capital appropriation to upgrade this area of tax collection is needed in the future.

In the interim, the Commission will review the process and update to electronic processing where applicable with current technology.

Observation No. 13: Physical Access to IT Computer Room Should Be Periodically Reviewed

Observation:

The number of individuals with access to the Commission's secured computer room appears large for the Commission's operations. It is unclear that the Commission has considered the business need for access granted to all of the individuals that currently have access.

Based on an October 14, 2016 inquiry, the Commission reported thirty-two Commission and Department of Information Technology (DoIT) employees and security vendor personnel had system-based authority to access the Commission's secure computer room. In reviewing the list of authorized individuals with the Commission, four individuals were identified as not having a business need for that level of access authority, including:

- Two DoIT employees and one external security vendor, who were identified as not requiring unaccompanied access to the computer room, and
- One retired Commission employee who returned to work on a part time basis.

Failure to limit and regularly monitor the continued business need of individuals with access to the computer room increases the risk that physical access to the information systems will not be controlled, increasing the risk to the security of the systems and information.

Recommendation:

The Commission should implement policies and procedures to ensure access to the computer room is restricted to individuals whose current job responsibilities require that access. The authority granted to individuals to access the computer room should be regularly reviewed to ensure it remains current and reflects any changes in the individuals' employment and job responsibilities.

Auditee Response:

Concur.

The Commission will review those parties with access to the computer room and develop a policy to minimize access to that area.

Observation No. 14: Continue Effort To Efficiently Document Store Lease Information

Observation:

The Commission did not maintain a complete and readily accessible file of documentation supporting its 70 store rental agreements during fiscal year 2016. The lack of complete and readily accessible lease information contributed to the Commission's difficulty in accumulating current, complete, and accurate data for year-end financial statement disclosure purposes.

During fiscal year 2016, the Commission paid approximately $5.4 million in rent for store space. The Commission's rents were a combination of tenant-at-will rentals and short and long-term leases. Some of the Commission's leases run through 2037. Financial accounting standards require the reporting of certain lease information, including future minimum lease payment information.

Audit testing of a judgmental sample of 12 of the Commission's store leases identified a $1.1 million understatement in the amount reported as future minimum lease payment in the Commission's lease note disclosures.

While the Commission reported it was in the process of improving its lease records during fiscal year 2016, the records used by the business office to make the year-end lease disclosure calculations did not appear current, accurate, and complete.

Recommendation:

The Commission should continue with its efforts to complete and maintain a readily accessible file of documentation supporting its store rental agreements. The Commission's business office should refer to the file when making the lease disclosure calculations to ensure the information in the disclosures is current, accurate, and complete.

Auditee Response:

Concur.

The Commission has completed this project. All existing leases and agreements related to leasehold and rental properties are kept both in hard copy, original document form in a secure file cabinet as well as in electronic format readily accessible to key personnel. The business office and Real Estate Administrator have additionally created a rental obligation matrix in Excel which is also readily accessible to the Commission electronically. This matrix captures future minimum lease payment obligations for the balance of term of all executed leases.

APPENDIX

Current Status Of Prior Audit Findings

The following is a summary of the status, as of January 27, 2017 of the observations contained in the financial audit of the New Hampshire Liquor Commission for the fiscal year ended June 30, 2015. That report can be accessed at, and printed from, the Office of Legislative Budget Assistant website:
www.gencourt.state.nh.us/LBA/AuditReports/FinancialReports/pdf/Liquor_2015_Management_Letter.pdf

	Status		
Internal Control Comments			
Material Weakness			
1. Strengthen Core Financial Accounting And Reporting *(See Current Observation No. 1)*	●	○	○
Significant Deficiencies			
2. Establish Written Policies And Procedures To Support All Significant Financial Accounting And Reporting Activities *(See Current Observation No. 1)*	●	○	○
3. Document The Responsibilities Of Key Employees	●	●	●
4. Establish Risk Assessment Process And Related Planning	●	●	○
5. Review The Need For Significant Overtime	●	○	○
6. Record Expenses In The Liquor Commission Fund	●	●	●
7. Strengthen Financial Accounting For, And Reporting Of, Capital Assets *(See Current Observation No. 6)*	●	○	○
8. Review The Operating Effectiveness Of Capital Asset Expenditure Controls	●	●	●
9. Ensure Store Employees Comply With Cash Handling Policies	●	○	○
10. Adhere To Statewide Policies And Procedures For Recording And Reporting Accounts Receivable *(See Current Observation No. 7)*	○	○	○
11. Strengthen Controls Over Refunds *(See Current Observation No. 8)*	●	○	○
12. Perform Regular Control Activities Over MAPPER System *(See Current Observation No. 10)*	●	○	○
13. Review Beer Tax Reporting Processes *(See Current Observation No. 12)*	○	○	○
14. Review The Biometric Timeclock System And Ensure Proper Controls Are Implemented	●	●	●
15. Expand Content Of Current Store Plan	●	●	●

State Compliance Comments

16.	Issue Timely Financial Statements	○	○	○
17.	Adopt And Maintain Administrative Rules Required By Statute	○	○	○

Status Key				**Count**
Fully Resolved	●	●	●	5
Substantially Resolved	●	●	○	1
Partially Resolved	●	○	○	7
Unresolved	○	○	○	4