

**STATE OF NEW HAMPSHIRE
LIQUOR COMMISSION**

**MANAGEMENT LETTER
FOR THE FISCAL YEAR ENDED JUNE 30, 2018**



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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, 2018 and have issued our report thereon dated December 21, 2018.

This management letter, a byproduct of the audit of the New Hampshire Liquor Commission for the fiscal year ended June 30, 2018, contains our auditor's report on internal control over financial reporting and on compliance and other matters and related audit findings. The appendix to this letter, beginning on page 13, provides a summary of the status of observations presented in the fiscal year 2017 and the fiscal year 2016 Liquor Commission management letters.

The New Hampshire Liquor Commission's fiscal year 2018 Comprehensive Annual Financial Report can be accessed online at:

http://www.gencourt.state.nh.us/LBA/AuditReports/FinancialReports/pdf/Liquor_2018_CAFR.pdf

Office of Legislative Budget Assistant
Office Of Legislative Budget Assistant

December 21, 2018

**STATE OF NEW HAMPSHIRE
LIQUOR COMMISSION
2018 MANAGEMENT LETTER**

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Acronyms Used

CFO - Chief Financial Officer

DoIT - Department Of Information Technology

GASB - Governmental Accounting Standards Board

HR – Human Resources

IT - Information Technology

LBA - Legislative Budget Assistant

NextGen - The Commission’s New Front-Office, Back-Office, Point Of Sale Information System

* No audit comments suggest legislative action may be required.

This report, and all other LBA-issued financial audit reports, 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, 2018 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, which collectively comprise the Commission's basic financial statements, and have issued our report thereon dated December 21, 2018, which includes an emphasis-of-matter paragraph noting the Commission's adoption of Governmental Accounting Standards Board (GASB) Statement No. 75, *Accounting and Financial Reporting for Postemployment Benefits Other Than Pensions* and GASB Statement No. 85, *Omnibus 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. 4 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 instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards* and which are described in Observations No. 5 and No. 6.

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

December 21, 2018

Internal Control Comments
Material Weakness

Observation No. 1: Implement And Staff A Financial Accounting And Reporting Structure Appropriate For The Commission's Size And Complexity

Observation:

Each management letter issued since 2013 has reported a material weakness in the Commission's core financial accounting and reporting resources, and has recommended the Commission enhance its operations by employing additional staff that have financial accounting and reporting expertise appropriate for the scope and complexity of the Commission's operations. Again, in fiscal year 2018, the Commission's ability to prepare accurate and timely financial statements was challenged necessitating the continued reporting of that material weakness comment. The fact that the Commission has not been able to resolve the weakness in its financial accounting and reporting operations over the past six and a half years continues to raise concerns as to management's commitment to resolving the weakness.

The Commission's accounting and financial reporting involves some of the more complex financial transactions and activities occurring in State government. The Commission is a \$700 million a year business, operating 79 stores and maintaining \$82 million of products in inventory. The Commission's financial reporting involves wholesale, retail, and government accounting practices that are an unusual mix for accounting and financial reporting professionals.

1. During fiscal year 2017, the Commission hired a business consulting firm to review the Commission's business office staffing levels and to make recommendations for strengthening the office. The firm's recommendations included creating a financial reporting section that would report to the Commission's comptroller position. As of December 2018, the Commission had not filled the lead position in the financial reporting section. While adding a financial reporting section was responsive to the consulting firm's report, the level in the Commission's organizational structure at which the section was added will likely not offer sufficient resources to attract and engage professionals with the skills and experience necessary to address and resolve the Commission's financial accounting and reporting challenges.
2. During fiscal year 2018, the Commission's chief financial officer (CFO) continued to accrue and be paid for overtime work at a rate that was inconsistent with other business office employees. During fiscal year 2018, the CFO was paid approximately \$20,000 for 400 overtime hours of work. No other Commission business office employee accrued more than 79 hours of overtime during that period. During fiscal year 2017, the CFO accrued 358 hours of overtime, and in fiscal year 2016 the CFO accrued 364 hours of overtime and 259 of compensatory time.

There is no apparent business case that could ascribe an advantage to the Commission requiring and depending on a single employee to work this relatively large number of

overtime hours, in lieu of sharing the workload and building the work experience of supporting staff. If the Commission's business needs require a particular employee to regularly work this many hours, with no other current employees either willing or able to assist, then the organization's accounting and financial reporting is operating with a critical, single point of failure. The Commission's continued reliance on the performance of a single employee is a significant organizational design weakness in financial operations and the Commission assumes significant risk in allowing this material weakness to remain unaddressed.

Recommendations:

The Commission must commit appropriate resources to implement and staff a financial accounting and reporting structure appropriate for the size and complexity of its business.

As recommended since fiscal year 2013, the Commission must enhance its financial accounting staff with additional staff having financial accounting and reporting expertise appropriate for the scope and complexity of the Commission's operations. In order to have reasonable confidence that the accounting and financial reporting needs of the Commission will be adequately met, and to reasonably ensure that the Commission will be able to prepare timely, accurate, and reliable financial reporting over time, the Commission should establish and locate the positions sufficiently high in the business office's organizational structure to provide the resources and visibility necessary to address the Commission's financial accounting and reporting weaknesses. Specifically, we recommend the head financial accounting and reporting position be placed at or above the level of the current Chief Financial Officer's position. This should allow the Commission to offer an employment opportunity with sufficient salary and job visibility to attract candidates with the education, experience, and other credentials necessary to meet the Commission's requirements. We also recommend the Commission seek the assistance of the financial accounting and reporting expertise within the State Comptroller's office during the recruitment and assessment of prospective candidates for the head financial accounting and reporting position.

The Commission should not allow, by design or by default, its financial operations to rely upon unreasonable amounts of overtime being worked by one employee. The Commission should immediately review the work assignments of its key financial staff to ensure that tasks and assignments are allocated in a manner that allows for greater division of responsibilities, and builds redundancy in critical operations, thereby lessening the Commission's reliance on the continuing performance of any individual employee. While additional financial-analyst level staff may also be needed, the Commission needs to ensure it has sufficient staff with higher-level experience in managing and performing complex financial accounting and reporting activities.

Auditee Response:

Concur.

We agree the Commission's accounting and financial reporting involves some of the more complex financial transactions and activities occurring in State government. In light of that fact,

combined with the more than \$100 million increase in gross sales since 2013, we also agree that adding a senior financial accounting and reporting position to absorb some of the CFO's considerable responsibilities is warranted. Accordingly, the Commission has commenced a review of the organization of the financial unit to determine the best structure.

For perspective, it is also important to note that the CFO has worked intensively to overcome the weaknesses identified as well as the challenges presented by turnover in key positions within the financial unit. The prior CFO was only with the Commission a year and the current Comptroller started just a month before fiscal year-end (May 2018) but has made great progress over the past year understanding the Commissions financial structure.

Significant Deficiencies

Observation No. 2: Review And Expand Accounts Payable Policies And Procedures

Observation:

Difficulties experienced by the Commission in determining and supporting its June 30, 2018 accounts payable demonstrated weaknesses in the Commission's processes, including lack of reasonable and clear policies and procedures, due care, and effective review and approval controls.

Examples of difficulties faced by the Commission in supporting its reported \$91 million of accounts payable at June 30, 2018 included:

- 1) Documentation provided by the Commission double counted approximately \$855,000 of liquor purchase transactions as both liquor stock and general accounts payable.
- 2) Documentation provided by the Commission included approximately \$630,000 of apparent liquor purchase transactions that had remained unpaid by the Commission for unexplained periods of time. Approximately \$590,000 of that balance was identified as relating to liquor stock purchases made prior to fiscal year 2015. The Commission could not explain why these accounts remained unpaid or provide evidence that the amounts were valid Commission liabilities and not problems in the accounting records. This issue of old accounts payable was identified and discussed with the Commission during the fiscal year 2017 audit.
- 3) The Commission could not provide documentation to support an additional \$770,000 of reported June 30, 2018 accounts payable.
- 4) The Commission performed several analyses of the year end accounts payable in response to auditor's concerns with the reported balance. Ultimately, the Commission corrected the double counting of the liquor stock payable noted in item number 1) above and, as noted in Observation No. 3, increased the reported June 30, 2018 liability for the balance of unredeemed promotional cards by approximately \$924,000.
- 5) Comparison of the June 30, 2018 accounts payable to the June 20, 2017 accounts payable identified that the Commission did not correctly identify and report approximately \$7 million of accounts payable and approximately \$8 million of offsetting depletion billings as of June 30, 2017.

A similar comment addressing weaknesses in the Commission's accounts payable processes was issued in the fiscal year 2016 management letter.

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:

- 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.
- Reporting liabilities related to issued and outstanding gift and promotion cards. As discussed in Observation No. 3, the Commission should regularly analyze trends in the issuance and redemption of cards. The Commission should establish policies and procedures that reasonably estimate the value of 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. These policies and procedures should be documented and consistently performed.

Auditee Response:

Concur.

The Commission is in the process of revising the accounts payable policies and procedures for monthly reconciliation of the liability accounts which will include verifying that all vendors are coded to the correct payable account.

The Commission is in the process of updating gift card and promo card issuance policies to include reconciliation to third party records. A trend analysis is being done on the promo periods to determine the reasonableness of the recorded redemption liability rate of promo cards and the rate will be adjusted accordingly.

Observation No. 3: Establish Objectives And Policies And Procedures For Gift And Promotional Card Programs

Observation:

The Commission has not fully designed and implemented controls for its gift and promotional card programs. The Commission has not documented objectives for the card programs or implemented policies and procedures to meet the administrative objectives of managing, controlling, and recording the related financial activity.

The Commission sells gift cards on-line and at its stores. The Commission also issues gift-card-like promotional cards during certain sales promotion events. Customers can use these gift and promotional cards like cash cards to make future purchases at Commission stores. The Commission's gift and promotional cards are transferrable, have values ranging from \$25 to \$200, and do not expire. In accordance with accounting standards, the Commission recognizes a liability for the value of sold and issued cards that have yet to be used by a customer in a purchase transaction.

Since beginning the marketing of gift and promotional cards in 2010, the Commission has calculated the liability for cash and promotional cards outstanding as 63% of the face value of the cards issued and unredeemed. The calculation assumes a 90% redemption rate and a standard 30% profit margin (70% cost factor). The 63% rate is applied against all issued and outstanding cards without regard to when the card was issued. The calculation has not been subsequently reviewed to determine whether the calculation's assumed 90% redemption rate reflects the Commission's actual experience over time. At June 30, 2018 the Commission recognized a gift and promotional card liability of \$1.2 million, an increase of \$281,000 over the prior fiscal year end. This same comment was initially noted in the fiscal year 2016 Management Letter.

In initially reporting its June 30, 2018 liability for gift and promotional cards outstanding, the Commission incorrectly reported only the current-year increase of \$281,000. The Commission subsequently adjusted the reported balance by including the liability for cards issued during prior years that remained unredeemed at June 30, 2018.

Recommendation

The Commission should design and document its objectives for its gift and promotional card programs and establish appropriate policies and procedures for meeting its objectives and controlling and recording the related financial activity in alignment with its objectives.

The Commission should review its gift and promotional card redemption data to determine whether the assumed redemption rate actually reflects the redemption pattern for sold and issued cards.

Auditee Response:

Concur in part.

The objective of promotional program is to bring greater awareness to the brand and increase the volume of sales in a highly competitive marketplace.

The Commission is in the process of updating gift card and promo card issuance policies to include reconciliation to third party records and will perform an annual trend analysis on the promo periods to determine the reasonableness of the recorded redemption liability rate of promo cards.

Observation No. 4: Review Information System User Access Controls

Observation:

The Commission's payroll and information technology controls did not reliably monitor and control user access authorities to ensure that the access authorities of terminated employees were removed timely from the automated time clock system during fiscal year 2018.

The September 2017 Time Clock User Password Report identified two prior employees as active time clock system users even though the individuals left employment with the Commission more than two months earlier. A review of a June 2018 Time Clock User Password Report identified one prior employee as an authorized user even though the individual left employment with the Commission six months earlier. The Commission removed the prior employees' access authorities subsequent to auditor inquiries.

While the audit did not identify any instances where the access control weakness may have been misused, timely monitoring and maintenance of access authorities is a key general control in essentially all information system control processes, including an automated time clock system.

Recommendation

The Commission should review the user access controls of its information systems, including its automated time clock system, to ensure that policies and procedures are appropriately designed and in operation to meet managements' objectives for the systems' security needs.

The Commission should ensure that information controls are sufficient to allow timely notification to responsible parties of new and terminated users, and that monitoring controls regularly review the continued performance and responsiveness of user access control procedures.

Auditee Response:

Concur.

Human Resources (HR) has revised the current "NH Liquor Commission Network Access Request Form" in order to add an area about Time Clock Software access and immediately removed the former employee's name.

Compliance Comments

Observation No. 5: Prepare And Submit Action Plans Required By Executive Order #2014-03

Observation:

The Commission has not submitted the action plans required by Executive Order #2014-03 to address audit findings included in the Commission's management letter reports issued since the June 16, 2014 promulgation of the Executive Order.

Executive Order #2014-03, as amended by Executive Order #2016-8, requires agencies to develop an action plan to address audit findings resulting from Financial and Performance Audits performed by the Audit Division of the Office of Legislative Budget Assistant since January 2013.

Agencies are required to publicly present the plan within 30 days of the audit being presented to the Joint Legislative Fiscal Committee of the General Court, and semi-annually, on the month anniversary of the audit date, prepare a report on their progress in responding to the audits until such time as the findings have been resolved in accordance with guidance issued by the Department of Administrative Services.

As part of that plan, agencies are also to identify what findings must be addressed by other entities, including the legislature in the form of changes to laws, rules or funding allocations, the federal government, or the Governor and Executive Council.

Executive Order #2014-03 further directs that both the original action plan for each audit, as well as subsequent progress reports, be posted on TransparentNH¹, to provide the public with information on state agencies efforts.

Recommendation:

The Commission should prepare and submit action plans required by Executive Order #2014-03 to address audit findings included in the Commission's management letters.

Auditee Response:

Concur.

It was the Commission misunderstanding that because we are audited annually and each year's responses and prior audit status are posted on the LBA website that this requirement was satisfied.

¹ <https://www.nh.gov/transparentnh/audit/index.htm>

Observation No. 6: Adopt Administrative Rules Required By Statute

Observation:

The Commission has not adopted administrative rules required by RSA 178:28 relative to purchase discounts allowed to Commission licensees.

RSA 178:28 I,V, Discount and Credit Sales to Licensees, states that:

Pursuant to RSA 541-A and in furtherance of the objectives of this chapter and title, the commission shall adopt rules providing for the following:

I. When fixing the price for sale of liquor and wine to on-premises licensees, the commission may allow discounts at percentages to be determined by the commission from the regular retail price on case lot orders F.O.B. the warehouse or commission direct delivery system. No discount determined by the commissioner under this paragraph shall be less than 10 percent.

V. A schedule of hours and procedures by which fortified wines and table wines may be purchased at the discount price for resale by holders of off-premises retail licenses at percentages of discount to be determined by the commission. Discounts for holders of off-premises retail licenses with annual wine purchases under \$350,000 shall be no less than 15 percent less than the regular retail price in the liquor stores and 20 percent less than the regular price F.O.B. at the warehouse.

As initially reported in the fiscal year 2013 audit, the Commission has not adopted administrative rules relative to the above statute. In its response to the 2013 finding, the Commission indicated it was considering requesting the statute requiring the rules be amended. During fiscal year 2018, the Commission reported it was no longer considering a revision to the statute, but it had not yet begun the rulemaking process for the respective rules.

Recommendation

The Commission should adopt the administrative rules required by statute. If the Commission determines the required rules are not necessary for the operation of the Commission, the Commission should request an appropriate revision to the statute.

Auditee Response:

Concur.

The Commission is currently drafting the required administrative rules.

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APPENDIX

Current Status Of Prior Audit Findings

The following is a summary of the status, as of December 21, 2018 of the observations contained in the New Hampshire Liquor Commission Management Letters for the fiscal years ended June 30, 2017 and 2016. Those reports can be accessed at, and printed from, the Office of Legislative Budget Assistant website: www.gencourt.state.nh.us/LBA/AuditReports/FinancialReports/pdf/.

		<u>Status</u>
2017 Audit Comments		
Internal Control Comments		
<i>Material Weakness</i>		
2017-1	Strengthen Core Financial Accounting And Reporting Resources <i>Enhance financial accounting staff with additional staff having financial accounting and reporting expertise appropriate for the scope and complexity of operations, establish comprehensive and documented policies and procedures for all critical financial activities, and consider compiling and reporting a more complete set of periodic interim financial statements (See Current Observation No. 1)</i>	● ○
<i>Significant Deficiencies</i>		
2017-2	Review Availability Of Information Technology Project Cost Data <i>Review with DoIT the potential for including additional job numbers in the DoIT timekeeping</i>	● ●
2017-3	Resolve Budgetary Retained Earnings Balance <i>Identify the source of the reported retained earnings balance</i>	● ○
2016 Audit Comments		
Internal Control Comments		
<i>Material Weakness</i>		
2016-1	Strengthen Core Financial Accounting And Reporting Resources <i>Enhance financial accounting staff with additional staff having financial accounting and reporting expertise appropriate for the scope and complexity of operations, establish comprehensive and documented policies and procedures for all critical financial activities, and consider compiling and reporting a more complete set of periodic interim financial statements (See Current Observation No. 1)</i>	● ○
<i>Significant Deficiencies</i>		
2016-2	Receive And Act Upon The Best Available Advice In The Planning, Development, And Implementation Of New Information System <i>Ensure the Commission is receiving and acting upon the best available advice in the planning, development, and implementation</i>	● ○

	<i>of its new information system</i>		
2016-3	Enact Chip-Card Point Of Sales Devices As Soon As Practical To Minimize Losses <i>Enact chip-card point of sales devices as soon as practical to lessen unnecessary losses from the use of non chip-enabled sales terminals</i>	●	●
2016-4	Establish Controls To Regularly Monitor And Reconcile The Cash Balances In The Liquor Fund <i>Establish controls to regularly monitor and reconcile the cash balances in the Liquor Fund as recorded in the general ledger</i>	●	○
2016-5	Review Annual Physical Inventory Process <i>Ensure inventories are well planned and instructions are clear, concise, comprehensive, and appropriately communicated to employees responsible for performing the inventory</i>	●	●
2016-6	Improve Control Over The Recording And Reporting Of Capital Assets <i>Establish supplemental policies and procedures, a recording and reporting system, appropriate segregation of duties and effective review and approval controls, and policies and procedures for an annual physical equipment inventory observation and count</i>	●	○
2016-7	Resolve Issues Causing Difficulties In Processing Accounts Receivable <i>Review the difficulties it experienced in processing fiscal year 2016 year-end accounts receivable and ensure there is a review and approval control in place and tools that outline standard processing</i>	●	●
2016-8	Expand Policies And Procedures And Consistently Perform Intended Refund Controls <i>Expand the design of its controls and establish reasonable control activities over all refunds and establish control monitoring activities to monitor compliance with intended controls</i>	●	●
2016-9	Review And Expand Accounts Payable Policies And Procedures <i>Review and expand accounts payable policies and procedures to ensure direction provided to staff promotes the accurate accrual of liabilities</i>	○	○
2016-10	Support And Perform Key Reconciliation Controls <i>Support controls such as reconciliations of key accounts in comparable information systems with written policies and procedures</i>	●	●
2016-11	Establish Policies And Procedures For The Routine Review Of The Accuracy Of Vendor Invoicing And Commission Payments <i>Ensure 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</i>	●	●

2016-12	Develop And Provide An Electronic Beer Tax Filing System <i>Develop and implement an electronic beer tax filing system for greater efficiency to taxpayers in filing returns and greater efficiency in the Commission's processing, reviewing, and auditing of the filed returns</i>	●	○
2016-13	Physical Access to IT Computer Room Should Be Periodically Reviewed <i>Ensure access to the computer room is restricted to individuals whose current job responsibilities require that access</i>	●	●
2016-14	Continue Effort To Efficiently Document Store Lease Information <i>Continue efforts to complete and maintain a readily accessible file of documentation supporting its store rental agreements</i>	●	●

Status Key

			<u>Count</u>
Fully Resolved	●	●	9
Remediation In Process (Action beyond meeting and discussion)	●	○	7
Unresolved	○	○	1

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