

DEPARTMENT OF ALCOHOLIC BEVERAGE CONTROL

Special Financial and Limited Performance Audit
For Procedures Performed During Fiscal Year 2017

Report No. 17-01



OFFICE OF THE STATE AUDITOR

AUDIT LEADERSHIP:

John Dougall, State Auditor
Hollie Andrus, CPA, Audit Director
Sean Clayton, Audit Senior



OFFICE OF THE
STATE AUDITOR

May 30, 2017

Members of the Utah Alcoholic Beverage Control Commission
and
Mr. Salvador D. Petilos, Executive Director
Department of Alcoholic Beverage Control

Dear Commissioners and Mr. Petilos:

We performed various procedures on certain aspects of the Department of Alcoholic Beverage Control's (DABC's) internal control reviewed during fiscal year 2017. These procedures were performed in accordance with *Utah Code*, Section 32B-2-302, were agreed to by DABC management, and were approved by the DABC Commission. This report covers the procedures outlined in the "Executive Summary."

These procedures do not constitute an audit conducted in accordance with generally accepted auditing standards, the objectives of which would be the expression of an opinion on DABC's internal control. Accordingly, we do not express such an opinion. Had we performed additional procedures, other matters might have come to our attention that would have been reported to you. Our recommendations resulting from the procedures are found within this report.

By its nature, this report focuses on exceptions, weaknesses, and problems. This focus should not be understood to mean there are not also various strengths and accomplishments. We appreciate the courtesy and assistance extended to us by DABC's personnel during the course of the engagement, and we look forward to a continuing professional relationship. If you have any questions, please contact me.

Sincerely,

Hollie Andrus, CPA
Audit Director
handrus@utah.gov
801-808-0467

Executive Summary

The Department of Alcoholic Beverage Control (DABC) is statutorily required to be audited every year. This report provides recommendations in six financial and performance areas to strengthen DABC's operations, internal controls, and accounting practices. Each area is outlined below.

TROUBLED IMPLEMENTATION OF ENTERPRISE RESOURCE PLANNING SYSTEM (ERP) CAUSED MULTI-MILLION DOLLAR ERRORS IN STATE OF UTAH'S GENERAL LEDGER (FINET)

We analyzed the procurement and implementation processes of the new ERP system (AX) discovering that multiple errors were made:

- DABC was responsible for overseeing the work of its system integration contractor
- "Going live" with the new system knowing it was not completely developed for implementation while simultaneously discontinuing use of the old system before complete end-to-end testing of AX
- Not performing month-end closing of AX to identify and minimize errors
- Not communicating these issues and difficulties in sufficient detail such that the State's Division of Finance fully understood these challenges in a timely manner

ERP SYSTEM MUST BE RECONCILED TO THE GENERAL LEDGER MONTHLY

We performed procedures to ensure the accuracy of the information presented in financial reports prepared for the Commission from July 2016 through February 2017 and determined that:

- From July 2016 through December 2016, DABC did not record approximately \$216 million in revenue or \$118 million in cost of goods sold (COGS) in FINET
- The December 2016 and January 2016 monthly financial reports continued to have material inconsistencies ranging from \$26 million to \$308 million in various reporting line items
- No monthly reconciliations between AX and FINET were performed to identify and minimize errors

DABC FINANCE DIVISION ACCOUNTING EXPERTISE COULD BE ENHANCED

DABC's Finance Division (Division) appears to lack the appropriate knowledge of retail and government accounting. We analyzed the workload, education and career path of the six Division employees. We found the following:

DEPARTMENT OF ALCOHOLIC BEVERAGE CONTROL

- Accounting expertise is limited
- Minimal opportunities for continuing education related to accounting
- Turnover in key Division director position has led to decreased confidence in management
- Division director delegates director-level responsibilities
- The Division failed to implement key recommendations from previous audits
- No succession plan to cover key Finance Division roles when vacancies arise

DABC'S ABILITY TO ANALYZE INDIVIDUAL RETAIL STORE REVENUES AND EXPENSES NOW POSSIBLE

During previous audits of DABC, we found that DABC does not record expenses at the store level. Because of this difficulty the Office of the State Auditor:

- Helped identify all store level expenses
- Developed SQL queries to pull store revenues and expenses from FINET
- Created a fiscal health reporting interface in Microsoft Access

In developing the queries above, we noted a weakness in how the Division reviews and processes transactions entered on its behalf by Department of Facilities Management (DFCM) employees. Furthermore, we noted that delivery to store expenses are not entered in a timely manner nor in the appropriate period.

STORE MANAGER TIME CARDS SHOULD BE REVIEWED BEFORE BEING APPROVED AND PAID

During our review of DABC time card policies and procedures, we observed the following:

- Regional managers are not reviewing the signed time card when approving the retail store manager's time in ESS
- DABC should consider alternate methods to provide time card data to regional managers prior to approval of time

TIME CARDS SHOULD BE ACCURATELY RECORDED

We found that retail store managers underutilize time card data entry tools provided to them. We tested 61 timecards covering two different pay periods and discovered the following:

- We observed retail store managers are not using State of Utah Department of Human Resource Management (DHRM) tools to calculate employee time cards
- While comparing the sampled time cards to ESS, we found that six time cards or 9.8% of our sample were incorrectly rounded resulting in employees either being underpaid or overpaid
- Retail store managers incorrectly entered time into ESS for two of the 61 sampled time cards resulting in one employee being underpaid six hours and another receiving 0.5 hours of regular pay instead of 0.5 hours of approved sick time

Table of Contents

Executive Summary	i
Finding 1: Troubled Implementation of Enterprise Resource Planning System (ERP) Caused Multi-Million Dollar Errors in State of Utah’s General Ledger.....	1
Recommendations	1
Finding 2: ERP System Must Be Reconciled to General Ledger Monthly	3
Recommendations	3
Finding 3: DABC Finance Division Accounting Expertise Could be Enhanced.....	4
Recommendations	5
Finding 4: DABC’s Ability to Analyze Individual Retail Store Revenues and Expenses is Now Possible	6
Recommendation.....	7
Finding 5: Store Manager Time Cards Should be Reviewed Before Being Approved and Paid .	8
Recommendation.....	8
Finding 6: Time Cards Should be Accurately Recorded.....	9
Recommendation.....	9
Department Of Alcoholic Beverage Control’s Response To Findings And Recommendations .	10
Auditor Concluding Remarks.....	15

Finding 1: Troubled Implementation of Enterprise Resource Planning System (ERP) Caused Multi-Million Dollar Errors in State of Utah’s General Ledger

DABC MISMANAGED DEPLOYMENT OF ERP SYSTEM

In 2012, after learning its current system would no longer be supported, DABC began the process to procure a new ERP system—Microsoft’s Dynamix AX (AX). We analyzed the procurement and implementation processes from the initial Requests for Proposals (RFPs) in 2012 through March 2017. Multiple issues were encountered in the implementation of the new ERP system. We noted various problems related to the system integrator. Ultimately, DABC was responsible for overseeing the work of its system integration contractor.

Deploying a new ERP system is a rare event, as such, DABC personnel lacked meaningful implementation experience and were heavily reliant on outside expertise. The timeline presented identifies key events in the selection and implementation of the ERP system (**Figure 1**). DABC’s significant missteps in the process include:

- Less preferable consultants leading the deployment;
- “Going live” with the new system knowing the system was not completely developed or ready for implementation while simultaneously discontinuing use of the old system;
- Not performing month-end closing of AX to isolate and minimize errors; and, Not communicating these issues and difficulties in sufficient detail such that the State’s Division of Finance fully understood the magnitude of the challenges with the implementation plan and timeline.

As a result, discrepancies between AX and FINET ranged upwards of \$200 million in the month of December 2016.

Recommendations

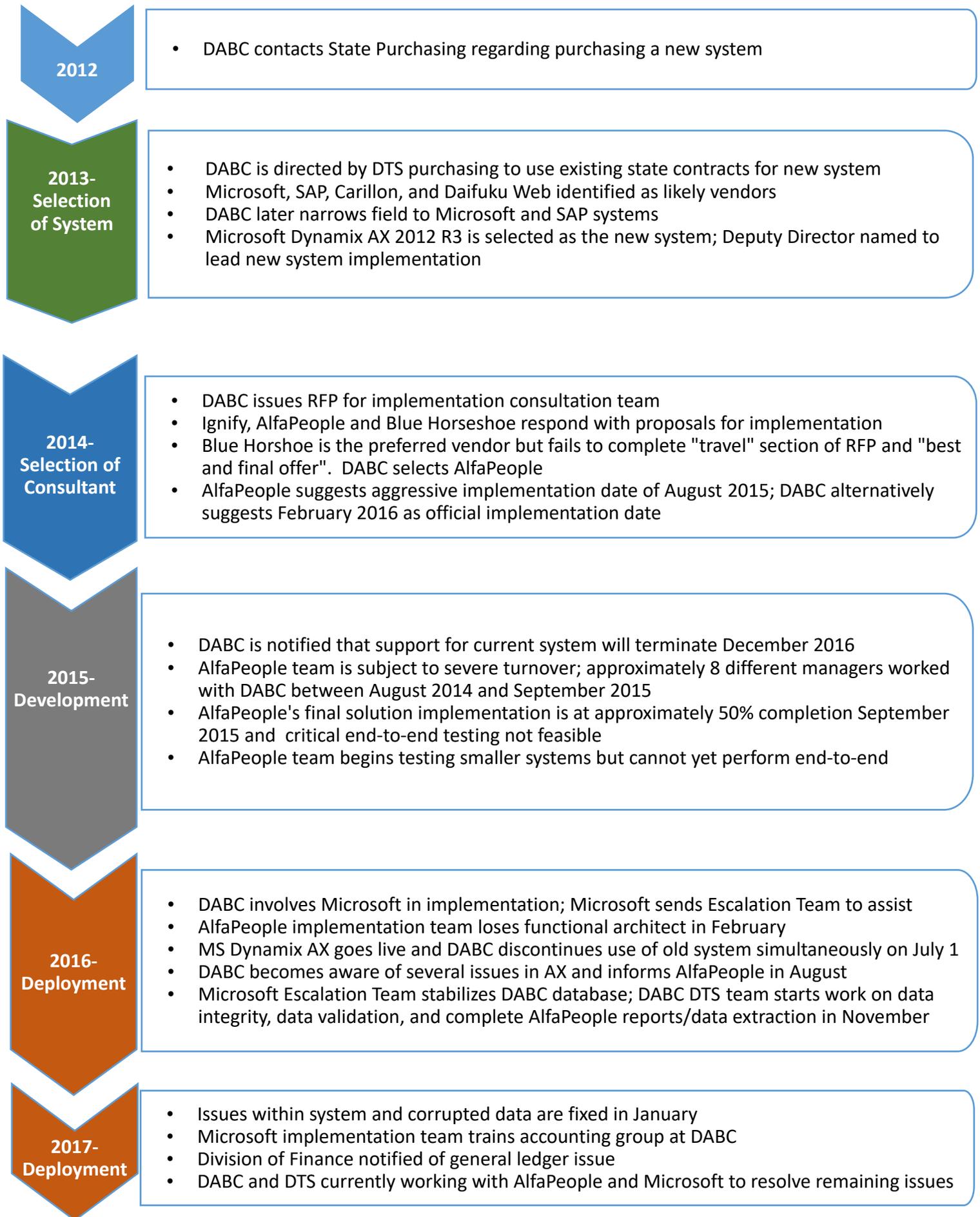
As DABC considers new systems in the future, we recommend DABC:

- **work closely with Division of Finance early in the implementation process;**
- **run new and old systems simultaneously during early phases of implementation; and,**
- **communicate issues and difficulties that arise in the implementation process.**

To improve DABC’s AX system, we recommend DABC:

- **contract with another third-party ERP implementation project manager to resolve current issues; and,**
- **perform monthly close-out of the AX system.**

FIGURE 1- TIMELINE FOR IMPLEMENTATION OF ERP SYSTEM



Finding 2: ERP System Must Be Reconciled to General Ledger Monthly

DABC'S GENERAL LEDGER WAS MATERIALLY INCORRECT FOR THE FIRST SIX MONTHS OF FISCAL YEAR 2017

To ensure the financial reports provided to the Commission are accurate, we compared reports for July 2016 through February 2017 to data in DABC's AX system and to DABC's general ledger (FINET). We determined the following:

- From July 2016 through December 2016, DABC did not record any revenue or cost of goods sold (COGS) in FINET. During this time, DABC earned approximately \$216 million in retail sales and incurred approximately \$118 million in COGS.
- For December 2016 and January 2017, DABC's monthly financial reports continued to have many material inconsistencies when compared to AX and FINET. In December, DABC began reporting revenues and COGS in FINET. Nevertheless, we noted differences ranging from \$26 million to \$308 million between DABC's monthly financial reports, FINET, and AX for Cash, Accounts Payable, Taxes Payable, Inventories, Accounts Receivable, Sales, and Cost of Goods Sold.

We compared the January-June 2016 reports to FINET and the previous ERP system and noted no significant deficiencies. The errors described above persisted for an unacceptably long time because DABC's Finance Division did not perform a monthly close of the system and did not reconcile it to FINET on a monthly basis. If DABC performed a monthly close and reconciliation of the system to FINET the possibility of future significant errors would be greatly reduced. Furthermore, it is an industry standard to close ones books at the end of each month. This practice ensures financial information is recorded and reconciled in the proper period and greatly enhances the financial reporting process.

Recommendations

To improve DABC's AX system, we recommend DABC:

- **contract with another third-party ERP implementation project manager to resolve current issues; and,**
- **perform monthly close-out of the AX system.**

Finding 3: DABC Finance Division Accounting Expertise Could be Enhanced

DABC HAS LIMITED FINANCIAL EXPERTISE

DABC's Finance Division (Division) appears to lack appropriate knowledge of retail and governmental accounting. As part of our review, we analyzed the education, career paths, and technical training of each employee of the Division. The Division consists of a Division Director and 5 employees. Their accounting experience, as a group, can be summarized as follows:

- Limited technical expertise in the areas of retail and governmental accounting.
- Limited continuing educational opportunities specific to individual technical roles.
- Minimal training opportunities to develop accounting and analytical skills. The training that is provided typically relates to State-required training on FINET, Defensive Driving, Workplace Harassment, IT Security Awareness, etc.

DABC LACKS ADEQUATE FINANCIAL LEADERSHIP

The Division has hired several Directors in the recent years. Turnover in this key leadership position has caused confusion among staff as to a staff's role and responsibilities and results in a general lack of confidence in management. Delegation of director-level responsibilities, such as the certification of monthly financial reports provided to the Commission, also promotes a lack of confidence in management as management is perceived as lacking the knowledge needed to effectively manage the Division.

Other concerns related to expertise and leadership arose as a result of additional procedures we performed. For instance:

- The Division did not perform any reconciling manual journal entries to record sales and costs of goods sold when it determined that AX was not communicating correctly with FINET, the;
- The Division had not implemented key recommendations from previous audits. These recommendations were to improve the Division's processes over daily bank deposits and write-offs of accounts receivable;
- The Division does not record expenses in a reasonable timeframe; and,
- The Division did not review any Accounts Receivable Aging Reports from July 1, 2016 through March 29, 2017.

FINANCE DIVISION HAS NO SUCCESSION PLAN

When reviewing the Division accounting experience and workload, we noticed that several key employees have between 26 and 39 years of service towards their retirement. State employees are eligible for full retirement benefits after 30 years of service. While Division staff does not seem to have heavy workloads, the staff is not cross-trained in each other's duties and the

Division does not have a succession plan to be prepared when these key long-time employees retire.

Recommendations

We recommend DABC:

- **Define clearly the Finance Division employees' roles and responsibilities;**
- **Work with the State of Utah's Division of Finance or hire an individual with governmental accounting knowledge to ensure its financial records properly include all transactions; and,**
- **Establish a succession plan for the Division, including cross-training of employees.**

Finding 4: DABC’s Ability to Analyze Individual Retail Store Revenues and Expenses is Now Possible

OFFICE OF THE STATE AUDITOR CREATED “FISCAL HEALTH REPORTS”

During our previous audit of DABC, we noted that DABC does not record expenses at the store level. This made it impossible for DABC and its store managers to monitor each store’s performance. Because of difficulties mentioned previously in this report, the Office of the State Auditor (Office):

- Identified all store-level expenses (e.g., salaries and benefits, utilities, lease payments, costs of goods sold, shipping expenses);
- Developed SQL queries to pull store revenues and expenses from FINET; and,
- Created retail financial reports in Microsoft Access.

These financial reports or “Fiscal Health Reports” include separate reports for overall fiscal summaries, wages and benefits, facilities expenses, other current expenses, and operations and maintenance (O&M) contract expenses covered by the State of Utah’s Division of Facilities & Construction Management (DFCM). To make the reports more accessible, the Office designed an interface in Microsoft Access to query and examine revenues and expenses on both an aggregate level and an individual store level.

DABC FINANCE DIVISION DID NOT PROPERLY RECORD OR REVIEW STORE EXPENSES

In developing the queries and reports mentioned above, we noted weaknesses in how the Division reviews and processes some transactions. In order for the Fiscal Health Reports to capture data properly, the Division must properly record and review all store expenses. For example,

- Expenses titled “Delivery to Stores” is not entered into the appropriate “Unit Code” in a reasonable time frame. This can be remedied by editing the “DO” used to track the shipping contract.
- Expenses related to DFCM O&M contracts are not entered into AX using the appropriate “Unit Code” or “Account Code”. DFCM uses its own tracking codes for DABC’s retail stores. These codes do not correspond to DABC’s tracking codes for the same stores. Before our audit, DABC did not review the O&M charges as FINET automatically processes these charges 21 days after the DFCM posts the transaction. Before this audit, DFCM did not provide the detail for the O&M charges. This detail will allow DABC to record the O&M charges at the store level. As a result of this audit, DFCM now provides the detail for all O&M charges.

If the Division properly records store-level delivery expenses and reviews and records each store's O&M expenses, these Fiscal Health Reports will assist DABC in operational decision making, will assist in the reconciliation of O&M charges initiated by DFCM, and will allow DABC's ERP system to be reconciled to FINET. They can also help store managers track revenues and expenses to see how their stores are performing.

Recommendation

We recommend DABC:

- **Use the Fiscal Health Reports on a monthly basis;**
- **Record expenses related to deliveries to stores properly, timely and in the correct period;**
- **Review O&M detailed information provided by DFCM and record these expenses at the store level; and,**
- **Provide to store managers access to these report.**

Finding 5: Store Manager Time Cards Should be Reviewed Before Being Approved and Paid

DABC REGIONAL MANAGERS DO NOT RECONCILE STORE MANAGERS' TIME CARDS TO THE PAYROLL SYSTEM BEFORE APPROVAL

During our review of DABC time card policy and procedures, we observed that regional managers are not reviewing the signed time card when approving a retail store manager's time in ESS. Regional Managers said they cannot review the signed time card before approving the time because the managers' time cards are not sent to DABC's main office in a timely manner. While the physical time card may not be available in the required timeframe, DABC should consider other methods to quickly provide regional managers the necessary information. For example, each store manager could photograph his/her timecard and send it to the corresponding regional manager via text messaging or email. Then, once the physical time card is received, the regional manager could compare the physical time card to the time entered into the time reporting system.

Recommendation

We recommend DABC create an efficient method to provide regional managers timely evidence of store managers' time cards.

Finding 6: Time Cards Should be Accurately Recorded

STORE MANAGERS UNDERUTILIZE TIME CARD DATA ENTRY TOOLS

We selected 61 timecards covering two different pay periods, compared them to DABC's data entry of the information, and discovered:

- DABC Retail Store Managers incorrectly rounded six of the 61 time cards tested (or 9.8%) resulting in six employees either being underpaid or overpaid; and,
- DABC Retail Store Managers incorrectly entered time into ESS for two of the 61 time cards tested (or 3.3%) resulting in an employee being underpaid six hours and another receiving 0.5 hours of regular pay instead of 0.5 hours of approved sick time.

Currently, retail store employees use paper time cards and punch them each time they start and end their shift. At the end of the pay period the employee signs his/her time card. Then the retail store manager uses a State of Utah Department of Human Resource Management (DHRM) tool to sum the employee's hours. This DHRM tool calculates the time worked using the appropriate rounding for fractions of hours. The retail store manager then enters the time worked from the time card to ESS. These rounding errors were caused by the retail store manager not using the approved DHRM time calculator. Using paper time cards and having store managers enter all the employees' time seems cumbersome, inefficient, and is error-prone.

Recommendation

We recommend DABC management implement a cost-effective time management system.

**Department Of Alcoholic Beverage Control's
Response To Findings And Recommendations**



GARY R. HERBERT
Governor

SPENCER J. COX
Lieutenant Governor

State of Utah

DEPARTMENT OF ALCOHOLIC BEVERAGE CONTROL

1625 South 900 West
P.O. Box 30408
Salt Lake City, Utah 84130-0408
(801) 977-6800 Telephone
(801) 977-6888 FAX
abc.utah.gov

Mr. John Dougall, State Auditor
Office of the State Auditor
315 House Building State Capitol Complex
Salt Lake City, UT 84115

State Auditor Dougall,

Thank you for the opportunity to respond to your audit, "Special Financial and Limited Performance Audit for Procedures Performed during Fiscal Year 2017."

We appreciate the audit team's efforts to conducting this audit. However, we question several of the conclusions contained in this report.

The DABC strongly disagrees with the Auditor's conclusion that the DABC mismanaged the deployment of the Enterprise Resource Planning (ERP) system. We readily acknowledge that the implementation has been challenging and we take full responsibility for the implementation's impacts on operations. Our disagreement with this conclusion is based on several factors:

1. The contract was awarded pursuant to a valid procurement. The DABC worked closely with the State Division of Purchasing to ensure that the procurement was conducted in accordance with the requirements of the state procurement code.
2. The successful vendor is dictated by the procurement process and the strict guidelines that accompanying it. The result cannot be changed simply because one bidder is stronger in one area than another. The agency must look at the entire bid and the results cannot be changed simply because we want to.
3. The decision to "Go Live" was not made in a vacuum. At that time the department faced a difficult choice between continuing with an "End of Life," unsupported legacy system or implementing a new, yet supported ERP. The decision to go live was made in consultation with a DTS IT team that brings 149 years of IT experience to the table. We chose the option that provided the department with the best opportunity to continue operations and serve our end users in the event of a system error.
4. The amount of risk in implementation was mitigated by a phased approach. Critical functions that were slated to go online were tested prior to July 1, 2016.

It is important to know that we considered the following in the decision to go live:

1. End of year 2012 – promised updates of legacy system go undelivered
2. February 2015 - Legacy support vendor announces system “End of Life” by Dec. 2016
3. September 2015- Key members of the legacy support team that worked closely with DABC were terminated by legacy support vendor and work is outsourced. This led to lack of confidence as to the future effectiveness of the legacy system.
4. Oracle no longer supported our legacy Database.

DABC management agrees that the DABC should reconcile FINET and AX monthly as we believe that will provide transparency to our monthly operations.

However we take issue with the inference that the DABC lost money. The DABC does not dispute that the two systems did not reconcile but we are confident that the State lost no money. Discrepancies were the result of system delays in recording the revenue and cost of goods sold and DABC Finance’s desire to obtain **accurate data** from the new ERP system. Moreover, the Sales Summary Journal (SSJ), a report that Finance has been using for sales revenue and cost of goods sold reconciliation was not finalized and made available to the team until January 2017. The DABC Division of Finance continued with its monthly reconciliation of AX and FINET upon receipt of the SSJ and has investigated the discrepancies.

The DABC did not sit idly by after identifying this reporting issue early in the implementation. Since that time we have worked to remedy the issue with the assistance of our contract vendor, 3rd party consultant and our in house DTS staff. We acknowledge this process has taken longer than we would have liked. When the issue was discovered resources were deployed to expedite the solution.

The DABC respectfully disagrees with the auditor on the issue of conducting month end closing. DABC Division of Finance has worked with the contract vendor and the DTS IT teams to perform month end closing since August 2016.

Moreover our records indicate the DABC Division of Finance had communicated the issues and difficulties to not only the State Division of Finance, but also the Director of Finance at the Tax Commission. The DABC continues to validate the corrected data and has been performing the monthly reconciliations.

The DABC is baffled as to the audit team’s conclusion that DABC Finance “appears to lack the appropriate knowledge of retail and government accounting.” We are concerned that the “Finding” is not based on performance, especially in light of the 165 years in retail and government accounting experience collectively within the division. However we do agree the accounting experience can be

enhanced and we are very open to providing training that would be valuable to the division.

While we agree, in principle, that the department should keep qualified people for as long as possible and will make every effort to do so, ultimately, the decision to stay or go lies with our employees. The DABC Finance Director will not delegate the signing of the certification of monthly financial reports provided to the Commission. That single task can be changed immediately.

The DABC disagrees with the statement that we failed to implement past recommendations. We note that:

1. The Finance team implemented the recommendations regarding daily bank deposits and write-off of accounts receivable since last audit. Employees were instructed to log receipts daily in the check log, endorse the checks immediately, deposit the receipts in accordance with State Finance policy, and contract Loomis to pick up the deposit daily.
2. DABC Finance has implemented process improvements for the accounts receivable write-offs. DABC informed the audit team for the reversal of non – renewal of the improved process during their field work.
3. DABC Finance reviewed the Accounts Receivable Aging reports since the last audit, but was unable to do so from July 2016 to March 2017 because the AR aging report was not ready.

The DABC finance is organizationally flat, with employees who have specialized skills and knowledge. We believe it is difficult to plan strategically for succession in this environment. However, we do agree with the audit team that cross training is critical so that we can have redundancies and we have, for several years, made it a priority for the division.

The DABC respectfully disagrees with the State Auditors' view on Finance division staff does not seem to have heavy workloads. It is a concern to the department that a skeleton Finance team that handles the Department's 420 million retail business faces the demands of an operation that on average, grows 5-6 % per year with no increase in Finance FTE's over years. The Finance team members' core workloads are heavy now and heavier with the addition of future stores.

DABC is perplexed by the audit team's refusal to acknowledge the work already done by the Finance division director in the area of monthly store forecasts. The implementation of internally created monthly store forecasts have been under discussion since August of 2016. We believe the department store forecasts have more details that meet department needs than what has been proposed by the audit team.

Time cards continue to be a concern for the DABC and we are currently seeking other methods to remedy this issue. We will immediately comply with the Regional Manager reviewing all store manager timecards for accuracy.

Sincerely,



Salvador D. Petilos
Dept. of Alcoholic Beverage Control

Auditor Concluding Remarks

The Executive Director's response to the audit continues to highlight how executive management consistently fails to take responsibility for the operations of DABC, often casting blame on others. Over the past several years, we have patiently noted opportunities for DABC to improve its operation. From our perspective, DABC continues to lack the management and operational practices which we would expect from private-sector retailers with comparable levels of sales, including inventory management at retail stores, efficient shipping processes, demand-driven scheduling to meet peak sales volume, and electronic time reporting system.

We continue to be concerned with DABC's planning, implementation, and deployment of its ERP system, particularly in regard to its impact on the financial information reported in FINET. We are especially troubled that management repeatedly blames other parties (e.g, the AX system consultants) for the ERP's deployment. We believe various steps could have been taken to mitigate the troubled implementation, particularly regarding the timing of the deployment and the "go live" approach.

We do not believe that DABC has the fundamental skills and leadership to ensure that its accounting support will be able to adequately meet the demands of a growing organization. We continue to question the Finance Division's ability to meet current operational demands

We are also deeply troubled that management would knowingly provide inaccurate and erroneous financial reports to its Commission.