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December 14, 2017

Performance Audit  
Recommendations and  
Corrective Actions for Audit:  
14-6

LIQUOR CONTROL SYSTEM

Fiscal Impact of Privatization  
Projected as Neutral, but DLC  
Could Take Other Actions that  
May Increase Profits

Dated: November 21, 2014

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# Overview

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The SAO makes recommendations designed to improve the operations of state government. For our work to produce benefits, auditees or the General Assembly must implement these recommendations, although we cannot require them to do so. Nevertheless, a measure of the quality and persuasiveness of our performance audits is the extent to which these recommendations are accepted and acted upon. The greater the number of recommendations that are implemented, the more benefit will be derived from our audit work.

In 2010, the SAO began to follow-up on the recommendations issued in our performance audits. Experience has shown that it takes time for some recommendations to be implemented. For this reason, we perform our follow-up activities one and three years after the calendar year in which the audit report is issued. Our annual performance reports summarize whether we are meeting our recommendation implementation targets.

<http://auditor.vermont.gov/about-us/strategic-plans-and-performance-reports>

This report addresses the requirements of Act 155 (2012) to post the results of our recommendation follow-up work on our website. The report does not include follow-up on recommendations issued as part of the state's financial statement audit and the federally mandated Single Audit, which are performed by a contractor. However, our current contract for this work requires the contractor to provide the results of its recommendation follow-up.

Audit Number & Name	Rec #	Recommendation	Follow-Up Date	Status	Review Comments
<a href="#">14-6 Liquor Control System: Fiscal Impact of Privatization Projected as Neutral, but DLC Could Take Other Actions that May Increase Profits</a>	1	Prepare or contract for an analysis to determine the optimum number and location of agent stores.	2015	Not Implemented	The Department of Liquor Control (DLC) reported having discussions with the <b>Liquor Control Board</b> regarding the number of agency stores but did not provide us with details. Additionally, DLC reported that this recommendation has not been implemented because the <b>Liquor Board</b> has imposed a moratorium on new stores due to current limitations of the department's point of sale (POS) system.
			2017	Implemented	The <b>DLC Commissioner</b> provided two analyses to determine optimum number of stores and locations. The first analysis was done in November 2015 by a consultant from the <b>National Alcoholic Beverage Control Association</b> and the second was done in May 2017 by students in the <b>Vermont Certified Public Managers Program</b> . Within the past year, DLC has opened or relocated five stores, closed two stores that were underperforming, and identified locations in eight counties for new retail outlets. DLC provided their updated criteria used for selecting and closing agency stores.
	2	Obtain a review of liquor pricing to establish a methodology for competitive pricing.	2015	Not Implemented	As we reported in the 2014 audit, DLC changed it's markup structure in 2013 but has not conducted a pricing study to establish a methodology for competitive pricing.
			2017	Implemented	The DLC <b>Commissioner reported</b> that a review of pricing comparisons with the border states of Maine, New Hampshire, and New York has been completed. In November 2016, DLC initiated a three-step approach to improve their price competition position by (1) changing the price programming structure to improve pricing for products that have promotional pricing, (2) reinventing the 802 Spirits marketing publication with <b>state-wide</b> distribution, featuring only discounted product pricing and comparisons with <b>NH</b> frontline price <b>and</b> (3) monthly updating of the DLC website with real-time pricing and highlighting sales items. According to the <b>DLC Commissioner</b> , this new strategy resulted in additional revenues of \$3 million in FY 2017.
	3	Perform or contract for an analysis of warehouse capacity.	2015	Implemented	DLC hired a consultant to perform an operational evaluation. The consultant's report, issued on September 29, 2015, included an analysis of warehouse capacity based on the current and alternative warehouse layouts.
			No further follow-up is required because the recommendation was implemented		
	4	Establish minimum and maximum inventory levels to be maintained in the warehouse and implement a systematic process to monitor manufacturers' compliance with established inventory levels.	2015	Implemented	DLC provided an example of their analysis of inventory levels which showed the current inventory levels (weeks on hand) in relation to the average weekly sales and available inventory. Each item is assigned a velocity code based on average weekly sales movement with corresponding acceptable minimum and maximum range. As of July 13, 2015, DLC has been using these inventory reports to monitor the manufacturer's compliance to established inventory levels.
			No further follow-up is required because the recommendation was implemented		
	5	Establish and implement a policy to assess manufacturers' fees for noncompliance with minimum and maximum inventory levels.	2015	Implemented	<b>DLC has implemented a new policy</b> , effective July 13, 2015, for assessing penalties for handling charges which includes overstock and out of stock items.
			No further follow-up is required because the recommendation was implemented		

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<a href="#">14-6 Liquor Control System: Fiscal Impact of Privatization Projected as Neutral, but DLC Could Take Other Actions that May Increase Profits</a>	6	Enhance the product attributes and financial metrics used for delisting decisions.	2015	Partially Implemented	DLC is now including more details, e.g., notes, comparisons to sales in other states, and the reasoning behind their delisting recommendations. However, DLC has not expanded their use of product attributes or financial metrics.	
			2017	Partially Implemented	The <b>DLC Commissioner</b> reported new listing and de-listing procedures were implemented in January and July 2017. Under the new delisting procedures, brokers and suppliers are no longer able to appeal DLC's decision and all products need to have a <b>gross income of more than \$2,500</b> in order to remain listed. DLC created six types of product classifications and a level of acceptable profitability by Stock Keeping Unit (SKU) number for regular listed and limited distribution SKU's. However, DLC did not provide evidence of adding additional product attributes and financial metrics for delisting decisions, which we recommended in our audit report such as margins, growth rates and case volume. Therefore, this recommendation stands as partially implemented.	
	7	Establish clear goals and targets for each performance category used to evaluate agent store performance, including sales targets.	2015	Not Implemented	DLC reported that this recommendation has not been implemented.	
			2017	Partially Implemented	The <b>DLC Commissioner</b> reported that new criteria were implemented in July-August 2017 for (1) incentive commissions which includes 50 objective performance criteria and a rating system of satisfactory, warning, and unsatisfactory, (2) revised agency contract obligations, and (3) revised agency criteria used to evaluate new applicants. However, <b>DLC did not provide evidence that sales targets have been implemented to evaluate the performance of agent stores</b> . Therefore, this recommendation stands as partially implemented.	
	8	Work with the AG's Office in an expeditious manner to bring the department into compliance with Bulletin No. 3.5.	2015	Implemented	DLC reported that a waiver of Bulletin 3.5 and approval of a contracting plan for liquor agency contracts was approved by the Secretary of Administration on January 21, 2014.	
	No further follow-up is required because the recommendation was implemented					
	9	Develop and implement systematic analysis of results of sales promotions, including comparison of actual results to estimates.	2015	Partially Implemented	In October 2015, DLC received approval from the Secretary of Administration to hire a <b>deputy commissioner</b> to focus on the business side of DLC which should provide the resources for analyzing sales data and recommending policy changes. Additionally, DLC plans on implementing a new POS system which will have the capability to provide more robust data analysis.	
			2017	Implemented	The department has developed multiple analyses of the <b>sale</b> program. The <b>DLC Commissioner</b> reported that he receives (1) monthly depletion reports comparing the sales program and total sales results on a monthly, quarterly, and year to-date basis; (2) quarterly performance reports which detail gross revenue, supplier and state programming spending, and net profitability for the period; and (3) three-year comparisons to establish trends and evaluate performance.	
	10	Determine what positions are needed to perform strategic and business analysis and recruit and hire for the positions.	2015	Partially Implemented	DLC reported that it has created a Deputy Commissioner position with the permission of the Secretary of Administration. The Liquor Control Board envisions working with the commissioner or the <b>deputy commissioner</b> to perform strategic and business analysis.	
			2017	Implemented	The <b>DLC Commissioner</b> reported that a new management team has been assembled. It consists of (1) the <b>deputy commissioner</b> who has been a key asset in developing and implementing a strategic plan, (2) the retail sales director who performs business analytics to track agency sales performance, agency product inventory levels, and develops consistent shelf set standards for agent stores, and (3) the professional marketing director responsible for re-branding and improving marketing outreach.	