

**DEPARTMENT OF ALCOHOLIC BEVERAGE CONTROL
RICHMOND, VIRGINIA**

**REPORT ON AUDIT
FOR THE YEAR ENDED
JUNE 30, 2002**



AUDIT SUMMARY

Our audit of the Department of Alcoholic Beverage Control of the Commonwealth of Virginia for the year ended June 30, 2002, found:

- the financial statements are presented fairly, in all material respects;
- no internal control matters that we consider material weaknesses; and
- no instances of noncompliance required to be reported under Government Auditing Standards.

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AUDIT SUMMARY

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AGENCY OFFICIALS

September 27, 2002

The Honorable Mark R. Warner
Governor of Virginia
State Capital
Richmond, Virginia

The Honorable Kevin G. Miller
Chairman, Joint Legislative Audit
and Review Commission
General Assembly Building
Richmond, Virginia

We have audited the accounts and records of the **Department of Alcoholic Beverage Control** as of and for the year ended June 30, 2002, and submit herewith our complete reports on financial statements and compliance and internal controls.

INDEPENDENT AUDITOR'S REPORT ON FINANCIAL STATEMENTS

We have audited the accompanying basic statements of the Department of Alcoholic Beverage Control as of and for the year ended June 30, 2002, as listed in the Table of Contents. The financial statements are the responsibility of the Department's management. Our responsibility is to express an opinion on these basic financial statements based on our audit.

We conducted our audit in accordance with 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. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

As discussed in Note 1A, the basic financial statements of the Department are intended to present the financial position and changes in financial position and cash flows on only that portion of the business-type activities and the aggregate remaining fund information of the Commonwealth of Virginia that is attributable to the transactions of the Department. They do not purport to, and do not, present fairly the financial position of the Commonwealth of Virginia as of June 30, 2002, and the changes in its financial position and its cash flows, for the year then ended in conformity with accounting principles generally accepted in the United States of America.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Department of Alcoholic Beverage Control as of June 30, 2002, and the changes in its financial position and cash flows for the year then ended, in conformity with accounting principles generally accepted in the United States of America.

INDEPENDENT AUDITOR'S REPORT ON COMPLIANCE AND
ON INTERNAL CONTROL OVER FINANCIAL REPORTING

In planning and performing our audit of the financial statements of the Department of Alcoholic Beverage Control as of and for the year ended June 30, 2002, we considered internal controls over financial reporting and tested compliance with certain provisions of laws, regulations, contracts, and grants in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in Government Auditing Standards.

Compliance

As part of obtaining reasonable assurance about whether the Department's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grants, 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 that are required to be reported under Government Auditing Standards.

Internal Control Over Financial Reporting

In planning and performing our audit, we considered the Department's internal control over financial reporting in order to determine our auditing procedures for the purpose of expressing our opinion on the financial statements and not to provide assurance on the internal control over financial reporting. Our consideration of the internal control over financial reporting would not necessarily disclose all matters in the internal control that might be material weaknesses. A material weakness is a condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements in amounts that would be material in relation to the financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. We noted no matters involving the internal control over financial reporting and its operation that we consider to be material weaknesses.

The "Independent Auditor's Report on Compliance and on Internal Control Over Financial Reporting" is intended solely for the information and use of the Governor and General Assembly of Virginia, and the Department of Alcoholic Beverage Control Board and management, and is not intended to be and should not be used by anyone other than these specified parties. However, this report is a matter of public record and its distribution is not limited.

EXIT CONFERENCE

We discussed this report with management at an exit conference held on September 30, 2002.

AUDITOR OF PUBLIC ACCOUNTS

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DEPARTMENT OF ALCOHOLIC BEVERAGE CONTROL
STATEMENT OF NET ASSETS
As of June 30, 2002

ASSETS

Current assets:	
Cash (Note 2)	\$ 272,981
Petty cash	130,000
Receivables	3,096,667
Inventory - Alcohol	26,991,709
Inventory - Lottery tickets	200,532
Prepaid expenses	709,406
Investments held by Treasurer of Virginia (Note 8)	<u>20,849</u>
Total current assets	<u>31,422,144</u>
Long term assets (Note 3):	
Land	1,577,406
Building, Net	590,302
Equipment, Net	<u>17,114,431</u>
Total long term assets	<u>19,282,139</u>
Total assets	<u><u>\$ 50,704,283</u></u>

LIABILITIES AND NET ASSETS

Current liabilities:	
Accounts payable	\$ 10,826,297
Installment notes payable (Note 6)	1,074,768
Deferred revenue	89,886
Due to Commonwealth of Virginia (Note 4)	28,106,433
Obligations under securities lending (Note 8)	20,849
Compensated absences payable (Note 7)	<u>2,250,673</u>
Total current liabilities	<u>42,368,906</u>
Long term liabilities:	
Installment notes payable (Note 6)	4,618,882
Compensated absences payable (Note 7)	<u>3,076,690</u>
Total liabilities	<u>50,064,478</u>
Net assets:	
Invested in capital assets, net of related debt	13,588,489
Unrestricted net assets	<u>(12,948,684)</u>
Total net assets	<u>639,805</u>
Total liabilities and net assets	<u><u>\$ 50,704,283</u></u>

The accompanying Notes to Financial Statements are an integral part of this statement.

DEPARTMENT OF ALCOHOLIC BEVERAGE CONTROL
STATEMENT OF REVENUES, EXPENSES, AND CHANGES IN NET ASSETS
For the Year Ended June 30, 2002

Operating revenues:	
Sales of alcohol	\$ 338,745,451
Sales of lottery tickets	7,079,411
License and permit fees	7,202,225
Wine wholesalers tax	2,780,588
Penalties	2,783,136
Federal grants and contracts	1,421,326
Mixed beverage tax on common carriers	40,169
Miscellaneous	605,535
	<u>360,657,841</u>
Net operating revenues	
	<u>360,657,841</u>
Operating expenses:	
Cost of sales of alcohol	221,641,489
Cost of sales of lottery tickets	6,712,076
Personal services	53,559,927
Continuous charges	11,324,063
Contractual charges	11,688,412
Supplies and materials	1,858,930
Depreciation	5,060,311
Expendable equipment	1,756,949
Other	898,439
	<u>314,500,596</u>
Total operating expenses	
	<u>314,500,596</u>
Operating income	
	<u>46,157,245</u>
Nonoperating revenues (expenses):	
Rents	20,520
Seized assets	(97,299)
	<u>(76,779)</u>
Total nonoperating revenues (expenses)	
	<u>(76,779)</u>
Net profit before transfers	
	<u>46,080,466</u>
Transfers out:	
Transfers of profits to the General Fund of the Commonwealth	(28,215,242)
Appropriation Act transfers	(18,021,509)
	<u>(46,236,751)</u>
Total transfers	
	<u>(46,236,751)</u>
Net income after transfers	
	(156,285)
Total net assets - July 1, 2001	
	<u>796,090</u>
Total net assets - June 30, 2002	
	<u>\$ 639,805</u>

The accompanying Notes to Financial Statements are an integral part of this statement.

DEPARTMENT OF ALCOHOLIC BEVERAGE CONTROL
STATEMENT OF CASH FLOWS
For the Year Ended June 30, 2002

Cash flows from operating activities:	
Cash received from sales	\$ 345,976,883
Cash received from licenses and fees	7,217,061
Cash received from other revenue	7,331,704
Cash payments for cost of sales	(228,416,537)
Cash payments for personal services	(53,477,504)
Cash payments for other expenses	<u>(27,438,297)</u>
Net cash provided by operating activities	<u>51,193,310</u>
Cash flows from noncapital financing activities:	
Net proceeds, notes payable, and other adjustments	754,403
Cash received from taxes	101,155,466
Transfers of tax collections to the General Fund of the Commonwealth	(86,341,416)
Transfers of tax collections to the Department of Taxation	(14,717,729)
Transfers of profit to the General Fund of the Commonwealth	(25,412,505)
Appropriation Act transfers	<u>(18,021,509)</u>
Net cash used for noncapital financing activities	<u>(42,583,290)</u>
Cash flows from capital financing activities:	
Acquisition of equipment	<u>(8,660,710)</u>
Net cash used for capital financing activities	<u>(8,660,710)</u>
Net decrease in cash and cash equivalents	(50,690)
Cash and cash equivalents - July 1, 2001	<u>453,671</u>
Cash and cash equivalents - June 30, 2002	<u><u>\$ 402,981</u></u>
Reconciliation of net profit to net cash provided by operating activities:	
Net profit before transfer	\$ 46,080,466
Adjustments to reconcile net profit to net cash provided by operating activities:	
Depreciation	5,060,311
Change in assets and liabilities:	
Increase in accounts receivable	(70,250)
Increase in inventory	(1,985,097)
Increase in compensated absences	82,423
Increase in accounts payable	1,922,125
Decrease in prepaid items	88,496
Increase in deferred revenue	<u>14,836</u>
Net cash provided by operating activities	<u><u>\$ 51,193,310</u></u>

Noncash financing activities:

The Department entered into an installment purchase agreement to purchase new point of sale cash registers and related software costing \$4,618,882.

The accompanying Notes to Financial Statements are an integral part of this statement.

DEPARTMENT OF ALCOHOLIC BEVERAGE CONTROL

NOTES TO FINANCIAL STATEMENTS

AS OF JUNE 30, 2002

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

A. Reporting Entity

The Department of Alcoholic Beverage Control administers ABC laws with an emphasis on public service and a focus on public safety by ensuring a safe, orderly, and regulated system for convenient distribution and responsible consumption of alcoholic beverages while generating a reasonable profit for the Commonwealth and its localities.

A separate report is prepared for the Commonwealth of Virginia, which includes all agencies, boards, commissions, and authorities over which the Commonwealth exercises or has the ability to exercise oversight authority. The Department is an agency of the Commonwealth of Virginia and is included in the general-purpose financial statements of the Commonwealth.

B. Fund Accounting

The activities of the Department are accounted for in an enterprise fund. The enterprise fund is used to account for operations that are financed and operated in a manner similar to private business enterprises where the intent of the governing body is that the costs of providing goods and services to the general public on a continuing basis, including depreciation, be financed or recovered primarily through user charges.

C. Basis of Accounting

The Department's records are maintained on the accrual basis whereby revenues are recognized when earned and expenses are recognized when the liability is incurred.

Operating revenues and expenses include activities related to the sale of alcohol and licenses, as well as enforcement activities. Nonoperating revenues and expenses include activities that have the characteristics of noncapital financing activities, such as the collection of rent, as defined by GASB Statement 9, *Reporting Cash Flows of Proprietary and Nonexpendable Trust Funds and Governmental Entities That Use Proprietary Fund Accounting*, and GASB Statement 34.

D. Inventories

Merchandise inventory, purchased for resale, is valued at average cost, which is lower than market value.

2. CASH WITH THE TREASURER OF VIRGINIA

All state funds of the Department are held by the Treasurer of Virginia, pursuant to Section 2.2-1800, et. seq., Code of Virginia, who is responsible for the collection, disbursement, custody, and investment of state funds. Each fund's equity in pooled state funds is reported as "Cash" on the balance sheet and is not categorized as to credit risk.

3. FIXED ASSETS

The following schedule presents the changes in fixed assets by category.

	Balance at June 30, 2001	Acquired	Deleted	Balance at June 30, 2002
Land	\$ 1,577,406	\$ -	\$ -	\$ 1,577,406
Buildings	9,216,382	-	-	9,216,382
Equipment	<u>24,087,906</u>	<u>13,279,592</u>	<u>(5,989,451)</u>	<u>31,378,047</u>
Total at historical cost	<u>34,881,694</u>	<u>13,279,592</u>	<u>(5,989,451)</u>	<u>42,171,835</u>
Less accumulated depreciation:				
Building	8,478,602	(147,478)	-	8,626,080
Equipment	<u>15,299,878</u>	<u>(4,869,185)</u>	<u>5,905,447</u>	<u>14,263,616</u>
Capital assets, Net	<u>\$11,103,214</u>	<u>\$ 8,262,929</u>	<u>\$ (84,004)</u>	<u>\$19,282,139</u>

The Department capitalizes all property, plant, and equipment that have a cost or value equal to or greater than \$5,000. Property, plant, and equipment are stated at cost and at the time of acquisition are set up in a comprehensive fixed asset system. Depreciation of the cost of property, plant, and equipment is provided on a straight-line basis over their estimated lives of from ten to thirty years on buildings and from three to eight years on equipment.

4. DUE TO THE COMMONWEALTH

A. Note Payable

The Department has a line of credit for \$25,000,000 with the Treasurer of Virginia. Repayment is made from revenue collections pursuant to Title 4.1, Chapter 1 of the Code of Virginia. As of June 30, 2002, the Department had outstanding \$23,439,680 of its available line of credit to extinguish a cash overdraft.

B. General Fund

The Department collects certain taxes on behalf of the General Fund of the Commonwealth. The state tax on sales is collected from store sales and is paid quarterly to the General Fund of the Commonwealth. The liter tax is collected on wholesalers' direct wine shipments. Twelve percent of the liter tax is retained by the Department and reported as wine wholesalers' tax on the Department's financial statements. The remainder is paid to the General Fund of the Commonwealth quarterly. Of the liter tax paid to the General Fund, the Commonwealth subsequently transfers 50 percent to localities. Collections and transfers of state tax on sales and liter tax are not reported on the Statement of Revenues, Expenses, and Changes in Net Assets. Activity relating to the amounts due to the General Fund for the year ended June 30, 2002, is summarized below.

	<u>State Tax on Sales</u>	<u>Liter Tax on Wine</u>	<u>Total</u>
Balance due to the General Fund, July 1, 2001	\$ (167,706)	\$ 267,431	\$ 99,725
Receipts for fiscal year	66,432,019	20,000,442	86,432,461
Transfers to the General Fund	<u>(66,368,852)</u>	<u>(19,972,564)</u>	<u>(86,341,416)</u>
Balance due to the General Fund, June 30, 2002	<u>\$ (104,539)</u>	<u>\$ 295,309</u>	<u>\$ 190,770</u>

C. Department of Taxation - Sales Tax

The Department collects sales tax on all sales of alcohol and remits collections monthly to the Department of Taxation. Sales tax collections and transfers are not reported on the Statement of Revenues, Expenses, and Changes in Net Assets. Activity relating to the amounts due to the Department of Taxation for the year ended June 30, 2002, is summarized below.

Balance due to the Department of Taxation, July 1, 2001	\$ 1,173,231
Sales tax collections	14,723,005
Transfers to the Department of Taxation	<u>(14,717,729)</u>
Balance due to the Department of Taxation, June 30, 2002	<u>\$ 1,178,507</u>

D. Earned Surplus

The Appropriation Act, Chapter 814 of the 2002 Acts of Assembly, requires the Department to transfer an estimate of its fourth quarter profits in the month of June. In accordance with the Alcoholic Beverage Control Act, Section 4.1-116 of the Code of Virginia, the Department transfers any additional net profit to the General Fund of the Commonwealth 50 days after the last day of the quarter. The Department underestimated

profit for the fourth quarter resulting in an additional \$3,297,476 due to the General Fund at June 30, 2002.

5. LEASE COMMITMENTS

The Department is committed under various operating lease agreements for store buildings. Rent expense under operating lease agreements amounted to \$9,147,860 for the year. A summary of future obligations under lease agreements as of June 30, 2002, follows.

Year Ending <u>June 30,</u>	
2003	\$ 6,625,767
2004	5,555,171
2005	4,364,599
2006	2,925,708
2007	992,029
2008	<u>113,465</u>
Total obligations	<u>\$20,576,739</u>

6. INSTALLMENT PURCHASES

During fiscal year 2002, the Department entered into a five-year installment purchase agreement through the Master Equipment Leasing Program offered by the Department of the Treasury in order to obtain new point of sale cash registers and software. The interest rate charges range from 4.1087 percent to 4.4192 percent. Principal and interest payments of this commitment for fiscal years subsequent to June 30, 2002 are as follows. Additional cash registers will be obtained and financed in fiscal year 2003 in order to complete the project.

Year Ending <u>June 30,</u>	<u>Principal</u>	<u>Interest</u>	Total <u>Obligations</u>
2003	\$1,074,768	\$222,103	\$1,296,871
2004	1,121,551	175,320	1,296,871
2005	1,170,372	126,499	1,296,871
2006	1,221,322	75,549	1,296,871
2007	<u>1,105,637</u>	<u>22,600</u>	<u>1,128,238</u>
Total	<u>\$5,693,650</u>	<u>\$622,071</u>	<u>\$6,315,722</u>

The following schedule presents the changes in long term debt.

<u>Balance at June 30, 2001</u>	<u>Increase</u>	<u>Decrease</u>	<u>Balance at June 30, 2002</u>
<u>\$ -</u>	<u>\$5,829,797</u>	<u>\$136,147</u>	<u>\$5,693,650</u>

7. COMPENSATED ABSENCES

Compensated absences reflected in the Statement of Net Assets represent the amounts of vacation, sick, and compensatory leave earned by employees of the Department, but not taken at June 30, 2002. The amount reflects all earned vacation, sick, and compensatory leave payable under the Commonwealth of Virginia's leave payout policies. Information on the Commonwealth's leave payout policies is available at the statewide level in the Commonwealth of Virginia's Comprehensive Annual Financial Report.

<u>Balance as of</u> <u>June 30, 2001</u>	<u>Increases</u>	<u>Decreases</u>	<u>Balance as of</u> <u>June 30, 2002</u>
<u>\$5,235,062</u>	<u>\$2,693,648</u>	<u>\$2,601,347</u>	<u>\$5,327,363</u>

8. SECURITIES LENDING TRANSACTIONS

Investments held by the Treasurer of Virginia represent the Department's allocated share of cash collateral received and reinvested and securities received for the State Treasury's securities lending program. Information related to the credit risk of these investments and the State Treasury's securities lending program is available on a statewide level in the Commonwealth of Virginia's Comprehensive Annual Financial Report.

9. COLLECTIONS OF MALT BEVERAGE TAX

During the year ended June 30, 2002, the Department collected \$41,950,467 in malt beverage taxes. These funds are deposited by the Department directly with the Treasurer of Virginia for credit to the General Fund of the Commonwealth and are not available to the Department to meet current operating needs and are not included in the financial statements.

10. PENSION PLAN AND OTHER POST RETIREMENT BENEFITS

The employees of the Department are employees of the Commonwealth. The employees participate in a defined benefit plan administered by the Virginia Retirement System (VRS). The VRS also administers life insurance and health related plans for retired employees. Information related to these plans is available on a statewide level only in the Commonwealth of Virginia's Comprehensive Annual Financial Report. The Commonwealth, not the Department, has overall responsibility for contributions to these plans.

11. RISK MANAGEMENT

The Department is exposed to various risks of loss related to torts: theft or, damage to, and destruction of assets; errors and omissions; non-performance of duty; injuries to employees; and natural disasters. The Virginia Lottery participates in insurance plans maintained by the Commonwealth of Virginia. The state employee health care and worker's compensation plans are administered by the Department of Human Resource Management and the risk management insurance plans are administered by the Department of Treasury, Division of Risk Management. Risk management insurance includes property, general liability, medical malpractice, faithful performance

of duty bond, automobile, and air and watercraft plans. The Virginia Lottery pays premiums to each of these Departments for its insurance coverage. Information relating to the Commonwealth's insurance plans is available at the statewide level in the Commonwealth of Virginia's Comprehensive Annual Financial Report.

12. CONTINGENT LIABILITIES

The Department is named as a party in several legal proceedings. It is not possible at the present time to estimate ultimate outcome or liability, if any, of the Department in respect to the various proceedings; however, it is believed that any ultimate liability resulting from these suits will not have a material, adverse effect on the financial condition of the Department.

DEPARTMENT OF ALCOHOLIC BEVERAGE CONTROL
Richmond, Virginia

BOARD MEMBERS
As of June 30, 2002

Vernon M. Danielsen, Chairman

Warren E. Barry

Esther H. Vassar