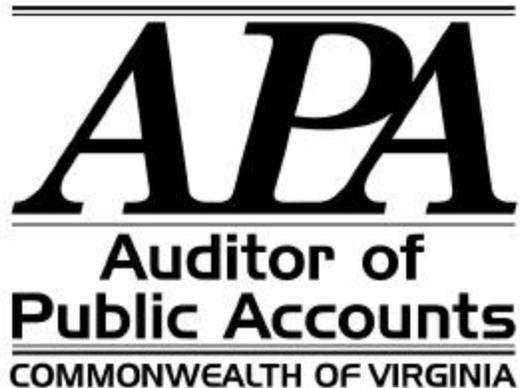


**DEPARTMENT OF ALCOHOLIC BEVERAGE CONTROL
RICHMOND, VIRGINIA**

**REPORT ON AUDIT
FOR THE YEAR ENDED
JUNE 30, 2001**



AUDIT SUMMARY

Our audit of the Department of Alcoholic Beverage Control for the year ended June 30, 2001, 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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September 25, 2001

The Honorable James S. Gilmore, III
Governor of Virginia
State Capitol
Richmond, Virginia

The Honorable Vincent F. Callahan, Jr.
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** (the Department) as of and for the year ended June 30, 2001, and submit herewith our complete reports on financial statements and compliance and internal controls over financial reporting.

INDEPENDENT AUDITOR'S REPORT ON FINANCIAL STATEMENTS

We have audited the balance sheet of the Department of Alcoholic Beverage Control as of June 30, 2001, and the related statements of revenues, expenses, and retained earnings, and cash flows for the year then ended. These financial statements are the responsibility of the Department's management. Our responsibility is to express an opinion on these 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, and evaluating the overall financial statement presentation. We believe our audit provides a reasonable basis for our opinion.

As discussed in Note 1A, the financial statements of the Department are intended to present the financial position and results of its operations and cash flows on only that portion of the financial reporting entity of the Commonwealth of Virginia that is attributable to the transactions of the Department.

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, 2001, and the results of its operations 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, 2001, 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 Governmental 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 controls over financial reporting and its operation that we consider to be material weaknesses.

Status of Prior Findings

The Department has taken adequate corrective action with respect to audit findings reported in the prior year.

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, General Assembly of Virginia, 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 on October 3, 2001.

AUDITOR OF PUBLIC ACCOUNTS

LCR:aom
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FINANCIAL STATEMENTS

DEPARTMENT OF ALCOHOLIC BEVERAGE CONTROL
BALANCE SHEET
As of June 30, 2001

ASSETS

Current assets:	
Cash (Note 2)	\$ 323,671
Petty cash	130,000
Receivables	3,026,417
Inventory-alcohol	24,813,524
Inventory-lottery tickets	393,621
Prepaid expenses	797,903
Investments held by Treasurer of Virginia (Note 7)	<u>44,216</u>
Total current assets	29,529,352
Long term assets:	
Fixed assets (Net of accumulated depreciation) (Note 3)	<u>11,103,214</u>
Total assets	<u>\$ 40,632,566</u>

LIABILITIES AND FUND EQUITY

Current liabilities:	
Accounts payable	\$ 9,984,127
Deferred revenue	75,050
Due to Commonwealth of Virginia (Note 4)	24,493,330
Obligations under Securities Lending (Note 7)	44,216
Compensated absences payable	<u>4,691</u>
Total current liabilities	34,601,414
Long term liabilities:	
Compensated absences payable	<u>5,235,062</u>
Total liabilities	<u>39,836,476</u>
Fund equity:	
Contributed capital	1,600,000
Retained earnings (Note 5)	<u>(803,910)</u>
Total equity	<u>796,090</u>
Total liabilities and fund equity	<u>\$ 40,632,566</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 RETAINED EARNINGS
For the Year Ended June 30, 2001

Operating revenues:	
Sales of alcohol	\$ 319,904,576
Sales of lottery tickets	7,009,398
License and permit fees	7,202,160
Wine wholesalers tax	2,688,768
Penalties	1,425,485
Federal grants and contracts	883,035
Mixed beverage tax on common carriers	84,035
Income from Securities Lending Transactions	132,307
Miscellaneous	<u>367,747</u>
Net operating revenues	<u>339,697,511</u>
Operating expenses:	
Cost of sales of alcohol	208,853,830
Cost of sales of lottery tickets	6,823,658
Personal services	52,387,888
Continuous charges	10,575,588
Contractual charges	9,838,834
Supplies and materials	1,645,207
Depreciation	6,337,036
Expendable equipment	1,187,608
Expenses for Securities Lending Transactions	132,307
Other	<u>594,999</u>
Total operating expenses	<u>298,376,955</u>
Operating income	<u>41,320,556</u>
Nonoperating revenues:	
Rents	20,520
Seized assets	<u>31,613</u>
Total nonoperating revenues	<u>52,133</u>
Net profit before transfers	<u>41,372,689</u>
Transfers out:	
Transfers of profits to the General Fund of the Commonwealth	(28,140,904)
Appropriation Act transfers	<u>(13,264,671)</u>
Total transfers	<u>(41,405,575)</u>
Net income after transfers	(32,886)
Retained Earnings (deficit) - July 1, 2000	<u>(771,024)</u>
Retained Earnings (deficit) - June 30, 2001 (Note 5)	<u>\$ (803,910)</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, 2001

Cash flows from operating activities:	
Cash received from sales	\$ 326,575,518
Cash received from licenses and fees	7,083,150
Cash received from other revenue	5,233,011
Cash payments for cost of sales	(219,229,369)
Cash payments for personal services	(52,084,157)
Cash payments for other expenses	<u>(23,852,702)</u>
Net cash provided by operating activities	<u>43,725,451</u>
Cash flows from noncapital financing activities:	
Net proceeds, notes payable, and other adjustments	1,201,073
Cash received from taxes	96,217,810
Transfers of tax collections to the General Fund of the Commonwealth	(82,864,353)
Transfers of tax collections to the Department of Taxation	(13,656,003)
Transfers of profit to the General Fund of the Commonwealth	(28,107,787)
Appropriation Act transfers	<u>(13,264,671)</u>
Net cash used for noncapital financing activities	<u>(40,473,931)</u>
Cash flows from capital financing activities:	
Acquisition of equipment	<u>(2,960,024)</u>
Net increase in cash and cash equivalents	291,496
Cash and cash equivalents - July 1, 2000	<u>162,175</u>
Cash and cash equivalents - June 30, 2001	<u>\$ 453,671</u>
Reconciliation of net profit to net cash provided by operating activities:	
Net profit before transfer	41,372,689
Adjustments to reconcile net profit to net cash provided by operating activities:	
Depreciation	6,337,036
Change in assets and liabilities:	
Increase in accounts receivable	(738,955)
Increase in inventory	(324,127)
Decrease in prepaid items	121,841
Increase in compensated absences	303,731
Decrease in accounts payable	(3,227,754)
Decrease in deferred revenue	<u>(119,010)</u>
Net cash provided by operating activities	<u>\$ 43,725,451</u>

The accompanying notes to financial statements are an integral part of this statement.

NOTES TO FINANCIAL STATEMENTS

DEPARTMENT OF ALCOHOLIC BEVERAGE CONTROL

NOTES TO FINANCIAL STATEMENTS

AS OF JUNE 30, 2001

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

A. Reporting Entity

The Department of Alcoholic Beverage Control controls the distribution of alcoholic beverages, operates local retail outlets, and enforces the laws of the Commonwealth pertaining to alcoholic beverages and access to tobacco products while providing a reliable source of revenue.

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 a part 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.

D. Inventories

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

E. Compensated Absences

Compensated absences reflected in the balance sheet represent the amounts of vacation, sick, and compensatory leave earned by employees of the Department, but not taken at June 30, 2001. 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.

2. CASH WITH THE TREASURER OF VIRGINIA

All state funds of the Department are held by the Treasurer of Virginia, pursuant to Section 2.1.177, 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 schedule below shows the breakdown of fixed assets by category at June 30, 2001.

	<u>Total Fixed Assets</u>	<u>Accumulated Depreciation</u>	<u>Net Fixed Assets</u>
Land	\$ 1,577,406	\$ -	\$ 1,577,406
Buildings	9,216,382	8,478,602	737,780
Equipment	<u>24,087,906</u>	<u>15,299,878</u>	<u>8,788,028</u>
Total	<u>\$34,881,694</u>	<u>\$23,778,480</u>	<u>\$11,103,214</u>

The following schedule presents the changes in Fixed Assets by category.

	<u>Balance at June 30, 2000</u>	<u>Acquired</u>	<u>Deleted</u>	<u>Balance at June 30, 2001</u>
Land	\$ 1,577,406	\$ -	\$ -	\$ 1,577,406
Buildings	9,216,382	-	-	9,216,382
Equipment	<u>24,371,222</u>	<u>2,960,024</u>	<u>(3,243,340)</u>	<u>24,087,906</u>
Total	<u>\$35,165,010</u>	<u>\$2,960,024</u>	<u>\$(3,243,340)</u>	<u>\$34,881,694</u>

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 10 to 30 years on buildings and from three to eight years on equipment. The Department capitalizes all property, plant, and equipment that have a cost or value greater than \$4,999 and an expected useful life of at least three years. In fiscal year 2001, the Department accelerated depreciation on its Product Distribution System and laptop computers. The change in the depreciation period increased depreciation expense by approximately \$1,300,000.

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, 2001, the Department had outstanding \$22,725,635 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 Retained Earnings. Activity relating to the amounts due to the General Fund for the year ended June 30, 2001, 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, 2000	\$ 76,006	\$ 427,552	\$ 503,558
Receipts for fiscal year	62,781,177	19,679,343	82,460,520
Transfers to the General Fund	<u>(63,024,889)</u>	<u>(19,839,464)</u>	<u>(82,864,353)</u>
Balance due to the General Fund June 30, 2001	<u>\$ (167,706)</u>	<u>\$ 267,431</u>	<u>\$ 99,725</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 Retained Earnings. Activity relating to the amounts due to the Department of Taxation for the year ended June 30, 2001, is summarized below.

Balance due to the Department of Taxation, July 1, 2000	\$ 1,071,944
Sales tax collections	13,757,290
Transfers to the Department of Taxation	<u>(13,656,003)</u>
Balance due to the Department of Taxation, June 30, 2001	<u>\$ 1,173,231</u>

D. Earned Surplus

The Appropriation Act, Chapter 1073 of the 2000 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 \$494,739 due to the General Fund at June 30, 2001.

5. DEFICIT RETAINED EARNINGS

The Department ended the year with a deficit retained earnings of \$803,910. This is attributable to the difference between the statutory method of calculating transfers to the Commonwealth prior to 1994 and calculating net profit.

6. LEASE COMMITMENTS

The Department is committed under various operating lease agreements for store buildings. Rent expense under operating lease agreements amounted to \$8,455,922 for the year. A summary of future obligations under lease agreements as of June 30, 2001, follows.

2002	\$ 5,536,752
2003	4,244,600
2004	3,193,829
2005	2,066,596
2006	769,798
Later years	<u>365,373</u>
Total obligations	<u>\$16,176,948</u>

7. 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.

8. COLLECTIONS OF MALT BEVERAGE TAX

During the year ended June 30, 2001, the Department collected \$40,632,396 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.

9. 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.

10. RISK MANAGEMENT AND EMPLOYEE HEALTH CARE PLANS

The Department participates in two self-insurance plans maintained by the Commonwealth of Virginia. The state employee health care plan is administered by the Department of Human Resource Management (formerly the Department of Personnel and Training) and the risk management insurance plans are administered by the Department of Treasury, Division of Risk Management. Risk management insurance includes worker's compensation, property, general (tort) liability, and automobile plans. Information relating to the Commonwealth's self-insurance plans is available at the statewide level in the Commonwealth's Comprehensive Annual Financial Report.

11. SURETY BOND

The employees of the Department were covered by a Faithful Performance Duty Bond administered by the Commonwealth of Virginia's Department of Treasury, Division of Risk Management with liability limits of \$500,000 for each occurrence. Information relating to the Commonwealth's self-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.

13. PENDING GASB STATEMENT

Governmental Accounting Standards Board, Statement No. 34, Basic Financial Statements – and Management's Discussion and Analysis – for State and Local Governments, issued June 1999, will be effective for the Commonwealth for the fiscal year ending June 30, 2002. This Statement imposes new standards for financial reporting. The changes to the Department's financial statements will be minimal since its activity is accounted for in an enterprise fund. However, the Department's management will be required to provide a management's discussion and analysis that gives readers an analysis of the agency's overall financial position and results of operations including a comparison of current year results with the prior year. The Department has identified necessary changes and is preparing to implement this Statement.

DEPARTMENT OF ALCOHOLIC BEVERAGE CONTROL
Richmond, Virginia

BOARD MEMBERS

Clarence W. Roberts, Chairman

Sandra C. Canada

Clater C. Mottinger