

Lexington ABC Board

Performance Audit Report



Alcoholic Beverage Control Commission
400 East Tryon Road, Raleigh, NC 27610
p: 919-779-0700 | f: 919-661-5927 | <http://abc.nc.gov>



ABC
COMMISSION
NORTH CAROLINA

TABLE OF CONTENTS

ABC Commission Statement.....	3
Operational Observations, Findings, and Recommendations.....	6
Auditor’s Summary.....	16
Lexington ABC Board Response.....	17
Appendices.....	19



ABC
COMMISSION
NORTH CAROLINA

Alcoholic Beverage Control

September 4, 2014

CHAIRMAN:
JAMES C. GARDNER

Lexington ABC Board
Corey D. Buggs, Chairman
PO Box 1562
Lexington, NC 27293

COMMISSIONERS:
JOEL L. KEITH
Wake Forest

KEVIN M. GREEN
Greensboro

ADMINISTRATOR:
MICHAEL C. HERRING

Dear Chairman Buggs,

LOCATION:
400 East Tryon Road
Raleigh NC 27610

We are pleased to submit this performance audit report on the Lexington ABC Board. The objective of this audit was to examine existing policies, practices, and controls and to provide recommendations on methods to improve operating efficiency at the ABC Board in accordance with new legislative mandates.

MAILING:
4307 Mail Service Center
Raleigh, NC 27699-4307

The report consists of an executive summary, background information, operational findings and recommendations along with your General Manager's response to our recommendations. This report will be posted on the Commission's public web site.

PHONE: (919) 779-0700
FAX: (919) 661-5927
<http://abc.nc.gov/>

We would like to thank you, the ABC Board and your staff for the assistance and cooperation provided to us during the audit. Additionally, we appreciate the efforts your Board has made to comply with the new performance standards along with your continuing efforts to improve customer service and increase profits.

Moniqua S. McLean
ABC Board Auditor

If we can be of assistance in the future, please advise.

Respectfully,

Michael C. Herring
Administrator

CC. North Carolina Association of ABC Boards

EXECUTIVE SUMMARY

By state law, the ABC Commission shall ensure that all local ABC Boards comply with established performance standards by conducting regular audit or performance evaluations. Performance standards shall include, but are not limited to, standards that address enforcement of ABC laws, store appearance, operating efficiency, solvency, and customer service. Performance audits are examinations of existing operating policies, practices, controls, and activities to determine those areas in which there may be a need for improvements. This audit was conducted in accordance with Government Auditing Standards. This report details findings and recommendations with regard to organizational and operational issues.

To achieve the objectives of the audit, ABC Commission staff

- Reviewed applicable General Statutes, ABC Commission Rules, and administrative policies;
- Reviewed applicable reports and studies of ABC boards with similar size and geography;
- Verified compliance with Commission and Board policies;
- Reviewed organizational chart and job descriptions;
- Reviewed ABC board annual audit for the fiscal year 2013;
- Visited both stores;
- Interviewed key ABC board personnel.

BACKGROUND INFORMATION

Chapter 653 of the 1965 Session Laws authorized the City of Lexington to hold an election based upon a petition of at least fifteen percent (15%) of the register voters. The referendum was held on December 21, 1971 and passed 2,970 to 2,565. The first retail sale occurred on January 14, 1972. A mixed beverage election was held on October 2, 1990 and passed 2,112 to 2,002.

Upon election of an ABC store, an ABC board was created consisting of a chairman and two members to serve for three year staggered terms. Current board members are Corey D. Buggs, board chairman, Jim Nance and Ted Smith, board members.

The Lexington ABC Board operates two retail stores. The board staffs five full-time employees and ten part-time employees. The administrative office staff consists of a full-time general manager and finance officer. The general manager is responsible for the oversight of all daily operations pertaining to the stores, inventory management, human resource organization, and other administrative decisions for the board. The finance officer is responsible for accounts payable functions, financial reporting activities, and other duties as required by the ABC Commission statutes and rules. Store employees are primarily responsible for providing friendly customer service to all customers, general store upkeep, and stock maintenance.

OPERATIONAL OBSERVATIONS, FINDINGS, AND RECOMMENDATIONS

On June 3, 2014, ABC Board Auditor, Moniqua S. McLean, visited the Lexington ABC administrative offices and stores and interviewed Brenda Leonard, general manager, and Darren Lindsay, finance officer. Below is a financial analysis followed by operational observations, findings, and recommendations related to the performance audit.

FINANCIAL ANALYSIS

PROFIT PERCENTAGE TO SALES

The profit percentage to sales is calculated by dividing the total income from operations by the total liquor sales (Total Income from Operations/Total Liquor Sales). The Commission has set goals based on the following breakdown:

- Gross sales greater than \$10M – target rate at 9%
- Gross sales between \$2M to \$10M – target rate at 6.5%
- Gross sales less than \$2M – target rate at 5%

In fiscal year 2013, the Lexington ABC Board had gross sales of \$3,533,180; income from operations was \$331,631, a 9.39% profit percentage to sales.

Factors affecting sales and profitability include:

- Surrounding towns and counties with ABC stores include Thomasville, Asheboro, and Rowan/Kannapolis;
- City population is 18,993, a 0.3% increase since 2010;
- Heavily trafficked area due to the position of the second location adjacent to a major highway and to a lake;
- Currently the ABC board rents the second location but plans to purchase property.

DISTRIBUTIONS

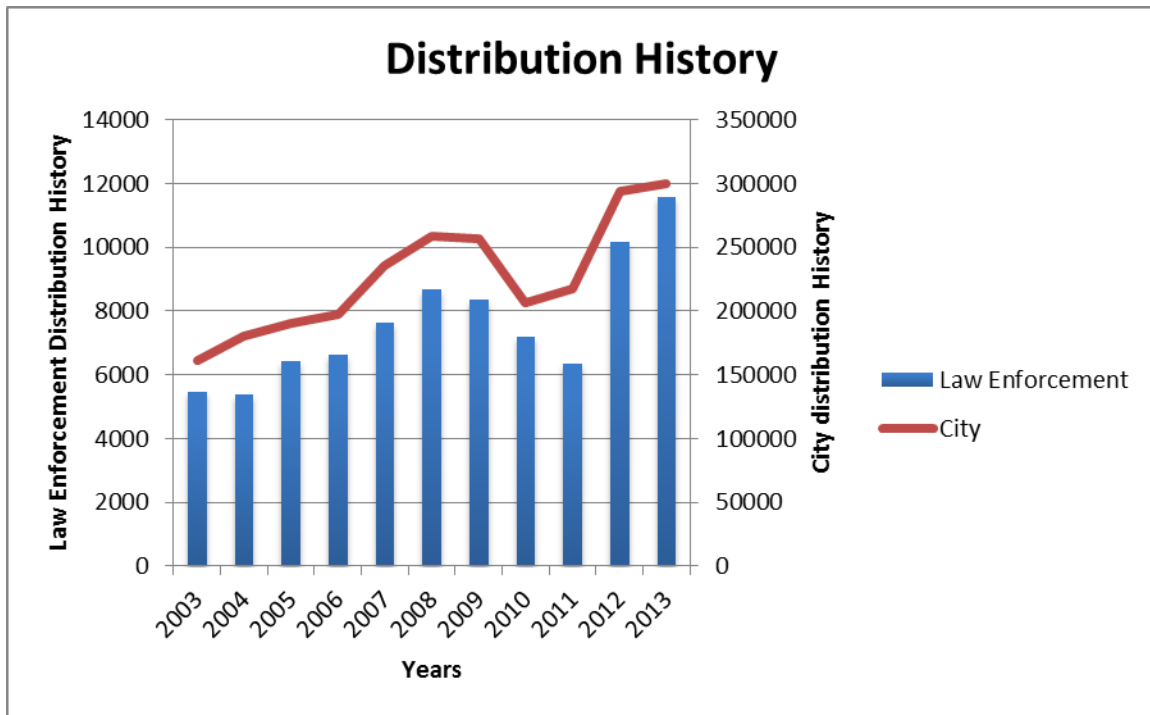
G.S. 18B-805 (b) requires the board to pay from gross receipts, all expenses, excise, mixed beverage, and bottle taxes. G.S. 18B-805 (c) (1) requires the board to make a minimum quarterly distribution of the 3 ½% markup rate to the county. In FY2013, the Lexington ABC board made the required minimum distribution to the city totaling \$102,855, plus an additional \$197,145 to the city. \$815,031 in excise and other taxes were paid to the NC Department of Revenue, the Department of Health and Human Services, and the county.

G.S. 18B-805 (c) (2) requires the board to distribute at least five percent (5%) of net profits to law enforcement. The remaining profits are to be distributed as follows:

- Fifteen percent (15%) to the Lexington General Fund for recreational purposes;
- Fifteen percent (15%) to the Lexington General Fund for schools;
- Seventy percent (70%) to the Lexington General Fund

The Lexington ABC Board has distributed \$11,581 to local law enforcement. The board is exempt from the seven percent (7%) alcohol education distribution.

Below is a distribution chart analyzing the high-low trend of the Lexington ABC Board in the past ten years.



WORKING CAPITAL

G.S. 18B-805 (d) allows the board to set aside a portion of the remaining gross receipts, within the limits set by the rules of the Commission, as cash to operate the ABC system. Working capital is total cash, investments, and inventory less all unsecured liabilities. Gross sales means gross receipts from the sale of alcoholic beverages less distributions as defined in G.S. 18B-805 (b), (2), (3), and (4). The Commission has set efficiency goals based on the following breakdown:

- Four months for boards with gross sales less than \$1.5M
- Three months for boards with gross sales less than \$50M and greater than or equal to \$1.5M
- Two months for boards with gross sales equal to or greater than \$50M

In FY2013, the Lexington ABC Board had a working capital of \$534,153, which is less than three months gross sales and is within the limits of NCAC 02R .0902.

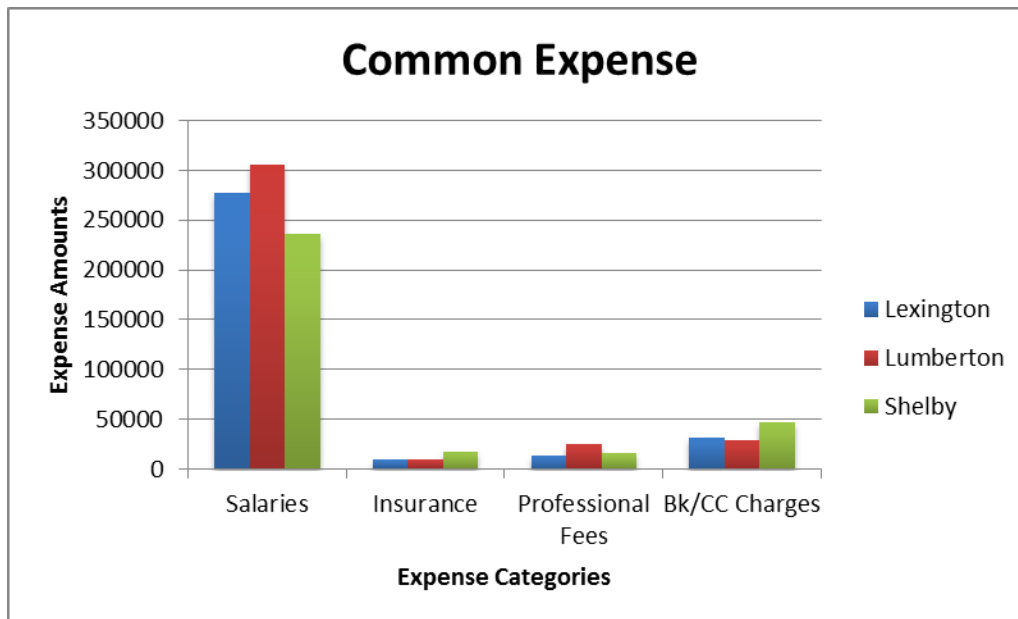
OPERATING COST RATIO

Operating costs are calculated by dividing total operating expenses less depreciation by the gross profit on sales (Total Operating Expenses less Depreciation/Gross Profit). Below are the average cost ratios for boards with and without mixed beverage sales (MXB):

- Single store boards with MXB sales that are equal to or greater than 25% of gross sales – cost ratio 0.75
- Single store boards with MXB sales less than 25% of gross sales – cost ratio 0.85
- Single store boards without MXB sales – cost ratio 0.85
- Boards with 2 stores with and without MXB sales – cost ratio 0.74
- Boards with 3 or more stores with and without MXB sales – cost ratio 0.64

The Lexington ABC Board operates two retail stores with mixed beverage sales: the operating cost ratio is 0.60. Mixed beverage sales make up 8% of total gross sales. In fiscal year 2013, sales increased 3.1% over last fiscal year as expenses decreased 3.9% over the same time period. The board rents the second location but has recently purchased property for a new store in the same area. The board rents the second location for \$28,542 annually.

A common expense analysis shows that Lexington ABC Board expenses compared with other similar size boards are relatively lower.



INVENTORY TURNOVER

The inventory turnover is calculated by dividing the cost of liquor by the average inventory in the system (Cost of Liquor/Average Inventory).

The Lexington ABC Board receives deliveries twice a month: the inventory turnover rate is 7.1. The average inventory turnover rate for similar boards with the same delivery schedule is 5.6.

NO RECOMMENDATIONS

STORE APPEARANCE AND CUSTOMER SERVICE

The Lexington ABC Board operates two retail stores with an average shelf space of approximately 980 linear feet and carries an average of 850 product codes.

- Both stores appeared clean and free of trash. Counter areas were neat making supplies easily accessible to staff.
- Exterior signage and landscaping around the stores were clean and free of trash. However, the exterior signage to Store #1 was hidden by tall trees. Interior signage was neat and visible. The Fetal Alcohol Syndrome poster was displayed in both locations.
- Security systems are in place and functional in all designated areas.
- Shelf management follows a marketing plan applying the highest priced product on the top shelves and the lowest priced product on the bottom shelves. In instances where a particular product had multiple flavors, horizontal brand blocking is used to keep similar products together. Multiple facings are used for bestselling items with heavy demand. End caps were often under-utilized in both stores.
- The state price book is available should customers inquire about specific product. Sales clerks' often refer to the price book for verification of product listing and pricing.
- Sales clerk's interaction with customers is attentive, courteous, and eager to meet the needs of customers.

RECOMMENDATIONS

1. Consider more effective ways to improve shelf management or product placement, such as the following:
 - Cross-merchandising by placing products that mix together on the same shelves. Intermingle North Carolina products within their specific category as well as having a designated area;
 - Reallocating shelf space from declining categories to those showing growth;
 - Optimize the floor space and end caps to incorporate valuable displays;
 - Allow more space for your more popular brands and re-allocating space when eliminating underperforming brands.

PERSONNEL AND TRAINING

- All board members, general manager, and the finance officer have completed the initial ethics training. A board member has since been reappointed and has not completed the reappointment ethics training.
- Cross training opportunities have been extended to key employees in the event the general manager is suddenly unavailable.
- Training is provided to new and existing staff on key areas, such as product knowledge, customer service, and clerk responsibilities on a continual basis.
- Personnel files are available and displayed human resource documentation and other personnel information as needed.

RECOMMENDATIONS

1. Consider additional training opportunities through the Commission and the ABC Officers Association on specific areas. The Commission offers Responsible Alcohol Sellers Program, RASP, training for ABC boards and mixed beverage permit holders. The NC ABC Officers Association offers ABC Inspection training for local law enforcement officers.
2. Board members are required by statute to receive a minimum of two hours of ethics education within twelve months after reappointment.

ABC BOARD POLICIES

- Policies adopted and submitted to the Commission include:
 - Code of Ethics
 - Law Enforcement Contract
 - Travel Policy (City of Lexington Travel Policy Approval FY2013)
 - FY2013 Annual Audit
 - FY2013 Budget (Proposed and Adopted)
 - Mixed Beverage Policy
 - Price Discrepancy Policy
 - Shelf Management Policy
 - Employee Manual (An updated version has not been adopted)

NO RECOMMENDATIONS

INTERNAL CONTROL PROCEDURES

- The general manager schedules all employees for work shift hours. Employees use a time entry system to record hours worked. The general manager and finance officer calculate hours worked to be entered into the payroll system. A payroll activity report is generated for review and for records retention.
- Cash drawers are counted by all clerks. Management has implemented procedures to handle cash drawer overages/shortages.
- Bank deposits are made regularly as required by the ABC Commission rule. Bank notifications are received and matched with corresponding daily register reports. Bank reconciliation are completed monthly by the finance officer.
- Physical inventory counts are completed monthly. Spot checks are conducted weekly and more frequently if potential problems arise. If discrepancies occur, the general manager and assistant general manager will investigate and recount for accuracy and verification. Once completed, the general manager will adjust the inventory system to match with the actual store counts.
- Out of an average of 850 product codes per store, approximately 140 product codes were sampled to ensure accurate pricing and all were correct.

NO RECOMMENDATIONS

ADMINISTRATIVE COMPLIANCE FINDINGS AND OBSERVATIONS

- Board meeting minutes were viewed and followed the order of proceedings, providing sufficient detail that a reasonable person would be able to follow what transpired. Board meeting minutes did not include a conflict of interest statement asking board members if conflicts existed with items on the meeting agenda.
- Board member appointment dates and compensation amounts were correct on the Commission website.
- Board member and general manager compensation amounts are in compliance with G.S. 18B-700 (g) and (g1).
- Law enforcement activity reports have been submitted to the Commission as required by G.S. 18B-501 (f1).
- The board is in compliance with G.S. 18B-700 (k); there are no immediate family members employed related to board members or the general manager.
- All board members, the general manager, and the finance officer are bonded for \$100,000, more than the required amount.
- Orders for liquor do not bear the pre-audit certificate as required by G.S. 18B-702 (m). However, management uses a purchases order for other common orders including the pre-audit certificate.
- All checks bear the approved certificate indicating that the item has been approved by the finance officer for payment. Two signatures are located on all paid checks - that of the finance officer and general manager.

RECOMMENDATIONS

1. Have the board chairman read the conflict of interest statement to all board members at the beginning of each meeting. Reference the conflict of interest statement was read in the board minutes. *Refer to Appendix B (1).*
2. Place the pre-audit certificate with the finance officer's signature on the order to LB&B before the transaction takes place. *Refer to Appendix B (2) for statute.*

AUDITOR'S SUMMARY

ABC Board Auditor, Moniqua S. McLean, presented to the board the performance audit recommendations on July 14, 2014. The board has since responded to the performance audit recommendations and strives to implement strategies to maintain profitability while reducing costs and meeting budget appropriations. Recent events have allowed the board to purchase property to relocate the second location. Policies and procedures have been implemented to ensure compliance with statutes and Commission rules and to ensure efficient operations while maintaining sufficient checks and balances.

LEXINGTON ABC BOARD

P.O. BOX 1562 LEXINGTON, N.C. 27293-1562 (336) 249-2528
419 N. MAIN STREET (336) 249-6131 FAX
Email lexabc@lexcominc.net

ABC BOARD

Corey D. Buggs – Chairman
Jim Nance
Ted Smith
Roger Tripp – Legal Advisor

Brenda Leonard
General Manager

August 14, 2014

Moniqua S. McLean, MAFM
ABC Board Auditor

Moniqua,

It was a pleasure meeting you during your visit to the Lexington ABC stores and it was very helpful to be given a chance to get another opinion about ideas and ways to improve our stores in appearance and sales volume. The City of Lexington ABC Board was pleased with the report you gave about how we have continued to grow despite our declining economy. Our city at one time was a growing and striving community full of furniture manufacturing and other manufacturing industries showing signs of economic security. Now with manufacturing industry gone away people are struggling to find jobs. Lexington has gradually turned into a service oriented community with small growth potential.

The City of Lexington ABC Board is proud to be able to continue to grow and strive on improving customer service, store appearance, and operating efficiency. We are always striving to have the lowest expenses as possible while maintaining the best quality and appearance possible. We were pleased to know that our expenses were lower than other comparable stores in the state. For Fiscal Year 2012 – 2013 sales increased 3.1% over previous years and our expenses decreased. With the purchase of a new property for our second store this will get us out from under a lease agreement and eventually the City will have an asset that will be beneficial to our city. This may set us back for a few years but the money will be going to something we will eventually own. This will eliminate the board from paying rent and eventually increase profit.

The Board has considered some of the suggestions that you proposed and I am happy to report that we have also implemented the most of them into our operation. We now have displays from suppliers in the floor area and are using the end caps for cross merchandising and doing displays with recipes and other attention getting props. We plan to move the North Carolina products to a larger area and also place similar products together. We intend to reallocate shelf space from declining products to show more popular brands. Declining products continue to be looked at and eliminated as soon as possible. We continue to grow store inventory by bringing in new products. The new

products are placed in there respective areas as well as in our New Product location area. By having new products in two locations, customers are exposed to the growth of the store volume.

The Board is considering using some of the training opportunities the ABC Officers Association offers on specific areas. Some being the training on how to spot fake identification and reducing and preventing on the job injuries.

The tree that was blocking the ABC sign has been trimmed and most of the sign is visible. We plan to have all the trees topped in the spring.

Our new Employees Policy Manuel has been present to the City of Lexington ABC Board for approval. After it is reviewed by our Legal Advisor, Roger Tripp, and any changes recommended are made, it will be ready for the boards approval and we will forward you an updated copy.

The Board Chairman has begun to read the Conflict of Interest Statement to all board members prior the beginning of the City of Lexington ABC Board meetings. The reading is recorded in the minutes. The Pre Audit Certificate is now being placed on the order sent to LB&B with the finance officer's signature.

Any other suggestions you have in the future, please let me know.

Thanks,



Brenda Leonard
General Manager
City of Lexington ABC Board

RECEIVED

AUG 20 2014

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APPENDIX A

Illustration 1



Exterior view of Store 1

Illustration 2



Counter view of Store 1

Illustration 3



Shelf management/product placement of Store 1

Illustration 4



Interior view of Store 2

Illustration 5



Shelf management/product placement view of Store 2

APPENDIX B

(1) OP 4.19.4 states, "In an effort to avoid possible conflicts of interest it is recommended at the beginning of each meeting the Chairman ask fellow board members if there are any potential conflicts of interest. This can be done by reading the following ethics reminder:

'In accordance with G.S. 18B-201, it is the duty of every Board member to avoid both conflicts of interest and appearances of conflicts. Does any member have any known conflict of interest or appearance of conflict with respect to any matters coming before the Board today? If so, please identify the conflict or appearance of conflict and refrain from any undue participation in the particular matter involved.'"

(2) 18B-702 (m) states "...the contract, agreement, or purchase order shall include on its face a certificate stating that the instrument has been pre-audited to assure compliance. The certificate, which shall be signed by the finance officer or any deputy finance officer approved, shall take substantially the following form:

"This instrument has been pre-audited in the manner required by GS 18B-702."

(Signature of finance officer)

APPENDIX C

RECOMMENDATION	REQUIRED BY STATUTE	IMPLEMENTATION STATUS
<p>Administrative Compliance:</p> <p>Affix the pre-audit certificate with the finance officer's signature on all orders before the transaction occurs.</p>	<p><input checked="" type="checkbox"/> Yes</p> <p><input type="checkbox"/> No</p>	<p>(Please provide documentation supporting implementation status.)</p> <p><input checked="" type="checkbox"/> Fully Implemented</p> <p><input type="checkbox"/> Partially implemented ___% complete. (Explain below.)</p> <p><input type="checkbox"/> Not implemented (Explain below.)</p> <p>Management has implemented procedures to include this practice.</p>