

Statesville ABC Board

Performance Audit Report



Alcoholic Beverage Control Commission
400 East Tryon Road, Raleigh, NC 27610
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ABC
COMMISSION
NORTH CAROLINA



Alcoholic Beverage Control

COMMISSIONERS:

September 26, 2011

JONATHAN S. WILLIAMS
Chairman, Raleigh

The Honorable Costi Kutteh, Mayor
City of Statesville
PO Box 1111
Statesville, NC 28687-1111

A. D. "ZANDER" GUY, JR.
Surf City

DANIEL L. BRIGGS
Lexington

Dear Mayor Kutteh,

ADMINISTRATOR:
MICHAEL C. HERRING

We are pleased to submit this performance audit report of the Statesville 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.

LOCATION:
400 East Tryon Road
Raleigh NC 27610

This report consists of an executive summary, background information and operational findings and recommendations. The General Manager of the Statesville ABC Board reviewed a draft copy of this report and his written comments are included.

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

We would like to thank the ABC Board and their staff for the assistance and cooperation provided to us during the audit and we hope you and your City Council Members will find the report informative.

PHONE: (919) 779-0700
FAX: (919) 662-3583
contactus@abc.nc.gov

Respectfully,

Michael C. Herring
Administrator

CC: Rob Hites, Town Manager

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EXECUTIVE SUMMARY

By state law, the ABC Commission shall ensure that all local ABC Boards comply with established performance standards by conducting regular audits 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 store annual financial audit for the fiscal year 2010;
- Visited the stores;
- Interviewed key ABC store personnel.

The Statesville ABC Board has responded to the performance audit recommendations and made extensive efforts to improve profitability. Since our visit, the board has taken steps to minimize costs, improve inventory turnover rates, and provide training opportunities. Internal controls have been modified to maintain proper segregation of duties and to adhere to statutes. Fiscal year 2011 audit reflects a profit before distributions of \$141,888 and distributions totaled \$141,888.

BACKGROUND INFORMATION

The town of Statesville is located in Iredell County approximately 45 miles north of Charlotte. A rural area, Statesville is convenient to urban locations such as Charlotte. The town was incorporated in 1789. The current population is approximately 26,644 which according to the US Census Bureau has increased by 21% in the last ten years. Economic characteristics for Statesville have shown a 12% increase in the labor force in the past ten years.

Chapter 534 of the 1965 Session Law authorized Statesville to hold an election upon a petition signed by at least fifteen percent of the registered voters. No election was held, however until House Bill 1092 passed in 1973 requiring the city to hold a referendum. The referendum was held on September 11, 1973. The vote for an ABC store passed 2,200 to 1,586. The first retail sales date was December 1, 1973. A mixed beverage referendum held on May 8, 1986 passed 2,832 to 2,775.

The Statesville ABC Board operates two retail stores. The board currently staffs eight full time and nine (including a certified law enforcement officer) part time employees. The administrative office staffs a full-time positions general manager and a full-time assistant general manager/finance officer. The general manager is responsible for oversight of the daily operations of the Statesville ABC system along with additional duties as assigned by the board or Commission. The assistant general manager/finance officer is responsible for receiving and depositing of receipts along with the disbursement of funds for the local board. Store manager duties involve the overall operations including sales, store maintenance, accounting, and recordkeeping. Clerk supervisor duties include the daily retail operating of the stores pertaining to loading and unloading of delivery trucks, accounting for stock, maintaining inventory records, and cashier functions. Clerk duties involve various retail functions including selling products and accounting for stock.

Profitability

In 2008, the Statesville ABC board opened a second store. Since the opening of the store, sales have increased but profit levels have dropped slightly due to higher operating expenses. For fiscal year 2010, the board showed a profit; total liquor sales were \$4,513,895, profit before distributions was \$116,470 resulting in a profit percentage to sales of 2.57%. In comparing sales over the past ten years of similar boards, sales for the Statesville ABC board have also increased following the state's 56% increase. *See Chart 1, 2, and 3.*

Factors affecting sales and profitability:

- Adult working population has increased 12% over the past ten years
- 6% of population is at or below poverty level
- 11.1% unemployment rate in Iredell County

Distribution Schedule

G.S. 18B-805 (c) (2) (3) requires that the board expend quarterly at least 5% of profits for law enforcement and at least 7% of profits for alcohol education. House Bill 304 in 1977 set the following quarterly distribution formula:

- 25% to Mitchell Community College to be used to retire the outstanding library debt for land acquisitions and capital improvements as the need arise
- 25% to Statesville Board of Education to improve the standards of city schools

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- Any remaining net profits are distributed to the City of Statesville to be allocated among the following:
 - Arts and Science Museum
 - Sheltered workshop for the handicapped and mentally retarded
 - Iredell County Mental Health Clinic
 - Iredell County Public Library
 - Statesville Recreation Commission
- All profits from the sale of mixed beverages are to be distributed to the City of Statesville

Since the opening of the second store in 2008, distributions have dropped. In 2010, the Statesville ABC board made distributions totaling \$106,627. Law enforcement distributions were \$ 52,403 and other distributions totaled \$ 54,224. *See Chart 3.*

FINDINGS AND RECOMMENDATIONS

On July 12, 2011, I visited the Statesville ABC board administrative office. I interviewed Tip Nicholson, General Manager, Gerald Peacock, Assistant General Manager/Finance Officer and other key personnel. I visited both stores within the city. The following are my findings related to the performance audit.

1. Inventory Turnover

The inventory turnover rate is calculated by dividing the cost of goods sold by the average inventory in the system. The Commission has set goals for determining an effective rate based on the frequency of deliveries. Below are the turnover rates based on a delivery schedule:

- Daily/weekly deliveries target at 6 times per year
- Bi-weekly deliveries target at 5 times per year
- Monthly deliveries target at 4.5 times per year

Statesville ABC board has a weekly delivery schedule. The inventory turnover rate for Statesville ABC is 5.3 and does not meet the target rate set by the Commission.

Recommendations:

- Explore different strategies for eliminating slow moving products.
- Move stock within stores and between stores to increase visibility.
- Monitor store inventories to avoid overstocking.
- Continue to take advantage of SPA's and quarterly price reductions whenever possible.
- Use recipe cards, displays, cross merchandizing, and other marketing techniques to increase sales.

2. Operating Costs

Operating costs are calculated by dividing total operating expenses less depreciation by the gross profit on sales. Below are the average cost ratios for boards with and without mixed beverage sales.

- Boards with 3 or more stores with MXB – cost ratio .67 or less
- Boards with 3 or more stores without MXB – cost ratio .94 or less
- Boards with 2 stores – cost ratio .83 or less
- Single store boards with MXB – cost ratio .77 or less
- Single store boards without MXB – cost ratio .93 or less.

The Statesville ABC board has an operating cost ratio of .84 while the average for similar size boards is .83 or less. To meet the goal of .83 and remain at current revenue levels, operating

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expenses must be reduced to less than \$850,000. To meet the goal and remain at current operating expense levels, revenue must be greater than \$4.7 million.

Recommendations:

- Because salaries and benefits are the largest segment of operating expenses, analyze personnel hours to assess efficient personnel usage.
- Request bids annually from various vendors to get the best rates possible on audit, credit card processing fees, and insurance and bonding rates.
- Reduce travel expense by sending just one board member to annual conferences on a rotating basis and having that person report back to board on topics covered; stay at an alternate location where room rates are closer to the state per diem.
- The ABC board has been paying travel expenses for Michelle Roke to sit on the NC Association of ABC Boards Board of Directors and, in that capacity, to attend meetings of the Board of Directors. Request reimbursement from NC Association of ABC Boards for travel expenses incurred while attending meetings of the Board of Directors. In addition to being an inappropriate use of public funds, this practice prevents service by board members of boards that cannot afford to subsidize the travel expense.

3. Profit percentage to sales

The profit percentage to sales is calculated by dividing the total profit before distributions by the total liquor sales. The Commission has set efficiency goals based on the following breakdown:

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

The Statesville ABC board has a profit percentage to sales of 2.57% and does not meet the targeted rate set by the Commission.

Recommendations:

- Analyze and reduce operating expenses to increase profits. Refer to above recommendations.
- Increase sales using the strategies recommended under inventory turnover and store appearance.

4. Working Capital

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:

- 4 months for boards with gross sales less than \$1.5M
- 3 months for boards with gross sales less than \$50M and greater than or equal to \$1.5M
- 2 months for boards with gross sales equal to or greater than \$50M

Statesville ABC Board

The Statesville ABC board has a working capital of \$394,043 and meets the goal set by the Commission.

5. Store Appearance

The linear footage for the Statesville ABC stores ranges from approximately 1450 to 1550 feet of shelf space. Both stores average approximately 1463 SKU's. *Refer to Appendix A for photos.*

- Both stores were clean, well lit, and smoke-free; countertops were free of clutter and bottles were not dusty.
- The shelf management system is clearly identifiable, consistent, and easily understood for each store.
- The Fetal Alcohol Syndrome poster was visible.
- The exterior area for both stores was clean and well manicured.

6. Policies and Procedures

- Board meeting minutes were available and followed the order of proceedings for conducting business meetings. The conflict of interest statement was referenced in the meeting minutes.
- The board employs a law enforcement officer; therefore a law enforcement contract is not needed.

7. Personnel/Training Compliance

- Training is conducted when need arises and whenever new information is available.
- Employees refer to a calendar made by the store managers for scheduling purposes.

Recommendations:

- Attend annual training, such as the Responsible Alcohol Seller Program, offered by the Commission and other approved venues.
- Create a checklist for use in training new and existing employees and have each employee sign it once training is completed.
- Extend cross-training opportunities to all employees.

8. Administrative Compliance

- Nepotism – The board currently employs two immediate family members who were grandfathered in when the statute changed.
- The board collects five cents for each empty box sold. Monies are handled appropriately through deposits to other income.

Statesville ABC Board

- Conference registration for spouses was paid by the board and then deducted from board member reimbursement.
- Purchase orders are not used for all store purchases.
- Checks are currently signed by both the finance officer and general manager. However, they do not bear the certificate on the face of the instrument which is required by GS 18B-702(q). The board purchased a stamp which includes the finance officer's signature.
- When an employee accidentally breaks a bottle, the board does not absorb the cost but instead writes up a vendor claim.

Recommendations:

- Relocate staff to avoid having one family member supervise the other. Clearly define the roles of each individual and who each will be reporting to. *Refer to Appendix B (1) for statute.*
- Conference registration for board member spouses must be prepaid by board members. Board funds cannot be used for this purpose even if reimbursed later.
- All certificates must have the finance officer's original signature. The signature cannot be a part of the stamp.
- Use purchase orders for ordering all store and office supplies. Purchase orders are required to have the pre-audit certificate signed by the finance officer. *Refer to Appendix B (2).*
- Orders to LB&B for liquor must have a pre-audit certificate signed by the finance officer. Approval must take place before the liability is incurred.
- All checks written after May 1, 2011 must include the certificate. *Refer to Appendix B (3).*
- If an employee breaks a bottle, the board is responsible for absorbing the cost of the breakage. When a bottle is broken on the truck or while in transition to the store, complete the Destruction of Unsalable Merchandise form.

9. Internal Controls

- Inventory is checked quarterly by store personnel and assistant general manager. The store managers verify the discrepancies and make the adjustments to the system the next business day.

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Chart 1

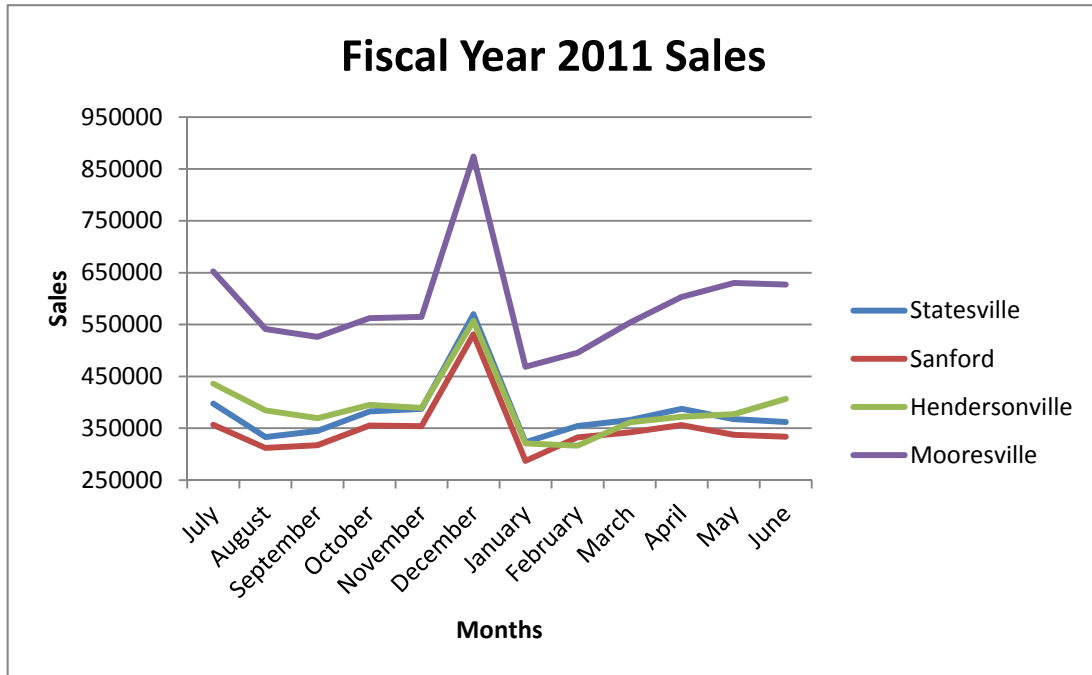


Chart 1 shows current year sales for similar sized boards.

Chart 2

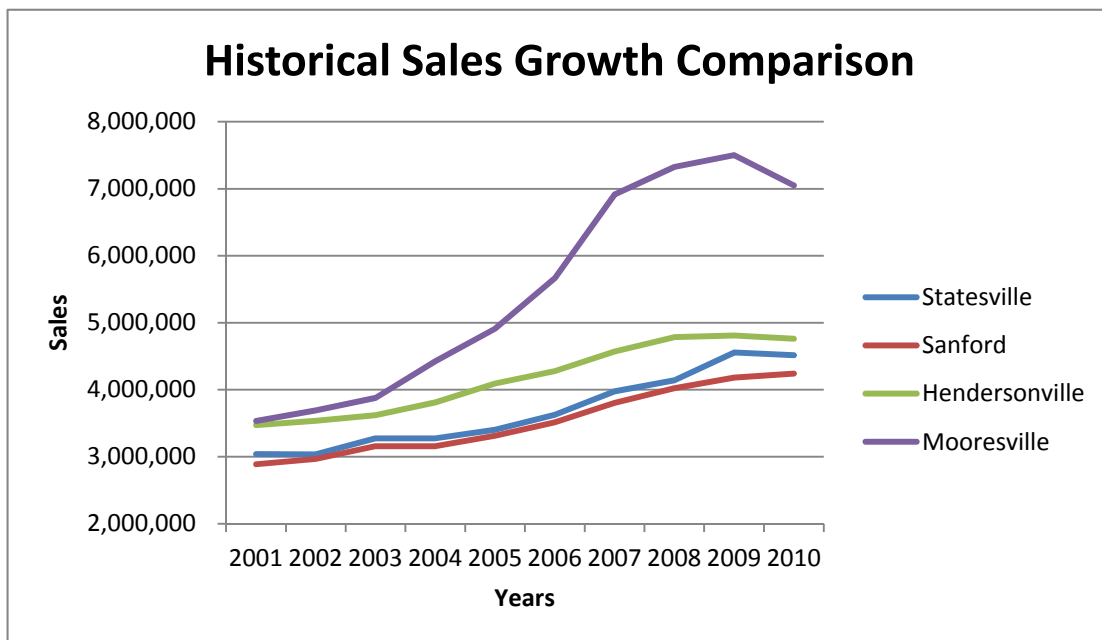


Chart 2 reflects the historical sales growth for similar boards for the past ten years.

Chart 3

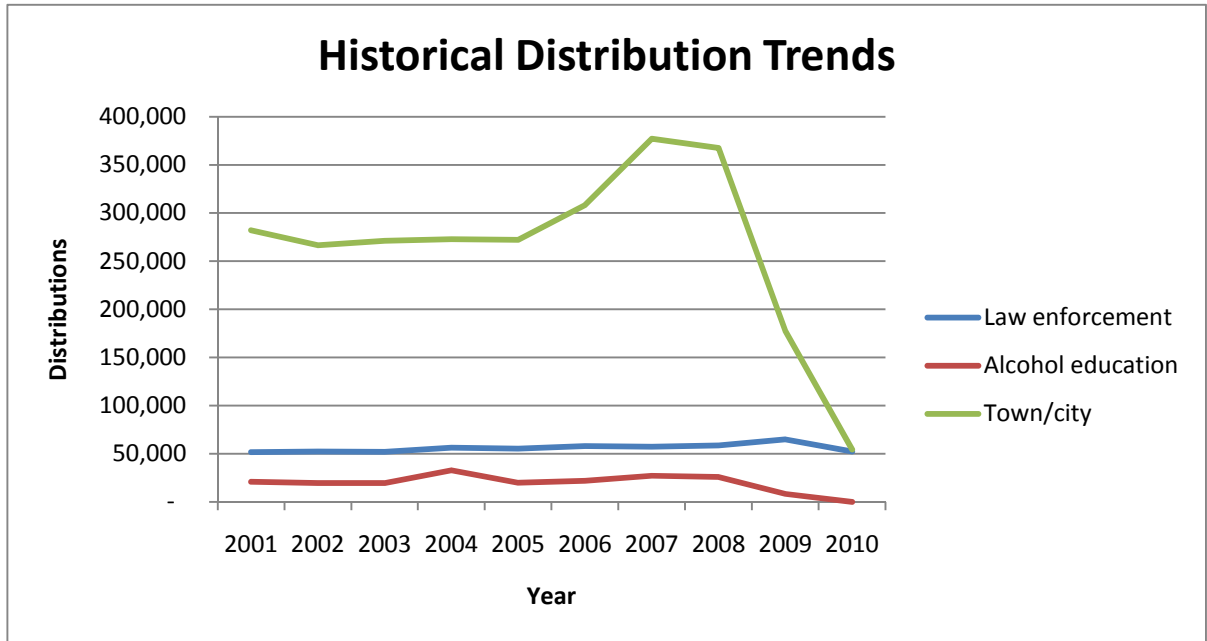


Chart 3 shows the downward trend of profit distributions to the appointing authority, law enforcement, and alcohol education. Note: In 2008, Statesville opened a second store resulting in a decrease in distributions.

Chart 4

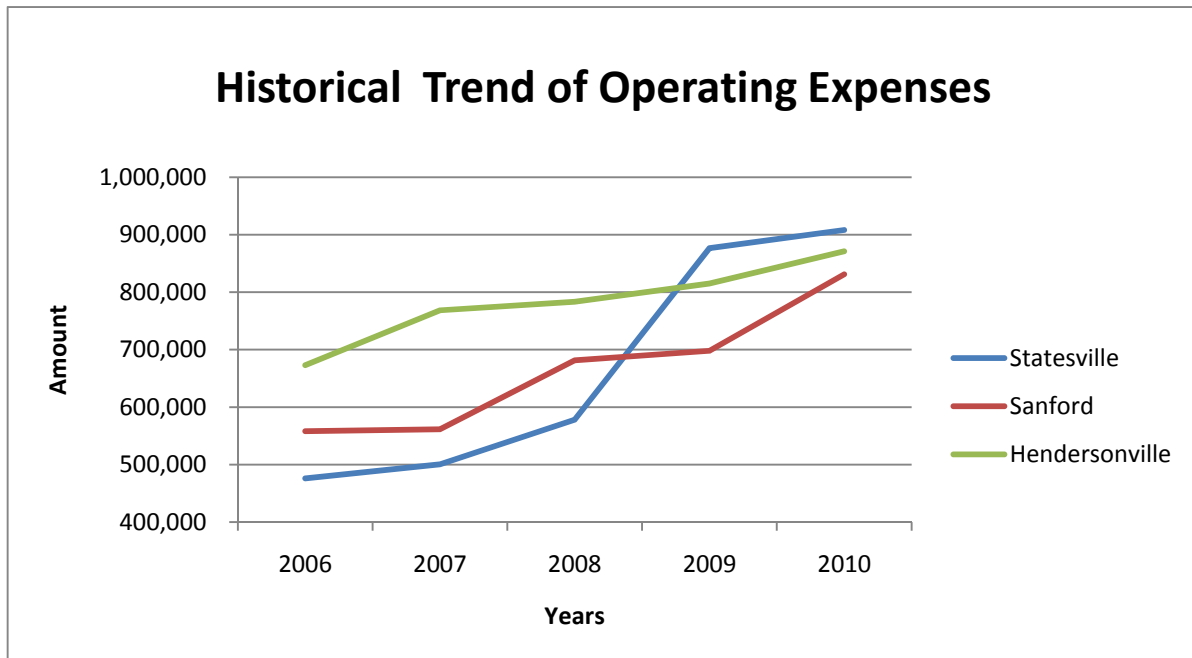


Chart 4 reflects the historical trend of operating expenses for similar sized boards.

Chart 5

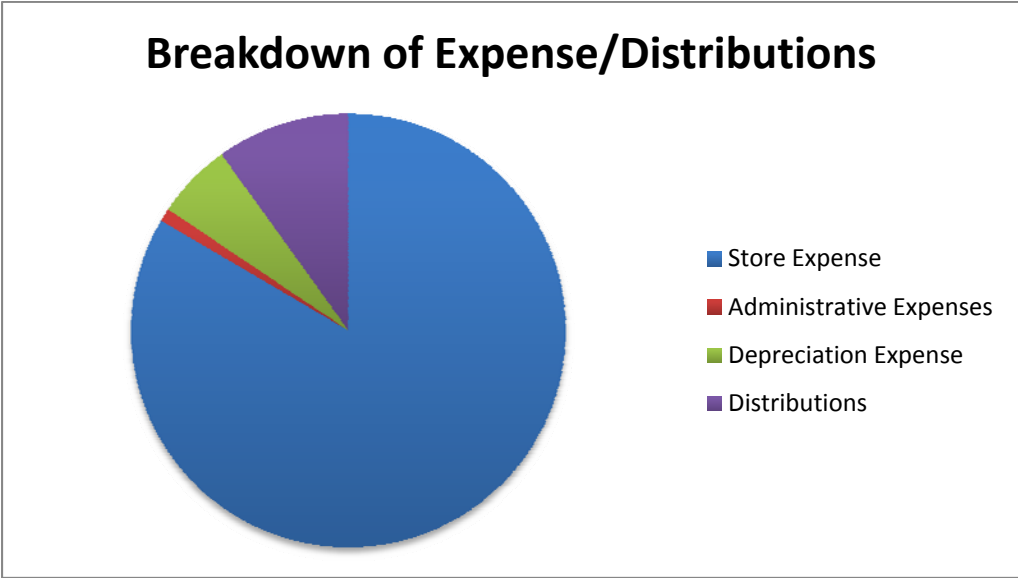


Chart 5 reflects the breakdown of gross profit between expenses and distributions to city.

APPENDIX A

Picture 1



Illustration of store.

Picture 2



Illustration of shelf management system.

Statesville ABC Board

Picture 3



Illustration of parking area at Store 1.

Picture 4



Illustration of counter area.

APPENDIX B

(1) 18B-700 (k) states *“Members of an immediate family shall not be employed within the local board if such employment will result in one member of the immediate family supervising another member of the immediate family, or if one member of the immediate family will occupy a position which has influence over another member’s employment, promotion, salary administration, or other related management or personnel considerations. This subsection applies to local board members and employees.”*

(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)*

(3) 18B-702(q) states *“...each check or draft on an official depository shall bear on its face a certificate signed by the finance officer or a deputy finance officer approved for this purpose by the local board. The certificate shall take substantially the following form:*

“This disbursement has been approved in the manner required by G.S. 18B-702.”

*_____
(Signature of finance officer).*

Statesville ABC Board

MEMO

To: Moniqua McLean, ABC Board Auditor
ABC Commission of North Carolina

From: Tip Nicholson, General Manager
Statesville ABC Board

Date: September 19, 2011

Subject: Statesville ABC Board Responses to Commission Performance
Audit Review

The Statesville ABC Board has reviewed the draft report of the performance audit performed by the ABC Commission of North Carolina. Following are our responses to the findings in the audit:

- Under the Statesville ABC Store Information section that is on page 4, information should be added to show that the original, enabling legislation of 1973 was amended in 1977 by the General Assembly when it passed Chapter 289 of House Bill 585. This legislation changed the distribution schedule for ABC Board profits so the schedule that is listed on page 5 is incorrect.
- On page 5, the report notes the drop in distributions since the opening of the second store in 2008. While this is a definite factor, other factors should be noted:
 - The decline in the local economy and the increase in unemployment.
 - The increase in both sales taxes and liquor excise taxes by the State of North Carolina.
 - A great decrease in local mixed beverage business which has seen a monthly average of \$55,900 in fiscal year 2007-2008 decline to a monthly average of \$42,527 in fiscal year 2010-2011. There is more board profit in mixed beverage sales than in regular retail sales which have also declined when adjusted for the 5% increase (from 25% to 30%) in liquor excise tax.
 - Distributions of profits improved from \$66,224 in fiscal year 2009-2010 to \$153,888 in fiscal year 2010-2011. This is more than a 132% increase from the previous year.
- On the Findings and Recommendations page beginning on page 6, it must be noted that the figures are from the fiscal year 2009-2010. Since this draft of the performance audit has been prepared, the audit for fiscal year 2010-2011 has been completed which show a dramatic improvement over the previous year.
- Concerning inventory turnover on page 6, the rate for the Statesville ABC Board in the last fiscal year was 5.9. This is better than the goal set by the Commission for stores that receive bi-weekly deliveries (5). It should be noted in the report that our stores are on a bi-weekly delivery schedule.
- Every recommendation that is made concerning inventory turnover has been addressed in the last two years. As a result, there has been improvement. Besides the recommendations that are listed, all store warehouses have been reorganized to be more efficient. Store managers are working closely with each other on inventory and with liquor representatives to help with slower moving items. We have also requested a digital recipe center that should be in place before the holidays.

- Concerning operating costs on page 6, the results of the recent audit show that the cost ratio for the Statesville ABC Board was .77 last year. This falls within the guidelines recommended by the Commission.
- The Statesville ABC Board has cut positions and hours over the last two years. It has also, following the lead of the City of Statesville, frozen salaries.
- The Statesville ABC Board has seen significant savings from ending old, costly contracts and bidding out services such as credit card processing, health insurance and banking.
- The Statesville ABC Board believes that both employee and board training are very important and that board members' attendance at the annual conferences is justified. Due to a change in policy on the state level, Board members no longer attend national conferences. The Statesville ABC Board is fortunate to have one of our members on the NC Association of ABC Boards board of directors and supports her efforts to bring back to us the most up to date and important information about the alcoholic beverage control industry.
- The Statesville ABC Board has no OPEB expenses that are referred to on page 7.
- Concerning profit percentage to sales on page 7, the rate for last year is 4.0%. While this rate is under the target rate of 6.5% set by the Commission, it should be noted that the rate doubled over the previous year and that distributions of profits improved from \$66,224 in fiscal year 2009-2010 to \$153,888 in fiscal year 2010-2011.
- Concerning administrative compliance on page 8, the legislation concerning supervision of staff by other family members had a provision that grandfathered in existing conditions. The Statesville ABC Board is comfortable with the current organizational structure and its supervision of all staff.
- The Statesville ABC Board's policy has been to prepay the conference registration for spouse attendance at conferences. The amount for the spouse registration has then been deducted from reimbursement for mileage and expenses costs when submitted by the board member. While this common sense arrangement has worked satisfactorily, the recommendation of the Commission is duly noted.
- The Statesville ABC Board has not had any new employees hired since 2008. Our employees are well trained and seasoned. We have been in contact with Charles Fuller, Information and Communication Specialist with the North Carolina ABC Commission and will be setting up additional employee training in house later this fall.
- Concerning internal controls on page 9:
 - The stamp for the finance officer has been changed so that his signature is not part of the stamp.
 - The Statesville ABC Board has purchase order forms available for any items not regularly purchased. For all recurring expenses, the invoice acts as the purchase order and is submitted and approved by the finance officer in accordance with the law.
 - LB&B orders are sent online by the store managers. Once email confirmation is received, the finance officer approves and signs the order.
 - All checks and payroll advises, now include the required certificate.

STATESVILLE ALCOHOL BEVERAGE CONTROL BOARD

Recommendation Follow-Up

RECOMMENDATION	REQUIRED BY STATUTE	IMPLEMENTATION STATUS
<p><u>Personnel/Training Compliance</u> – Have training opportunities for all employees.</p>	<p><input type="checkbox"/> Yes</p> <p><input checked="" type="checkbox"/> No</p>	<p>(Please provide documentation supporting implementation status.)</p> <p><input checked="" type="checkbox"/> Fully Implemented</p> <p><input checked="" type="checkbox"/> Partially implemented 25% complete. (Explain below.)</p> <p><input type="checkbox"/> Not implemented (Explain below.)</p> <p>The Board has contacted an Information and Communication Specialist to begin employee training in the fall.</p>
<p><u>Administrative Compliance</u> – Have purchase orders for ordering store and office supplies with the required pre-audit certificate.</p> <p>Have all checks include the approved certificate as required.</p> <p>All certificates must the finance officer’s original signature.</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>The Board has purchase forms available for items not regularly purchased.</p> <p>All checks and payroll advises include the certificate.</p> <p>The certificate was changed so that the finance officer’s signature is not part of the stamp.</p>

Statesville ABC Board

<p>Administrative Compliance – Prepay board member spouse conference registration</p>	<p><input type="checkbox"/> Yes</p> <p><input checked="" type="checkbox"/> No</p>	<p>Please provide documentation supporting implementation status.)</p> <ul style="list-style-type: none"><input checked="" type="checkbox"/> Fully Implemented<input type="checkbox"/> Partially implemented ____% complete. (Explain below.)<input type="checkbox"/> Not implemented (Explain below.) <p>The board has implemented steps to begin prepayments of spousal registration.</p>
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