

# FINANCIAL AUDIT

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## Commonwealth of Pennsylvania Liquor Control Board

State Stores Fund  
Liquor License Fund

### Audit Report

Harrisburg, Pennsylvania  
For the years ended June 30, 2016 and 2015

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December 2016



Commonwealth of Pennsylvania  
Department of the Auditor General

Eugene A. DePasquale • Auditor General

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**PENNSYLVANIA LIQUOR CONTROL BOARD**  
**STATE STORES FUND – JUNE 30, 2016**  
**LIQUOR LICENSE FUND – JUNE 30, 2016**

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**PENNSYLVANIA LIQUOR CONTROL BOARD**  
**STATE STORES FUND – JUNE 30, 2016**  
**LIQUOR LICENSE FUND – JUNE 30, 2016**

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## **BACKGROUND**

### **Introduction**

The Pennsylvania Liquor Control Board (PLCB) is an entity of the Commonwealth of Pennsylvania (Commonwealth) authorized by law to regulate the sale and distribution of alcoholic beverages in the Commonwealth. Included within this mandate is the authority to establish, operate and maintain Pennsylvania Fine Wine & Good Spirits stores for the sale of liquor, including wine and spirits.

The PLCB serves as the Commonwealth's responsible seller of wine and spirits, regulates Pennsylvania's beverage alcohol industry and promotes social responsibility and alcohol education, while maximizing financial returns for the benefit of all Pennsylvanians.

### **History and Agency Overview**

With the end of Prohibition in 1933, various laws regarding alcohol regulation were passed by the Pennsylvania General Assembly, including the Liquor Control Act and the Beverage License Law. These laws created the PLCB. The statutory authority for PLCB is Act 21 of April 12, 1951, P.L. 90; as reenacted by Act 14 of June 29, 1987, P.L. 32. In conformance with the Pennsylvania Liquor Code, the PLCB regulates the manufacture, possession, sale, consumption, importation, use, storage, transportation, and delivery of wine, liquor, alcohol, and malt or brewed beverages in the Commonwealth.

Through fiscal year 2015–16 all package sales of wines and spirits in Pennsylvania, with the exception of those sold by licensed limited wineries and distilleries, were made through Fine Wine & Good Spirits stores operated by the PLCB. These included both retail sales to individual consumers and wholesale sales to licensed establishments where wines and spirits are sold by the drink. While malt and brewed beverages are not sold through the system, the PLCB does regulate those sales through the licensing of distributors, restaurants, hotels, supermarkets, and clubs that sell those beverages.

Additionally, the PLCB, in conjunction with the state Gaming Control Board, reviews applications and conducts background investigations of PLCB licensees wishing to obtain tavern gaming licenses.

On June 8, 2016, Governor Wolf signed Act 39 into law. Act 39 liquor reforms changed more than 35 sections of the Liquor Code and added a number of new sections – the most sweeping changes to liquor laws in Pennsylvania since the end of Prohibition in 1933. The law, which took effect on Aug. 8, 2016, will impact PLCB operations in the next fiscal year and beyond.

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**PENNSYLVANIA LIQUOR CONTROL BOARD**  
**STATE STORES FUND – JUNE 30, 2016**  
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**BACKGROUND (Continued)**

The PLCB, an independent administrative board, is comprised of three members who are appointed to staggered four-year terms by the Governor with the concurrence of two-thirds of the Senate. The Board is responsible for the management of the PLCB in the areas of directing the state-operated Fine Wine & Good Spirits stores and authorizing the licensing of establishments that manufacture or sell alcohol. The PLCB also provides a comprehensive program of alcohol education aimed at promoting responsible consumption and avoidance of abuse among legal consumers, and prevention of purchase and consumption by minors. The PLCB funds the operations of the Pennsylvania State Police Bureau of Liquor Control Enforcement, which is responsible for enforcing the liquor laws and regulations throughout the Commonwealth.

The PLCB is primarily responsible for the accounting and reporting of the Liquor License Fund and the State Stores Fund. The Liquor License Fund is an agency fund that serves as a pass-through account for fees for hotel, restaurant, and club liquor and/or beer licenses. These fees are returned semi-annually to the municipalities in which the licenses are located, while interest earned on fund deposits is credited to the General Fund.

The State Stores Fund is an enterprise fund that serves as the general operating fund for the PLCB. This fund receives revenues from the sale of goods, primarily through Fine Wine & Good Spirits stores, and various non-operating revenues including fees not credited to the Liquor License Fund. The State Stores Fund also covers the costs and expenses associated with the operation and administration of all PLCB functions as outlined and prescribed by the Pennsylvania Liquor Code and pays for services provided by other departments such as the Department of the Auditor General for auditing services and the Office of Comptroller Operations for personnel assigned to supporting the PLCB. In addition, the fund provides monies to the Pennsylvania State Police for enforcement of the Liquor Code, as noted above, and the Department of Drug & Alcohol Programs for alcohol abuse programs, and makes annual profit transfers to the General Fund.

The 18 percent liquor tax and 6 percent state sales tax collected by the PLCB are routinely transferred to the General Fund. Local sales taxes collected are remitted to Philadelphia and Allegheny County, as appropriate.

The PLCB operates over 600 Pennsylvania wine and spirits stores with gross annual sales in excess of \$2.43 billion for fiscal year 2015-2016, an increase of 4.1 percent over the previous fiscal year. As a result, the PLCB's return to the Pennsylvania General Fund and state Treasury also grew, including \$348.0 million in liquor tax, \$135.6 million in state sales tax and \$100 million operational profits transferred to the General Fund. Additionally, the PLCB provided \$26.1 million to fund Pennsylvania State Police liquor control enforcement efforts, afforded \$3.3

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**PENNSYLVANIA LIQUOR CONTROL BOARD**  
**STATE STORES FUND – JUNE 30, 2016**  
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**BACKGROUND (Continued)**

million to support the Pennsylvania Department of Drug & Alcohol Programs and returned \$4.6 million to local municipalities. Beginning in 2013, the Alcohol Education grants for reducing underage and dangerous drinking went to a two-year cycle. The amount awarded by the PLCB for first year grant funding in the two year grant cycle ending June 30, 2017 was \$1.1million.

**Key Facts**

- All tax moneys collected are transferred to the State Treasury. All revenues remaining, after payment of PLCB operating expenses and after required appropriations are made to other entities and Commonwealth agencies, are made available to be transferred to the State Treasury.
- The PLCB is the largest purchaser of wine and spirits in the United States, and passes significant volume purchase discounts on to customers.
- The PLCB operates over 600 stores, which are leased from private landlords.
- 100% of the required State and Local Sales Taxes are collected by the PLCB and reported to the Pennsylvania Department of Revenue.
- The state liquor tax of 18% is included in the shelf price of each item.
- The PLCB outsources warehousing services for 3 distribution centers in Pennsylvania.
- In fiscal year 2015-2016, PLCB processed slightly more than 71,000 license and permit applications.
- The PLCB has an established formal Bureau of Alcohol Education, which provides educational material to youth, legal consumers and beverage alcohol servers.
- The PLCB funds grants to colleges and universities, communities that host these institutions, municipalities, and their organizations such as law enforcement departments and non-profit organizations to develop and/or maintain environmental management prevention strategies and other proven prevention strategies to reduce dangerous and underage drinking.



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EUGENE A. DePASQUALE  
AUDITOR GENERAL

### **Independent Auditor's Report**

The Honorable Tom Wolf  
Governor  
Commonwealth of Pennsylvania  
Harrisburg, PA 17120

The Honorable Tim Holden  
Chairman  
Pennsylvania Liquor Control Board  
Harrisburg, PA 17124

#### **Report on the Financial Statements**

We have audited the accompanying financial statements of the Pennsylvania Liquor Control Board (PLCB) - State Stores Fund, which comprise of the Statements of Net Position as of June 30, 2016 and 2015, and the related Statements of Revenues, Expenses and Changes in Net Position and Statements of Cash Flows for the years then ended, and the related notes to the financial statements; and the PLCB - Liquor License Fund, which comprise of the Statements of Fiduciary Net Position as of June 30, 2016 and 2015, and the related Statements of Changes in Fiduciary Net Position for the years then ended, and the related notes to the financial statements.

#### ***Management's Responsibility for the Financial Statements***

Management is responsible for the preparation and fair presentation of these financial statements in accordance with accounting principles generally accepted in the United States of America; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.

### ***Auditor's Responsibility***

Our responsibility is to express an opinion on these financial statements based on our audits. We conducted our audits 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 and financial highlights are free of material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

As discussed in Note A, the financial statements present only the PLCB and do not purport to, and do not, present fairly the financial position of the Commonwealth of Pennsylvania as of June 30, 2016 and 2015, and the changes in its financial position and cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

### ***Opinion***

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the PLCB-State Stores Fund and Liquor License Fund as of June 30, 2016 and 2015, and the results of the State Stores Fund's operations and its cash flows for the fiscal year then ended, and the Liquor License Fund's changes in assets and liabilities for the fiscal year then ended in accordance with accounting principles generally accepted in the United States of America.

## ***Other Matters***

### ***Required Supplementary Information***

Accounting principles generally accepted in the United States of America require that the management's discussion and analysis on pages 7 through 10, schedule of PLCB contributions and schedule of PLCB's proportionate share of net pension liability on pages 36-37 be presented to supplement the financial statements. Such information, although not a part of the financial statements, is required by the Governmental Accounting Standards Board who considers it to be an essential part of financial reporting for placing the financial statements in an appropriate operational, economic, or historical context. We have applied certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States of America, which consisted of inquiries of management about the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the financial statements, and other knowledge we obtained during our audit of the financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

### ***Other Information***

The Background has not been subjected to the auditing procedures applied in the audit of the financial statements, and accordingly, we do not express an opinion or provide any assurance on it.

### **Other Reporting Required by *Government Auditing Standards***

In accordance with *Government Auditing Standards*, we have also issued our report dated December 6, 2016, on our consideration of PLCB's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering PLCB's internal control over financial reporting and compliance.



Eugene A. DePasquale  
Auditor General

December 6, 2016

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**PENNSYLVANIA LIQUOR CONTROL BOARD**  
**STATE STORES FUND – JUNE 30, 2016**  
**LIQUOR LICENSE FUND – JUNE 30, 2016**

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**PLCB Management’s Discussion and Analysis**

**Management’s Responsibility for the Financial Statements**

PLCB management is responsible for the preparation, integrity and fair presentation of the Agency’s financial statements. The accompanying financial statements have been prepared in accordance with accounting principles generally accepted in the United States and, as such, include amounts based on estimates and judgments by management. The PLCB maintains a system of internal controls which is designed to provide reasonable assurance that its financial statements are free from material misstatement due to fraud or error.

**Discussion of Basic Financial Statements**

The accounts of the State Stores Fund and the Liquor License Fund are reported using the accrual basis of accounting and on a fiscal year basis, comprised of 12 calendar months.

The basic financial statements included in this audit report are the State Stores Fund Comparative Statement of Net Position as of June 30, 2016 and 2015; State Stores Fund Comparative Statement of Revenues, Expenses and Changes in Fund Net Position for the fiscal years ended June 30, 2016 and 2015; State Stores Fund Comparative Statement of Cash Flows for the fiscal years ended June 30, 2016 and 2015; the Liquor License Fund Statement of Fiduciary Net Position for the fiscal years ended June 30, 2016 and 2015; and the Liquor License Fund Statement of Changes in Fiduciary Net Position for the fiscal year ended June 30, 2016 and June 30, 2015.

The State Stores Fund Comparative Statement of Net Position provides information about assets and liabilities and reflects the net financial position of the State Stores Fund at the end of each fiscal year. The Comparative Statement of Revenues, Expenses and Changes in Fund Net Position reports the operating revenue activity, expenses related to such activity and operating transfers out for each fiscal year. The Comparative Statement of Cash Flows outlines the cash inflows and outflows relating to the operations for each fiscal year. The Liquor License Fund Statement of Fiduciary Net Position provides information about assets and liabilities that reflect the position of the Liquor License Fund for each fiscal year end. The Statement of Changes in Fiduciary Net Position illustrates the net asset and net liability activity throughout the fiscal year. The basic financial statements also include Notes to Financial Statements that provide additional information that is essential to a full understanding of the data provided in the statements. These statements provide current and long-term information about the PLCB’s financial position.

Although the liquor tax is incorporated into the retail price of products and is discussed herein as part of the sales analysis and transfers out, neither it nor the state and local sales taxes are reflected in the basic financial statements as revenue, expenses or liabilities.

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**PENNSYLVANIA LIQUOR CONTROL BOARD**  
**STATE STORES FUND – JUNE 30, 2016**  
**LIQUOR LICENSE FUND – JUNE 30, 2016**

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**PLCB Management’s Discussion and Analysis (Continued)**

**Executive Summary & Highlights**

Fiscal year 2015-16 sales grew 4.1 percent over the prior year as a result of volume increases plus a minor increase in average retail price per unit. PLCB fiscal year 2015-16 net income of \$103.9 million was \$20.3 million, or 24.2 percent, greater than last year reflecting higher sales, a slight improvement in gross margin, relatively flat operating expenses and a decrease in combined non-operating revenues and expenses.

Other financial highlights include:

- Higher operating income of \$131.8 million, representing a year-over-year increase of \$20.3 million or 18.2 percent.
- Net cash flow from operating activities of \$171.8 million, up \$32.7 million from the prior year, was more than sufficient to cover a \$100 million profit transfer to the General Fund, the costs of the Pennsylvania State Police’s liquor control enforcement, transfers to the Department of Drug & Alcohol Programs and the PLCB’s capital expenditures programs.
- Year-end cash and investments increased \$33.4 million to \$295.4 million, due to positive net cash flow from operations.
- Total liabilities increased by \$105.5 million to \$906.5 million, reflecting primarily the continuing increase in the PLCB’s share of the Commonwealth’s net pension liability and other post-employment benefits.
- The PLCB’s total net position improved slightly, but was still in a net deficit position of \$238.2 million as of June 30, 2016.

**Revenues and Costs**

**Sales**

Sales and tax revenue in fiscal year 2015-16 totaled \$2.43 billion, an increase of \$94.8 million or 4.1 percent over fiscal year 2014-15. Excluding liquor and sales taxes, net sales of \$1.94 billion were up \$75.6 million, also 4.1 percent over the prior year. Unit volume growth accounted for the majority of the sales increase, while price per unit increased by less than 1 percent. By product category, sales growth was relatively balanced, with spirits and wine increasing by 4.2 percent and 3.8 percent, respectively.

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**PENNSYLVANIA LIQUOR CONTROL BOARD**  
**STATE STORES FUND – JUNE 30, 2016**  
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**PLCB Management’s Discussion and Analysis (Continued)**

Within the PLCB’s customer base, retail sales to individual consumers grew 4.2 percent, while sales to licensees increased by 3.2 percent. Retail sales made up nearly 80 percent of total sales. On a volume basis, spirit unit sales grew 3.5 percent, and wine unit sales grew 3.0 percent, while spirit gallon sales increased 2.5 percent and wine gallon sales increased 1.8 percent. Debit/credit card purchases represented approximately 65 percent of sales during fiscal year 2015-16, up from 62 percent last year. The average sale per debit and credit card transaction was \$30.65 and \$53.57, respectively, versus \$30.44 and \$53.81 during the prior year.

**Gross Margin**

Gross margin increased to 31.3 percent in fiscal year 2015-16 from 31.2 percent last year. The increase is due in part to increases in vendor promotion allowances, which were up \$11 million or 8.6 percent, and PLCB forward-buying in advance of vendor price increases.

**Operating Income & Expense**

Operating income for the year ended June 30, 2016, was \$131.8 million, up \$20.3 million, or 18.2 percent, from the \$111.5 million reported last year. The increase was almost entirely a function of higher sales, as operating expenses were up only \$4.2 million.

Within operating expenses, salary and wages for fiscal year 2015-16 were essentially flat compared to the prior year, while workers’ compensation expense decreased \$22.3 million, significantly offsetting the effects of a \$17 million increase in total pension expense. Non-payroll related expenses grew by \$3.7 million, or 2.5 percent compared to the prior year, mostly due to increases in store rent, which was up 5.1 percent, and credit and debit card service fees, which increased 8.2 percent.

**Transfers Out**

The Bureau of Liquor Control Enforcement within the Pennsylvania State Police received \$26.1 million in funding in fiscal year 2015-16, an increase of \$0.4 million, or 1.4 percent, over the previous year. Contributions to the Department of Drug & Alcohol Programs increased to \$3.3 million, reflecting a legislatively mandated retroactive increase to \$2.5 million for fiscal year 2014-15 and a similar amount for fiscal year 2015-16.

Also as legislatively mandated, the PLCB transferred \$100 million in profits to the General Fund during fiscal year 2015-16, a \$20 million increase over the \$80 million profit transfer in the prior year.

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**PENNSYLVANIA LIQUOR CONTROL BOARD**  
**STATE STORES FUND – JUNE 30, 2016**  
**LIQUOR LICENSE FUND – JUNE 30, 2016**

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**PLCB Management’s Discussion and Analysis (Continued)**

Other contributions to the General Fund during fiscal year 2015-16 generated by the PLCB’s operations, but not reflected as revenues, expenses, or cash flows in the State Stores Funds financial statements, included \$135.6 million in state sales tax and \$348 million in liquor tax, both up 4.1 percent over the prior year. Additionally, the PLCB remitted \$8.7 million in local sales taxes to Philadelphia and Allegheny County.

Licensing fees returned to local municipalities from the Liquor License Fund were \$4.6 million for fiscal year 2015-16, compared to \$4.5 million in the prior year.

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**PENNSYLVANIA LIQUOR CONTROL BOARD**

**FINANCIAL STATEMENTS**

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**PENNSYLVANIA LIQUOR CONTROL BOARD  
STATE STORES FUND  
COMPARATIVE STATEMENTS OF NET POSITION  
(EXPRESSED IN THOUSANDS)**

<b><u>ASSETS</u></b>	<b><u>June 30, 2016</u></b>	<b><u>June 30, 2015</u></b>
Current assets:		
Cash	\$ 19,963	\$ 20,210
Temporary investments	275,395	241,702
Accounts and claims receivable, net	1,481	1,305
Due from other funds	87	28
Merchandise inventories, net	244,159	230,093
Operating supplies	492	202
Prepaid expenses	<u>-</u>	<u>3,766</u>
Total current assets	<u>\$ 541,577</u>	<u>\$ 497,306</u>
Noncurrent assets:		
Non-depreciable capital assets:		
Land	\$ 323	\$ 323
Depreciable capital assets:		
Building	19,558	19,558
Leasehold improvements	758	758
Machinery and equipment	51,585	46,576
Intangibles	20,559	27,541
Less: accumulated depreciation	<u>(53,565)</u>	<u>(57,728)</u>
Net depreciable capital assets	<u>\$ 38,895</u>	<u>\$ 36,705</u>
Total noncurrent capital assets	<u>\$ 39,218</u>	<u>\$ 37,028</u>
Total assets	<u>\$ 580,795</u>	<u>\$ 534,334</u>
Total deferred outflows of resources – Note C	\$ 93,191	\$ 31,039
<b><u>LIABILITIES</u></b>		
Current liabilities:		
Trade accounts payable	\$ 256,513	\$ 253,125
Miscellaneous accounts payable	13,003	12,339
Accrued expenses	20,322	16,695
Self-insurance – Note L	7,772	7,817
Due to other funds – Note E	8,688	7,690
Due to fiduciary funds	1,602	1,378
Due to other governments	481	495
Total current liabilities	<u>\$ 308,381</u>	<u>\$ 299,539</u>
Noncurrent liabilities:		
OPEB – Note C	90,178	76,653
Self-Insurance – Note L	39,287	42,109
Net pension liability – Note C	449,175	362,685
Compensated absences	<u>19,507</u>	<u>20,092</u>
Total noncurrent liabilities	<u>\$ 598,147</u>	<u>\$ 501,539</u>
Total liabilities	<u>\$ 906,528</u>	<u>\$ 801,078</u>

**PENNSYLVANIA LIQUOR CONTROL BOARD  
STATE STORES FUND  
COMPARATIVE STATEMENTS OF NET POSITION (Continued)  
(EXPRESSED IN THOUSANDS)**

	<b><u>June 30, 2016</u></b>	<b><u>June 30, 2015</u></b>
Total deferred inflows of resources – Note C	\$ 5,636	\$ 3,002
<b><u>NET POSITION</u></b>		
Net investment in capital assets	\$ 39,218	\$ 37,028
Restricted for:		
State Stores Fund (deficit)	<u>(277,396)</u>	<u>(275,735)</u>
Total net position	<u>\$ (238,178)</u>	<u>\$ (238,707)</u>

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

**PENNSYLVANIA LIQUOR CONTROL BOARD  
STATE STORES FUND  
COMPARATIVE STATEMENTS OF REVENUES, EXPENSES AND CHANGES IN NET POSITION  
(EXPRESSED IN THOUSANDS)**

	<u>Fiscal Year Ended June 30, 2016</u>	<u>Fiscal Year Ended June 30, 2015</u>
Sales net of taxes	\$1,937,885	\$1,862,270
Less: Cost of goods sold	<u>1,332,286</u>	<u>1,281,140</u>
Gross profit from sales	<u>\$ 605,599</u>	<u>\$ 581,130</u>
Less: Operating expenses:		
Purchasing, storage and transportation	20,786	18,433
Stores' operations and supervision	368,992	365,466
Central administrative support	68,518	69,683
Comptroller operations	5,817	4,714
Commonwealth-provided services	9,715	11,291
Total	<u>\$ 473,828</u>	<u>\$ 469,587</u>
Operating profit from state stores	<u>\$ 131,771</u>	<u>\$ 111,543</u>
Other operating revenues (expenses):		
Enforcement fines	1,892	1,976
License fees	12,884	12,315
Miscellaneous income	3,611	3,695
Administrative law judge	(2,491)	(2,543)
Legal	(3,359)	(3,570)
Licensing and investigations	(15,110)	(14,498)
Total	<u>\$ (2,573)</u>	<u>\$ (2,625)</u>
Total operating income	<u>\$ 129,198</u>	<u>\$ 108,918</u>
Nonoperating revenues (expenses):		
Interest income/loss	893	429
Other	(143)	(23)
Total	<u>\$ 750</u>	<u>\$ 406</u>
Income before operating transfers	<u>\$ 129,948</u>	<u>\$ 109,324</u>
Operating transfers out:		
PSP enforcement – Note I	<u>26,091</u>	<u>25,726</u>
Income after enforcement/before other transfers	<u>\$ 103,857</u>	<u>\$ 83,598</u>
Other operating transfers:		
Transfers out:		
General Fund – Note G	(100,000)	(80,000)
Drug and alcohol programs – Note H	(3,328)	(1,672)
Total	<u>\$ (103,328)</u>	<u>\$ (81,672)</u>
Change in net position	<u>\$ 529</u>	<u>\$ 1,926</u>
Net position – beginning	\$ (238,707)	\$ (240,633)
Restated - Note M		
Total net position – ending	<u>\$ (238,178)</u>	<u>\$ (238,707)</u>

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

**PENNSYLVANIA LIQUOR CONTROL BOARD  
STATE STORES FUND  
COMPARATIVE STATEMENTS OF CASH FLOWS  
(EXPRESSED IN THOUSANDS)**

	<b>Fiscal Year Ended <u>June 30, 2016</u></b>	<b>Fiscal Year Ended <u>June 30, 2015</u></b>
<b>Cash flows from operating activities:</b>		
Receipts from customers	\$ 1,956,037	\$ 1,879,999
Payments to suppliers	<u>(1,784,218)</u>	<u>(1,740,843)</u>
Net cash provided by (used for) operating activities	\$ 171,819	\$ 139,156
<b>Cash flows from noncapital financing activities:</b>		
Operating transfers out	<u>(127,763)</u>	<u>(107,398)</u>
Net cash used for noncapital financing activities	\$ (127,763)	\$ (107,398)
<b>Cash flows from capital and related financing activities:</b>		
Acquisition and construction of capital assets	<u>(11,503)</u>	<u>(11,503)</u>
Net cash used for capital and related financing activities	\$ (11,503)	\$ (11,503)
<b>Cash flows from investing activities:</b>		
Purchase of investments	(1,613,172)	(1,415,178)
Proceeds from sale and maturities of investments	1,579,479	1,383,742
Investment income	<u>893</u>	<u>429</u>
Net cash used in investing activities	\$ (32,800)	\$ (31,007)
Net decrease in cash	\$ (247)	\$ (10,752)
Cash – beginning of year	<u>20,210</u>	<u>30,962</u>
Cash – end of year	<u>\$ 19,963</u>	<u>\$ 20,210</u>
<b>Reconciliation of operating income (loss) to net cash provided by (used for) operating activities:</b>		
Operating income	\$ 129,198	\$ 108,918
Depreciation	9,170	9,510
<b>Change in assets and liabilities:</b>		
Accounts receivable	(176)	(486)
Inventory	(14,356)	(23,508)
Due from other funds	(59)	229
Other operating net assets	3,766	(467)
Deferred outflows – pension related	(62,153)	(17,884)
Accounts payable and accrued liabilities	7,679	(5,075)
Due to other funds	(658)	(2,742)
Due to pension trust funds	224	(399)
Net pension liability	86,491	31,708
Due to other government	(14)	(270)
Deferred inflows – pension related	2,634	3,002
Other post-employment benefit obligations	13,525	13,023
Self-insurance liabilities	(2,867)	23,957
Compensated absences	<u>(585)</u>	<u>(360)</u>
Total adjustments	<u>\$ 42,621</u>	<u>\$ 30,238</u>
Net cash provided by (used for) operating activities	<u>\$ 171,819</u>	<u>\$ 139,156</u>

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

**PENNSYLVANIA LIQUOR CONTROL BOARD  
LIQUOR LICENSE FUND  
STATEMENTS OF FIDUCIARY NET POSITION  
(EXPRESSED IN THOUSANDS)**

<b><u>ASSETS</u></b>	<b><u>June 30, 2016</u></b>	<b><u>June 30, 2015</u></b>
Current assets:		
Cash with Treasury	\$ -	\$ 5
Cash in transit	92	80
Investments – short term	<u>2,327</u>	<u>2,275</u>
Total assets	<u>\$ 2,419</u>	<u>\$ 2,360</u>
<b><u>LIABILITIES</u></b>		
Current liabilities:		
License fees due to municipalities	\$ 2,417	\$ 2,358
Other liabilities	<u>2</u>	<u>2</u>
Total liabilities	<u>\$ 2,419</u>	<u>\$ 2,360</u>

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

**PENNSYLVANIA LIQUOR CONTROL BOARD  
LIQUOR LICENSE FUND  
STATEMENT OF CHANGES IN FIDUCIARY NET POSITION – Fiscal Year Ended June 30, 2016  
(EXPRESSED IN THOUSANDS)**

	<u>Balance June 30, 2015</u>	<u>Additions</u>	<u>Deductions</u>	<u>Balance June 30, 2016</u>
<b><u>ASSETS</u></b>				
Cash – Note K	\$ 85	\$ 9,009	\$ 9,002	\$ 92
Temporary investments – Note K	<u>2,275</u>	<u>4,484</u>	<u>4,432</u>	<u>2,327</u>
Total assets	<u>\$ 2,360</u>	<u>\$ 13,493</u>	<u>\$ 13,434</u>	<u>\$ 2,419</u>
 <b><u>LIABILITIES</u></b>				
Due to municipalities	\$ 2,358	\$ 4,576	\$ 4,517	\$ 2,417
Other liabilities	<u>2</u>	<u>2</u>	<u>2</u>	<u>2</u>
Total liabilities	<u>\$ 2,360</u>	<u>\$ 4,578</u>	<u>\$ 4,519</u>	<u>\$ 2,419</u>

- The notes to the financial statements are an integral part of this statement -

**PENNSYLVANIA LIQUOR CONTROL BOARD  
LIQUOR LICENSE FUND  
STATEMENT OF CHANGES IN FIDUCIARY NET POSITION – Fiscal Year Ended June 30, 2015  
(EXPRESSED IN THOUSANDS)**

	<u>Balance</u> <u>June 30, 2014</u>	<u>Additions</u>	<u>Deductions</u>	<u>Balance</u> <u>June 30, 2015</u>
<b><u>ASSETS</u></b>				
Cash – Note K	\$ 62	\$ 9,092	\$ 9,069	\$ 85
Temporary investments – Note K	<u>2,351</u>	<u>4,476</u>	<u>4,552</u>	<u>2,275</u>
Total assets	<u>\$ 2,413</u>	<u>\$ 13,568</u>	<u>\$ 13,621</u>	<u>\$ 2,360</u>
<b><u>LIABILITIES</u></b>				
Due to municipalities – Note K	\$ 2,411	\$ 4,561	\$ 4,614	\$ 2,358
Other liabilities	<u>2</u>	<u>2</u>	<u>2</u>	<u>2</u>
Total liabilities	<u>\$ 2,413</u>	<u>\$ 4,563</u>	<u>\$ 4,616</u>	<u>\$ 2,360</u>

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

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**PENNSYLVANIA LIQUOR CONTROL BOARD**  
**STATE STORES FUND – JUNE 30, 2016**  
**LIQUOR LICENSE FUND – JUNE 30, 2016**

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**NOTE A – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES**

The basic financial statements present only the financial position and results of the PLCB and do not present the financial position of the Commonwealth of Pennsylvania. The significant accounting policies employed by PLCB in the preparation of the accompanying financial statements are as follows:

***Fund Accounting:*** The PLCB is primarily responsible for the accounting and reporting of the State Stores Fund and the Liquor License Fund. The State Stores Fund is an enterprise fund primarily used to account for wine and spirit sales and related operating expenses. The Liquor License Fund is an agency fund used for the collection and subsequent disbursement of certain annual license fees, which are returned to municipalities.

The preparation of financial statements in conformity with generally accepted accounting principles requires the PLCB to make estimates and assumptions that affect the reported amount of assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

***Basis of Accounting:*** The State Stores Fund is reported using the economic resources measurement focus and the accrual basis of accounting. Under this measurement focus, all assets, deferred outflows of resources, liabilities, and deferred inflows of resources associated with the operations of this fund are included in the Statement of Net Position. Under the accrual basis of accounting, revenues are recognized in the fiscal year earned and expenses are recognized in the fiscal year incurred.

The Liquor License Fund, a fiduciary type fund, uses the accrual basis of accounting to report assets and liabilities. This fund has no measurement focus and does not report operating activity.

***Cash:*** Cash includes PLCB funds held by the State Treasurer, imprest balances held at financial institutions and change used at state stores.

***Temporary Investments:*** The PLCB participates in the Treasury Department's Commonwealth Investment Program (CIP) with other Commonwealth agencies. Practically all individual funds which are part of the Commonwealth are participants in the CIP. The Treasury Department accounts for each participating fund's equity (considered "shares") in the CIP on a daily basis. "Share" balances of participating funds fluctuate considerably during the fiscal year, based on the timing of cash receipts and disbursements in the participating fund, and are reported as temporary investments. The CIP is considered an internal investment pool. Temporary investments are reported at fair value.

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**PENNSYLVANIA LIQUOR CONTROL BOARD**  
**STATE STORES FUND – JUNE 30, 2016**  
**LIQUOR LICENSE FUND – JUNE 30, 2016**

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**NOTE A – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES**  
**(Continued)**

*Cash Equivalents:* No investments which could be defined as cash equivalents have been treated as such on the Statement of Cash Flows; therefore, only net changes in cash are displayed.

*Inventories:* Inventories are stated at weighted average cost. In January 2012, the PLCB implemented a bailment inventory management program. PLCB began entering into bailment agreements with certain suppliers that require the suppliers to continue to hold title to stock at PLCB warehouse facilities until it is withdrawn from bailment for shipment to PLCB stores. The bailment inventory management program significantly reduced on hand inventory valuation. Product warehousing and handling, as well as transportation to store costs, are reported as part of merchandise inventories and are charged to cost of goods sold as product is sold.

The allowance for obsolete inventory was \$233 thousand at June 30, 2016 and \$151 thousand at June 30, 2015. Management will regularly review, at least once annually, inventory quantities on hand and increase/decrease the provision for obsolete inventory as necessary based upon factors that include historical unsalable product write-off, the age of the inventory and forecasts of product demand.

*Capital Assets and Depreciation:* Capital assets are reported at cost in the Statement of Net Position. The cost of land is reported; for other types of capital assets, the following minimum per item dollar reporting thresholds are used:

Building	\$5,000
Leasehold improvements	\$5,000
Machinery and equipment	\$5,000
Intangible assets	\$5,000

Capital assets (excluding land) are depreciated over the useful lives using the straight-line method. The following useful lives are being used:

Building	10-20 years
Leasehold improvements	3-15 years
Machinery and equipment	5-10 years
Intangible assets	5-10 years

**PENNSYLVANIA LIQUOR CONTROL BOARD**  
**STATE STORES FUND – JUNE 30, 2016**  
**LIQUOR LICENSE FUND – JUNE 30, 2016**

**NOTE A – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES**  
**(Continued)**

**Taxes:** An 18 percent state liquor excise tax and a 6 percent state sales tax are collected and remitted monthly to the Department of Revenue for the General Fund. The PLCB also collects and remits a 1 percent local sales tax for Allegheny County and a 2 percent local sales tax for Philadelphia County. Taxes collected for the years ended June 30, 2016, and June 30, 2015 are as follows (amounts in thousands):

	<b>Fiscal Year Ended June 30, 2016</b>	<b>Fiscal Year Ended June 30, 2015</b>
Liquor Tax	\$348,056	\$334,414
State Sales Tax	135,581	130,193
Local Sales Tax	<u>8,688</u>	<u>8,493</u>
Total	<u>\$492,325</u>	<u>\$473,100</u>

**Compensated Absences:** Employees accumulate annual leave depending on length of credited service from between 2.7 percent to 10 percent of regular hours paid. Generally a maximum of 45 days may be carried forward at the end of each calendar year. Employees are paid for accumulated annual leave upon termination or retirement.

Employees earn sick leave based on an agreed upon percentage of regular hours paid. Generally, a maximum of 300 days may be carried forward at the end of each calendar year. Most retiring employees that meet service, age or disability requirements are paid in accordance with the following schedule:

<b>Days Available at Retirement</b>	<b>Percentage Payment</b>	<b>Maximum Days Paid</b>
0-100	30%	30
101-200	40%	80
201-300	50%	150
Over 300 (in last year of employment)	100% of days over 300	11

**PENNSYLVANIA LIQUOR CONTROL BOARD**  
**STATE STORES FUND – JUNE 30, 2016**  
**LIQUOR LICENSE FUND – JUNE 30, 2016**

**NOTE A – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES**  
**(Continued)**

The accumulated annual and sick leave and related payroll benefits payable reported for the fiscal year ended June 30, 2016 and June 30, 2015 (amounts in thousands) was \$24,384 (\$4,877 current and \$19,507 non-current) and \$25,115 (\$5,023 current and \$20,092 non-current), respectively. It is the PLCB’s policy to record the cost of annual and sick leave in accordance with GASB Statement 16. The expense and corresponding liability are reflected in the financial statements.

The following summary provides aggregated information reported for the fiscal years ended June 30, 2016 and June 30, 2015 of the compensated absences liabilities to include the additions and reductions during the fiscal years then ended (amounts in thousands):

<b>Fiscal Year</b> <b><u>End</u></b>	<b>Liability –</b> <b><u>Beginning Balance</u></b>	<b><u>Additions</u></b>	<b><u>Reductions</u></b>	<b>Liability –</b> <b><u>Ending Balance</u></b>
June 30, 2016	\$25,115	\$16,533	\$17,264	\$24,384
June 30, 2015	\$24,641	\$17,299	\$16,825	\$25,115

***Pension Costs and Liability:*** In the State Stores Fund Statement of Net Position, pension liabilities are reported at their actuarial present value of projected benefit payments to periods of employee service. The Commonwealth’s policy is to fund employer contributions to the State Employees’ Retirement System (SERS) as required by their Boards, through statutory authority, or as required based on other applicable statutory requirements. Since SERS is a cost-sharing, multiple-employer pension plan, and the PLCB participates in SERS, the PLCB reports a net pension liability as required by GASB 68.

For purposes of measuring the net pension liability, deferred outflows of resources and deferred inflows of resources related to pensions, and pension expense, information about the fiduciary net position of the Pension Plan (Plan) and additions to/deductions from their fiduciary net position have been determined on the same basis as they are reported by the Plan. For this purpose, benefit payments (including refunds of employee contributions) are recognized when due and payable in accordance with the benefit terms. Investments are reported at fair value.

***New Accounting Pronouncements:*** The PLCB adopted GASB Statement No. 72, “Fair Value Measurement and Application” and GASB Statement No. 76, “The Hierarchy of Generally Accepted Accounting Principles for State and Local Governments”. The adoption of these statements had no effect on the previously reported amounts.

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**PENNSYLVANIA LIQUOR CONTROL BOARD**  
**STATE STORES FUND – JUNE 30, 2016**  
**LIQUOR LICENSE FUND – JUNE 30, 2016**

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**NOTE B – DEPOSITS AND INVESTMENTS**

The Treasury Department has the authority to manage, invest, and reinvest the moneys of all funds which are not legally authorized to be invested by a board, commission or State officer. The Treasury Department manages and invests moneys of the Commonwealth through the Commonwealth Investment Program (CIP). The PLCB participates in the CIP's Pool 999 investment pool. Pool 999 is designed to provide a high degree of liquidity and safety. Pool 999 is organized similarly to a money market fund, with an expectation of a stable net asset value per share. Treasury accounts for each participating fund's equity, or shares, in the pool on a daily basis. Share balances of participating funds vary considerably during the fiscal year, based on the timing of cash receipts and disbursements. PLCB has reported the fair value of its shares as of June 30, 2016 and 2015, the fund's year-end. Shares in Pool 999 are reported as temporary investments.

The CIP pools are considered internal investment pools of the Commonwealth of PA and are subject to the requirements of GASB Statement No. 40. GASB Statement No. 40 requires state and local governments to make certain disclosures relating to investment risk, consisting of credit risk (including custodial credit risk and concentrations of credit risk), interest rate risk, and foreign currency risk, in addition to custodial credit risk and foreign currency risk on deposits. The Treasury Department has formally adopted written investment policies to address these investment risks and has disclosed those risks associated with its total pooled deposits and investments in the Commonwealth of Pennsylvania's June 30, 2016 Basic Financial Statements.

PLCB's total deposit balance (amounts in thousands) of \$20,055 and \$20,295 at June 30, 2016 and 2015, respectively, was not exposed to either custodial credit risk or foreign currency risk.

As a participant in Treasury's CIP Pool 999, PLCB's investments are exposed to credit risk and interest rate risk mentioned above. Credit risk is the risk that an issuer or other counterparty to an investment will not fulfill its obligations. The credit risk of fixed income instruments susceptible to credit quality rating is measured by nationally recognized statistical rating agencies (or NRSRAs) such as Moody's Investors Service. Treasury's CIP investment pools are not rated by an NRSRA. Interest rate risk is the risk that an investment's value will change, advantageously or adversely, due to a change in the absolute value of interest rates. The Treasury Department measures interest rate risk using option adjusted duration. Duration is a measure of an investment's sensitivity to changes in interest rates. The higher the duration, the greater the changes in fair value when interest rates change. The average option adjusted duration of Treasury's CIP Pool 999 at June 30, 2016 is approximately 0.083 years.

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**PENNSYLVANIA LIQUOR CONTROL BOARD**  
**STATE STORES FUND – JUNE 30, 2016**  
**LIQUOR LICENSE FUND – JUNE 30, 2016**

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**NOTE C – PENSION AND OTHER POSTEMPLOYMENT BENEFITS**

**General Information about the Pension Plan**

**Plan Description:** To provide pension benefits for employees of state government and certain other organizations, the SERS administers a cost-sharing multiple-employer defined benefit retirement plan. The plan, covering substantially all Commonwealth employees, is a contributory defined benefit pension plan as established by Commonwealth laws. Membership in SERS is mandatory for most PLCB (and other state) employees. Article II of the Commonwealth's constitution assigns the authority to establish and amend the benefit provision of the plan to the General Assembly.

SERS issues stand-alone, audited financial statements which are publicly available at [www.sers.pa.gov](http://www.sers.pa.gov). Written requests for financial statements should be directed to the following address:

State Employees' Retirement System  
30 North Third Street, Suite 150  
Harrisburg, PA 17101-1716

**Benefits Provided:** Under the plan, for most employees hired prior to January 1, 2011, retirement benefits vest after 5 years of credited service. Generally, employees who retire at age 60 or, if under age 60, with 35 years of service are entitled to a normal (unreduced) annual retirement benefit. The general annual benefit is 2 percent of a Class A member's highest three-year average salary multiplied by years of service. This annual benefit is 2.5 percent for Class AA members.

Act 2010-120 (Act 120), which preserved all benefits in place for then current members, mandated a number of benefit reductions for new members effective January 1, 2011. The benefit reduction included a new class of membership that accrues benefits at 2 percent of their final average salary instead of the previous 2.5 percent. The new vesting period changed from five to ten years of credited service, and the option to withdraw lump sum accumulated employee contributions was eliminated. The new normal retirement age is 65 for most employees. Act 120 created a new A-3 class of service and an optional A-4 class for most employees that entered SERS membership for the first time on or after January 1, 2011. The general annual benefit for Class A-3 members is 2 percent of the member's highest three-year average salary times years of service while the Class A-4 benefit accrual rate is 2.5 percent.

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**PENNSYLVANIA LIQUOR CONTROL BOARD**  
**STATE STORES FUND – JUNE 30, 2016**  
**LIQUOR LICENSE FUND – JUNE 30, 2016**

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**NOTE C – PENSION AND OTHER POSTEMPLOYMENT BENEFITS**  
**(Continued)**

*Contributions:* Section 5507 of the State Employees Retirement Code (SERC) (71 Pa. C.S. §5507) requires the Commonwealth and other employers whose employees are SERS members to make contributions to the fund on behalf of all active members and annuitants necessary to fund the liabilities and provide the annuity reserves required to pay benefits. SERS funding policy, as set by the SERS board, provides for periodic active member contributions at statutory rates. The SERS funding policy also provides for periodic employer contributions at actuarially determined rates based on SERS funding valuation, expressed as a percentage of annual retirement covered payroll, such that they, along with employee contributions and an actuarially determined rate of investment return, are adequate to accumulate assets to pay benefits when due. However, Act 2010-120 imposes rate increase collars (limits on annual rate increases) on employer contributions. The collar for Commonwealth fiscal year 2014-2015 was 4.5% and will remain at that rate until no longer needed. The PLCB's contributions to the SERS were (amounts in thousands) \$37,688 and \$30,881 for the years ended June 30, 2016 and 2015, respectively.

*Summary of Significant Accounting Policies:* The SERS financial statements are prepared on the accrual basis of accounting, whereby expenses are recorded when the liability is incurred, revenues are recorded in the accounting period in which they are earned and become measurable, and investment purchases and sales are recorded as of the related trade date. Member and employer contributions are recognized in the period in which employee salaries are reported. Benefits and refunds are recognized when due and payable in accordance with the terms of the plan.

*Pension Liabilities, Pension Expense, and Deferred Outflows of Resources and Deferred Inflows of Resources Related to Pensions:* At June 30, 2016, PLCB reported a liability of \$449,176 thousand for its proportionate share of the SERS net pension liability. The net pension liability attributed to participation in the SERS was measured as of December 31, 2015, and the total pension liability used to calculate the net pension liability was determined by an actuarial valuation as of that date. PLCB's proportion of the SERS net pension liability was based on a projection of the Commonwealth's long-term share of contributions to the pension plan relative to the projected contributions of all participating SERS employers, actuarially determined. At December 31, 2015, PLCB's reported proportionate share of the SERS net pension liability was 2.47 percent which was an increase of .03 percent from its proportion measured as of December 31, 2014.

**PENNSYLVANIA LIQUOR CONTROL BOARD**  
**STATE STORES FUND – JUNE 30, 2016**  
**LIQUOR LICENSE FUND – JUNE 30, 2016**

**NOTE C – PENSION AND OTHER POSTEMPLOYMENT BENEFITS**  
**(Continued)**

As of June 30, 2016, PLCB recognized pension expense of \$64,659 (in thousands) and reported deferred outflows of resources and deferred inflows of resources related to pensions from the following sources:

	<b>Deferred Outflows of Resources</b>	<b>Deferred Inflows of Resources</b>
	<i>(in Thousands)</i>	
Differences between expected and actual experience.....	\$ 9,095	\$ -
Change in assumptions.....	13,345	-
Differences between projected and actual investment earnings.....	45,734	-
Change in proportion.....	5,570	5,144
Differences between employer contributions and proportionate share.....	662	492
Contributions subsequent to measurement date.....	18,785	-
<b>Total.....</b>	<b>\$ 93,191</b>	<b>\$ 5,636</b>

The \$18,785 (in thousands) reported as deferred outflows of resources related to pensions resulting from PLCB’s contributions to SERS subsequent to the measurement date will be recognized as a reduction of the net pension liability in the year ended June 30, 2017. Other amounts reported as deferred outflows of resources and deferred inflows of resources related to pensions will be recognized in pension expense as follows:

<b>Year Ending (June 30):</b>	<b>(in Thousands)</b>
2016	\$17,642
2017	17,642
2018	17,642
2019	14,830
2020	1,015

**Actuarial Assumptions:** Every five years, SERS is required to conduct an actuarial experience study to determine whether the assumptions used in its annual actuarial valuations remain accurate based on current and anticipated demographic trends and economic conditions. The *18th Investigation of Actuarial Experience* study for the period 2011 – 2015 was released in March 2016. The actuary, under oversight of the SERS Board, reviewed economic assumptions (such as the assumed future investment returns and salary increases) as well as demographic assumptions (such as employee turnover, retirement, disability, and death rates). Some assumption adjustments increased projected cost and some decreased projected cost, but the overall result was a slight increase to the net pension liability.

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**PENNSYLVANIA LIQUOR CONTROL BOARD**  
**STATE STORES FUND – JUNE 30, 2016**  
**LIQUOR LICENSE FUND – JUNE 30, 2016**

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**NOTE C – PENSION AND OTHER POSTEMPLOYMENT BENEFITS**  
**(Continued)**

Economic assumption recommendations resulting from the experience study included: keeping the targeted investment return rate assumption at 7.5%; keeping the inflation rate at 2.75 percent; keeping the general salary growth rate at 3.05 percent; and decreasing career salary growth rates, by varying amounts depending upon the employee's length of service at all service levels. In addition to the five-year experience study, SERS reviews its investment return assumption in light of economic conditions every year as part of its annual valuation.

Most demographic assumptions remained the same as or similar to experience over the last five years. However, the experience study did recommend changing some assumptions, which are highlighted as follows. The study recommended decreasing disability retirement rates for all active members. Additionally, it recommended adjusting superannuation separation rates, early retirement separation rates, and withdrawal rates for certain active member groupings (gender, age, years of service) in both the general and special membership classes. Furthermore, it recommended decreasing most annuitant and survivor mortality rates.

The board adopted the actuarial assumptions set forth in the *18th Investigation of Actuarial Experience* at its March 2016 meeting. The study can be viewed at [www.SERS.pa.gov](http://www.SERS.pa.gov).

The following methods and assumptions were used in the actuarial valuation for the December 31, 2015, measurement date:

Actuarial Cost Method	Entry age
Amortization Method	Straight-line amortization of investments over five years and amortization of assumption changes and noninvestment gains/losses over the average expected remaining service lives of all employees that are provided benefits
Investment rate of return	7.5% net of expenses including inflation
Projected salary increases	Average of 5.7% with range of 3.85% to 9.05% including inflation
Asset valuation method	Fair (market) value
Inflation	2.75%

**PENNSYLVANIA LIQUOR CONTROL BOARD**  
**STATE STORES FUND – JUNE 30, 2016**  
**LIQUOR LICENSE FUND – JUNE 30, 2016**

**NOTE C – PENSION AND OTHER POSTEMPLOYMENT BENEFITS**  
**(Continued)**

Mortality Rate	Projected RP-2000 Mortality Tables adjusted for actual plan experience and future improvement
Cost of living adjustments	Ad hoc

The long-term expected rate of return on pension plan investments was determined using a building-block method in which best estimate ranges of expected future real rates of return are developed for each major asset class. These ranges are combined to produce the long-term expected rate of return by weighting the expected future real rates of return by the target asset allocation percentage and by adding expected inflation. The target allocation and best estimates of arithmetic real rates of return for each major asset class are summarized in the following table:

<u>Asset Class</u>	<u>Target Allocation</u>	<u>Long-term Expected Rate of Return</u>
Alternative Investments	15.00%	8.50%
Global Public Equity	40.00%	5.40%
Real Assets	17.00%	4.95%
Diversifying Assets	10.00%	5.00%
Fixed Income	15.00%	1.50%
Liquidity Reserve	3.00%	0.00%
Total	<u>100.00%</u>	

**Discount Rate:** The SERS discount rate used to measure the total pension liability was 7.5 percent. The projection of cash flows used to determine the discount rate assumed that employee contributions will be made at the rates applicable for each member and that employer contributions will be made based on rates determined by the actuary. Based on those assumptions, the SERS fiduciary net position was projected to be available to make all projected future benefit payments of current active and non-active SERS members. Therefore the long-term expected rate of return on SERS investments was applied to all periods of projected benefit payments to determine the total pension liability.

**PENNSYLVANIA LIQUOR CONTROL BOARD**  
**STATE STORES FUND – JUNE 30, 2016**  
**LIQUOR LICENSE FUND – JUNE 30, 2016**

**NOTE C – PENSION AND OTHER POSTEMPLOYMENT BENEFITS**  
**(Continued)**

*Sensitivity of the PLCB’s proportionate share of the net pension liability to change in the discount rate:* The following chart presents the PLCB’s proportionate share of the SERS net pension liability using the discount rate of 7.5 percent, as well as what the PLCB’s proportionate share of the net pension liability would be if it were calculated using a discount rate that is 1 percentage point lower (6.5 percent) or 1 percentage point higher (8.5 percent) higher than the current rate.

	<b>1% Decrease</b> <b>6.5%</b>	<b>Current</b> <b>Discount Rate</b> <b>7.5%</b>	<b>1% Increase</b> <b>8.5%</b>
	(in Thousands)		
PLCB’s proportionate share of SERS net pension liability as of the 12/31/15 measurement date	\$557,961	\$449,176	\$355,898

*Pension plan fiduciary net position:* Detailed information about the pension plan’s fiduciary net position is available in the separately issued SERS financial report.

*Payables to the pension plan:* For the fiscal year ended June 30, 2016, the PLCB reported an accounts payable for the employers’ share of retirement contributions to the SERS in the amount of \$458 thousand.

Additional pertinent information regarding SERS, outside the scope of PLCB reporting, is published each year as part of the Commonwealth of Pennsylvania’s Basic Financial Statements included in its Comprehensive Annual Financial Report.

**Other Post-Employment Benefits**

*Postemployment Health Care Benefits:* The Commonwealth established and sponsors a Retired Employees Health Program (REHP) plan which provides postemployment benefits other than pensions (OPEB). This plan is administered by the Pennsylvania Employee Benefits Trust Fund, which acts as a third-party administrator and administers the REHP under an administrative agreement with the Commonwealth. The plan is a single employer defined benefit OPEB plan. The PLCB participates in the REHP, which provides a variety of healthcare benefits to eligible retirees. The OPEB plan and benefit provisions therein have been established under pertinent statutory authority. The OPEB plan does not issue a stand-alone financial report nor is it included in the financial statements of a public employee retirement system.

**PENNSYLVANIA LIQUOR CONTROL BOARD**  
**STATE STORES FUND – JUNE 30, 2016**  
**LIQUOR LICENSE FUND – JUNE 30, 2016**

**NOTE C – PENSION AND OTHER POSTEMPLOYMENT BENEFITS**  
**(Continued)**

REHP contribution requirements are established by the Office of Administration and the Governor’s Budget Office. During the fiscal year ended June 30, 2016, the PLCB contributed \$418 for each active employee paid and reported as part of biweekly payroll expenses for its employees. For the fiscal year ended June 30, 2016, the PLCB’s allocated share of the total REHP Annual OPEB Cost (amounts in thousands) of \$1,169,885 (for the Commonwealth’s fiscal year ended June 30, 2016) was \$47,677. The last year that was fully funded for the entire REHP Annual OPEB Cost, for all REHP-participating organizations, was for the fiscal year ended June 30, 2008. The unfunded OPEB liability has been recorded for subsequent fiscal years. The prior year unfunded liability (amounts in thousands) of \$76,653, plus an additional increase of \$13,525, resulted in a total unfunded liability of \$90,178 as of June 30, 2016.

Additional pertinent information on the REHP, outside the scope of PLCB reporting, including overall actuarial liabilities and assumptions related to the Commonwealth as a whole, are published each year as part of the Commonwealth of Pennsylvania’s Basic Financial Statements included in the Comprehensive Annual Financial Report.

**NOTE D – CAPITAL ASSETS**

Changes in capital assets for the fiscal year ended June 30, 2016 are as follows (amounts in thousands):

**Fiscal year ended June 30, 2016:**

	<b><u>Balance</u></b> <b><u>June 30, 2015</u></b>	<b><u>Additions</u></b>	<b><u>Retirements</u></b>	<b><u>Balance</u></b> <b><u>June 30, 2016</u></b>
Non-depreciable capital assets:				
Land.....	\$ 323	\$ -	\$ -	\$ 323
Depreciable capital assets:				
Building.....	19,558	-	-	19,558
Leasehold improvements.....	758	-	-	758
Machinery and equipment.....	46,576	8,229	3,220	51,585
Intangibles .....	<u>27,541</u>	<u>3,274</u>	<u>10,256</u>	<u>20,559</u>
Total capital assets.....	<u>\$ 94,756</u>	<u>\$ 11,503</u>	<u>\$ 13,476</u>	<u>\$ 92,783</u>

**PENNSYLVANIA LIQUOR CONTROL BOARD**  
**STATE STORES FUND – JUNE 30, 2016**  
**LIQUOR LICENSE FUND – JUNE 30, 2016**

**NOTE D – CAPITAL ASSETS (Continued)**

Changes in capital assets accumulated depreciation for the fiscal year ended June 30, 2016 are as follows (amounts in thousands):

	<u>Balance</u> <u>June 30, 2015</u>	<u>Additions</u>	<u>Retirements</u>	<u>Balance</u> <u>June 30, 2016</u>
Buildings.....	\$ 12,516	\$ 795	\$ -	\$ 13,311
Leasehold improvements.....	564	48	-	612
Machinery and equipment....	24,967	4,389	3,078	26,278
Intangibles.....	<u>19,681</u>	<u>3,938</u>	<u>10,255</u>	<u>13,364</u>
Total accumulated depreciation	<u>\$ 57,728</u>	<u>\$ 9,170</u>	<u>\$ 13,333</u>	<u>\$ 53,565</u>

**Fiscal year ended June 30, 2015:**

	<u>Balance</u> <u>June 30, 2014</u>	<u>Additions</u>	<u>Retirements</u>	<u>Balance</u> <u>June 30, 2015</u>
Non-depreciable capital assets:				
Land.....	\$ 323	\$ -	\$ -	\$ 323
Depreciable capital assets:				
Building.....	19,558	-	-	19,558
Leasehold improvements.....	2,478	-	1,720	758
Machinery and equipment.....	40,384	7,157	965	46,576
Intangibles .....	<u>50,742</u>	<u>4,346</u>	<u>27,547</u>	<u>27,541</u>
Total capital assets.....	<u>\$ 113,485</u>	<u>\$ 11,503</u>	<u>\$ 30,232</u>	<u>\$ 94,756</u>

Changes in capital assets accumulated depreciation for the fiscal year ended June 30, 2015 are as follows (amounts in thousands):

	<u>Balance</u> <u>June 30, 2014</u>	<u>Additions</u>	<u>Retirements</u>	<u>Balance</u> <u>June 30, 2015</u>
Buildings.....	\$ 11,640	\$ 876	\$ -	\$ 12,516
Leasehold improvements.....	2,202	74	1,712	564
Machinery and equipment....	21,665	4,252	950	24,967
Intangibles.....	<u>42,921</u>	<u>4,308</u>	<u>27,548</u>	<u>19,681</u>
Total accumulated depreciation	<u>\$ 78,428</u>	<u>\$ 9,510</u>	<u>\$ 30,210</u>	<u>\$ 57,728</u>

**NOTE E – DUE TO OTHER FUNDS**

At June 30, 2016 and June 30, 2015, a total (amounts in thousands) of \$8,688 and \$7,690, respectively, was due to other funds. This total was due to various funds.

**PENNSYLVANIA LIQUOR CONTROL BOARD**  
**STATE STORES FUND – JUNE 30, 2016**  
**LIQUOR LICENSE FUND – JUNE 30, 2016**

**NOTE F – LEASE COMMITMENTS**

The PLCB, through the Department of General Services, has operating leases covering all of its Fine Wine and Good Spirits store locations and some equipment. The leases generally provide for an initial term of three to ten years. Most leases have options for renewal. For leases not renewed, but not terminated, the lease will continue as a renewal in 90 day increments into the future. For such leases, only 90 days of future rental commitments are included in the rental commitment schedule below.

Rental expenses (amounts in thousands), for the fiscal year ended June 30, 2016 and June 30, 2015 were \$47,297 and \$44,902, respectively.

The following is a schedule of future minimum rental commitments for noncancelable operating leases in effect as of June 30, 2016, (amounts in thousands):

<u>Fiscal Year Ended June</u>	<u>Fine Wine and Good Spirits Store Leases</u>
2017	\$36,755
2018	31,344
2019	25,813
2020	20,220
2021	16,784
Total Minimum Lease Payments:	<u>\$130,916</u>

**NOTE G – OPERATING TRANSFERS TO GENERAL FUND**

The PLCB is subject to profit transfer requirements pursuant to 47 P.S. §8-802(f), determined annually by the Governor’s Office, whereby stipulated funds are transferred to help finance the General Fund.

Act 10A of 2015 was enacted December 29, 2015 with a provision that the sum of \$100 million shall be transferred from the State Stores Fund to the General Fund. The Act 10A of 2015 transfer did not replace or supplant the PLCB’s authority to make payments to the General Fund pursuant to 47 P.S. §8-802(f).

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**PENNSYLVANIA LIQUOR CONTROL BOARD**  
**STATE STORES FUND – JUNE 30, 2016**  
**LIQUOR LICENSE FUND – JUNE 30, 2016**

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**NOTE G – OPERATING TRANSFERS TO GENERAL FUND (Continued)**

The required transfers were \$100 million and \$80 million for the fiscal years ended June 30, 2016 and June 30, 2015, respectively.

**NOTE H – OPERATING TRANSFER FOR DRUG AND ALCOHOL PROGRAMS**

Per Act 1987-14, two percent of the PLCB's profits from the sale of alcohol shall be transferred to the Department of Drug and Alcohol Programs (DDAP) for drug and alcohol rehabilitation programs. The PLCB establishes a liability for the amount due to the DDAP and transfers the payment in the subsequent fiscal year.

In addition to the fiscal year 2014-2015 amount for the purposes set forth in Act 1987-14, Act 25 of 2016 was enacted April 25, 2016 and contains a provision that resulted in an additional \$828 thousand other operating transfer out to DDAP reported in fiscal year 2015-2016.

Act 85 of 2016 was enacted July 13, 2016 and contains a provision that resulted in a \$2.5 million other operating transfer out to DDAP reported for fiscal year 2015-2016 (for fiscal year 2016-2017 transfer) for the purposes set forth in Act 1987-14.

The amount of the liabilities (amounts in thousands) established to the DDAP were \$3,328 and \$1,672 for the fiscal years ended June 30, 2016 and June 30, 2015, respectively.

**NOTE I – OPERATING TRANSFER FOR LIQUOR CONTROL ENFORCEMENT**

The PLCB provides the funding for the Pennsylvania State Police, Bureau of Liquor Control Enforcement, which is responsible for enforcing the laws and regulations governing the trafficking of alcoholic beverages throughout the Commonwealth. The transfers (amounts in thousands) were \$26,091 and \$25,726 for the fiscal years ended June 30, 2016 and June 30, 2015, respectively.

**NOTE J – CONTINGENCIES-LITIGATION**

The PLCB is a defendant in various legal proceedings pertaining to matters normally incidental to routine operations. Based on the current status of these legal proceedings, it is the opinion of the PLCB's management and counsel that they will not have a material effect on the PLCB's financial position.

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**PENNSYLVANIA LIQUOR CONTROL BOARD**  
**STATE STORES FUND – JUNE 30, 2016**  
**LIQUOR LICENSE FUND – JUNE 30, 2016**

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**NOTE K – STATEMENT OF CHANGES IN FIDUCIARY NET POSITION**

The Statement of Changes in Fiduciary Net Position illustrates the net asset activities throughout each fiscal year for the Liquor License Fund.

Cash additions include cash received from license application fees as well as cash resulting from the sale of temporary investments. Cash deductions include the purchase of temporary investments as well as cash remitted to the municipalities.

Temporary investments' additions and deductions result from the purchase and sale of securities.

Due to municipalities' additions include monies received from license application fees. Due to municipalities' deductions include payments remitted to municipalities.

**NOTE L – SELF-INSURANCE LIABILITIES**

The Commonwealth is self-insured for statutory workers' compensation, which includes indemnity and medical payments (employee disability) for its employees injured on the job. The Commonwealth is also self-insured for annuitant medical/hospital claims and for tort liability claims. Major tort risks include automobile, employee and general torts. For property losses, the Commonwealth has a \$1 million retention with excess commercial insurance coverage up to \$1 billion per occurrence. There was no reduction in commercial insurance coverage during the fiscal year ended June 30, 2016. No settlements exceeded commercial insurance coverage during each of the past three fiscal years. The Commonwealth has established various administrative policies, which are intended to avoid or limit the aforementioned risks.

PLCB participates in each Commonwealth self-insurance program and pays prescribed program amounts or rates throughout its fiscal year. These amounts, reported as current fiscal year expenses, finance a portion of cumulative, estimated self-insurance liabilities incurred, in amounts sufficient to fund ongoing program needs. These amounts do not finance all cumulative, estimated self-insurance liabilities incurred. Therefore, accrued liabilities for employee disability and annuitant medical/hospital claims are established based on reserves computed from the Commonwealth's claim experience; such claims are not discounted and do not include non-incremental claims adjustment expenses.

**PENNSYLVANIA LIQUOR CONTROL BOARD**  
**STATE STORES FUND – JUNE 30, 2016**  
**LIQUOR LICENSE FUND – JUNE 30, 2016**

**NOTE L – SELF-INSURANCE LIABILITIES (Continued)**

At June 30, 2016 and June 30, 2015, respectively, the State Stores Fund reported (amounts in thousands) a \$47,059 liability (\$7,772 as current and \$39,287 as non-current) and \$49,926 liability (\$7,817 as current and \$42,109 as non-current) for employee disability claims.

The following summary provides aggregated information for the fiscal years ended June 30, 2016 and June 30, 2015 of the reported self-insurance liabilities to include the incurred claims and payments during the fiscal years then ended (amounts in thousands):

<b>Fiscal Year End</b>	<b>Liability – Beginning Balance</b>	<b>Incurred Claims</b>	<b>Payments</b>	<b>Liability – Ending Balance</b>
June 30, 2016	\$49,926	\$ 2,477	\$5,344	\$47,059
June 30, 2015	\$30,565	\$26,831	\$7,470	\$49,926

**NOTE M – RESTATEMENT**

Restatement Due to Change in Accounting Principle:

The implementation of GASB 68 resulted in the reporting of a pension liability and deferred outflow, therefore, the State Store Fund’s beginning net position at July 1, 2014 was restated.

Presented below are the changes to the State Store Fund’s Statement of Net Position as a result of implementing GASB 68. The State Stores Fund Net Position changed by a total of \$(317,822,168).

	<b>State Stores Fund</b>
<b>Net Position, as previously reported, at June 30, 2014.....</b>	\$ 77,189,035
Apply GASB 68	
Pension Liability.....	\$ (330,976,835)
Deferred Outflows.....	\$ 13,154,667
Total Prior Period Adjustment.....	\$ (317,822,168)
<b>Net Position, as restated, at July 1, 2014.....</b>	<b>\$ (240,633,133)</b>

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**PENNSYLVANIA LIQUOR CONTROL BOARD**  
**STATE STORES FUND – JUNE 30, 2016**  
**LIQUOR LICENSE FUND – JUNE 30, 2016**

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**NOTE N – SUBSEQUENT EVENT**

On June 8, 2016, the Governor of Pennsylvania signed into law Act 39 of 2016 (Act 39). Effective August 8, 2016, Act 39 made significant changes to PLCB operations including: permits for limited wine sales at hotel and restaurant license holders, including approved grocery or convenience stores; direct wine shipment from registered vendors to Pennsylvania residents; removed restrictions to the number of open stores and hours on Sundays; created a new 24/7 casino liquor license; limited special liquor order mark-ups, allowed for common retail pricing flexibility; approved auctions of expired liquor licenses; and authorized Pennsylvania lottery sales at state stores. Act 39 will impact PLCB operations beginning in the next fiscal year.

**PENNSYLVANIA LIQUOR CONTROL BOARD**  
**STATE STORES FUND – JUNE 30, 2016**  
**LIQUOR LICENSE FUND – JUNE 30, 2016**

**Schedule of PLCB’s Contributions** *(Dollar Amounts in Thousands)*

*Last Ten Fiscal Years Ended June 30 <sup>(1)</sup>*

	2016	2015
Contractually required contribution <sup>(2)</sup>	\$ 33,752	\$ 27,044
Contributions in relation to the contractually required contribution	\$ 33,752	\$ 27,044
Contribution deficiency (excess)	-	-
PLCB’s covered-employee payroll	\$166,701	\$162,037
Contributions as a percentage of covered-employee payroll	20.25%	16.69%

<sup>(1)</sup> PLCB adopted GASB 68 on a prospective basis for the fiscal year ended June 30, 2015; therefore, only two years are presented in the above schedules. The amounts presented for each fiscal year were determined as of December 31.

<sup>(2)</sup> The contractually required contribution disclosed above is based on minimum floor rates or suppressed rates resulting from collars that are required based on statutory law. These rates are determined by SERS actuary during the annual funding valuation and include an adjustment to the “preliminary employer contribution rate” calculated before the minimum floor or collars are applied. These “final employer contribution rates” fall within the realm of an appropriate contractually required contribution calculation under actuarial standards of practice and temporarily defer a portion of the payments that work towards fully funding the plan.

**PENNSYLVANIA LIQUOR CONTROL BOARD**  
**STATE STORES FUND – JUNE 30, 2016**  
**LIQUOR LICENSE FUND – JUNE 30, 2016**

**Schedule of PLCB’s Proportionate Share of the Net Pension Liability** *(Dollar Amounts in Thousands)*

*Last Ten Fiscal Years Ended June 30 <sup>(1)</sup>*

	2016 <sup>(2)</sup>	2015
PLCB’s proportion of the net pension liability	2.47%	2.44%
PLCB’s proportionate share of the net pension liability	\$449,176	\$362,685
PLCB’s covered-employee payroll	\$166,701	\$162,037
PLCB’s proportionate share of the net pension liability as a percentage of its covered-employee payroll	269.45%	223.83%
Plan fiduciary net position as a percentage of the total pension liability	58.90%	64.80%

<sup>(1)</sup> PLCB adopted GASB 68 on a prospective basis for the fiscal year ended June 30, 2015; therefore, only two years are presented in the above schedules. The amounts presented for each fiscal year were determined as of December 31.

<sup>(2)</sup> Every five years, SERS is required to conduct an actuarial experience study to determine whether the assumptions used in its annual actuarial valuations remain accurate based on current and anticipated demographic trends and economic conditions. The 18<sup>th</sup> Investigation of Actuarial Experience study for the period 2011 – 2015 was released in March 2016 and can be viewed at [www.sers.pa.gov](http://www.sers.pa.gov). The actuary, under oversight of the SERS Board, reviewed economic assumptions (such as the assumed future investment returns and salary increases) as well as demographic assumptions (such as employee turnover, retirement, disability, and death rates). Some assumption adjustments increased projected cost and some decreased projected cost, but the overall result was an increase to the net pension liability.



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EUGENE A. DePASQUALE  
AUDITOR GENERAL

**Report on Internal Control Over Financial Reporting and on Compliance and Other  
Matters Based on an Audit of Financial Statements Performed in Accordance With  
*Government Auditing Standards***

Independent Auditor's Report

The Honorable Tom Wolf  
Governor  
Commonwealth of Pennsylvania  
Harrisburg, PA 17120

The Honorable Tim Holden  
Chairman  
Pennsylvania Liquor Control Board  
Harrisburg, PA 17124

We have audited, 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, the accompanying Statements of Net Position, Statements of Revenues, Expenses and Changes in Net Position, and Statements of Cash Flows for the State Stores Fund, and the Statements of Fiduciary Net Position and Statements of Changes in Fiduciary Net Position for the Liquor License Fund of the Pennsylvania Liquor Control Board (PLCB) as of and for the years ended June 30, 2016 and 2015, and the related notes to the financial statements and have issued our report thereon dated December 6, 2016.

**Internal Control Over Financial Reporting**

In planning and performing our audit of the financial statements, we considered PLCB's internal control over financial reporting (internal control) to determine the audit procedures that are appropriate in the circumstances for the purpose of expressing our opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of PLCB's internal control. Accordingly, we do not express an opinion on the effectiveness of PLCB's internal control.

*A deficiency in internal control* exists when the design or operation of a control does not allow management or employees in the normal course of performing their assigned functions, to prevent, or detect and correct, misstatements on a timely basis. *A material weakness* is a

deficiency, or combination of deficiencies, in internal control such that there is a reasonable possibility that a material misstatement of the PLCB's financial statements will not be prevented, or detected and corrected on a timely basis. A *significant deficiency* is a deficiency, or a combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance.

Our consideration of internal control over financial reporting was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control that might be material weaknesses or significant deficiencies, material weakness or significant deficiencies may exist that were not identified. Given these limitations, during our audit we did not identify any deficiencies in internal control that we consider to be material weaknesses. However, material weaknesses may exist that have not been identified.

### **Compliance and Other Matters**

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

### **Purpose of This Report**

The purpose of this report is solely to describe the scope of our testing of internal control and compliance and the results of that testing, and not to provide an opinion on the effectiveness of PLCB's internal control or on compliance. This report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering PLCB's internal control and compliance. Accordingly, this communication is not suitable for any other purpose.



Eugene A. DePasquale  
Auditor General

December 6, 2016

**COMMONWEALTH OF PENNSYLVANIA  
PENNSYLVANIA LIQUOR CONTROL BOARD  
JUNE 30, 2016  
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Commonwealth of Pennsylvania

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