

Valdese ABC Board

Performance Audit Report



Alcoholic Beverage Control Commission
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ABC
COMMISSION
NORTH CAROLINA

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ABC

COMMISSION
NORTH CAROLINA

Alcoholic Beverage Control

January 6, 2017

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Valdese ABC Board
Mr. Seth Eckard, Chairman
1018 Main Street West
Valdese, NC 28690

Dear Chairman Eckard,

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

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

We would like to thank you, the ABC Board and your staff for the assistance and cooperation provided to us during the audit. Additionally, we appreciate the efforts your Board has made to comply with the new performance standards. Your continued efforts to increase profitability and reduce expenses is commendable and should remain your most important goal.

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

Respectfully,

A handwritten signature in black ink, appearing to read "R. A. Hamilton".

Robert A. Hamilton
Administrator

CC: North Carolina Association of ABC Boards

OBJECTIVE, PURPOSE, AND SCOPE

G.S. 18B-705 (a) authorizes the ABC Commission or alcohol law enforcement agents to conduct regular, special audits, or performance evaluations on all ABC boards. Performance audits are examinations of existing operating policies, practices, controls, and activities to determine those areas in which there may be a need for improvement.

The audits or evaluations are to ensure that all local ABC Boards comply with established performance standards pursuant to G.S. 18B-203 (a) (20). The audit scope includes performance standards that address compliance with ABC laws, store appearances, operating efficiency, solvency, and customer service.

To achieve the objectives of the audit, auditors:

- Reviewed applicable General Statutes, ABC Commission Rules, and administrative policies
- Reviewed applicable reports and studies of ABC boards with similar size and geography
- Consulted with specialists at UNC School of Government
- Verified compliance with Commission and Board policies
- Reviewed organizational chart and job descriptions
- Reviewed ABC board annual independent financial audits
- Visited the store(s)
- Interviewed key ABC board personnel.

As a basis for evaluating internal control, auditors applied the internal control guidance contained in professional auditing standards. Internal control is the process by which the board and management provide reasonable assurance that operations are effective and efficient, reliable, and in compliance with applicable rules, laws and regulations. As discussed in the standards, internal control consists of five interrelated components, which are (1) control environment, (2) risk assessment, (3) control activities, (4) information and communication, and (5) monitoring.

BACKGROUND INFORMATION

G.S. 18B-601 (c) authorized the Town of Valdese to hold an election for an ABC store. The referendum was held March 2, 2010 and passed 1,000 to 560. A mixed beverage election occurred on the same date and passed 1,032 to 533.

Upon election of an ABC store, the town was authorized to create an ABC board consisting of a chairman and two board members to serve for three-year staggered terms. Current board members include Seth Eckard, chairman, Jennifer Hudson and W.T. Sorrell. Since the audit fieldwork, Jennifer Hudson's term has expired. The town appointed Joseph Andrew Thompson to serve for three years.

The Valdese ABC Board employs one full-time general manager and seven part-time employees. The general manager is responsible for providing sufficient oversight of all daily operations including policy implementation and human resource management. The board has hired a finance officer that provides additional internal controls. All store employees have a primary responsibility of providing friendly customer service, store upkeep, and routine stock maintenance.

FINANCIAL ANALYSIS

PROFIT PERCENTAGE TO SALES

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

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

In FY2015, the Valdese ABC Board had gross sales of \$892,333; income from operations was \$33,943, a 3.80% profit percentage to sales. Sales revenue increased 10.64% over FY2014.

DISTRIBUTIONS

G.S. 18B-805 (b) requires the board to pay from gross receipts, all expenses, mixed beverage and bottle taxes. G.S. 18B-805 (c) requires the board to make a minimum quarterly distribution of the 3½% markup and .01/.05 cent bottle tax to the county.

G.S. 18B-805 (c) (2) requires a local board to distribute quarterly at least five percent (5%) of profits to law enforcement and at least seven percent (7%) toward alcohol education.

In FY2015, the Valdese ABC Board did not make distributions to the town. The ABC Board has an agreement with the town withholding distributions until the store pays off the debt incurred.

WORKING CAPITAL

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

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

In FY2015, the Valdese ABC Board has not retained working capital as required by the ABC Commission rule due to the debt incurred.

OPERATING COST RATIO

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

- Boards with 3 or more stores – cost ratio 0.63 or less
- Board with 1 or 2 stores with MXB – cost ratio .73 or less
- Boards with 1 or 2 stores without MXB – cost ratio .85 or less

The Valdese ABC Board operates one retail store with mixed beverage sales. Mixed beverage sales make up 7.7% of total gross sales. In FY2015, the Valdese ABC Board's operating cost ratio is 0.79.

The ABC board leases the current space for operations. Total rental expenses for FY2015 \$18,720

The FY2015 financial audit has indicated a "going concern" notation that states the following:

"...As shown in the accompanying financial statements, the Valdese ABC Board's liabilities exceeded its assets by \$81,023 for the year ended June 30, 2015. The Board has taken mitigating actions including renegotiation of their rent agreement and obtaining borrowing from the Town to pay down their line of credit with a local bank. Management believes the above actions will allow the Organization to continue as a going concern for a reasonable period of time, and therefore, these financial statements do not include any adjustments that might be necessary if the Organization was unable to continue as a going concern."¹

¹ Valdese ABC Board Financial Audit For the Years Ended June 30, 2015 and 2014 completed by Lowdermilk Church & Co., L.L.P. Certified Public Accountants

FINDINGS AND RECOMMENDATIONS

STORE APPEARANCE AND OPERATIONS

As a routine procedure, the ABC Auditor tours ABC store locations, evaluates interior and exterior store appearances, verifies product pricing, and interviews store personnel. The Valdese ABC Board operates one retail store with approximately 1,100 linear feet of shelf space and carries approximately 1,000 product codes.

- The interior area of the store appeared well-lit and clean contributing to a comfortable shopping experience.
- The store's signage is neat and visible. The Fetal Alcohol Syndrome poster is displayed and visible to the public.
- Shelf management and/or product placement follows industry standards and ABC Commission rules that show the following:
 - Each product is displayed within its designated category
 - Premium products show at eye level and lowest-price products on the bottom shelves
 - Sizes are consistent going from largest on the right to smallest to the left
 - Cross merchandising is utilized where possible to encourage impulse shopping
 - Bottles are fronted and dusted throughout the store
 - Displays are created by store personnel. As a marketing strategy, management partners with neighboring businesses, borrowing items to use as props for displays within the ABC store.
- The North Carolina Liquor Quarterly is available for retail and mixed beverage customers. Sales clerks often refer to the North Carolina Liquor Quarterly for verification of products and pricing. Monthly sales information is shared with mixed beverage and retail customers on a consistent basis.
- Cash drawers are maintained by all clerks. All clerks are responsible for their own cash drawer. Management has implemented procedures for handling cash drawer overages/shortages.
- Bank deposits are made regularly according to the ABC Commission rules. Bank notifications are received and matched with corresponding daily register reports. Bank reconciliations are completed by the general manager and a board member.

NO RECOMMENDATIONS

PERSONNEL AND ABC TRAINING

- All board members and the general manager have completed the initial ethics training as required. One board member has since been reappointed and is planning to complete the training within one year of the reappointment term.
- Cross training has been extended on some key administrative duties to employees in the event the general manager or finance officer are unavailable.
- Additional training is provided to new and existing staff on key areas such as product knowledge, customer service, and clerk responsibilities. The general manager and other staff often attend various training courses offered by the NC ABC Commission, such as the Responsible Alcohol Sellers Program, and the NC Association of ABC Boards.
- Personnel files are available for all employees and include the required documentation and other information as needed for payroll and federal guidelines.

NO RECOMMENDATIONS

ABC BOARD POLICIES

The Valdese ABC Board's policies and manual have been updated to include, but are not limited to, the following:

- Code of Ethics
- Law Enforcement Contract (Valdese Police Department)
- Valdese ABC Board Travel Policy (Town of Valdese Approved in May 2016)
- Valdese ABC Board Employee Handbook/Manual and Addendums that include the following:
 - Sale to Underage Policy
 - Price Discrepancy Policy
 - Valdese ABC Board Procurement Card Policy
- Valdese ABC Board Mixed Beverage Policy

Policies are required to be submitted to the Commission within fifteen days prior to adoption as required by the Commission rule, NCAC 15A .1102.

G.S. 18B-702 requires the board to adopt a budget and budget message and an annual independent audit for the fiscal year. The Valdese ABC Board has submitted the following as required:

- FY2017 Annual Budget (Proposed and Adopted)
- FY2015 Annual Independent Audit

NO RECOMMENDATIONS

INTERNAL CONTROL AND ADMINISTRATIVE OPERATIONS

- The assistant manager schedules employees for work shift hours. All employees complete a time sheet to record hours worked. Time sheets are signed by the employee. Once completed, the general manager will verify and begin the payroll process.
- A physical inventory count is performed monthly by scheduled staff consisting of two teams. Frequent spot checks are conducted throughout the month. After the count is conducted and an exception report is generated, the teams will recount each other for verification. Discrepancies are investigated and conducted by the assistant manager and the general manager. The inventory management system allows for multiple users to adjust the inventory system while creating a historical file of users.
- Breakage forms are submitted as required by the Commission rules. Management has implemented procedures for handling breakage when a customer/employee breaks product.
- In reviewing a sample of travel reimbursements, procedures were followed according to the travel policy submitted.
- Law enforcement activity reports have been submitted to the Commission as required by G.S. 18B-501 (f1).
- All purchases are pre-audited by the finance officer utilizing the certificate as required in G.S. 18B-702 (m). Other common purchases are indicated through use of a purchase order and are paid with a board issued the procurement card or by reimbursement.
- A procurement card is issued to the board with the general manager as the authorized user. Procurement card reconciliations are performed by the finance officer and the general manager monthly. Additional specifications on the usage are found in the procurement card policy.
- Checks bear the approved certificate as required by G.S. 18B-702 (q) indicating that the items have been approved by the finance officer for payment. Two signatures are located on all paid checks; that of the finance officer and a board member. In the event the board member or finance officer is unavailable, the general manager is authorized to sign checks.
- The board pays all invoices using an Automated BillPay system with the bank. All documentation is verified by the general manager and signed by the finance officer.
- Out of approximately 1,000 product codes within the store, approximately 100 product codes were sampled to ensure accurate pricing and all were correct.

NO RECOMMENDATIONS

ABC BOARD COMPLIANCE

- Board meeting minutes were reviewed and found to provide sufficient detail that a reasonable person would be able to follow what transpired.
- Board meeting minutes include a conflict of interest statement asking board members if conflicts exist with the items on the meeting agenda.
- The board notifies the public of board meetings through the local newspaper.
- Board member appointment dates and compensation amounts are current on the Commission website.
- Board member and general manager compensation are in compliance with G.S. 18B-800 (g) and (g1).
- The board is in compliance with G.S. 18B-700 (k). There are no employees who are related to board members or the general manager.
- All board members, the general manager, and the finance officer are bonded for \$50,000 as required by G.S. 18B-700 (i).

NO RECOMMENDATIONS

AUDITOR'S SUMMARY

A board meeting was held on August 15, 2016 with the Valdese ABC Board. Discussions were held regarding the financial position of the store and the strategies needed to increase profits. The board strives to improve profitability while maintaining budget appropriations. Policies have been adopted by the board and management continues to implement policies according to current practices.

VALDESE ABC BOARD

1018 MAIN STREET WEST • VALDESE, NC 28690 • PHONE 828-879-2227 • FAX 828-874-0332

August 29, 2016

Ms. Moniqua S. McLean
ABC Board Auditor
NC ABC Commission
4307 Mail Service Center
Raleigh, NC 27699-4307

Dear Ms. McLean,

On behalf of the Valdese ABC Board I want to thank you for your field work at our Board on June 9th and for attending our meeting on August 15th to review the ABC Commission's performance audit. We really appreciate the insights and positive feedback you shared with the Board. And of course we are pleased that there were no recommendations included in the audit.

There have been many challenges since the Board opened the store on October 5, 2010—the result of the successful passage by a two to one margin vote by the Citizens of Valdese for the alcohol referendum on March 2, 2010. The ABC Board was appointed by the Valdese Town Council at their April 2010 meeting.

One of the Board's first actions was to commission a local CPA firm for a Forecast Report for the financial operation of the store. Additionally, the Board enlisted the assistance of the NC ABC Commission to provide additional data from ABC Boards located in towns similar to Valdese to help with revenue and expense projections. Using this information, the Board acquired a commercial bank loan for a POS system, equipment, shelving, outdoor signage, initial liquor stock, etc., and also for major interior renovations at its leased location, including two rooftop HVAC units.

During the first fiscal year of operation, FY 10/11, revenues were significantly less than the Forecast Report projected and continued through November 2014. Due to this situation, a loan from the Valdese Economic Development Investment Corporation (VEDIC) of \$25,000 was acquired in February 2011 for operating expenses.

The challenges the Board faced during the first four years of operation were many. We opened at the height of the banking and housing crisis. It was also during a time when our area experienced record unemployment (12.7% when we opened—among the worst in the state) after a decade of an eroded furniture and textile manufacturing base. The Settings, a lakefront community intended for high end second homes, filed for bankruptcy just three months after the store opened. And perhaps worst of all, in May of 2013, our largest MXB customer relocated the business from its lakeside location to another in a neighboring county resulting in an annual revenue loss of nearly \$30,000.

A number of measures were implemented to reduce cost. The commercial loan was modified to interest only and the landlord agreed to defer rent. Relationships were formed with neighboring Boards to share

products and deliveries. Our inventory controls were tightened and product selection scrutinized. Where possible annual expenses were broken into installments to maximize cash flow. Every area of potential cost savings was explored.

The Board approached the Town of Valdese for a series of loans to begin paying down the principal on the commercial bank loan, repay the VEDIC loan, and pay deferred rent to the landlord. The following has been loaned by the Town to the Board:

November 15, 2013, the sum of \$72,775:
 \$30,000 commercial bank loan principal payment
 \$25,000 VEDIC loan repayment
 \$17,775 landlord deferred rent
November 15, 2014, the sum of \$30,000
November 15, 2015, the sum of \$30,000

The Valdese Town Council has committed to loan the ABC Board the following amounts:

November 15, 2016, the sum of \$30,000
November 15, 2017, the sum of \$50,000
November 15, 2018, the sum of \$50,000

The ABC Board promptly uses the annual loans to pay principal owed by the Board for the commercial bank loan. The Board pays 4% interest to the Town each November. To date that sum is \$7,022. The next interest payment this November of \$5,311 will bring the total interest paid to the Town to \$12,333—a significantly greater return than traditional investments available to local governments.

Despite much slower than projected sales in the first four years of operation, there is great optimism for the store's future based on the significant sales growth experienced since December 2014. Compared to the previous fiscal year, sales in FY 14/15 increased 10.5%. Fiscal year 15/16 sales increased 7.7%. If this trend continues, sales could top \$1 million this fiscal year for the first time. The Forecast Report predicted this milestone to occur in FY 12/13.

As we shared with you during our meeting, because the State prohibits advertising and limits marketing of ABC stores, our focus is on providing excellent customer service and a superior customer experience. This has generated and continues to generate positive word-of-mouth marketing resulting in the retail growth the store has experienced. Loyal customers express a preference for shopping at the Valdese ABC store due to the pleasant atmosphere and the great customer service they receive from the dedicated staff. We want to be among the best stores in the system for customer satisfaction. We believe this will distinguish us from our competitors, lead to even greater sales growth, and ultimately, the ability to begin distributing profits to benefit the citizens of the Town of Valdese much sooner.

The general economic health of the geographic area continues to improve. As mentioned earlier, the unemployment rate when the store opened was 12.7% compared to 5.1% this June. Construction is set to begin in the Settings (the bankrupt lakefront development mentioned previously) early next year with the completion of the infrastructure in the development by the end of this year. More high end residential communities are being developed along the lakefront property within the Town limits.

New businesses have contributed to more people having a reason to come to Valdese. Formal Showcase bridal and formal wear, My Nails nail salon, and a collectible toy store have opened in the past year. The two temporary employment agencies and the NC Department of Public safety training center, all opened

the previous year, have also helped contribute to the Board's overall 8.1% retail sales growth this past fiscal year. We continue to acquire retail customers who discover that Valdese actually has an ABC store.

Several factors contributed to a more than 90% increase in MXB sales in FY 14/15. A restaurant in the county opened with moderate MXB sales, was open only a year, and added less than 10% to our sales volume during that time. In July 2014 another restaurant occupied the lakeside location of our former customer. While they had no plans to apply for MXB permits, our manager met with the owner and shared the previous owner's sales data and other information about the profitability of MXB sales. They have been our top customer ever since. Sales at Valdese's first restaurant serving liquor-by-the-drink, opened in February 2015, have steadily increased. In FY 15/16, sales from these two customers and our other two grew, leading to a 2.7% increase, despite the closure of the restaurant in the county (mentioned above) the previous year. At this time, we are unaware of any other restaurants opening that would be potential MXB customers.

Prospects for job growth and creation continue to improve. Meridian Industries recently broke ground on an \$8 million expansion at its existing Valdese location just a few blocks from the store that will add 25 new jobs. While they initially do not plan on any ABC permits, Old World Baking has begun renovation of a downtown building that will house a bakery and café on the ground floor and create seven full-time jobs when it opens this fall. Upscale apartments are being constructed on the upper floor. In neighboring Rutherford College, a distillery recently received permits to begin production. There is a sense that a lot is going on in Valdese these days.

Even though the economy in our area has improved we continue look for ways to operate more efficiently and reduce costs. Rent was renegotiated to a lower rate in 2013. The lease is up for renewal again this fall with the hopes of reducing that cost further and for a longer term. The sharing of products and fill-in deliveries at neighboring Boards has helped address the challenge of testing new products and having only two product deliveries a month. We continue to monitor supplier and vendor cost and make changes in those areas to help reduce expenses.

As manager for the Town of Valdese and chairman of the Valdese ABC Board, I help ensure the communication between the two entities stays open, current, and transparent. The Board has the support of the Mayor and Town Council and we are delighted to have our Performance Audit Report shared with them. The loan from the Town to the Board is testament to the value our local government places on having an ABC store as a part of a vibrant, progressive, and growing community. Without the Town's help it is very likely the Board would not have successfully faced the many challenges detailed earlier.

The Valdese ABC store has become a vital part of the business community bringing many people from surrounding areas to town. It is important to the Board that we are also a good corporate citizen. Our membership in the Valdese Merchants Association and involvement in Rotary are ways in which we stay connected with other businesses and project a positive image in our community.

We thank you for the time and effort put into our performance audit. It was a pleasure to have you attend our Board meeting and share your valuable guidance. We take great pride in our store and appreciate our efforts being validated by the Commission's audit.

Sincerely,



Seth Eckard,
Chairman