

Pilot Mountain ABC Board

Performance Audit Report



Alcoholic Beverage Control Commission
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ABC
COMMISSION
NORTH CAROLINA



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NORTH CAROLINA

Alcoholic Beverage Control

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May 30, 2012

Pilot Mountain ABC Board
Mr. Marshall Atkins, Chairman
PO Box 1478
Pilot Mountain, NC 27041

Dear Chairman Atkins,

We are pleased to submit this performance audit report on the relatively new Pilot Mountain ABC store. 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 and 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.

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

Respectfully,

Michael C. Herring
Administrator

Cc: North Carolina Association of ABC Boards

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EXECUTIVE SUMMARY

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

To achieve the objectives of the audit, ABC Commission staff

- Reviewed applicable General Statutes, ABC Commission Rules, and administrative policies;
- Review applicable reports and studies of ABC boards with similar size and geography;
- Verified compliance with Commission and Board policies;
- Reviewed organizational chart and job descriptions;
- Reviewed ABC store annual audit for the fiscal year 2011;
- Visited the store;
- Interviewed key ABC board personnel.

The Pilot Mountain ABC Board has responded to the performance audit recommendations. The store is in its second year of operation and is striving to reduce costs while increasing profits. Policies and procedures have been adopted and implemented to maintain compliance with statutes and Commission rules. Internal controls have been established to maintain stronger segregation of duties and checks and balances.

BACKGROUND INFORMATION

Pilot Mountain is located in Surry County within a thirty mile radius of the Virginia border. Surrounding towns, all in Surry County, with ABC stores include Dobson, Mt. Airy, and Elkin. The US Census Bureau reports a population of 1,477 in 2010.

G.S. 18B-601 (c) authorized the Town of Pilot Mountain to hold an election for an ABC store. The referendum was held on May 6, 2008 and passed 240 to 206. A mixed beverage election was held on the same date and passed 247 to 196. The store opened on December 10, 2009.

Upon election of an ABC store, Pilot Mountain was authorized to create an ABC Board consisting of a chairman and two members to serve for three year terms. Current board members are Marshall Atkins, board chairman, Dwight Atkins and Larry Cooke, board members.

The Pilot Mountain ABC Board operates one retail store and staffs one full-time manager and two part-time clerks. The board has contracted with a CPA to act as finance officer. Duties of the manager include ordering liquor products, inventory management, computer support, and various clerk duties. All clerks are responsible for daily stocking, floor upkeep, and retail functions including selling products.

Profitability

For fiscal year 2011, the board showed a loss; gross sales were \$671,890, income from operations was -\$11,178, resulting in a profit percentage to sales of -1.66%. Current year sales have showed a significant increase of 4.7% over last year. In comparing Pilot Mountain ABC and other similar size boards, sales have continued to increase since the stores opening in 2009.

Factors affecting sales and profitability:

- Total population for the town of Pilot Mountain has increased 14% over the past ten years
- Adult working population and poverty levels have increased 25% over the past ten years
- 10.9% unemployment rate for Surry County in February which resulted in a .20% decrease from the previous month
- Five year lease on store totaling \$115,419, and a \$175,000 bank line of credit

Distributions

G.S. 18B-805 (c) (2) and (3) requires the board to distribute quarterly at least five percent of profits for law enforcement and at least seven percent profits for alcohol education. Remaining profits will be distributed to Pilot Mountain General Fund.

For FY2011, the Pilot Mountain ABC Board did not make distributions to law enforcement, alcohol education, or to the appointing authority.

FINDINGS AND RECOMMENDATIONS

On March 6, 2012, ABC Commission Board Auditor, Moniqua S. McLean, visited the Pilot Mountain ABC store and interviewed Paula Jones, general manager. The following are the findings and recommendations relating to the performance audit.

Inventory Turnover

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

- Once a week deliveries target at 6 times or more per year
- Twice a month deliveries target at 5 times or more per year
- Monthly deliveries target at 4.5 times or more per year

The Pilot Mountain ABC Board has a bi-weekly deliver schedule. The inventory turnover rate for the Pilot Mountain ABC Board is 4.4 and has missed the target set by the Commission.

Recommendations:

- Maximize inventory turnover using the following methods:
 - Continuing to split cases with nearby boards to increase variety while minimizing costs
 - Analyzing sales data and history to plan orders and to take advantage of Special Purchase Allowance offers whenever possible
 - Identifying dead stock by moving to a visible location until sold through, encouraging more impulse shopping
 - Using recipe cards, displays, and other proven marketing techniques to increase sales

Operating Cost

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

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

The Pilot Mountain ABC Board has an operating cost ratio of 1.00 and is over the target goal set by the Commission. Overhead expenses are high due to the store rental. To meet the goal and remain at current expense levels of \$162,014, revenues must be increased by \$228,110 to approximately \$900,000. To meet the goal and remain at current revenue levels of \$671,890, expense levels will need to be reduced by \$38,514 to approximately \$123,500. In comparing expense analyzes with similar size boards, Pilot Mountain ABC's expenses are slightly over in the salaries and credit card fee categories. *Refer to Appendix A for chart analysis of common expense comparisons.*

Recommendations:

- Continue to monitor budget more frequently to ensure that the actual expenses do not exceed the budgeted amounts.
- Because salaries and rent are the largest segment of operating expenses, analyze personnel hours to assess efficient personnel usage by determining when your slowest hours occur and consider adjusting the number of personnel needed for those time periods. Re-negotiate rental agreements to get a better rate.
- Request bids annually from various vendors to get the best rates possible on audit, utilities, maintenance contracts, and credit card fees.

Profit percentage to sales

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

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

The Pilot Mountain ABC Board has a profit percentage to sales of -1.66% and does not meet the goal set by the Commission. However, if sales continue to increase, this percentage will also continue to improve.

Recommendations:

- Increase sales strategies by developing new marketing techniques. *Refer to recommendations under inventory turnover.*
- Analyze and reduce operating expenses to increase profits by monitoring budget. Provide year-to-date reports to board members detailing how much has been spend. *Refer to recommendations under operating costs.*

Working Capital

Working capital is total cash, investments, and inventory less all unsecured liabilities. Gross sales means gross receipts from the sale of alcoholic beverages less distributions as defined in G.S. 18B-805 (b), (2), (3), and (4). The Commission has set efficiency goals based on the following breakdown:

- 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

Under the new guidelines, the Pilot Mountain ABC Board had a working capital of \$82.832 in FY2011 and is within the limits set by the Commission.

Store Appearance and Customer Service

The Pilot Mountain ABC store has approximately 928 linear feet of shelf space. The store has approximately 900 to 950 product codes. Refer to Appendix B for photos.

- Both interior and exterior areas of the store were clean, well-lit, and inviting. Countertops were free of clutter.
- The shelf management system was clearly defined, consistent, and easily understood. Bottles were dusted, fronted, and well-stocked.
- The required Fetal Alcohol Syndrome poster was displayed.
- Upon entering the store, the employees greeted customers in a professional manner exhibiting good customer service. Employees expressed a high level of product knowledge when called upon by customers and also encouraged use of the Virtual Bartender System within the store.

Policies and Procedures

- The board has adopted the following policies and copies were submitted to the Commission:
 - Travel policy
 - Code of Ethics
 - Employee handbook
- The law enforcement contract was not filed with the Commission. A copy was submitted to the auditor upon visit.
- All employees maintain their own cash drawer. The cash drawers are counted daily at the beginning of each shift. Any shortages that arise, the employee responsible will make up the difference.
- Inventory counts are performed weekly by whoever is working. Unsaleable items are removed from inventory immediately. Because inventory is counted weekly, spot checks are not conducted unless necessary. When discrepancies arise, the general manager will check behind to investigate the occurrences.
- The general manager creates a schedule for all employees and maintains records for vacation and sick hours earned and used.

Personnel and Training

- All board members, the finance officer, and the general manager have attended the mandatory ethics class.
- Training is provided annually to employees through the RASP class. Training is also provided on an as-needed basis on new information.
- Cross training is available to key employees on administrative duties such as ordering liquor and closing the end of the month.

Recommendations:

- Continue providing training opportunities for employees on alcohol education, customer service, and other approved Commission training modules.
- Continue cross training employees on key functions such as ordering liquor, to back up the general manager should she be suddenly unavailable.

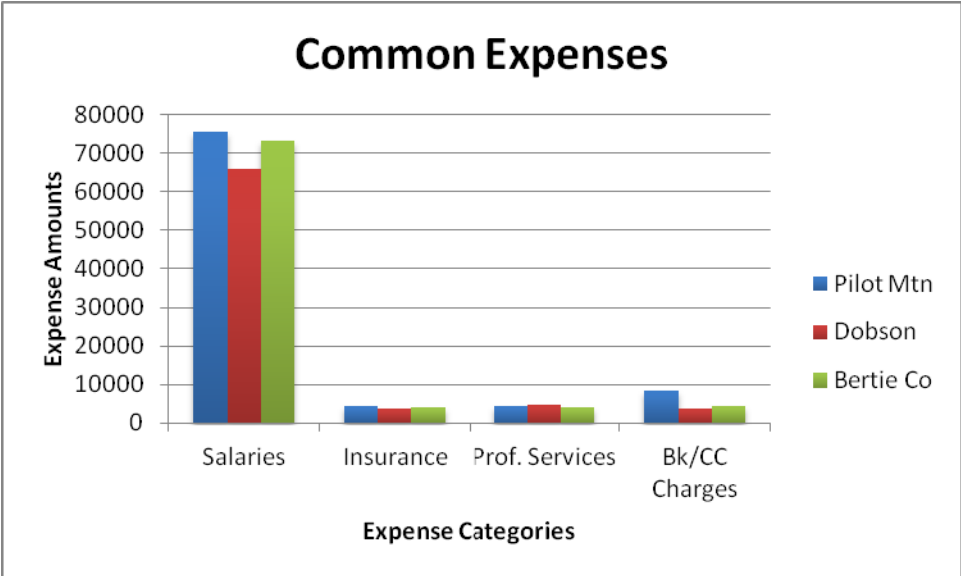
Administrative Compliance and Internal Controls

- Board meeting minutes were available to view and followed the order of proceedings for conducting a business meeting. However, the conflict of interest statement was not referenced.
- Board information on the Commission website does not reflect the current board members' latest appointment dates or the general manager's salary information.
- Nepotism – The board does not employ any immediate family members.
- Purchase orders are not used when ordering store and office supplies.
- Orders to LB&B do not bear the pre-audit certificate as required by G.S. 18B-702 (m).
- All checks have the approved certificate and signed by the finance officer as required by G.S. 18B-702(q). All checks have two signatures, the finance officer and a board member.
- A deputy finance officer has not been appointed to fill in if the finance officer is unable to work.
- Out of approximately 900 product codes, approximately 85 codes were sampled and one shelf tag was found that did not reflect the price set by the Commission. 61-962 Southern Comfort .75L showed the May 2011 price on shelf.

Recommendations:

- In an effort to avoid possible conflicts of interest, it is recommended that at the beginning of each board meeting the Chairman ask fellow board members if there are any potential conflicts of interest. *Refer to Appendix C (1).*
- Update board information on the Commission website to reflect current appointment dates and salary information of board members and general manager.
- Have the pre-audit certificate and the finance officer's signature on all purchase orders and liquor orders before the purchase is made. *Refer to Appendix C (2).*
- Appoint a deputy finance officer to aid in the duties of the finance officer when she is absent.
- North Carolina statutes require uniform pricing in all ABC stores. Audit all shelf tags in the store and the cash register for correct pricing. To ensure accurate pricing in the future, incorporate a shelf tag audit (by section) into the weekly inventory count.

APPENDIX A



Common expense comparison reveals that salaries and the credit card fees of Pilot Mountain are higher than other similar size boards.

APPENDIX B



Counter view of store.



Incorrect shelf price.

APPENDIX C

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

'In accordance with GS 18B-201, it is the duty of every Board member to avoid both conflicts of interest and appearances of conflicts. Does any member have any known conflict of interest or appearance of conflict with respect to any matters coming before the Board today?'

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

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

(Signature of finance officer)

To: Moniqua McLean

Date: 5-22-12

From: Pilot Mountain ABC Board

Subject: Response to the Performance Audit

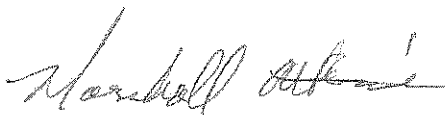
The Pilot Mountain Board would like to thank Ms. McLean and the ABC commission by implementing recommendations from a performance audit.

Our store is a teenager as far as ABC stores go. We welcome the opportunity for an outside source to come in and as our board sees it as a learning tool. We have also learned a lot from the various ABC stores close to us. Items you brought to our attention, such as inventory turnover are being looked at very strongly, and as mentioned being such a young store, our customers keep asking for different brands. We try to please the customer and find out what is selling the best. We are also starting to use purchase orders, as you suggested. The Board members status have been corrected and sent to Laurie Lee. One item concerning our expenses that you brought up is our expenses are higher because of us renting our retail and storage space. This avenue was taken by the Board because of never having a store and not knowing if it would be successful. Therefore the board decided to rent with less exposure in the event the store turned out to be a losing proposition.

Thankfully the store is in a profitable situation now and at some time will look to have our own structure.

It is nice to know that we can and will get back with you on occasions with questions.

The Pilot Mountain ABC Board



Marshall Atkins (Chairman of the Board)

Larry Cooke

Dwight Atkins

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MAY 22 2012

NC ABC COMMISSION

PILOT MOUNTAIN ALCOHOL BEVERAGE CONTROL BOARD

Recommendation Follow-Up

| RECOMMENDATION | REQUIRED BY STATUTE | IMPLEMENTATION STATUS |
|--|---|---|
| <p>Administrative Compliance and Internal Controls: **Update all board information on the Commission website.</p> <p>Use purchase orders when ordering store and office supplies.</p> | <p><input checked="" type="checkbox"/> Yes</p> <p><input type="checkbox"/> No</p> <p>**Required by Commission rule.</p> | <p>(Please provide documentation supporting implementation status.)</p> <p><input checked="" type="checkbox"/> Fully Implemented</p> <p><input type="checkbox"/> Partially implemented ___% complete. (Explain below.)</p> <p><input type="checkbox"/> Not implemented (Explain below.)</p> <p>Management has updated all information on the Commission website and is currently using purchase orders when ordering supplies.</p> |
| <p>Administrative Compliance and Internal Controls (continued):</p> <p>Affix the pre-audit certificate on all liquor orders.</p> <p>Appoint a deputy finance officer.</p> <p>Audit shelf tags to ensure accurate pricing with the Commission.</p> | <p><input checked="" type="checkbox"/> Yes</p> <p><input type="checkbox"/> No</p> | <p>(Please provide documentation supporting implementation status.)</p> <p><input checked="" type="checkbox"/> Fully Implemented</p> <p><input type="checkbox"/> Partially implemented ___% complete. (Explain below.)</p> <p><input type="checkbox"/> Not implemented (Explain below.)</p> <p>Management has begun incorporating the pre-audit certificate on all liquor orders. To ensure accurate pricing, management has implemented procedures to verify the correct prices. The board has appointed a deputy finance officer.</p> |