FINANCIAL AUDIT

Commonwealth of Pennsylvania
Pennsylvania Liquor Control Board

State Stores Fund
Liquor License Fund

Audit Report

Harrisburg, Pennsylvania
For the Fiscal Years Ended June 30, 2015 and 2014

December 2015

EUGENE A. DEPASQUALE • AUDITOR GENERAL •

Commonwealth of Pennsylvania
Department of the Auditor General

Eugene A. DePasquale • Auditor General

TABLE OF CONTENTS

BACKGROUND

INTRODUCTION

The Pennsylvania Liquor Control Board (PLCB) is an entity of the Commonwealth of Pennsylvania 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 and Good Spirits stores for the sale of liquor, including wine and spirits.

The PLCB serves as the commonwealth's responsible retailer of wine and spirits and regulator of the beverage alcohol industry and strives to maximize returns to the people of Pennsylvania.

HISTORY

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 Pennsylvania Liquor Control Board (Board), an independent administrative board. The Board was given four (4) major functions:

1. Establish a system of state-operated stores for the sale of wine, liquor and alcohol for off-premises consumption. Subsequently, the legislature has authorized the Board to buy and sell other items, such as corkscrews, liquor and wine accessories, trade publications, gift cards/certificates, wine- or liquor-scented candles, and wine glasses. [47 P.S. §§ 2-207(a), 305].

2. License establishments wishing to sell alcoholic beverages for on-premises consumption, to manufacture, import, warehouse and/or transfer alcoholic beverages, and to sell malt or brewed beverages at the wholesale and/or retail level.

3. Develop regulations in order to carry out its functions.

4. Enforce all state laws and regulations involving the sale of alcohol. In 1987, enforcement responsibilities were transferred to the Pennsylvania State Police, Bureau of Liquor Control Enforcement (BLCE).

BACKGROUND (Continued)

Currently, the duties of the Board include:

- Purchase and sale of wines and spirits and accessories.
- Control of the manufacture, possession, sale, consumption, importation, use, storage, transportation and delivery of liquor, alcohol and malt or brewed beverages within the Commonwealth.
- Setting of wholesale and retail prices at which liquor and alcohol shall be sold in its stores.
- Determination of locations of its stores.
- Granting and issuance of all licenses and permits authorized to be issued under the Liquor Code.
- Leasing, furnishing and equipping of building accommodations as required.
- Adoption, publication and dissemination of regulations necessary for the efficient administration of the Liquor Code.
- Establishment, operation and maintenance of its stores.
- Administration of a statewide alcohol education program.
- Appointments of personnel.
- Initial appellate review for citation cases.
- Awarding of money to various organizations, local government entities, and educational institutions in the form of grants.

PLCB OPERATIONS

The PLCB operates over 600 Pennsylvania wine and spirits stores with gross annual sales of over $2.34 billion USD for fiscal year 2014-2015, an increase of 4.2 percent over the previous year. As a result, the PLCB's return to the Pennsylvania General Fund and state Treasury also grew, including $334.4 million in liquor tax, $130.2 million in state sales tax and $80 million operational profits transferred to the General Fund. Additionally, the PLCB provided $25.7 million to fund Pennsylvania State Police liquor law enforcement efforts, afforded $1.7 million to support the Pennsylvania Department of Drug and Alcohol Programs, returned $4.5 million to local municipalities and approved $2.3 million in alcohol education grants to 65 programs around the state promoting responsible alcohol consumption and deterring underage drinking.

BACKGROUND (Continued)

This year the PLCB implemented benefit accounting and reporting changes, consistent with the Commonwealth which are reflected for the first time in the fiscal year 2014-2015 financial statements resulting in a $49.2 million reduction in net income. Had these changes – which result from the commonwealth's growing benefit costs and liabilities related to pensions, workers' compensation and other post-employment benefits – not been implemented, net profit for the year would have totaled a record $132.8 million, 2.5 percent growth over fiscal year 2013-2014.

KEY FACTS

- All tax moneys collected are transferred to the State Treasury. In fact, 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, infusing approximately $44 million to Pennsylvania's economy.
- 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, which contribute more than $45 million to Pennsylvania's economy.
- Administrative costs are shared between the operations of the marketing, licensing and alcohol education functions, resulting in true economies of scale.
- In FY 2014-2015, PLCB processed almost 67,000 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.
- The BLCE is responsible for the enforcement of all liquor laws. The PLCB fully funds this function out of operational revenues. In FY 2014-2015, the PLCB transferred over $25 million to the BLCE.
- The PLCB policy of "zero tolerance" for sales to minors and intoxicated individuals has resulted in store employees challenging, or "carding," over 1.33 million suspected minors in the 2014 calendar year.

Commonwealth of Pennsylvania
Department of the Auditor General
Harrisburg, PA 17120-0018
Facebook: Pennsylvania Auditor General
Twitter: @PAAuditorGen
www.PaAuditor.gov

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, 2015 and 2014, 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, 2015 and 2014, 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, 2015 and 2014, 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, 2015 and 2014, 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.

Emphasis of Matter

Change in Accounting Principles

As discussed in Note A to the financial statements, the PLCB implemented the following pronouncements: GASB Statement No. 68, *Accounting and Fniancial Reporting for Pensions – an amendment of GASB No. 27*; and GASB Statement No. 71, *Pension Transition for*

Contributions Made Subsequent to the Measurement Date – an amendment of GASB Statement No. 68. Our opinion is not modified with respect to this matter.

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 15 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 18, 2015, 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.

December 18, 2015

Eugene A. DePasquale
Auditor General

PLCB Management's Discussion and Analysis

Agency Overview

The statutory authority for the 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 Pennsylvania Liquor Control Board (PLCB) regulates the manufacture, possession, sale, consumption, importation, use, storage, transportation and delivery of liquor, alcohol and malt or brewed beverages in the Commonwealth. All package sales of wines and spirits in Pennsylvania, with the exception of wines sold by licensed limited wineries and distilleries, are made through the Fine Wine and Good Spirits stores operated by the PLCB. These include 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 Board does regulate those sales through the licensing of the distributors, restaurants, hotels, supermarkets and clubs that sell those beverages.

On November 27, 2013, House Bill No. 1098 was signed into law. The bill made changes to the Local Option Small Games of Chance Act which allows certain PLCB licensees to obtain a tavern gaming license and offer their patrons small games of chance. PLCB, in conjunction with the Gaming Control Board, review the applications and conduct background investigations as the basis for recommending action on the application by the PLCB Board of Directors.

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 Wine and Spirits stores and authorizing the licensing of establishments that manufacture or sell liquor and alcohol. While not mandated, the Board does provide for a comprehensive program of alcohol education aimed at promoting moderation 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 laws and regulations governing the trafficking of alcoholic beverages 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 which 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.

PLCB Management's Discussion and Analysis (Continued)

The State Stores Fund is an enterprise fund, which serves as the general operating fund for the Liquor Control Board. This fund receives revenues from the sale of goods through Fine Wine and Good Spirits stores, fees not credited to the Liquor License Fund, fines and penalties for law violations by licensees, and losses and damages recovered. Expenditures cover all costs associated with the operation and administration of all PLCB functions as outlined and prescribed by the Pennsylvania Liquor Code. In addition, the fund also provides monies to the Pennsylvania State Police for enforcement of the Liquor Code Law, the Department of Drug and Alcohol for alcohol abuse programs, the Department of the Auditor General for auditing services, and the Office of Comptroller Operations assigned to the PLCB. Annual profit transfers are made from this fund to the General Fund.

Discussion of Basic Financial Statements

The State Stores Fund and the Liquor License Fund are accounted for on a fiscal year basis, comprised of 12 calendar months.

The accounts of the State Stores Fund are reported using the accrual basis of accounting. The accounts of the Liquor License Fund are reported using the accrual basis of accounting for recognizing assets and liabilities. The audit report consists of financial statements including the Statement of Net Position; Statement of Revenues, Expenses and Changes in Net Position; and Statement of Cash Flows for the State Stores Fund for the fiscal years ended June 30, 2015 and June 30, 2014; and the Liquor License Fund Statement of Fiduciary Net Position and the Statement of Changes in Fiduciary Net Position for the fiscal years ended June 30, 2015 and June 30, 2014.

The Statement of Net Position provides information about assets and liabilities and reflects the financial position at the fiscal year end. The Statement of Revenues, Expenses and Changes in Net Position reports the operating revenue activity and the expenses related to such activity for the fiscal year. The Statement of Cash Flows outlines the cash inflows and outflows relating to the operations for the fiscal year. The Statement of Fiduciary Net Position provides information about assets and liabilities which reflect the position of the Liquor License Fund at the fiscal year end. The Statement of Changes in Fiduciary Net Position illustrates the net asset activities throughout the fiscal year for the Liquor License Fund. The financial statements also include Notes 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.

PLCB Management's Discussion and Analysis (Continued)

The financial statements represent only the Pennsylvania Liquor Control Board and do not present the financial position of the Commonwealth of Pennsylvania. The following is a discussion on the current-year results of operations for the State Stores Fund.

Executive Summary & Highlights

Fiscal year 2014-15 sales growth improved to 4.2 percent over the prior year with increases attributable equally to wine and spirits sales. Growth was driven by focusing our limited advertising resources on high-impact media in targeted markets, expanding the number of stores carrying Chairman's Selection products and an attractive mix of product discounts.

However, sales growth was more than offset at the bottom line by several year-end accounting valuation adjustments related to commonwealth benefit programs that significantly reduced PLCB net income. The impact of growing pension and benefit costs is a systemic problem facing all commonwealth agencies. The PLCB is a self-funded organization with an enterprise fund reporting this level of detail in PLCB's financial statements.

Changes in accounting principles and revisions by the commonwealth on how certain benefit expenses and liabilities are allocated among agencies were implemented that reduced net income by $49.2 million. PLCB net income of $83.6 million was $40.1 million (32.4 percent) less than last year. Without these benefit adjustments, net income would have been $132.8 million, 2.5 percent higher than the previous year.

The PLCB continued to invest in the business this year through store rebranding and refurbishment and information technology system upgrades and improvements. With the increased usage of credit and debit cards, the PLCB is improving its stores' point of sale (POS) system with the new embedded "chip and pin" smart-card technology. The PLCB embarked on key new initiatives benefitting licensees and increased our education programs related to alcohol awareness and responsible consumption.

- Lower operating income of $108.9 million represents a compound annual growth rate (CAGR) of 1.2 percent since fiscal year 2010-11. Operating income has been adversely affected by dramatic increases in benefits costs in excess of sales growth, specifically in the following categories: pension (105.6 percent), workers compensation (520.6 percent) and retiree healthcare (29.6 percent).
- Positive operating cash flow of $139.1 million enabled the PLCB to pay the fiscal year 2014-15 profit transfer in January 2015.
- Year-end cash and investments increased $20.7 million to $261.9 million due to positive cash flow from operations.

PLCB Management's Discussion and Analysis (Continued)

- Trade accounts payables were reduced by $6.2 million to $253.1 million.
- PLCB ended fiscal year 2014-15 with a total of $497.3 million in current assets including $230.1 million in merchandise inventory. Inventory grew from the prior year by $23.5 million primarily to accommodate increased customer demand in the luxury wine segment and to offer expanded choice in the premium brands.
- After payment of all expenses, including inter-agency transfers, transfers to the General Fund and transfers for the Department of Drug and Alcohol Programs, PLCB's net assets increased by $1.9 million. However, due to first-year recognition of the PLCB's net pension liability of $362.7 million, overall net position reflects a deficit of $238.7 million for fiscal year 2014-15.

Revenues and Costs

Sales

Sales and tax revenue in fiscal year 2014-15 totaled $2.34 billion, an increase of $94.8 million or 4.2 percent over fiscal year 2013-14.

Sales growth was evenly balanced with spirits and wine increasing by 4.1 percent and 4.3 percent, respectively. Wine sales increases were driven by the luxury segment, which grew 9.7 percent. Since introduction in 2010, the Chairman's Selection program has been a tremendous success for the PLCB. In the last five years, Chairman's Selection wine sales have grown at a compound rate of 7.8 percent. PLCB has also offered more optimal selections and a more attractive mix of discounts. Additionally, 28 Fine Wine & Good Spirits stores were rebranded during the year including five new stores openings.

Within the PLCB's customer base, retail sales, or sales to individual consumers, grew 4.7 percent while sales to licensees increased by 2.5 percent. Retail sales have grown to more than 79 percent of total sales. On a volume basis, spirit unit sales grew 2.6 percent and wine unit sales grew 1.7 percent, while spirit gallon sales increased 2.3 percent and wine gallon sales increased 1.1 percent. Debit/credit card purchases represented approximately 62 percent of sales, up from 60 percent last year. Average sale per debit and credit card transaction was $30.44 and $53.81, respectively, versus $30.21 and $53.94 the prior year.

PLCB Management's Discussion and Analysis (Continued)

Sales growth was attained by offering consumers a broader selection of product offerings with a more attractive mix of discounts. The PLCB lets consumers know about those discounts by focusing limited advertising resources on high-impact media in targeted markets while also growing social media presence to communicate directly with consumers. The PLCB remains committed to opening rebranded Fine Wine & Good Spirits stores, expanding the number of stores carrying Chairman's Selection products. Sales growth was positively impacted by the recently initiated Chairman's Advantage program, which introduced lower-priced premium products to consumers. Further, the agency has continued to focus on staff training to improve customer service by providing wine information, recommendations and guidance for customers needing assistance.

Gross Margin

Gross margin increased to 31.2 percent in fiscal year 2014-15 from 31.1 percent last year. The increase is due in part to increases in the volume of vendor promotion allowances, and the PLCB buy-ins in advance of vendor price increases.

Operating Income & Expense

Operating income for the fiscal year ended June 30, 2015, was $108.9 million, $39.4 million or 26.6 percent less than $148.3 million reported last year. The decline is attributable to year-end adjustments that increased the costs for participation in commonwealth-negotiated benefit programs for pension, other post-employment benefits and worker's compensation.

Day-to-day operational expenses excluding pension, worker's compensation and post-employment benefits costs grew by 5.3 percent in the most recently completed fiscal year. Operational expense growth included long-term investments to the business such as store rebrands, upgrades to point of sale technology and development of new online licensee systems facilitating wine and spirits orders and registration.

Pension

For fiscal year 2014-15 the PLCB recorded pension expense of $47.7 million, a $24.5 million (105.6 percent) increase from $23.2 million in the prior year.

PLCB employees are members of the State Employees' Retirement System (SERS). SERS is the administrator of a cost-sharing, multiple-employer, defined-benefit retirement plan established to provide pension benefits for commonwealth employees. Membership in the SERS is mandatory for PLCB employees.

PLCB Management's Discussion and Analysis (Continued)

As required for reporting in accordance with Generally Accepted Accounting Principles (GAAP), the commonwealth adopted Government Accounting Standards Board (GASB) Statement No. 68 for fiscal year 2014-15, which establishes standards for recognizing expenses, deferred inflows and outflows of resources and requires the PLCB to record on its balance sheet its share of the commonwealth's unfunded pension liability. SERS' actuary determined the PLCB share of the unfunded liability to be $331 million at the start of the year and $362.7 million at year end. The addition of the pension liability to the PLCB balance sheet reduced the net asset position from $77.2 million last year to a deficit of $238.7 million at June 30, 2015. Moreover, under GASB Statement No. 68 the annual changes in the pension liability, deferred inflows and deferred outflows will be charged to net income each year. In fiscal year 2014-15, the change in pension accounting rules resulted in an overall year-end adjustment that reduced net income by $16.8 million.

<u>Worker's Compensation</u>

PLCB worker's compensation expenses grew in fiscal year 2014-15 to $27.2 million, a $22.8 million (520.6 percent) increase over $4.4 million recorded the prior year. The PLCB's share of the commonwealth liability increased by $19.4 million (63.3 percent) to $49.9 million.

In 2014 the commonwealth made the following changes to the accounting for worker's compensation, all with a negative impact to PLCB:

- An experience-based contribution process for determining current worker's compensation expense by agency was adopted. This resulted in a doubling of the current expense allocation to the PLCB from the prior method employed by the commonwealth wherein total workers compensation expense was allocated based on payroll.
- The commonwealth as a whole had been underfunding its liability, which with the current year adjustment, resulted in a $161 million increase in the commonwealth liability to $861 million.
- The commonwealth increased the allocation of the $861 million commonwealth liability to the PLCB by over 1.4 percent. This change was implemented to be consistent with the change to experience-based allocations of current expense. Adjustment to the worker's compensation estimates resulted in a $19.4 million increase in fiscal year 2014-15 PLCB expense.

PLCB Management's Discussion and Analysis (Continued)

Retiree Medical, or Other Post-Employment Benefit Costs (OPEB)

PLCB OPEB expenses increased in fiscal year 2014-15 to $40.5 million, a $9.2 million (29.6 percent) increase over $31.3 million recorded last year. PLCB's share of the commonwealth liability increased by $13 million (20.5 percent) to $76.7 million.

PLCB employees are eligible for retiree medical benefits when length of service and other requirements are met. The OPEB portion of the obligation is a measure of the future health care cost for active and retired employees. Similar to the pension benefit obligation, the final determination of expense is dependent upon actuarial review and reporting is done in accordance with GAAP. The commonwealth reported an increase in the OPEB obligation of $341 million, the PLCB share of which totaled $13 million.

Increases in these three benefit expenses and related liabilities are primarily attributable to these long-term obligations not being adequately funded by the commonwealth for some time. Moreover, the complex nature of various actuarial and economic estimates that go into the final liability determinations will continue to result in significant adjustments not determined until two to three months after the close of a fiscal year. The scope, volatility and timing of the valuations will make it extremely difficult to forecast results and make decisions with respect to pricing and business investments.

PLCB Management's Discussion and Analysis (Continued)

The following table presents the five-year growth in the expense and related liability for these benefit items.

PLCB benefits information (dollar amounts in thousands):

	Fiscal Year Ended 30-Jun-15	Fiscal Year Ended 30-Jun-14	Fiscal Year Ended 30-Jun-13	Fiscal Year Ended 30-Jun-12	Fiscal Year Ended 30-Jun-11	CAGR *
Pension - Expense	$ 47,708	$ 23,199	$ 16,233	$ 10,998	$ 6,992	61.6%
% increase over prev. year	105.6%	42.9%	47.6%	57.3%	35.7%	
Pension - Liability	$ 362,685	$ 330,977	-	-	-	9.6%
% increase over prev. year	9.6%					
Workers Comp. - Expense	$ 27,226	$ 4,387	$ 5,462	$ 5,295	$ 7,100	39.9%
% inc/dec. over prev. year	520.6%	-19.7%	3.2%	-25.4%	-30.2%	
Workers Comp. - Liability	$ 49,926	$ 30,565	$ 30,918	$ 30,517	$ 29,928	13.6%
% inc/dec. over prev. year	63.3%	-1.1%	1.3%	2.0%	13.0%	
OPEB – Expense	$ 40,518	$ 31,271	$ 33,100	$ 29,858	$ 27,646	10.0%
% inc/dec. over prev. year	29.6%	-5.5%	10.9%	8.0%	-35.2%	
OPEB - Liability	$ 76,653	$ 63,630	$ 57,379	$ 46,147	$ 36,024	20.8%
% increase over prev. year	20.5%	10.9%	24.3%	28.1%	44.0%	

* CAGR – Compount Annual Growth Rate

A portion of the decline in income is also attributable to higher operating expenses associated with growth of our business. Credit/debit card fees increased by $2.2 million, or 9.6 percent, primarily due to increase in overall sales volume and customers increasing usage of cards versus cash. Information technology expenses increased by $1.6 million, or 9.9 percent. These increases paid for Oracle software and support and new initiatives including LOOP, direct-shipping to licensees, PLCB+ (on-line licensing renewal process) and point of sale upgrades. The commonwealth's decision to migrate information technology servers to Ashburn, VA, also increased expenses. Store leases increased by $1.4 million, or 3.2 percent, due to store build-outs associated with store rebranding and refurbishment efforts. Advertising expenses increased by $1.2 million, or 21.9 percent, primarily for alcohol education and awareness programs.

PLCB Management's Discussion and Analysis (Continued)

Operating Transfers Out

The Bureau of Liquor Control Enforcement within the Pennsylvania State Police received $25.7 million in funding in fiscal year 2014-2015, an increase of $800,000, or 3.1 percent, over the previous year. Over the last five years, PLCB transfers to Pennsylvania State Police have grown at a compound rate of 6.1 percent, while enforcement fines marginally increased by 1.8 percent. Transfers to the Department of Drug and Alcohol Programs, which are statutorily set at 2 percent of profits each year, decreased to $1.7 million from $2.5 million the prior year. As directed by the Governor's Budget Office, $80 million in profit was transferred to the General Fund in January 2015. In fiscal year 2014-2015, the PLCB generated $544.6 million in contributions to the Pennsylvania Treasury, returned $4.5 million in license fees to local municipalities and collected and remitted $8.5 million in local sales tax to Philadelphia and Allegheny counties.

Condensed, comparative, financial statement information for the State Stores Fund is as follows (dollar amounts in thousands):

	Fiscal Year Ended 30-Jun-15	Fiscal Year Ended 30-Jun-14	Fiscal Year Ended 30-Jun-13	Fiscal Year Ended 30-Jun-12	Fiscal Year Ended 30-Jun-11	CAGR *
Sales Net of Taxes	$ 1,862,270	$ 1,786,502	$ 1,731,463	$ 1,657,205	$ 1,571,223	4.3%
Gross Profit	$ 581,130	$ 555,835	$ 539,416	$ 511,738	$ 490,262	4.3%
Gross Margin	31.2%	31.1%	31.2%	30.9%	31.2%	
Operating Expenses	$ 469,587	$ 407,789	$ 387,535	$ 387,057	$ 386,083	5.0%
Operating Income	$ 108,918	$ 148,308	$ 151,850	$ 124,991	$ 103,757	1.2%
Transfers to State Police	$ 25,726	$ 24,958	$ 23,984	$ 21,738	$ 20,308	6.1%
Drug & Alcohol Transfers	$ 1,672	$ 2,474	$ 2,567	$ 2,070	$ 1,674	0.0%
Net Income	**$ 83,598**	**$ 123,683**	**$ 128,366**	**$ 103,494**	**$ 83,704**	**0.0%**
Liquor Tax	$ 334,414	$ 320,912	$ 311,248	$ 298,144	$ 281,746	4.4%
State Sales Tax	$ 130,193	$ 124,880	$ 121,093	$ 116,033	$ 109,652	4.4%
Local Sales Tax	$ 8,493	$ 8,270	$ 8,143	$ 7,835	$ 7,386	3.6%
License Fees Returned **	$ 4,466	$ 4,522	$ 4,436	$ 4,469	$ 4,522	-0.3%
Number of Stores (not in 000)	603	606	605	608	610	
Average Sales per Store	$ 3,088	$ 2,948	$ 2,862	$ 2,726	$ 2,576	
Operating Exp./Net Sales	25.2%	22.8%	22.4%	23.4%	24.6%	
Contributions/Net Sales	31.4%	31.7%	31.9%	32.0%	33.8%	
Return on Assets	20.5%	30.5%	35.8%	28.1%	23.8%	

* CAGR – Compound Annual Growth Rate

** As provided by statute, a portion of license fees are returned to municipalities. Rates have not increased since 1991.

PENNSYLVANIA LIQUOR CONTROL BOARD

FINANCIAL STATEMENTS

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

ASSETS	**June 30, 2015**	**June 30, 2014**
Current assets:		
Cash	$ 20,210	$ 30,962
Temporary investments	241,702	210,266
Accounts and claims receivable, net	1,305	819
Due from other funds	28	257
Merchandise inventories, net	230,093	206,548
Operating supplies	202	240
Prepaid expenses	3,766	3,299
Total current assets	$ 497,306	$ 452,391
Noncurrent assets – Note D:		
Non-depreciable capital assets:		
Land	$ 323	$ 323
Depreciable capital assets:		
Building	19,558	19,558
Leasehold improvements	758	2,478
Machinery and equipment	46,576	40,384
Intangibles	27,541	50,742
Less: accumulated depreciation	(57,728)	(78,428)
Net depreciable capital assets	$ 36,705	$ 34,734
Total noncurrent capital assets	$ 37,028	$ 35,057
Total assets	$ 534,334	$ 487,448
Total deferred outflows of resources – Note C	$ 31,039	$ -
LIABILITIES		
Current liabilities:		
Trade accounts payable	$ 253,125	$ 259,333
Miscellaneous accounts payable	12,339	9,985
Accrued expenses	16,695	13,320
Self-insurance – Note L	7,817	4,596
Due to other funds – Note E	7,690	10,432
Due to fiduciary funds	1,378	1,777
Due to other governments	495	765
Total current liabilities	$ 299,539	$ 300,208
Noncurrent liabilities:		
OPEB – Note C	76,653	63,630
Self-Insurance – Note L	42,109	25,969
Net pension liability – Note C	362,685	-
Compensated absences – Note A	20,092	20,452
Total noncurrent liabilities	$ 501,539	$ 110,051
Total liabilities	$ 801,078	$ 410,259

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

	June 30, 2015	June 30, 2014
Total deferred inflows of resources – Note C	$ 3,002	$ -
NET POSITION		
Net investment in capital assets	$ 37,028	$ 35,057
Restricted for:		
State Stores Fund (deficit)	(275,735)	42,132
Total net position	$ (238,707)	$ 77,189

- 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)

	Fiscal Year Ended June 30, 2015	Fiscal Year Ended June 30, 2014
Sales net of taxes	$1,862,270	$1,786,502
Less: Cost of goods sold	1,281,140	1,230,667
Gross profit from sales	$ 581,130	$ 555,835
Less: Operating expenses:		
Purchasing, storage and transportation	18,433	16,228
Stores' operations and supervision	365,466	311,294
Central administrative support	69,683	62,669
Comptroller operations	4,714	4,864
Commonwealth-provided services	11,291	12,734
Total	$ 469,587	$ 407,789
Operating profit from state stores	$ 111,543	$ 148,046
Other operating revenues (expenses):		
Enforcement fines	1,976	1,767
License fees	12,315	12,050
Miscellaneous income	3,695	3,048
Administrative law judge	(2,543)	(2,314)
Legal	(3,570)	(3,247)
Licensing and investigations	(14,498)	(11,042)
Total	$ (2,625)	$ 262
Total operating income	$ 108,918	$ 148,308
Nonoperating revenues (expenses):		
Interest income/loss	429	420
Other	(23)	(87)
Total	$ 406	$ 333
Income before operating transfers	$ 109,324	$ 148,641
Operating transfers out:		
PSP enforcement – Note I	25,726	24,958
Income after enforcement/before other transfers	$ 83,598	$ 123,683
Other operating transfers:		
Transfers out:		
General Fund – Note G	(80,000)	(80,000)
Drug and alcohol programs – Note H	(1,672)	(2,474)
Total	$ (81,672)	$ (82,474)
Change in net position	$ 1,926	$ 41,209
Net position – beginning Restated - Note M	$ (240,633)	$ 35,980
Total net position – ending	$ (238,707)	$ 77,189

- 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)

	Fiscal Year Ended June 30, 2015	Fiscal Year Ended June 30, 2014
Cash flows from operating activities:		
Receipts from customers	$ 1,879,999	$ 1,803,352
Payments to suppliers	(1,740,843)	(1,630,134)
Net cash provided by (used for) operating activities	$ 139,156	$ 173,218
Cash flows from noncapital financing activities:		
Operating transfers out	(107,398)	(107,432)
Net cash used for noncapital financing activities	$ (107,398)	$ (107,432)
Cash flows from capital and related financing activities:		
Acquisition and construction of capital assets	(11,503)	(3,937)
Net cash used for capital and related financing activities	$ (11,503)	$ (3,937)
Cash flows from investing activities:		
Purchase of investments	(1,415,178)	(1,400,225)
Proceeds from sale and maturities of investments	1,383,742	1,350,511
Investment income	429	420
Net cash used in investing activities	$ (31,007)	$ (49,294)
Net increase in cash	$ (10,752)	$ 12,555
Cash – beginning of year	30,962	18,407
Cash – end of year	$ 20,210	$ 30,962
Reconciliation of operating income (loss) to net cash provided by (used for) operating activities:		
Operating income	$ 108,918	$ 148,308
Depreciation	9,510	13,205
Change in assets and liabilities:		
Accounts receivable	(486)	194
Inventory	(23,508)	(8,162)
Due from other funds	229	(209)
Other operating net assets	(467)	(517)
Deferred outflows – pension related	(17,884)	-
Accounts payable and accrued liabilities	(5,075)	9,458
Due to other funds	(2,742)	3,639
Due to pension trust funds	(399)	-
Net pension liability	31,708	-
Due to other government	(270)	522
Deferred inflows – pension related	3,002	-
Other post-employment benefit obligations	13,023	6,251
Self-insurance liabilities	23,957	49
Compensated absences	(360)	480
Total adjustments	$ 30,238	$ 24,910
Net cash provided by (used for) operating activities	$ 139,156	$ 173,218

- 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)

	June 30, 2015	June 30, 2014
ASSETS		
Current assets:		
Cash with Treasury	$ 5	$ -
Cash in transit	80	62
Investments – short term	2,275	2,351
Total assets	$ 2,360	$ 2,413
LIABILITIES		
Current liabilities:		
License fees due to municipalities	$ 2,358	$ 2,411
Other liabilities	2	2
Total liabilities	$ 2,360	$ 2,413

- 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)

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

- 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, 2014
(EXPRESSED IN THOUSANDS)

	Balance June 30, 2013	Additions	Deductions	Balance June 30, 2014
ASSETS				
Cash – Note K	$ 69	$ 9,049	$ 9,056	$ 62
Temporary investments – Note K	2,292	4,545	4,486	2,351
Total assets	$ 2,361	$ 13,594	$ 13,542	$ 2,413
LIABILITIES				
Due to municipalities – Note K	$ 2,359	$ 4,498	$ 4,446	$ 2,411
Other liabilities	2	2	2	2
Total liabilities	$ 2,361	$ 4,500	$ 4,448	$ 2,413

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

NOTE A – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The significant accounting policies employed by the Pennsylvania Liquor Control Board (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 Store 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 on 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 fund type, 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 cash in transit, 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.

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.

PLCB established a $350 thousand provision for obsolete inventory during the fiscal year ended 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. The allowance for obsolete inventory was $151 thousand at June 30, 2015 and $0 at June 30, 2014.

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

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 fiscal years ended June 30, 2015, and June 30, 2014 are as follows (amounts in thousands):

	Fiscal Year Ended June 30, 2015	**Fiscal Year Ended June 30, 2014**
Liquor Tax	$334,414	$320,912
State Sales Tax	130,193	124,880
Local Sales Tax	8,493	8,270
Total	$473,100	$454,062

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:

Days Available at Retirement	**Percentage Payment**	**Maximum Days Paid**
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

The accumulated annual and sick leave and related payroll benefits payable reported for the fiscal year ended June 30, 2015 and June 30, 2014 (in thousands) was $25,115 ($5,023 current and $20,092 non-current) and $24,641 ($4,182 current and $20,452 non-current), respectively. It is the PLCB's policy to record the cost of annual and sick leave in accordance with GASB Statement No. 16. The expense and corresponding liability are reflected in the financial statements.

NOTE A – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

The following summary provides aggregated information reported for the fiscal years ended June 30, 2015 and June 30, 2014 of the compensated absences liabilities to include the additions and reductions during the fiscal years then ended (amounts in thousands):

Fiscal Year End	Liability - Beginning Balance	Additions	Reductions	Liability - Ending Balance
June 30, 2015	$24,641	$17,299	$16,825	$25,115
June 30, 2014	$24,657	$16,836	$16,852	$24,641

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 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 Statement No. 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. 68, "Accounting and Financial Reporting for Pensions – an amendment of GASB Statement No. 27". See Note C for pension and Note M for restatement information. The Commonwealth adopted GASB Statement No. 71, "Pension Transition for Contributions Made Subsequent to the Measurement Date, an amendment of GASB Statement No. 68". See Note C for pension and Note M for restatement information.

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

NOTE B – DEPOSITS AND INVESTMENTS (Continued)

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, 2015 and 2014, 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, 2015 Basic Financial Statements.

PLCB's total deposit balance (in thousands) of $20,295 and $31,024 at June 30, 2015 and 2014, 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, 2015 is approximately 0.083 years.

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, 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

NOTE C – PENSION AND OTHER POSTEMPLOYMENT BENEFITS (Continued)

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. 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.

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

NOTE C – PENSION AND OTHER POSTEMPLOYMENT BENEFITS (Continued)

due. However, Act 2010-120 imposes rate increase collars (limits on annual rate increases) on employer contributions. The collar for Commonwealth fiscal year 2013-2014 was 4.5% and will remain at that rate until no longer needed. The PLCB's contributions to the SERS were (in thousands) $30,881 and $23,199 for the fiscal years ended June 30, 2015 and 2014, 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, 2015, PLCB reported a liability of $362,685 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, 2014, 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, 2014, PLCB's reported proportionate share of the SERS net pension liability was 2.44% which was an increase of .02% from its proportion measured as of December 31, 2013.

As of June 30, 2015, PLCB recognized pension expense of $47,708 thousand and reported deferred outflows of resources and deferred inflows of resources related to pensions from the following sources:

	Deferred Outflows Of Resources	Deferred Inflows Of Resources
	(in Thousands)	
Differences between expected and actual experience	$ 1,969	$ -
Differences between projected and actual investment earnings	10,479	-
Change in proportion	2,729	2,700
Differences between employer contributions and proportionate share	505	302
Contributions subsequent to measurement date	15,357	-
Total	**$ 31,039**	**$ 3,002**

NOTE C – PENSION AND OTHER POSTEMPLOYMENT BENEFITS (Continued)

The $15,357 thousand 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, 2016. Other amounts reported as deferred outflows of resources and deferred inflows of resources related to pensions will be recognized in pension expense as follows:

Year Ending (June 30):	(in Thousands)
2015	$3,098
2016	3,098
2017	3,098
2018	3,098
2019	287

Actuarial Assumptions: The total pension liability in the SERS (December 31, 2014) actuarial valuation was determined using the following actuarial assumptions, applied to all periods included in the measurement:

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 6.1% with range of 4.30% to 11.05% including inflation
Asset valuation method	Fair (market) value
Inflation	2.75%
Mortality Rate	Projected RP-2000 Mortality Tables adjusted for actual plan experience and future improvement
Cost of living adjustments	Ad hoc

NOTE C – PENSION AND OTHER POSTEMPLOYMENT BENEFITS (Continued)

Some of the methods and assumptions mentioned above are based on the *17th Investigation of Actuarial Experience*, which was published in January 2011, and analyzed experience from 2006 through 2010. SERS actuary made recommendations with respect to the actuarial assumptions and methods based on their analysis. The next experience study will cover the years 2011 through 2015 and is expected to be released in early 2016.

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:

Asset Class	Target Allocation	Long-term Expected Rate of Return
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	100.00%	

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.

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

NOTE C – PENSION AND OTHER POSTEMPLOYMENT BENEFITS (Continued)

1 percentage point lower (6.5 percent) or 1 percentage point higher (8.5 percent) higher than the current rate.

	1% decrease 6.5%	Current discount rate 7.5%	1% increase 8.5%
		(in thousands)	
PLCB's proportionate share of SERS net pension liability as of the 12/31/14 measurement date	$464,228	$362,685	$275,374

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, 2015, the PLCB reported an accounts payable for the employers' share of retirement contributions to the SERS in the amount of $631 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.

REHP contribution requirements are established by the Office of Administration and the Governor's Budget Office. During the fiscal year ended June 30, 2015, the PLCB contributed $334 for each active employee paid and reported as part of biweekly payroll expenses for its employees. For the fiscal year ended June 30, 2015, the PLCB's allocated share of the total REHP Annual OPEB Cost of $1,136,817 thousand (for the Commonwealth's fiscal year ended June 30, 2015) was $46,329 thousand. The last year that was fully funded for the entire

NOTE C – PENSION AND OTHER POSTEMPLOYMENT BENEFITS (Continued)

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 of $63,630 thousand, plus an additional increase of $13,023 thousand, resulted in a total unfunded liability of $76,653 thousand as of June 30, 2015.

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 years ended June 30, 2015 and June 30, 2014 are as follows (amounts in thousands):

Fiscal year ended June 30, 2015:

	Balance June 30, 2014	Additions	Retirements	Balance June 30, 2015
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 ……………………	50,742	4,346	27,547	27,541
Total capital assets…………….	$ 113,485	$ 11,503	$ 30,232	$ 94,756

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

	Balance June 30, 2014	Additions	Retirements	Balance June 30, 2015
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……….………….	42,921	4,308	27,548	19,681
Total accumulated depreciation	$ 78,428	$ 9,510	$ 30,210	$ 57,728

NOTE D – CAPITAL ASSETS (Continued)

Fiscal year ended June 30, 2014:

	Balance June 30, 2013	Additions	Retirements	Balance June 30, 2014
Non-depreciable capital assets:				
Land…………………………..	$ 323	$ -	$ -	$ 323
Depreciable capital assets:				
Building………………………..	19,620	-	62	19,558
Leasehold improvements……...	2,912	-	434	2,478
Machinery and equipment….…	39,268	3,190	2,074	40,384
Intangibles ……………………	59,557	747	9,562	50,742
Total capital assets…………….	$ 121,680	$ 3,937	$ 12,132	$ 113,485

Changes in capital assets accumulated depreciation for the fiscal year ended June 30, 2014 are as follows (amounts in thousands):

	Balance June 30, 2013	Additions	Retirements	Balance June 30, 2014
Buildings……………………	$ 10,807	$ 895	$ 62	$ 11,640
Leasehold improvements…...	2,387	163	348	2,202
Machinery and equipment….	20,030	3,708	2,073	21,665
Intangibles……….………….	44,044	8,439	9,562	42,921
Total accumulated depreciation	$ 77,268	$ 13,205	$ 12,045	$ 78,428

NOTE E – DUE TO OTHER FUNDS

At June 30, 2015 and June 30, 2014, a total (in thousands) of $7,690 and $10,432, respectively, was due to other funds. This total was due to various funds.

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.

NOTE F – LEASE COMMITMENTS (Continued)

Rental expenses (in thousands), for the fiscal years ended June 30, 2015 and June 30, 2014 were $44,902 and $43,522, respectively.

The following is a schedule of future minimum rental commitments for noncancelable operating leases in effect as of June 30, 2015 (expressed in thousands):

Fiscal Year Ended June	Fine Wine and Good Spirits Store Leases
2016	$35,214
2017	28,795
2018	23,278
2019	18,333
2020	13,452
Total Minimum Lease Payments:	$119,072

NOTE G – OPERATING TRANSFERS TO GENERAL FUND

The PLCB is subject to profit transfer requirements, determined annually by the Governor's Office, whereby stipulated funds are transferred to help finance the General Fund. The required transfers were $80 million for each of the fiscal years ended June 30, 2015 and June 30, 2014.

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 for drug and alcohol rehabilitation programs. The PLCB establishes a liability for the amount due to the Department of Health and transfers the payment in the subsequent fiscal year. The amount of the liability established to the Department of Drug and Alcohol Programs for the fiscal years ended June 30, 2015 and June 30, 2014 (in thousands) was $1,672 and $2,474, 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 (in thousands) were $25,726 and $24,958 for the fiscal years ended June 30, 2015 and June 30, 2014, 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.

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 $500 million per occurrence. There was no reduction in commercial insurance coverage during the fiscal year ended June 30, 2015. 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.

NOTE L – SELF-INSURANCE LIABILITIES (Continued)

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.

At June 30, 2015 and June 30, 2014, respectively, the State Stores Fund reported (in thousands) a $49,926 liability ($7,817 as current and $42,109 as non-current) and $30,565 liability ($4,596 as current and $25,969 as non-current) for employee disability claims.

The following summary provides aggregated information for the fiscal years ended June 30, 2015 and June 30, 2014 of the reported self-insurance liabilities to include the incurred claims and payments during the fiscal years then ended (amounts in thousands):

Fiscal Year Ended	Liability - Beginning Balance	Incurred Claims	Payments	Liability - Ending Balance
June 30, 2015	$30,565	$26,831	$7,470	$49,926
June 30, 2014	$30,918	$6,070	$6,423	$30,565

NOTE M – RESTATEMENT

Restatement Due to Change in Accounting Principle:

The implementation of GASB Statement No. 68 resulted in the reporting of a pension liability and deferred outflow, therefore, the State Store Fund's beginning net position has been restated.

Presented below are the changes to the State Store Fund's Statement of Net Position as a result of implementing GASB Statement No. 68. The State Stores Fund Net Position changed by a total of $(317,822) thousand.

NOTE M – RESTATEMENT (Continued)

	State Stores Fund (in thousands)	
Net Position, as previously reported, at June 30, 2014	$	77,189
Apply GASB 68		
Pension Liability		(330,977)
Deferred Outflows		13,155
Total Prior Period Adjustment	$	(317,822)
Net Position, as restated, at July 1, 2014	$	(240,633)

Fiscal year ending June 30, 2014 amounts are not restated because all of the GASB Statement No. 68 actuarial data is not available.

Commonwealth of Pennsylvania
Department of the Auditor General
Harrisburg, PA 17120-0018
Facebook: Pennsylvania Auditor General
Twitter: @PAAuditorGen
www.PaAuditor.gov

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, 2015 and 2014, and the related notes to the financial statements and have issued our report thereon dated December 18, 2015.

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 and therefore, 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. We did identify certain deficiencies in internal control, described in the accompanying Finding Section as Finding No. 1 that we consider to be significant deficiencies.

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.*

PLCB's Response to the Findings

PLCB's response to the findings identified in our audit is described in the accompanying Finding Section. PLCB's response was not subjected to the auditing procedures applied in the audit of the financial statements, and accordingly, we express no opinion on it.

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.

December 18, 2015

Eugene A. DePasquale
Auditor General

Finding No. 1 - General Computer Controls in the Outsourced Data Center Need Improvement

Condition: During the fiscal year ended June 30, 2015, the Pennsylvania Liquor Control Board (PLCB's) Oracle servers were located at the Commonwealth's Data Powerhouse (DPH). The Commonwealth contracts with Unisys Corporation (Unisys) and International Business Machines Corporation (IBM) as service organizations to provide managed services to DPH, including data hosting and programming support services. The following operating effectiveness exceptions were noted within the Service Organization Controls (SOC 1) examination of DPH under Statements on Standards for Attestation Engagements (SSAE) No. 16. These exceptions resulted in a qualified opinion because of weaknesses in physical and logical access and in the non-achievement of the related control objectives. This table includes the specific exceptions that were noted as a result of the SOC 1 examination of the Data Powerhouse for the period July 1, 2014 to June 30, 2015. Furthermore, PLCB management was not aware of the SOC report or the exceptions noted as of the time of our audit procedures.

Control	Exception
Access requests are completed through the Unisys Security Manager. Data Center badge requests are required to be approved by Unisys and submitted to the Commonwealth's Bureau of Enterprise Strategic Technology Services Security Managers for approval before the access cards may be issued.	Inspected the access authorization documentation for a selection of users granted access to the Data Center and determined that authorization by the Unisys Security Manager and the Commonwealth's Bureau of Enterprise Strategic Technology Services Security Manager was not documented for three of eight selected users.
Unisys Security and Facility Mangers perform monthly Data Center access reviews to verify that individuals who have access to the Data Center require this level of access to perform their job function.	Inspected Data Center Access Reviews for a selection of months, and inquired of the Site Services Administrator and determined that Data Center Access Reviews were not performed to verify that users with Data Center access required that level of access to perform their job function for three of five months selected. Additionally, the Data Center Access Review was not completed timely for one of five months selected.

When an employee with badge access to the Data Center is terminated or off-boarded from the DPH project, Unisys sends a notification to the Commonwealth requesting that the badge be deactivated to remove Data Center access for the employee.	Inspected notifications for a selection of terminated or off-boarded employees that had Data Center badge access and determined that notifications were not sent to the Commonwealth for the removal of Data Center access prior to the employee's departure for two out of eight employees selected. Inspected the Data Center badge access history reports associated with the two users noted above and determined that the user's card keys did not access the facility subsequent to the termination or off-board date. Inspected the Data Center badge access listing and compared it to the list of terminated/off-boarded employees and determined that one employee retained Data Center access for over one month after they were off-boarded because the Commonwealth was not notified in a timely manner. Inspected the Data Center badge access history report associated with the user noted above and determined that the user's card key did not access the facility subsequent to their off-board date. Inspected the RVR [Regular Visitor Roster] and compared it to the list of terminated/off-boarded employees and determined that one individual remained on the RVR for over five months after they were off-boarded. Inspected the RVR sign-in sheet and determined that the noted employee did not use their RVR access subsequent to their off-board date.
When an employee with logical access to agency systems has been terminated, the agency is notified via email to deactivate employee system accounts and access on the next working day of departure.	Inspected termination notifications for a selection of terminated Unisys and IBM employees who possessed agency system access and determined that 6 of 25 terminations were not communicated to the Commonwealth on a timely basis. Inspected login history reports for the employees noted above and determined that five out of six employees did not log in to agency systems subsequent to their termination. For the remaining employee, systems logs were not retained for a sufficient duration to conclude.

Unisys administers network infrastructure devices for systems housed within the DPH. Access is gained through authentication against the TACACS+ server.	Inspected the TACACS+ access listing for users with system administrator rights and inquired of a Network Engineer and determined that access to manage network infrastructure devices was not restricted to users with networking responsibility for 1 of 16 users, who was a terminated employee. Inspected the last login date within the TACACS+ server associated with the terminated employee noted above, and determined that the user's account was not used subsequent to their termination date.

The first three exceptions noted above related to the following control objective: "Controls provide reasonable assurance that physical access to computer equipment, storage media, and program documentation is restricted to properly authorized individuals." The fourth exception noted above related to the following control objective: "Controls provide reasonable assurance that logical access to system resources is restricted to properly authorized individuals." The remaining exception related to a control objective that was achieved and did not contribute to the qualified opinion.

Criteria: Management is responsible for activities that are outsourced to external service providers. Those responsibilities include, but are not limited to, monitoring service providers and ensuring that deficiencies in the environments are addressed and/or implementing mitigating controls to reduce the impact of those deficiencies.

Cause: The contract to outsource DPH is managed by the Office of Administration (OA). The SOC report was not received by OA until November 2015, almost two months later than in previous years. This may have contributed to the lack of PLCB management knowledge of the qualified opinion of the report and of the exceptions noted. Specific to the noted exceptions:

- For the three users granted access to the DPH without proper approvals, Unisys responded to the SOC auditors that the individuals had been granted access to the Commonwealth Technology Center (CTC). Unisys granted the individuals' access to the DPH based on their authorization to access CTC. Although this has been standard practice, future requests for approval will need to be in writing.
- For the Data Center Access Reviews that were not performed, Unisys stated that there was an oversight due to increased workload and technical difficulties with reports as a result of a SharePoint upgrade.

- Regarding the notifications that were not sent to the Commonwealth for employees who terminated or off-boarded from the DPH project and who retained physical access to the DPH, Unisys responded that their managers did not follow established processes to immediately inform the Security Administrator (SA) and the Commonwealth.
- For the six employees whose terminations were not communicated to the Commonwealth on a timely basis and who retained logical access to agency systems, Unisys responded that they have taken steps to reinforce the timely reporting of outgoing staff with managers and subcontractors.
- For the terminated employee with access to the TACACS+ server, the specific individual joined the PACS [Pennsylvania Compute Services] contract and worked with Unisys for approximately 30 days. They were assigned a TACACS account to manage network access, but did not use that account subsequent to their termination.

Effect: Because PLCB management was unaware of the receipt of the SOC report, they were also unaware of the exceptions that could directly affect PLCB systems and data. Specifically, the untimely deletion of the Unisys and IBM contractors' access could have allowed unauthorized access to PLCB's servers. Without appropriate monitoring of the service provider's environment and activities, deficiencies could go undetected, remain unresolved and introduce unnecessary risk to the Liquor Control Board.

As of September 2015, PLCB's Oracle's servers were moved from DPH to the new Pennsylvania Compute Services (PACS) datacenter, also outsourced to Unisys. Without appropriate monitoring of the controls at the vendor-managed datacenter, similar exceptions could continue to occur, exposing PLCB servers to similar risks in the future.

Recommendation: PLCB management should work with OA to monitor the service organization to ensure the appropriate controls are in place over the outsourced IT environment. PLCB management should also obtain a copy of the SOC report and follow up on the exceptions noted by reviewing applicable logs to determine if any of the separated contractors inappropriately accessed PLCB systems.

PLCB Response: As noted, the PLCB was not provided results of the DPH SOC I examination and was unaware of the exceptions noted therein. The PLCB acknowledges our responsibility to manage third part service providers (TPSPs) to which we've outsourced PLCB activities and to review TPSP audit reports provided.

The PLCB has migrated PLCB assets from DPH to the Unisys PACS environment and have reviewed PACS SOC I & II data center reports prepared in accordance with AICPA SSAE 16 standards. The exceptions noted have been addressed satisfactorily and the PLCB will continue to review future TPSP audits and actively manage TPSP plans to remediate exceptions found that may represent an unacceptable risk to PLCB assets.

COMMONWEALTH OF PENNSYLVANIA
PENNSYLVANIA LIQUOR CONTROL BOARD
JUNE 30, 2015
DISTRIBUTION LIST

This report was initially distributed to the following:

The Honorable Tom Wolf
Governor
Commonwealth of Pennsylvania

The Honorable Tim Holden
Chairman
Pennsylvania Liquor Control Board
Commonwealth of Pennsylvania

The Honorable Randy Albright
Budget Secretary
Commonwealth of Pennsylvania

The Honorable Timothy A. Reese
State Treasurer
Commonwealth of Pennsylvania

The Honorable Kathleen G. Kane
Attorney General
Commonwealth of Pennsylvania

Mr. Oren Bachman
Director of Finance
Pennsylvania Liquor Control Board

Mr. Brian Lyman
Director, Bureau of Audits
Office of the Budget

Mr. Michael Blinn
Assistant Comptroller
Liquor Control Board Audit Services Division, Bureau of Audits
Office of the Budget

Mr. Jason Lutcavage
Director of Administration
Pennsylvania Liquor Control Board

The Honorable Michael Negra
Member
Pennsylvania Liquor Control Board

Ms. Anna Maria Kiehl
Chief Accounting Officer
Commonwealth of Pennsylvania

Mr. Michael J. Burns, Director
Bureau of Accounting and Financial Management
Office of the Budget

Ms. Mary Spila
Collections/Cataloging
State Library of Pennsylvania

The Honorable Charles T. McIlhinney Jr., Chair
Law and Justice Committee

The Honorable John Taylor, Chair
Liquor Control Committee

The Honorable Paul Costa
Democratic Chair
Liquor Control Committee

This report is a matter of public record and is available online at www.PaAuditor.gov. Media questions about the report can be directed to the Pennsylvania Department of the Auditor General, Office of Communications, 229 Finance Building, Harrisburg, PA 17120; via email to: news@PaAuditor.gov.