FINANCIAL AUDIT

Commonwealth of Pennsylvania
Liquor Control Board

State Stores Fund
Liquor License Fund

Audit Report

Harrisburg, Pennsylvania
For the years ended June 30, 2020 and 2019

December 2020

EUGENE A. DEPASQUALE • AUDITOR GENERAL •

Commonwealth of Pennsylvania
Department of the Auditor General

Eugene A. DePasquale • Auditor General

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Background

Introduction

The Pennsylvania Liquor Control Board (PLCB) is an entity of the Commonwealth of Pennsylvania (Commonwealth) authorized by law to regulate the sale and distribution of alcoholic beverages in the Commonwealth.

The mission of the PLCB is to responsibly sell wine and spirits as a retailer and wholesaler, regulate Pennsylvania's alcohol industry, promote alcohol education and social responsibility and maximize financial returns for the benefit of all Pennsylvanians.

History and Agency Overview

With the end of Prohibition in 1933, various laws regarding alcohol regulation were passed by the Pennsylvania General Assembly, including the Liquor Control Act and the Beverage License Law, which created the PLCB. The statutory authority for the PLCB is Act 21 of 1951, P.L. 90; as reenacted by Act 14 of 1987, P.L. 32.

Act 39 of 2016 liquor reforms changed more than 35 sections of the Liquor Code and added a number of new sections – the most sweeping changes to liquor laws in Pennsylvania since the end of Prohibition in 1933. Act 39 reforms allowed for sale of wine to go by restaurant license holders, including grocery and convenience stores; eliminated proportional pricing according to a standard markup formula and authorized flexible pricing; sanctioned a customer relationship management program; eliminated restrictions on Sunday hours for Fine Wine & Good Spirits (FW&GS) stores; enabled the PLCB to auction expired restaurant licenses; authorized Pennsylvania Lottery sales in FW&GS stores; and expanded direct wine and beer shipment options for Pennsylvania residents. It also established grant programs for developing and promoting Pennsylvania's wine and beer industries.

The PLCB is an independent administrative board governed by a board whose three members are appointed to staggered four-year terms by the Governor and confirmed by two-thirds of the state Senate.

The PLCB regulates the manufacture, importation, sale, distribution and disposition of liquor, alcohol, and malt or brewed beverages in the Commonwealth. Key functions of the PLCB include the following:

- The operation of about 600 FW&GS stores across Pennsylvania, including 108 Premium Collection stores, thirteen Licensee Service Centers and an e-commerce fulfillment center.

Background (Continued)

- Licensure and regulation of about 16,500 retail and wholesale licensees and nearly 1,000 wineries, breweries, and distilleries in the Commonwealth, which requires annual processing of about 79,000 applications for various license and permit authorities.

- Wholesale sales and distribution of wine and spirits to licensees for resale at retail, including distribution of wine to more than 1,300 licensees authorized to sell wine to go.

- Public education efforts regarding alcohol focusing on three key pillars: delivering no-use and zero-tolerance messages to those under the age of 21, encouraging responsible consumption for those over 21 and promoting responsible alcohol service and practices among licensees.

While enforcement of the Liquor Code is not the PLCB's responsibility, the PLCB funds the operations of the Pennsylvania State Police Bureau of Liquor Control Enforcement, which is responsible for enforcing liquor laws and regulations throughout the Commonwealth.

The PLCB is primarily responsible for the accounting and reporting of the Liquor License Fund and the State Stores Fund. The Liquor License Fund is a special revenue fund that serves as a pass-through account for fees for hotel, restaurant and club liquor and 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 Commonwealth's General Fund.

The State Stores Fund is an enterprise fund that serves as the general operating fund for the PLCB. This fund receives revenues from the sale of goods, primarily through FW&GS stores and sales to licensees, as well as various other operating revenues including fees not credited to the Liquor License Fund. The State Stores Fund also covers the costs and expenses associated with operation and administration of all PLCB functions.

The 18 percent liquor tax and 6 percent state sales tax collected by the PLCB are transferred monthly to the General Fund. Local sales taxes collected are remitted timely and in full to Philadelphia and Allegheny Counties.

The PLCB achieved gross annual sales of $2.56 billion for fiscal year 2019-2020, a decrease of 4.2 percent from the previous fiscal year. As a result, PLCB operations generated $365.7 million in liquor tax and $143.9 million in state sales tax, and provided for additional transfers to the General Fund totaling $185.1 million for the year. The PLCB also returned $8.8 million in local sales taxes to the Philadelphia and Allegheny Counties. Additionally, the PLCB provided $30.8 million to fund liquor control enforcement efforts, afforded $4.2 million to support the Pennsylvania Department of Drug & Alcohol Programs, awarded $2.2 million in grants supporting Pennsylvania's wine and beer industries, awarded alcohol education grants of $0.8 million and collected $4.3 million in liquor license application fees for return to local municipalities.

Background (Continued)

Key Facts

- State and local sales taxes applicable to PLCB sales are collected by the PLCB and fully remitted to the General Fund.

- The state liquor tax of 18% is included in the retail price of each item, excluding accessory items, and is remitted by the PLCB to the General Fund.

- 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 General Fund.

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EUGENE A. DEPASQUALE
AUDITOR GENERAL

Independent Auditor's Report

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

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

Report on the Financial Statements

We have audited the accompanying financial statements of the Pennsylvania Liquor Control Board (PLCB) – State Stores Fund, which comprise of the Statements of Net Position as of June 30, 2020 and 2019, 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 Balance Sheets as of June 30, 2020 and 2019, and the related Statements of Revenues, Expenditures, and Changes in Fund Balance 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 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.

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, 2020 and 2019, and the results of the State Stores Fund's operations and its cash flows for the fiscal years then ended, and the Liquor License Fund's revenue and expenditure activity for the fiscal years then ended in accordance with accounting principles generally accepted in the United States of America.

Emphasis of Matters

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, 2020 and 2019, 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.

As discussed in Note N to the financial statements, effective July 1, 2019 the PLCB adopted GASB Statement No. 84, *Fiduciary Activities.* As a result of implementing this standard, the PLCB reported a restatement of the Liquor License Fund as a special revenue fund. Our opinion is not modified with respect to that matter.

Other Matters

Required Supplementary Information

Accounting principles generally accepted in the United States of America require that the managements' discussion and analysis on pages 7-10; and the schedules of pension amounts – PLCB's schedule of contributions and PLCB's schedule of proportionate share of net pension liability, and schedules of postemployment benefits other than pensions (OPEB) amounts – PLCB's schedule of contributions and PLCB's schedule of allocated share of net OPEB liability on pages 38-41 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 8, 2020, 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 8, 2020

Eugene A. DePasquale
Auditor General

PLCB Management's Discussion and Analysis

Management's Responsibility for the Financial Statements

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

Discussion of Basic Financial Statements

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

The basic financial statements included in this audit report are the State Stores Fund Comparative Statements of Net Position as of June 30, 2020 and 2019; State Stores Fund Comparative Statements of Revenues, Expenses, and Changes in Net Position for the fiscal years ended June 30, 2020 and 2019; State Stores Fund Comparative Statements of Cash Flows for the fiscal years ended June 30, 2020 and 2019; the Liquor License Fund Balance Sheet as of June 30, 2020 and 2019; and the Liquor License Fund Statement of Revenues, Expenditures, and Changes in Fund Balance for the fiscal years ended June 30, 2020 and June 30, 2019.

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

Although the liquor tax is incorporated into the retail price of alcohol products sold by the PLCB and is discussed herein as part of the sales analysis and transfers out, neither this tax nor state and local sales taxes are reflected as revenue in the basic financial statements.

PLCB Management's Discussion and Analysis (Continued)

Executive Summary & Highlights

Until the COVID-19 public health crisis, the PLCB had achieved year-over-year sales growth for each of the past 26 years. For the first eight months of fiscal year 2019-20, PLCB sales were on a record pace, with year-to-date sales through February 4.5% ahead of the prior year. However, beginning in the middle of March, Fine Wine & Good Spirits (FW&GS) stores and licensee service centers were temporarily closed and e-commerce operations were briefly suspended in response to Governor Tom Wolf's COVID-19 mitigation efforts.

Despite online and curbside pickup sales options available beginning in April, the closure of FW&GS stores to traditional traffic – compounded by limited sales to bars and restaurants due to COVID-19 occupancy limits and business restrictions – hampered sales and tax revenue from March through June, even as some stores began reopening to limited in-store traffic in May 2020. As a result, fiscal year 2019-20 sales decreased 4.1% from the prior year. PLCB fiscal year 2019-20 net income of $208.7 million was $17.7 million, or 9.2%, greater than the prior year, with the increase due primarily to decreased operating expenses related to significant declines in other post-employment benefit (OPEB) costs and pension expenses.

Other financial highlights include:

- The gross profit percentage was 32.0%, up 0.3% from June 2019.

- Operating income increased $17.4 million (8.0%) to $234.6 million.

- Net cash flow from operating activities of $170.3 million, (a decrease of $72.2 million from the prior year), was the primary source of funding for the $185.1 million cash transfer to the General Fund, $30.8 million to fund the Pennsylvania State Police's Liquor Code enforcement efforts, $2.3 million in transfers to the Department of Drug & Alcohol Programs and $6.9 million for capital expenditures.

- Year-end cash and investments decreased $49.8 million (17.9%) to $228.8 million, which were used as a secondary source of funding for the activities identified above.

- Total liabilities decreased by $270.9 million to $1.3 billion, due primarily to a $174.4 million reduction in the net OPEB liability for retiree health benefits resulting from the Retired Employees Health Program (REHP) actuarial valuation. Also contributing to lower liabilities was a $71.6 million decrease in net pension liability due to higher investment earnings versus projections.

PLCB Management's Discussion and Analysis (Continued)

Revenues and Costs

Sales

Sales and tax revenue in fiscal year 2019-20 totaled $2.56 billion, a decrease of $110.9 million, or 4.1%, from fiscal year 2018-19. Excluding liquor and sales taxes, net sales of $2.04 billion were down $87.6 million, a 4.1% decrease from the prior year. By product category, spirit sales shrank by 6.4%, while wine sales shrank by 1.0%. Overall unit sales shrank by 4.4% from fiscal year 2018-19.

PLCB wholesale business (sales to licensees) was significantly impacted by the COVID-19 public health crisis in fiscal year 2019-20, with disparate impacts to different kinds of licensees. Overall, licensee sales were up 5.0% from fiscal year 2018-19. However, PLCB wine sales to holders of wine expanded permits (licensees like grocery stores, convenience stores and mass merchant retailers that continued to sell wine to go through the pandemic) grew by 117.8% in 2019-20. Conversely, sales to other licensees were down 22.9% in 2019-20. Wine sales to all licensees were up 39.6% in 2019-20. Sales of spirits to all licensees were down 22.5% in 2019-20.

The COVID-19 public health crisis had a significant impact on PLCB retail sales in fiscal year 2019-20, with FW&GS stores temporarily closed from the middle of March through late April. Retail sales declined 7.1% for fiscal year 2019-20, with year-to-date sales up 2.8% through February, but down 28.2% for March through June. Retail spirit sales were down 1.2% for the fiscal year, while retail wine sales were down 15.0%. As a result of store closures, PLCB e-commerce sales experienced dramatic increases, up 436.9% for fiscal year 2019-20. Online sales grew by 37.6% through February, and then increased by 1,306.5% for March through June.

Operating Income & Expense

Operating income for the fiscal year ended June 30, 2020, was $234.6 million, up $17.5 million, or 8.0% from the $217.1 million reported the prior year. The increase was mostly attributable to a $44.6 million decrease in operating expenses, which offset a $22.4 million decrease in gross profit from sales and a $4.8 million decrease in other operating revenues.

PLCB Management's Discussion and Analysis (Continued)

The reduction in operating expenses was driven primarily by a $46.8 million reduction in OPEB retiree health benefit costs, mostly due to REHP's actuarial valuation results, and by a $15.4 million (20.1%) decrease in total pension expenses. Operating expenses were also favorably impacted by a $3.1 million decrease in advertising costs, a $1.6 million decrease in debit/credit card expenses and a $1.1 million decrease in grant expense reimbursements.

Partially offsetting these decreases were expense increases in several areas. Paid compensation for salaries, wages, overtime and awards increased by $7.7 million or 4.2%. Worker compensation costs increased by $1.8 million, and unemployment compensation costs increased by $1.5 million. Store rents increased by $3.5 million (6.5%) due to FW&GS remodeling efforts and the transition of a number of standard stores into larger Premium Collection stores. Banking services increased by $1.7 million with the implementation of Smart Safes in all stores and licensee service centers, which will deliver longer-term efficiencies and cost savings. Expense increases for store-freight/shipping ($2.3 million) and office/other supplies ($1.9 million) were generally related to COVID-19 costs.

The decrease in other operating revenues was primarily due to the $5.6 million decrease in license fees, which was partially offset by a $1.2 million increase in miscellaneous income, (mostly from an increase in e-commerce shipping fees collected). The decrease in the licensing fees was the result of a $3.9 million decline in license auction proceeds and a $2.5 million decrease in application and other fees largely attributable to fee deferrals put into place as a result of the pandemic and its impact on licensees. These decreases were partially offset by increases in wine expanded permit fees of $0.4 million and other permit fees of $0.4 million.

Transfers Out

The Bureau of Liquor Control Enforcement within the Pennsylvania State Police received $30.8 million in funding in fiscal year 2019-20, a decrease of $0.5 million (1.5%) from the previous year. The Department of Drug & Alcohol Programs will receive $4.2 million, [2 percent of net income as mandated by 47 P.S. §8-802(c)], and $185.1 million was transferred to the General Fund pursuant to 47 P.S. §8-802(f) and as determined annually by the Governor's Office.

Other contributions to the General Fund during fiscal year 2019-20 generated by the PLCB's operations – but not reflected as revenues, expenses or cash flows in the State Stores Fund's financial statements – included $365.7 million in liquor tax and $143.9 million in state sales tax, an overall 4.2% decrease. Additionally, the PLCB remitted $8.8 million in local sales taxes to Philadelphia and Allegheny Counties.

Licensing fees returnable to local municipalities from the Liquor License Fund were $4.3 million for fiscal year 2019-20, compared to $4.5 million in the prior year.

PENNSYLVANIA LIQUOR CONTROL BOARD

FINANCIAL STATEMENTS

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

ASSETS	**June 30, 2020**	**June 30, 2019**
Current assets:		
Cash	$ 46,642	$ 52,271
Temporary investments	182,118	226,279
Accounts and claims receivable, net	7,419	3,617
Due from other funds	197	5
Merchandise inventories	226,514	246,114
Operating supplies	758	383
Prepaid expenses	1,390	523
Total current assets	$ 465,038	$ 529,192
Noncurrent assets:		
Non-depreciable capital assets:		
Land	323	323
Depreciable capital assets:		
Building	20,875	20,875
Leasehold improvements	197	342
Machinery and equipment	49,226	49,063
Intangibles	23,374	22,458
Less: accumulated depreciation	(65,151)	(63,692)
Net depreciable capital assets	$ 28,521	$ 29,046
Total noncurrent capital assets	$ 28,844	$ 29,369
Total assets	$ 493,882	$ 558,561
Total deferred outflows of resources – Notes C, D	$ 117,522	$ 160,429
LIABILITIES		
Current liabilities:		
Trade accounts payable	$ 252,137	$ 289,656
Miscellaneous accounts payable	16,639	14,017
Accrued expenses	17,623	15,317
OPEB – Note D	18,874	8,994
Self-Insurance – Note M	5,595	5,194
Due to other funds – Note F	17,732	13,507
Due to fiduciary funds	2,609	2,086
Due to other governments	732	557
Total current liabilities	$ 331,941	$ 349,328
Noncurrent liabilities:		
OPEB – Note D	410,695	594,961
Self-Insurance – Note M	47,995	48,841
Net pension liability – Note C	458,686	530,292
Compensated absences	24,809	21,598
Total noncurrent liabilities	$ 942,185	$ 1,195,692
Total liabilities	$ 1,274,126	$ 1,545,020

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

	June 30, 2020	June 30, 2019
Total deferred inflows of resources – Note C, D	$ 423,027	$ 279,157
NET POSITION		
Investment in capital assets, Net of related debt	$ 28,844	$ 29,369
Deficit	(1,114,593)	(1,134,556)
Total net position	$ (1,085,749)	$ (1,105,187)

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

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

	Fiscal Year Ended June 30, 2020	Fiscal Year Ended June 30, 2019
Sales net of taxes	$ 2,039,324	$ 2,126,928
Cost of goods sold	(1,386,560)	(1,451,773)
Gross profit from sales	$ 652,764	$ 675,155
Operating (expenses):		
Retail operations	(354,270)	(384,400)
Marketing and merchandising	(11,540)	(15,853)
Supply chain	(7,327)	(6,642)
Wholesale operations	(1,453)	(1,726)
Information technology services	(27,439)	(30,235)
Regulatory affairs	(16,006)	(19,783)
Administration	(11,230)	(13,487)
Finance	(2,477)	(3,326)
Board and secretary	(2,672)	(5,174)
Legal	(3,522)	(3,713)
Commonwealth-provided services	(16,353)	(14,577)
Total	$ (454,289)	$ (498,916)
Operating profit	$ 198,475	$ 176,239
Other operating revenues (expenses):		
Enforcement fines	1,410	1,846
License fees	32,906	38,474
Miscellaneous income	4,586	3,389
Administrative law judge	(2,797)	(2,809)
Total	$ 36,105	$ 40,900
Total operating income	$ 234,580	$ 217,139
Non-operating revenues (expenses):		
Interest income	4,906	5,866
Other	5	(707)
Total	$ 4,911	$ 5,159
Income before operating transfers	$ 239,491	$ 222,298
Operating transfers out:		
PSP enforcement – Note J	(30,779)	(31,257)
Income after enforcement/before other transfers	$ 208,712	$ 191,041
Other operating transfers:		
Transfers out:		
General Fund – Note H	(185,100)	(185,100)
Drug and alcohol programs – Note I	(4,174)	(3,821)
Total	$ (189,274)	$ (188,921)
Change in net position	$ 19,438	$ 2,120
Total net position – beginning	$ (1,105,187)	$ (1,107,307)
Total net position – ending	$ (1,085,749)	$ (1,105,187)

~ 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

(AMOUNTS IN THOUSANDS)

	Fiscal Year Ended June 30, 2020	Fiscal Year Ended June 30, 2019
Cash flows from operating activities		
Receipts from customers	$ 2,074,233	$ 2,168,595
Payments to suppliers	(1,903,909)	(1,926,053)
Net cash provided by (used for) operating activities	$ 170,324	$ 242,542
Cash flows from noncapital financing activities:		
Operating transfers out	(218,148)	(218,857)
Net cash used for noncapital financing activities	$ (218,148)	$ (218,857)
Cash flows from capital and related financing activities:		
Acquisition and construction of capital assets	(6,877)	(9,261)
Proceeds from capital assets	5	1
Net cash used for capital and related financing activities	$ (6,872)	$ (9,260)
Cash flows from investing activities:		
Purchase of investments	(1,534,151)	(1,552,908)
Proceeds from sale and maturities of investments	1,578,312	1,530,705
Investment income	4,906	5,866
Net cash used in investing activities	$ 49,067	$ (16,337)
Net increase (decrease) in cash	$ (5,629)	$ (1,912)
Cash – beginning of year	52,271	54,183
Cash – end of year	$ 46,642	$ 52,271
Reconciliation of operating income (loss) to net cash provided by (used for) operating activities:		
Operating income	$ 234,580	$ 217,139
Depreciation	7,402	8,160
Change in assets and liabilities:		
Accounts receivable	(3,802)	(2,886)
Inventory	19,225	12,328
Due from other funds	(192)	844
Other operating net assets	(867)	(450)
Deferred outflows – pension related	42,906	(71,798)
Accounts payable and accrued liabilities	(32,591)	16,390
Due to other funds	2,320	(7,800)
Due to pension trust funds	523	154
Net pension liability	(71,605)	89,615
Due to other governments	175	31
Deferred inflows – pension related	143,870	170,978
Other postemployment benefit obligations	(174,386)	(189,400)
Self-insurance liabilities	(445)	(1,551)
Compensated absences	3,211	788
Total adjustments	$ (64,256)	$ 25,403
Net cash provided (used for) operating activities	$ 170,324	$ 242,542

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

PENNSYLVANIA LIQUOR CONTROL BOARD
LIQUOR LICENSE FUND
BALANCE SHEET
(AMOUNTS IN THOUSANDS)

ASSETS	**June 30, 2020**	**June 30, 2019**
Current assets:		
Cash in transit	$ 146	$ 65
Investments – short term	1,930	2,205
Total assets	$ 2,076	$ 2,270
LIABILITIES AND FUND BALANCE		
Current liabilities:		
License fees due to municipalities	$ 2,076	$ 2,270
Fund balance:		
Restricted	-	-
Total Fund Balance – Note - N	-	-
Total liabilities and fund balance	$ 2,076	$ 2,270

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

PENNSYLVANIA LIQUOR CONTROL BOARD
LIQUOR LICENSE FUND
STATEMENTS OF REVENUES, EXPENDITURES, AND CHANGES IN FUND BALANCE
For the Years Ending June 30, 2020 and June 30, 2019
(AMOUNTS IN THOUSANDS)

	Balance June 30, 2020	Balance June 30, 2019
REVENUES		
Liquor License Application Fees Collected, Net of Refunds	$ 4,273	$ 4,468
Total Revenues	$ 4,273	$ 4,468
EXPENDITURES		
Liquor License Fees for Return to Municipalities	$ 4,273	$ 4,468
Total Expenditures	$ 4,273	$ 4,468
Net Change in Fund Balance	-	-
Fund Balance, July 1, Restated, Note - N	-	-
Fund Balance - ending	$ -	$ -

~ 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 a special revenue fund used for the collection and subsequent disbursement of certain annual license fees, which are returned to municipalities.

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

Basis of Accounting: The State Stores Fund is reported using the economic resources measurement focus and the accrual basis of accounting. Under this measurement focus, all assets, deferred outflows of resources, liabilities, and deferred inflows of resources associated with the operations of this fund are included in the State Stores Fund 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. Also, all dollar amounts in the financial statements and notes are stated in thousands unless otherwise indicated.

The Liquor License Fund, a special revenue fund, uses the modified accrual basis of accounting to report assets and liabilities.

Cash: Cash includes PLCB funds held by the State Treasurer, imprest balances held at financial institutions and change used at the Fine Wine and Good Spirits (FW&GS) 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.

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

NOTE A – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

Inventories: Inventories are stated at weighted average cost. The PLCB utilizes a bailment inventory management program. PLCB enters 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 FW&GS stores. Product warehousing and handling, as well as transportation to store costs, are reported as part of merchandise inventories and are charged to cost of goods sold as product is sold.

The allowance for obsolete inventory was $100 at June 30, 2020 and $157 at June 30, 2019. 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.

PLCB established an allowance for inventory shrinkage beginning fiscal year ended June 30, 2020. This reserve is based primarily on a sample of actual shrink results from previous physical inventories. Changes in the estimated shrink reserve may be necessary based on the results of physical inventories. The allowance for inventory shrinkage was $1,700 as of June 30, 2020.

Capital Assets and Depreciation: Capital assets are reported at cost in the State Stores Fund 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 (amounts in whole dollars):

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, 2020 and 2029 are as follows:

	Fiscal Year Ended June 30, 2020		Fiscal Year Ended June 30, 2019	
Liquor Tax	$	365,707	$	381,876
State Sales Tax		143,946		150,195
Local Sales Tax		8,777		9,680
Total	$	518,430	$	541,751

Sales are reported net of these collected and remitted taxes in the financial statements.

Compensated Absences: From July 1, 2016 to the end of the 2016 leave calendar year, employees accumulated annual leave based on 2.7 to 10 percent of regular hours paid. Effective with the beginning of the 2017 leave calendar year, employees accumulate annual leave based on 4.24 to 11.93 percent of regular hours paid. Generally, a maximum of 45 days may be carried forward at the end of each leave 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 leave 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 years ended June 30, 2020 and 2019 was $29,535 ($4,726 current and $24,809 non-current) and $26,664 ($5,066 current and $21,598 non-current), respectively. It is the PLCB's policy to record the cost of annual and sick leave in accordance with Governmental Accounting Standards Board (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 fiscal years ended June 30, 2020 and 2019 of the compensated absences liabilities to include the additions and reductions during the fiscal years then ended:

Fiscal Year Ended	Liability – Beginning Balance	Additions	Reductions	Liability – Ending Balance
June 30, 2020	$ 26,664	$ 20,906	$ 18,035	$ 29,535
June 30, 2019	$ 25,691	$ 18,410	$ 17,437	$ 26,664

Pension Costs and Liability: The PLCB participates in the State Employees' Retirement System (SERS) cost-sharing, multiple-employer defined-benefit pension plan. The Commonwealth's policy is to fund employer contributions to the SERS as required by the SERS Board, through statutory authority, or as required based on other applicable statutory requirements. As prescribed by GASB Statement No. 68, an actuarial valuation was prepared to value the SERS pension liability, deferred outflows of resources, and deferred inflows of resources at the actuarial present value of projected benefit payments related to periods of employee service.

In the State Stores Fund Statement of Net Position, the PLCB reports its share of the net pension liability, deferred outflow of resources, and deferred inflow of resources. The changes in the net pension liability will be recognized in pension expense. Balances projected for the deferred outflow of resources and deferred inflow of resources will be amortized over a closed period matching the expected remaining service life of all employees or a closed period of five years.

Other Postemployment Benefit (OPEB) Costs and Liability: The PLCB participates in the Commonwealth's single-employer defined benefit OPEB plan, the Retired Employees Health Program (REHP). The Commonwealth's policy is to fund employer contributions to the REHP under contribution policies established by the Office of Administration and the Office of the Budget. As prescribed by GASB Statement No. 75, an actuarial valuation was prepared to value the OPEB liability, deferred outflow of resources, and deferred inflow of resources for the REHP at the actuarial present value of projected benefit payments related to periods of employee service.

In the State Stores Fund Statement of Net Position, the PLCB reports its share of the net OPEB liability, deferred outflow of resources, and deferred inflow of resources. The changes in the net OPEB liability will be recognized in OPEB expense. Balances projected for the deferred outflow of resources and deferred inflow of resources will be amortized over a closed period matching the expected remaining service life of all employees or a closed period of five years.

NOTE A – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

New Accounting Pronouncements - Adopted: The PLCB adopted GASB Statement No. 84, "Fiduciary Activities". After applying the new criteria for identifying activities that should be reported as a fiduciary fund under this statement, PLCB determined that the Liquor License Fund changed from being reported as an agency fund to a special revenue fund. See Note N for restatement information, due to a change in accounting principle.

New Accounting Pronouncements - To Be Adopted: GASB issued Statement No. 87, "Leases" in June 2017. This Statement establishes a single model for lease accounting based on the principle that leases are financings of the right to use an underlying asset. Under this statement, a lessee is required to recognize a lease liability and an intangible right-to-use lease asset, and a lessor is required to recognize a lease receivable and deferred inflow of resources. The PLCB currently leases over 600 store properties for their retail operations, and this statement will be effective for the PLCB's fiscal year ending June 30, 2021 financial statements. The June 30, 2020 net position will not be restated for the cumulative effect of applying GASB 87, due to offsetting assets and liabilities at implementation.

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 CIP. The PLCB participates in the CIP's Pool 99 investment pool. Pool 99 is designed to provide a high degree of liquidity and safety. Pool 99 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, 2020 and 2019, the fund's fiscal years end. Shares in Pool 99 are reported as temporary investments.

The CIP pools are considered internal investment pools of the Commonwealth of Pennsylvania 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, 2020 Basic Financial Statements.

PLCB's total deposit balance of $46,788 and $52,336 at June 30, 2020 and 2019, respectively was not exposed to either custodial credit risk or foreign currency risk.

NOTE B – DEPOSITS AND INVESTMENTS (Continued)

As a participant in Treasury's CIP Pool 99, 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 99 at June 30, 2020 is approximately 0.80 years.

NOTE C – PENSION

General Information about the Pension Plan

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

The 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.

NOTE C – PENSION (Continued)

Act 120 of 2010 (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 5 to 10 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 (71 Pa. C.S. §5507) requires the Commonwealth and other employers whose employees are the 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. The 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 the SERS funding valuation, expressed as a percentage of annual covered payroll, such that they, along with employee contributions and an actuarially determined rate of investment return, are adequate to accumulate assets to pay benefits when due. Act 2017-5 includes a savings "plow-back" provision requiring that the annual savings achieved through SERS' benefit changes flow back into the Defined Benefit Plan through the employer contribution rate rather than to other non-pension obligations. The PLCB's contributions to the SERS were $54,454 and $52,306 for the fiscal years ended June 30, 2020 and 2019, 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: The PLCB reported a liability of $458,686 and $530,291 for its proportionate share of the SERS net pension liability as of June 30, 2020 and 2019, respectively. The net pension liability attributed to participation in the SERS was measured as of December 31, 2019, and the total pension liability used to calculate the net pension liability was determined by an actuarial valuation as of that date.

NOTE C – PENSION (Continued)

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, 2019, PLCB's reported proportionate share of the SERS net pension liability was 2.52 percent which was a decrease of 0.03 percent from its proportion measured as of December 31, 2018.

For the fiscal years ended June 30, 2020 and 2019, PLCB recognized pension expense of $61,298 and $76,674, respectively, and reported deferred outflows of resources and deferred inflows of resources related to pensions from the following sources:

Fiscal year ended June 30, 2020:

	Deferred Outflows of Resources	Deferred Inflows of Resources
Differences between expected and actual experience…	$ 5,719	$ 3,107
Change in assumptions……………………………….	17,675	-
Differences between projected and actual investment earnings……………………………………………….	-	32,713
Change in proportion…………………………………	7,780	6,819
Differences between employer contributions and proportionate share…………………………………...	931	640
Contributions subsequent to measurement date………	26,748	-
Total	$ 58,853	$ 43,279

Fiscal year ended June 30, 2019:

	Deferred Outflows of Resources	Deferred Inflows of Resources
Differences between expected and actual experience…	$ 7,958	$ 5,746
Change in assumptions……………………………….	14,128	-
Differences between projected and actual investment earnings……………………………………………….	51,594	-
Change in proportion…………………………………	6,950	7,438
Differences between employer contributions and proportionate share…………………………………...	978	676
Contributions subsequent to measurement date………	26,274	-
Total	$ 107,882	$ 13,860

For the fiscal year ended June 30, 2020, the $26,748 reported as deferred outflows of resources related to pensions resulting from PLCB's contributions to the SERS subsequent to the measurement date will be recognized as a reduction of the net pension liability in the fiscal year ended June 30, 2021. Other amounts reported as deferred outflows of resources and deferred inflows of resources related to pensions will be recognized in pension expense as follows:

NOTE C – PENSION (Continued)

Fiscal Years Ending June 30	Pension Expense
2021	$ (491)
2022	(4,319)
2023	5,708
2024	(13,045)
2025	974

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

The SERS Board adopted the actuarial assumptions set forth in the *18th Investigation of Actuarial Experience* at its March 2016 meeting. The study can be viewed at www.SERS.pa.gov.

In addition to the five-year experience study, the SERS reviews its investment return assumption in light of economic conditions every year as part of its annual valuation. Based on this work, the SERS Board approved, at its June 2019 meeting, a reduction in the assumed investment rate of return from 7.25 percent to 7.125 percent effective with the December 31, 2019 actuarial valuation.

The following methods and assumptions were used in the actuarial valuation for the December 31, 2019, measurement date:

Actuarial cost method	Entry age
Amortization method	Straight-line amortization of investments over five years and amortization of assumption changes and noninvestment gains/losses over the average expected remaining service lives of all employees that are provided benefits.
Investment rate of return	7.125% net of expenses including inflation

NOTE C – PENSION (Continued)

Projected salary increases	Average of 5.60% with range of 3.70% to 8.90% including inflation
Asset valuation method	Fair (market) value
Inflation	2.60%
Mortality rate	Projected RP-2000 Mortality Tables adjusted for actual plan experience and future improvement
Cost of living adjustments	Ad hoc

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

Asset Class	Target Allocation	Expected Rate of Return
Private equity	16.00%	7.25%
Global public equity	48.00%	5.15%
Real assets	12.00%	5.26%
Multi-strategy	10.00%	4.44%
Fixed income	11.00%	1.26%
Cash	3.00%	0.00%
Total	100.00%	

Discount Rate: The SERS discount rate used to measure the total pension liability was reduced to 7.125 percent in 2019 from 7.25 percent in 2018. 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 the SERS investments was applied to all periods of projected benefit payments to determine the total pension liability.

NOTE C – PENSION (Continued)

Sensitivity of the PLCB's proportionate share of the net pension liability to change in the discount rate: The following table presents the PLCB's proportionate share of the SERS net pension liability using the discount rate of 7.125 percent, as well as what the PLCB's proportionate share of the net pension liability would be if it were calculated using a discount rate that is 1 percentage point lower (6.125 percent) or 1 percentage point higher (8.125 percent) than the current rate.

	1% Decrease 6.125%	Current Discount Rate 7.125%	1% Increase 8.125%
PLCB's proportionate share of SERS net pension liability as of the December 31, 2019 measurement date	$ 582,836	$ 458,686	$ 352,399

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: At June 30, 2020, the PLCB reported an accounts payable for the employers' share of retirement contributions to the SERS in the amount of $2,625.

Additional pertinent information regarding the 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 (CAFR).

NOTE D – OTHER POSTEMPLOYMENT BENEFITS

General Information about the Retired Employees Health Program Plan

Plan Description: 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 REHP is provided as part of collective bargaining agreements with most Commonwealth labor unions. All policy decisions and types and levels of benefits for the REHP fall under the purview of the Commonwealth's Executive Board and Secretary of Administration. REHP does not have a governing board. The REHP plan does not issue a stand-alone financial report nor is it included in the financial statements of a public employee retirement system.

NOTE D – OTHER POSTEMPLOYMENT BENEFITS (Continued)

Benefits Provided: Benefit provisions included in the REHP plans are established and may be amended by the establishing sponsor. The REHP plan provides postemployment healthcare benefits to eligible employees. Employees who retire from the Commonwealth and meet one of the following eligibility criteria are eligible to receive REHP benefits:

- 25 or more years of service;
- 20 or more years of service and superannuation age – age 50 for Park Rangers, Capitol Police and certain enforcement officers or age 60 for all other employees (age 55 or 65 for employees subject to Act 120 of 2010);
- Disability retirement – requires five years of service (no service requirements for enforcement officers).

Contributions: The REHP contribution requirements are contractually required and established by the Office of Administration and the Office of the Budget. The contribution rates are established as a set amount per current active REHP eligible employee per biweekly pay in order to fund the REHP plan.

During the fiscal year ended June 30, 2020, the contractually required contribution rate for the PLCB began the fiscal year at $288 (whole dollars) and was lowered to $230 after two pay periods for each current REHP eligible active employee per biweekly pay period. For employees who retired after June 30, 2005 and before July 1, 2007 the retiree contribution is set at 1% of employee’s final annual salary. PLCB employees who retired on or after July 1, 2007 but before July 1, 2011 are currently required to pay retiree contributions of 3% of either their final annual salary or final average salary, whichever is less. PLCB employees who retire on or after July 1, 2011 are currently required to pay retiree contributions of 3% of their final average salary. Upon enrollment in Medicare, PLCB employees who are currently paying 3% will pay retiree contributions of 1.5% of either their final annual salary or final average salary, whichever applies.

The REHP funding rate needed to fund current year annuitant health care costs are established as part of the Commonwealth’s annual budgeting process. Any additional contributions to advance fund annuitant health care liabilities are determined annually by the Commonwealth. During the fiscal year ended June 30, 2020, advance funding of $50,000 for REHP was contributed to the Other Postemployment Benefits Investment Pool, a pension (and other employee benefit) trust fund. The PLCB’s contributions to the REHP trust for the fiscal year ended June 30, 2020 was $23,376.

OPEB Liabilities, OPEB Expense, and Deferred Outflows of Resources and Deferred Inflows of Resources Related to OPEB: At June 30, 2020, the PLCB reported a liability of $429,569 for its proportionate share of the REHP’s net OPEB liability. The net OPEB liability for the REHP was measured as of June 30, 2019, and the total OPEB liability used to calculate the net OPEB liability was determined by an actuarial valuation as of that date. The PLCB’s allocation of the net

NOTE D – OTHER POSTEMPLOYMENT BENEFITS (Continued)

OPEB liability was based on PLCB contributions to the plan relative to the total contributions to the plan over the measurement period. At June 30, 2019, the PLCB's proportionate share was 4.12 percent.

For the fiscal year ended June 30, 2020, the PLCB recognized OPEB expense of $(46,747), and reported deferred outflows of resources and deferred inflows of resources related to OPEB from the following sources:

Fiscal year ended June 30, 2020:

	Deferred Outflows of Resources	Deferred Inflows of Resources
Differences between expected and actual experience…	$ -	$ 319,488
Change in assumptions……………………………….	13,742	59,499
Differences between projected and actual investment earnings………………………………………………	-	761
Change in allocation and differences between employer contributions and allocated share………….	25,279	-
Contributions subsequent to measurement date……...	19,648	-
Total	$ 58,669	$ 379,748

Fiscal year ended June 30, 2019:

	Deferred Outflows of Resources	Deferred Inflows of Resources
Differences between expected and actual experience…	$ -	$ 184,978
Change in assumptions……………………………….	-	79,396
Differences between projected and actual investment earnings……………………………………………….	-	923
Differences between employer contributions and proportionate share…………………………………...	29,170	-
Contributions subsequent to measurement date………	23,376	-
Total	$ 52,546	$ 265,297

The deferred outflow of contributions subsequent to the measurement date of $19,648 will be recognized as a reduction of the net OPEB liability in the fiscal year ended June 30, 2021. Other amounts reported as deferred outflows and deferred inflows of resources will be recognized in OPEB expense as follows:

NOTE D – OTHER POSTEMPLOYMENT BENEFITS (Continued)

Fiscal Years Ending June 30	OPEB Expense	
2021	$	86,546
2022		86,546
2023		81,811
2024		60,902
2025		24,786
Thereafter		136

Actuarial Assumptions: The total OPEB liability in the June 30, 2019 actuarial valuation was determined using the following actuarial assumptions applied to all periods included in the measurement, unless otherwise specified:

Actuarial cost method	Entry age
Asset valuation method	Fair (market) value
Investment rate of return	5.00%
Inflation	2.60%
Salary increases	2.90%
Healthcare cost trend rates:	
Medicare retiree	5.9% for 2019 decreasing to an ultimate rate of 4.1% for 2075 and later years
Non-Medicare retiree	6.0% for 2019 decreasing to an ultimate rate of 4.1% for 2075 and later years
Amortization method	Straight-line amortization of investments over five years and amortization of assumption of changes and noninvestment gains/losses over the average expected remaining service lives of all employees that are provided benefits

Mortality rates were based on the RP-2000 Male and Female Combined Health Mortality Tables projected (using Projection Scale AA) to 2016 for males and 2020 for females, and then further adjusted to ensure sufficient margin improvement in certain age ranges. Disabled participants

NOTE D – OTHER POSTEMPLOYMENT BENEFITS (Continued)

mortality rates were based on the RP-2000 Male and Female Disabled Retiree Mortality Tables projected (using Projection Scale AA) to 2021 for males and to 2017 for females. Each table includes a margin for future improvement in life expectancy.

The actuarial assumptions used in the June 30, 2019 valuation were based on the SERS experience study that covered the years 2011 through 2015. The approved recommendations from that study were used to determine the assumptions for this valuation, where applicable. The inflation assumption was selected by the SERS Board during an April 2017 meeting based on a review of actual plan experience and the prevalent economic outlook. Consistent with prior valuations, these demographic assumptions assume beginning of year decrements (retirement, withdrawal, death, disability, etc.). Cost of living adjustments (COLA) may be granted on an ad hoc basis; there were no COLAs granted during the measurement period.

The long-term expected rate of return on OPEB plan investments is determined using a risk premium review. This review compares the current relationship between fixed income and equity and their relationship over long periods of time to come up with an expected rate of return. Other variables considered in the expected rates of return are a reversion to the mean for each asset class. Best estimates of arithmetic real rates of return for each major asset class included in the target asset allocation as of June 30, 2019 are summarized in the following table:

Asset Class	Target Allocation	Long-term Expected Rate of Return
Domestic equity	40.0%	5.6%
International equity	27.0%	5.8%
Fixed income	23.0%	1.7%
Real estate	8.0%	4.6%
Cash and Cash Equivalents	1.5%	0.9%
Private Equity	0.5%	10.4%
Total	100.0%	

Discount Rate: The discount rate used for the total OPEB liability reported at June 30, 2020 was 3.50 percent. This single discount rate was based on the 20-year Bond Buyer GO Index municipal bond rate as of the measurement date of June 30, 2019. Since the REHP has insufficient assets to meet next year's projected benefit payments, the municipal bond rate was applied to all periods of the projected benefit payments to determine the total OPEB liability. The projection of cash flows used to determine the single discount rate for each fiscal year end assumed that employer contributions will be made based on the current funding policy for future years.

NOTE D – OTHER POSTEMPLOYMENT BENEFITS (Continued)

Sensitivity of the net OPEB liability to changes in the discount rate: The following presents the net OPEB liability of the PLCB, as well as what the PLCB's net OPEB liability would be if it were calculated using discount rate that are one percentage point lower (2.50%) or one percentage point higher (4.50%) than the current discount rate.

	1% Decrease 2.50%	Current Discount Rate 3.50%	1% Increase 4.50%
PLCB's proportionate share of REHP net OPEB liability as of the June 30, 2019 measurement date	$ 487,369	$ 429,569	$ 381,188

Sensitivity of the net OPEB liability to changes in the healthcare cost trend rates: The following presents the net OPEB liability of the PLCB, as well as what the PLCB's net OPEB liability would be if it were calculated using healthcare cost trend rates (Non-Medicare Benefits/Medicare Benefits) that are one percentage point lower (5.00% / 4.90% decreasing to 3.1%) or one percentage point higher (7.00% / 6.90% decreasing to 5.1%) than the current healthcare cost trend rates.

	1% Decrease 5.00% / 4.90% grading down to 3.1%	Current health Trend rate 6.0% / 5.1% grading down to 4.1%	1% Increase 7.00% / 6.90% grading down to 5.1%
PLCB's proportionate share of REHP net OPEB liability as of the June 30, 2019 measurement date	$ 373,160	$ 429,569	$ 498,956

OPEB plan fiduciary net position: Detailed information about the REHP OPEB plan's fiduciary net position is available in the separately issued Commonwealth of Pennsylvania's CAFR.

Payable to the OPEB plan: At June 30, 2020, the PLCB reported an accounts payable for the employer's share of the retirees' health contributions to the Office of Administration in the amount of $891.

NOTE E – CAPITAL ASSETS

Changes in capital assets for the fiscal year ended June 30, 2020 are as follows:

Fiscal year ended June 30, 2020:

	Balance June 30, 2019	Additions	Retirements	Balance June 30, 2020
Non-depreciable capital assets:				
Land	$ 323	$ -	$ -	$ 323
Depreciable capital assets:				
Building	20,875			20,875
Leasehold improvements	342		144	198
Machinery and equipment	49,063	1,508	1,345	49,226
Intangibles	22,458	5,369	4,454	23,373
Total capital assets	$ 93,061	$ 6,877	$ 5,943	$ 93,995

Changes in capital assets accumulated depreciation for the fiscal year ended June 30, 2020 are as follows:

	Balance June 30, 2019	Additions	Retirements	Balance June 30, 2020
Building	$ 15,777	$ 869	$ -	$ 16,646
Leasehold improvements	207	36	144	99
Machinery and equipment	35,753	2,848	1,345	37,256
Intangibles	11,955	3,649	4,454	11,150
Total accumulated depreciation	$ 63,692	$ 7,402	$ 5,943	$ 65,151

NOTE E – CAPITAL ASSETS (Continued)

Changes in capital assets for the fiscal year ended June 30, 2019 are as follows:

Fiscal year ended June 30, 2019:

	Balance June 30, 2018	Additions	Retirements	Balance June 30, 2019
Non-depreciable capital assets:				
Land	$ 323	$ -	$ -	$ 323
Depreciable capital assets:				
Building	20,809	66	-	20,875
Leasehold improvements	612	-	270	342
Machinery and equipment	47,905	5,050	3,892	49,063
Intangibles	25,990	4,145	7,677	22,458
Total capital assets	$ 95,639	$ 9,261	$ 11,839	$ 93,061

Changes in capital assets accumulated depreciation for the fiscal year ended June 30, 2019 are as follows:

	Balance June 30, 2018	Additions	Retirements	Balance June 30, 2019
Building	$ 14,903	$ 874	$ -	$ 15,777
Leasehold improvements	440	37	270	207
Machinery and equipment	35,710	3,227	3,184	35,753
Intangibles	15,610	4,022	7,677	11,955
Total accumulated depreciation	$ 66,663	$ 8,160	$ 11,131	$ 63,692

NOTE F – DUE TO OTHER FUNDS

At June 30, 2020 and 2019, a total of $17,732 and $13,507 respectively, was due to other funds. These totals were due to various funds.

NOTE G – LEASE COMMITMENTS

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

Rental expenses, for the fiscal years ended June 30, 2020 and 2019 were $59,908 and $56,292, respectively.

NOTE G – LEASE COMMITMENTS (Continued)

The following is a schedule of future minimum rental commitments for non-cancelable operating leases in effect as of June 30, 2020:

Fiscal Years Ending June 30	Fine Wine and Good Spirits Store Leases
2021	$ 58,919
2022	53,784
2023	49,008
2024	42,654
2025	36,783
Total Minimum Lease Payments:	$ 241,148

NOTE H – OPERATING TRANSFERS TO GENERAL FUND

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

Per Act 39 of 2016, any commissions, compensation or any type of incentive award based upon the sale of lottery tickets and games shall be deposited by the PLCB into the General Fund.

Per Act 166 of 2016, all moneys collected from converting an eating place retail dispensing license to a restaurant license, casino license fees, and license auction proceeds shall be transferred from the State Stores Fund to the General Fund.

The required transfers to the General Fund totaled $185,100 in each of the fiscal years ended June 30, 2020 and 2019.

NOTE I – OPERATING TRANSFER FOR DRUG AND ALCOHOL PROGRAMS

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

The amount of the liabilities established to the DDAP were $4,174 and $3,821 for the fiscal years ended June 30, 2020 and 2019, respectively.

NOTE J – 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 were $30,780 and $31,257 for the fiscal years ended June 30, 2020 and 2019, respectively.

NOTE K – 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 L – BALANCE SHEET – LIQUOR LICENSE FUND

The Balance Sheet illustrates the net assets and liabilities at each fiscal year end for the Liquor License Fund activity as authorized by PA Statute Title 47, Article VIII, §801.

Deposits and investments include cash received from license application fees not received by the Treasury Department at the balance sheet date, and net short-term investments resulting from the purchase and sale of Treasury Department securities (see Note A, Temporary Investments).

Liabilities and fund balance include moneys received from license application fees not returned to municipalities at the balance sheet date.

NOTE M – 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 $2.5 million retention with excess commercial insurance coverage up to $1 billion per occurrence. There was no reduction in commercial insurance coverage during the fiscal year ended June 30, 2020. 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 M – 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, 2020 and 2019, respectively, the State Stores Fund reported a $53,590 liability ($5,595 as current and $47,995 as non-current) and $54,035 liability ($5,194 as current and $48,841 as non-current) for employee disability claims.

The following summary provides aggregated information for the fiscal years ending June 30, 2020 and 2019, of the reported self-insurance liabilities to include the incurred claims and payments during the fiscal years then ended:

Fiscal Year Ended	Liability – Beginning Balance	Incurred Claims	Payments	Liability – Ending Balance
June 30, 2020	$ 54,035	$ 5,632	$ 6,077	$ 53,590
June 30, 2019	$ 55,586	$ 3,972	$ 5,523	$ 54,035

NOTE N – RESTATEMENT

Restatement Due to Change in Accounting Principle:

Effective July 1, 2019, the Liquor License Fund implemented GASB Statement No. 84, Fiduciary Activities. PLCB previously reported the activity of the Liquor License Fund as an agency (fiduciary) fund. Beginning in FY 2019-2020, such activity has been more appropriately reported as a special revenue fund under GASB Statement No. 54, Fund Balance Reporting and Governmental Fund Type Definitions. Accordingly, the newly established special revenue fund reports a restated beginning balance of $0, which is equal to the restatement of net current assets and current liabilities previously reported in the agency fund Statement of Fiduciary Net Position.

Fiscal year ended June 30, 2019 amounts are restated to conform with the requirements of GASB Statements No. 84 and 54.

REQUIRED SUPPLEMENTARY INFORMATION

Pension Schedules

Schedule of PLCB's Contributions (Dollar amounts in thousands)

Last Ten Fiscal Years Ended June 30[1]	2020	2019	2018	2017	2016	2015
Contractually required contribution[2]	$ 52,986	$ 52,235	$ 48,227	$ 40,348	$ 33,752	$ 27,044
Contributions in relation to the contractually required contribution	$ 52,986	$ 52,235	$ 48,227	$ 40,348	$ 33,752	$ 27,044
Contribution deficiency (excess)	$ -	$ -	$ -	$ -	$ -	$ -
PLCB's covered-employee payroll	$ 180,355	$ 174,048	$ 171,016	$ 162,310	$ 166,701	$ 162,037
Contributions as a percentage of covered-employee payroll	29.38%	30.01%	28.20%	24.86%	20.25%	16.69%

~ The notes to required supplementary information are an integral part of this schedule. ~

[1] PLCB adopted GASB 68 on a prospective basis for the fiscal year ended June 30, 2015; therefore, only six years are present in the above schedule. The amounts presented for each fiscal year were determined as of December 31st of the prior year.
[2] The contractually required contribution disclosed above is based on minimum floor rates or suppressed rates resulting from collars that are required based on statutory law. These rates are determined by SERS actuary during the annual funding valuation and include an adjustment to the "preliminary employer contribution rate" calculated before the minimum floor or collars are applied. These "final employer contribution rates" fall within the realm of an appropriate ADC calculation under actuarial standards of practice and temporarily defer a portion of the payments that work towards fully funding the plan.

REQUIRED SUPPLEMENTARY INFORMATION (Continued)

Pension Schedules

Schedule of PLCB's Proportionate Share of the Net Pension Liability (Dollar amounts in thousands)

Last Ten Fiscal Years Ended June 30[1]	2020	2019	2018	2017	2016[2]	2015
PLCB's proportion of the net pension liability	2.52%	2.55%	2.55%	2.48%	2.47%	2.44%
PLCB's proportionate share of the net pension liability	$ 458,686	$ 530,291	$ 440,677	$ 477,444	$ 449,176	$ 362,685
PLCB's covered employee payroll	$ 180,355	$ 147,048	$ 171,016	$ 162,310	$ 166,701	$ 162,037
PLCB's proportionate share of the net pension liability as a percentage of its covered employee payroll	254.32%	304.68%	257.68%	294.16%	269.45%	223.83%
Plan fiduciary net position as a percentage of the total pension liability	63.11%	56.39%	62.97%	57.80%	58.90%	64.80%

[1] PLCB adopted GASB 68 on a prospective basis for the fiscal year ended June 30, 2015; therefore, only six years are presented in the above schedule. The amounts presented for each fiscal year were determined as of December 31st of the prior year.

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

REQUIRED SUPPLEMENTARY INFORMATION (Continued)

OPEB Schedules

Schedule of PLCB's Contributions (Dollar amounts in thousands)

Last Ten Fiscal Years Ended June 30[1]

	2020	2019	2018
Contractually required contribution[2]	$ 24,615	$ 20,490	$ 29,409
Contributions in relation to the contractually required contribution	$ 23,376	$ 24,623	$ 26,157
Contribution deficiency (excess)	$ 1,239	$ (4,133)	$ 3,252
PLCB's employee covered payroll	$ 129,950	$ 126,621	$ 124,980
Contributions as a percentage of employee covered payroll	17.99%	19.45%	20.93%

~ The notes to required supplementary information are an integral part of this schedule. ~

[1] PLCB adopted GASB 75 on a prospective basis for the fiscal year ended June 30, 2018; therefore, only three years are presented in the above schedule. The amounts presented were measured as of June 30th of the prior year.
[2] Contribution requirements for the REHP are determined annually by the Commonwealth based on projected cash flow requirements and a projected contribution toward pre-funding future cash outlays.

REQUIRED SUPPLEMENTARY INFORMATION (Continued)

Schedule of PLCB's Allocated Share of the Net OPEB Liability (Dollar amounts in thousands)

Last Ten Fiscal Years Ended June 30[1]

	2020	2019	2018
PLCB's allocation of the net OPEB liability	4.12%	4.11%	3.96%
PLCB's allocated share of the net OPEB liability	$ 429,569	$ 603,955	$ 793,355
PLCB's employee covered payroll	$ 129,950	$ 126,621	$ 124,980
PLCB's allocated share of the net OPEB liability as a percentage of its employee covered payroll	330.57%	476.98%	634.79%
Plan fiduciary net position as a percentage of the total OPEB liability	3.74%	2.22%	1.39%

[1] PLCB adopted GASB 75 on a prospective basis for the fiscal year ended June 30, 2018; therefore, only three years are presented in the above schedule. The amounts presented were measured as of June 30th of the prior year.

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EUGENE A. DEPASQUALE
AUDITOR GENERAL

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

Independent Auditor's Report

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

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

We have audited, in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States, the accompanying Statements of Net Position, Statements of Revenues, Expenses and Changes in Net Position, and Statements of Cash Flows for the State Stores Fund, and the Balance Sheets and the Statements of Revenues, Expenditures, and Changes in Fund Balance for the Liquor License Fund of the Pennsylvania Liquor Control Board (PLCB) as of and for the years ended June 30, 2020 and 2019, and the related notes to the financial statements and have issued our report thereon dated December 8, 2020.

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. Given these limitations, during our audit we did not identify any deficiencies in internal control that we consider to be material weaknesses. However, material weaknesses may exist that have not been identified.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the PLCB's financial statements are free from material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*.

Purpose of this Report

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

Eugene A. DePasquale

December 8, 2020

Eugene A. DePasquale
Auditor General

Observation No. 1 – Controls Over Outsourced Inventory Management Systems Need Improvement

During a prior fiscal year, PLCB management amended existing contracts with two warehouse vendors to require the vendors to implement new inventory management systems to replace PLCB's legacy system, effectively outsourcing certain information technology (IT) controls to these vendors. PLCB management did not develop an understanding of the IT controls at each vendor over these outsourced systems as required by Commonwealth Management Directive (MD) 325.13, *Service Organization Controls*, effective November 22, 2017. While PLCB management documented and monitored how the vendors' systems interacted with PLCB's systems and ensured appropriate inventory controls were in place, PLCB management did not develop an understanding of logical access controls, configuration management controls, and service delivery controls needed to ensure the security of Commonwealth information maintained in these systems. Further, the contract amendments did not include the Commonwealth's standard audit, security, and confidentiality language required in IT contracts.

Since the dates that the contract amendments were signed, the Office of Administration/Office for Information Technology (OA/OIT) revised Information Technology Policy (ITP) – BUS011, IT S*ervice Organization Management and Cloud Requirements* and issued two new policies, OPD-BUS011B – *System and Organization Controls Reporting Procedure* and OPD-BUS011C – *System and Organization Correspondence Procedure,* effective January 27, 2020. The new policies include System and Organization Control (SOC) report guidance that may apply to these systems and require additional vendor management controls, including OA/OIT's *Requirements for non-Commonwealth Hosted Applications/Services,* referenced in ITP-BUS011.

Recommendation

We recommend PLCB management develop monitoring procedures over the outsourced warehouse inventory systems to ensure effective IT controls and to comply with Management Directive 325.13. We also recommend PLCB update their contracts with these two vendors to include the Commonwealth's standard audit, security, and confidentiality language as well as the vendors' acceptance of OA/OIT's *Requirements for non-Commonwealth Hosted Applications/Services*. Finally, we recommend that PLCB work with OA/OIT to ensure PLCB vendor management procedures comply with the Commonwealth service organization management policies noted above.

COMMONWEALTH OF PENNSYLVANIA
PENNSYLVANIA LIQUOR CONTROL BOARD
JUNE 30, 2020
DISTRIBUTION LIST

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The Honorable Daniel J. Deasy
Minority Chair
House Liquor Control Committee

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