FINANCIAL AUDIT

Commonwealth of Pennsylvania
Pennsylvania Liquor Control Board

State Stores Fund
Liquor License Fund

Audit Report

Harrisburg, Pennsylvania
For the Years Ended June 30, 2017 and 2016

December 2017

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. Included within this mandate is the authority to establish, operate and maintain Pennsylvania Fine Wine & Good Spirits stores for the sale of liquor, including wine and spirits.

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

History and Agency Overview

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

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

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

BACKGROUND (Continued)

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

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

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

The PLCB operates over 600 Pennsylvania wine and spirits stores with gross annual sales of $2.53 billion for fiscal year 2016-2017, an increase of 3.9 percent over the previous fiscal year. As a result, the PLCB's return to the Pennsylvania General Fund and state Treasury also grew, including $361.9 million in liquor tax, $142.0 million in state sales tax and $216.7 million profit and cash transfers to the General Fund. Additionally, the PLCB provided $28.1 million to fund Pennsylvania State Police liquor control enforcement efforts, afforded $2.5 million to support the Pennsylvania Department of Drug & Alcohol Programs and returned $4.5 million to local municipalities. Beginning in 2013, the Alcohol Education grants for reducing underage and dangerous drinking went to a two-year cycle. The amount awarded by the PLCB for second year grant funding in the two year grant cycle ending June 30, 2017 was $1.1 million.

BACKGROUND (Continued)

Key Facts

- All tax moneys collected are transferred to the State Treasury. All revenues remaining, after payment of PLCB operating expenses and after required appropriations are made to other entities and Commonwealth agencies, are made available to be transferred to the State Treasury.
- The PLCB is the largest purchaser of wine and spirits in the United States, and passes significant volume purchase discounts on to customers.
- The PLCB operates over 600 stores, which are leased from private landlords.
- 100% of the required State and Local Sales Taxes are collected by the PLCB and reported to the Pennsylvania Department of Revenue.
- The state liquor tax of 18% is included in the shelf price of each item.
- The PLCB outsources warehousing services for 3 distribution centers in Pennsylvania.
- In fiscal year 2016-2017, PLCB processed more than 71,000 license and permit applications.
- The PLCB has an established formal Bureau of Alcohol Education, which provides educational material to youth, legal consumers and beverage alcohol servers.
- The PLCB funds grants to colleges and universities, communities that host these institutions, municipalities, and their organizations such as law enforcement departments and non-profit organizations to develop and/or maintain environmental management prevention strategies and other proven prevention strategies to reduce dangerous and underage drinking.

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EUGENE A. DEPASQUALE
AUDITOR GENERAL

Independent Auditor's Report

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

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

Report on the Financial Statements

We have audited the accompanying financial statements of the Pennsylvania Liquor Control Board (PLCB) - State Stores Fund, which comprise of the Statements of Net Position as of June 30, 2017 and 2016, 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, 2017 and 2016, 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.

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, 2017 and 2016, 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

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, 2017 and 2016, 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.

Other Matters

Required Supplementary Information

Accounting principles generally accepted in the United States of America require that the management's discussion and analysis on pages 7 through 10, schedule of PLCB contributions and schedule of PLCB's proportionate share of net pension liability on pages 35-36 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, 2017, on our consideration of PLCB's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering PLCB's internal control over financial reporting and compliance.

Eugene A. DePasquale

December 8, 2017

Eugene A. DePasquale
Auditor General

PLCB Management's Discussion and Analysis

Management's Responsibility for the Financial Statements

PLCB management is responsible for the preparation, integrity, and fair presentation of the agency's financial statements. The accompanying financial statements have been prepared in accordance with accounting principles generally accepted in the U.S., 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 on a fiscal year basis, comprised of 12 calendar months.

The basic financial statements included in this report are the State Stores Fund Comparative Statement of Net Position as of June 30, 2017 and June 30, 2016 and State Stores Fund Comparative Statements of Revenues, Expenses, and Changes in Net Position for the fiscal years ended June 30, 2017 and June 30, 2016; State Stores Fund Comparative Statement of Cash Flows for the fiscal years ended June 30, 2017 and June 30, 2016; and the Liquor License Fund Statement of Fiduciary Net Position as of June 30, 2017 and June 30, 2016 and the Liquor License Fund Statement of Changes in Fiduciary Net Position for the fiscal years ended June 30, 2017 and June 30, 2016.

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

PLCB Management's Discussion and Analysis (Continued)

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

Executive Summary & Highlights

The liquor reforms contained in Acts 39, 85, and 166 of 2016 impacted all facets of the PLCB's business and regulatory functions. While the goals of these reforms were to increase both consumer convenience and revenue, not all elements of the changes were accretive to the PLCB's net income for fiscal year 2016-17.

Key liquor reform changes having direct impact on PLCB operations include the following:

- Elimination of proportional markup and adoption of flexible pricing on the 150 best-selling brands of wine and the 150 best-selling brands of spirits. This change allows the PLCB to both maximize financial returns to the Commonwealth and offer competitive retail prices for consumers.
- Introduction of retail wine sales for carryout at private retailers. The PLCB is the wine wholesaler to holders of wine expanded permits, who purchase wine at a 10 percent discount off PLCB normal retail prices.
- Auction of restaurant licenses that expired or lapsed since 2000. Three auctions were conducted via sealed bid in fiscal year 2016-17 which offered a total of 140 licenses. Auction proceeds are held in escrow and recorded as revenue when the license transfers are approved. Revenue recognized from auctions through the end of the fiscal year totaled $4.0 million with another $8.5 million of unearned revenue held in escrow as of June 30, 2017.
- Removal of restrictions limiting Fine Wine & Good Spirits store hours of operation on Sundays and holidays.

Other financial highlights include:

- Fiscal year 2016-17 sales grew $74.9 million or 3.9 percent over the prior year. PLCB fiscal year 2016-17 net income of $104.9 million was $1.0 million, or 1.0 percent, higher than the prior year, reflecting higher sales and license fees offset by lower gross margin and higher operating expenses.

PLCB Management's Discussion and Analysis (Continued)

- License fees grew by $17.9 million, or 139.0 percent, due to statutory increases to license fees (surcharges) and new revenue from the auction of expired and lapsed restaurant licenses.

- Operating transfers to the General Fund totaled $216.7 million. Other contributions to the General Fund during fiscal year 2016-17 generated by the PLCB's operations, but not reflected as revenues, expenses, or cash flows in the State Stores Fund financial statements, included $361.9 million in liquor tax and $142.0 million in state sales tax, an overall 4.2 percent increase. In addition, the PLCB remitted $9.1 million in local sales taxes to Philadelphia and Allegheny County.

- Net cash flow of $184.9 million from operating activities, which was up $13.1 million from the prior year after covering all PLCB operating expenses (including implementation costs related to the 2016 liquor reforms), PLCB funding of Pennsylvania State Police liquor control enforcement efforts, and transfers to the Department of Drug and Alcohol Programs.

- Year-end cash and investments decreased by $66.0 million to $229.4 million, due to legislatively mandated transfers to the General Fund that exceeded operating cash flow.

- Total liabilities increased by $58.0 million to $964.5 million, reflecting primarily the PLCB's share of the Commonwealth's increasing net pension liability and other post-employment benefits.

- The PLCB's total net deficit position increased to $388.6 million from $277.4 million the prior fiscal year due to the increased transfer of cash to the General Fund and to higher employee benefit obligations.

Revenues and Costs

Sales

Sales and tax revenue in fiscal year 2016-17 totaled $2.53 billion, an increase of $95.5 million, or 3.9 percent, over fiscal year 2015-16. Excluding liquor and sales taxes, net sales of $2.01 billion were up $74.9 million, also 3.9 percent over the prior year. Unit volume growth accounted for all the sales increase, while expanded sales at a discount to the new wine expanded permit licensees substantially offset vendor price increases. Total wine sales growth, including sales to holders of wine expanded permits, was 5.0 percent, while spirit sales grew 2.9 percent.

PLCB Management's Discussion and Analysis (Continued)

Operating Income & Expense

Operating income for the fiscal year ending June 30, 2017, was $130.9 million, up $1.7 million, or 1.3 percent, from the $129.2 million reported the prior year. The increase is attributable to increases in license fees of $17.9 million and gross profit of $16.3 million, substantially offset by a $30.3 million increase in operating expenses and a $2.1 million reduction in miscellaneous income and enforcement fines. License fee increases resulting from the 2016 legislative changes include the following, along with other less significant fee changes:

- $9.5 million as a result of increased licensee renewal fees (surcharges);
- $4.0 million in revenue realized by fiscal year end from the auction of expired restaurant licenses; and
- $1.3 million in fees generated from the conversion of eating place licenses, which allow for the sale of malt and brewed beverages but not wine or liquor, to restaurant licenses, which allow for the sale of beer, wine and liquor.

Operating expenses for the fiscal year ended June 30, 2017 increased $30.3 million or 6.2 percent. Within operating expenses, salary and wages increased by $7.5 million, or 4.4 percent, due to Commonwealth negotiated rate increases and higher overtime associated with expanded Sunday and holiday sales hours. Employee benefits expense increased by $16.0 million, or 9.4 percent, primarily driven by increases in pension expense of $10.3 million and worker's compensation expense of $4.3 million. Non-payroll related expenses grew by $6.9 million, or 4.5 percent.

Transfers Out

The Bureau of Liquor Control Enforcement within the Pennsylvania State Police received $28.1 million in funding in fiscal year 2016-17, an increase of $2.0 million, or 7.7 percent, over the previous year. Contributions to the Department of Drug and Alcohol Programs decreased to $2.5 million from $3.3 million the prior year. Legislation in 2015-16 increased the annual transfer to the Department of Drug and Alcohol Programs to $2.5 million and contained a retroactive increase for 2014-15 of $0.8 million.

The PLCB transferred $216.7 million to the General Fund during fiscal year 2016-17, a $116.7 million increase over the $100.0 million transfer the prior year.

Licensing fees returned to local municipalities from the Liquor License Fund totaled $4.5 million for fiscal year 2016-17, compared to $4.6 million in the prior year.

PENNSYLVANIA LIQUOR CONTROL BOARD

FINANCIAL STATEMENTS

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

ASSETS	June 30, 2017	June 30, 2016
Current assets:		
Cash	$ 40,011	$ 19,963
Temporary investments	189,403	275,395
Accounts and claims receivable, net	2,107	1,481
Due from other funds	30	87
Merchandise inventories	254,917	244,159
Operating supplies	359	492
Prepaid expenses	3,083	-
Total current assets	$ 489,910	$ 541,577
Noncurrent assets:		
Non-depreciable capital assets:		
Land	323	323
Depreciable capital assets:		
Building	19,816	19,558
Leasehold improvements	583	758
Machinery and equipment	47,112	51,585
Intangibles	29,508	20,559
Less: accumulated depreciation	(61,236)	(53,565)
Net depreciable capital assets	$ 35,783	$ 38,895
Total noncurrent capital assets	$ 36,106	$ 39,218
Total assets	$ 526,016	$ 580,795
Total deferred outflows of resources – Note C	$ 105,862	$ 93,191
LIABILITIES		
Current liabilities:		
Trade accounts payable	$ 269,949	$ 256,513
Miscellaneous accounts payable	19,279	13,003
Accrued expenses	11,806	20,322
Self-insurance – Note L	6,740	7,772
Due to other funds – Note E	8,553	8,688
Due to fiduciary funds	1,906	1,602
Due to other governments	484	481
Total current liabilities	$ 318,717	$ 308,381
Noncurrent liabilities:		
OPEB – Note C	107,216	90,178
Self-Insurance – Note L	42,257	39,287
Net pension liability – Note C	477,444	449,175
Compensated absences	18,905	19,507
Total noncurrent liabilities	$ 645,822	$ 598,147
Total liabilities	$ 964,539	$ 906,528

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

	June 30, 2017	June 30, 2016
Total deferred inflows of resources – Note C	$ 19,818	$ 5,636
NET POSITION		
Net investment in capital assets	$ 36,106	$ 39,218
Restricted for:		
State Stores Fund (deficit)	(388,585)	(277,396)
Total net position	$ (352,479)	$ (238,178)

- 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, 2017	Fiscal Year Ended June 30, 2016
Sales net of taxes	$2,012,789	$1,937,885
Cost of goods sold	(1,390,882)	(1,332,286)
Gross profit from sales	$ 621,907	$ 605,599
Operating (expenses):		
Retail operations	(400,020)	(375,905)
Marketing and merchandising	(14,792)	(12,550)
Supply chain	(10,419)	(8,237)
Wholesale operations	(1,194)	-
Information technology services	(33,086)	(32,521)
Regulatory affairs	(22,280)	(20,516)
Administration	(14,430)	(13,234)
Finance	(3,717)	(5,393)
Board and secretary	(6,145)	(5,050)
Legal	(3,067)	(3,359)
Commonwealth-provided services	(13,437)	(15,532)
Total	$ (522,587)	$ (492,297)
Operating profit	$ 99,320	$ 113,302
Other operating revenues (expenses):		
Enforcement fines	1,353	1,892
License fees	30,813	12,884
Miscellaneous income	2,020	3,611
Administrative law judge	(2,623)	(2,491)
Total	$ 31,563	$ 15,896
Total operating income	$ 130,883	$ 129,198
Nonoperating revenues (expenses):		
Interest income	2,225	893
Other	(106)	(143)
Total	$ 2,119	$ 750
Income before operating transfers	$ 133,002	$ 129,948
Operating transfers in/(out):		
PSP enforcement – Note I	(28,107)	(26,091)
Income after enforcement/before other transfers	$ 104,895	$ 103,857
Other operating transfers:		
Transfers out:		
General Fund – Note G	(216,696)	(100,000)
Drug and alcohol programs – Note H	(2,500)	(3,328)
Total	$ (219,196)	$ (103,328)
Change in net position	$ (114,301)	$ 529
Net position – beginning	$ (238,178)	$ (238,707)
Total net position – ending	$ (352,479)	$ (238,178)

- 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, 2017	Fiscal Year Ended June 30, 2016
Cash flows from operating activities:		
Receipts from customers	$ 2,046,406	$ 1,956,037
Payments to suppliers	(1,861,485)	(1,784,218)
Net cash provided by (used for) operating activities	$ 184,921	$ 171,819
Cash flows from noncapital financing activities:		
Operating transfers out	(245,856)	(127,763)
Net cash used for noncapital financing activities	$ (245,856)	$ (127,763)
Cash flows from capital and related financing activities:		
Acquisition and construction of capital assets	(7,267)	(11,503)
Proceeds from capital assets	32	-
Net cash used for capital and related financing activities	$ (7,235)	$ (11,503)
Cash flows from investing activities:		
Purchase of investments	(1,549,743)	(1,613,172)
Proceeds from sale and maturities of investments	1,635,736	1,579,479
Investment income	2,225	893
Net cash used in investing activities	$ 88,218	$ (32,800)
Net decrease in cash	$ 20,048	$ (247)
Cash – beginning of year	19,963	20,210
Cash – end of year	$ 40,011	$ 19,963
Reconciliation of operating income (loss) to net cash provided by (used for) operating activities:		
Operating income	$ 130,883	$ 129,198
Depreciation	10,239	9,170
Change in assets and liabilities:		
Accounts receivable	(626)	(176)
Inventory	(10,624)	(14,356)
Due from other funds	57	(59)
Other operating net assets	(3,083)	3,766
Deferred outflows – pension related	(12,670)	(62,153)
Accounts payable and accrued liabilities	11,196	7,679
Due to other funds	(1,581)	(658)
Due to pension trust funds	304	224
Net pension liability	28,268	86,491
Due to other government	3	(14)
Deferred inflows – pension related	14,182	2,634
Other post-employment benefit obligations	17,038	13,525
Self-insurance liabilities	1,937	(2,867)
Compensated absences	(602)	(585)
Total adjustments	$ 54,038	$ 42,621
Net cash provided by (used for) operating activities	$ 184,921	$ 171,819

- 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)

ASSETS	**June 30, 2017**	**June 30, 2016**
Current assets:		
Cash in transit	$ 86	$ 92
Investments – short term	2,390	2,327
Total assets	$ 2,476	$ 2,419

LIABILITIES		
Current liabilities:		
License fees due to municipalities	$ 2,476	$ 2,417
Other liabilities	-	2
Total liabilities	$ 2,476	$ 2,419

- 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, 2017
(EXPRESSED IN THOUSANDS)

	Balance June 30, 2016	Additions	Deductions	Balance June 30, 2017
ASSETS				
Cash	$ 92	$ 8,995	$ 9,001	$ 86
Temporary investments	2,327	4,486	4,423	2,390
Total assets	$ 2,419	$ 13,481	$ 13,424	$ 2,476
LIABILITIES				
Due to municipalities	$ 2,417	$ 4,574	$ 4,515	$ 2,476
Other liabilities	2	-	2	-
Total liabilities	$ 2,419	$ 4,574	$ 4,517	$ 2,476

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

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

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

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

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

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

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

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.

NOTE A – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Inventories: Inventories are stated at weighted average cost. The PLCB has 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 PLCB stores. The bailment inventory management program significantly reduces on hand inventory valuation. Product warehousing and handling, as well as transportation to store costs, are reported as part of merchandise inventories and are charged to cost of goods sold as product is sold.

The allowance for obsolete inventory was $193 thousand at June 30, 2017 and $233 thousand at June 30, 2016. Management will regularly review, at least once annually, inventory quantities on hand and increase/decrease the provision for obsolete inventory as necessary based upon factors that include historical unsalable product write-off, the age of the inventory and forecasts of product demand.

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

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

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

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

NOTE A – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Taxes: An 18 percent state liquor excise tax and a 6 percent state sales tax are collected and remitted monthly to the Department of Revenue for the General Fund. The PLCB also collects and remits a 1 percent local sales tax for Allegheny County and a 2 percent local sales tax for Philadelphia County. Taxes collected for the years ended June 30, 2017, and June 30, 2016 are as follows (amounts in thousands):

	Fiscal Year Ended June 30, 2017	Fiscal Year Ended June 30, 2016
Liquor Tax	$361,856	$348,056
State Sales Tax	142,005	135,581
Local Sales Tax	9,060	8,688
Total	$512,921	$492,325

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 5.39 to 11.55 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

NOTE A – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

The accumulated annual and sick leave and related payroll benefits payable reported for the fiscal year ended June 30, 2017 and June 30, 2016 (amounts in thousands) was $24,552 ($5,647 current and $18,905 non-current) and $24,384 ($4,877 current and $19,507 non-current), respectively. It is the PLCB's policy to record the cost of annual and sick leave in accordance with GASB Statement 16. The expense and corresponding liability are reflected in the financial statements.

The following summary provides aggregated information reported for the fiscal years ended June 30, 2017 and June 30, 2016 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, 2017	$24,384	$17,455	$17,287	$24,552
June 30, 2016	$25,115	$16,533	$17,264	$24,384

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

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

New Accounting Pronouncements: The PLCB will adopt GASB Statement No. 75, Accounting and Financial Reporting for Postemployment Benefits Other Than Pensions (GASB 75), for the fiscal year beginning July 1, 2017. Many of the provisions of GASB 75 are parallel to the provisions of GASB 68 for pensions. Pension accounting and financial reporting were overhauled with GASB 68, and the changes made for OPEB mostly follow the same guidelines.

NOTE A – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

The GASB 75 OPEB expense is designed to recognize in the current period income statement certain changes to the Net OPEB Liability (NOL). Changes to the NOL not fully recognized in a given years' OPEB expense will be tracked as deferred inflows and outflows, and recognized incrementally in the OPEB expense over time.

The cumulative effect of applying GASB 75 will be reported as a restatement of beginning net position as of July 1, 2017, in the PLCB financial statements for the FYE June 30, 2018, due to a change in accounting principle.

NOTE B – DEPOSITS AND INVESTMENTS

The Treasury Department has the authority to manage, invest, and reinvest the moneys of all funds which are not legally authorized to be invested by a board, commission or State officer. The Treasury Department manages and invests moneys of the Commonwealth through the Commonwealth Investment Program (CIP). The PLCB participates in the CIP's Pool 999 investment pool. Pool 999 is designed to provide a high degree of liquidity and safety. Pool 999 is organized similarly to a money market fund, with an expectation of a stable net asset value per share. Treasury accounts for each participating fund's equity, or shares, in the pool on a daily basis. Share balances of participating funds vary considerably during the fiscal year, based on the timing of cash receipts and disbursements. PLCB has reported the fair value of its shares as of June 30, 2017 and 2016, 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 40). GASB 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, 2017 Basic Financial Statements.

PLCB's total deposit balance (amounts in thousands) of $40,098 and $20,055 at June 30, 2017 and 2016, 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 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, 2017 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, the SERS administers a cost-sharing multiple-employer defined benefit retirement plan. The plan, covering substantially all Commonwealth employees, is a contributory defined benefit pension plan as established by Commonwealth laws. Membership in SERS is mandatory for most PLCB (and other state) employees. Article II of the Commonwealth's constitution assigns the authority to establish and amend the benefit provision of the plan to the General Assembly.

SERS issues stand-alone, audited financial statements which are publicly available at www.sers.pa.gov. 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 AND OTHER POSTEMPLOYMENT BENEFITS (Continued)

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 due. However, Act 2010-120 imposes rate increase collars (limits on annual rate increases) on employer contributions. The collar for Commonwealth fiscal year 2015/2016 was 4.5%, and will no longer apply effective July 1, 2017. The PLCB's contributions to the SERS were (amounts in thousands) $45,199 and $37,688 for the years ended June 30, 2017 and 2016, 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, 2017, PLCB reported a liability of $477,444 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, 2016, and the

NOTE C – PENSION AND OTHER POSTEMPLOYMENT BENEFITS (Continued)

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, 2016, PLCB's reported proportionate share of the SERS net pension liability was 2.48 percent which was an increase of .01 percent from its proportion measured as of December 31, 2015.

As of June 30, 2017, PLCB recognized pension expense of $74,979 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……………………..	$ 6,893	$ 10,683
Change in assumptions..	29,163	-
Differences between projected and actual investment earnings…………...	40,124	-
Change in proportion……………………………………………………	6,597	8,508
Differences between employer contributions and proportionate share….....	917	627
Contributions subsequent to measurement date……………………………	22,168	-
Total	$ 105,862	$ 19,818

The $22,168 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, 2018. 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)**
2017	$ 21,342
2018	21,342
2019	18,531
2020	2,423
2021	236

NOTE C – PENSION AND OTHER POSTEMPLOYMENT BENEFITS (Continued)

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

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

In addition to the five-year experience study, SERS reviews its investment return assumption in light of economic conditions every year as part of its annual valuation. Based on this work, SERS actuary recommended, and SERS Board adopted at the April 2017 meeting, a reduction in the targeted investment return rate assumption to 7.25 percent for the 2016 actuarial valuation from 7.5 percent used for the 2015 actuarial valuation based on the experience study. In addition, SERS actuary recommended, and SERS Board adopted, a reduction in the inflation rate to 2.6 percent for the 2016 valuation from 2.75 percent used for the 2015 actuarial valuation based on the experience study. The change in inflation rate also impacted the general salary growth rate, which was lowered to 2.9 percent for the 2016 valuation from 3.05 percent used for the 2015 valuation based on the experience study.

The following methods and assumptions were used in the actuarial valuation for the December 31, 2016, 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	7.25% net of expenses including inflation

NOTE C – PENSION AND OTHER POSTEMPLOYMENT BENEFITS (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	Long-term Expected Rate of Return
Alternative Investments	16.00%	8.00%
Global Public Equity	43.00%	5.30%
Real Assets	12.00%	5.44%
Hedge Funds	12.00%	4.75%
Fixed Income	14.00%	1.63%
Cash	3.00%	-0.25%
Total	100.00%	

Discount Rate: The SERS discount rate used to measure the total pension liability was 7.25 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.

NOTE C – PENSION AND OTHER POSTEMPLOYMENT BENEFITS (Continued)

Sensitivity of the PLCB's proportionate share of the net pension liability to change in the discount rate: The following chart presents the PLCB's proportionate share of the SERS net pension liability using the discount rate of 7.25 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 (6.25 percent) or 1 percentage point higher (8.25 percent) than the current rate.

	1% Decrease 6.25%	Current Discount Rate 7.25%	1% Increase 8.25%
		(in thousands)	
PLCB's proportionate share of SERS net pension liability as of the 12/31/16 measurement date	$590,859	$477,443	$380,320

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, 2017, the PLCB reported an accounts payable for the employers' share of retirement contributions to the SERS in the amount of $1.2M.

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.

NOTE C – PENSION AND OTHER POSTEMPLOYMENT BENEFITS (Continued)

REHP contribution requirements are established by the Office of Administration and the Governor's Budget Office. During the fiscal year ended June 30, 2017, the PLCB contributed $362 for each active employee paid and reported as part of biweekly payroll expenses for its employees. For the fiscal year ended June 30, 2017, the PLCB's allocated share of the total REHP Annual OPEB Cost of $1,107,290 thousand (for the Commonwealth's fiscal year ended June 30, 2017) was $44,182 thousand. The last year that was fully funded for the entire REHP Annual OPEB Cost, for all REHP-participating organizations, was for the fiscal year ended June 30, 2008. The unfunded OPEB liability has been recorded for subsequent fiscal years. The prior year unfunded liability of $90,178 thousand, plus an additional increase of $17,038 thousand, resulted in a total unfunded liability of $107,216 thousand as of June 30, 2017.

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

NOTE D – CAPITAL ASSETS

Changes in capital assets for the fiscal year ended June 30, 2017 are as follows (amounts in thousands):

Fiscal year ended June 30, 2017:

	Balance June 30, 2016	Additions	Retirements	Balance June 30, 2017
Non-depreciable capital assets:				
Land…………………………..	$ 323	$ -	$ -	$ 323
Depreciable capital assets:				
Building………………………..	19,558	258	-	19,816
Leasehold improvements……...	758	123	298	583
Machinery and equipment….…	51,585	(3,380)	1,093	47,112
Intangibles ……………………	20,559	10,266	1,317	29,508
Total capital assets…………….	$ 92,783	$ 7,267	$ 2,708	$ 97,342

Negative amounts in the above additions column result from reclasses between Machinery and Equipment and Intangibles and do not impact the overall totals.

NOTE D – CAPITAL ASSETS (Continued)

Changes in capital assets accumulated depreciation for the fiscal year ended June 30, 2017 are as follows (amounts in thousands):

	Balance June 30, 2016	Additions	Retirements	Balance June 30, 2017
Buildings……………………	$ 13,311	$ 789	$ -	$ 14,100
Leasehold improvements…...	612	60	298	374
Machinery and equipment….	26,278	4,774	(399)	31,451
Intangibles…………………..	13,364	4,616	2,669	15,311
Total accumulated depreciation	$ 53,565	$ 10,239	$ 2,568	$ 61,236

Negative amounts in the above retirements column result from reclasses between Machinery and Equipment and Intangibles and do not impact the overall totals.

Fiscal year ended June 30, 2016:

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

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

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

NOTE E – DUE TO OTHER FUNDS

At June 30, 2017 and June 30, 2016, a total (amounts in thousands) of $8,553 and $8,688 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.

Rental expenses (amounts in thousands), for the fiscal year ended June 30, 2017 and June 30, 2016 were $51,342 and $47,297, respectively.

The following is a schedule of future minimum rental commitments for noncancelable operating leases in effect as of June 30, 2017, (amounts in thousands):

Fiscal Year Ended June	Fine Wine and Good Spirits Store Leases
2018	$45,978
2019	39,104
2020	32,124
2021	26,242
2022	11,675
Total Minimum Lease Payments:	$155,123

NOTE G – OPERATING TRANSFERS TO GENERAL FUND

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

NOTE G – OPERATING TRANSFERS TO GENERAL FUND (Continued)

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

The required transfers were $216.7 million and $100 million for the fiscal years ended June 30, 2017 and June 30, 2016, respectively.

NOTE H – OPERATING TRANSFER FOR DRUG AND ALCOHOL PROGRAMS

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

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

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

The amount of the liabilities (amounts in thousands) established to the DDAP were $2,500 and $3,328 for the fiscal years ended June 30, 2017 and June 30, 2016, respectively.

NOTE I – OPERATING TRANSFER FOR LIQUOR CONTROL ENFORCEMENT

The PLCB provides the funding for the Pennsylvania State Police, Bureau of Liquor Control Enforcement, which is responsible for enforcing the laws and regulations governing the trafficking of alcoholic beverages throughout the Commonwealth. The transfers (amounts in thousands) were $28,107 and $26,091 for the fiscal years ended June 30, 2017 and June 30, 2016, 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 $1 billion per occurrence. There was no reduction in commercial insurance coverage during the fiscal year ended June 30, 2017. No settlements exceeded commercial insurance coverage during each of the past three fiscal years. The Commonwealth has established various administrative policies, which are intended to avoid or limit the aforementioned risks.

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

NOTE L – SELF-INSURANCE LIABILITIES (Continued)

At June 30, 2017 and June 30, 2016, respectively, the State Stores Fund reported a $48,997 thousand liability ($6,740 thousand as current and $42,257 thousand as non-current) and $47,059 thousand liability ($7,772 thousand as current and $39,287 thousand as non-current) for employee disability claims.

The following summary provides aggregated information for the fiscal years ended June 30, 2017 and June 30, 2016 of the reported self-insurance liabilities to include the incurred claims and payments during the fiscal years then ended (amounts in thousands):

Fiscal Year End	Liability – Beginning Balance	Incurred Claims	Payments	Liability – Ending Balance
June 30, 2017	$47,059	$7,658	$5,720	$48,997
June 30, 2016	$49,926	$2,477	$5,344	$47,059

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

Last Ten Fiscal Years Ended June 30 [(1)]

	2017	2016	2015
Contractually required contribution [(2)]	$ 40,348	$ 33,752	$ 27,044
Contributions in relation to the contractually required contribution	$ 40,348	$ 33,752	$ 27,044
Contribution deficiency (excess)	-	-	-
PLCB's covered-employee payroll	$162,310	$166,701	$162,037
Contributions as a percentage of covered-employee payroll	24.86%	20.25%	16.69%

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

(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.

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

Last Ten Fiscal Years Ended June 30 [1]

	2017	2016 [2]	2015
PLCB's proportion of the net pension liability	2.48%	2.47%	2.44%
PLCB's proportionate share of the net pension liability	$477,444	$ 449,176	$ 362,685
PLCB's covered-employee payroll	$162,310	$ 166,701	$ 162,037
PLCB's proportionate share of the net pension liability as a percentage of its covered-employee payroll	294.16%	269.45%	223.83%
Plan fiduciary net position as a percentage of the total pension liability	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 two years are presented in the above schedules. The amounts presented for each fiscal year were determined as of December 31.

(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 an increase to the net pension liability.

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EUGENE A. DEPASQUALE
AUDITOR GENERAL

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

Independent Auditor's Report

The Honorable Tom Wolf Governor Commonwealth of Pennsylvania Harrisburg, PA 17120	The Honorable Tim Holden Chairman Pennsylvania Liquor Control Board Harrisburg, PA 17124

We have audited, in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States, the accompanying Statements of Net Position, Statements of Revenues, Expenses and Changes in Net Position, and Statements of Cash Flows for the State Stores Fund, and the Statements of Fiduciary Net Position and Statements of Changes in Fiduciary Net Position for the Liquor License Fund of the Pennsylvania Liquor Control Board (PLCB) as of and for the years ended June 30, 2017 and 2016, and the related notes to the financial statements and have issued our report thereon dated December 8, 2017.

Internal Control Over Financial Reporting

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

A *deficiency in internal control* exists when the design or operation of a control does not allow management or employees in the normal course of performing their assigned functions, to prevent, or detect and correct, misstatements on a timely basis. A *material weakness* is a deficiency, or combination of deficiencies, in internal control such that there is a reasonable possibility that a material misstatement of the PLCB's financial statements will not be prevented, or detected and corrected on a timely basis. A *significant deficiency* is a deficiency, or a combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance.

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

Compliance and Other Matters

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

Purpose of This Report

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

Eugene A. DePasquale

December 8, 2017

Eugene A. DePasquale
Auditor General

Observation – Vendor Management Controls at PLCB Need Improvement

PLCB's policies and procedures do not establish formal requirements for consistently monitoring vendor activities and reporting. Also, procedures are not formalized to ensure any necessary corrective action occurs to remediate/mitigate vendor control deficiencies. Specifically, we noted the following:

- System and Organization Control (SOC) reports required by contracts were not consistently obtained for applicable vendor services.
- SOC reports were provided with untimely periods of coverage not coinciding with the audit period, making them unusable to the financial auditors and not useful to PLCB.
- SOC reports with noted exceptions were not provided to PLCB to facilitate timely follow-up of control deficiencies.
- Complimentary user entity controls in SOC reports were not available to PLCB and/or were not reviewed to ensure that appropriate controls were in place and operating effectively at PLCB.

Recommendation

We recommend PLCB management evaluate and update its vendor management policies and procedures. The evaluation and update should include, at a minimum:

- Monitoring and enforcing vendors' compliance with contract requirements;
- Ensuring that service organizations supporting PLCB processes are operating with effective controls and within PLCB expectations;
- Requiring SOC reports to be timely, and include six months of the audit period at a minimum, for effective monitoring and appropriate audit coverage;
- Reviewing SOC reports for qualified opinions and control objective exceptions, performing effective follow-up, and ensuring corrective actions are implemented when required;
- Reviewing SOC report complimentary user entity controls to ensure those controls are in place and operating effectively at PLCB and/or applicable sub-service organizations.

COMMONWEALTH OF PENNSYLVANIA
PENNSYLVANIA LIQUOR CONTROL BOARD
JUNE 30, 2017
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This report was initially distributed to the following:

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