

FINANCIAL AUDIT
OF THE

MICHIGAN LIQUOR CONTROL COMMISSION

DEPARTMENT OF CONSUMER AND INDUSTRY SERVICES

October 1, 1997 through September 30, 1999

EXECUTIVE DIGEST

MICHIGAN LIQUOR CONTROL COMMISSION

INTRODUCTION

This report contains the results of our financial audit* of the Michigan Liquor Control Commission (MLCC), Department of Consumer and Industry Services, for the period October 1, 1997 through September 30, 1999.

AUDIT PURPOSE

This financial audit was conducted as part of the constitutional responsibility of the Office of the Auditor General. Financial audits are conducted at various intervals to permit the Auditor General to express an opinion on the State's financial statements.

BACKGROUND

MLCC is governed by Sections 436.1101 - 436.2303 of the *Michigan Compiled Laws* (Act 58, P.A. 1998, the Michigan Liquor Control Code of 1998). MLCC consists of five members, each appointed for a term of four years by the Governor with the advice and consent of the Senate. The responsibilities of MLCC include the oversight of alcoholic liquor distribution within the State; licensing of the manufacture, importation, and sale of liquor; levy and collection of excise and specific taxes on liquor, beer, and wine; and enforcement of the Michigan Liquor Control Code. MLCC is organizationally located within the Department of Consumer and Industry Services.

* See glossary at end of report for definition.

During fiscal year 1996-97, MLCC privatized the liquor inventory warehousing and distribution function, which required extensive revision to the process by which liquor products were ordered, purchased, stored, and delivered to the retailers.

As of September 30, 1999, MLCC had 167 employees. During fiscal year 1998-1999, MLCC issued 28,789 retail liquor licenses and 5,194 manufacturer/wholesaler licenses. The Liquor Purchase Revolving Fund's total revenue for the fiscal year was approximately \$147.6 million and total expenses and operating transfers were approximately \$44.8 million.

AUDIT OBJECTIVES,
CONCLUSIONS, AND
NOTEWORTHY
ACCOMPLISHMENTS

Audit Objective: To assess and report on MLCC's compliance with certain provisions of laws, regulations, contracts, and grants, noncompliance with which could have a direct and material effect on the financial statements, and on its internal control* over financial reporting, based on our audit of the financial statements.

Conclusion: Our assessment of compliance did not disclose any instances of noncompliance that could have a direct and material effect on the financial statements. Also, our assessment of internal control over financial reporting did not disclose any material weaknesses*. However, we noted a reportable condition* regarding mail opening and cash receipts (Finding 1).

Noteworthy Accomplishments: MLCC reported that during December 1999 it implemented a voluntary electronic funds transfer (EFT) program for licensees to pay for liquor purchases. This removes the collection responsibility from the authorized distribution agent (ADA).

* See glossary at end of report for definition.

As of April 4, 2000, 214 licensees had enrolled in the EFT program. We subsequently were informed by MLCC that EFT program participation had increased to 359 licensees as of May 22, 2000.

MLCC also reported that it designed and implemented a new inventory control process in the fall of 1999. This process ensures that State-owned inventory reserved for pending sales is adjusted weekly to a calculated amount necessary to meet sale orders for a two-day level. This process allows the State to minimize its investment in inventory waiting for delivery to licensees.

MLCC further reported that it made significant improvements in its system of accounting for liquor wholesale operations. MLCC staff completely rewrote the system to be compatible with the entry of information into the State's Michigan Administrative Information Network (MAIN) before the end of each month. Effective October 1999, MLCC's information technology system processes sales data from source transactions submitted within two days of delivery of the liquor to the licensee by the ADAs. Sales data is reconciled to the information reported by the ADAs to ensure its accuracy and is then entered into MAIN.

Audit Objective: To audit the Liquor Purchase Revolving Fund financial statements as of and for the fiscal years ended September 30, 1999 and September 30, 1998.

Conclusion: We expressed an unqualified opinion* on the Liquor Purchase Revolving Fund financial statements.

* See glossary at end of report for definition.

AUDIT SCOPE

Our audit scope was to examine the financial and other records of the Michigan Liquor Control Commission for the period October 1, 1997 through September 30, 1999. Our audit was conducted in accordance with generally accepted auditing standards and *Government Auditing Standards* issued by the Comptroller General of the United States and, accordingly, included such tests of the records and such other auditing procedures as we considered necessary in the circumstances.

**AGENCY RESPONSES
AND PRIOR AUDIT
FOLLOW-UP**

Our audit report includes 1 finding and 3 corresponding recommendations. The agency preliminary response indicated that MLCC agreed with all 3 recommendations.

MLCC had complied with all 11 of the prior audit recommendations.

September 5, 2000

Mr. Walter Keck, Acting Chairperson
Michigan Liquor Control Commission
7150 Harris Drive
Lansing, Michigan
and
Ms. Kathleen M. Wilbur, Director
Department of Consumer and Industry Services
G. Mennen Williams Building
Lansing, Michigan

Dear Mr. Keck and Ms. Wilbur:

This is our report on the financial audit of the Michigan Liquor Control Commission, Department of Consumer and Industry Services, for the period October 1, 1997 through September 30, 1999.

This report contains our executive digest; description of agency; audit objectives, audit scope, and agency responses and prior audit follow-up; comments, finding, recommendations, and agency preliminary response; and independent auditor's reports on compliance and on internal control over financial reporting and on the financial statements.

This report also contains the Liquor Purchase Revolving Fund financial statements and notes to the financial statements; the Michigan Liquor Control Commission's schedule of governmental funds revenue and operating transfers, presented as supplemental information; and a glossary of acronyms and terms.

Our comments, finding, and recommendations are organized by audit objective. The agency preliminary response was taken from the agency's response subsequent to our audit fieldwork. The *Michigan Compiled Laws* and administrative procedures require that the audited agency develop a formal response within 60 days after release of the audit report.

We appreciate the courtesy and cooperation extended to us during this audit.

AUDITOR GENERAL

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Description of Agency

The Michigan Liquor Control Commission (MLCC) is governed by Sections 436.1101 - 436.2303 of the *Michigan Compiled Laws* (Act 58, P.A. 1998, the Michigan Liquor Control Code of 1998). MLCC was originally established by Act 8, P.A. 1933, as amended (Sections 436.1 - 436.58 of the *Michigan Compiled Laws*). The Michigan Liquor Control Code of 1998, which became effective on April 14, 1998, essentially reorganized the older statutes in a more comprehensible and accessible form.

MLCC consists of five members, each appointed for a term of four years by the Governor with the advice and consent of the Senate. The responsibilities of MLCC include the oversight of alcoholic liquor distribution within the State; licensing of the manufacture, importation, and sale of liquor; levy and collection of excise and specific taxes on liquor, beer, and wine; and enforcement of the Michigan Liquor Control Code. MLCC is organizationally located within the Department of Consumer and Industry Services.

MLCC has primary responsibility for the Liquor Purchase Revolving Fund, which accounts for the purchase, distribution, and sale of alcoholic liquor. The net income from alcoholic liquor sales is transferred to the State's General Fund in accordance with Section 18.1435 of the *Michigan Compiled Laws*. MLCC licensing and enforcement activities are accounted for both in the Liquor Purchase Revolving Fund and in the General Fund.

During fiscal year 1996-97, MLCC privatized the liquor inventory warehousing and distribution function, which required extensive revision to the process by which liquor products were ordered, purchased, stored, and delivered to the retailers. MLCC closed all 63 wholesale State liquor stores and its 3 liquor warehouses. Under the privatization provisions of the Michigan Liquor Control Code, suppliers of liquor are required to have a contract or written agreement with authorized distribution agents (ADAs) for the transport, storage, and delivery of liquor products to retail licensees. After going through an MLCC certification process, MLCC must appoint the ADAs before they are permitted to provide services in Michigan. In addition to the services provided for the suppliers of liquor, ADAs also take licensees' orders for liquor products.

As of September 30, 1999, MLCC had 167 employees. During fiscal year 1998-99, MLCC issued 28,789 retail liquor licenses and 5,194 manufacturer/wholesaler licenses. The Liquor Purchase Revolving Fund's total revenue for the fiscal year was approximately \$147.6 million and total expenses and operating transfers were approximately \$44.8 million.

Audit Objectives, Audit Scope, and Agency Responses and Prior Audit Follow-Up

Audit Objectives

Our financial audit of the Michigan Liquor Control Commission (MLCC), Department of Consumer and Industry Services, had the following objectives:

1. To assess and report on MLCC's compliance with certain provisions of laws, regulations, contracts, and grants, noncompliance with which could have a direct and material effect on the financial statements, and on its internal control over financial reporting, based on our audit of the financial statements.
2. To audit the Liquor Purchase Revolving Fund financial statements as of and for the fiscal years ended September 30, 1999 and September 30, 1998.

Audit Scope

Our audit scope was to examine the financial and other records of the Michigan Liquor Control Commission for the period October 1, 1997 through September 30, 1999. Our audit was conducted in accordance with generally accepted auditing standards and *Government Auditing Standards* issued by the Comptroller General of the United States and, accordingly, included such tests of the records and such other auditing procedures as we considered necessary in the circumstances.

Agency Responses and Prior Audit Follow-Up

Our audit report includes 1 finding and 3 corresponding recommendations. The agency preliminary response indicated that MLCC agreed with all 3 recommendations.

The agency preliminary response which follows the recommendations in our report was taken from the agency's written comments and oral discussion subsequent to our audit fieldwork. Section 18.1462 of the *Michigan Compiled Laws* and Department of Management and Budget Administrative Guide procedure 1280.02 require the Department of Consumer and Industry Services to develop a formal response to our audit finding and recommendations within 60 days after release of the audit report.

MLCC had complied with all 11 of the prior audit recommendations.

COMMENTS, FINDING, RECOMMENDATIONS, AND AGENCY PRELIMINARY RESPONSE

COMPLIANCE AND INTERNAL CONTROL OVER FINANCIAL REPORTING

COMMENT

Audit Objective: To assess and report on the Michigan Liquor Control Commission's (MLCC's) compliance with certain provisions of laws, regulations, contracts, and grants, noncompliance with which could have a direct and material effect on the financial statements, and on its internal control over financial reporting, based on our audit of the financial statements.

Conclusion: Our assessment of compliance did not disclose any instances of noncompliance that could have a direct and material effect on the financial statements. Also, our assessment of internal control over financial reporting did not disclose any material weaknesses. However, we noted a reportable condition regarding mail opening and cash receipts.

Noteworthy Accomplishments: MLCC reported that during December 1999 it implemented a voluntary electronic funds transfer (EFT) program for licensees to pay for liquor purchases. This removes the collection responsibility from the authorized distribution agent (ADA). As of April 4, 2000, 214 licensees had enrolled in the EFT program. We subsequently were informed by MLCC that EFT program participation had increased to 359 licensees as of May 22, 2000.

MLCC also reported that it designed and implemented a new inventory control process in the fall of 1999. This process ensures that State-owned inventory reserved for pending sales is adjusted weekly to a calculated amount necessary to meet sale orders for a two-day level. This process allows the State to minimize its investment in inventory waiting for delivery to licensees.

MLCC further reported that it made significant improvements in its system of accounting for liquor wholesale operations. MLCC staff completely rewrote the system to be

compatible with the entry of information into the State's Michigan Administrative Information Network (MAIN) before the end of each month. Effective October 1999, MLCC's information technology system processes sales data from source transactions submitted within two days of delivery of the liquor to the licensee by the ADAs. Sales data is reconciled to the information reported by the ADAs to ensure its accuracy and is then entered into MAIN.

FINDING

1. Mail Opening and Cash Receipts

MLCC did not maintain proper internal control over mail opening and the processing of cash receipts. Control weaknesses increase the risk that cash receipts could be lost or misused.

During fiscal years 1998-99 and 1997-98, MLCC's cashier's office received approximately \$66.4 million and \$64.6 million, respectively. MLCC's mailroom opened and processed approximately 95% of these receipts. Our review of MLCC's mail opening and processing of cash receipts disclosed:

- a. MLCC did not always ensure that two employees opened the mail under controlled conditions.

MLCC's normal procedures require two employees to open the mail. However, when one of the two mailroom employees is absent or when a large volume of mail is received during a license renewal period, mail is opened by a single employee. When this happens, the unopened mail may be taken to an employee's desk in an unsecured area outside the mailroom and the employee opens the mail alone.

Department of Management and Budget (DMB) Administrative Guide procedure 1270.02 provides that two persons should open mail under controlled conditions.

- b. MLCC did not ensure that mailroom staff recorded all cash receipts on a cash receipts log.

Checks received to replace previous not sufficient funds (NSF) checks are given directly to cashier staff without being recorded on mailroom logs. Also, if the number of remittances was small (5 or fewer) and under \$1,000, these checks were given directly to the cashier without first being recorded on mailroom logs.

DMB Administrative Guide procedure 1270.02 provides for the inclusion of all mailroom receipts on a cash receipts log.

- c. MLCC did not require mailroom staff to restrictively endorse all checks immediately upon receipt.

Checks are restrictively endorsed by cashier unit staff when they receive the checks from the mailroom rather than by MLCC staff responsible for opening the mail.

DMB Administrative Guide procedure 1270.02 provides that all checks and money orders be restrictively endorsed immediately upon receipt.

Taking receipts from the mail room before they are opened, recorded, and restrictively endorsed weakens the accountability for these funds. DMB Administrative Guide procedure 1270.02 requires an agency to develop procedures that provide alternate controls if the agency determines that it is impractical to comply with any of the control features mentioned in the procedure. Justification for these alternate controls and internal operating procedures must be submitted to and approved by DMB prior to implementation. MLCC had not requested approval to develop alternate controls.

RECOMMENDATIONS

We recommend that MLCC maintain proper internal control over mail opening and the processing of cash receipts by:

- (a) Ensuring that two employees open the mail under controlled conditions.
- (b) Ensuring that mailroom staff record all cash receipts on a cash receipts log.

- (c) Requiring mailroom staff to restrictively endorse all checks immediately upon receipt.

AGENCY PRELIMINARY RESPONSE

MLCC agreed with these recommendations. MLCC informed us that the mailroom function has been transferred to the Department of Consumer and Industry Services mailroom since the audit.

FINANCIAL ACCOUNTING AND REPORTING

COMMENT

Audit Objective: To audit the Liquor Purchase Revolving Fund financial statements as of and for the fiscal years ended September 30, 1999 and September 30, 1998.

Conclusion: We expressed an unqualified opinion on the Liquor Purchasing Revolving Fund financial statements.

Independent Auditor's Report on Compliance and
on Internal Control Over Financial Reporting

April 5, 2000

Michigan Liquor Control Commission Members
7150 Harris Drive
Lansing, Michigan
and
Ms. Kathleen M. Wilbur, Director
Department of Consumer and Industry Services
G. Mennen Williams Building
Lansing, Michigan

Dear Commission Members and Ms. Wilbur:

We have audited the financial statements of the Liquor Purchase Revolving Fund, Michigan Liquor Control Commission, Department of Consumer and Industry Services, as of and for the fiscal years ended September 30, 1999 and September 30, 1998 and have issued our report thereon dated April 5, 2000. We conducted our audit in accordance with generally accepted auditing standards and the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States.

Compliance

As part of obtaining reasonable assurance about whether the Michigan Liquor Control Commission's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grants, 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 instances of noncompliance that are required to be reported under *Government Auditing Standards* and which are described in Finding 1.

Internal Control Over Financial Reporting

In planning and performing our audit, we considered the Michigan Liquor Control Commission's internal control over financial reporting in order to determine our auditing procedures for the purpose of expressing our opinion on the financial statements and not to provide assurance on the internal control over financial reporting. Our consideration of the internal control over financial reporting would not necessarily disclose all matters in the internal control over financial reporting that might be material weaknesses. A material weakness is a condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements in amounts that would be material in relation to the financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. We noted no matters involving the internal control over financial reporting and its operation that we consider to be material weaknesses.

This report is intended solely for the information and use of the Michigan Liquor Control Commission, the State's management, and the Legislature and is not intended to be and should not be used by anyone other than these specified parties. However, this report is a matter of public record and its distribution is not limited.

AUDITOR GENERAL

Independent Auditor's Report on
the Financial Statements

April 5, 2000

Michigan Liquor Control Commission Members
7150 Harris Drive
Lansing, Michigan
and
Ms. Kathleen M. Wilbur, Director
Department of Consumer and Industry Services
G. Mennen Williams Building
Lansing, Michigan

Dear Commission Members and Ms. Wilbur:

We have audited the accompanying balance sheet of the Liquor Purchase Revolving Fund, Michigan Liquor Control Commission, Department of Consumer and Industry Services, as of September 30, 1999 and September 30, 1998 and the related statement of revenues, expenses, and changes in retained earnings and statement of cash flows for the fiscal years then ended. These financial statements are the responsibility of the Michigan Liquor Control Commission's management and the Department's management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with generally accepted auditing standards 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 includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

As described in Note 1b, the accompanying financial statements present only the Liquor Purchase Revolving Fund and are not intended to present fairly the financial position and results of operations and cash flows of the State of Michigan or its enterprise funds.

In our opinion, the financial statements referred to in the first paragraph present fairly, in all material respects, the financial position of the Liquor Purchase Revolving Fund as of September 30, 1999 and September 30, 1998 and the results of its operations and cash flows for the fiscal years then ended in conformity with generally accepted accounting principles.

In accordance with *Government Auditing Standards*, we have also issued a report dated April 5, 2000 on our tests of the Michigan Liquor Control Commission's compliance with certain provisions of laws, regulations, contracts, and grants and on our consideration of its internal control over financial reporting.

The accompanying supplemental financial schedule, the schedule of governmental funds revenue and operating transfers, is presented for purposes of additional analysis and is not a required part of the Liquor Purchase Revolving Fund's financial statements referred to in the first paragraph. Such information has been subjected to the auditing procedures applied in the audit of the financial statements and, in our opinion, is fairly stated, in all material respects, in relation to the financial statements taken as a whole.

AUDITOR GENERAL

LIQUOR PURCHASE REVOLVING FUND
Michigan Liquor Control Commission
Department of Consumer and Industry Services
Balance Sheet
As of September 30

	<u>1999</u>	<u>1998</u>
ASSETS		
Current Assets:		
Cash	\$ 4,383,376	\$ 1,636,502
Equity in State Treasurer's Common Cash	49,276,051	52,504,340
Accounts receivable	685,468	990,393
Inventory of liquor (Note 3)	6,757,526	5,065,192
Prepaid distribution costs	466,510	348,750
Other assets	89,399	91,019
Total Current Assets	<u>\$ 61,658,330</u>	<u>\$ 60,636,196</u>
Fixed Assets (Note 2):		
Land	\$ 98,030	\$ 98,030
Buildings	2,415,111	2,415,111
Total Fixed Assets	<u>\$ 2,513,141</u>	<u>\$ 2,513,141</u>
Less: Accumulated depreciation	1,787,838	1,712,464
Net Fixed Assets	<u>\$ 725,303</u>	<u>\$ 800,677</u>
Total Assets	<u>\$ 62,383,633</u>	<u>\$ 61,436,873</u>
LIABILITIES AND FUND EQUITY		
Current Liabilities:		
Accounts payable	\$ 47,076,847	\$ 41,366,753
Warrants outstanding	5,759,094	5,478,460
Deferred revenue	5,468	489,273
Compensated absences (Note 7)	605,971	873,315
Amounts due to other funds	52,035	53,333
Total Current Liabilities	<u>\$ 53,499,415</u>	<u>\$ 48,261,134</u>
Long-Term Liabilities:		
Compensated absences (Note 7)	2,208,479	0
Total Liabilities	<u>\$ 55,707,894</u>	<u>\$ 48,261,134</u>
Fund Equity:		
Retained earnings (Note 9)	6,675,739	13,175,739
Total Liabilities and Fund Equity	<u>\$ 62,383,633</u>	<u>\$ 61,436,873</u>

The accompanying notes are an integral part of the financial statements.

LIQUOR PURCHASE REVOLVING FUND
Michigan Liquor Control Commission
Department of Consumer and Industry Services
Statement of Revenues, Expenses, and Changes in Retained Earnings
For the Fiscal Years Ended September 30

	<u>1999</u>	<u>1998</u>
TOTAL GROSS SALES	\$ 638,028,367	\$ 602,747,343
Less: discounts allowed	<u>108,479,961</u>	<u>102,936,890</u>
PROCEEDS - SALE OF LIQUOR	\$ 529,548,406	\$ 499,810,453
Less: Cost of liquor sold		
Beginning inventory	\$ 5,065,192	\$ 12,128,540
Add: Purchases	387,862,769	360,304,029
Less: Ending inventory	<u>(6,757,526)</u>	<u>(5,065,192)</u>
Cost of liquor sold	\$ 386,170,435	\$ 367,367,377
GROSS REVENUE FROM SALE OF LIQUOR	\$ 143,377,971	\$ 132,443,076
Add: Gain on sale of equipment	\$	\$ 10,856
Rent, miscellaneous, and Michigan Administrative Information Network refund	316,384	44,400
Nonoperating revenue	40,888	207,889
Interest revenue (Note 6)	<u>3,823,779</u>	<u>2,420,765</u>
Total Other Revenue	\$ 4,181,051	\$ 2,683,910
TOTAL REVENUE	\$ 147,559,022	\$ 135,126,986
EXPENSES AND TRANSFERS		
MLCC Expenses:		
Commission	\$ 320,008	\$ 304,095
Management support	2,550,535	2,609,031
Licensing and enforcement (Liquor Purchase Revolving Fund portion only)	4,706,273	4,169,868
Distribution cost paid to suppliers (Note 8)	28,293,517	26,701,460
Compensated absences (Note 7)	1,941,136	(911,926)
Depreciation of fixed assets	75,373	75,373
Loss on disposal of assets		62,841
Total MLCC Expenses	\$ 37,886,842	\$ 33,010,742
Other Agencies' Expenses:		
Department of Attorney General	\$ 774,600	\$ 656,797
Office of the Auditor General	79,300	78,200
Department of Civil Service - Personnel	68,540	205,547
CIS - Data processing services	3,330,763	3,419,200
CIS - Rent (MLCC rent only)	669,026	433,102
CIS - Executive direction	466,326	728,194
CIS - Administrative offices	<u>1,565,843</u>	<u>2,198,887</u>
Total Other Agencies' Expenses	\$ 6,954,398	\$ 7,719,927
Excluding Transfers Not Related to MLCC		
TOTAL EXPENSES AND TRANSFERS	\$ 44,841,240	\$ 40,730,669
NET INCOME (not including taxes and grants)	\$ 102,717,782	\$ 94,396,317
Add: Specific tax, liquor 1.85%	<u>9,303,861</u>	<u>8,846,111</u>
NET REVENUE (before unrelated expenses)	\$ 112,021,643	\$ 103,242,428
CIS - Transfers for grants not related to MLCC	<u>6,675,000</u>	<u>6,535,000</u>
NET INCOME	\$ 105,346,643	\$ 96,707,428
Transfers to General Fund - Cash (Note 9)	<u>111,846,643</u>	<u>96,707,428</u>
Changes in Retained Earnings (Note 9)	\$ (6,500,000)	\$
Retained Earnings - Beginning	13,175,739	13,175,739
RETAINED EARNINGS - ENDING	\$ 6,675,739	\$ 13,175,739

The accompanying notes are an integral part of the financial statements.

LIQUOR PURCHASE REVOLVING FUND
Michigan Liquor Control Commission
Department of Consumer and Industry Services
Statement of Cash Flows
For the Fiscal Years Ended September 30

CASH FLOWS FROM OPERATING ACTIVITIES	1999	1998
Net Income (Loss)	\$ 102,717,782	\$ 94,396,317
Add: Department of Attorney General	774,600	656,797
Office of the Auditor General	79,300	78,200
Department of Civil Service - Personnel	68,540	205,547
Loss on write-off of assets		62,841
Less: Interest revenue	(3,823,779)	(2,420,765)
Nonoperating revenue	(40,888)	(207,889)
Gain on sale of equipment		(10,856)
	\$ 99,775,555	\$ 92,760,192
Operating Income (Loss)		
Adjustments to reconcile operating income with net cash provided by (used in) operating activities:		
Depreciation	75,373	75,373
Nonoperating revenue	40,888	207,889
Changes in assets and liabilities:		
Inventories	(1,692,334)	7,063,348
Amounts due from other funds		1,448,222
Other assets	306,545	(844,143)
Prepaid distribution costs of inventory	(117,760)	(348,750)
Accounts payable and other liabilities	7,651,230	3,434,747
Amounts due to other funds	(1,298)	(1,031,275)
Deferred revenue	(483,804)	472,482
Net cash provided (used) by operating activities	\$ 105,554,394	\$ 103,238,085
CASH FLOWS FROM NONCAPITAL FINANCING ACTIVITIES		
Specific tax on spirits	\$ 9,303,861	\$ 8,846,111
Prior year retained earnings transferred to General Fund	(6,500,000)	
Operating transfers out to other funds	(112,944,083)	(104,182,972)
Net cash provided (used) by noncapital financing activities	\$ (110,140,222)	\$ (95,336,861)
CASH FLOWS FROM CAPITAL AND RELATED FINANCING ACTIVITIES		
Net cash provided (used) by capital and related financing activities	\$ 0	\$ 10,856
CASH FLOWS FROM INVESTING ACTIVITIES		
Interest revenue	\$ 3,823,779	\$ 2,420,765
Net cash provided by investing activities	\$ 3,823,779	\$ 2,420,765
Net cash provided (used) - all activities	\$ (762,049)	\$ 10,332,845
Cash and cash equivalents at beginning of year	48,662,382	38,329,537
Cash and cash equivalents at end of year	\$ 47,900,333	\$ 48,662,382
RECONCILIATION OF CASH AND CASH EQUIVALENTS		
Per Balance Sheet Calculations:		
Cash	\$ 4,383,376	\$ 1,636,502
Equity in Common Cash	49,276,051	52,504,340
Warrants outstanding	(5,759,094)	(5,478,460)
Cash and cash equivalents at end of year	\$ 47,900,333	\$ 48,662,382

The accompanying notes are an integral part of the financial statements.

Notes to the Financial Statements

Note 1 Significant Accounting Policies

a. Reporting Entity

The accompanying financial statements report the financial position and results of operations and cash flows of the Liquor Purchase Revolving Fund, Michigan Liquor Control Commission (MLCC), Department of Consumer and Industry Services, as of and for the fiscal years ended September 30, 1999 and September 30, 1998. This Fund is a part of the State of Michigan's reporting entity and is reported as an enterprise fund in the *State of Michigan Comprehensive Annual Financial Report (SOMCAFR)*.

The notes accompanying these financial statements relate directly to the Liquor Purchase Revolving Fund. The *SOMCAFR* provides more extensive general disclosures regarding the State's Summary of Significant Accounting Policies, Budgeting and Budgetary Control, Treasurer's Common Cash, and Pension Benefits and Other Postemployment Benefits.

b. Basis of Accounting and Presentation

The financial statements contained in this report are prepared on the accrual basis of accounting. The accrual basis of accounting, which emphasizes the measurement of total financial position and results of operations, is explained in more detail in the *SOMCAFR*.

The accompanying financial statements present only the Liquor Purchase Revolving Fund. Accordingly, they are not intended to present fairly the financial position and results of operations and cash flows of the State of Michigan or its enterprise funds.

MLCC reclassified certain expenses for presentation purposes to improve reader understanding of the statement. This is in addition to the restatement described in Note 8. Therefore, the presentation in this report

for the statement of revenues, expenses, and changes in retained earnings for the fiscal year ended September 30, 1998 differs from that presented in MLCC's Annual Financial Report for the fiscal year ended September 30, 1998. There is no effect on net income or retained earnings for the fiscal year.

Note 2 Fixed Assets and Depreciation

MLCC owns one warehouse, including the land, located at 2251 Dix Highway, Lincoln Park. The Lincoln Park warehouse was vacated in November 1998 and is anticipated to be sold during fiscal year 1999-2000.

Note 3 Inventory

Inventory is stored and handled by private authorized distribution agents on behalf of MLCC. Inventory is purchased daily in amounts sufficient to fill orders received the prior day. The inventory is valued at the latest quoted price, which equates approximately to cost. This method of inventory valuation is not in accordance with generally accepted accounting principles. However, it did not materially affect reported inventory valuation.

Note 4 Retirement Contributions

The Liquor Purchase Revolving Fund contributed a total of approximately \$733,533 and \$646,997 to two employee retirement plans for fiscal years 1998-99 and 1997-98, respectively. New employees hired after March 30, 1997 participate in a defined contribution plan that is separate from the State Employees' Retirement System defined benefits plan. Employees hired before March 31, 1997 are covered by the defined benefits plan unless they chose to convert to the defined contribution plan during 1997.

Note 5 Budgeting and Budgetary Control

The Legislature, through the annual appropriations acts, establishes a budget for all Liquor Purchase Revolving Fund expense categories, except for liquor purchased for resale and depreciation.

Note 6 Interest Revenue

For investment purposes, Liquor Purchase Revolving Fund cash is kept in the State Treasurer's Common Cash Fund. The Liquor Purchase Revolving Fund

began receiving credit for the interest earned on its cash balances deposited with the State Treasurer effective April 14, 1998.

Note 7 Compensated Absences

Compensated absences liabilities are computed annually by the Department of Management and Budget to recognize the future liability for employees' current leave balances. The calculation uses an average of the current year and the prior year annual and sick leave payoffs to determine the current portion of the compensated absences liability. The current liability then is subtracted from the total liability to determine the long-term portion of the liability.

The computed current compensated absences liability for fiscal year 1997-98 was more than the total compensated absences liability. This was the result of a large decrease in the number of employees during fiscal year 1996-97 because of early retirements and privatization of the liquor distribution system. Therefore, the net total compensated absences liability was considered to be a current liability, with nothing reported as a long-term liability for fiscal year 1997-98.

To record the current expenses related to changes in the compensated absences liability, entries are made to increase or decrease the current and long-term compensated absences liabilities to their present calculated levels. These entries result in the recording of a compensated absences expense for the current fiscal year in the amount of the liability increase. A liability decrease results in a negative expense.

Note 8 Distribution Cost Paid to Suppliers

The distribution cost paid to suppliers is \$5.42 per case paid directly to the liquor suppliers by MLCC for the warehousing and delivery of spirits to retail licensees. Suppliers were required to add \$1.08 per case to the State's payment and pay at least \$6.50 per case to the authorized distribution agents for providing this service.

The financial statement presentation of the distribution cost paid to suppliers was restated from MLCC's Annual Financial Report for the fiscal year ended

September 30, 1998. In the fiscal year 1997-98 report, it was included in the cost of goods sold. In fiscal year 1998-99, it is an MLCC general expense.

Note 9 Transfer of Net Income and Excess Retained Earnings

Section 18.1435 of the *Michigan Compiled Laws* provides that the Liquor Purchase Revolving Fund transfer all net income to the State's General Fund at the end of each fiscal year. For fiscal year 1998-99, an additional \$6,500,000 of retained earnings was transferred at the request of the State budget director.

SUPPLEMENTAL INFORMATION

UNAUDITED

MICHIGAN LIQUOR CONTROL COMMISSION
 Department of Consumer and Industry Services
 Schedule of Governmental Funds Revenue and Operating Transfers
For the Fiscal Years Ended September 30

	1999	1998
GENERAL FUND		
General Purpose Revenue:		
Beer excise tax	\$ 40,516,177	\$ 43,127,914
Liquor specific tax	25,434,147	23,917,089
Wine excise tax	7,294,427	7,178,378
Mixed spirit excise tax	703,249	689,497
Penalties imposed by MLCC	1,719,369	1,694,536
Miscellaneous	37,255	31,293
Total General Purpose Revenue	\$ 75,704,624	\$ 76,638,707
Restricted Revenue:		
Liquor specific tax for tourism and convention facility promotion	\$ 25,460,802	\$ 24,575,050
Retail License Fees:		
55% to local governments	5,286,991	5,249,741
41.5% to licensing and enforcement	3,988,519	3,959,608
3.5% to alcoholism prevention programs	336,383	334,077
Sunday sales license fees	1,244,845	1,220,988
Liquor license transfer fees	661,245	681,070
License fees for Grape and Wine Industry Council	550,935	408,280
Inspection fees	302,629	297,460
Liquor Control Act	7,425	6,900
Miscellaneous	43,375	45,541
Total Restricted Revenue	\$ 37,883,150	\$ 36,778,715
Total General Fund Revenue	\$ 113,587,773	\$ 113,417,422
Operating Transfers:		
Department of Civil Service assessment	\$ 68,540	\$ 205,547
Department of Attorney General assessment	774,600	656,797
Office of the Auditor General assessment	79,300	78,200
Department of Consumer and Industry Services	12,706,958	13,314,383
Net Income to General Fund	105,346,643	96,707,428
Retained Earnings to General Fund	6,500,000	
Total Operating Transfers	\$ 125,476,041	\$ 110,962,355
Total General Fund Revenue and Operating Transfers	\$ 239,063,814	\$ 224,379,777
SCHOOL AID FUND		
Liquor specific tax	\$ 25,434,147	\$ 23,917,089
Sales tax on liquor	9,698	9,115
Total School Aid Fund Revenue	\$ 25,443,845	\$ 23,926,204

Glossary of Acronyms and Terms

ADA	authorized distribution agent.
CIS	Department of Consumer and Industry Services.
DMB	Department of Management and Budget.
EFT	electronic funds transfer.
financial audit	An audit that is designed to provide reasonable assurance about whether the financial statements of an audited entity are fairly presented in conformity with generally accepted accounting principles.
internal control	A process, effected by an entity's management and other personnel, designed to provide reasonable assurance regarding the achievement of objectives in the following categories: (a) reliability of financial reporting, (b) effectiveness and efficiency of operations, and (c) compliance with applicable laws and regulations.
MAIN	Michigan Administrative Information Network.
material weakness	A condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements in amounts that would be material in relation to the financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions.
MLCC	Michigan Liquor Control Commission.

reportable condition A matter coming to the auditor's attention relating to a significant deficiency in the design or operation of internal control that, in the auditor's judgment, could adversely affect the Liquor Purchase Revolving Fund's ability to record, process, summarize, and report financial data consistent with the assertions of management in the financial statements.

SOMCAFR *State of Michigan Comprehensive Annual Financial Report.*

unqualified opinion An auditor's opinion in which the auditor states, without reservation, that the financial statements are fairly presented in conformity with generally accepted accounting principles.