

Alcoholic Beverage Control Authority Enactment Clause 14

The Alcoholic Beverage Control Authority (the "Authority") has developed a summary table and a brief narrative as a response to Enactment Clause 14 for the Alcoholic Beverage Control Authority legislation.

Enactment Clause 14 of the legislation requires:

That by October 15 each year, the Alcoholic Beverage Control Authority or its successor shall, for the purposes of identifying the total costs of the operation and administration of the Department or its successors to be funded from the revenues generated by such entity, submit to the General Assembly a report detailing the total percentage of gross revenues required for the operation and administration of the Department, excluding expenditures made for the purchase of distilled spirits, for the prior fiscal year, and a relative comparison to the three prior fiscal years.

	In Millions				As a Percentage of Sales			
	FY2018	FY2017	FY2016	FY2015	FY2018	FY2017	FY2016	FY2015
Sales	983.3	940.1	897.6	848.1	100.0%	100.0%	100.0%	100.0%
- Excise Tax	161.0	154.6	147.9	139.9	16.4%	16.4%	16.5%	16.5%
+ Other Revenue	22.3	22.0	22.0	21.9	2.3%	2.3%	2.5%	2.6%
Net Revenue	844.6	807.5	771.8	730.0	85.9%	85.9%	86.0%	86.1%
Cost of Goods Sold	473.7	452.0	432.8	411.7	48.2%	48.1%	48.2%	48.5%
Operation Costs	130.3	123.1	116.5	110.7	13.3%	13.1%	13.0%	13.1%
Administrative Costs	44.9	43.8	40.4	38.7	4.6%	4.7%	4.5%	4.6%
Regulatory Costs	16.5	16.9	17.3	17.9	1.7%	1.8%	1.9%	2.1%
Profit	179.2	171.7	164.8	151.1	18.2%	18.3%	18.4%	17.8%

Note: All support costs (e.g. Human Resources, Information Technology, Finance, etc.) for Regulatory and Operations are included in the Administrative Costs category.

Note: The Authority's total operation cost excludes the year-end VRS pension liability adjusting entries, the new GASB 75 liability adjusting entries for other postemployment benefit (OPEB), and the federal grant entries because they are non-operational costs. However, these costs were included in the year-end financials.

The Authority has opted to include a more detailed chart than what is required by the legislation. This will permit the General Assembly to be familiar with the magnitude of our business and have the percentage of revenue data that was requested. Inclusion of the cost of goods sold (i.e.: purchase of distilled spirits, Lottery and Virginia is for Lovers (VIFL) Merchandise) data allows the General Assembly to see the full picture of the Authority's operations and a high level Statement of Revenues, Expenses, and Changes in Net Position (Profit and Loss).

There are four major categories of ABC costs: Cost of Goods Sold, Operation Costs, Administrative Costs, and Regulatory Costs. The Cost of Goods Sold is simply the cost that the Authority incurs to purchase the distilled spirits, Lottery tickets, VIFL merchandise that are sold in the ABC stores. The Operation Costs includes the costs to operate the Authority's stores (Personnel cost, store rentals, utilities, etc.), the costs to operate the Authority's Distribution Center (Warehouse), and the overhead costs of the leadership and support functions that are directly linked to either the store operations or the Distribution Center. The Administrative Costs

are the most diverse cost group as it includes all of the administrative functions that are necessary to support the business. These include Information Technology, Internal Audit, Procurement, Policy & Planning, Education, Marketing, Human Resources, Financial Management, Public Relations, Property Management, the Authority's Leadership, and charges for services from other state agencies. The Regulatory Costs category represents the costs to operate the Authority's Enforcement division and the Hearings & Appeals function. Enforcement operates under a separate appropriation than the rest of the Authority; however, the Enforcement division remains a part of the overall costs that affects the Authority's profits. In addition, there are approximately 2,000 new licensees each year that require a full investigation to include a background check of the owners, corporate structure review, complete financial review, and making a determination about the suitability of the applicant to possess an ABC license in Virginia.

Cost of Goods Sold increases are primarily driven by sales volume. In fiscal year 2018, the Cost of Goods Sold represents 48.2% of the sales revenue collected. This percentage is consistent with previous years.

Operation Costs, Administrative Costs, and Regulatory Costs are all primarily driven by personnel needs (salary, healthcare, retirement, etc.). In addition, Operation Costs include new stores, store rentals (with rent escalation clauses), utilities, and freight to transport product from the warehouse to the stores.

Administrative Costs increases are primarily driven by the cost of Information Technology, new store construction costs, an aging central office & warehouse facility (repairs), and the increased focus on Marketing and Communications over the past few years (to communicate information about the Authority and its products). These costs are all tied back to either revenue generating activities or activities that support continued operation of the business.

In the Administrative Costs category, information technology retains a great deal of importance. As the Authority continues to migrate from VITA to third party vendors where beneficial based on either cost of service levels, Administrative cost related to VITA is slowly decreasing and Non-VITA cost is gradually increasing. The authority is also undertaking various projects such as providing licensees with the ability to pay taxes online via ACH, replacement of the aging systems with the new financial and licensing system. Even though there are increases in cost related to the migration and the implementation of these systems, the Authority expects VITA costs to continue to decrease which would create a net neutral effect on the P&L. However, the authority will continue to see significant cost decreases once the migration and the implementation of these systems are completed and operational.

Regulatory Costs are also expected to increase due to the additional regulatory activities the increase in licensing funds will support. Costs will also be driven by the growth in the number of retail licensees and the consistent increase in manufacturing. However, in the short term, with the high vacancy rate within the enforcement division, increases in regulatory cost will be offset by the current vacancies until additional non-sworn personnel are hired to support regulatory activities.