UNIVERSITY BOOKSTORE INVENTORY PROCEDURES AND CONTROLS

November 29, 2017

Office of Internal Audit and Compliance

Report No. 136-18

DATE: November 29, 2017

TO: Ray Presnell, Springfield Bookstore Director

FROM: Donna Christian, Director of Internal Audit and Compliance
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CC: Dr. Dee Siscoe, Vice President of Student Affairs
Rachael Dockery, General Counsel
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UNIVERSITY BOOKSTORE INVENTORY PROCEDURES AND CONTROLS

BACKGROUND

On May 26, 2017, Internal Audit reviewed the annual physical inventory count at the Missouri State Bookstore. The physical inventory on this date was reconciled to the inventory balances recorded in the Bookstore's point of sale system and the University's accounting system at the fiscal year end of June 30, 2017 for the University's financial statements. The Bookstore's inventory balance during the last five years is as follows:

FYE June 30	Sales (Retail)	Inventory (Costs)
2017	$14,648,897	$6,340,006
2016	$15,767,532	$6,190,350
2015	$15,279,233	$3,948,774
2014	$15,571,547	$4,007,757
2013	$15,776,401	$4,735,104

Again, similar to FY16, the inventory balance was considerably higher than previous years because the new textbooks for fall had been received prior to June 30, 2017

Effective November 14, 2016 the Bookstore replaced their point of sale (POS) system (BookLog) with a new system (Ratex). Internal Audit also performed test counts on the transfer of inventory balances from the old POS system to Ratex to provide assurances of an accurate transition.

The Bookstore continues to be a fiscally successful operation. It has not only been able to contribute to the direct needs of the students, faculty and staff, but it also financially contributes to the University's operating fund through budget transfers.

OBJECTIVE AND SCOPE

The objective was to review inventory procedures, test the accuracy of the annual physical inventory count of the Missouri State Bookstore, and review Bookstore operations to ensure business plans and policies are in place to maximize revenue. The scope of the audit included, but was not limited to the fiscal year ended June 30, 2017.

SUMMARY

A detailed analysis of the Bookstore's Ratex Point of Sale system inventory value and the inventory value recorded in the University's Banner system was completed for June 30, 2017. The Ratex system balance of $6,340,006 was $129,981 (wholesale cost) higher than the amount recorded in Banner. Similar to last year, this is the inverse of the typical year-end inventory comparison and did not allow any evaluation of shrinkage.

Included in this report are recommendations addressing the need for:

- Improved physical inventory procedures
- Written procedures to better manage and minimize losses of obsolete textbooks
- Written procedures to dispose of obsolete merchandise
- A business plan focusing on textbook sales and the profitability of affiliate stores
- Significant improvement in system controls
- Consultation with the University's General Counsel regarding the POS system contract

Sincerely,

Donna Christian

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Audit Fieldwork Completed: September 22, 2017

OBSERVATIONS, RECOMMENDATIONS AND MANAGEMENT RESPONSES

1. PHYSICAL INVENTORY COUNT AND SHRINKAGE

Internal Audit observed and tested the annual physical inventory at the Bookstore. The Bookstore inventory value at June 30, 2017 totaled **$6,340,006**.

Department		Value (Cost)
New Textbooks	$	4,273,887
Used Textbooks		900,936
Total Textbooks		5,174,823
Accessories & Furnishings		58,583
Campus Living		3,994
Clinique		52,048
Clothing		389,517
Electronics		303,546
Food		51,973
Gifts		130,794
Graduation		54,052
Greek		20,444
Souvenirs		16,699
School and Art Supplies		68,293
Tradebooks		15,240
Grand Total	$	**6,340,006**

A physical inventory count was performed on May 26, 2017. The physical inventory value was compared with the values in the Bookstore's Point of Sale (POS) system, Ratex. We selected 206 items (21% of the inventory cost value) for verification and noted the following:

- One side of a clothing rack was overlooked during the initial count. Another clothing item was in two locations, but only one location was counted. Adjustments were made to the physical inventory values totaling almost $3,000 to correct these errors.

- Some clothing was sold to the Athletic Department prior to closing the books, but the clothing was not pulled from the racks until after the inventory was frozen in the POS system. An adjustment was made to the physical inventory count totaling approximately $1,400 to correct this error.

- A University department purchased and picked up fifteen Apple IMACs costing $38,310 prior to the physical inventory verification on May 26, 2017. However, the sale was not recorded and the University department's budget was not charged until July 17, 2017, over 45 days after pick up and even into the next fiscal year. No merchandise should leave the Bookstore without properly recording the sale. An adjustment was made to correct this error.

- Dead or obsolete textbooks were not adjusted out of the Banner inventory at actual costs upon disposition. At the suggestion of Ratex, the deadbooks were recorded in the POS system as a return and the cost of the book was manually adjusted to agree with the sale price. Consequently, Banner was overstated and an adjustment totaling $134,863 was made to correct the Banner inventory balance.

After all known errors were corrected, the inventory balance was reconciled to the University's general ledger inventory balances in Banner for financial statement presentation at June 30, 2017. We found that the inventory balance in Ratex was slightly higher than the inventory value in Banner by $129,981. Overall, this difference is inverse of the typical inventory reconciliation; however, the difference was not material (only 2% of the total inventory at cost or 1.2% at retail).

This was the Bookstore's first year-end inventory reconciliation using their new POS system. The system calculates cost as a percentage of retail pricing rather than tracking the actual cost of the inventory items. Considering the POS system has only been active for 7 months, some of the cost percentages used by the system may become more accurate over time resulting in a more typical inventory reconciliation. Management should continue to monitor inventory balances through monthly reconciliations and regular monitoring of departmental inventory balances.

Recommendation

Continue to perform periodic reconciliations of inventory costs to monitor any differences between the Ratex system balances and the University's Banner accounting system. Additionally, at the time of the next physical inventory, ensure all items are accurately scanned, and all sales are recorded prior to items leaving the Bookstore.

Management Response

We evaluate and look to improve our annual inventory processes including scanning all areas, validating and correcting discrepancies. Reports generated by Ratex aid us in accurate inventory counts and verifications. We will continue performing reconciliations that monitor Ratex and Banner. Tighter controls will be used to ensure all payment for department merchandise has been verified before leaving the store through the shipping and receiving area.

2. OBSOLETE INVENTORY

A. Textbook inventory management procedures for dead or obsolete textbooks continues to be extremely important in bookstore management. Our two prior audit reports have addressed the need to properly monitor dead books to ensure the Bookstore receives the most value for the books and losses are minimal. There are three main options for unsold textbooks: 1) return textbooks to the vendor for a full credit/refund if within time restraints, 2) sell textbooks to wholesale book buyers for a discounted amount 3) sell textbooks through a Monsoon account (eBay).

As previously reported in fiscal year 2015, dead or obsolete textbooks costing $287,895 were sold to wholesale book buyers for $145,059, for a loss of $142,836. In fiscal year 2016, dead or obsolete textbooks costing $308,218 were sold to wholesale book buyers for $124,710, for a loss of $183,508.

With the implementation of the new point-of-sale system in fiscal year 2017, dead and obsolete textbooks were not routinely identified and sold. During fiscal year 2017 textbooks costing $160,007 were sold to wholesale book buyers for $71,152 for a loss of $88,854. However, on October 26, 2017, the Bookstore had dead or obsolete textbooks costing approximately $369,000 on hand that needed to be sold. Timeliness of processing these textbooks is essential in order to reduce the loss of this obsolete inventory.

Considering the large value of dead or obsolete textbook inventory on hand, inventory management procedures should be put in writing to help guide bookstore personnel in routinely managing this inventory, and ensuring the bookstore successfully minimizes their losses in this area.

B. Annually a five-day tent sale is held where obsolete clothing, gift and souvenir items, and some electronics, are sold at a progressive discount. After the sale, some of the items are returned to the store shelves and some are stored until the next tent sale. Approximately $80,000 of this merchandise was received prior to 7/1/2014 and needs to be written off and disposed of. Examples include a 2005 Apple Production Suite software (retail $499), iPod from 2006 (retail $149-$269) and various iPhone 4/4s covers (retail $18-$65). Management should develop written procedures on how to select and discard obsolete merchandise.

Recommendations

A. We again recommend that Bookstore personnel continually analyze textbook inventory based on the semester of adoption and ensure dead or obsolete textbooks are identified and sold on a timely basis to receive the most value. Also, written procedures should be established prescribing the process used to best minimize the amount of loss.

B. Written procedures should be established prescribing how to select and discard obsolete merchandise.

Management Response

We continually look for new ways to liquidate outdated books using various vendors. To take care of immediate needs, we have disposed of various outdated inventory. We will look at better ways to liquidate obsolete inventory. We will develop written procedures that direct us to selecting and discarding obsolete merchandise.

3. SALES AND PROFITABILITY

Textbook Sales

The Bookstore has experienced a decline in textbook sales recently. For the year ending June 30, 2017, textbook sales have declined by almost $600,000 when compared to the year ending June 30, 2016. Additionally, for the first three months of fiscal year 2018, textbook sales have declined $700,000 compared to this same three-month period last year. The decline appears to be continuing at an accelerated rate. With textbook sales accounting for over 65% of the total Bookstore sales, the continuing decrease is a significant concern.

There may be several possible reasons that have contributed to this decline. For instance, some classes are using digital or online materials to reduce the costs of textbooks for students. Also, the bookstore discontinued their textbook reservation program after installing their new POS system that does not support a reservation program. We also noted a decrease in direct marketing efforts to students. For example, the bookstore previously received daily reports of students' enrollment and sent a congratulatory email directing them on how to order their textbooks from the bookstore. The bookstore no longer sends these emails to students upon enrollment.

With campus bookstores nationwide seeing a reduction in textbook sales, the main mission of the bookstores is being challenged. Currently, a University committee is working to reduce student textbook costs by moving to online materials. While management should continue to actively monitor textbook sales and aggressively market textbooks directly to students, management should also be considering a plan designed to reshape the Bookstore's business model given the move away from the textbook market. In order to remain current and profitable, redefining the Bookstore's revenue model is essential.

Affiliate Store Profits

The Bookstore has seven affiliate store locations on campus: Maroon Nation, Bear Necessities, 1905, PawPrints, BearStop, Boomers Convenience, and BearWear Team Store.

Prior audit reports have noted that some of these locations are not profitable and recommendations were made to establish an improved business plan for these locations. Our review of monthly profit and loss statements for these affiliate stores continues to show poor performance by several stores. The store Paw Prints showed times during the summer months where sales revenue was so low that management should have consider temporarily closing the store during these months. For example, monthly sales at Paw Prints for May and June 2017 were less than $1,000 for each month. Net losses during these two months totaled over $4,500. In total for fiscal year 2017, PawPrints had sales of approximately $59,000, with a net loss of approximately ($17,500). Two other affiliate stores also posted net losses for fiscal year 2017, Maroon Nation ($3,302) and 1905 ($9,438).

To eliminate or reduce future losses, bookstore management should establish an improved business plan for the affiliate stores showing poor performance. When affiliate stores such as Paw Prints, show months with very little sales activity, consideration should be given to temporarily closing the store during the summer months when most students and faculty are away from campus.

Recommendations:

Continue to actively monitor textbook sales and aggressively market textbooks to maximize profits. Additionally, as the textbook market place is being reduced, management should establish a business plan that identifies other revenue sources. Bookstore management should also evaluate the profitability of all affiliate stores and establish an improved business plan for the stores showing poor performance.

Management Response

The decline of textbook sales is industry wide. We are looking at ways to improve our on-line sales channel, and be more efficient during our rush periods. To generate more textbook sales, we have resumed sending daily emails to students who have registered for the Spring 2018 semester, soliciting on-line orders. These daily emails will continue through January. We are improving our process of delivering a more efficient, timely way of processing on-line textbook orders, becoming an effective point of delivery. We will look to modify store formats of our affiliate stores so they remain relevant and profitable. Management will continue to evaluate affiliate store performance, create a business plan that may include new store formats.

4. SYSTEM CONTROLS

The Bookstore's part-time Systems Analyst position has been unfilled since August 2016. Some of the duties of this position were reassigned to other employees, but some of the duties are not being performed. Our review noted several control weaknesses and other issues related to reassigning and/or not performing duties:

- Currently the Bookstore Business Manager initializes new employee access within the POS system. Having the Business Manager, who is responsible for all financial functions, initialize new employee access within the system weakens internal controls by not adequately segregating duties.

- Two Bookstore employees have provided their POS system login credentials to various student workers. These employees have access to computer fields such as, inventory pricing and receiving that student workers should not access. While employees should refrain from revealing their login credentials, a review of all employee access within the POS system should also be performed periodically to ensure all access is appropriate.

- In December 2016, the Bookstore purchased a scheduling software called SubitUp, costing **$2,907**. As of October 2017, ten months after the purchase, this software has not been installed and is not being utilized.

The former part-time Systems Analyst performed a variety of computer hardware and software oversight duties, while not having responsibilities over sales, inventory or financial functions. This segregation of duties provided an added layer of control that is currently missing. Additionally, installing software on a timely basis could also be the responsibility of a System Analyst.

If the part-time System Analyst position is not going to be replaced, the Bookstore should take steps to reassign duties to employees in a manner to ensure duties are adequately segregated.

Recommendation

Ensure employees refrain from disclosing their login credentials. Install and utilize the SubitUp software or return it for a refund. Additionally, if the System Analyst position is going to be eliminated, duties of the former System Analyst should be delegated in such manner as to establish adequate segregation of duties and proper internal controls.

Management Response

We are looking into steps to separate duties at the hiring process. As our new administrative assistant becomes more familiar with our system and processes, the Business manager will relinquish certain duties that will strengthen internal controls. Action has been taken to ensure student employees that need access to back office functions can access the necessary modules. This will eliminate the need to share POS system login credentials. Implementation of the SubitUP software continues. The vendor has offered a discount for the annual renewal. Other Bookstore personnel have assumed duties of the part-time Systems Analyst position.

5. RATEX CONTRACT

In June 2016, the University accepted a proposal from Ratex Business Solutions, Inc. for a new POS at the Bookstore. Installation of hardware, software and staff training was completed with the Ratex system going live on November 14, 2016.

The total cost of the contract award was $324,055, with 50% due with signed contracts, 25% due at delivery of hardware and software and the final 25% due after going live. Additional payments not covered by contract such as add-ons, travel, maintenance and other installation charges have totaled approximately $166,300.

As of November 2017, the newest version of the Ratex POS system has not been installed. While this version of the system was included in the proposal accepted by the University and demonstrated to bookstore personnel during the procurement process, Ratex has explained that the program is still in the development stages. At the time of the bid letting and bid acceptance, Ratex did not communicate to the University that this module was not yet available. Despite Ratex not fulfilling all contract provisions, the final payment of $81,013 to Ratex was approved and paid in April 2017. According to the Bookstore Director, he has an email dated August 2016 from the Ratex CEO confirming future product delivery.

Considering the large dollar value of this contract, the Bookstore Director should have obtained the advice of the University's General Counsel prior to making the final payment. At that time options such as a formal contract addendum with a guaranteed timeline for delivery of the bid product could have been considered.

Recommendation

Consult with the University's General Counsel to determine what options exist considering the University has now paid the full balance of a contract but the vendor has not yet complied with all contract terms.

Management Response

Shortly before our launch in November 2016, the newer POS version of Ratex was not ready for implementation. Ratex installed a legacy version, which we are currently using. They agreed not to charge the Bookstore for licensing, training, travel associated or maintenance of the legacy product. Emails dated August 2, 2016 from Ratex's CEO verifies this. We are continuing to stay in contact with Ratex concerning their release of the latest POS version. They have taken steps recently toward this newer version. The Bookstore will seek the advice of General Counsel concerning forthcoming payments of annual maintenance fees to Ratex.

6. BOOKSTORE CASH COUNT AND CASH REGISTER CONTROLS

On May 30, 2017, the cash assigned to the Bookstore, including all cash in the safe as well as all cash at all locations, was counted and verified. The following was determined:

- Total cash counted was **$13,000**. This agrees to the amount recorded in the University's accounting records and to the petty cash worksheet maintained by Financial Services.

- During the Internal Audit cash count, miscellaneous cash receipts, cash overages from September 16, 2015 and remote Volleyball sales from September 9, 2015, totaling $87.54 were located under paperwork and counted. The money had been on hand for nearly two years, and was subsequently deposited on June 1, 2017, after our cash count.

- Our review of the cash logs at the Bookstore showed that the following prescribed procedures are being followed:

  - Cash drawers are counted by the manager daily and recorded into Ratex.

  - Two different employees count the cash in the safe twice each day (morning and evening). Each count is recorded in Ratex.

Recommendation

Ensure all monies are deposited in a timely manner.

Management Response

We will continue to verify cash on hand in the manner that meets the university's demands.