Baker Bookstore Inventory Procedures

December 14, 2023

Report No. 186-23

Office of Internal Audit & Risk Management

Missouri State
U N I V E R S I T Y

DATE: December 14, 2023

TO: James P. Sexton, Director of Bookstore
Jennifer Douglas, Business Manager

CC: Dee Siscoe, Vice President for Student Services
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FROM: Natalie B. McNish, Director of Internal Audit and Risk Management

Baker Bookstore Inventory Procedures

BACKGROUND
The Office of Internal Audit and Risk Management (herein "Office") receives and reviews inventory records from all departments with recorded inventory values each fiscal year. Based upon our analysis of risk at the time of the review, inventories are selected to be physically confirmed. On May 25, 2023, the Office conducted limited procedures to confirm physical inventory counts for the Baker Bookstore.

OBJECTIVE AND SCOPE
The objective was to review the bookstore's procedures to confirm and adjust inventory values at year end. The scope included the fiscal year ended June 30, 2023.

SUMMARY
End of year procedures to reconcile inventory balances between the Ratex and Banner systems need significant improvement, Journal entries developed to record the reconciliation were inaccurate, incomplete, and unreviewed. Chargebacks are not appropriately monitored or written off when necessary, and physical inventory procedures were found to be inadequate in some departments. In addition, improvements are needed to ensure timely payment of invoices, appropriate use of purchase orders, reconciliation of quantities ordered, received, and invoiced, and to ensure access to systems is appropriately controlled.

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Audit Field Work Completed: October 25, 2023

OBSERVATIONS, RECOMMENDATIONS AND MANAGEMENT RESPONSES

1. End-of-year procedures

At the end of each fiscal year, the bookstore must complete several tasks beginning with a physical inventory and ending with journal entries to balance all accounts. During our review of these processes, significant weaknesses were identified.

A. Ratex – Banner Reconciliation

Procedures to reconcile the Ratex and Banner systems were not timely, complete, or accurate. At the end of each fiscal year and after physical inventory has been finalized, the Business Manager reconciles the inventory balances recorded in the Ratex system to those in the Banner system. This complex process accounts for all payables, pending credits, and pre-paid purchase orders and merchandise. It also allows for a detailed review of charges to ensure entries are properly recorded and if necessary, adjustments can be made for misallocated or incorrectly coded invoices. Through this process, entries to adjust the Banner accounting system are developed and communicated to financial services for entry. During our review of the 2023 reconciliation, we noted the following concerns:

- The reconciliation was not completed in a timely manner. An incomplete and inaccurate reconciliation was first provided on August 17, 2023. This was returned for correction and not resubmitted until September 12, 2023. This delay created several issues for the reconciliation itself (see other issues noted below), Financial Services, and Internal Audit.

- Amounts recorded as "Balance per Banner" were incorrect. The first step in the reconciliation process is to identify the current balance for each account in the Banner accounting system. When reviewing the first version of the 2023 reconciliation, the balances presented were incorrect. Further investigation identified the root cause of this error was reliance on an ARGOS report without verification of the data.

- The reconciliation was incomplete. When reviewing the first version of the 2023 reconciliation, we found no expense had been captured to acknowledge the value of new textbooks used in the rental program that lost value when they were returned as used textbooks. In addition, we found no adjustments recorded to account for incorrectly coded invoices which were easily identified with a cursory review.

- The reconciliation was inaccurate. Upon review of the second version of the 2023 reconciliation, we found miscalculations, omissions, and other inaccuracies (see separate finding "Credits" below) which caused accounts payable, accrued accounts payable, holding for credit and miscellaneous entries to be underreported by more than $300,000.

To ensure the accuracy of accounting information, reconciliations must be timely, complete, and accurate.

B. Journal Entries

Management does not have an effective process for the analysis and review of manually calculated, end-of-year journal entries for formatting and data accuracy. As a result, misstatements to the financial statements might not be detected and corrected. End-of-year journal entries are prepared by the Business Manager using the reconciliation that they perform to adjust the Banner account balances to agree to Ratex. Our review of these journal entries prepared by the bookstore identified concerns including 12 inaccurate and nine (9) missing journal entries. These errors were caused by incorrect methodology and logic used in the manual creation and formatting of the entries. Further, the entries

were not reviewed or approved by management prior to submission. While the reconciliation process, which includes these journal entries, is reviewed by Internal Audit each year, it is important to remember that Internal Audit review does not take the place of controls, and the depth and breadth of our work varies based upon risk analysis.

C. Chargebacks

The bookstore has not made a concerted effort to follow up on outstanding chargebacks (records of a return to a vendor that is pending receipt of a credit memo). Historically, chargebacks are held by the bookstore for no more than one year before being written off as part of the end-of-year procedures. As a result, 42 returns recorded on the chargeback log totaling $150,041 were determined to be over one year old and uncollectible. Many of these date back to early 2021. To ensure the best use of bookstore resources, outstanding chargebacks should be followed up on and credits applied quickly. If the credit becomes uncollectible, an adjustment should be made to the appropriate accounting records.

D. Physical Inventory Procedures

As stated in several past letters to management regarding annual inventory procedures, initial inventory counts are often incomplete or inaccurate. On May 31, 2023, our office conducted limited procedures to confirm physical inventory counts. We found the error rate for trade books, souvenirs, and school supplies were less than 1%, which is commendable. The error rate for clothing, gifts, and course materials were less than 5%, which is tolerable. However, error rates for other departments (textbooks, accessories, electronics, graduation, and Apple Inc.) exceeded this threshold. In one department, some discrepancies were found to be related to relying on packaging stickers instead of counting the actual contents. Counting errors creates additional work for Department Managers who must work to identify these discrepancies and make corrections prior to the end of the inventory period.

Recommendations

A. Develop procedures to complete periodic reconciliations of Ratex and Banner accounting data, ensure all end of year reconciliations are prepared timely and include complete and accurate information.

B. Ensure journal entries prepared are accurate and develop procedures for managerial review and approval prior to submission.

C. Actively pursue all outstanding chargebacks and, when deemed uncollectible, adjust the appropriate accounting records.

D. Ensure bookstore employees understand the importance of complete and accurate initial inventory counts to minimize future error rates.

Management's Responses

The following responses were provided by James Sexton, Bookstore Director:

A. *For FY24 management is implementing procedures to reconcile reports between the systems quarterly to ensure that we will have more complete and accurate information on a timelier basis. Going forward we plan to use the appropriate ARGOS report that was identified during the inventory audit process period. This will have the store in a better financial standing between the systems throughout the academic year, and at inventory time.*

B. *Management is putting new procedures in place to track submission of journal entries between the systems. The Accounting Specialist will verify journal entries are recorded to correct accounts with appropriate balances on a monthly basis. Errors will be noted in the report for the Business Manager*

to action with corrected journal entry. The Store Director will continue to review budgets and journal entries on a monthly basis. Adding an additional check and balance process on verification of correct journal entries on a monthly basis is anticipated to improve accuracy throughout the year.

C. *Management is implementing a more structured process to ensure there is a timely follow-up on chargebacks that are still outstanding, partial or in total, at 90 days. Will add to the current tracking additional information including contact information, details of the communication, as well as tracking verification so to keep all correspondence in one location. Additional follow-up will be completed every 30 days thereafter initial follow-up. The goal will be to have chargebacks completed within 120 to 180 days of the initial date. At inventory time we will conduct a complete review of all chargeback information and take appropriate action on any outstanding items, up to and including a write-off to ensure the new fiscal year has a clean start with only current paperwork in place.*

D. *We will continue to have our Business Manager put together our structured inventory plan approximately 2 months prior to the inventory days that will be shared with the full-time staff via email. In addition to this, the Store Director will implement two training periods prior to physical inventory to ensure staff are trained/reviewed on the inventory process. One will be approximately one week before inventory with the full-time team, and the other on the morning of inventory day with all staff scheduled to complete the physical count of inventory on hand. Key focus of this training will be to stress the importance of an accurate initial count of inventory, and to confirm understanding of the process by all.*

2. Other Controls & Procedures

While reviewing inventory and other year-end procedures, other control weaknesses were noted.

A. Timely payment

Payments to vendors were not always made timely. Four (4) invoices for graduation regalia totaling $57,098 received in May 2022, were not paid until July 2023. During our prior and current inventory reviews, discrepancies in the graduation department were noted. These invoices were held as accrued payables in the prior year as the department manager was working with the vendor to return unused merchandise and receive invoiced items before processing. However, at some point, the invoices were no longer followed-up on and were unpaid. While this does not appear to be a prevalent issue and no late fees or additional charges were noted from the vendor, the bookstore does not have a process for tracing invoices received to payment. Tracking invoices would ensure the accuracy and timeliness of payments and ensure positive vendor relationships.

B. Purchasing Controls

Controls over purchases of inventory are not always adequate. Purchase orders document the quantity and value of items ordered and should be completed when the order is placed. Delivery logs document the quantity of items received and are completed when the order is received. These documents should then be used to validate vendor invoices before processing payment.

During our review of physical inventory performed for the graduation department, we confirmed significant discrepancies in the quantity and value of inventory items on hand. Following several re-counts to ensure accuracy, we reviewed a choice of purchase orders, along with their respective delivery logs and invoices for four (4) different buyers. We determined:

- Quantity of items received are not reconciled to quantity of items invoiced. In our review, we noted numerous issues where receiving reports and invoices could not be reconciled for graduation regalia. For example, in November 2022, the bookstore received 365 bachelor's gowns. The corresponding invoices paid in January 2023 show the bookstore was invoiced for 395 gowns. Many other instances of over and under payment were noted over the past year. Of the 25 invoices

judgmentally selected for review, seven (28%) could not be reconciled to the attached receiving information. Since a complete review was not completed, we are unable to determine if a credit or balance is due.

- Purchase orders are not always issued when the order is placed, but rather when the items are delivered. Of the 11 purchase orders issued for graduation regalia between January 1, 2023, and May 25, 2023 (date of physical inventory), six (6) purchase orders were issued the same day as items were received and posted. Similar issues were also noted in the school supply department.

To ensure accuracy of inventory and accounting records, reduce the risk of theft or loss, and to maintain positive relationships with vendors, adequate purchasing controls must be developed and enforced.

C. User Access

The bookstore does not have adequate controls over user access to the Ratex system. In a review of 98 active user ids, we found 47 were issued to employees or contractors who are no longer working for the bookstore, 19 were generic user ids, and three (3) current employees did not have a unique user id. To control access and monitor user activity, a unique user identification and password should be assigned to each user of a system. User identifications and passwords should be kept confidential and changed periodically.

Recommendations

A. Establish procedures that facilitate the tracking and timely payment of invoices.

B. Require purchase orders be prepared when orders are placed and require reconciliation of delivery logs and invoices before processing for payment. In addition, the bookstore should investigate if any credit or balance is due to the vendor.

C. Provide and require use of a unique user identification for all employees and terminate or deactivate access upon termination of employment or contract.

Management's Responses

The following responses were provided by James Sexton, Bookstore Director:

A. *Processes are being put in place to have statements from vendors worked in a more timely manner, on a monthly basis, to ensure that all open items are reconciled between 30 and no later than 60 days. Process will include the Accounting Specialist verifying the statements by the 15th of each month of all open items listed on the statement and taking action on any invoice over 30 days old. We will have documentation listed on each statement that will be held in a monthly file to be referenced for subsequent months to ensure that payments and credits are verified so we are able to finalize any and all transactions in a timely manner.*

B. *Setting a more structured process with buyers to ensure all purchase orders are created fully with the product on the day the order is sent to the vendor. This will include having the quantities as well as the accurate cost/retail included as part of the purchase order when created. If there are issues with any order, such as backorder, pricing, or low stock, there will be notes added to the PO as well as having the information updated prior to the arrival of the merchandise. Any discrepancies found at the time of receiving will be addressed between the receiving department and the appropriate buyer to resolve with the vendor prior to processing invoice for payment.*

C. *Management is currently in the process of deactivating cashier access for those employees no longer with the bookstore. A spreadsheet has been developed to track all cashier ID's so we can monitor access and appropriately limit access in a more timely fashion. This spreadsheet is kept in a file with restricted access and will be reviewed and actioned on a semi-annual basis to ensure information is up to date. In addition, a review of all current employees for the need to have unique access to the back-office portion of the system. For those employees with access that are no longer employed, the access will be revoked, password updated on the backend server and not give the user ID the ability to update their password on our Ratex system to ensure the access stays revoked. In addition, access on these users will be set to access the "about" screen only, so they will be locked out of all screens that have action items. We plan to make the review of current staff a semi-annual process to ensure that all inactive employees' access has been removed from all systems.*