



Internal Audit

***V.H. DRAGO COLLEGE STORE REVIEW –
WEST PLAINS CAMPUS***

May 15, 2014

Office of Internal Audit



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

DATE: May 15, 2014

TO: Kathy Schloss, Drago Bookstore Manager

FROM: Donna Christian, Director of Internal Audit and Compliance
Tami Reed, Senior Internal Auditor

CC: Dr. Herbert Lunday, Dean of Student Services – West Plains
Dr. Drew Bennett, Chancellor – West Plains
Clifton M. Smart III, University President

**RE: INTERNAL AUDIT: V.H. DRAGO COLLEGE STORE REVIEW – WEST PLAINS
CAMPUS**

BACKGROUND

Dr. Herbert Lunday, Dean of Student Services, West Plains, contacted Internal Audit to request a review of the current financial condition of the Drago College Store. The store has experienced decreasing sales and profits in recent years.

In 1993, the V.H Drago College Store opened in its current location on the West Plains campus. Previously, textbooks were supplied to the West Plains campus through a combined effort of the West Plains campus and the Springfield Bookstore.

Currently, the V.H. Drago College Store provides the West Plains campus and the surrounding community with textbooks, Grizzly clothing and souvenirs, and other educational/personal school and office supplies, as well as computer equipment. The store is staffed by three full-time employees, including a Bookstore Manager, a Supply Buyer, and a General Merchandise Buyer. In addition to the full-time staff, the college store employs up to five student workers during various times of the year.

BookLog System software supports the operational/business functions such as the point of sale, inventory control, textbook and general merchandise, and other financial management functions. Daily and monthly journal transactions are manually posted by the West Plains Business Office personnel into Banner, the University's information data system.

OBJECTIVE AND SCOPE

The objective of this review is to analyze the financial condition of the Drago College Store and determine reasons for the decrease in revenues and profits. The financial records and management decisions during the fiscal years 2009 through 2013 were included in this review.

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SUMMARY

The Drago College Store has reported declining sales and profits in recent years. A summary of the sales, change in fund balance, and year-end inventory for the Drago College Store are as follows:

Year*	Sales (Retail)	Change In Fund Balance	Year-end Inventory (Cost)
2013	\$802,979	\$(9,810)	\$120,180
2012	\$947,762	\$76,800	\$156,856
2011	\$1,030,381	\$113,992	\$179,022
2010	\$1,077,220	\$98,773	\$146,625
2009	\$939,296	\$60,709	\$142,827

*See Appendix A for complete income and expense reports for the college store.

Various factors have caused the decline in sales and profits at the Drago College Store, including a decreasing profit margin, an increasing participation in book rental programs, a decrease in student enrollment, and an increase in expenditures. Nationally, college bookstores have been faced with a significant fluctuation in noted trends in sales, offered products, and services that are driven by new technology and market demands. As the Drago College Store looks to the future, management needs to closely monitor the store's financial condition, review the store's increased participation in the book rental program and establish a closer working relationship with the Springfield Bookstore to better prepare for future market demands.

We wish to thank the West Plains Administration, Business Office and Drago College Store management for their support during this review.

Sincerely,



Donna Christian, CPA, CGFM
Director of Internal Audit and Compliance



Senior Internal Auditor: Tami Reed
Audit Field Work Completed: March 14, 2014

OBSERVATIONS, RECOMMENDATIONS AND MANAGEMENT RESPONSES

In reviewing the financial status and the profitability of the college store, there are several variables that could have impacted the profitability of the business. Some of the notable areas are as follows:

1. Profit Margin

Historically, there are certain percentage markups that have been generally followed (both on the West Plains and the Springfield campuses) in determining the retail price of an item. In FY13, Drago College Store management began utilizing a pricing software program to assist in the pricing of both new and used textbooks. The software program compares the proposed retail price of a textbook to online competitors and recommends a retail price that will be competitive. However, utilizing the pricing software resulted in a lower profit margin for West Plains during FY13.

Between FY09 and FY12, the gross profit margins for new and used textbooks were reduced by almost 5 percent because of the pricing software. Assuming sales of new and used textbooks would have held constant in FY13, the college store could have realized an additional \$36,470 in profits in FY13 without using the pricing software.

In January 2014, management made the decision to discontinue using the pricing software and return to their previous pricing methods.

Recommendation:

Continue to monitor the gross profit margin to ensure profitability while remaining competitive in the market.

Management Response:

While it may be difficult to ensure profitability while remaining competitive in the market, we will continue to monitor the gross profit margin, as recommended.

2. Rental Programs

(A) School-Wide Rental Program: With the consent of the Chancellor and the Dean of Student Services, the college store began offering a school-wide textbook rental program in Fall 2010. The rentals were established for textbooks in five required courses with high enrollment rates. This was the exact opposite approach the Springfield Bookstore took because high-volume book sales generate higher sales revenue and subsequently provide the benefit to the college store of buying the book back from the student and reselling it. While the rental income has increased over the years since the implementation, the book sales, new and used, have decreased at a higher rate. As shown in the table below, total book sales have decreased \$260,991 (\$923,171 - \$662,180) since FY10 while rental revenue has increased by only \$43,536 (\$51,341 - \$7,805).

	FY09	FY10	FY11	FY12	FY13
New Book Sales	\$396,224	\$445,353	\$394,383	\$377,359	\$335,941
Used Book Sales	397,110	477,818	408,145	354,141	326,239
Total Book Sales	<u>\$793,334</u>	<u>\$923,171</u>	<u>\$802,528</u>	<u>\$731,500</u>	<u>\$662,180</u>
Rental Revenue	\$7,680	\$7,805	\$19,816	\$35,661	\$51,341

The textbook rentals were offered in-house for the first several years. In-house rentals are very labor intensive, requiring the monitoring of textbook returns and charge-outs for non-returned books, as well as the college store assuming all the risks. Some of these risks

include textbooks not being used in a subsequent semester; they are then dead inventory when returned. In other situations there may be an insufficient used textbook inventory to fill the rental orders so a new textbook will be issued as a rental, and when the textbook is returned to inventory it has to be marked down to a used textbook.

The Nebraska Book Corporation (NBC) Book Rental Program was adopted for the Spring, Summer and Fall 2012 semesters. The college store received their revenue from these book rentals through rebates from NBC. However, NBC did not assume any liability for unreturned books, as those books were charged back to the college store. The college store did not track inventory losses associated with this program, but discontinued using the program after one year.

Starting in the Spring 2013 semester (to current), the college store entered into an agreement with Rafter, Inc. (dba BookRenter) for an in-store book rental program. The books available for rental were significantly expanded from the original 5 courses in the Fall 2010 semester to 73 courses in the Fall 2013 semester and now 94 courses in the Spring 2014 semester. Students are charged a rental fee by Rafter, Inc. at a kiosk at the college store and submit a credit card number in case the books are not returned. Rafter, Inc. then pays the college store the retail price of the textbooks and assumes the liability for unreturned books. Revenues from this program were \$18,984 for the Fall 2013 semester but dropped to only \$7,685 for the Spring 2014 semester. The significant decrease could not be explained other than perhaps that the orientation in the Fall promoted the rental, and there was no orientation in the Spring to promote the rental program.

The terms and conditions in the current Rafter, Inc. contract do not appear to adequately protect the college store. The contract provides Rafter exclusive rental services but does not include any provisions ensuring Rafter, Inc. does not rent to students directly. Although all rentals to date have been from the Drago College Store inventory, the contract allows for Rafter's to use their own inventory which would decrease the profitability of these rentals (from approximately 33 percent to less than 15 percent). Future negotiations of the rental contract should include provisions protecting the college store's interest and profitability.

The Rafter, Inc. contract was signed by Kathy Schloss, Drago College Store Manager. The Delegation of Contracting Authority memorandum issued by President Clifton M. Smart, III on August 12, 2013, authorized the Chancellor of West Plains and the West Plains Director of Business and Support Services to sign contracts on the West Plains campus.

(B) Student Athlete and Student Ambassador Rental Programs: In 1993, a rental program was created for West Plains' student-athletes where books are provided through their athletic scholarships. In 2000, book rentals were also added for Student Ambassadors as a part of their scholarships. Rather than a rental charge for each book, there is an established rental charge per student. In Fall 2011, the rental charge was increased from \$75 to \$80 per student.

The college store does not calculate the profit or loss on these two rental programs to ensure the rental fees cover the cost of the books. The rental income and the inventory write-off that directly relates to these rentals was calculated for two semesters and is shown below:

Semester	Rental Income	Inventory Write-Off On Rental Books
Spring 2013	\$3,600	\$5,386
Fall 2013	\$4,160	\$3,048

The inventory write-off would include both the new books that had to be used in the rental program and returned to inventory as used books and the books that are no longer going to be used in a future semester, thus considered dead books. The amount associated with dead

books was calculated for two semesters for this review, but is not routinely documented at the end of each semester by the college store.

The college may be absorbing a loss on the rentals to the student-athletes and the student ambassadors. These two rental programs should be evaluated to ensure the rental fees cover the cost to the college store.

Recommendations:

- (A) 1. Evaluate the books included in the book rental program. Consider excluding the high volume books.
- 2. Initiate contract revisions that include provisions protecting the college store’s interest and profitability in the book rental program.
- 3. In the future, only those authorized on the Delegation of Contracting Authority memorandum should sign contracts on behalf of the University.
- (B) 1. Monitor the rental programs for the student-athletes and ambassadors to ensure profitability. This includes evaluating the rental fees charged and calculating the value of dead books each semester to provide a basis for calculating the profit or loss associated with the programs.

Management Responses:

- (A) 1. *While we followed the high volume books recommendations of Follett Higher Education and the examples of stores at other universities, we will evaluate the books included in the book rental program, as recommended.*
- 2. *We will initiate contract revisions that include the recommended provisions.*
- 3. *We will ensure contracts will only be signed by authorized persons.*
- (B) 1. *We will re-evaluate the rental fees charged to student-athletes and ambassadors to include the calculation of the value of dead books.*

3. Enrollment and Average Sales Per Student

The West Plains campus has been experiencing decreasing enrollment numbers since Fall 2011. In addition, the average sales per student has also decreased. As a result, there are not only fewer student customers on campus, but also each student is spending less on average at the college store.

A decrease in student enrollment has a direct impact on the sales at the college store. It decreases the sale of textbooks, school supplies, and spirit/souvenir sales. Enrollment at the West Plains campus since FY09 is as follows:

Semester	FY09	FY10	FY11	FY12	FY13	FY14
Fall	1,834	2,162	2,229	2,142	2,102	2,123
Spring	1,518	1,821	1,843	1,726	1,768	1,667
Summer	514	620	585	504	553	-
Total	3,866	4,603	4,657	4,372	4,423	-

The table below identifies a \$55.91 (\$226.08 - \$170.17) decrease in the average sales per student between FY09 and FY13. A large portion of this decrease may be reflective of the increased participation in textbook rental programs discussed in part 2.A above.

	FY09	FY10	FY11	FY12	FY13
Taxable Sales*	\$874,037	\$1,032,057	\$959,398	\$878,684	\$752,668
Enrollment	3,866	4,603	4,657	4,372	4,423
Avg. Sales/Student	\$226.08	\$224.21	\$206.01	\$200.98	\$170.17

*Represents only sales subject to sales taxes and does not include sales made to the University departments, ticket sales and other nontaxable sales. Taxable sales appear to be the best representation of sales made directly to the student population.

Recommendation:

None.

4. **Expenditures**

Although sales have decreased since FY10, total expenditures have continued to increase. An analysis of some categories of expenses is as follows:

- (A) Salaries and employee benefit costs have increased by \$17,755 since FY10. In addition to the across-the-board and incremental raises for all employees, approved by the Board of Governors, the college store manager was given an equity adjustment to raise her salary to 80% of the mid-point of the pay grade range.
- (B) Donations and promotional items that are provided by the bookstore to various recipients totaled \$10,712 in FY12 and \$8,238 in FY13. The primary recipient of these promotional items is the annual Grizzly Golf Classic--\$9,018 in FY12 and \$6,586 in FY13. Similar contributions have been made to this annual fundraising activity for many years.

These levels of promotional and donation items appear to be high in comparison to the amount being provided by the Springfield Bookstore which recorded over \$15 million in sales in FY13 and approximately \$39,000 in promotional items. West Plains recorded \$802,979 in total sales in FY13 and \$8,238 in promotional items.

Drago College Store evaluates donation/promotion requests as they are received, on a request by request basis. No formal request form or budget has been established to help monitor the request as to the purpose, nature, or amount.

- (C) In January 1993, an agreement between the Trustee of Vivian H Drago Charitable Remainder Unitrust and the Board of Regents of Southwest Missouri State University was signed, leasing the property where the Drago College Store is located for \$16,800 annually. The trust document dated December 30, 1991, states, "*the trust terms begins with the date of this Agreement and shall end twenty (20) years thereafter....Upon the end of the trust term, the Trustee shall distribute all of the then principal and income of the unitrust other than the amount due to the Donor, to the Southwest Missouri State University Foundation Incorporated, to be used for the West Plains Campus for its general purposes...*" Consequently, Drago College Store's last monthly lease payment was made in November 2011, and the monthly payments of \$1,400 per month (\$16,800 per year) are no longer an expense.

However, in FY12, the contribution from the Drago College Store to the West Plains' operating budget was increased from \$53,320 annually to \$78,320. This \$25,000 increase was implemented a year after the lease payments discontinued but at the same time that sales were starting to decline, creating a substantially negative impact on the finances of the college store.

Recommendations:

- (A) Continue to monitor salary and fringe benefit expenditures to ensure they can be supported with the current level of revenue.
- (B) Evaluate the amount of promotional items provided by the college store, ensuring they are justifiable and reasonable in comparison with sales. A donation request form to document the purpose/justification should be established.

- (C) Consider evaluating the required transfer to the general operating fund based upon the profitability of the college store. Annual evaluations may be performed to determine if increases to the transfer can be funded.

Management Responses:

- (A) *We will monitor salary and benefit expenditures, as recommended.*
- (B) *We will evaluate the amount of promotional items provided by the college store, as recommended. If a decision is made to continue the contributions to the Grizzly Golf Classic, those contributions will be reflected in the budget, beginning FY15. We have always complied with the MSU System gift reporting requirements. Once we became aware of the Donation Request Form in March 2014, we implemented it immediately.*
- (C) *We will work with Business Services to re-evaluate the required transfer to the general operating budget.*

5. WP Drago College Store and Springfield Bookstore

The two university bookstores, Drago College Store and the Springfield Bookstore, operate independently under different management. Historically, there has been limited cooperative arrangements between the two bookstores. Although there are some similar management processes, such as using Booklog (the point of sales system) and Follett (the book buyback company), there are few other cooperative agreements. There continues to be significant differences, such as the rental program to students, student athletes, and ambassador's rental program, as well as pricing methods.

As the Springfield campus has greater purchasing power, based on sales, it appears that the Drago College Store may benefit from more cooperative arrangements.

Recommendation:

A greater working relationship between the Springfield Bookstore and the Drago College Store may be valuable to both stores. Such a relationship would require communication between the store's management on services provided, profit margins, and third party agreements. This relationship may prove both financially beneficial, as well as create longevity in the store's operations.

Management Response:

We look forward to developing a greater working relationship between the Springfield Bookstore and the Drago College Store.

Appendix A**West Plains Drago College Store****Comparative Income Statements**

Fiscal Years Ending June 30, 2009 through June 30, 2013

	FY09	FY10	FY11	FY12	FY13
Book rental fees	7,680.00	7,805.00	19,815.82	35,660.87	51,340.83
Commissions	4,783.37	5,202.05	4,242.50	3,000.70	1,694.98
Sales - Taxable	874,037.48	1,032,056.66	959,398.18	878,684.15	752,667.63
Sales - Nontaxable	65,258.89	45,163.56	70,983.01	69,078.22	50,310.91
Cost of Goods Sold	(632,580.42)	(735,106.86)	(683,606.60)	(619,495.24)	(585,404.87)
Freight Charges	(14,375.95)	(13,672.55)	(11,677.29)	(13,531.00)	(10,746.09)
Discounts	(20,352.96)	(15,959.45)	(17,064.62)	(18,958.32)	(16,574.45)
Miscellaneous	551.71	2,023.03	1,021.95	3,847.65	1,586.85
Returned Check Charges	140.00	70.00	140.00	90.00	30.00
Investment Income	8,837.06	3,158.02	6,612.52	8,217.04	7,927.12
Total Net Income	<u>293,979.18</u>	<u>330,739.46</u>	<u>349,865.47</u>	<u>346,594.07</u>	<u>252,832.91</u>
Salaries and Wages	95,362.47	102,006.91	103,799.99	109,533.51	113,509.92
Fringe Benefits	24,944.86	26,857.36	26,474.77	30,469.50	33,109.19
Total Personnel Services	<u>120,307.33</u>	<u>128,864.27</u>	<u>130,274.76</u>	<u>140,003.01</u>	<u>146,619.11</u>
Utilities	4,470.19	3,936.52	3,899.88	3,678.97	3,815.29
Travel	1,641.68	2,297.83	2,575.29	2,537.59	2,520.19
Supplies	7,586.71	9,062.98	6,917.23	10,897.63	6,198.75
Services	24,741.90	13,237.37	15,376.18	16,418.48	17,362.14
Other Expenses	256.05	596.08	(880.19)	520.00	871.25
Advertising Expenses	3,440.80	3,851.10	7,590.22	9,017.97	6,586.36
Rental - Facilities	16,800.00	16,800.00	16,800.00	8,400.00	350.00
Total Operating Expenses	<u>58,937.33</u>	<u>49,781.88</u>	<u>52,278.61</u>	<u>51,470.64</u>	<u>37,703.98</u>
Total Expenses	<u>179,244.66</u>	<u>178,646.15</u>	<u>182,553.37</u>	<u>191,473.65</u>	<u>184,323.09</u>
Net Income Before Transfers	<u>114,734.52</u>	<u>152,093.31</u>	<u>167,312.10</u>	<u>155,120.42</u>	<u>68,509.82</u>
WP College Store Transfer to Operating	<u>54,025.77</u>	<u>53,320.00</u>	<u>53,320.00</u>	<u>78,320.00</u>	<u>78,320.00</u>
Net Change to Fund Balance	<u>60,708.75</u>	<u>98,773.31</u>	<u>113,992.10</u>	<u>76,800.42</u>	<u>(9,810.18)</u>
Fund Balance, June 30	<u>661,832.52</u>	<u>760,605.86</u>	<u>874,597.96</u>	<u>951,398.38</u>	<u>941,588.20</u>