



***Review of Vending Machine
Services Contract***

February 19, 2020

Office of Internal Audit and Risk Management



Missouri State[™]

U N I V E R S I T Y

DATE: February 19, 2020

TO: Michael Wills, Director of Procurement, Procurement Services
Steve Foucart, Chief Financial Officer

CC: Rachael Dockery, General Counsel
Clifton M. Smart III, University President

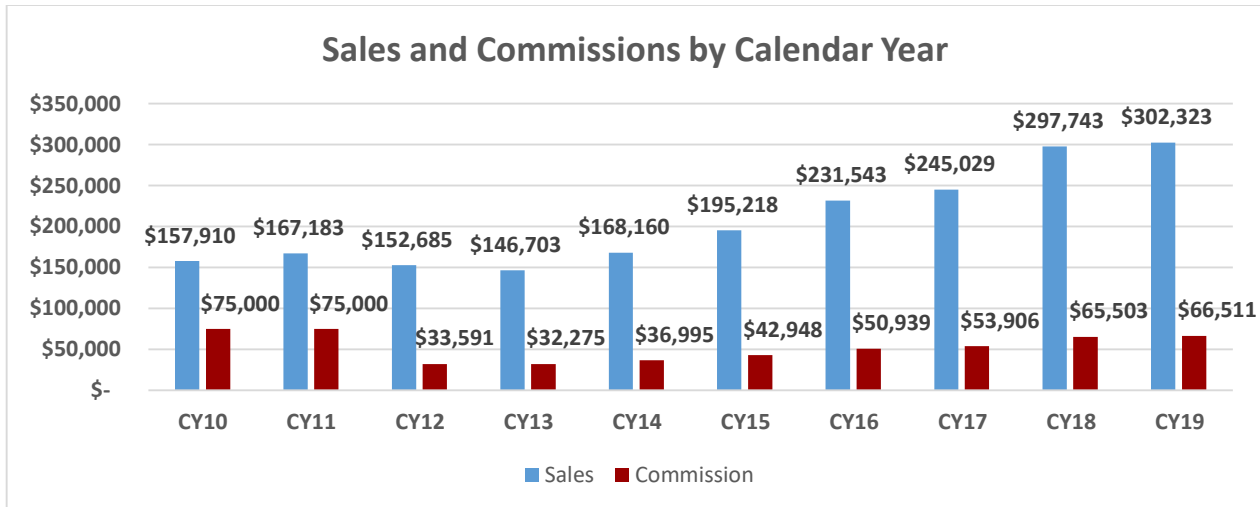
FROM: Donna Christian, Director of Internal Audit and Risk Management
Jane Dewberry, Senior Auditor

Review of Vending Machine Services Contract

BACKGROUND

Prior to 2005, the University owned and maintained all food vending machines on the Springfield campus (with the beverage machines outsourced to Pepsi Americas). During 2003 and 2004, the University averaged only \$8,000 net profit on average sales of \$446,875 per year so a decision was made to also outsource the food vending machines. A six-year contract running from January 1, 2005 through December 31, 2011 was awarded to Canteen Vending. They would use the University-owned machines and, in addition to paying a \$100,000 up front bonus, would pay commissions of 20% on gross sales with a yearly guaranteed minimum of \$75,000. Unfortunately, vending sales were not as high as Canteen had anticipated so the University received only the \$75,000 minimum payment each year of the contract. Over the initial period, the contract was assumed by Burch Food Services, and then by Jackson Brothers, both Canteen affiliates.

A new five-year contract effective January 1, 2012, was awarded to Jackson Brothers with renewal options extending through December 31, 2021. Terms of the new contract provided commissions of 22% on gross sales with a guaranteed minimum of \$31,000 per year. In addition, Jackson Brothers purchased all remaining University-owned machines for \$53,300. The chart below shows sales and commissions by year for the last 10 years.



There are currently 49 vending machines (40 snack, 2 frozen, 3 refrigerated, 3 coffee, and 1 office supply machine), 9 change machines, and a micro market on campus.

OBJECTIVE AND SCOPE

The objectives were to review compliance with contract terms and accuracy of commissions paid to the University. The scope included, but was not necessarily limited to, calendar years 2016 through 2019.

SUMMARY

Our review identified the need to improve monitoring of commission revenue calculations. Commissions were underpaid to the University by \$4,385 between June and September 2019. Additionally, the vendor is not providing detailed sales reports as required by contract and reported sales should be compared with vending machine meter readings to ensure accuracy.

The addition of a micro market at the efactory has resulted in some contract terms being violated and a conflict of interest among vendors that has reduced the University's commission rate on beverages. Going forward more input is needed from the University's Office of Procurement to avoid these issues when new vending is added to campus.

Vending products and pricing were not always submitted to the University by the vendor to approve as the contract requires. The University's vending contract was originally written in 2012, and is outdated in the use of various vending terminology and does not address current vending issues such as Payment Card Industry (PCI) compliance.

Donna K. Christian, CPA, CGFM,
Director of Internal Audit and Risk Management

Jane Dewberry, Senior Internal Auditor
Audit Field Work Completed: January 28, 2020

OBSERVATIONS, RECOMMENDATIONS AND MANAGEMENT RESPONSES

1. Commissions

No one from the University appears to be monitoring the accuracy of commissions paid. The Office of Procurement receives a copy of the commission report monthly, but places the report in a file and does not review it for contract compliance.

- A. According to the vending machine services contract, commissions paid to the University should be calculated on gross sales, including sales taxes. However, commission checks received from January 2012 through October 2017 had a note typed on them stating sales tax was deducted prior to the calculation of commissions. When questioned, a Senior Vice President at Jackson Brothers indicated the statement was in error and sales taxes had not been deducted prior to the calculation of commissions.

In an attempt to verify the calculation of commissions, we requested detailed sales reports; however, Jackson Brothers could not provide detailed sales reports. The Senior Vice President explained that even though detailed sales reports were not available, meter readings from machines could be used to calculate sales. When we attempted to use meter readings to calculate sales we noted that meter readings were also not reliable. We were also told that commissions were not calculated based upon product sales, but were calculated based upon the amount of money turned in from each machine.

In June 2019, Jackson Brothers began using new vending software that provided more detailed reporting. Our review of commission calculations from June to September 2019 identified that sales taxes were improperly deducted to calculate commission and 12 campus vending machines were not included on the commission report resulting in an underpayment to the University of \$4,385 for the four-month period. This was an unintentional error that occurred during the migration to the new software, however, it might have continued indefinitely if not for the audit review. This illustrates the need for the University to monitor commission reports. Jackson Brothers subsequently paid the University \$4,385 and corrected the commission report errors beginning in October 2019.

Because of the lack of detailed sales reports, it is not clear whether or not commissions prior to June 2019 were calculated correctly. Further, calculating commissions based upon money collected (not sales) makes the University liable for cash shortages which is not in accordance with contract terms. Also, the failure to provide detailed sales reports violates contract terms as well.

- B. According to Jackson Brother's representatives, the new vending software will more accurately track sales and meter readings. With this in mind, we calculated sales based upon machine meter readings to compare to sales reports. We calculated sales of **\$81,559** for July through November 2019. Comparing this amount to the **\$78,099** gross sales (based on cash collections) reported on the commission reports indicates a **\$3460 cash shortage** occurring over the 5 month period and a **loss of \$761** in commissions paid to the University. Jackson Brothers should be investigating these shortages which may be due to errors in their new software or could be due to theft. These numbers represent just 30 of our vending machines since meter readings for the entire period were not available for the others, so cash shortages may be higher than shown here.

Recommendations

- A. Procurement Services should request and receive detailed sales reports as required by contract terms and periodically review the calculation of commissions paid to the University for accuracy.
- B. Procurement Services should request Jackson Brothers to calculate sales based upon vending machine meter readings to verify the accuracy of sales amounts used to calculate commissions.

Management's Responses

A. *Procurement Services will request Jackson Brothers to provide detailed future sales reports, and will work through University Financial Services for a periodic review of the calculation of commissions paid to the University.*

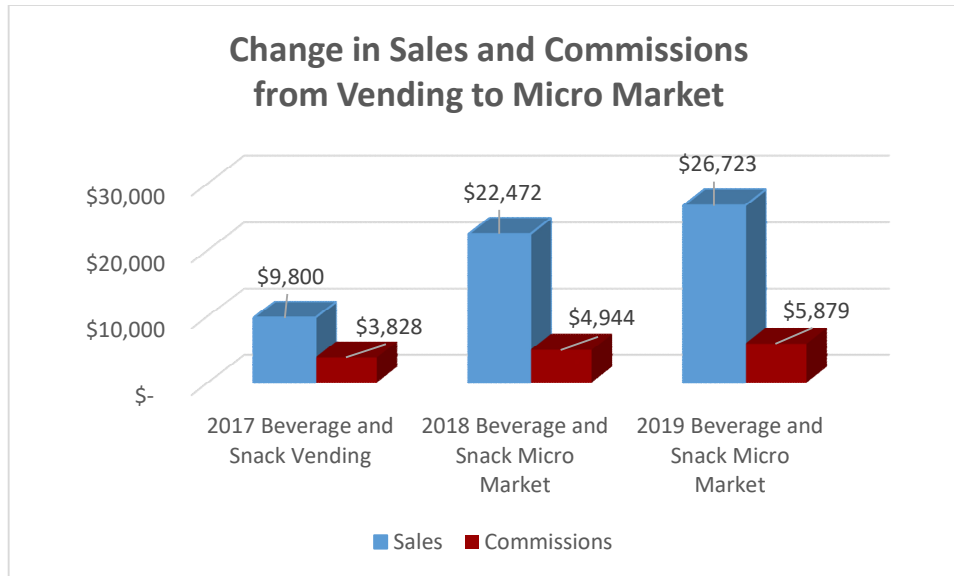
B. *Procurement Services will request Jackson Brothers to calculate sales based upon vending machine meter readings, to verify the accuracy of sales amounts used to calculate commissions.*

2. Efactory Micro Market

In February 2018 a micro market was installed at the efactory by Jackson Brothers. Micro markets have the appearance of an unattended mini convenience store where customers select items from open shelves and coolers, then use a self-checkout scanner to pay with a credit card. The Director of Procurement allowed the efactory staff and Jackson Brothers to work out the details in switching the building over from vending machines to a micro market. The lack of guidance from the Director of Procurement who had knowledge of University contract terms created several issues as follows:

- A. The efactory had a University network jack installed that was attached to a Jackson Brothers server to run the micro market's software. The server transmits credit card information off-campus to a third party vendor. This violates University policy and leaves the University vulnerable to potential PCI DSS (Payment Card Industry Data Security Standards) compliance violations that can result in severe penalties and fines. The University's Division of Information Services was not told that an outside server was attached to the University network jack and used to transmit payment card data until we brought it to their attention. The server was disconnected and the micro market is currently operating through a Jackson Brothers cellular line. The vending contract specifically states that the University does not allow access to its network. With the proper notification, PCI compliance documentation and a contract addendum for access to the University's network, different options would have been available to Jackson Brothers.
- B. The micro market sells beverage products even though the University's contract with Jackson Brothers excludes beverage sales and the University's contract with Ozark Coca Cola provides them exclusive rights to all beverage sales (soft drinks, juice, bottled water) on campus. When the micro market was installed at the efactory, the Coke beverage machines were removed. The University receives on average a 45 percent commission from Ozark Coca Cola for beverage sales but is only receiving a 22 percent commission on these sales from Jackson Brothers. Our discussion with Ozark Coca Cola and Jackson Brothers revealed that Jackson Brothers is purchasing the beverages sold in the micro market from Ozark Coca Cola. As a result, Ozark Coca Cola products are still being sold at the efactory, only through Jackson Brothers resulting in a lower commission rate for the University. There appears to be a conflict of interest in these beverage transactions that result in a loss of commission revenue to the University. While the contracts with each vendor include terms to avoid this type of conflict, no one was monitoring the contract terms to ensure they were being followed. The Director of Procurement indicated that he was unaware that the Coke beverage machines had been removed and beverages were being sold from the micro market.

The table below shows how sales through the micro market increased significantly over sales through vending machines; however, commissions paid to the University have not increased at the same rate.



A contract modification for both Jackson Brothers and Ozarks Coca Cola is needed if the micro market concept is going to continue on campus. The loss of beverage commissions should be considered when modifying contract terms.

Recommendation

Procurement Services should have participated in setting up the micro market to ensure contract terms and University policy were followed. If micro markets are going to continue or increase on campus, contract addendums should be put in place that would ensure the University receives an appropriate amount of commissions and conflicts of interests are avoided.

Management's Responses

If the efactory Micro Market is going to continue on campus, a Jackson Brothers contract amendment will be put in place to confirm that Jackson Brothers can sell Coca Cola products purchased from Ozarks Coca Cola. Prices will be included in the amendment, and the Jackson Brothers contract commission rate will continue to apply to any sales of Coca Cola products.

3. Product and Pricing Issues

The vending machine services contract indicates the University has the right to select the types of products sold and requires University approval of product pricing. While the contractor has submitted price increase requests for the list of products included in the 2012 original contract, we identified additional items being sold that had never been submitted to the University for approval:

- Office supplies are being sold through a vending machine in the library. The sale of office supplies and their prices have not been approved in the contract.
- Some vending machines on campus charge ten cents more per item when a credit/debit card is used. The University has not approved the higher price for credit/debit card purchases. The contractor removed the ten-cent charge after we brought this matter to his attention.

- Coke products sold at the efactory micro market have not been submitted to the University for price approval, and are sold at a price higher than the University's Beverage Contractor sells the same products at other places on campus. If approval had been requested for the prices charged, the University's Procurement office might have then been alerted to the fact that items not allowed in the current contract were being sold at the micro market.

Recommendation

Procurement Services should meet with the Jackson Brothers representatives and remind them of the scope of items allowed to be sold under their contract. If the University approves of them selling Coke products at the efactory micro market and office supplies at the library, then the contract should be amended to include these items and prices for these items should be submitted for University approval.

Management's Response

Procurement Services will meet with representation from Jackson Brothers and reconfirm the scope of items allowed to be sold under the contract.

If the University approves of Jackson Brothers selling of Coca Cola products at the efactory Micro Market and office supplies at the library, then the contract will be amended to include these items, after prices for these items have been submitted for University approval.

4. New Contract

The University's Procurement Office renewed the vending contract with Jackson Brothers in November 2019 for one year. The contract was originally written in 2012 and is outdated in the use of various vending terminology. The contract also does not address PCI compliance for credit card transactions or include an audit clause that reflects the use of electronic data that is currently available.

Recommendation

When renewing the vending contract at the end of 2020, Procurement Services should ensure to update contract terms to reflect current practices.

Management's Response

Before the end of 2020, Procurement Services will issue a new solicitation with a current scope of work, or will amend and extend the existing contract to include a reference to PCI compliance language for credit card transactions, and will include a clause stating that cellular service is an option for contractor transmission of credit card data.