



KCCC Liquor Operation Audit

September 2015

CITY OF KILLEEN

A Report to the City
of Killeen Audit
Committee

Committee Members

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Report Summary

The Killeen Civic and Conference Center contracts with Jesters to manage its liquor operation. The current contract requires that an internal audit be performed annually. This audit was conducted to comply with this contract stipulation as well as to follow up on prior year audit findings.

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GOVERNMENT AUDITING STANDARDS COMPLIANCE

This performance audit was conducted in accordance with Generally Accepted Government Auditing Standards. Those standards require that the audit be planned and performed to obtain sufficient, appropriate evidence to provide a reasonable basis for the findings and conclusions based on the audit objectives. I believe that the evidence obtained provides a reasonable basis for the findings and conclusions based on the audit objectives.

AUDIT STAFF

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September 2015



AUDIT REPORT HIGHLIGHTS

Why This Audit Was Conducted

This audit was conducted to comply with a contract stipulation and to follow up on prior year audit findings.

What Was Recommended

It was recommended that City staff and Jesters implement appropriate review procedures to ensure that the monthly reports are accurate and free of error. The KCCC checking account used in the liquor operation should be closed immediately and an alternate form of payment should be used instead.

KCCC Liquor Operation Audit

August 11, 2016

Mayor and Council,

I am pleased to present this audit of the Killeen Civic and Conference Center (KCCC) liquor operation.

BACKGROUND

- The City of Killeen contracts with Jesters, an outside company, to manage the City's liquor operation at the KCCC.
- KCCC staff oversees the contract.
- The City provides all of the supplies for the operation, including liquor, beer, wine, sodas, cups, etc.

OBJECTIVE AND SCOPE

The objective of the audit was to determine whether KCCC implemented the necessary controls needed to safeguard the City's assets as recommended in prior year audits. The audit scope included the liquor operations between September 2014 and September 2015.

WHAT WAS FOUND

The audit revealed multiple errors on the monthly inventory reports that were not investigated and corrected in a timely manner. The lack of adequate review procedures has allowed the errors to continue without notice. Adequate review is essential to ensuring that reports are accurate and free of error.

Additionally, the KCCC checking account that has historically been utilized to purchase necessary items for the liquor operation does not comply with City Charter requirements, and should be closed immediately.

I appreciate the cooperation and assistance I received from the KCCC staff during this audit.

Amanda R. Wallace

Amanda R. Wallace, City Auditor

BACKGROUND

The City of Killeen maintains a liquor license or permit with the Texas Alcoholic Beverage Commission (TABC), which allows for the sale and distribution of alcohol at the Killeen Civic and Conference Center. The City also maintains a caterer's permit, which allows for the sale and distribution of alcohol at other facilities as long as TABC approval is obtained prior to each event.

The City of Killeen contracts with Jesters to manage its mixed beverage service at the Killeen Civic and Conference Center (KCCC) as well as each catered event. KCCC staff oversees the contract and ensures that the City's assets are safeguarded and that complete records of the operation, including all tax records and returns, are maintained.

According to the aforementioned contract, Jesters provides management, supervision, and direction of the operation in a manner that is in accordance with standards comparable to those prevailing in other first-class mixed beverage operations in Texas. Such management services include, without limitation, serving beverages, both alcoholic and non-alcoholic, to the City's customers in accordance with their needs, and maintaining all records and financial information required by the TABC.

The City procures all alcoholic and non-alcoholic beverages, supplies, equipment, and outside services which are directly related to the service of alcoholic beverages, and also retains full authority and control over the purchase and storage of alcoholic beverages.

Jesters collects and is accountable for all cash receipts from the operation, and is responsible for any losses that occur between collection of the cash and delivery of the cash to the City.

The City pays Jesters monthly, as compensation, 40% of the gross receipts realized by the City for alcoholic beverage service charges.

OBJECTIVE, SCOPE, AND METHODOLOGY

The KCCC Liquor Operation Audit was conducted in order to comply with a contract stipulation as well as to follow up on the findings noted in prior year audit reports. This audit was also included in the FY2016 Audit Plan, as presented to the City Council and the Audit Committee.

Objective

The objective of the audit was to determine whether KCCC implemented the necessary controls needed to safeguard the City's assets as recommended in prior year audits.

Scope

The audit scope included the liquor operations between September 2014 and September 2015.

Methodology

To accomplish the audit objective, the following steps were performed:

- Conducted interviews with KCCC staff and obtained information on policies and procedures as well as staff responsibilities.
- Obtained and tested data from KCCC staff relating to the management of the alcohol operation.
- Analyzed supporting documentation to determine whether the policies and procedures were adhered to.
- Analyzed policies to determine effectiveness.
- Considered fraud, waste, and abuse as related to the audit objective.

AUDIT RESULTS

The procedures in place were reviewed with KCCC staff and an overall understanding of the policies and procedures was obtained in order to perform the audit.

A randomly chosen sample of 15 events with alcohol was tested during the audit. For each of these 15 events, the supporting documentation was reviewed, which included register tapes reporting the amount of sales for each event as well as the deposit that was received for each event. The auditor verified the number of register tapes for each event in comparison with KCCC records regarding the number of bars for each event. The auditor also verified that the deposit that was received agreed to the total sales as reflected on the register tapes.

Five months were selected at random to test with regard to inventory records and monthly deposit records – September and November of 2014, and April, June, and August of 2015. In these five months, the monthly revenue report provided by Jesters was compared to the final inventory reports provided by Jesters, and all purchases were traced to the inventory reports.

An inventory analysis was completed during the audit for each month from September 2014 through September 2015. Each month was reviewed with regard to the sales reported, deposits received, spills reported, and any variance between the sales and the deposits. The completed analysis revealed negative variances in 6 of the 13 months in the audit period, which means that the cash received during these months was reported to be less than the amount of sales.

Finding 1: April 2015 purchases were not reflected correctly on the inventory report.

As part of the City's agreement with Jesters to manage the liquor operation at the KCCC, Jesters provides monthly inventory reports that reflect beginning inventory, plus any purchases, minus ending inventory at month-end to calculate the number of servings sold for each product. This is multiplied by the price charged per serving to ascertain the calculated expected sales. As noted above, April 2015 was one of the months selected to test for completeness in including all purchases on the inventory report. In testing April purchase invoices, it was noted that the purchases for three separate products were not accurately reported on the inventory report which resulted in a variance of \$1,790.79 between the calculated expected sales and the amount of cash received for the month.

Finding 2: There were errors in the sales calculations for the months of June, July and August.

In analyzing the monthly inventory reports, it was noted that for three months – June, July, and August of 2015, the calculated expected sales for several different liquors and wines were not calculated correctly, resulting in inaccurate variances for each month. The errors for these months included reporting negative calculated expected sales and failing to properly utilize the excel spreadsheet formulas in calculating expected sales.

Finding 3: Large variances were not investigated and/or corrected.

The variances reported between calculated expected sales and the amount of cash received for the month were 10% of sales or greater for the months of November 2014, and February and August of 2015. Two of these were negative, meaning that the cash received totaled an amount less than the sales reported. There was no documented effort noted in the audit to determine the cause of these large variances.

Finding 4: Beginning inventory does not consistently agree to the ending inventory from the prior month.

The beginning inventory for any given month should agree to the ending inventory from the prior month. The beginning inventory for the months of March and June 2015 did not agree to the ending inventory from the prior month. It does, however, agree to the actual inventory counts, which means there is either an error in the inventory report, or an error in the actual inventory counts. For the month of September 2015, the beginning inventory does not agree to the ending inventory from the prior month or the actual inventory counts.

Finding 5: Revenue reported on Mixed Beverage Tax report for August 2015 does not agree to revenue as reported on inventory report.

According to Texas statute, all mixed beverage and private club permit holders are required to remit to the State Comptroller a 6.7% gross receipts tax on mixed beverage sales each month. In addition to this, an 8.25% mixed beverage sales tax is also required to be remitted to the State Comptroller each month. In comparing the Mixed Beverage Tax reports to the revenue as reported by Jesters on the inventory reports, it was noted that, for the month of August 2015, the revenue for liquor as presented on the Mixed Beverage Tax report was \$1,899 more than the revenue as presented on Jesters inventory report.

Finding 6: KCCC's checking account does not meet City Charter requirements.

Article VII, Section 78 of the City Charter requires that all City disbursements be signed by the City Manager and the Director of Finance. The KCCC has historically paid its invoices for the liquor operation purchases by check using a separate checking account since the vendors usually require payment upon delivery. This separate checking account does not meet the referenced Charter requirement; therefore, it must be closed immediately.

OBSERVATIONS

Observation 1: Cost of Goods Sold should be evaluated.

Cost of Goods Sold (COGS) is an important aspect of financial reporting with regard to the sale of inventory. Inventory is recorded as a balance sheet item at the time of purchase. Only when the inventory is sold is it then reported on the income statement as an expenditure, COGS. Jesters prepares a monthly inventory report, which includes cost of goods sold calculations for each inventoried product. Because prices fluctuate throughout a single month for each product, it is difficult to determine the true cost of goods sold on a report that is prepared manually once every month. Without utilizing an inventory software to track the price paid for each product on any given day, the cost of goods sold calculation is ultimately an estimate.

I recommend reviewing the prices paid on a regular basis, such as monthly or bimonthly. Prices should be updated on the inventory spreadsheet as often as they are reviewed. A more ideal recommendation, dependent upon available funds, is to utilize an inventory software. This is available through Quickbooks, which is already utilized by KCCC. This would reduce the recurring manual errors in the inventory reports and would allow for more accurate financial reports.

RECOMMENDATIONS

The recommendations listed below are a result of the audit effort and are subject to the limitation of the scope of the audit. I believe that these recommendations provide reasonable approaches to help resolve the issues identified. I also believe that operational management is in a unique position to best understand their operations and may be able to identify more efficient and effective approaches, and I encourage them to do so when providing their responses to the recommendations. As such, I strongly recommend the following:

- 1. All purchases should be reflected on the corresponding months' inventory report. Adequate review procedures should be implemented to ensure that all purchases are included.**
- 2. Staff should be aware of red flags, such as negative sales figures, so that errors can be corrected timely. Adequate review procedures should be implemented to ensure that calculations are accurate.**
- 3. Variances in excess of 10% should be investigated timely and documented properly. If a large variance is the result of errors in reporting, then the errors should be corrected.**
- 4. The beginning inventory for each product should agree to the ending inventory of the prior month. Any deviations from this are errors and should be corrected.**
- 5. The Mixed Beverage Tax report should agree to the revenue report as submitted by Jesters as well as the inventory report as submitted by Jesters.**
- 6. The KCCC checking account must be closed immediately. An alternate form of payment should be used for all liquor operation purchases.**

See Appendix A for Management's Response to each recommendation.

APPENDIX A

MANAGEMENT'S RESPONSE



INTEROFFICE MEMORANDUM

TO: Lillian Ann Farris – Interim City Manager *pld 6/23/16*
FROM: Leslie K. Hinkle, Executive Director of Community Development
DATE: June 17, 2016
SUBJ: **Management Response to 2015 KCCC Liquor Operation Audit**

Attached for your review is the management response for the findings outlined in the KCCC Liquor Operation Audit for 2015. KCCC staff and I have met with the Internal Auditor and understand the concerns listed and are making the changes noted in the responses.

If you have any questions, please do not hesitate to contact me.

Leslie Hinkle, Executive Director of Community Development

Management Response to 2015 Audit Findings

1. April 2015 purchases were not reflected correctly on the inventory report.

Staff of KC3 and Jesters will review the pricing on a regular basis. We are meeting with Jester's to recommend they purchase a laptop or tablet with an inventory software program that will remain on site at the KCCC. This will allow inventory to be done and tracked regularly. This will reduce the recurring manual errors on the inventory reports. Also, when cash is turned in the next business day, KC3 staff will review the inventory report from previous events. Double checking the entries before entering the data into the spreadsheet will eliminate the human error made when entering the data late at night after all bars are closed out. Staff will also review all invoices to ensure accuracy in the inventory reports received.

2. There were errors on the sales calculation for the months of June July and August 2015

Staff will review sales figures on a regular basis to ensure that there are no negative sales. Going to an automated system instead of a manual one should reduce errors in the future.

3. Large variances were not investigated and/or corrected.

Variances in excess of 10% will be investigated and responded to in a timely manner. Some of the variances are due to the size of glass or container used for pouring wine. Red wine should receive 4 ounce pours and white wine should receive 6 ounce pours. With no markings on the glassware, it is up to the bartenders to use their judgement in pouring; this has been noted for some of the variances. We are moving to marked glassware that has the ounce lines indicated on the glass. This should decrease variances in pours.

4. Beginning inventory does not consistently agree to the ending inventory from the prior month.

When the new management agreement with Jesters was approved in March 2016, we instituted inventories to be completed at the end of each bar event. We also will be developing an improved spreadsheet for the inventory control and used throughout the reporting. Again, human error will be reduced. An old excel spreadsheet from years ago was being copied and pasted over and over again and some of the formulas are not accurate.

5. Revenue reported on Mixed Beverage Tax report for August 2015 does not agree to the revenue as reported on the inventory report.

Staff will ensure that the revenue reports submitted by Jesters and the inventory reports match the Mixed Beverage Tax report. Having software for inventory control will reduce errors in reporting.

6. KCCC's checking account does not meet City Charter requirements.

The purchase of alcohol, beer and related goods has been obtained by check using a separate checking account. This has been the procedure for the past 14 years. Once we were made aware from the City Auditor that this is a violation of City Charter, we initiated the process of obtaining a P-card just for the purchase of alcohol and related items; however, the distributors will not accept P-cards for purchase. All wholesale distributors work with an electronic funds transfer system that moves funds directly from our bank account to theirs. This will also process alcohol invoices for electronic payment according to each invoice due date reducing the delivery time and assuring State liquor law compliance.

APPENDIX B

CURRENT STATUS OF PRIOR YEAR AUDIT RECOMMENDATIONS

1. **FINDING:** Catering permit not obtained from TABC for one tested event.
RECOMMENDATION: TABC approval should be obtained prior to any catered event taking place. Events which are not city-affiliated or on city property should not be catered.
CURRENT STATUS: There were no findings in the current audit concerning this issue.

2. **FINDING:** KCCC did not submit any deposits between 12/17/13 and 1/6/14 despite numerous events held during that time.
RECOMMENDATION: Deposits should be submitted daily or after each event.
CURRENT STATUS: There were no findings in the current audit concerning this issue.

3. **FINDING:** Cost of Goods Sold is not calculated for special orders.
RECOMMENDATION: COGS should be calculated for all sales, to include special order sales.
CURRENT STATUS: There were no findings in the current audit concerning this issue.

4. **FINDING:** Variances are not consistently calculated correctly.
RECOMMENDATION: Variances should be calculated correctly, and any large or unusual variances should be investigated and clearly documented.
CURRENT STATUS: There were three variances that were 10% or greater in the current audit, which lacked documentation as to the cause of the large variances. See current year finding 3 on page 4.

5. **FINDING:** An escrow account is used for all liquor activity.
RECOMMENDATION: The proper accounts should be used when recording activity from the liquor operation throughout the fiscal year. The escrow account should be closed and no longer used.
CURRENT STATUS: There were no findings in the current audit concerning this issue.